

Management Report_

of Telefónica Deutschland

Holding AG

Overview of the 2013 financial year

- Provision of management services by Telefónica Deutschland Holding AG in its function as parent company of Telefónica Deutschland Group
- First Annual General Meeting with a resolution to pay a dividend of EUR 0.45 per eligible share – total distribution EUR 502,625,430
- Agreement between Telefónica Deutschland, Telefónica, S. A. and Koninklijke KPN N.V. (“KPN”) governing the acquisition of KPN’s German mobile communications business, E-Plus, by Telefónica Deutschland

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The figures in the following have been rounded in accordance with established commercial practice.

Figures or additions within a table may therefore result in sums different from those shown in the same table.

1. Basis of the Company

1.1 Business Model

1.1.1 Structure of Telefónica Deutschland Holding AG and the Telefónica Deutschland Group

Legal basis

Telefónica Deutschland Holding AG (also referred to as "Telefónica Deutschland") is a corporation (AG) incorporated under German law.

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

The financial year of the company corresponds to the calendar year (January 1 to December 31).

The company is listed in the regulated market of the Frankfurt stock exchange. The security identification number (WKN – Wertpapierkennnummer = security identification number) is A1J5RX, the ISIN (International Securities Identification Number) DE000A1J5RX9. As of December 31, 2013, Telefónica Deutschland Holding AG has a share capital of EUR 1,116,945,400. It is divided into 1,116,945,400 registered shares with no-par value each representing a notional amount of EUR 1.00 in the registered share capital. 23.17% of the shares are in free float, the remaining 76.83% are held by Telefónica Germany Holdings Limited, Slough, United Kingdom. Each non-par share in general grants one vote at the General Meeting.

As of December 31, 2013, the authorized capital of Telefónica Deutschland Holding AG allows the Management Board of the company, with the approval of the Supervisory Board, to increase the share capital in the period up until September 17, 2017 once or repeatedly up to a total of EUR 558,472,700 by issuing new no-par value registered shares against cash or contribution in kind. Furthermore, the share capital of Telefónica Deutschland Holding AG is conditionally increased by up to EUR 558,472,700 (conditional capital 2012/1).

The Telefónica Deutschland Holding AG is the parent company of the German Telefónica Deutschland Group.

It is included in the consolidated accounts of the ultimate holding company, the Telefónica, S.A., Madrid, Spain (Telefónica, S.A.) as of December 31, 2013 (Telefónica, S.A. Group). The parent company of the Telefónica Deutschland Group is the Telefónica Germany Holdings Limited, a sub-

subsidiary of the O2 (Europe) Limited, Slough, UK (O2 (Europe) Limited).

As of December 31, 2013, the legal persons of Telefónica Deutschland Holding AG are arranged according to the organizational chart on the opposite page.

In the reporting period, with Articles of Association as of February 26, 2013, the Telefónica Deutschland Finanzierungs GmbH, with its registered office in Munich, was founded and registered in the commercial register of the local court in Munich on March 14, 2013. It is a subsidiary of the Telefónica Germany GmbH & Co. OHG. Effective from November 7, 2013, Telefónica Deutschland Finanzierungs GmbH changed its name to O₂ Telefónica Deutschland Finanzierungs GmbH.

Up until October 31, 2013, Telefónica Germany Online Services GmbH ("TOS") belonged to the Telefónica Deutschland Group. On September 12, 2013, the Telefónica Germany GmbH & Co. OHG and the Host Europe GmbH concluded an agreement regarding the sale of Telefónica Germany Online Services GmbH (TOS). In this context, the domination agreement and the loss transfer agreement between the TOS and Telefónica Germany GmbH & Co. OHG was mutually terminated on September 30, 2013. With the fulfillment of all the necessary closing conditions, the shares of TOS were transferred to the Host Europe Group on October 31, 2013.

In the reporting period, GKHH Fibre Optic GmbH belonged to the Telefónica Deutschland Group for the period from December 4, 2013 to December 30, 2013. This company was a spin-off for new foundation out of Telefónica Germany GmbH & Co. OHG registered with the commercial register on December 4, 2013. On December 30, 2013, Versatel Holding GmbH took over all shares of GKHH Fibre Optic GmbH pursuant to the share purchase and transfer agreement with Telefónica Germany GmbH & Co. OHG as of October 16, 2013.

On July 23, 2013, Telefónica Deutschland Holding AG, Telefónica, S.A. and Koninklijke KPN N.V. (KPN) concluded an agreement for the acquisition of KPN's German mobile communications business E-Plus by Telefónica Deutschland. The completion of the transaction still requires the approval of the competent regulatory authorities and further customary closing conditions. The closing of the transaction is expected in mid-2014 (section 7 Acquisition of E-Plus).

Management and governing bodies

The company's governing bodies are the Management Board, the Supervisory Board and the General Meeting. The powers of these organs are established by the German Stock Corporation Act (Aktengesetz – AktG), the Articles of Association of the company and the by-laws of the Management Board and the Supervisory Board.

Management Board

The members of the Management Board are appointed by the Supervisory Board for a period of no more than five years and can be re-appointed without limitation, in each case for no more than five years. The Supervisory Board may recall a Management Board member before expiry of his period in office in the event of an important reason such as the gross breach of duties or if the General Meeting adopts a no-confidence resolution in relation to the Management Board member in question. Further reason for termination such as a mutual termination agreement can also be taken into consideration. The Supervisory Board can nominate one Management Board member as chair or spokesperson for the Management Board and another Management Board member as vice-chair or vice-spokesperson. The members of the Management Board of the company were in general appointed for the period up until September 17, 2015.

At the reporting date of December 31, 2013, the Management Board of the company consisted of of three members:

- René Schuster, CEO (Chief Executive Officer), until January 31, 2014 (section 5, Report on Events after the Reporting Period)
- Rachel Empey, CFO (Chief Financial Officer)
- Markus Haas, CSO (Chief Strategy Officer)

Supervisory Board

Pursuant to the Articles of Association of the company, sections 95, 96 of the German Stock Corporation Act and section 7 of the German Co-Determination Act, the Supervisory Board comprises twelve members, of whom six are representatives of shareholders and six representatives of employees. If the General Meeting does not set a shorter period of office at the election of shareholder representatives, then the Supervisory Board members and potential substitute members are elected until the end of the General Meeting

that resolves on the discharge of the Supervisory Board for the fourth financial year after the start of the period in office; the financial year in which the period of office begins is not counted.

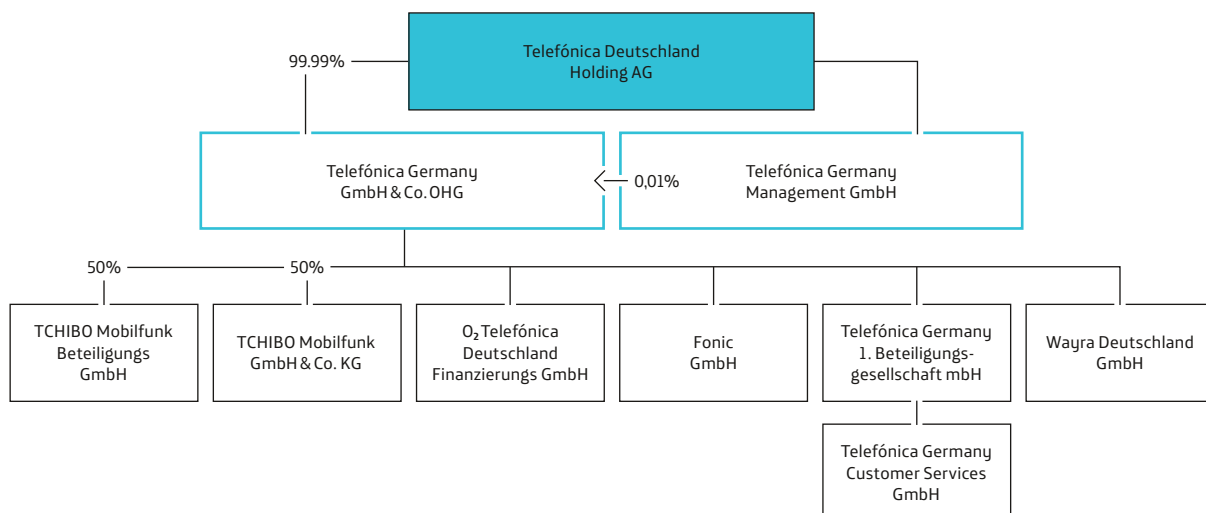
All shareholder representatives in the Supervisory Board were appointed for the period up to the end of the General Meeting, which resolves on the discharge for the financial year ending December 31, 2016.

On May 29, 2013, six employee representatives and for four of them again four substitute members were elected to cover the event of a premature resignation.

1.1.2 Business activity

Telefónica Deutschland Holding AG acts as a holding company, is responsible as a service provider for the management and strategic orientation of the Telefónica Deutschland Group and its operative business activities, and has specialized in the provision of telecommunications services and distribution of hardware. Telefónica Deutschland generates its revenues through the remuneration of service provisions, which it delivers to its subsidiaries. These include management services, which the Board provides in the fields of business strategy and communication, control, new business and innovation for the Telefónica Deutschland Group. The Telefónica Deutschland Group is active in the following business sectors:

The Telefónica Deutschland Group is the third largest telecommunications service provider in Germany (based on 2013 reported revenues), with 25.2 million customer connections as of December 31, 2013. The Telefónica Deutschland Group offers private and business customers voice, data and added value services in wireless communications and wire-



line networks. In addition, the Telefónica Deutschland Group is among the leading wholesale providers in Germany. We offer our wholesale partners access to our infrastructure and to our services. We are a part of the Telefónica, S. A. Group, one of the biggest telecommunications corporations in the world.

We operate a nation-wide mobile communications network reaching over 99% of the German population with GSM and approx. 75% with UMTS as of December 31, 2013. The expansion of our LTE network is in full swing and as of December 31, 2013 we already have over 40% of the population covered with the new high-speed wireless communications technology. In addition we operate a nation-wide wireline network. Our strategic partnership with Telekom Deutschland GmbH, Bonn, expands our wireline network coverage to 98% and in addition enables us to service over 13 million households with high-speed DSL internet access and data transmission rates of up to 50Mbit/s. In addition on December 20, 2013 we concluded a contract for the expansion of the wireline network cooperation with Telekom Deutschland GmbH. It will grant us access to Telekom's high-speed internet and the possibility to offer our customers products with transmission rates of up to 100Mbit/s in connection with the new Vectoring Technology. The cooperation still requires the final approval of the supervisory authorities, which is expected within the first six months of 2014.

Our sales and marketing approach is based on a strong multi brand strategy that addresses a broad range of customer segments with our product and services. We offer the majority of our postpaid and prepaid wireless and wireline communications products and bundled offers via our core brand O₂. We continually strive for an improvement in the market positioning of O₂, particularly in order to gain premium customers in the private and business customer area. For a number of years our strategic focus has particularly been the sale of wireless postpaid services to smartphone users. This group of customers, which as of December 31, 2013 comprises 69% of the O₂ postpaid customer base, generates above-average sales figures in comparison to users without a smartphone through the use of mobile data services and an elevated interest in the new wireless communications standard LTE. The interest in smartphones and the use of wireless data is also growing in the prepaid area. As of December 31, 2013, 31% of our prepaid customers are already using a smartphone and it is for this reason that we also offer special prepaid tariffs for smartphone users.

For several years we have been selling mobile phones and other hardware independently of wireless communications charges at fixed prices via our successful "O₂ My Handy" model. Here the customer can choose whether to pay the entire price upfront or to make a down-payment and pay the remaining purchase price in twelve or 24 monthly installments. This provides price transparency to the customer with regards to the cost of both the mobile phone and the wireless communications services. Customers have a large choice of

mobile phones, including the latest premium devices, with attractive payment conditions. Our main suppliers of mobile phones are Samsung, Apple, Nokia, HTC and Sony Mobile Communications. Our focus with the "O₂ My Handy" model lies predominantly on the sale of smartphones with internet capability, which constituted 98% of the mobile phones sold by us to postpaid customers in the 2013 financial year (as of December 31, 2013). Particularly worthy of note here is the development of the proportion of smartphones with LTE capability. While in January 2013, only 4% of the smartphones sold by us to postpaid customers had LTE capability, the proportion was already around 80% in December 2013. In addition, the "O₂ My Handy" model is also used by customers of our secondary brands and our wholesale partners. We are serving the growing demand for wireless data services in these customer segments via a large range of cheap entry-level smartphones.

With secondary and partner brands and via our wholesale channels we reach further groups of customers, whom we do not appeal with our core brand O₂. Our secondary brands include the brands Fonice and netzclub, which are fully controlled by us, as well as brands from joint operations and strategic partnerships such as, for example, TCHIBO mobil and Türk Telekom Mobile. We also market high-speed DSL internet access and wireline telephony. Our multi brand approach enables us to address a broad spectrum of customers and to maximize our sales range through customized product offers, sales and marketing.

As part of the wholesale business we offer wireless communications, wireline and added value services for customers such as 1&1, mobilcom/debitel, Drillisch, Kabel Deutschland and Unitymedia KabelBW. In the wireline area we make a range of Unbundled Local Loop (ULL) services, including wireline telephony and high-speed internet, available to our wholesale partners. Furthermore, we offer added value services such as e.g. billing services or the management of telephone numbers and SIP accounts. This comprehensive portfolio enables our wholesale partners to independently service their end-customers and at the same time gives us the opportunity to increase our range and to achieve economies of scale.

Small office/home office (SoHo) as well as small and medium-size business customers (SME) are addressed via our core brand O₂, large international businesses via the brand "Telefónica Multinational Solutions". We market our products via a diversified sales platform. This includes direct selling channels like our nation-wide network of independently operated O₂ franchise and premium partner shops, online and tele-sales as well as indirect selling channels like partnerships in retail trade/online retail trade and retailers/cooperations.

1.2 Goals and Strategies

Telefónica Deutschland Holding AG is responsible for the management of the Telefónica Deutschland Group and its business activities. In this capacity, it is also competent in the development of the Telefónica Deutschland Group's business strategy.

Rapid technological progress and a sharply increasing digitalization are characteristic of the development of the telecommunications market. We are convinced that this opens attractive business opportunities by aligning our offer so that it fits perfectly with our customers' wishes. As one of the leading digital telecommunications corporations we want to play our part in making the opportunities of digital technology available to everyone.

It is against this background that we pursue our objective to further enhance our successful competitive position and generating profitable growth opportunities. The following strategic priorities will help us to achieve our goals:

Capitalize on multi-brand portfolio and high level of customer satisfaction

Our goal is to strengthen our position in the German telecommunications market with our core brand O₂ and with a strong portfolio of secondary and partner brands. Furthermore, we are continuously analyzing potential strategic partnerships in order to address special niche markets or customer segments with new brands.

With a comprehensive customer service, customer loyalty and customer satisfaction programs we want to provide our customers with a consistently high-value service, ensure transparency and thus increase customer confidence. We claim to be one of the most beloved telecommunications service providers with the most satisfied customers on the German telecommunications market. We are convinced that our high customer satisfaction values reduce termination rates and increase recommendation rates.

We want to offer an uncomplicated, reliable and personalized customer experience at all points of customer contact (so-called touch points) and over all sales channels. To achieve this, we will use our customer knowledge more efficiently and offer our customers targeted products and services that correspond with their needs. Here it is our endeavor to provide them with as seamless a transition as possible between the various channels. At the same time, we will strengthen the service in our shops and expand selling via our customer service channel. In this way, we can use all existing touch points to generate additional revenue.

We are expanding our online and e-care capacity so that our customers can comfortably resolve their own questions and problems via various channels. This includes our internet portal, the wireless portal, the support community, self-service, and social media. For this we are strengthening the digital services in our customer loyalty, telesales and

service teams and also enhance the online systems in our shops. In addition, we are supporting a change of thinking to essentially digital behavior. So, as to support this process, we have developed a new multi-channel comprehensive customer journey as a strategic manual for interaction with our customers. This will increase customer satisfaction and, in addition, minimize customer service costs.

Generally speaking, we are striving for an increased profitability by continuously improving our operating efficiency in order to guarantee a strong cash flow. Important levers here are the active management of our customer base and the ARPU performance (ARPU: average revenue per user) with the focus on data use, as well as the launch of various efficiency initiatives. The goal of these measures is the optimization of processes, the increase of network performance and the trimming of our IT systems as well as the intensified incorporation of direct marketing channels in order to optimize the process and the costs of acquiring customers.

Monetize mobile data and fixed broadband/convergence opportunities across all segments

We intend, primarily with our core brand O₂, to ramp up mobile service revenue through increasing data use due to the quickly growing number of smartphone users. In this way we will compensate for losses in the classic communications services such as telephony and SMS due to price slumps, regulatory effects and substitution with other services. The central criteria for success in this connection are the expansion of our LTE network, which is progressing, and our portfolio of plans, which is designed for data use and aligns itself with the individual data demand of our postpaid and prepaid customers.

In addition, our cooperation with Telekom Deutschland GmbH mentioned in section 1.1.2 Business activity, will allow us to offer high-speed internet products in the wireline area in future with transmission rates of up to 100Mbit/s. Such an offer strengthens both our market position in the wireline area as well as our convergence strategy and will generate additional revenue.

We assume that there will be growing demand for converging product offerings. Therefore, in the future we would like to focus on even stronger and converged offers of wireless communications and wireline services in order to increase the average revenue per user (ARPU), to reduce the termination rates in wireless communications and our customer acquisition costs. The core of our convergence strategy is targeted cross selling into the existing customer base. We achieve this by selling additional products and services to our customers who currently make use of only wireless communications or wireline services as well as gaining further wireless connections within households. In order to exhaust the cross selling potential of our customer base we offer price reductions when customers purchase certain combinations of products from wireless communications and/or fixed-line services from us.

We also want to fully exhaust the potential of convergent products when gaining new customers. For this purpose, we plan to bring innovative new product combinations of wireless and wireline communications to the market in the course of 2014. We are convinced that our convergence strategy enables us to secure our position in the wireless communications market, increase the profitability of our wireline services and reduce termination rates.

Differentiate O₂ as the best value-for-money LTE brand in the German market

We assume that, due to the broad offering of LTE capable devices, LTE use will significantly increase in Germany in 2014. The LTE technology significantly enhances the wireless user experience. The reasons for this are the maximal download speed of currently up to 75Mbit/s, shorter reaction times and unrestricted surfing through improved latency as well as better coverage in internal spaces due to the 800MHz frequency. That gives us the opportunity to target quality-oriented high-value customers. At the moment we are positioning LTE within our O₂ premium tariffs with a surcharge compared to 3G tariffs in order to fully exhaust the potential. Due to the improved user experience, LTE customers are prone to significantly higher data usage than 3G customers, which in turn enables new monetizing approaches such as e.g. the targeted upselling of data packages in excess of the data volume contained in the contract.

In 2013, we have achieved significant progress in the expansion of our LTE network. At the end of the year we are covering over 40% of the population with the new high-speed wireless communications technology. In 2014 we will drive the expansion of our LTE network onwards and once again significantly increase the population coverage. We will expand our LTE network in accordance with the market demand and will concentrate on blanket network coverage in large cities. In addition, our LTE strategy will in the medium term lead to lower investment expenses because, with increasing LTE use, the data traffic can be redirected from UMTS to LTE. At the same time, the 3G data traffic also continues to grow, so we will divide our investments between LTE and 3G. It is our goal to increase revenues in the wireless data business through the constant expansion of our network and the thereby increased population coverage.

Seize opportunities in the Business Segment and for Digital Services

We address freelancers as well as small, medium-sized and large national businesses with our core brand O₂. The brand "Telefónica Multinational Solutions", in contrast, is aimed at large international customers. For our core brand O₂, it is our goal to be perceived by our customers more strongly as a business customer brand as well. We want to increase our market share and our revenue by even more effectively monetizing wireless data use which is also growing strongly in the

BSB segment and to distinguish ourselves from our competitors via powerful marketing, innovative products (among others selected cloud, security and IT services), the best cost-performance ratio as well as strong customer service.

To increase sales and make our products even more attractive for smartphone users across all segments, we are continually expanding our offer with digital added-value services. These include, among others, wireless financial services as well as innovative wireless communications, entertainment and security solutions.

1.3 Management System

The Telefónica Deutschland Group is centrally managed by the members of the Management Board and the Management at the operative level of the Telefónica Germany GmbH & Co. OHG. The goal is the generation of profitable corporate growth.

The encouragement of entrepreneurial behavior is one of the most important fundamentals of the corporation. That is why the corporation has anchored a clear responsibility for results in the individual organizational units.

The corporate leadership strives to provide its shareholders with growth in value. In addition, it is firmly convinced that the satisfaction of customers is the key to realizing this goal.

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
- Finance-related and operative performance indicators
- Monthly reporting to Management Board and Supervisory Board
- Continual opportunity and risk management
- Leadership by agreements on goals at all levels of the organization

1.3.1 Strategic setting process

As part of the annual planning process the corporate strategy is reviewed by the Management Board of Telefónica Deutschland. Here, long-term strategic goals for the positioning of the corporation on the German market as well as a business plan for the next three years are worked out. The decisions are based on current market and competition analysis as well as market prognoses, which are compared with the corporate vision and the long-term strategic goals.

With this systematic approach, chances and opportunities for growth are ascertained and investment decisions made.

In close cooperation with the individual organizational units, the corporate strategy as well as the ascertained opportunities and potential for growth of the corporation are translated into concrete strategies for each organizational unit. For the practical implementation of the strategies at the level of the organizational units, in each case the relevant opportunities are prioritized and concrete financial objectives in the form of key performance indicators (KPI) to measure the strategic implementation as well as the most important measures necessary for the realization of the goals, are defined. The detailed budget planning for the next financial year then occurs on the basis of the agreed three-year goals. At the same time the short-term strategic priorities are set.

1.3.2 Description of the management system

For the management of our strategic and operative goals we have nominated key performance indicators (KPI) in order to measure our corporate success. The following finance-related and non-finance-related performance indicators are a component of the management system and value management of the Telefónica Deutschland Group and reflect the interests of our various stakeholders.

The following finance-related monitoring parameters have a particular significance for the value-oriented monitoring and evaluation of growth and profitability in our corporation:

Revenue and operating result

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

By the use of the OIBDA margin, which expresses as a percentage the relationship of the operating result before depreciation and amortization (OIBDA) on total revenue, we measure the profitability of our operative business. The OIBDA margin as a fundamental monitoring parameter enables a comparison of the operative performance that was achieved in the individual reporting periods and businesses. The implementation of the OIBDA to calculate the figure of the OIBDA margin is advantageous, as this variable eliminates potential differences that can be caused by variations in the tax positions (for example on a change of the effective tax rates or deferred taxes and their effect on individual periods or businesses), depreciation and other positions. Thus, the OIBDA margin is often used to compare the business activity of telecommunications corporations. However, as other

corporations possibly use a different basis of calculation for OIBDA, it is possible that our representation of the OIBDA margin is not comparable with other corporations.

Investment activity

The investment expenditure, CapEx, is comprised of the additions to property, plant and equipment and intangible assets. The investments are primarily for the expansion of the coverage and capacity of our network (particularly for LTE and 3G) as well as product development. Intangible assets primarily include licenses for wireless communications standards and software for office and IT applications. CapEx is a fundamental factor for the security of our future business activity.

Alongside our fundamental finance-related key performance indicators such as the wireless service revenue, the OIBDA margin and CapEx, we have also provided other finance-related and non-finance-related figures in the annual report.

Free cash flow

The internal monitoring parameter free cash flow before the payment of dividends from continuing business operations is defined as the sum of the cash flows from the operating activity and the investment activity. The free cash flow implicitly provides information about the change in Working Capital. Working Capital Management is thus an essential part of the managing of the free cash flow in the relevant reporting period.

The figure 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, which were made for the maintenance or expansion of the business. The figure provides information about the change in the corporation's available financial funds, which enable Management, for example, to make investments in growth or to pay dividends or to service debt.

Net leverage ratio

Net leverage ratio is defined as the quotient of the net financial debt and the operating result before depreciation and amortization (OIBDA) for the last twelve months, whereby extraordinary effects are not taken into account. Net financial debts include all short and long-term interest-bearing assets and interest-bearing financial liabilities. The net leverage ratio relates the net debt level to an operative success figure (OIBDA) and thus provides Management with information about the corporation's debt reduction ability. We are actively monitoring the capital structure, with the objective of keeping the net leverage ratio below 1.0x over the medium term ("target level").

As part of its dividend policy, Telefónica Deutschland has therefore also decided to refrain from paying dividends distributing capital or capital reserves in cash or buying back

shares if the net leverage ratio materially and consistently exceeds the target leverage of less than 1.0x.

Postpaid net adds

New contractual customers for the period less those contractual customers leaving are designated as the postpaid net additional customers (net adds). A continually positive number of net adds leads to a growing customer base and reflects successful customer management. The number of postpaid net adds is influenced by many 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. The goal of this KPI is, among other things, the evaluation of customer retention and customer acquisition measures in the valuable postpaid segment.

Customer satisfaction

Customer satisfaction is among the most important priorities of our business. Thus we continually strive for a better positioning of our core brand O₂ in order to gain premium consumer and business customers for wireless telecommunications products, wireline products and convergent services in the postpaid sector. We claim to be the most popular brand with the most satisfied customers on the German telecommunications market. This means that we create customer-oriented offers and provide outstanding services on all our customer interfaces. We are convinced that our high level of customer satisfaction has a positive impact on churn rates and increases recommendation rates.

We measure customer satisfaction regularly by means of external examinations and in all decisions we weigh up how it could effect customer satisfaction.

Employee satisfaction

A business is always only as successful as its employees. Our employees have made an important contribution to our success. Their dedication, their commitment and their engagement have made us the corporation that we are today.

We regularly review the satisfaction of our employees by means of external reviews and we take their feedback seriously in order to further improve our corporation.

1.3.3 Budgeting and planning system

The integrated planning system is based on strategic and operative goals. The Telefónica Deutschland Group sets internal objectives for the Group with regards to all relevant performance indicators – which are described in section 1.3.2. To develop a long-term three-year plan, the anticipated market development as well as internal expectations with regards to progress in the areas of growth and efficiency evolution are discussed once a year. The first plan year is

depicted on a monthly basis in order to establish a detailed budgeting. For reasons of control the budget is updated twice a year. Alongside the results that have already been achieved and which will be analyzed as part of the monthly reporting, the current market development and the additional opportunities or risks that are known at the relevant point in time are taken into account in the updating. This prognosis is then used in order to introduce operative improvements or in order to seize new opportunities that offer themselves to the Group.

1.4 Product Development and Innovation Management

Product development

Innovative and customer-oriented products form the basis of our sustainable growth in turnover and results. For this reason we are continually expanding and improving our product portfolio. With a comprehensive analysis of our customer groups we have gained important knowledge in the past year, in order to exactly tailor our product and services offering as part of our multi-brand strategy to the needs of the relevant target group. Thus, in spring we completely re-aligned the O₂ tariff portfolio. With the new O₂ Blue tariffs our customers only choose between various data volumes – telephone calls and the sending of SMS in all German networks is included. Through the speedy dissemination of smartphones these tariffs optimally match the changed usage patterns of our customers and their desire for an offer comprised of integrated voice and data services. In the high-value smartphone tariffs of the O₂ core brand we offer customers access to our high-speed LTE network and enable additional offers like multi-card and roaming offers.

We also introduced an attractive All-In offer in October 2013 in the wireline area. With the new O₂ DSL All-In Portfolio our customers can make unlimited telephone calls to wirelines and all German wireless telecommunications networks. With the VDSL variety it is possible, with up to 50Mbit/s, to surf the internet with up to three times the speed of a conventional DSL connection. Since 2012 we have been working successfully with Telekom Deutschland GmbH as part of the VDSL contingent model. On December 20, 2013 we concluded a contract with Telekom for the expansion of the wireline network cooperation. This is subject to the final approval from the supervisory authorities. For our wireline products we will in future increasingly use the high-speed infrastructure of Telekom. In this way our customers will receive an even better performing and future-proof wireline offer.

With the expansion of our product portfolio we are developing attractive offers with high levels of customer use and tapping new fields of business. Here, mobile payments are a focal point where we are taking a clear leading role. In 2013

we introduced the first alternative mobile payment process with "mpass", which allows payments both in fixed retail stores as well as over the internet, and it enables our customers to carry out money transfers directly from smartphone to smartphone. In addition, in February 2013 we presented the new electronic "O₂ Wallet" as a test version. The "O₂ Wallet" is a type of digital wallet with which our customers can use both our own payment service, "mpass", as well as other bank cards and rebate cards and vouchers and, by means of the transfer standard NFC, can pay directly at the cash register in fixed retail stores or e.g. can redeem vouchers. In doing so, the user's bank details and customer data are protected with high security standards.

A further product development in the area of wireless shopping is "O₂ More Local". The new service offers customers, who take up the offer, attractive priority offers in their direct vicinity via SMS or MMS. The offers or vouchers can be redeemed directly when shopping in the relevant store. The service is free and works with all commercially available mobile telephones. This location-related service has also been available to our network club customers since August 2013.

Against the background of the increasing security requirements for many customers, in October 2013 we brought "O₂ Protect" onto the market. With this product we offer our customers comprehensive all-round protection for smartphones, tablets and PCs. The package contains effective anti-virus protection as well as regular data backups. If lost or stolen, devices can be located and blocked; personal data can be deleted via remote access.

In the entertainment area we have added to our innovative EA Games tariff with a music product. Here, together with Napster, we offer a highly attractive music flat-rate tariff for smartphones and PCs. Our entertainment pack includes a broad range of diverse entertainment services for smartphone users. This has rounded off our portfolio in the security and entertainment area.

New tariffs and products for business customers

In the course of the year we have also further developed the tariffs for our business customers. Thus all business customer tariffs have LTE capability. With the new O₂ combination advantage, all telecommunications needs can be covered at attractive conditions by a single source. For business travel to foreign countries the new "EU+ Travel Option" offers effective cost control with all-inclusive prices. In addition, business customers who need a wireline number in a foreign country can now book this to their wireless telecommunications contract.

As well as attractive tariffs, we offer our business customers a multitude of services. Internationally active businesses can link their branches in over 170 countries, prioritize data flows and optimize their entire digital communications with the new "Telefónica Global mWAN" offer. With the new "O₂ Mobile Device Management" we make it easier to admin-

ister mobile end-devices in businesses. Those responsible for IT can centrally configure and administer smartphones and tablets that are used differently in the business via a new web platform and thus bring the "bring your own device" trend into harmony with the existing security guidelines.

A further product innovation is the "O₂ Signal Box", a small UMTS wireless telecommunications cell with which business customers can smooth out reception difficulties in buildings and ensure optimal wireless telecommunications reception. Our new "Promotion Pad" from O₂ links cloud technology and wireless telecommunications to a new form of advertising. Retail traders and other tradespersons can present advertising content and customer information on digital screens in their selling spaces. The complete solution, which is easy to operate, is delivered with an advertising configurator with which the customer can quickly and professionally create advertisements without any previous knowledge.

Data communication between machines (M2M) is one of the most important mobile telecommunications growth fields. In June 2013 Telefónica Deutschland Group introduced a new platform in Germany with "Smart M2M". The web-based complete solution is directed towards all business customers across sectors who would like to centrally and cost-effectively administer, visualize and monitor their variously linked devices. The technology plays an important role, for example, in logistics where, with our solutions, fleets of vehicles can be monitored more efficiently and at a lower cost. But diverse fields of application are also opening up in building technology, in health services, in traffic systems and automatic vending machines. Thus, since 2013, together with Sparkassen DirektVersicherung we have been offering the first German telematic car insurance. A telematics box in the car analyzes the individual driving behavior and provides the collected information to a smartphone app. The users can thus optimize their driving behavior and use the information gained to their advantage. Insurance premiums can be calculated on the basis of the actual driving behavior of the insured persons.

Innovation management

For our future growth it is critical that we recognize trends and new technological developments early and transform these into customer-oriented products and bring them onto the market quickly. For this we use the worldwide innovation network of the Telefónica, S. A. Group and optimize the relevant global products. In addition we develop targeted products and services that are of strategic significance for the German market.

A focus of our research and development in the previous year was the new wireless telecommunications standard LTE, which enables significantly faster data transmission. In February 2013, we were the first network operator worldwide to successfully transfer telephone conversations from the LTE network without interruption to the UMTS network. This

so-called “handover” is particularly important when driving so that conversations do not break off. Further advantages are shorter call connection times and longer battery life. In addition, Germany’s currently fastest LTE wireless telecommunications cell has been running in test mode since November 2013 at our company building in Munich. It enables download speeds of up to 225Mbit per second. With that, the same services can be used on a smartphone or tablet that up to now have only been possible on fixed devices with WLAN.

A further novelty in the network technology area is the “Live Check” service, which we have been offering since February 2013. With this customers can quickly and easily check the quality and functional capability of the O₂ wireless telecommunications network in the internet at their location or any other location in Germany. Customers can log disturbances via a service App and receive notification as soon as they are cleared.

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

With the “Lean Start-up” approach we accelerate the market introduction of new products and at the same time reduce development expenses. New products are tested and evaluated at an early stage of development by selected target customers. The customer feedback decides whether we continue with the product development or end it. The Lean Start-up cycle “develop, test, learn” together with our agile product development methods has already proven itself in the development of new tariffs. We were thus able to cut the time span to market introduction by more than half.

Involving our customers more in product development and thus accelerating market introduction are among our most important priorities. The “O₂ Ideas Forum”, which was launched in 2010, provides customers with the opportunity to submit suggestions to us for new products and services. The ideas are then discussed and prioritized by other customers on the O2.de portal. Around 1,600 ideas have been submitted by customers in this process. In addition, since 2011 we have been operating the “O₂ Ideas Laboratory”. Here we introduce new concepts and products to our customers at an early stage of development and receive their direct feedback. Around 1,300 customers and further interested users have registered themselves on the ideas portal. By implementing selected ideas from the “O₂ Ideas Forum” and the “O₂ Ideas Laboratory” we not only improve our products but rather we also deliver credible proof of our excellent customer orientation.

Through the start-up initiative, Wayra, the Telefónica Deutschland Group supports young technology businesses and thus secures itself access to new business models. In addition, since 2012 we have been operating the Wayra Academy in Munich, where start-ups further develop their business models and bring them to market maturity. In addition, we are in close contact with leading research institutes and actively involve ourselves in the exchange of innovative ideas. Thus we regularly attend technical conferences and panel discussions like the DLD conference (Digital-Life-Design) and represent re:publica, which brings together pioneers from the IT and telecommunications branches.

2. Economic Report

2.1 Overall Economic and Branch-Related Conditions

Telefónica Deutschland Holding AG, Munich acts as a holding company and is additionally responsible as a service provider for the management and strategic orientation of the Telefónica Deutschland Group and its operative business activities. Through investment in its subsidiaries, the asset, financial and profit situation of Telefónica Deutschland is also influenced by the development of its subsidiaries. The economic and statutory framework conditions are thus also indirectly relevant to Telefónica Deutschland

2.1.1 Economic environment

Overall economic environment in Germany

The world economic environment has gradually brightened somewhat during the course of 2013. The Euro area is increasingly coming out of the recession and the average annual economic performance for the Euro area fell by only 0.4% in 2013 in comparison to the previous year.

The German economy recorded stable development in 2013 with stronger economic growth than in the other Euro countries. After a weak start to the year the German economic situation improved again in the second half of the year. According to the Federal Ministry of Economics and Technology, 2013 saw the gross domestic product (GDP) increase by 0.4%, primarily supported by robust private consumption.

(Source: Deutsche Bundesbank (German Central Bank), German Federal Ministry for the Economy)

1 — GDP development 2011–13 for Germany and the Euro area

(in %)	2011	2012	2013
Germany	3.3	0.7	0.4
Euro area average	1.6	(0.7)	(0.4)

General trends on the German telecommunications market

In the German telecommunications sector, alongside continuing customer demand for more bandwidth, various other trends can be observed. Thus convergent products and services are becoming ever more popular. The strong demand for wireless data usage and the increasing smartphone and tablet penetration enable the wireless telecommunications network operators' further opportunities for growth, which will also continue into the future. Smartphones and tablets

are becoming the trailblazers for the digital revolution in Germany. At the same time, the monetization of the wireless data business will continue to gain strongly in significance for wireless telecommunications providers. The increasing availability of cloud services is responsible, according to the industry association BITKOM, for a profound change in information technology. With Cloud Computing the use of IT services occurs according to demand via decentralized computers that are connected via data networks (in the "Cloud") instead of on local computers. A further trend is the growing market of machine-to-machine communication (M2M) with countless application possibilities.

The German wireless telecommunications market

In Germany the number of connections (i.e. SIM cards) increased from 113.2m at the end of 2012 to 115.2m at the end of December 2013. The German wireless telecommunications market is thus, measured by the number of customers, the biggest within the EU. The wireless penetration increased from the end of 2012 from 138% to 141% at the end of December 2013. The customer growth in 2013 is primarily attributed to the postpaid sector. Postpaid customers made up 48% of the total connections as at the end of December 2013. At the end of 2012 the proportion was still 47%.

The mobile telecommunications market was very dynamic in 2013 and characterized by intense competition, primarily driven by the strong demand for smartphones and the increasing number of smartphone tariffs. According to Yankee Group Research, by now around 50% of all mobile phone owners use a smartphone. At the same time, according to industry association BITKOM, the number of tablets sold increased from 4.4m in 2012 to around 8m in 2013.

The increasing penetration of wireless end-devices with internet capability such as smartphones or tablets and the increasing use of wireless data services also showed itself in the strong growth of revenues from wireless data on the German market: In 2013, according to Analysys Mason, wireless data revenue increased by about 19% in comparison to the previous year. By contrast, revenue from wireless telephony and SMS declined, driven by price decline, regulatory effects and changed customer behavior.

The German wireless telecommunications market is an established market with four wireless telecommunications network operators. As of December 31, 2013, the Telefónica Deutschland Group held, with 19.4m accesses, a market share of 16.8%.

(Source: Business data, Analysys Mason, BITKOM)

The German wireline market

Intense competition prevails on the German market for wireline broadband services as well. The number of subscriber lines increased in comparison to the previous year by approximately 2% and the customer base grew by the end

of September 2013 to approximately 28.5m. The proportion of DSL connections here is 81%.

(Source: Analysys Mason: Telecoms Market Matrix Q3 2013, January 2014)

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

2.1.2 Regulatory influences on the Telefónica Deutschland Group

Telecommunications services and the operation of telecommunications networks are subject in particular to the regulation of the German Telecommunications Act of June 22, 2004 in the version from August 7, 2013 and certain complementary regulations to the Telecommunications Act.

The Telecommunications Act implements the European legal framework for electronic communications networks and services, which was adopted in November 2009 (in the following: Legal Framework). The Legal Framework comprises, among other things, the provisions of the Framework Directive (2002/21/EC), the Authorization Directive (2002/20/EC), the Access Directive (2002/19/EC), the Universal Service Directive (2002/22/EC) and the Directive about the Protection of Privacy in Electronic Communications (2002/58/EC).

The Telecommunications Act contains provisions that affect the following, among other things: (i) the organization and authority of the regulatory authority, (ii) registration obligations, (iii) the granting of easements, (iv) the allocation of frequencies, (v) access obligations, (vi) fee regulation, (vii) misuse oversight, (viii) consumer protection as well as (ix) data protection and public security. Some of these obligations apply only to service providers who have significant market power in their relevant market. Other obligations apply or can be imposed by the German Federal Network Agency (Bundesnetzagentur – BNetzA) even if the corresponding operator has no particular market power.

In November 2009 the European Parliament followed a suggestion of the European Commission and adopted legal provisions to amend certain Directives within the Legal Framework in order to strengthen the competitiveness and the rights of consumers on the European telecommunications markets and in order to promote access to the fast broadband internet connections. The changes to the existing Legal Framework came into force on December 19, 2009 and had to be implemented in national law.

While the majority of the new provisions came into force in May 2012, for some of them there were transition deadlines. Worthy of mention in this connection are the provisions regarding the free queue, the regulations regard-

ing a change of service provider and standards regarding the transparency of end-customer contracts.

On the basis of Article 20 of the Universal Service Directive, in 2012 changes were made to section 43a of the Telecommunications Act (Telekommunikationsgesetz – TKG) regarding the transparent description of services in telecommunications contracts. The Federal Network Agency is empowered under section 43a para. 3 TKG to make corresponding standards. In May 2013 the Federal Network Agency set out key points to that effect and at the same time suggested that businesses self-regulate. Leading associations from the telecommunications industry and their members – among them the Telefónica Deutschland Group – have developed a voluntary agreement and submitted it to the Federal Network Agency, which has as its object the information that must be provided to the consumer in future before, during and after conclusion of the contract. In February 2014, the proposal was considered by the Federal Network Agency to be insufficient; a public authority draft decree has since been drawn up and will be submitted to an oral hearing in the near future.

Telekom Deutschland GmbH's VDSL contingent model and planned expansion of the wireline cooperation

In July 2012 the Federal Network Agency approved Telekom Deutschland GmbH's so-called VDSL contingent model. With this model Telekom Deutschland GmbH grants its competitors VDSL bit stream access on the basis of agreed access quotas.

In December 2012 Telefónica Germany GmbH & Co. OHG executed a fee model of this kind with Telekom Deutschland GmbH and offers VDSL to its customers on this basis. With the offer of VDSL the Telefónica Deutschland Group receives access to about 11m households and thus promotes a further form of competitive wireline structures.

Telefónica Germany GmbH & Co. OHG concluded a contract with Telekom Deutschland GmbH on December 20, 2013 to expand the wireline network cooperation. It comprises on the one hand a further development of the contingent model ("Migration contract") by Telekom Deutschland, which will be offered by Telekom Deutschland identically to all service providers, and a bilateral agreement ("Transformation contract"). The cooperation comprises the intensified use of Telekom's high-speed infrastructure by Telefónica Deutschland for its wireline products. As part of this cooperation, which is due to begin in 2014, Telefónica Deutschland will be able to implement the transition from its own ADSL infrastructure to an NGA platform that is fit for the future. The transition is expected to be fully completed by 2019. Telefónica Deutschland will continue to use Telekom's VDSL and vectoring wholesale products.

The Federal Network Agency confirmed that the cooperation accords with the Telecommunications Act in its draft judgment of December 17, 2013, and provisionally stayed proceedings. The cooperation still requires a final decision

of the Federal Network Agency, which will only be made following national consultation as well as a consultation with the European Commission. This final decision is expected in the first half of 2014.

Roaming III

On May 30, 2012 the Council of the European Union adopted new, re-worked roaming regulations, which replace the 2009 regulations ("Roaming III"). These new roaming regulations came into force on July 1, 2012 and apply until June 30, 2022. The roaming III regulations will further reduce the current price caps for voice calls and SMS messages and introduce a new price cap for data services in the end-customer area. The price caps were also reduced stepwise for wholesale, and new structuring measures introduced, in order to promote competition between the operators. From July 1, 2014 customers will be able to acquire inland and roaming services separately with different operators but retain the same telephone number. In addition, since July 1, 2012 the operators of virtual mobile telecommunications networks (MVNO) have had the right to use the networks of other operators at wholesale prices in order to offer roaming services.

The regulations also contain provisions for transparent prices and for the improvement of information about the end-customer roaming fees.

With regards to the end-customer prices, some of the new provisions of the Roaming III Regulations that came into force on July 1, 2012, provide as follows since July 1, 2013:

- 28 cents per minute for a call;
- 8 cents per minute for receiving a call;
- 9 cents per SMS sent and
- 53 cents per megabyte (MB) for data transmission or surfing the internet in foreign countries (billing in kilobytes).

Decisions regarding the termination fees for wireless and wireline networks (MTR/FTR)

MTR

On July 19, 2013 the Federal Network Agency in its final decision confirmed the, initially provisionally approved, mobile telecommunications termination rates (MTR) for the Telefónica Deutschland Group (with EUR 0.0185 per min. from December 1, 2012 and with EUR 0.0179 per min. from December 1, 2013). The MTR are approved until November 30, 2014. Telefónica Germany GmbH & Co. OHG is expected to apply to the Federal Network Agency in April 2014 for approval of the MTR from December 1, 2014.

The provisional decision was notified to the European Commission together with the regulatory order, which was also issued to Telefónica Germany GmbH & Co. OHG on July 19, 2013 and which forms the legal basis of the ex ante price regulation. As part of the notification process the European Commission expressed significant misgivings about the fee

method and the fee level. Telefónica Germany GmbH & Co. OHG filed suit on August 16, 2013 against the MTR decisions with the goal of achieving higher termination rates.

FTR

On August 30, 2013 the Federal Network Agency issued the final decision with respect to the fixed-line termination rates (FTR) for Telekom Deutschland GmbH. The local FTR were reduced by 20% with this decision with effect from December 1, 2012 limited in time until November 30, 2014. By reason of the regulatory standards Telekom Deutschland GmbH's FTR will also have an effect on the FTR of alternative network operators. The Federal Network Agency issued regulatory orders in November and December 2013 for the FTR of the alternative network operators. The regulatory order was issued to Telefónica Germany GmbH & Co. OHG on November 20, 2013. The ex-post regulation, which was valid until November 19, 2013, was thus replaced by an ex-ante regulation. Accordingly, on November 21, 2013 Telefónica Germany GmbH & Co. OHG made an application to the Federal Network Agency for approval of the FTR. At the end of February 2014, a provisional decision of the Federal Network Agency was made regarding the local FTR that applied from November 20, 2013 up to November 30, 2014. Before final decisions are issued by the Federal Network Agency the decisions are firstly notified with the European Commission.

Decisions regarding the fees for the subscriber line (SL)

On June 26, 2013 the Federal Network Agency released its final decision for the subscriber line, the so-called "last mile". In accordance with that decision Telekom Deutschland GmbH is permitted to require EUR 10.19 monthly from its competitors for leasing the SL at the major distributor from July 1, 2013. Most recently, EUR 10.08 per month was due for this. The main distributor is the central point in Telekom Deutschland GmbH's network from which the individual copper lines lead to the end-customers. In contrast, Telekom Deutschland GmbH may in future charge its competitors only EUR 6.79 per month instead of the EUR 7.17 charged to date.

With this decision the fee for the main distributor SL was raised for the first time in years and against the trend of other EU Member States. The European Commission had recently recommended a corridor between EUR 8.00 and EUR 10.00 for the main distributor SL, however as part of the notification process it then voiced no serious misgivings about the draft decision notified by the Federal Network Agency so that the decision has now been finally issued. Telefónica Deutschland Group's wireline business is currently based primarily on the main distributor SL.

The future development of the GSM licenses

The GSM licenses, which authorize the use of the frequency spectrum in the frequency sectors 900MHz and 1,800MHz, expire at the end of 2016. The Federal Network Agency is

currently working on a decision about the future of these frequencies. In November 2012 the Federal Network Agency released an information paper in which four possible scenarios with regard to the future of the spectrum were illustrated. The possibilities extend from an extension to an isolated allocation of the GSM licenses through to scenarios in which the allocation of the GSM spectrum is made together with additional spectra, which are expected to be available in the coming years. The Federal Network Agency has released a draft decision on the basis of the submissions on the information paper. Opinions regarding the draft could be submitted up to October 4, 2013. Telefónica Germany GmbH & Co. OHG also made use of this opportunity. The opinions were published on the internet site of the Federal Network Agency.

(Source: www.bundesnetzagentur.de/cln_1931/DE/Sachgebiete/Telekommunikation/Unternehmen_Institutionen/Frequenzen/OeffentlicheNetze/Mobilfunknetze/Projekt2016/Projekt2016.html)

"Digital Single Market" Initiative of the EU Commission

Under the catchphrase "digital single market", on September 11, 2013 the EU Commission adopted a package containing various measures, which improve the framework conditions for investments in modern broadband networks and should create more favorable framework conditions for a strong European telecommunications sector. The draft regulations contain, in part, positive elements, which could improve the competitiveness of the sector in the long-term, such as, in particular, the suggestions for a stronger coordination of frequency allocations and the rules for frequency auctions. At the same time however, the package contains measures that have a direct negative effect on the revenue of network operators such as e.g. regarding roaming and international long distance conversations or which mean additional costs and a further regulation and limitation on the freedom to contract, such as stricter provisions for customer protection. The package will now be commented upon by member states as well as businesses. Currently it is also being discussed in European Parliamentary committees and those committees view the measures for the regulation of roaming, among other things, critically. It is not yet possible to say when and in what form the package will be adopted. But due to the elections for the European Parliament, which will take place in May 2014, it cannot be assumed that the legislative-making procedure will be completed in 2014.

2.2 Overview of the 2013 Financial Year

Telefónica Deutschland Holding AG is responsible as a service provider for the management of the Telefónica Deutschland Group and its operative business activities. From the additional charges for these management costs, revenues amounting to EUR 9,706k were achieved in the 2013 financial year.

On May 7, 2013 the first ordinary General Meeting of Telefónica Deutschland Holding AG took place. Next to the discharge of the Supervisory Board and Management Board and the election of the auditor for the Consolidated Financial Statements and Financial Statements of Telefónica Deutschland Holding AG, the General Meeting resolved to distribute a dividend of EUR 0.45 per dividend-entitled share, a total of EUR 502,625,430.00.

The Board of Telefónica Deutschland decided and disclosed on November 7, 2013 that it intended, at the next ordinary General Meeting for the 2013 financial year, to propose a cash dividend of an amount of around EUR 525m.

On July 23, 2013, Telefónica Deutschland, Telefónica, S.A. and Koninklijke KPN N.V. ("KPN") signed an agreement regarding the acquisition of KPN's German mobile network, E-Plus by Telefónica Deutschland. In our opinion, a mobile network operator will arise from the merger of Telefónica Deutschland and the E-Plus group which will generate considerable economies of scale and have enormous potential to compete successfully and with a clear vision against the current market leaders across all segments in Europe's largest economy. As of December 31, 2013, the execution still required the agreement of the General Meeting of Telefónica Deutschland and was subject to the approval of the responsible authorities, as well as further customary contractual conditions. The transaction is expected to take place in the middle of 2014 (section 5 Report on Events after the Reporting Period).

The following can be noted concerning the Telefónica Deutschland Group:

In 2013 Telefónica Deutschland has executed its strategy in a very dynamic and competitive environment with a clear focus on data monetization. Our operating and financial performance also reflects a shift in communications' behavior from customers, adopting a more digital lifestyle, and the current regulatory framework.

As such, the development of our wireless service revenues is broadly in line with expectations and reflects the market evolution. We were able to broadly defend our market position in respect of wireless service revenue share.

In the wireline business we saw the expected decline of revenues driven by the increasing demand for high speed access and a further reduction of the low margin voice transit business.

The resulting OIBDA margin in 2013 broadly meets expectations in a transition year towards the next technology standard (LTE) and reflects the performance of revenues as well as an increased commercial activity in the second half of the year, particularly around customer retention and devices. This was not completely offset by additional efficiencies in the business. A capital gain from the sale of assets in the fourth quarter added EUR 76m to OIBDA.

In line with our outlook, we increased capital expenditures in the 2013 financial year due to the accelerated rollout of the LTE network whilst at the same time densifying the 3G network to maintain quality of mobile data services. In total, the forecast maximum level of CapEx was not exceeded.

Consolidated net financial debt decreased significantly in 2013, resulting in a leverage ratio that is well below our leverage ratio target of at or below 1.0x.

In the 2013 financial year we have been able to demonstrate our ability to increase free cash flow in a particularly demanding environment while strengthening our financial profile.

Significant events

In the fourth quarter of the financial year 2013 we sold Telefónica Germany Online Services GmbH (TOS) and the GKHH Fibre Optic GmbH in order to focus even more on our core business going forward.

In May 2013, the Telefónica Deutschland Group via the Telefónica Germany GmbH & Co. OHG concluded with the Telekom Deutschland GmbH a “Memorandum of Understanding” to expand wireline cooperation. This comprises the future intensified usage of the high-speed infrastructure of the Telekom Deutschland GmbH by the Telefónica Deutschland Group for its wireline products. Within the scope of this cooperation, the Telefónica Deutschland Group will be able to implement the transition from the independent ADSL infrastructure through to a sustainable NGA platform. In future, Telefónica Deutschland intends to increasingly use VDSL- and vectoring wholesale products provided by the Telekom Deutschland GmbH. The transition should be fully completed in 2019. A binding agreement for the wireline cooperation with the Telekom Deutschland GmbH was concluded on December 20, 2013. The cooperation includes regulating aspects which are subject to an inspection by the Federal Network Agency and the Federal Cartel Office. The Federal Network Agency has approved the cooperation in their preliminary draft decision, but their final decision will be provided after consultation with the European Commission. We expect to receive this decision in the first half of 2014. In the event of the authorities failing to sanction the cooperation, this could necessitate further investments in our own wireline structure or might restrict our ability to offer technically competitive products in the future.

On February 26, 2013 we founded the Telefónica Deutschland Finanzierungs GmbH, Munich, and renamed it to O₂ Telefónica Deutschland Finanzierungs GmbH with effect as of November 7, 2013. Via our subsidiary, O₂ Telefónica Deutschland Finanzierungs GmbH, we issued a senior unsecured 5-year bond in November 2013 with a nominal value of EUR 600m and a maturity on November 22, 2018 in the regulated market of the Luxembourg Stock Exchange. The net proceeds generated from the bond will be used for general corporate purposes.

The business development is further detailed in the following sections.

2.2.1 Earnings Position

The comparability of the earnings position as of December 31, 2013 with the previous year's is limited since the company first assumed its function as a joint stock holding in the 2012 financial year 2012 upon registration in the Commercial Register as of September 26 and at this point in time, the currently valid service level agreements came into force.

Sales revenues

In the financial year, revenues to an amount of EUR 9,706k (2012: EUR 1,676k) were achieved. The revenues essentially include additional charges for the costs of the remuneration of the members of the Board, as well as further management costs (EUR 9,466k) (see also section 1.2.2). Moreover, deducted costs for management services (amounting to EUR 240k) were included which Telefónica Deutschland Holding AG provides for Telefónica Germany GmbH & Co. OHG and Telefónica Germany Management GmbH. In 2012, these also comprised compensation for the costs associated with the initial public offering (EUR 676k).

Other operating profit

Other operating profit was reduced from EUR 207k in the 2012 financial year to EUR 8k in the 2013 financial year. In the previous year, these primarily included profits from the derecognition of liabilities in relation to associated companies.

Personnel expenses

The personnel expenses for the financial year amounted to EUR 4,094k (2012: EUR 932k) and include the remuneration of the Board, including social security contributions.

Other operating expenses

Other operating expenses climbed from EUR 703k in the 2012 financial year to EUR 11,183k in the 2013 financial year. They essentially include costs accrued in connection with the planned cash capital increase in respect of the purchase of E-Plus (EUR 5,431k), as well as legal and consultancy fees from external service providers.

Financial result

The financial result amounted to EUR 7k in the 2013 period under review. Thereby, the financial result remained almost at the level of the previous year (2012: EUR 20k) and essentially arose from the positive cash pool balance.

Annual accounts

In 2013, the company made a net loss of an amount of EUR 5,537k (2012: annual net profit of an amount of EUR 282k). The reason for this development was, above all, the increase in other operating expenses due to the cost of the planned acquisition of E-Plus.

2.2.2 Financial Position

2.2.2.1 Principles and goals of financial management

The Telefónica Deutschland Holding AG is responsible as a service provider for the management of the Telefónica Deutschland Group and its operative business activities. Thus, it essentially finances itself out of the additional charges for these management services for Telefónica Germany GmbH & Co. OHG and Telefónica Germany Management GmbH. In addition, the Telefónica Deutschland Holding AG is integrated into the group-wide finance management of the Telefónica Deutschland Group.

Risk control and a central management are the fundamental principles of the financial management of the Telefónica Deutschland Group. The goal of financial management is to continually ensure financial liquidity and stability. Risk controls are used in order to anticipate potential risks and to mitigate them with appropriate security measures. An important parameter here is the net leverage ratio. The Telefónica Deutschland Group intends to maintain a net leverage ratio of below 1x ("target leverage"). The net leverage ratio corresponds to the net financial liabilities divided by OIBDA. The company aims to protect solvency by (a) refraining from paying dividends, distributing capital or capital reserves in cash or buying back shares, if the ratio of net financial debt/OIBDA materially and consistently exceeds the target leverage, and (b) restricting the use of new debt to pay dividends, allowing it only if the ratio of net financial debt/OIBDA complies with the target leverage.

2.2.2.2 Finance

Long-term finance agreements

The Telefónica Deutschland Holding AG is integrated into the group-wide financial management of the Telefónica Deutschland Group.

In the context of the group-wide financial management, Telefónica Germany GmbH & Co. OHG signed a credit agreement as creditor on September 12, 2012 with the finance company of the Telefónica Group (Telfisa Global B.V. – TG B.V.).

Under the agreement, Telfisa Global B.V. grants a credit facility (in the following: the credit facility) with an initial amount of EUR 1.25bn, with an interest rate equal to the three-month Euribor, plus a margin of initially 120 basis points, increasing by 40 basis points each year. The repayment schedule provides for annual repayments until 2017, each being 20% of the original total loan amount of EUR 1.25bn.

On the basis of the high volume, these finance agreements are also relevant for Telefónica Deutschland Holding AG as a parent company.

Telefónica Germany GmbH & Co. OHG is entitled to repay the credit facility early in whole or in part with payment installments of at least EUR 100,000 on an interest payment date – or at any point in time subject to a market standard breakage fee. If Telefónica Germany GmbH & Co. OHG cannot comply with its payment obligations under the loan contract, a default interest is payable, which is 2 percentage points above the agreed interest rate.

Taking into account the loan granted by Telfisa Global B.V. on September 12, 2012 of EUR 1.25bn and the annual repayment of EUR 0.25bn in September 2013 and the early repayment of EUR 0.15bn in December 2013, our future repayment obligations from long-term financial agreements are configured as illustrated in table 4 (as of: December 31, 2013). Due to the high volume, these finance agreements are also relevant for Telefónica Deutschland Holding AG as the parent company.

Revolving credit facility

In August and September 2012, Telefónica Germany GmbH & Co. OHG concluded revolving credit facility agreements with several banks. Thus Telefónica Germany GmbH & Co. OHG has EUR 710m banking liquidity lines with a term of over one year. The facilities have not been drawn. The interest rate for drawings under the individual agreements is calculated as Euribor plus a margin and is applied to the amount drawn down.

Bonds

In November 2013, O₂ Telefónica Deutschland Finanzierungs GmbH issued a bond with a nominal value of EUR 600m and a term of five years. The bond pays an annual coupon of 1.875%. The bond was issued at a price of 99.162% resulting in a total yield of 2.053% p.a. The bond has been approved for trading on the Luxembourg Stock Exchange by the Commission de Surveillance du Secteur Financier of the Grand Duchy of Luxembourg (CSSF). Telefónica Deutschland Holding AG guarantees the punctual payment of interest, capital and any other amounts payable under the bond. The issuer transferred the net issuing proceeds of the bond to its shareholder Telefónica Germany GmbH & Co. OHG as part of a loan contract. Telefónica Germany GmbH & Co. OHG will use the net proceeds for general business financing.

Cash pooling

The Telefónica Deutschland Holding AG, as well as the Telefónica Deutschland Group shall also participate in future as cash pool participants in the liquidity management system of the Telefónica Group. Agreements have been made with Telfisa Global B.V. for deposits and liquidity management. The liquid funds of the entire Telefónica, S.A. Group are centralized by means of these agreements. In this way we can benefit from the economies of scale of the entire Telefónica, S.A. Group as well as from the internal set-off of receivables and liabilities that exist between us and the participants within the Telefónica, S.A. Group. In accordance with the cash pooling agreements the total liquidity surplus, which is recorded in our accounts within the cash pool, is automatically transferred to main accounts that are maintained by Telfisa Global B.V. on a daily basis. In addition we can use other methods in order to pay the cash in to the cash pool account and in order to balance out receivables and liabilities via the cash pool that are to be allocated to companies in the Telefónica, S.A. Group and third parties. We can draw from the cash pool account in an amount that exceeds our cash deposits up to EUR 40m. In this way we can cover our need for working capital. The level of funds held in the cash pool may not exceed our free cash flow for the last 18 months. Further, we are entitled to make cash deposits in separate accounts with a term from one to a maximum of twelve months. We receive interest payments for credit in the cash pool account, based on a reference interest rate (Libor or Euribor, depending on the currency), plus/minus a margin on the basis of market prices.

For deposits that are made in separate accounts for a term of between one and a maximum of twelve months, an agreement is reached in each case with the Telefónica Group regarding the applicable interest rate. Similarly, we are obliged to make interest payments if we take money from the cash pool in excess of our cash deposits. The average interest rate for borrowed capital is calculated based on a reference interest rate (Libor or Euribor, depending on the currency), plus a margin.

The agreements regarding deposits and liquidity management are automatically extended each calendar year unless terminated by one of the contracting parties before expiry of the contractual year within a 30 business days' notice. Under certain circumstances the agreements can also be terminated immediately – for example if the contractually agreed payments are not made or if we have reason to assume that our contractual right to repayment cannot be fully met. In accordance with the deposit and liquidity management agreement and subject to compliance with the legal framework conditions that apply to the set-off of receivables, rights to repayment with respect to the deposits can be set off against liabilities from loans granted to us by Telfisa Global B.V. In the case of Telefónica Germany GmbH & Co. OHG this also includes the outstanding amount

of EUR 0.85bn from the existing credit facility, that was granted by Telfisa Global B.V. on September 12, 2012 with an initial amount of EUR 1.25bn. In addition, as part of the agreements about deposits and liquidity management, we are granted comprehensive rights to information with regards to the financial position of the Telefónica, S.A. Group and Telfisa Global B.V. are granted to us.

In this way, we can weigh on whether we want to continue to participate in the cash pooling or whether termination rights should be exercised. Telefónica, S.A. has guaranteed the performance of Telfisa Global B.V.'s obligations under the cash pooling agreements.

2.2.3. Analysis of the asset and capital structure

Financial assets

The financial assets include the investments in Telefónica Germany GmbH & Co. OHG as well as the shares in Telefónica Germany Management GmbH. The investment book value amounts to a total of EUR 5,246,252k (2012: EUR 5,758,877k) as of December 31, 2013. The reduction especially resulted from a withdrawal of capital at Telefónica Germany GmbH & Co. OHG of an amount of EUR 522,625k.

Receivables against affiliated companies

The receivables against affiliated companies primarily concern receivables out of the cash pooling against Telfisa Global B.V., Amsterdam of an amount of EUR 12,364k (2012: EUR 3,256k), as well as receivables for the management services pertaining to Telefónica Germany GmbH & Co. OHG of an amount of EUR 2,485k (2012: EUR 1,959k).

Other Assets

The other receivables of an amount of EUR 5,987k primarily concern costs already accrued in connection with the planned acquisition of E-Plus (EUR 5,887k).

Cash on hand and bank balances

The cash and credit balances in credit institutions were reduced by EUR 3,100k in 2012 to EUR 0 as of December 31, 2013. This decrease leads back to the enhanced cash pooling with Telfisa B.V.

Provisions

As of December 31, 2013, the provisions amounted to EUR 6,639k. With respect to the previous year, they had risen by EUR 5,610k. They primarily concerned liabilities from the remuneration of the Board (EUR 2,484k). Moreover, they include provisions for the pending purchase invoice of an amount of EUR 3,989k.

Trade payables

The trade payables rose, with respect to the effective date of the previous year's report (2012: EUR 306k) by EUR 2,158k and amounted to EUR 2,464k as of December 31, 2013. They are essentially costs accrued in the context of the planned acquisition of E-Plus.

Equity

Changes to equity of an amount of EUR 508,162k are first and foremost due to the distributed dividends of an amount of EUR 502.625k.

3. Employees

Number of employees

In the 2013 financial year, as in 2012, the company had no employees.

The telecommunications market finds itself in continuous transition, which again and again poses new challenges for our employees as well. For this reason we specifically promote measures to impart the required capabilities and skills to our employees and to regularly further educate them. We also give our employees the freedom to further develop

their own capabilities. In this way we ensure that the skills of the business always correspond with the requirements of the market. We promote an open working environment based on equal opportunity. In addition, we are committed to ensuring that our employees can combine the requirements of career and family with one another. For that reason the Telefónica Deutschland Group is one of the most attractive employers in Germany, which is documented and substantiated by many surveys and awards.

Important areas of personnel management

Business Transformation

The core task of Business Transformation is advice in relation to and the implementation of all HR relevant aspects as part of the planning and implementation of change processes in the business areas. These are e.g. reorganization projects in order to again and again re-align our core business so that we as a business remain competitive. Thus in 2013 in one large project we unified all selling channels (online, private customers and business customers) in one area in order to exploit synergies.

Culture Change

Our employees contribute significantly to the sustainable success of our business. With Culture Change we have estab-

2 — Balance sheet

(Euros in thousands)	As of December 31			
	2013	2012	Change	% Change
Financial assets	5,246,252	5,758,877	(512,625)	(8.9)
Receivables from affiliates	14,946	5,954	8,992	>100
Other assets	5,987	–	5,987	100
Cash on hand and bank balances	–	3,100	(3,100)	(100)
Deferred income	5	–	5	100
Total assets = total equity and liabilities	5,267,191	5,767,931	(500,741)	(8.7)
Provisions	6,639	1,028	5,610	>100
Trade and other payables	2,515	704	1,812	>100
Equity	5,258,037	5,766,199	(508,162)	(8.8)

3 — Long-term financial liabilities

(Euro in millions)	Maturity according to period				
	2014	2015	2016	2017	2018
Senior credit facilities	100	250	250	250	0
Capital lease	2	1	0	0	0
Bonds	0	0	0	0	600
Total (nominal value)	102	251	250	250	600

lished a program in order to align the behavior of all employees even more strongly with our strategic goals within the next twelve months.

For the German culture team this involves, on completely different levels, the promotion of a certain attitude in the business: to inspire employees, to give them freedom and responsibility, but also to stand by decisions and implement them consistently. To be open, to actively approach customers, to learn how and above all why people and businesses use technology. And also: to question processes, products, and ways of thinking. At the end of the day this always involves creating an environment in which new ideas arise and to excite our customers.

Employee Proposition

We understand Employee Proposition to mean a promise to our employees of performance beyond the purely material side. Alongside salary and fringe benefits this includes in particular intangible issues such as e.g. a good work-life balance or flexible working hours. A good Employee Proposition serves to create employee loyalty and promotes the appeal as employer so as to be able to recruit the best employees in the future as well. It helps us to increase the awareness and recommendation rate of Telefónica Deutschland Group as an employer. With our strong presence at innovative personnel trade fairs and recruitment events we are also positioning ourselves as an attractive employer.

Operational Excellence

It is our goal to permanently optimize HR services and HR processes with standardized methods so that we achieve the highest possible quality at low cost. Our HR systems (such as e.g. our personnel management system Chorus) should make our employees' lives easier and save time in the normal working day.

4. Corporate Responsibility

Digital communication brings the world not only closer together; it is also key for sustainable development. With our Corporate Responsibility (CR) Strategy we are following this vision. It offers us a set of clear guidelines as to which direction we want to head in and which priorities we want to champion. These are:

- Enabling better lives – we aim to make our customers' working and living world easier and more sustainable by providing smart digital solutions.
- Transforming society – we aim to utilize the power of technology to promote a more prosperous, healthier and more inclusive society by supporting and

developing voluntary commitment through digital communication, and supporting social and community innovations.

- Caring for the planet – we aim to make a sustainable lifestyle possible for all of our customers with digital products and services, while consistently optimizing resource conservation and efficiency in internal processes.

CR Management

We have defined clear management responsibilities. The Corporate Responsibility department works across all areas and coordinates CR activities. Together, the CR Team and the departments formulate clear goal setting agendas and key monitoring figures as the basis for our CR management. These are then approved by the Management Board and are integrated corporate-wide into key management processes. Performance is reviewed regularly. Group-wide key monitor-

4 — Society

	Unit	2012	2013
Donations and investments in non-profit projects	EUR	986,739	307,967 ¹
Participants in Think Big (young people)	Number	17,000	14,000 ²
Participants in the Corporate Volunteering Program (employees)	Number	797	771
Hours worked in the Corporate Volunteering Program	Number	6,881	9,758

- 1 In 2013 Fundacion Telefónica bore all expenses for the projects in the Think Big Program and thus Telefónica Deutschland Group investments in not-for-profit projects significantly decreased. Fundacion Telefónica's investment in the German Think Big program was around EUR 2m in 2013.
- 2 The number includes 13,000 young people in the Think Big Program and 1,000 young people in the Think Big School Program.

5 — Environment

	Unit	2012	2013
CO ₂ emissions through electricity consumption and vehicle fleet ¹	Tons	237,790	239,380
CO ₂ emissions through business travel ²	Tons	3,990	3,389
Total electricity consumption	MWh	486,029	489,634
of that network	MWh	462,644	467,907
of that offices, shops, call center	MWh	23,385	21,727
Proportion of electricity consumption from renewable energy ³	Per cent	70	58
Water consumption	Cubic meters	92,160	93,059
Paper consumption ⁴	Tons	673	585
Number of old mobile phones received at O ₂ ⁵	Number	47,898	43,906
Proportion of Eco Index reviewed mobile phones	Per cent	78.72	75.68

- 1 Calculation of CO₂ emissions in accordance with Group-wide standards by Telefónica, S.A. in accordance with ISO 14.064, Greenhouse Gas Protocol (Scope 1+2) & ITU-T L.1420; some results for 2012 were updated due to the updating of CO₂ emission factors.
- 2 Other indirect emissions through business travel (Scope 3) changed in this year because we no longer include travel by car.
- 3 Our proportion of electricity consumption from renewable energy sank in comparison to 2012 to 58% because, since 2013, Deutsche Telekom no longer uses green energy certificates. Accordingly, our green electricity proportions that are related to the Telekom main distributor drop out of our calculation.
- 4 Paper consumption continues to sink as part of the internal digitalization and the further forcing of the adjustment to online billing. In addition in 2013 no account enclosures were produced.
- 5 The number of old mobile phones includes mobile phones that are directed to the recycling process and are reworked in the "Re-Use" process or are accepted through our mobile phone trade-in program.

ing figures are defined for the issues: employees, customers, environment, corporate management, health and security in the workplace, society and suppliers. These key figures are verified externally on an annual basis.

— **CURRENT FIGURES ONLINE: WWW.TELEFONICA.DE/VERANTWORTUNG**

Stakeholder Dialogue

In order to align the further development of our business and our contribution to society with the needs of our stakeholders, we foster an intensive dialogue on various channels:

- For our customers, shops and the hotline are important contact points. With the “O₂ Customer Forum” we are providing an additional online platform for customers to communicate with each other and with employees.
- For communicating with our employees, we use various channels. We obtain important insights through regular surveys regarding employee satisfaction.
- Telefónica Germany's representative office in Berlin acts as an interface to politics, economy and associations. It accompanies relevant legislation and policy-making, allowing us to bring our technical know-how into the political process. Our corporate principles ban donations to any political parties.

Studies and surveys help us to better understand the requirements of our stakeholders and to portray these in our business processes. The Telefónica Global Millennial Study published in June 2013 gives an indication of how the generation of 18- to 30-year-olds will organize their future in an even more digital world. How young people can implement their ideas and commitment through digital technology is also outlined in the Commitment Report “Jugendliche digital” (Young digitals), which we published in 2013 in cooperation with betterplace lab. Information relevant to investor relation is made available through the Investor Relations department and the Media department on the corporate website.

Social Responsibility

Digital communication is one of the most influential and effective forces for societal transformation and can make a significant contribution to social innovation. Therefore, the promotion of digital media skills and entrepreneurial thinking among young people is a primary focus of our commitment.

Think Big

As in previous years, our youth program Thing Big was at the center of our social responsibility activities. Together with Fundación Telefónica and the Deutsche Kinder- und Jugendstiftung (German Children and Youth Foundation), we are making Thing Big a reality. The goal of the program is to

provide young people with the skills to implement their own non-for-profit projects and while doing so, to further develop their digital expertise. Since the start of the program in 2010, approximately 40,000 young people have implemented around 2,000 projects. A few examples are creating an App for traineeship, youth radio or a donation project for the homeless. In 2013 around 13,000 participants committed themselves to 669 projects.

Just one reason for the great success of Think Big is the involvement of our employees. They donate their time to act as mentors and share their technical knowledge, either in person or online. In 2013, 771 employees gave a total of 9,758 working hours (2012: 797 employees, 6,881 hours).

Think Big School

We started the Think Big School in 2013 in cooperation with Yaez as a media partner and the Mozilla Foundation. The program promotes innovation and the entrepreneurial spirit of students, as well as developing their digital media expertise. The Think Big School offers students in the 9th and 10th grade the opportunity to develop their own digital business ideas on project days with the Telefónica Deutschland Group. To date around 1,000 students have participated in 32 project days at the Think Big School in five different cities: Munich, Hamburg, Nuremberg, Bremen and Rostock. Around 200 employees accompanied them as part of the corporate volunteering program.

Further commitment

Alongside Think Big we support various programs and initiatives in the area of digital life and media expertise, for example the mobile phone video clip competition “Ohrenblick mal” (Listen up) from the JFF Institute for media pedagogy or the search machine suitable for children fragFINN (askFINN). In addition, in 2013 Telefónica Deutschland supported the development of learning materials for the teaching of media expertise, which can be used in school classes as Open Educational Resources. Moreover, we have also been actively involved in the work of the “Zentrum für Kinderschutz im Internet” (Centre for the Protection of Children in the Internet), a Think Tank founded by the Federal Ministry for Families for youth media protection. In Spring 2013 we received the title IT-Stifter (IT Benefactor) 2013. Via the portal Stifter-helfen.de we have made around 3,000 O₂ product bundles, each with a value of EUR 150, available to non-profit organizations.

During the devastating floods in Summer 2013 we initiated a donation campaign for employees, customers and business partners via the online donation platform betterplace.org – Telefónica Deutschland Group employees coordinated delegations of helpers on site and young people from the Think Big Program were actively involved in the flood assistance. We started a further online donation campaign

because of typhoon “Haiyan” in the Philippines. In total 452 donors have collected EUR 25,476. Telefónica Germany added a further EUR 25,000 to that. In 2013 countless employees, customers and business partners were involved in the donation and volunteer campaigns initiated by us for the victims of the floods in Summer 2013 and typhoon “Haiyan” in the Philippines.

Environment and Climate Protection

Climate protection and saving resources are important principles of our environmental management. Since 2004, our environmental management system has been certified in accordance with ISO 14001. In 2013, compliance with the standard was confirmed again. Since 2011, Telefónica Deutschland has been a member of the Bundesdeutscher Arbeitskreis für Umweltbewusstes Management e. V. (B.A.U.M., the German Task Force for Environmentally Aware Management). With around 550 members, B.A.U.M. is the largest environmental initiative in the European market.

Resource Efficiency

Through exchanging outdated printers for more efficient models, we were able to reduce the number of printers by 75% and energy consumption by approximately 70% at the end of 2013. This means that around 380 tons of CO₂ were saved. Through further procedural improvements, 13m sheets of paper were also saved. In addition, all printers were technically modified for recycled paper. All internal printers were equipped with recycled paper in 2014. Since 2013, AfB (Arbeit für Menschen mit Behinderung – Work for People with Disabilities) Social & Green IT, a non-profit GmbH (Gesellschaft mit beschränkter Haftung – company with limited liability), recycles a substantial part of our decommissioned IT hardware.

Our mobile phone recycling initiatives were an important contribution to the saving of resources in 2013. With 16,520 recycled mobile phones and 3,033 mobile phones in the trade-in program, we achieved our recycling goals. In order to motivate our customers to return unused devices, the profits from the recycling of mobile phones go to non-profit environmental projects, selected by O₂ customers. In 2013 we donated EUR 46k to Naturefund e.V., Plant-for-the-Planet Foundation and for an environmental project in a SOS Children's Village. In 2013 we participated once again in the collection campaign “Clever entsorgen – Handy, Laptop & Co.” (Clever disposal – Mobile, Laptop & Co) (www.handy-clevertentsorgen.de) under the auspices of the Bavarian Environmental Ministry; and we are committed to the “Sustainability” Task Force of the IZMF e. V. (Informationszentrum Mobilfunk e. V. – Information Centre Mobile Telecommunications Association).

Awareness Building for Environmental Issues and Future Challenges

As a sign of increasing environmental awareness, in our O₂ shops we use only environmentally friendly paper shopping bags instead of plastic bags. We participated in Earth Hour and switched off all lights in the O₂ Tower and in all shops. The symbolic action on March 23rd was to increase awareness for the need of more climate protection. Since 2011, we especially promote the ECO-Index with which information about ecological and social sustainability from end-devices is communicated in our shops.

Digitalization and telecommunications play a central role in the configuration of a sustainable future. Digitalization also shows its added value in the protection of the environment e.g. in the M2M sector, or data communication between machines. With the O₂ Fleet Store it is possible to reduce e.g. the CO₂ emissions of a fleet of vehicles by up to 10%. M2M will play a key role in the energy transition. There is great potential for energy management in buildings, as well as the intelligent interlinkage between electricity consumers and producers.

Energy Efficiency in the Network

In 2013 we complemented and/or replaced existing air conditioners at 101 locations with a free cooling unit, saving 4,500 kWh per year per location. With the integration of more modern and efficient rectifiers, we were able to reduce energy consumption at 56 locations by approx. 3,700 kWh per year. At 3,353 locations, we replaced the engineering systems for UMTS technology with more productive units and thus reduced the energy consumption per location by approx. 2,600 kWh. Additional measures, such as the use of stand-by mode for transmitting units that are temporarily not required, led to further energy savings.

In total, the consumption of electricity and subsequently CO₂ emissions have increased slightly at Telefónica Deutschland in comparison to the previous year. This can be attributed to the network expansion and the increase in customer connections. 58% of the total electricity demand came from renewable sources. 100% green electricity is used at O₂'s owned shops and all office buildings. To further reduce CO₂ emissions, we participate in the German Post DHL's “GoGreen” Program and have off-set mail, in order to become almost CO₂-neutral.

5. Report on Events after the Reporting Period

Issue of a 7-year bond (Bond II)

On February 10, 2014 the Telefónica Deutschland Group issued a senior unsecured 7-year bond with a nominal value of EUR 500m. The bond has a maturity on February 10, 2021 and was issued by O₂ Telefónica Deutschland Finanzierungs GmbH, Munich, and is guaranteed by Telefónica Deutschland Holding AG. The coupon for the fixed interest bond is 2.375% and the issue price 99.624%. The issue spread was 100 basis points over the seven-year Euro Midswap Rate, resulting in a yield of 2.434%. The bond has a denomination of EUR 1,000 and was issued on the basis of a bond security prospectus. O₂ Telefónica Deutschland Finanzierungs GmbH, Munich, has transferred the net proceeds of the bond to Telefónica Germany GmbH & Co. OHG, Munich, in the form of a loan. The net proceeds generated by the bond will be used for general corporate purposes.

Change in the Management Board of Telefónica Deutschland

On January 31, 2014, René Schuster left in mutual agreement as CEO and member of the Management Board. On January 29, 2014, the Supervisory Board of Telefónica Deutschland approved a respective termination agreement. Since February 1, 2014, the responsibilities of the CEO were taken over jointly by Chief Financial Officer, Rachel Empey and Chief Strategy Officer, Markus Haas, in addition to their responsibilities to date. Rachel Empey focuses on the operative business and Markus Haas on the preparation for the E-Plus integration.

Extraordinary General Meeting

On December 30, 2013 the Management Board of Telefónica Deutschland called an extraordinary General Meeting, which took place on February 11, 2014. In such extraordinary General Meeting, the General Meeting of Telefónica Deutschland approved the following capital measures for the E-Plus transaction:

- Increase in the share capital by up to EUR 3.7bn against cash contributions with a subscription right of the shareholders, as well as a related amendment of the Articles of Association;
- Authorization of the Management Board, with the approval of the Supervisory Board, to execute a capital increase against contribution in kind by up to EUR 475m and the related amendment of the Articles of Association (authorized capital 2014/I).

The resolution passed by the general meeting on the authorization to increase share capital by up to EUR 3.7bn was registered in the commercial register on February 25, 2014.

Furthermore, the extraordinary General Meeting resolved a new conditional capital 2014/I whilst suspending the former conditional capital 2012/I. The new conditional capital 2014/I was registered in the commercial register on February 25, 2014, whilst suspending the former conditional capital 2012/I.

6. Risk and Opportunity Management

The following explanations of risk and opportunity management essentially relate to the Telefónica Deutschland Group. Since the Telefónica Deutschland Holding AG is responsible as a management and holding company for the management of the Telefónica Deutschland Group, all the risks and opportunities also relate to the Telefónica Deutschland Holding AG, on the basis of which a comprehensive, group-wide view is represented.

The Telefónica Deutschland Group anticipates and recognizes new business opportunities in order to increase the long-term company value and to pursue growth in revenue. However, to maximize these opportunities and increase efficiency the corporation also has to take certain risks. Our risk management is designed to recognize these risks early and to actively manage them.

6.1 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. Due to Telefónica Deutschland Group's regional focus of its activities, it is not significantly affected by e.g. foreign currency risks. The Telefónica Deutschland Group is exposed to the risk of default from the operative business (trade receivables) and from receivables from the Telefónica, S.A. Group.

In addition there are liquidity risks for the Telefónica Deutschland Group that are connected with its credit risks and market risks or a weakening of its operative business or disruption of the financial markets.

If such financial risks occur, they may lead to negative impacts on the asset, financial and earnings position and the cash flow of the Telefónica Deutschland Group.

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

Market risk

Market risk is the risk that changes in market prices, such as, for example, changes in currency conversion rates and interest rates, will affect the value of the Telefónica Deutschland Group's financial instruments or earnings.

Currency risk

The underlying currency for the financial reports of the Telefónica Deutschland Group is the Euro. All contracts of the subsidiaries of the Telefónica Deutschland Group will also be based on the Euro, thus the Telefónica Deutschland Group is not subject to any translation risk. However, aside from the translation risk there is a transaction risk, which primarily arises from the business relationship of the Telefónica Deutschland Group with its suppliers or business partners in countries with a different national currency than the Euro. Because the Telefónica Deutschland Group finances itself exclusively through self-generated cash in Euro as well as in Euro-denominated debt and equity, there is no exchange rate risk through debts that are denominated in a currency other than the Euro. The net risk position from foreign currency risks in the balance sheet comprises non-derivative and derivative financial instruments in foreign currencies as well as future positions in foreign currencies of the following year.

For significant currency risks identified, derivative contracts are closed with the Telefónica, S. A. Group Treasury.

Interest risk

Interest risks arise predominantly from cash pooling accounts and deposits of the Telefónica Deutschland Group as well as through loan agreements as borrower and interest swaps. The Telefónica Deutschland Group deposits cash surpluses almost exclusively in cash pooling and deposit accounts with Telfisa Global B.V. These accounts and the bank accounts pay a variable interest rate. The loan agreements of the Telefónica Deutschland Group as borrower carry a variable interest rate. In November 2013 an interest rate swap was signed in connection with the issuance of the bond for a partial amount of the bond's nominal value. On the basis of 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. This interest swap compensates, to the level of its nominal amount,

the effects of future market interest rate changes on the fair value of the underlying fixed interest financial liabilities from the issuance of the bond (fair value hedge).

The hedging relationship is recognized in accordance with hedge accounting under IAS 39. At the start of the hedging relationship both the relation between the hedging instrument and the underlying transaction as well as the goal and strategy of the hedge were documented. A specific allocation of the hedging instrument to the corresponding liability followed and an estimate of the degree of effectiveness of the hedging relationship. The existing hedging relationship is continuously monitored for effectiveness.

Credit risk

Credit risk describes the risk of financial losses from the inability of contractual partners to pay back or service debts in accordance with the contract. The Telefónica Deutschland Group's maximum credit risk initially corresponds with the book value of the financial assets (disregarding any guarantees or securities).

The Telefónica Deutschland Group considers the management of the commercial credit risk to be critical in order to achieve its goals for sustainable growth of the business and the customer base in harmony with its risk management guidelines. For the management and monitoring of the credit risk, suitable processes have been set up.

This approach for credit risk management is based on the ongoing monitoring of the expected risks and the level of default. Here, particular attention is paid to customers who can have a significant effect on the consolidated accounts of the Telefónica Deutschland Group and for them, depending on the business area and the type of relationship, appropriate credit management instruments are used, such as credit insurance or security to limit the credit risk. To control the credit risk, Telefónica Deutschland Group regularly conducts an analysis of the maturity structure of trade receivables and only reports adjustments for doubtful receivables with a credit risk. The Telefónica Deutschland Group has concluded cash pooling and deposit agreements with the TG B.V. with regards to its cash surpluses in accordance with the Telefónica corporate policy and it deposits the majority of its cash surpluses there. The majority of the cash surpluses of the Telefónica Deutschland Group are thus concentrated in an associated company of the Telefónica, S. A. Group. The Telefónica, S. A. is rated by international rating agencies with an Investment Grade Rating. The remaining cash surpluses are distributed across several German banks that have been rated by international rating agencies with Investment Grade.

Liquidity risk

The liquidity risk includes the risk that a business cannot comply with its financial obligations, which are processed either in cash or with other financial assets. The Telefónica Deutschland Group ensures, for the management of the liquidity risk, that it has sufficient liquidity at all times to fulfill its obligations, both under normal and under demanding circumstances. The Telefónica Deutschland Group works on its liquidity management closely with the Telefónica, S. A. Group and, in accordance with the corporate policy, has concluded cash pooling and deposit agreements with the TG B.V., Holland. It deposits the majority of its cash surplus there. The liquidity risk is reduced by the inflowing funds generated by the operative business of the Telefónica Deutschland Group, by the opportunity to factor debts and by maintaining (currently unused) credit facilities.

Capital management

The Telefónica Deutschland Group strives to guarantee the sustainability of the business and to maximize shareholder value. It monitors its capital costs with the goal of an optimal capital structure. The Telefónica Deutschland Group monitors in particular its equity quota and the OIBDA. Further information regarding risk management and financial instruments can be found in the consolidated notes for the financial year ended December 31, 2013 (Note 28 Financial Instruments and Risk Management).

6.2 Risk Management and Risk Reporting

Fundamental risk management principles

As part of our business activity we are confronted with various business, legal, financial and other (global) risks. We perform our services on the basis of the organizational, strategic and financial decisions and provisions made by us.

Every business activity involves risks that can prejudice the process of goal-setting and goal fulfillment. These risks arise from the uncertainty of future events – often due to insufficient information – and have the result that objectives can be missed. If risks are not recognized and dealt with they can endanger the successful development of the corporation. In order to react appropriately to this fact, the corporate management has introduced a risk management process. This should guarantee immediate and complete transparency with regard to newly arising business risks and changes to existing risks.

Risk management is an immanent component of the decision-making process with the Telefónica Deutschland Group. The process ensures that risk evaluations are taken into account for the decision-making and measures are taken early to minimize and deal with the risks. As a result the evaluation, communication and management of risks is the

task of all managers of the corporation. The risk management department compiles the corporation's risk registry, which also covers the subsidiaries. As part of the creation of the risk registry it is ensured that risks of a similar type or of cumulative effect are aggregated and thus provided for overall consideration. In addition the so-called bottom-up approach, i.e. the identification of risks through the operative units, is complemented by the so-called top-down approach, in order to ensure a cross-business perspective of risk. 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 in order to enable a full classification as well as integrated management and to evaluate the relevance for future reporting. Here the role is continually in contact with all areas of the corporation and our risk coordinators in order to progressively pursue and evaluate risks and their management and development. Responsible employees are individually trained in order to ensure a uniform, structured process of risk identification and evaluation. In addition, fundamental training is available for participation by all employees in order to sensitize them generally to the management of risks.

Risks are evaluated with regard to their effect on our business goals both from an operational as well as financial viewpoint. The risk registry is based on a data base that contains all identified risks, their status and defined action plans.

In a formal forward-looking process, the risk registry and Telefónica Deutschland's total risk and that of its subsidiaries are subject of quarterly reporting to the Management Board. The Audit Committee is regularly informed about risks and their development.

Opportunities are not captured in the risk management system.

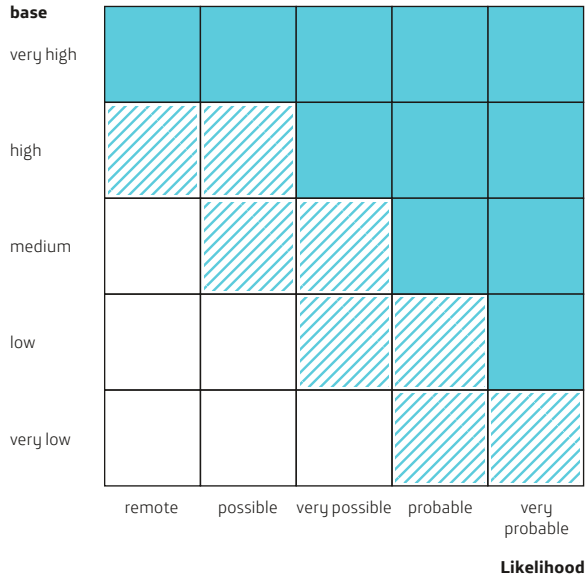
Risk evaluation

In the following section the risks are illustrated that can significantly prejudice our financial situation, our competitiveness or our ability to implement the objectives. The illustration is in accordance with the so-called Gross Presentation, where the risk is fully covered, without consideration for reducing influences through mitigating measures defined and carried out as part of the risk management.

Essentially, the lower threshold value for internal risk reporting to the Management, the Management Board and the Supervisory Board and / or the Audit Committee is currently EUR 6m. To ascertain the risks illustrated in the following with significant influence on the business development we use a 5x5 matrix as a starting point, within which the potential level of damages and the relevant probability of occurrence are each divided into five categories:

6 — Risk profile

Economic impact on cash flow base



■ critical risks ■ moderate risks □ minor risks

From the combination of the potential level of damages and the estimated probability of occurrence, the individual risk points are divided into three categories (critical, moderate and minor risks). All risks with a very high potential level of damages are seen as critical for the corporation, and here the estimated probability of occurrence is not taken into account. With an increasing probability of occurrence the risk points with a high or medium potential level of damages also fall into this category.

For internal use and reporting within the Telefónica Deutschland Group risks are divided into business risks, operational risks, financial risks and other (global) risks; this division consequently also forms the basis of this section of the report. The relevant risks from the business risk, operational risk and financial risk areas are discussed in accordance with their ranking in the relevant category.

In addition, our corporation can be influenced by other or additional risks of which we are presently unaware or that we do not consider significant in accordance with the current state of knowledge. Moreover, it cannot be precluded that risks that are currently estimated as minor, will change within the period of the prognosis in such a way that they can have a potentially greater effect than the risks currently estimated as critical.

6.3 Risks

Business risks

Competitive markets and changing customer demands

We operate in markets characterized by a high level of competition and continuous technological developments. Our corporation faces an increasing competition with alternative telecommunications service providers – among them cable operators, MVNOs and corporations for entertainment electronics – and competes in addition with alternative telecommunications services like OTT (Over-The-Top). In order to prevail against these corporations we have to successfully market and make available our services and products. We have to react to the business activities of our competitors and anticipate technological changes, new customer needs and the general economic, political and social conditions. This implies a critical risk in achieving our growth and financial targets.

Regulatory environment

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

Licenses and frequencies

Our licenses and frequency usage rights are limited in time and dependent on a preceding assignment, which represents a critical risk to the operation and development of the network. If we do not extend or cannot newly obtain the licenses and frequency usage rights necessary for our business or if the financial conditions for the use of these licenses and rights changes significantly, this can operate to the detriment of our business activity. Delays in the approval of usage rights, particularly for radio relay frequencies, by the Federal Network Agency could significantly prejudice the performance and the expansion of our wireless telecommunications network.

Non-approval of planned business mergers, take-overs or cooperations

The Telefónica Deutschland Group constantly evaluates opportunities to realize increases in efficiency and operative profit also through cooperations, additional purchases and fusions. Agreements between corporations who are active in the same or neighboring substantive markets are subject to the supervision and by and large to the requirement for approval from the responsible cartel authorities (EU Commission, Federal Cartel Office, Federal Network Agency). Furthermore it is possible to issue approvals only on certain conditions. The withholding of approval or the stipulation of extensive conditions carries the critical risk that the profitability of the agreement is reduced, planned savings,

synergies and growth expectations cannot be generated to the full extent or the possibility that contractual damages become due.

Termination fees wireless communications

The termination fees in wireless communications have sunk in Europe in recent years and there were considerable reductions in Germany as well (reductions of over 50% since December 2010). Various reviews of these fees and court processes regarding regulatory measures have not yet concluded. The European Commission intends to make a further considerable reduction to wireline and wireless telecommunications termination fees and has issued a recommendation for the calculation of these tariffs by the relevant national regulatory authority. As a result, the decision of the German Federal Network Agency is subject to approval by the European Commission (notification process). Because the Federal Network Agency has to date not completely followed the recommendation there is a moderate risk that the decisions of the Federal Network Agency could be changed. Moreover it is possible for third parties to submit comments and to proceed contrary to the decisions. Any further reduction in the termination fees would have negative effects on revenues of the Telefónica Deutschland Group.

Termination fees wireline

In 2013 an ex-ante price regulation for wireline termination fees was imposed on alternative operators, including Telefónica Deutschland Group. It had already been decided that the lowest possible termination fee (the so-called local fee) would correspond with that of Deutsche Telekom AG. It remains open how the Federal Network Agency will decide this question if interconnection structures different to that of Deutsche Telekom AG lead to different fees and if the structure is different from operator to operator. A provisional decision of the Federal Network Agency regarding the local FTR application from November 20, 2013 is expected on January 30, 2014. Before final decisions are issued by the Federal Network Agency the decisions are first of all notified to the European Commission, which involves a moderate risk of deterioration. Any further reduction of the termination fees would have negative effects on the service revenue of the Telefónica Deutschland Group.

Other regulatory influences on fees

Other price-regulated services include international roaming, SMS and data services. The European Parliament and the European Council have approved the Roaming III Regulations. This sets fee caps for the period from July 2012 to July 2014 for voice and SMS services at the level of the end-customer and large customers and moreover provides for further reductions. In addition, Roaming III regulates the data roaming prices at the level of the end-customer and large customers and establishes rules to increase price transparency and to

better explain fees to roaming customers. Since July 1, 2012, MVNOs have had the right to use the networks of other operators at large customer fees in order to offer roaming services. From July 2014 wireless telecommunications network operators must separate the sale of roaming services and domestic wireless telecommunications services. That gives customers the opportunity to choose another network operator for calls in other member states. It is not currently foreseeable how customers and competitors will react to this situation. The products arising could endanger our margins on roaming services. The regulatory authorities can take additional measures at any time in order to curtail roaming tariffs and wireline or wireless telecommunications termination fees. They could similarly oblige us to grant third parties access to our networks at reduced prices. There is the moderate risk that further reductions of these tariffs and fees could prejudicially affect our business activity, our financial situation and our operating result.

In order to guard against these regulatory risks the Telefónica Deutschland Group maintains close communications with the decision makers on a national and international level in order to bring our interests and standpoint into 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.

Insurance

Considering the existing opportunities and evaluating the financial reasonability the Telefónica Deutschland Group makes use of the opportunity to counter risks by taking out insurance policies. In particular, risks in connection with the operation of the technical infrastructure and breaches of copyright or patent rights are thereby significantly reduced, essentially to the selected excess.

Despite an existing risk management process there is the moderate risk that unforeseen events will entail financial losses, should our accruals or our insurance cover turn out to be insufficient. As part of the management of our insurance protection, a regular review of our insurance cover takes place with the goal of achieving the best possible cover for all conceivable risks.

Macro-economic factors

Macro-economic factors can prejudice consumer spending and growth prospects for the German telecommunications market in general and have a negative influence on our market penetration, the new added value services and traffic, our customer numbers, the average return per user (ARPU) and particularly on the number of our business customers. Recessive general conditions could likewise lead to an increase in payment defaults and/or delays by our customers, greater customer migration and difficulties in gaining new customers. In consideration of the overall current economic climate,

we see the minor risk of a negative influence on the desired growth and revenue targets.

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

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

Operational Risks

Service quality

The success of our business activity is dependent on our ability to gain customers and to retain existing customers. A key factor for success here is anticipating technical requirements and the desires of customers and reacting to them in good time. False interpretations or incorrect decisions could imply the critical risk of negatively influencing the acceptance of our products by customers and lead to us not reaching our growth and revenue targets.

There is a critical risk that lasting or repeated disturbances or damages in our wireless telecommunications or wireline networks and in our technical facilities could have a negative influence on customer satisfaction and result in a loss of customers or service revenue losses. In addition there is a risk that costly repairs are required to restore operations.

Supplier defaults

As wireless telecommunications and wireline operators and providers of telecommunications services and products we are (like other corporations in the branch as well) dependent on a few main suppliers (e.g. Deutsche Telekom AG, BT Germany), which implies a critical risk. These make important products and services available that primarily relate to the IT and network infrastructure. If these suppliers do not make their products and services available when due, this could endanger the operation and expansion of the network, which in turn could prejudicially affect our corporation and the operating result. The same applies if service providers to whom we award projects for reasons of efficiency, do not perform the services by the required deadline or to the required quality. As part of our supplier management we continuously evaluate risks and the quality of the services made available in order to be able to identify weak points early on and take preventative action against them.

Legal risks

In the course of our business activity we collect and process customer data and other personal data. Misuse or the loss of such data could represent a breach of the relevant laws and provisions and result in fines, loss of reputation and the migration of customers. In addition we could be confronted

with lawsuits that relate to the breach of third party intellectual property rights. Equally we are possibly not capable of appropriately protecting our own proprietary rights.

Damages could result from penalty clauses agreed in the contracts with suppliers and customers if we do not comply with our obligations or fail to meet agreed purchasing quantities, for example.

To avoid legal risks, the Telefónica Deutschland Group maintains an internal legal department and has continuous contact with external law firms and authorities, associations and official groups. Due to the numerous legal obligations, complex agreements and conflicting interests particularly with consumer protection organizations, there is a moderate risk that our business result or reputation could be negatively influenced.

Personnel

We are competing with other companies when it comes to qualified and experienced personnel. It is for this reason that we implement employee surveys, internal projects and a well-balanced remuneration, training and work structure to maintain high employee satisfaction and the positioning of the Telefónica Deutschland as an attractive employer. Taking as a basis the results of internal and external surveys, we consider the risk of a shortage in personnel to be minor.

Financial risks

Taxes

Like every corporation, we are regularly the subject of tax audits. These could be considered a critical risk. These can lead to higher tax payments for prior tax periods, if the tax authorities have a divergent opinion about the interpretations and payments that form the basis of our income tax return. In 2012 Telefónica Germany Management GmbH and OHG filed a correction of the wage tax declaration for the period from January 2008 up to October 2012 for employee benefits. The effects on wage tax, value-added tax as well as corporate income and trade tax have to be finally agreed on with the tax authorities. Since December 2012 both companies as well as Telefónica Deutschland Holding AG have been the subject of a wage tax audit for the tax period January 2008 to, as of now, December 2013. To date there are no final results from these audits.

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

Moreover, there is the minor risk that we could become incapable of using our carried forward tax losses to the full extent.

Liquidity

We operate a capital-intensive business, which makes significant investments necessary. We have established a comprehensive investment program for which significant outlay will be necessary in the foreseeable future as well. The program is aimed at, among other things, the maintenance and optimization of our wireless telecommunications and wireline networks and further investments for the expansion of the HSPA (High Speed Package Access) and LTE technology. The costs for the frequency usage rights, which are necessary for the operation of our existing networks and technology, the costs and the rental expenses for their availability and the costs associated with our wireline networks form a significant part of our cost base and could increase (similarly part of the business risks). We are convinced that we can comply with our financial obligations in the next twelve months. We have negotiated favorable payment and delivery conditions with our suppliers and concluded cash pooling and factoring contracts to improve our working capital. However, it cannot be guaranteed that such arrangements or agreements will also be possible in future or can be concluded on favorable conditions. Further, in the future we may not be capable of generating sufficient inflows of financial funds to cover our investment needs. With regards to our further growth, our planned strategy, the market developments or the development of new technology we therefore possibly need additional sources of finance for our working capital. As a result we may have to take up additional debt or equity at possibly a considerable level. Our ability to take additional capital to finance our business activity could be influenced by various factors here, for example, from market interest rate changes, restrictive agreements in connection with our debt instruments or from a downgrading of our credit rating or the credit rating of our majority shareholder. Future loan agreements could contain clauses that limit our financing opportunities or work against us in the implementation of business changes. Because we are exposed to the credit risks of our customers, the recovery of receivables could be complicated and as a result our working capital position could be encumbered. Overall we assess the risk concerning liquidity as minor.

Other (global) risks

As at the end of the financial year no significant other (global) risks are present.

6.4 Opportunity Management

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

The opportunities and growth potential ascertained in the strategic goal-setting process are prioritized as part of an annual planning process in close cooperation with the individual business areas and relevant strategic goals are derived from that. To measure the strategic implementation, concrete financial objectives in the form of key finance-related monitoring figures are defined at the level of the organization units.

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

Opportunities

Greater demand for wireless data, LTE and convergent products

The development of the German telecommunications market, one of the largest telecommunications markets in Europe, will continue to be driven by wireless data business and the increased use of wireless data devices like smartphones and tablets. This trend will be further strengthened in 2014 through the expansion of the LTE networks and the resulting increased demand for LTE end-devices and plans. The increasing demand for fast broadband services in wireless telecommunications and wireline networks with simultaneously increased demand for convergent solutions on the part of German consumers will similarly be a growth driver for the data business. However, losses in the classic communications services like telephony and SMS through price slumps, regulatory effects and substitution with other services will not subside in 2014.

Should the individual facets of the German telecommunications market, such as e.g. the smartphone penetration or the demand for LTE and convergent products in comparison to the losses in the classic communications services develop more positively than set out in our prognosis, then our financial and operating results could exceed our current forecast.

Cooperation with Telekom Deutschland GmbH in the wireline network

Should the expansion of the wireline cooperation with Telekom Deutschland GmbH for the increased use of its high-speed wireline network infrastructure as described in section 1.1.2 Business activity, ultimately get regulatory approval this could positively affect our wireline revenues and our OIBDA and lead to us exceeding our forecast.

Expansion of our LTE network

As already mentioned in section 1.2 Goals and Strategies, in 2014 we will further progress the expansion of our LTE network and again considerably increase the population coverage in comparison to 2013.

Should our expansion of the LTE network proceed more quickly than illustrated in our prognosis due to more positive general conditions, our share of wireless data business could grow more strongly than predicted and thus our financial revenue and operating results could exceed our current forecast.

B2B market

In section 1.2 Goals and Strategies, the initiatives to use the opportunities on the B2B market were detailed.

Should our business customer segment develop better than currently expected, this could positively affect our service revenues and our OIBDA and lead to us exceeding our forecast.

Digital innovation

In order to fully exploit our position on the German market for wireless telecommunications services and to monetarize additional opportunities for growth, we have introduced innovative digital products and services in various areas like communication, financial services (e.g. mpass), M2M (e.g. pay how you drive) or in the area of digital signage (e.g. Promotion Pad) or we plan the introduction of these shortly. They were or will be primarily developed together with Telefónica Digital or by one of many supported start-up enterprises from our Wayra Academies. Telefónica Digital's task is to use the opportunities in the digital world and to generate new growth for the entire Group.

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

Belonging to the Telefónica, S. A. Group

As a part of one of the largest telecommunications corporations in the world, Telefónica Deutschland benefits from economies of scale in the areas of purchasing, cooperations and development of digital products.

Should these economies of scale develop better than currently expected this could positively affect our operating revenue and our earnings position and lead to us exceeding our forecast.

6.5 Summary of the Risk and Opportunities Position

According to our evaluation the greatest potential effects result from the intensive competition on the German telecommunications market, the regulatory environment and from the issue of ensuring a qualitatively high value service. Compared to the previous year we see the most prominent positive development in the risk position in the positive development of the macro-economic environment in Germany. With regards to our own measures in the previous

financial year we note a reduction of the risks in relation to our ability to make technologically competitive, innovative products available in a timely fashion and to market these via adequate channels of distribution. The risk in connection with the introduction of SEPA (Single Euro Payments Area) mentioned in previous publications is no longer relevant for reporting purposes following the implementation of the internal projects and successful first payment processes.

In accordance with our assessment, the Telefónica Deutschland Group's position of significant risks and opportunities in comparison to the previous year, other than the risks and opportunities that result from the E-Plus acquisition, which is covered in more detail in the following, and the improved macro-economic environment, has not changed significantly.

Presently no risks have been identified by us that either alone or cumulatively with other risks would be capable of endangering the continued existence of our corporation.

We are convinced that, in the coming financial year as well, we will be able to identify relevant risks in good time and to take appropriate measures to counter them by continuing to implement the risk management approach to date.

We are confident that the earning power of our corporation forms a solid basis for our future business development and ensures the resources needed in order to pursue the opportunities that offer themselves to the corporation. Considering our technological high-value product offering, our position in the market, our digital innovation power, the fact that we belong to one of the largest telecommunications corporations in the world, our committed employees and our structured processes to recognize risks early and identify opportunities, we are confident of being able to successfully meet the challenges that result from the risks and opportunities mentioned in 2014.

7. Acquisition of E-Plus

7.1 Overview

On July 23, 2013 the Telefónica Deutschland, Telefónica, S. A. and Koninklijke KPN N.V. (KPN), concluded an agreement for the acquisition of KPN's German mobile business, E-Plus, by Telefónica Deutschland. As consideration, KPN receives in total EUR 3.7bn in cash (subject to price adjustment) and newly to be issued shares.

The cash component to be paid to KPN will be financed via a cash capital increase of Telefónica Deutschland. The shares that are to be issued as a further consideration to KPN should be generated via a capital increase against contribution in kind. By this KPN will have a 24.9% stake in the Telefónica Deutschland after the capital increases.

Thereafter, pursuant to the agreement as of July 23, 2013 in the amended version as of August 26 and 28, 2013, as well as of December 5, 2013, the Telefónica, S. A. shall acquire from KPN a share of 4.4% of the Telefónica Deutschland for EUR 1.3bn. Furthermore, a call option agreement was concluded with KPN, which grants Telefónica, S. A. the right to acquire from KPN a further share of up to 2.9% of the Telefónica Deutschland. This right can be exercised one year after the conclusion of the call option agreement at an exercise price of up to EUR 0.51bn.

This would finally lead to a holding of Telefónica, S. A. in Telefónica Deutschland of 62.1%, or, in the case of the complete exercise of the call options of 65.0% respectively, and of KPN of 20.5%, or, in the case of the complete exercise of the call option, 17.6% respectively. The free float will then amount to 17.4%.

Assuming the Transaction had taken place as of December 31, 2012, Telefónica Deutschland would have served approximately 43 million aggregated customers and recorded aggregated revenues (prior to consolidation) of EUR 8.6bn (based on 2012 revenues of Telefónica Deutschland and the E-Plus Group). In our view, the combination of Telefónica Deutschland and the E-Plus Group will establish a mobile network operator generating significant economies of scale and with great potential in Europe's largest economy with a clear vision and commitment to compete against the incumbent market leaders across all segments. This company will have an enhanced customer proposition with a high quality wireless communications network, sufficient capacity to address increasing demands for high quality (data) services, and an extensive distribution network and a multi-brand strategy serving different customer needs.

7.2 Business of the E-Plus Group

The E-Plus Group, headquartered in Dusseldorf, Germany, provides customers in Germany with multi-brand wireless telecommunication services, offering postpaid and prepaid services targeted at multiple market segments. The E-Plus Group is the third largest wireless provider in Germany by number of subscribers, approximately 24.9 million as of December 31, 2013. Total revenue of the E-Plus Group amounted to EUR 3,197m for 2013. EBITDA in the E-Plus Group amounted to EUR 963m for 2013. As of December 31, 2013, the E-Plus Group employed more than 4,000 full-time employees. The E-Plus Group's multi-brand portfolio includes E-Plus and BASE as well as various other brands such as a youth-focused brand (yourfone), a no-frills brand (Blau), and brands focused on affordable wireless services for various ethnic communities (Ay Yildiz and Ortel Mobile) and an online brand (Simyo), which provides SIM cards for mobile phones online with and without subscription. Wholesale partners of the E-Plus Group include MedionMobile (AldiTalk), ADAC, MTV and the Nature and Biodiversity Conservation Union of Germany (NABU). The BASE brand will be transferred to KPN prior to completion of the Transaction, it being agreed that Telefónica Deutschland after the Transaction may continue to use the BASE brand in Germany.

7.3 Reasons for the Acquisition and Strategy

With the acquisition of the E-Plus Group, we intend to create a leading digital telecommunications company in the German market. Telefónica Deutschland and the E-Plus Group contemplate the merger as their best way to effectively compete in the mid- and long term. We believe that the Transaction will create a third market player – in addition to the two market leaders – well placed to serve the large and steadily growing group of high-value customers in the wireless telecommunications industry.

7.4 Estimated Synergy Effects

We estimate that the Transaction will realize significant synergy effects in the amount over EUR 5bn⁴, particularly with respect to distribution, customer service and network synergies, with incremental value from financial and tax synergies as well as additional revenue and other synergies.

Telefónica Deutschland expects to achieve those synergies by the following measures:

- Distribution and customer service synergies: the combination of both distribution networks will increase efficiency in distribution and customer service costs leveraging best practices and scale as well as channel management and overheads;
- Network Synergies: the combined businesses intend to pursue a rollout focusing on one common nationwide LTE network based on improved capital expenditure and operational expenditure and enhanced cash flow generation, which should allow the combined businesses to make the necessary investments. The combined businesses are also expected to benefit from an improved quality of their 3G networks due to the consolidation of both networks. Further consolidation will include the main, backhaul and core network with reduced operational expenditure from network integration (i.e., rentals, power, maintenance, transport costs, overheads) as well as site consolidation and rationalization, i.e., the reduction of mobile sites. The combined businesses will additionally benefit from increased efficiency by leveraging the scalable transmission agreement with Deutsche Telekom;
- Sales, Administration, and Overheads synergies: the combination of both entities is expected to lead to a reduction in these expenses due to process rationalization and a continued focus on becoming a leaner and more agile organization;
- Revenue and other synergies: the combined businesses intend to exploit SME opportunities from a broader and higher quality platform and will be able to utilize high speed fixed broadband cross-selling opportunities across an enlarged customer base.

7.5 Status of the Transaction

Completion of the transaction is subject to certain closing conditions. The Transaction was approved by the extraordinary General Meeting of KPN on October 2, 2013.

The Transaction is, in particular, conditional upon the approval of the relevant antitrust authorities. The prenotification process commenced soon after the sale of the E-Plus

Group to Telefónica Deutschland was announced, and the formal notification has already been filed. The European Commission has initiated the so-called "second-phase investigation".

However, the timing of completion of the Transaction is subject to numerous uncertain factors outside of our control, such as the duration of the merger clearance and potential legal proceedings with regard to challenges of shareholder resolutions.

As of December 31, 2013, the execution of the transaction required the approval of the General Meeting of the Telefónica Deutschland and the approval of the competent authorities and further standard closing conditions. The completion of the transaction is expected in mid-2014.

7.6 Risks from the Acquisition

Business risks

Risks if the transaction fails

Should the responsible cartel authority not approve the transaction, the transaction will not take place. In this case we would be obliged to pay KPN a break fee. Should the suspending conditions not eventuate on or before March 1, 2015 or if they are waived, KPN, Telefónica, S. A. and Telefónica Deutschland Holding AG can each terminate the agreement and as a result the transaction would fall through. For the Telefónica Deutschland Group a failure of the transaction could lead to reputational damage (e.g. on the share or bond market) as well as to financial detriments, which, among other things, can result from the accrued efforts and the costs arising in connection with the transaction.

Risks of cartel law approval with conditions

The approval of the transaction could, on the part of the cartel authorities or the regulatory authority, be associated with conditions or made dependent on the so-called "corrective measures" offered by Telefónica Deutschland Group. This could lead to the transaction not freeing up the estimated synergy effect, which could significantly detrimentally affect the business activity as well as the financial and earnings position of Telefónica Deutschland Group. Furthermore, the Telefónica Deutschland Group could decide not to proceed with the transaction following a weighing up of the possible effects.

The business risks associated with the transaction are considered to be critical.

⁴ The total value of synergies was calculated as the net present value of the transaction computed as the sum of the present values of forecasted future cash flows including so-called "terminal value" (present value of expected future cash flows beyond the explicit forecast horizon) after tax.

Operational risks

The integration of the E-Plus Group will demand a lot of time and attention from the Management of both corporations. Should the integration efforts keep Management from other responsibilities, this could have detrimental effects on the business activity.

Both the Telefónica Deutschland Group and the E-Plus Group are dependent on employees in key positions for a successful integration, the implementation of a common strategy and the further carrying out of the business activity. A loss of such employees and / or know how could delay or negatively influence the merger of the corporations, which could detrimentally affect the business activity as well as the financial and earnings position of the Telefónica Deutschland Group.

Any significant delay in the integration of the E-Plus Group with Telefónica Deutschland Group could detrimentally influence or delay the attainment of the planned synergy effects or lead to a reduction in customer satisfaction associated with increased customer migration, which could significantly detrimentally affect the business activity as well as the financial and earnings position of the Telefónica Deutschland Group.

The Management is aware of the operational risks of the transaction and has taken this into consideration in the organization of the pre-merger phase, particularly by training up special working groups as well as transferring operative responsibilities, which has reduced the overall risk to a minor level.

Further risks of the transaction

The acquisition of the E-Plus Group carries the risk that the price to be paid to KPN is seen to be too high by the market, that the transaction proves to be less successful than expected, that the combined corporations do not develop as expected by the market and that the service revenue and results targets pursued as part of the transaction are not attained. Furthermore the acquisition of the E-Plus Group is subject to the risk that Telefónica Deutschland Group may not be able to integrate the acquired companies as planned or only at higher costs than originally planned and/or the intended synergy effects cannot be realized as planned in whole or in part.

Furthermore we could be exposed to risks from problems that have not been revealed as part of the due diligence investigations preceding the transaction.

A further risk is represented by the fact that the purchase price in accordance with the acquisition agreement could be increased as per the purchase price mechanism regulated in SPA with regard to the debt situation (working capital and net financial debt).

7.7 Opportunities of the Acquisition

In the event of a successful conclusion of the transaction Telefónica Deutschland Group anticipates significant economies of scale and synergy effects from this in particular in marketing, customer service and network as well as an increase in value from additional service revenues and would thus achieve a significant strengthening of its competitive position. The new corporation would be well positioned to construct one of the most modern high-speed wireless telecommunications networks in Germany. Our customers would benefit first and foremost from the improved network quality that would result from this. Established brands, the right infrastructure for wireline and wireless telecommunications as well as a large customer base would enable Telefónica Deutschland Group to proceed with their strategy in a competition-intensive market and to service all relevant customer segments.

8. Essentials of the Remuneration System

Remuneration of Management Board members

On the basis of the decision of the General Meeting of October 5, 2012, in accordance with section 286(5) German Commercial Code (HGB), the Telefónica Deutschland Holding AG did not publish the supplementary information for stock corporations listed in the stock exchange, in accordance with section 285, 9a) sentence 5 to 8 German Commercial Code (HGB). In this paragraph, the main features of the system for the remuneration of the Board are presented along with the above-mentioned limitations.

The total remuneration awarded to the Board of Telefónica Deutschland Holding AG for the period ending on December 31, 2013 amounted to EUR 4,094k or EUR 932k for the business period December 31, 2012, in accordance with section 285, 9a German Commercial Code (HGB). In the total remuneration, short-term performance-based components are included of an amount of EUR 926k, as well as components with a long-term incentive of an amount of EUR 295k.

Furthermore, the Board of Telefónica Deutschland Holding AG was granted promises in the financial year regarding share options in Telefónica S. A., Madrid, Spain. The total commitments made to the Board in the 2013 financial year amounted to EUR 515k (2012: EUR 547k), for 53,364 (2012: 56,638) entitlements to free transfer of ownership of shares.

The total remuneration of the Management Board members comprises a fixed salary, variable cash remuneration and long-term remuneration components, company car, life and accident insurance, contributions to pension insurance, non-monetary benefits such as, among others, fixed travel allowances, rental allowance, the reimbursement of the cost of British social insurance, reimbursement of moving costs, flights home, school fees, employer expenditures, tax compensation and compensation for exchange rate losses. Not all Management Board members receive these benefits.

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

The fixed component comprises the annual fixed salary, which is paid in twelve equal monthly installments, and the above-mentioned non-monetary benefits. The Management Board members receive either an allowance to establish a private pension fund of 20% of the annual fixed salary or a retirement commitment.

The variable portion of the remuneration comprises three variable performance-related remuneration components.

1) The first variable portion of the remuneration is an annual cash bonus ("Bonus I"). Bonus I is calculated in accordance with the formula target bonus times business performance

times individual performance. The target bonus is set as a percentage of the relevant annual fixed salary.

For the business performance three components are critical, and these are aligned with the success of Telefónica Deutschland Holding AG ("Telefónica Deutschland Component"), Telefónica Europe ("Telefónica Europe Component") and Telefónica, S. A. ("Telefónica, S. A. Component"). The relationship between the Telefónica Deutschland Component, Telefónica Europe Component and Telefónica, S. A. Component is 70:15:15. The parameters for the measurement of the Telefónica Deutschland Component and the Telefónica Europe Component and their weighting are set annually by the Supervisory Board. If less than 50% of the relevant target value is achieved then the value for the business performance factor is 0% (knock-out). In the event that the target achievement has a factor of 100%, and the performance target is exceeded then there is an upper limit of 125%. Intermediate values of target achievement are not linearly interpolated, but rather are ascertained in accordance with a payout curve set by the Supervisory Board. The Telefónica, S. A. Component is set by the Supervisory Board in accordance with discretionary obligations. The corporate performance of Telefónica, S. A. in the relevant year guides the exercise of the discretion.

In order to ascertain the personal performance of the individual Management Board members, personal objectives are set annually at the start of the year by the Supervisory Board. At the start of the following year, the achievement of the goals is reviewed and the Supervisory Board grades each Management Board member into one of five performer classes to which bandwidths of goal achievement percentages are allocated in each case, and allocates each Management Board member a certain percentage value; here the knock-out threshold is also 50%. The Personal Performance is capped at 150%.

2) The second variable remuneration component is the participation in the Performance and Investment Plan (PIP) 2011, which was adopted by the General Meeting of Telefónica, S. A. in 2011. Members of the Management Board of Telefónica Deutschland Holding AG have participated in PIP since 2011.

In accordance with the PIP, members of the Management Board with the approval of the Supervisory Board are allocated a certain number of performance shares as a bonus (award). The number of performance shares is calculated by dividing an amount that corresponds to a certain proportion of the fixed annual salary of the relevant Management Board member by the average listed price of Telefónica, S. A. shares (Core Award). After three years the performance shares give the right to (free) acquisition of the corresponding number of Telefónica, S. A. shares if the relevant person still works for a company in the Telefónica, S. A. Group at the end of the time period and the price of Telefónica, S. A.

shares over the “vesting period” together with the associated dividend distributions in the period (Total Shareholder Return Telefónica, S. A.) corresponds to at least the median of the Total Shareholder Return (share yield) of a reference index from worldwide telecommunications corporations. 30% of the performance shares awarded “vest” if Telefónica, S. A.’s Total Shareholder Return corresponds to the median of these corporations. The number of “vested” shares increases to 100% if Telefónica, S. A.’s Total Shareholder Return is in the upper quartile of the reference index. If Telefónica, S. A.’s Total Shareholder Return lies between the upper quartile and the median, the number of allocated shares is calculated on a linear proportionate basis. If Telefónica, S. A.’s Total Shareholder Return lies under the median of the reference index then the entitlements are forfeited.

In addition to the Core Award there is an “Enhanced Award”. The condition for this is that a Management Board member acquires a certain number of shares in Telefónica, S. A. at their own cost. The own investment is capped at 25% of those performance shares that are allocated under the Core Award. If the objectives with regards to Telefónica, S. A.’s Total Shareholder Return are achieved then the Management Board member receives shares in Telefónica, S. A. in the amount of 30% or 100% of the shares that they acquired with their own funds. The number of these shares is limited to 25% of the Core Award.

3) The third variable remuneration component is a deferred bonus (Bonus II). In order to avoid an excessive incentive effect through the PIP and thus too strong an incentive for the pursuit of corporate goals there is Bonus II. Here the Management Board members are provided with an amount equal to a share of the annually paid Bonus I as a prospective bonus. The Management Board member has the right to the full amount after a period of three years if the Total Shareholder Return of Telefónica Deutschland Holding AG is in the upper quartile of the Total Shareholder Return of a reference group comprising the DAX-30 companies. The Management Board member has the right to 50% of Bonus II if the Total Shareholder Return of Telefónica Deutschland Holding AG corresponds to the median of the reference group. If the Total Shareholder Return of Telefónica Deutschland Holding AG lies between the upper quartile and the median, Bonus II is calculated linear-proportionally. If Telefónica Deutschland Holding AG lies under the median then there is no right for payments.

Remuneration of Supervisory Board members

The members of the Supervisory Board receive a fixed remuneration of EUR 20k annually in accordance with the Articles of Association, which is payable at the end of the financial year. The Chair of the Supervisory Board receives EUR 80k and the Vice-Chair of the Supervisory Board EUR 40k. The Chair of the Audit Committee receives an additional EUR 50k if the Chair of the Supervisory Board or the Vice-Chair doesn’t hold the chair in this committee. Supervisory Board members who hold office in the Supervisory Board or the position of Chair of the Supervisory Board or Chair of a Committee only for a certain part of the financial year receive a time-based proportionate remuneration.

Alongside the remuneration the corporation reimburses the Supervisory Board members for the expenses that arise in the fulfillment of their duties as Supervisory Board members as well as any value-added tax on their remuneration and their expenses.

All current members of the Supervisory Board who work for Telefónica, S. A. or Telefónica Europe plc. have waived their remuneration for their current period of office to the extent that the remuneration rights exceed EUR 2k per year.

No remuneration is paid for services provided personally outside of the stated activities of the Supervisory Board and the Committees, in particular for consultancy or brokering services.

9. Internal Control and Risk Management System Related to the Process of Group Accounting

The risk management and internal control system relating to the Telefónica Deutschland Group accounting, including Telefónica Deutschland Holding AG, is an integral part of the general risk management process and closely interconnected with this in respect of reporting and related activities. It includes the organizational structure as well as the control and monitoring structures with which we ensure that corporate issues are captured, treated and analyzed in accordance with the law and are subsequently taken up in the IFRS consolidated accounts.

In addition, Telefónica Deutschland Holding AG's annual accounts are also subject to the provisions of the internal control system. In recognition of the obligations of the majority shareholder in accordance with the Sarbanes Oxley Act (SOX) enacted in 2002 in the USA, which result from the registration of Telefónica, S. A. with the US SEC (Securities and Exchange Commission) and also affect subsidiaries, the Telefónica Deutschland Group warrants the fulfillment of the above-mentioned SOX requirements.

As part of the existing Corporate Governance, Telefónica Deutschland Group's internal control system also corresponds with the statutory requirements from, for example, section 107 para. 3 clause 2 AktG (Aktiengesetz – German Stock Corporation Act) and section 297 para. 2 HGB (Handelsgesetzbuch – German Commercial Code).

The internal control system (Internes Kontrollsystem – IKS) with its guidelines, procedures and measures contemplates that the consolidated accounts of the Telefónica Deutschland Group are prepared in compliance with the relevant laws and norms. For this we analyze new laws, financial reporting standards and other communiqués, where non-compliance would represent a significant risk for the due and proper process of our financial reporting. The Accounting Policies & Reporting department codifies all reporting and valuation methods in the corporation-wide guidelines for accounting and revenue recognition and the local statutory HGB standards. The financial reporting of the subsidiaries is carried out either by Telefónica Germany GmbH & Co. OHG or in close cooperation with this company. In order to ensure the early identification of risks, financial reports are created monthly. As part of the SOX activities reports about Group-wide financial indicators are created quarterly, whereby

the reasons for significant changes to the most important accounts are transparently made and evaluated.

Telefónica Deutschland Holding AG's Audit Committee supervises the effectiveness of the internal control system in accordance with section 107 para. 3 clause 2 AktG, whereby the setting of the exact extent and composition of the said system is left to the discretion of the Management Board.

The Internal Audit department is assigned the task of undertaking independent reviews of the effectiveness and efficiency of the internal control system for all subsidiaries. The Internal Audit department is granted unrestricted rights to review, to be informed and to access for the fulfillment of its tasks. Advice is presented to the Management Board of Telefónica Deutschland at least bi-annually regarding the effectiveness of the SOX relevant controls, which currently cover around 95% of our total revenues and expenses, among other things. In addition, an independent audit of selected business events is undertaken by the Audit department Intervention as part of the operative control process.

The internal control system captures all processes relevant for financial reporting as well as those processes that support the IT systems. With regards to the IT systems, particularly IT security, change management and the operative IT processes are controlled. Fundamental pillars of the control system are the appointment of sufficiently qualified employees and their continuous further education, strict compliance with the four-eyes principle and a clear separation of tasks in order to fulfill the goals of the internal control system such as, for example, ensuring that the annual reports and consolidated accounts are accurate and complete.

The responsible persons are made aware of mistakes, weaknesses or opportunities for improvement that come to light together with action plans; these plans are the object of follow-up measures by Internal Audit in order to further improve the effectiveness and efficiency of the internal control system.

10. Other Declarations

10.1 Report on Relations with Affiliated Companies

Telefónica Deutschland Holding AG was, in the period from January 1 until December 31, 2013, 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 previously mentioned companies.

Thus the Management Board of Telefónica Deutschland Holding AG has prepared a report about the relationships with associated corporations in accordance with section 312 paragraph 1 AktG. This report includes the following final declaration:

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

10.2 Management Declaration pursuant to Section 289a of the HGB

The corporation has published this declaration, which also contains the Declaration of Compliance pursuant to section 161 AktG, on its website (WWW.TELEFONICA.DE/ERKLAERUNG-ZUR-UNTERNEHMENSFUEHRUNG) and in the section Corporate Governance/Declaration of Compliance in the annual report. This management declaration pursuant to section 289a HGB is a part of this Management Report.

10.3 Takeover-related Disclosures pursuant to Section 315 para. 4 and Section 289 para. 4 of the HGB

Composition of the subscribed capital

Telefónica Deutschland Holding AG has a share capital of EUR 1,116,945,400. The share capital is divided into 1,116,945,400 no-par value registered shares each with a proportionate share of the share capital of EUR 1.00 ("shares"). The share capital is fully paid. As of December 31, 2013 and at establishment of this Management Report Telefónica Deutschland Holding AG did not hold any of its shares. In accordance with section 6 para. 2 of the Articles of Association the shareholders have no right to securitize shares. Every share in general grants one vote at the General Meeting. The shares are 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. Other than the statutory insider-trading provisions there are no internal governance provisions that provide for further lockout periods associated with the publication of quarterly and annual results for 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

Telefónica Germany Holdings Limited, Slough, United Kingdom, holds more than 75% of the shares in Telefónica Deutschland Holding AG; therefore Telefónica Germany Holdings Limited holds more than 75% of the voting rights. Via Telefónica Germany Holdings Limited both O2 (Europe) Limited, Slough, United Kingdom, as well as Telefónica, S.A., Madrid, Spain, indirectly hold more than 75% of the shares in Telefónica Deutschland Holding AG. Other than this we were not informed of stake holdings in the share capital of Telefónica Deutschland Holding AG to the extent of more than 10% of the voting rights and we are not aware of such stake holdings.

Shares with special rights

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

Control of voting rights when employees hold stakes in the capital

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

Appointment and recall of Management Board members

Pursuant to section 7 of the Articles of Association and section 84 AktG the Supervisory Board determines the number of members on the Management Board and is responsible for their appointment and recall as well as for the appointment of the Chair of the Management Board (Chief Executive Officer (CEO)). Substitute members of the Management Board can be appointed. As of December 31, 2013, the Management Board of Telefónica Deutschland Holding AG consists of three members. Management Board members are appointed by the Supervisory Board for a period of office of no more than five years. They can be re-appointed and the period in office can be extended provided one period of office does not exceed a period of five years. The Supervisory Board may recall a Management Board member in the event of an important reason such as a gross breach of duties or if the General Meeting adopts a no-confidence resolution in relation to the Management Board member in question. Other reasons for recall – such as a mutual terminated agreement – remain unaffected.

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

Pursuant to section 31 MitbestG a majority of two thirds of the votes of Supervisory Board members is necessary for the appointment and recall of Management Board members. If this majority is not reached on a first round of voting by the Supervisory Board, then the appointment or recall can occur on the recommendation of the Mediation Committee, which is to be formed in accordance with section 27 para. 3 MitbestG, in a further round of voting with a simple majority of the votes of the Supervisory Board members. If the prescribed majority is again not achieved then a third round of voting must occur which again requires a simple majority; however for this round of voting the Chair of the Supervisory Board has two votes.

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

Changes to the Articles of Association

In accordance with section 179 para. 1 sentence 1 AktG any change to the Articles of Association of Telefónica Deutschland Holding AG requires a resolution of the General Meeting. In accordance with section 27 of the Articles of Association together with section 179 para. 2 sentence 2 AktG, resolutions of the General Meeting of Telefónica Deutschland regarding changes to the Articles of Association are passed with simple majority of the votes cast and by simple majority of the share capital represented at the passing of the resolution. If the law mandates a higher majority of votes or capital then 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 para. 1 sentence 2 AktG together with section 17 para. 3 of the Articles of Association.

Authorizing the Management Board to issue shares

The powers of the Management Board are governed by sections 76 et seq. AktG together with section 8 et seq. of the Articles of Association. In particular the Management Board runs the company and represents it in and out of court.

Authorization 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 December 31, 2013, the following authorizations of the Management Board for the issuing of shares exist:

Authorized capital

As of December 31, 2013, the Management Board is authorized, with the approval of the Supervisory Board, to increase the share capital of the company in the period until September 17, 2017, once or several times, by a total of EUR 558,472,700 by issuing new no-par value shares in exchange for cash and/or contribution in kind (authorized capital 2012/I). The authority contemplates that shareholders' subscription rights can in certain cases be completely or partially excluded (section 4 para. 3 of the Articles of Association).

Conditional capital

For the purpose of the issue of registered no-par value shares to the holders or creditors of bonds, the share capital of the company is conditionally increased by up to EUR 558,472,700 by issuing 558,472,700 new registered no-par value shares (conditional capital 2012/I).

By resolution at the General Meeting of October 5, 2012 the Management Board has been authorized until October 4, 2017 and subject to the approval of the Supervisory Board to, on one or more occasions, issue convertible bonds, warrant bonds, profit participation rights and/or participating bonds (and/or combinations of such instruments) (together "bonds") in bearer and/or registered form with or without limited maturity in an aggregate nominal value of up to EUR 1,500,000,000 and to grant and/or impose on the holders or creditors of bonds conversion or option rights to shares in the company representing a total notional amount in the share capital of up to EUR 558,472,700 (in words: five hundred fifty-eight million four hundred and seventy-two thousand and seven hundred Euro), subject to the more detailed terms and conditions of issue of such bonds. Shareholders shall in principle be granted a right to subscribe for the bonds. The authorization provides that subject to the approval of the Supervisory Board, the subscription right of the shareholders can, however, be excluded

- a) for fractional amounts; furthermore
- b) provided that the issue price is not substantially lower

than the market value of the bonds with conversion and/or option rights or option obligation and the shares issued or to be issued in order to satisfy the conversion and option rights or conversion obligation do not exceed in total 10% of the share capital;

c) to the extent profit participation rights or participating bonds are issued without conversion rights or obligations or an option right, provided the interest rate and the issue price of the profit participation rights or participating bonds correspond at the date of issue to current market values; and d) to the extent the bonds are issued in written form contributions in kind for the purpose of directly or indirectly acquiring companies, parts of companies, participations in companies or other assets and the value of the contribution in kind is reasonably proportionate to the value of the bonds.

Authorizing the Management Board to buy back shares

The authorization of the Management Board to buy back own shares is governed by section 57 para. 1 sentence 2 and sections 71 et seq. AktG. The Management Board is not entitled to buy back own shares by the General Meeting pursuant to section 71 para. 1 no. 8 AktG.

Change in control / Compensation agreements

Telefónica Deutschland Holding AG's significant agreements that contain a change in control clause relate to financing. In the event of a change of control, these contracts grant the contracting partners, in accordance with normal practice, the right to terminate, which has as a consequence the obligation to fulfill all outstanding obligations.

The employment contracts of the Management Board members of Telefónica Deutschland Holding AG grant the right to terminate these contracts in the event of a takeover offer by a third party with a three months' notice; however this termination must occur within six months of a change in control. In this event the relevant Management Board member can claim a one-off compensatory amount equal to one year's salary plus the most recently received bonus, whereby the compensation may not exceed the remuneration that would have been payable up to expiry of the contract.

11. Outlook for Telefónica Deutschland Holding AG

The Telefónica Deutschland Holding AG acts as a management and holding company. The long-term future business development thus crucially depends on the development of the operative companies of the Telefónica Deutschland

Group, particularly Telefónica Deutschland GmbH & Co. OHG. Therefore, the economic and market development, as well as the expected development of important key performance indicators at the level of the Telefónica Deutschland Group are described below. In view of existing contracts connected with the remuneration of management services, it may be assumed that any future incidental operative costs of the Telefónica Deutschland Holding AG can be covered and thus a balancing of the expenditure and therefore an offset result can be achieved. Uncertainties result from the previously clarified E-Plus transaction.

11.1 Economic Outlook for Germany

The most recent prognoses regarding the development of the Euro area indicate that the upward trend will continue in 2014. For the Euro area a rise in economic output by 1.0% is forecast in 2014.

For 2014 the outlook for the German economy, according to the German Federal Ministry for the Economy, continues to be positive and it expects a growth in the gross domestic product of 1.7%. Private consumption should remain an important instigator considering continuing favorable general conditions for employment and income.

7 — GDP Growth 2012–14 Germany and Euro area

(in %)	2012	2013	2014
Germany	0.7	0.4	1.7
Euro area	(0.7)	(0.4)	1.0

(Source: German Central Bank, Federal Ministry for the Economy (Bundesministerium für Wirtschaft – BMWi))

11.2 Market Expectations

In 2014, the market development in Germany, one of the biggest telecommunications markets in Europe, will again be driven by rising customer demand for broadband services, in wireless telecommunications and also in the wireline network. The boom in smartphones and tablets as well as a growing demand for LTE are driving the growth in wireless data services. Thus the market for wireless internet will soon supersede mobile telephone calls as the most important driver of revenue for German wireless telecommunications service providers. At the same time the negative trend for wireless voice and SMS will continue through further price pressure and changed customer behavior.

The increasing demand for speed in wireless telecommunications and wireline networks with the strong demand for convergent solutions on the part of German consumers will similarly be a driver of growth.

(Source: corporate data)

11.3 Expectations for Telefónica Deutschland Group

Outlook for the first half of 2014

In a German law governed sale and purchase agreement dated July, 23 2013 (amended on August 26, 28 2013 and December, 5 2013), between Koninklijke KPN N.V., Telefónica, S. A. and Telefónica Deutschland Holding AG, the latter agreed to purchase all assets, certain liabilities and business activities of E-Plus Mobilfunk GmbH&Co. KG and its direct and indirect subsidiaries (the "Transaction"). Telefónica Deutschland Group expects that the Transaction will unlock an expected net present value of synergies higher than EUR 5bn, net of integration costs. The closing of the Transaction is subject to the occurrence of a number of conditions, and in particular, the merger control approval of the European Commission. The in-depth inquiry by the European Commission began on December, 20 2013 and is expected to be completed in the second quarter of 2014. Telefónica Deutschland Group expects to close the Transaction by mid-2014.

The above-mentioned Transaction will likely change the scope of operations of Telefónica Deutschland from mid-2014, and as a result, it is unable to provide an outlook for the full year 2014.

Telefónica Deutschland Group expects the German telecommunication market to continue being active and competitive in the period under consideration, with ongoing pressure on mobile revenues from competition and changing customer behavior, for example impacting revenues from SMS. A lower year-on-year impact from the regulation of mobile termination rates is also expected (minus 3% rate cut from December 2013).

Telefónica Deutschland Group will remain focused on the mobile market, driven by a multi-brand, data-centric approach, with convergent fixed-mobile propositions also supporting the core business. The ongoing adoption of LTE-enabled smartphones and the associated increase of demand for quality mobile data services will continue to drive the business in the period of consideration.

However, Telefónica Deutschland does not expect this to fully offset a number of headwinds, mainly the effect from customers renewing their long-term contracts to lower price levels and the general decline of SMS usage in the German market.

As a result, Telefónica Deutschland expects a continuation of trends in wireless service revenue for the first half of 2014, showing a similar year-on-year performance to the last quarter of 2013, excluding the impact from mobile termination rate cuts.

Telefónica Deutschland Group continues monitoring the mobile market and anticipates an increasing level of competition around bundles of smartphone tariffs and devices with a focus on value maximization. The combination of revenue performance with higher year-on-year commercial investments and a lower margin from the sale of handsets will likely outweigh additional efficiencies in the business in the period under consideration, and thus, it is expected that OIBDA margin in the first half of 2014 will show a limited year-on-year erosion from 2013 level (23.4%), similar to the underlying year-on-year OIBDA margin performance seen in previous quarters.


In terms of investments, the LTE network rollout will continue to be the main priority for Telefónica Deutschland in the period under consideration, balancing investments from other areas. In the first half of 2014, Telefónica Deutschland Group expects Capital Expenditures to show a moderate decline compared to the same period of the prior year (EUR 296m), owing to a different investment planning, and also taking into account the envisaged integration with E-Plus.

The Management Board of Telefónica Deutschland Group reiterates its intention to propose to the General Shareholders' Meeting a cash dividend for the year ending December 31, 2013 of approximately EUR 525m, payable in 2014.

Munich, March 7, 2014

Telefónica Deutschland Holding AG

The Management Board



Rachel Empey



Markus Haas

Annual Financial
Statements_
for the financial year
ended December 31, 2013

Balance Sheet

Assets (in EUR)	As of December 31	
	2013	2012
A) Fixed assets		
Financial assets		
Investments in affiliated companies	5,246,251,853.31	5,758,877,283.31
	5,246,251,853.31	5,758,877,283.31
B) Current assets		
I. Receivables and other assets		
1. Receivables from affiliates	14,946,060.53	5,953,930.80
2. Other assets	5,987,448.39	0.00
II. Cash on hand and bank balances	0.00	3,100,000.00
	20,933,508.92	5,953,930.80
C) Accruals and deferrals	5,333.35	0.00
Total assets	5,267,190,695.58	5,767,931,214.11

Equity and Liabilities (in EUR)	As of December 31	
	2013	2012
A) Equity		
I. Subscribed capital	1,116,945,400.00	1,116,945,400.00
II. Additional paid-in capital	430,095.00	430,095.00
III. Revenue reserves	14,083.91	14,083.91
Legal reserve	14,083.91	14,083.91
IV. Net retained earnings	4,140,647,078.29	4,648,809,332.27
	5,258,036,657.20	5,766,198,911.18
B) Provisions		
Other provisions	6,638,552.14	1,028,400.00
	6,638,552.14	1,028,400.00
C) Liabilities		
1. Trade payables	2,464,164.16	306,116.44
2. Liabilities to affiliates	0.00	32,311.09
3. Other liabilities	51,322.08	365,475.40
– thereof from taxes EUR 51,322.08 (previous year: EUR 365,475.00) –		
	2,515,486.24	703,902.93
Total Equity and Liabilities	5,267,190,695.58	5,767,931,214.11

Income Statement_

(in EUR)	January 1 to December 31	
	2013	2012
1. Revenues	9,706,193.35	1,675,894.93
2. Other operating income	7,845.17	206,637.32
3. Personnel expenses	(4,094,002.66)	(931,656.13)
a) Salaries	(4,090,442.65)	(930,666.81)
b) Social security contributions	(3,560.01)	(989.32)
4. Other operating expenses	(11,183,178.77)	(702,891.54)
5. Other interest and similar income	7,622.86	19,997.90
– thereof from affiliated companies: EUR 6,469.86 (in the previous year), EUR 12,139.55 –		
6. Interest and similar expenses	(204.00)	0.00
7. Income from ordinary business activities	(5,555,724.05)	267,982.48
8. Income taxes	18,900.07	13,695.62
9. Loss/Profit for the year	(5,536,823.98)	281,678.10
Net retained earnings of the previous year	4,648,809,332.27	11,834,438,151.08
Dividend payments	(502,625,430.00)	(7,185,896,413.00)
10. Profit carryforward	4,146,183,902.27	4,648,541,738.08
11. Addition to legal reserve	0.00	(14,083.91)
12. Net retained earnings	4,140,647,078.29	4,648,809,332.27

Statement of Changes in Fixed Assets 2013_

(in EUR)				Historical costs
	1.1.2013	Additions	Disposals	31.12.2013
Financial assets				
Investments in affiliated companies	5,758,877,283.31	10,000,000.00	522,625,430.00	5,246,251,853.31
	5,758,877,283.31	10,000,000.00	522,625,430.00	5,246,251,853.31

	Accumulated depreciation				Book value	
	1.1.2013	Additions	Disposals	31.12.2013	31.12.2013	31.12.2012
	0.00	0.00	0.00	0.00	5,246,251,853.31	5,758,877,283.31
	0.00	0.00	0.00	0.00	5,246,251,853.31	5,758,877,283.31

Notes to the Annual Financial Statements_

for the financial year ended December 31, 2013

1.

General Information on the Annual Financial Statement

The Annual Financial Statements of Telefónica Deutschland Holding AG, Munich (also referred to as "Telefónica Deutschland") for the financial year 2013 have been prepared in accordance with the principles of the German Commercial Code (HGB) and the German Stock Corporation Act (AktG).

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

The company is listed in the regulated market of the Frankfurt Stock Exchange. The security identification number (Wertpapierkennnummer – WKN) is A1J5RX, the ISIN (International Securities Identification Number) is DE000A1J5RX9. As of December 31, 2013, Telefónica Deutschland Holding AG has a share capital of EUR 1,116,945,400. It is divided into 1,116,945,400 registered shares with no-par values each representing a notional amount of EUR 1.00 in the registered share capital. 23.17% of the shares are in free float, the remaining 76.83% are held by Telefónica Germany Holdings Limited, Slough, United Kingdom (Telefónica Germany Holdings Limited). Each non-par share in general grants one vote at the General Meeting. There are no limitations on voting rights. The majority shareholder Telefónica Germany Holdings Limited possesses no other voting rights.

Telefónica Deutschland Holding AG is the parent company of the German Telefónica Deutschland Group, which is included in the consolidated financial statements of the group's ultimate holding company, Telefónica, S.A., Madrid, Spain (Telefónica, S.A. Group) as of December 31, 2013. The parent company of the Telefónica Deutschland Group is Telefónica Germany Holdings Limited, a subsidiary of O2 (Europe) Limited, Slough, United Kingdom (O2 (Europe) Limited).

As of the reporting date Telefónica Deutschland is classified as a large corporation in accordance with section 267 (3), sentence 2 HGB.

The income statement has been prepared using the nature of expense method in accordance with section 275 (2) HGB. The structure has not been changed compared to the previous year.

Limited comparability with the previous annual financial statements

The comparability of the results of operations with the prior year is limited as of December 31, 2013, since the company started its function as a holding company on September 26, 2012 in the financial year 2012 by registration in the commercial register and the currently applicable service level agreements came into force on this date.

First ordinary General Meeting

On May 7, 2013 the first ordinary General Meeting of Telefónica Deutschland Holding AG took place. Next to the discharge of the Supervisory Board and Management Board and the election of Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft with its registered office in Stuttgart, branch office Munich, as auditor for the Consolidated Financial Statements and Annual Financial Statements of Telefónica Deutschland Holding AG, the General Meeting resolved to distribute a dividend of EUR 0.45 per dividend-entitled share, a total of EUR 502,625,430.00.

Agreement for the reimbursement of management services

Telefónica Deutschland Holding AG has signed agreements with Telefónica Germany GmbH & Co. OHG, Munich, and Telefónica Germany Management GmbH, Munich. The agreements include the obligation to render management services for Telefónica Germany GmbH & Co. OHG and Telefónica Germany Management GmbH. Telefónica Germany GmbH & Co. OHG and Telefónica Germany Management GmbH shall reimburse Telefónica Deutschland Holding AG a lump sum of EUR 30k per quarter. Furthermore, Telefónica Germany GmbH & Co. OHG shall reimburse the cost of remuneration for the members of the Management Board, as well as other administration cost. The total amount of the reimbursements is included in the company's revenues.

Significant Events and Transactions in the Financial Year

Dividend for the 2013 financial year

On November 7, 2013, the Management Board of Telefónica Deutschland resolved and announced that it is intended to propose a cash dividend of approx. EUR 525m to the next ordinary General Meeting for the 2013 financial year. This corresponds to a dividend of around EUR 0.47 for each share with dividend rights.

Agreement on the acquisition of E-Plus

On July 23, 2013 Telefónica Deutschland, Telefónica, S. A. and Koninklijke KPN N.V. (KPN) concluded an agreement for the acquisition of KPN's German mobile business, E-Plus, by Telefónica Deutschland. As consideration, KPN receives in total EUR 3.7bn in cash (subject to price adjustment) and newly to be issued shares. The cash component to be paid to KPN will be financed via a cash capital increase of Telefónica Deutschland. The shares that are to be issued as a further consideration to KPN should be generated via a capital increase against contribution in kind. By this KPN will have a 24.9% stake in Telefónica Deutschland after the capital increases.

Thereafter, pursuant to the agreement as of July 23, 2013, in the amended version as of August 26 and 28, 2013, as well as of December 5, 2013, Telefónica, S. A. shall acquire from KPN a share of 4.4% of Telefónica Deutschland for EUR 1.3bn. Furthermore, a call option agreement was concluded with KPN, which grants Telefónica, S. A. the right to acquire from KPN a further share of up to 2.9% of Telefónica Deutschland. This right can be exercised one year after the conclusion of the call option agreement at an exercise price of up to EUR 0.51bn.

This would finally lead to a holding of Telefónica, S. A. in Telefónica Deutschland of 62.1%, or, in case of the complete exercise of the call options of 65.0% respectively, and of KPN of 20.5%, or, in the case of the complete exercise of the call option, 17.6% respectively. The free float will then amount to 17.4%.

KPN's extraordinary General Meeting approved the transaction with a large majority on October 2, 2013.

As of December 31, 2013 the execution of the transaction still required the approval of the General Meeting of Telefónica Deutschland and the approval of the competent authorities and further standard closing conditions. The completion of the transaction is expected mid-2014.

In addition, reference is made to the note on the events after the reporting period.

2.

Accounting Policies

The accounting policies used in the preparation of the Annual Financial Statements as of December 31, 2013 are in accordance with the provisions of sections 242 to 256a and 264 to 288 of the German Commercial Code (HGB), as well as the relevant provisions of the German Stock Corporation Act (AktG). The accounting policies remained unchanged compared to the prior year.

The financial assets are carried at historical costs, less any impairment, to account for lower fair values at the reporting date. If the reasons for the impairment do no longer exist, impairment losses are reversed according to section 253 para. 5, sentence 1 of the HGB.

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

Indirect pension liabilities are determined in accordance with the provisions of the German Commercial Code and in accordance with the recognized principles of actuarial calculations using the "projected unit credit method" (PUC method). The calculation also considers trends with respect to prospective entitlement or pension development, as well as the company-specific age and gender-related probability of fluctuation. An interest rate of 4.9% and a pension trend of 2% as well as the mortality tables 2005G by Klaus Heubeck were used.

In order to fulfill the pension obligations, funds have been invested in the support fund "ProFund Unabhängige Gruppen-Unterstützungskasse e.V.". The assets are measured at their fair market value.

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

Liabilities are recorded at their settlement amount.

Deferred taxes resulting from tax loss carryforwards or temporary and quasi-permanent differences between the commercial law-related valuations of assets, liabilities and deferred income and the tax bases are determined as follows: The amounts of the resulting tax burden or relief are measured considering each company's individual tax rate on the date of the temporary differences' reversal. They are not discounted. Deferred tax liabilities and deferred tax assets are offset. Deferred tax assets are not capitalized based on the related option not to recognize them.

3.

Notes to the Balance Sheet**Financial assets**

The investments in affiliated companies refer to the investment in Telefónica Germany GmbH & Co. OHG, Munich, whose personally liable partner is the company itself, amounting to EUR 5,235,822k (2012: EUR 5,758,447k), and the investment in Telefónica Germany Management GmbH, Munich amounting to EUR 10,430k (2012: EUR 430k).

The changes to the carrying amount of the investment in Telefónica Germany GmbH & Co. OHG result from the withdrawal of the amount of EUR 522,625k.

For further information, we refer to the schedule of the development of the fixed assets.

Receivables

The receivables from affiliates primarily relate to receivables from cash pooling due from Telfisa Global B.V., Amsterdam, Netherlands, amounting to EUR 12,364k (2012: EUR 3,256k) as well as receivables for management services due from Telefónica Germany GmbH & Co. OHG in an amount of EUR 2,485k (2012: EUR 1,959k).

The other assets amounting to EUR 5,987k mainly relate to capitalized cost, incurred in connection with the envisaged acquisition of E-Plus (EUR 5,887k).

All receivables and other assets have a remaining term of less than one year.

Equity**Subscribed capital**

The registered share capital of Telefónica Deutschland Holding AG amounts to EUR 1,116,945,400. The registered share capital is divided into 1,116,945,400 shares with no-par value and a notional amount of the registered share capital of EUR 1.00 each ("Shares"). The registered share capital is fully paid. As of December 31, 2013 Telefónica Deutschland Holding AG did not hold any of its own shares. 23.17% of the shares are in free float, the remaining 76.83% are held by Telefónica Germany Holdings Limited.

Authorized capital

As of December 31, 2013 the Management Board is authorized with the approval of the Supervisory Board to increase the share capital of Telefónica Deutschland once or several times in the period until September 17, 2017 by a total of EUR 558,472,700 by issuing up to 558,472,700 new non-par value registered shares in exchange for a cash and/or contribution in kind (authorized capital 2012/I). The authorization for the Management Board provides that the shareholders' subscription rights under section 4 (3) of the Articles of Association can be excluded in whole or in part in certain cases.

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 2012/I).

By resolution at the General Meeting of October 5, 2012 the Management Board has been authorized until October 4, 2017 and subject to the approval of the Supervisory Board to, on one or more occasions, issue convertible bonds, warrant bonds, profit participation rights and/or participating bonds (and/or combinations of such instruments) (together "bonds") in bearer and/or registered form with or without limited maturity in an aggregate nominal value of up to EUR 1,500,000,000 and to grant and/or impose on the holders or creditors of bonds conversion or option rights to shares in the company representing a total

notional amount in the share capital of up to EUR 558,472,700 (in words: five hundred fifty-eight million four hundred and seventy-two thousand and seven hundred Euro), subject to the more detailed terms and conditions of issue of such bonds. Shareholders shall in principle be granted a right to subscribe for the bonds. The authorization provides that subject to the approval of the Supervisory Board, the subscription right of the shareholders can, however, be excluded

- a) for fractional amounts; furthermore
- b) provided that the issue price is not substantially lower than the market value of the bonds with conversion and/or option rights or option obligation and the shares issued or to be issued in order to satisfy the conversion and option rights or conversion obligation do not exceed in total 10% of the share capital;
- c) to the extent profit participation rights or participating bonds are issued without conversion rights or obligations or an option right, provided the interest rate and the issue price of the profit participation rights or participating bonds correspond at the date of issue to current market values; and
- d) to the extent the bonds are issued in written form contributions in kind for the purpose of directly or indirectly acquiring companies, parts of companies, participations in companies or other assets and the value of the contribution in kind is reasonably proportionate to the value of the bonds.

Additional paid-in capital

The additional paid-in capital of Telefónica Deutschland Holding AG remains unchanged at EUR 430k and fulfills the requirements under section 272 (1), 1 HGB. The contribution occurred in accordance with a contribution agreement dated September 18, 2012 in connection with a contribution in kind.

Revenue reserve

Revenue reserve contains a legal reserve in accordance with section 150 (2) AktG of EUR 14k (2012: EUR 14k).

Profit distribution

On May 7, 2013 the first ordinary General Meeting of Telefónica Deutschland Holding AG took place, during which it was resolved to distribute a dividend of EUR 0.45 for each share with dividend rights; a total of EUR 502,625k.

Pension provisions

Telefónica Deutschland Holding AG exercises the option of section 28 (1, 2) Introductory Act to the German Commercial Code (EGHGB) not to record indirect pension liabilities covered by the support fund ProFund Unabhängige Gruppen-Unterstützungskasse e.V.

As of December 31, 2013 pension liabilities amount to EUR 121k. To cover this liability, as of December 31, 2013 EUR 168k is held on a trust basis for Telefónica Deutschland Holding AG.

Provisions

The other provisions amounting to EUR 6,639k (2012: EUR 1,028k) mainly relate to provisions for outstanding invoices of EUR 3,989k. Furthermore, expenses for the compensation of the Management Board (EUR 2,484k) are included.

Liabilities

Trade payables amounting to EUR 2,464k (2012: EUR 306k) mainly relate to cost incurred in connection to the planned purchase of E-Plus.

All liabilities have a remaining term of less than one year and are unsecured.

Deferred taxes

Deferred tax assets mainly result from temporary differences at the level of Telefónica Germany GmbH & Co. OHG as well as from the usage of tax loss carryforwards. Telefónica Deutschland Holding AG is the taxable entity for the purpose of the corporation income tax (CIT). The tax rate for deferred tax assets is 15.825% for corporate income tax and solidarity surcharge and 17.15% for commercial tax. No use is made of the option to report deferred tax assets as per section 274 (1), sentence 2 HGB.

4.

Notes to the Income Statement

Revenues

Revenues amount to EUR 9,706k (2012: EUR 1,676k) and essentially comprise the imbursement for the cost of the remuneration of the members of the Management Board, as well as further administration cost (EUR 9,466k), which, under the agreements for the reimbursement for management services (as explained under "I. General Information for the Annual Financial Statement – Agreement for the Reimbursement of Management Services"), are assumed by Telefónica Germany GmbH & Co. OHG.

Also included are those management services charged for a total of EUR 240k which are rendered by Telefónica Deutschland Holding AG to Telefónica Germany GmbH & Co. OHG and Telefónica Germany Management GmbH.

Personnel expenses

The personnel expenses of EUR 4,094k (2012: EUR 932k) include the expenses from the remuneration of the Management Board, including social security.

Other operating expenses

The other operating expenses in the financial year in the amount of EUR 11,183k (2012: EUR 703k) primarily include cost incurred in connection with the planned cash capital increase, with respect to the acquisition of E-Plus (EUR 5,431k), as well as legal and consulting fees for external service providers. Thereof, EUR 2,149k relate to consulting fees for the previous year and have been recharged.

Other interest and similar income

Other interest and similar income in the amount of EUR 8k (2012: EUR 20k) result from the positive cash-pooling balance.

Income taxes

The income taxes of an amount of EUR 19k (2012: EUR 14k) include refunds of corporate income tax and relate to ordinary business activities of the company.

5.

Other Information

Additional information with respect to the Supervisory Board and the Management Board**Remuneration of the Management Board and the Supervisory Board**

The total remuneration of the members of the Management Board for the financial year ended December 31, 2013 amounted to EUR 4,049k (2012: EUR 932k).

Telefónica Deutschland Group has not granted the members of the Management Board any securities or loans and has not assumed any guarantees for them.

Furthermore, commitments for 53,364 share options in Telefónica, S. A., Madrid, Spain were granted to the Management Board of Telefónica Deutschland Holding AG in the financial year. The fair value per option amounted to EUR 6.40.

In accordance with the decision of the General Meeting of October 5, 2012, Telefónica Deutschland Holding AG is exempt from additional disclosures for listed stock corporations, pursuant to section 286 (5) HGB in connection with section 285 9 (a), sentences 5–8 HGB.

The members of the Supervisory Board received remuneration for their activities of a total of EUR 162k in 2013 and EUR 19k in 2012.

Telefónica Deutschland Group has not granted the members of their Supervisory Board any securities or loans and has not assumed any guarantees for them.

Management Board

The members of the Management Board of Telefónica Deutschland Holding AG as of December 31, 2013 are listed as below:

Name	Function
Rachel Clare Empey	Chief Financial Officer (CFO), Member of the Management Board
Markus Haas	Chief Strategy Officer & General Counsel, Member of the Management Board
René Schuster	Chief Executive Officer (CEO) Chairperson of the Management Board Member of Telefónica Europe Executive Committee Member of Telefónica Europe Advisory Board Member of Telefónica Europe Project Approvals Committee Member of the Management Board of the Telefónica Global Transformation Committee Retired on January 31, 2014

Supervisory Board

The members of the Supervisory Board of Telefónica Deutschland Holding AG as of December 31, 2013 are listed as below:

Name	Function
Eva Castillo Sanz	Chairperson of the Supervisory Board; Current mandates: Telefónica, S. A., Member of the Board Telefónica Europe, plc, Chairperson and Chief Executive Officer Telefónica Czech Republic, a. s., Chairperson of the Supervisory Board Tuenti Technologies, S. L., Chairman Bankia S. A., Member of the Board Comillas – ICAI Foundation, Member of the Board
Imke Blumenthal	Vice Chairperson of the Supervisory Board Current mandates: Chairperson of the Works and Group Committee of Telefónica Deutschland Vice Chairperson of the Works Committee of the North-Western Region for Telefónica Deutschland
Maria Pilar López Álvarez	Member of the Supervisory Board Current mandates: Telefónica Europe plc, Member of the Management Board (Director) Telefónica Czech Republic, a. s., Member of the Supervisory Board mm02 plc, Member of the Management Board (Director) O2 Holding Ltd, Member of the Management Board (Director) O2 (Europe) Limited, Director Wolesley PLC, Non-Executive Director
Angel Vilá Boix	Member of the Supervisory Board Current mandates: Telefónica S. A., Chief Financial Officer and Corporate Development Officer Telco S.P.A., Vice Chairman
Patricia Cobián González	Member of the Supervisory Board Current mandates: Telefónica Europe plc, Member of the Management Board (Director)
Enrique Medina Malo	Member of the Supervisory Board Current mandates: Telefónica Europe, plc, Member of the Management Board mm02 Europe plc, Member of the (Director) O2 Holding Ltd, Member of the Management Board (Director) O2 (Europe) Limited, Member of the Management Board (Director) Wayra UK Limited, Member of the Management Board (Director) O2 Cedar Limited, Member of the Management Board O2 Networks Limited, Member of the Management Board O2 International Holdings Limited, Member of the Management Board
Michael Hoffmann	Member of the Supervisory Board Current mandates: Lekkerland AG & Co. KG [German Limited Partnership], Chief Executive Officer
Thomas Pfeil*	Member of the Supervisory Board Current mandates: Service Manager for Telefónica Germany GmbH & Co. OHG; Vice Chairperson for the Group Works Committee for Telefónica Deutschland
Jan-Erik Walter*	Current mandates: Vice Chairperson of the Munich Works Committee for Telefónica Deutschland
Marcus Thurand*	Member of the Supervisory Board Current mandates: Vice President for Network Operations of Telefónica Germany GmbH & Co. OHG
Christoph Heil*	Member of the Supervisory Board Current mandates: Ver. di. [United Services Union] Consultant, Berlin Capgemini GmbH, Member of the Supervisory Board
Claudia Weber*	Member of the Supervisory Board Current mandates: Deputy Manager, ver. di Munich Region/Trade Union Secretary

* Employee representative

Auditor's fees

The information concerning the total auditor's fees of Telefónica Deutschland Holding AG is omitted, in accordance with section 285, 17 HGB, since the company is part of the consolidation group of Telefónica Deutschland Holding AG ("Telefónica Deutschland Group") and the information is included within the consolidated financial statements as of December 31, 2013.

Number of employees

In financial year 2013 – as in 2012 – the company had no employees.

Contingent liabilities and other financial commitments

Contingent liabilities

Telefónica Deutschland Holding AG shall assume warranty obligations for its subsidiaries in its function as parent company of the Telefónica Deutschland Group. As part of the bond issued by O₂ Telefónica Deutschland Finanzierungs GmbH, Telefónica Deutschland assumes with the guarantee of November 2013 to each holder of the bond issued in an amount of EUR 600m with an unconditional and irrevocable guarantee of correct and punctual payment of all amounts payable by the issuer in relation to the bond in accordance with all the terms of the bonds.

The risk of a claim from the contingent liabilities is considered to be very low. This assessment is based on the fact that O₂ Telefónica Deutschland Finanzierungs GmbH is an indirect subsidiary of Telefónica Deutschland Holding AG and is fully controlled by Telefónica Germany GmbH & Co. OHG. The creditworthiness of O₂ Telefónica Deutschland Finanzierungs GmbH is thus determined by the operative business activities of the Telefónica Deutschland Group itself.

List of shares held pursuant to section 285, 11 and 11a HGB

Name and legal form	Registered Office	Share in the Capital	Equity on 31.12.2012 in Euros in thousands	Result of the 2012 Financial Year Euros in thousands
Telefónica Germany GmbH & Co. OHG ^{1,2}	Munich	100	3,991,894	1,177,449
Telefónica Germany Management GmbH	Munich	100	569	21
Telefónica Germany I Beteiligungsgesellschaft [Investment Company] mbH [Limited Liability]	Munich	100	85,778	1,052 ³
Telefónica Germany Customer Services GmbH	Munich	100	15,342	155,544
Wayra Deutschland GmbH	Munich	100	275	0 ³
Fonic GmbH	Munich	100	25	0 ³
O ₂ Telefónica Germany Finanzierungs [Finance] GmbH	Munich	100	n/a	n/a
TCHIBO Mobilfunk [mobile communications] Beteiligungs [Investment] GmbH	Hamburg	50	37	1
TCHIBO Mobilfunk GmbH & Co. KG	Hamburg	50	4,996	1,098

1 § 285 no. 11a HGB

2 99,99% Telefónica Deutschland Holding AG; 0,01% Telefónica Germany Management GmbH

3 After transfer of the profit/loss

Parent company/Consolidated Financial Statement

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

Voting rights notification pursuant to section 26 (1) of the WpHG:**BlackRock Inc., New York, NY, USA:**

On June 6, 2013 BlackRock, Inc., New York, NY, USA has informed us according to section 21 (1) WpHG that via shares its voting rights on Telefónica Deutschland Holding AG, Munich, Germany, have exceeded the threshold of 3% of the voting rights on June 4, 2013 and amounted to 3.02% (which corresponds to 33,702,924 voting rights) on that day. 3.02% of the voting rights (which corresponds to 33,702,924 voting rights) are attributed to the company, pursuant to section 22 (1), sentence 1, no. 6 in combination with section 22 (1) sentence 2 WpHG.

On July 17 2013 BlackRock, Inc., New York, NY, USA has informed us according to section 21 (1) WpHG that via shares its voting rights on Telefónica Deutschland Holding AG, Munich, Germany have fallen below the threshold of 3% of the voting rights on July 15, 2013 and amounted to 2.99% of the voting rights (which corresponds to 33,443,076 voting rights) on that day. 2.99% of the voting rights (which correspond to 33,443,076 voting rights) are attributed to the company, pursuant to section 22 (1) 1, no. 6, in combination with section 22 (1) 2 WpHG.

On October 24, 2013 BlackRock, Inc., New York, NY, USA has informed us according to section 21 (1) WpHG that via shares its voting rights on Telefónica Deutschland Holding AG, Munich, Germany, have exceeded the threshold of 3% of the voting rights on October 22, 2013 and amounted to 3.03% (which corresponds to 33,820,307 voting rights) on that day. 3.03% of the voting rights (which corresponds to 33,820,307 voting rights) are to be attributed to the company, pursuant to section 22 (1) sentence 1, no. 6, in combination with section 22 (1) sentence 2 WpHG.

On January 17, 2014 BlackRock, Inc., New York, NY, USA has informed us according to section 21 (1) WpHG that via shares its voting rights on Telefónica Deutschland Holding AG, Munich, Germany have fallen below the threshold of 3% of the voting rights on January 15, 2014 and amounted to 2.89% of the voting rights (which corresponds to 32,330,698 voting rights) on that day. 2.89% of the voting rights (which correspond to 32,330,698 voting rights) are to be attributed to the company, pursuant to section 22 (1) sentence 1, no. 6, in combination with section 22 (1) sentence 2 WpHG.

BlackRock HoldCo 2 Inc., Wilmington, DE, USA

On June 7, 2013 BlackRock Holdco 2, Inc., Wilmington, DE, USA has informed us according to section 21 (1) WpHG that via shares its voting rights on Telefónica Deutschland Holding AG, Munich, Germany have exceeded the threshold of 3% of the voting rights on June 5, 2013 and amounted to 3.12% (which corresponds to 34,829,613 voting rights) on that day. 3.12% of the voting rights (which corresponds to 34,829,613 voting rights) are to be attributed to the company, pursuant to section 22 (1) sentence 1, no. 6, in combination with section 22 (1) sentence 2 WpHG.

On July 16, 2013 BlackRock Holdco 2, Inc., Wilmington, DE, USA has informed us according to section 21 (1) WpHG that via shares its voting rights on Telefónica Deutschland Holding AG, Munich, Germany have fallen below the threshold of 3% of the voting rights on July 12, 2013 and amounted to 2.98% (which corresponds to 33,336,846 voting rights) on that day. 2.98% of the voting rights (which correspond to 33,336,846 voting rights) are to be attributed to the company, pursuant to section 22 (1) sentence 1, no. 6, in combination with section 22 (1) sentence 2 WpHG.

On October 24, 2013 BlackRock Holdco 2, Inc., Wilmington, DE, USA has informed us according to section 21 (1) WpHG that via shares its voting rights on Telefónica Deutschland Holding AG, Munich, Germany have exceeded the threshold of 3% of the voting rights on October 22, 2013 and amounted to 3.03% (which corresponds to 33,811,969 voting rights) on that day. 3.03% of the voting rights (which correspond to 33,811,969 voting rights) are to be attributed to the company, pursuant to section 22 (1) sentence 1, no. 6, in combination with section 22 (1) sentence 2 WpHG.

On January 16, 2014 BlackRock Holdco 2, Inc., Wilmington, DE, USA has informed us according to section 21 (1) WpHG that via shares its voting rights on Telefónica Deutschland Holding AG, Munich, Germany have fallen below the threshold of 3% of the voting rights on January 14, 2014 and amounted to 2.98% (which corresponds to 33,232,797 voting rights) on that day. 2.98% of the voting rights (which correspond to 33,232,797 voting rights) are to be attributed to the company, pursuant to section 22 (1) sentence 1, no. 6 in combination with section 22 (1) sentence 2 WpHG.

BlackRock Financial Management Inc., New York, NY, USA

On June 7, 2013 BlackRock Financial Management, Inc., New York, NY, USA has informed us according to section 21 (1) WpHG that via shares its voting rights on Telefónica Deutschland Holding AG, Munich, Germany have exceeded the threshold of 3% of the voting rights on June 5, 2013 and amounted to 3.12% (which corresponds to 34,829,613 voting rights) on that day. 3.12% of the voting rights (which correspond to 34,829,613 voting rights) are attributed to the company, pursuant to section 22 (1) sentence 1, no. 6 in combination with section 22 (1) sentence 2 WpHG.

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Declarations of Compliance with the German Corporate Governance

On February 11, 2014, the Management Board and Supervisory Board of Telefónica Deutschland Holding AG issued a latest declaration of compliance in accordance with section 161 of the German Stock Corporation Act (AktG) that is publicly available to the shareholders of Telefónica Deutschland Holding AG on the Telefónica Holding AG website (WWW.TELEFONICA.DE/ENTSPRECHENSERKLAERUNG).

Events after the Reporting Period

Issue of a 7-year bond (Bond II)

On February 10, 2014, Telefónica Deutschland Group issued a senior 7-year bond with a nominal value of EUR 500m. The bond has a maturity on February 10, 2021 and was issued by O₂ Telefónica Deutschland Finanzierungs GmbH, Munich, and is guaranteed by Telefónica Deutschland Holding AG. The coupon for the fixed interest bond is 2.375% and the issue price 99.624%. The issue spread was 100 basis points over the seven-year Euro Midswap Rate, resulting in a yield of 2.434%. The bond has a denomination of EUR 1,000 and was issued on the basis of a bond security prospectus. O₂ Telefónica Deutschland Finanzierungs GmbH, Munich, has transferred the net issue proceeds of the bond to Telefónica Germany GmbH & Co. OHG, Munich, in the form of a loan. The net proceeds generated by the bond will be used for general corporate purposes.

Change in the Management Board of Telefónica Deutschland

On January 31, 2014, René Schuster left in mutual agreement as CEO and member of the Management Board. On January 29, 2014, the Supervisory Board of Telefónica Deutschland approved a respective termination agreement. Since February 1, 2014, the responsibilities of the CEO were taken over jointly by Chief Financial Officer, Rachel Empey and Chief Strategy Officer, Markus Haas, in addition to their responsibilities to date. Rachel Empey focuses on the operative business and Markus Haas on the preparation for the E-Plus integration.

Extraordinary General Meeting

On December 30, 2013 the Management Board of Telefónica Deutschland called an extraordinary General Meeting, which took place on February 11, 2014. In such extraordinary General Meeting, the General Meeting of Telefónica Deutschland approved the following capital measures for the E-Plus transaction:

- Increase the share capital by up to EUR 3.7bn against cash with subscription right of the shareholders, as well as a related amendment of the Articles of Association;
- Authorization of the Management Board, with approval of the Supervisory Board, to execute a capital increase against contribution in kind up to EUR 475m and the related amendment of the Articles of Association (authorized capital 2014/I).

The resolution passed by the General Meeting on the authorization to increase share capital by up to EUR 3.7bn was registered in the commercial register on February 25, 2014.

Furthermore, the extraordinary General Meeting resolved a new conditional capital 2014/I whilst suspending the former conditional capital 2012/I. The new conditional capital 2014/I was registered in the commercial register on February 25, 2014, whilst suspending the former conditional capital 2012/I.

Munich, March 7, 2014

Telefónica Deutschland Holding AG

Management Board



Empey, Rachel Clare



Haas, Markus

Telefónica Deutschland Holding AG

Declaration of the Statutory Representatives

To the best of our knowledge, and in accordance with the applicable reporting principles, the Financial Statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company, and the Management Report includes a fair review of the development and performance of the business and the position of the Company, together with a description of the material opportunities and risks associated with the expected development of the Company.

Munich, March 7, 2014

Telefónica Deutschland Holding AG

The Management Board



Rachel Empey



Markus Haas

Audit opinion

We have audited the annual financial statements, comprising the balance sheet, the income statement and the notes to the financial statements, together with the bookkeeping system, and the management report of Telefónica Deutschland Holding AG, Munich, for the fiscal year from 1 January 2013 to 31 December 2013. The maintenance of the books and records and the preparation of the annual financial statements and the management report in accordance with German commercial law are the responsibility of the Company's management. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit.

We conducted our audit of the annual financial statements in accordance with Sec. 317 HGB ("Handelsgesetzbuch": "German Commercial Code") and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany) (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual financial statements in accordance with German principles of proper accounting and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records, the annual financial statements and the management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the annual financial statements and management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the annual financial statements comply with the legal requirements and give a true and fair view of the net assets, financial position and results of operations of the Company in accordance with German principles of proper accounting. The management report is consistent with the annual financial statements and as a whole provides a suitable view of the Company's position and suitably presents the opportunities and risks of future development.

Munich, 18. March 2014

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft

Dahmen
Wirtschaftsprüfer
German Public Auditor

Vogel
Wirtschaftsprüferin
German Public Auditor

Glossary_

The glossary also contains abbreviations as used in the Group Management Report.

3G	Third generation mobile communications standard (see UMTS)
4G	Fourth generation mobile communications standard (see LTE)
ADSL	Asymmetrical Digital Subscriber Line (see DSL)
ARPU	Average Revenue per User
Broadband	Refers to telecommunication in which a wide band of frequencies is available to transmit information
CapEx	Capital Expenditure: additions in fixed and intangible assets
Carrier	Telecommunication network operator authorized by the federal network agency
CF	Cash flow
Cloud Service	Cloud services are dynamic infrastructure, software or platform services provided online
Convergence	Signifies the bundling of different digital services, which to some extent use different transmission technologies, into one product, e.g. wireless and wireline
Cross-selling	Marketing term denoting the sale of related or complementary products or services
DLD	Digital-Life-Design
DSL	Digital Subscriber Line: technology to transmit data in the local loop to private end-customers
EasT	Experts as Trainers: program for training and continuing education
EC	European Commission
EU	European Union
Euribor	Euro Interbank Offered Rate
FCF	Free cash flow
FNA	Federal Network Agency: Bundesnetzagentur
FTR	Fixed network Termination Rates
GDP	Gross Domestic Product
GfK	Consumer research association (Gesellschaft für Konsumforschung)
GPS	Global Positioning System
GSM	Global System for Mobile Communications: this is the global standard for digital mobile communications
HSPA	High-Speed Package Access
Hosting	Providing storage capacity via the internet
IDR	Issuer Default Rating

Internet	Worldwide network of computers on the basis of an IP (Internet Protocol) without any central network management
IPO	Initial public offering
IT	Information Technology
Joint Venture	Two or more companies founding a new enterprise for cooperation
LAN	Local Area Network: a group of computers and associated devices that share a common communications line or wireless link
Libor	London Interbank Offered Rate
Live Check	Website and app which customers can use to get location-based information on the current quality of the O ₂ mobile communications network
LTE	Long Term Evolution: further development of the UMTS/HSPA mobile communications standard
M2M	Machine-to-Machine communication, automatic exchange of information between machines
MMS	Multimedia Messaging Service
mpass	Mobile payment service
MTR	Mobile termination rates
Multi-brand strategy	Enables Telefónica Deutschland to provide customers in all segments offers that suit their exact needs through various own and partner brands
MVNO	Mobile Virtual Network Operator
NFC	Near Field Communication: a short-range wireless connectivity standard
NGO	Non Governmental Organization
n.m.	not measured
NRA	National Regulatory Authority
O ₂ My Handy	Monthly payment model for mobile phones and other devices
OIBDA	Operating Income before Depreciation and Amortization
OTT	Over The Top
PBX	Private Branch Exchange: a telephone system within an enterprise that switches calls between enterprise users on local lines while allowing all users to share a certain number of external phone lines
PIP	Performance and Investment Plan
POS	Point of Sale
Prepaid/Postpaid	In contrast to postpaid contracts, prepaid communication services are services for which credit has been purchased in advance with no fixed-term contractual obligations
Retail	Sale of goods and services to end users; as opposed to resale or wholesale business
Roaming	Using a communication device or subscriber identity in a different network other than one's home network

SIM	Subscriber Identity Module: a chip card to insert into a mobile phone and identifies the user within the network
SIP	Session Initiation Protocol: an Internet Engineering Task Force (IETF) standard protocol for initiating an interactive user session that involves multimedia elements such as video, voice, chat, gaming, and virtual reality
Smartphone	Wireless handset that can be used as a mobile phone, a web browser, and an e-mail reader simultaneously
SME	Small and Medium-sized Enterprises
SMS	Short Message Service
SoHo	Small and Home offices
Tablet	A wireless, portable personal computer with a touch screen interface
Telefónica	Telefónica, S. A., Madrid/Spain
Telefónica Deutschland	Telefónica Deutschland Holding AG (former: Telefónica Germany Verwaltungs GmbH), Munich
Telefónica Deutschland Group	The companies included in the Consolidated Financial Statements of Telefónica Deutschland
Telefónica Group	The companies included in the Consolidated Financial Statements of Telefónica
ULL	Unbundled Local Loop: bridges the distance between the local exchange and the termination point on the customer's premises or in their home, so it is also known as the "last mile"
UMTS	Universal Mobile Telecommunications Service: international mobile communications standard of the third generation which unites mobile multimedia and telematics service under the frequency spectrum of 2GHz.
VAT	Value Added Tax
VDSL	Very High Data Rate Digital Subscriber Line (see DSL)
VPN	Virtual Private Network
WAN	Wide Area Network: a geographically dispersed telecommunications network
Wholesale	Selling services to third parties who sell them to their own end customers either directly or after further processing

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