Telefonica
Deutschland

Interim Group Report_

for the period January 1 to March 31, 2014

Portrait of Telefónica Deutschland_

Telefónica Deutschland Headquarters in Munich.

With more than 25 million customer accesses and annual revenues in 2013 of EUR 4.9bn, Telefónica Deutschland is one of Germany's top three integrated telecommunications operators. Listed on the Frankfurt Stock Exchange since 2012, the company is a leading provider of wireless and wireline services, including voice, data and value-added services, to private and business customers in Germany. The indirect majority shareholder is the Spanish company Telefónica S.A. – one of the world's largest telecommunications operators.

Telefónica Deutschland is especially known for its core O_2 brand, which has been successfully offering wireless and wireline products for private and business customers for many years. As part of its multi-brand strategy, Telefónica Deutschland also addresses additional customer groups through familiar secondary and partner brands, such as Fonic, netzclub and TCHIBO mobil. Telefónica Deutschland is also a leading provider of wholesale services to customers such as 1&1, mobilcom/debitel, Drillisch and cable operators. The company also targets large multinational corporations through the Telefónica group's offering.

The company is a leading provider of smartphone tariffs and products, particularly through its core O_2 brand. Telefónica Deutschland sets new standards in the German telecommunications market in this area with innovative and customer-friendly products: With its "O_2 Blue All-In" wireless tariffs launched in 2013, the company became the first German network provider to gear its entire rate portfolio towards customers' data needs.

The foundation for this is a competitive mobile network, which is among the most advanced in Europe. More than 30,000 base stations provide coverage for over 99% of the German population. Since 2010, Telefónica Deutschland has also been expanding the new mobile communications standard LTE in Germany, which enables significantly faster mobile data transmission rates. As of end of April 2014, Telefónica Deutschland's LTE network reached already 50% of the German population and the roll-out continues. As an integrated operator, Telefónica Deutschland also offers wireline and DSL products. This includes high-speed VDSL access, which it provides through its long-term cooperation with Deutsche Telekom and covers almost 15 million German households.

To secure its future growth, Telefónica Deutschland is also committed to active innovation management. Complementing the research conducted by the Telefónica group's global innovation network, the company invests in a large number of projects in Germany. The vision of Telefónica Deutschland with its roughly 6,000 employees is to improve people's quality of life and drive social progress through digital products and services. Through its "Think Big" initiative, the company is especially committed to helping young people, and has supported more than 2,000 projects in this field since 2010.

Content_

The following figures have been rounded according to established commercial principles.
Additions of the figures can thus lead to amounts that deviate from those shown in the tables.

Financial Highlights_

Financial Overview

(Euros in millions)	January 1 to March 31 2014	2013	% Change
Revenues	**1,122**	**1,230**	**(8.8)**
Wireless service revenues	707	733	(3.6)
Operating income before depreciation and amortization (OIBDA)	**234**	**278**	**(15.8)**
OIBDA margin	20.9%	22.6%	(1.8%-p.)
Operating income	**(33)**	**(2)**	**1,673.9**
Profit for the period	**(40)**	**(13)**	**213.5**
Basic earnings per share from continuing operations (in Euros)[1]	**(0.04)**	**(0.01)**	**213.5**
CapEx	**(132)**	**(146)**	**(9.3)**
Operating cash flow (OIBDA-CapEx)	**102**	**133**	**(23.0)**
Free cash flow pre dividends from continuing operations[2]	**107**	**105**	**1.8**
Total accesses (in thousands)	**25,004**	**25,332**	**(1.3)**
Mobile accesses (in thousands)	19,275	19,325	(0.3)
Postpaid (%)	**53.8%**	**52.8%**	**1.0%-p.**
Total ARPU	**12.1**	**12.5**	**(3.3)**
Postpaid churn (%)	**1.6%**	**1.5%**	**0.1%-p.**
(%) non-SMS data over total data revenues	**72.0%**	**63.4%**	**8.6%-p.**
Employees (Full-time equivalent)	**5,959**	**5,994**	**(0.6)**

	As of March 31 2014	As of December 31 2013	% Change
Net financial debt[3]	**481**	**468**	**2.8**
Leverage[4]	0.4x	0.4x	6.6

1 Basic earnings per share from continuing operations are calculated by dividing profit (loss) after taxes for the period from continuing operations by the weighted average number of ordinary shares of 1,117m.

2 Free cash flow pre dividends from continuing operations is defined as the sum of cash flow from operating activities from continuing operations and cash flow from investing activities from continuing operations.

3 Net financial debt includes all current and non-current interest-bearing financial assets and interest-bearing financial liabilities. Net financial debt is calculated as follows: non-current interest-bearing debt (EUR 1,813,396k in 2014 and EUR 1,342,584k in 2013) + non-current finance lease payables (EUR 1,004k in 2014 and EUR 1,340k in 2013) + current interest-bearing debt (EUR 6,547k in 2014 and EUR 102,059k in 2013) + current finance lease payables (EUR 1,454k in 2014 and EUR 1,649k in 2013) minus the non-current "O_2 My Handy" receivables (EUR 56,507k in 2014 and EUR 83,209k in 2013) and since June 2014 the current portion of "O_2 My Handy" receivables (EUR 98,943k in 2014 and EUR 188,013k in 2013) minus loan to third parties included in other current financial assets (EUR 504k in 2014 and EUR 458k in 2013) and minus cash and cash equivalents (EUR 1,185,937k in 2014 and EUR 708,545k in 2013).
Note: The current portion of "O_2 My Handy" receivables is shown under trade and other receivables in the Consolidated Statement of Financial Position and the non-current portion of "O_2 My Handy" receivables is shown under other non-current financial assets in the Consolidated Statement of Financial Position.

4 Leverage is defined as net financial debt divided by LTM (Last Twelve Months) OIBDA (EUR 1,193m in 2014; EUR 1,277m in 2013) excluding non-recurring factors.

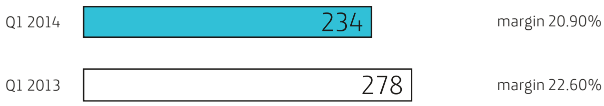
Wireless Service Revenues
(Euros in millions)

–3.6%

Increasing LTE adoption in the postpaid segment being offset by the impact from tariff renewals to lower price levels, acceleration of SMS declines and lower performance of the prepaid segment.

OIBDA/OIBDA Margin
(Euros in millions)

–15.8%



Decline of OIBDA and OIBDA margin mainly driven by the impact from lower revenues and increased commercial spend to drive commercial performance.

Wireless Accesses
(in thousands)

–0.3%

Postpaid continued to be the main driver, customer base increased to 10.4 million customers (+1.6% year-on-year) and its share over total mobile base grew by 1.0 percentage points year-on-year, to reach 53.8%.

Non-SMS Data over Total Data Revenues
(in %)

+8.6%-p.

Mobile data continued to be a main driver for revenue performance driven by increasing smartphone penetration and growing demand for data services fostered by LTE.

Highlights January–March 2014_

1 — "O₂ Unite"

Wireless_

1 — "O_2 Unite" – new tariff model for business customers
With "O_2 Unite", Telefónica Deutschland introduced a new tariff model for business customers in March. Instead of booking single tariffs for each employee, companies order an overall contingent depending on the size of the company. The cost-efficient contracts include a pool of call minutes, texts, and data that can be used by all employees. The new tariff model offers companies exact cost control and can be flexibly adapted to the respective company size without the need to negotiate single contracts for each employee. Business customers can test "O_2 Unite" three months free of charge.

2 — LTE included in all "O_2 Blue All-in" tariffs
In April, Telefónica in Germany introduced the extended tariff portfolio "O_2 Blue All-in" with even more added value for customers: Mobile high-speed surfing with LTE is now included in all "O_2 Blue All-in" tariffs. In addition, integrated roaming packages offer a carefree surfing and calling experience within the EU. Self-employed and young people benefit from additional advantages. Especially for discerning customers, the new tariff "O_2 Blue All-in Premium" was introduced: It offers a comprehensive mobile high-speed data volume, voice call, text- and data-packages in Germany and the EU as well as the security package "O_2 Protect". The tariffs can be combined with the latest smartphones and ordered as attractive bundle offers.

2 — "O_2 Blue All-in" including LTE

3 — netzclub and Fonic

3 — Fonic and netzclub with new campaigns
In the first quarter, Telefónica´s secondary brands Fonic and netzclub started new advertising campaigns to intensify their target group marketing. With a new TV spot, Fonic launched in February the campaign "You don´t need more, so do not pay more", which addresses mainly price-sensitive smartphone users. "Take part in the free internet culture" was the slogan of a new campaign started in March by netzclub to market its ad-sponsored mobile tariffs. The campaign included YouTube videos, internet radio spots and a raffle.

4 — Galaxy S5, Moto X, HTC One – O_2 offers new top devices
O_2 extended its product portfolio with three new top-smartphones in the first quarter: Just a few hours after the world premiere at the Mobile World Congress in February, customers of O_2 in Germany could pre-order the new Samsung Galaxy S5. Also in February Telefónica in Germany started the sale of the new Motorola flagship smartphone Moto X, that can be comfortably controlled through voice commands. Since March, O_2 customers could also pre-order the new HTC top-model One (M8), which, like its predecessor, distinguishes itself through its premium aluminium case.

5 — VDSL

Wireline_

5 — O_2 VDSL tariffs for young people, families and self-employed
Since March, Telefónica in Germany offers VDSL with special tariffs also for young people, families, self-employed and small companies. The high-speed connections with download-rates of up to 50 MBit/s bring ideal internet access to homes and offices. With its VDSL offerings, Telefónica reaches almost 15 million households all over Germany.

Innovation_

6 — Complete M2M-solutions for companies
At the yearly trade show CeBIT, Telefónica Deutschland and Software AG presented their new product portfolio for complete Machine-to-Machine (M2M) solutions for companies. The offer with the name Smart Business Solutions includes all necessary components from a single source: connectivity, hardware, applications, and hosting. Thus, companies from all branches can develop their own M2M-solutions perfectly suiting their business models.


6 — M2M-World

7 — VoLTE-handover in the O_2 live network
An important technical obstacle in the rollout of the new mobile standard LTE is the so-called VoLTE-handover – which stands for the inaudible handover of voice calls to older 2G- and 3G-networks. This is always necessary when a mobile user leaves the LTE transmission range. To avoid dropped calls, LTE smartphones have to use 2G or 3G for voice calls until now. But now the network specialists at Telefónica Deutschland reached the breakthrough: After successful tests in the laboratory, the handover also works in the O_2 live network since January. Telefónica Deutschland is among the first providers worldwide that master this technology. Retail customers will also benefit soon.

Company_

8 — Personnel changes

End of January, the previous CEO René Schuster left the Management Board in mutual agreement. Additionally to their existing responsibilities, Chief Financial Officer (CFO) Rachel Empey and Chief Strategy Officer (CSO) Markus Haas jointly took over the responsibilities as CEO. Since February 1, 2014, Rachel Empey is focusing on the operational business and Markus Haas on the preparation of the E-Plus integration.

Rachel Empey
Chief Financial Officer (CFO)

Markus Haas
Chief Strategy Officer (CSO)

9 — Shareholders approve capital measures

At the extraordinary General Meeting on February 11, 2014, the shareholders of Telefónica Deutschland Holding AG approved the capital measures related to the acquisition of E-Plus with high majority. Over 99% of the valid votes approved the suggested authorization for cash capital increase and for the capital increase by contribution in kind. Shareholders of E-Plus' mother company KPN had already approved the sale of E-Plus in October last year. The closing of the transaction, which is still subject to antitrust approval by the European Commission, is expected by mid-2014.

10 — Successful placement of new bond

In February, Telefónica Deutschland successfully placed a 7-year bond with a total volume of EUR 500m. The unsecured fixed-rate bond is due in February 2021 and pays a 2.375% coupon. In November last year, Telefónica Deutschland had already placed a successful debut bond with a volume of EUR 600m.

11 — Store at Berlin Tauentzien

11 — Awards for Telefónica Deutschland

At the beginning of the year, products and services of Telefónica Deutschland were independently tested and honoured: The specialist journal "connect" rated O_2 DSL as "very good" for its quality at Web TV. According to a study by Open Signal about LTE data-speed, O_2 has the fastest LTE network in Germany. The new O_2 Life Concept Store was awarded with the prestigious iF Award 2014 for design. In a comparison of all-net flat rates by the portal allnet-flat-vergleich24.de, "O_2 Blue All-in S" and "O_2 Loop" were the best value for money offers in their categories. A test by the magazine "connect Freestyle" rated Fonic as "very good" among discount tariffs. Readers of the trade magazine "handelsjournal" awarded the mobile and contactless payment service "mpass" as top retail product 2014.

---

12 — Corporate responsibility: New projects

Telefónica Deutschland is taking its responsibility as corporation seriously: As the first provider in Germany, O_2 introduced the so-called 3-in-1 SIM-card in March, which has less plastic packaging and saves resources. With a few simple steps the new cards can be broken into all three common SIM-formats. Also, there is no plastic card as carrier anymore. Following a call of World Wildlife Fund For Nature (WWF), Telefónica Deutschland took part in "Earth Hour" in March: By completely switching-off all lights at the O_2 tower it set an example for climate protection. In February, a number of young people of the Think Big initiative were visiting Telefónica Deutschland in Munich, receiving support and coaching for their projects. Also, for the annual "Girls' Day" 100 female pupils visited our sites in Munich and Hamburg and developed together with employees of Telefónica digital project ideas.

Interim Group Management Report_ for the period January 1 to March 31, 2014

Overview of the period from January to March 2014_

- At the end of March 2014, Telefónica Deutschland Group had 25m customer accesses, a year-on-year decrease of 1.3%. The mobile access base remained stable year-on-year at 19.3m, while fixed line accesses declined by 4.6% year-on-year to 5.7m.
- Smartphone penetration continued its positive trend, reaching 32.8% (70.7% in the O_2 consumer postpaid segment and 21.2% in the O_2 consumer prepaid segment) with an encouraging share of LTE enabled devices sold over total (approx. 78%). At the end of April 2014 the mark of 1m LTE enabled handsets sold was exceeded.
- Fixed broadband business further improving its operating performance, with 18k retail DSL net disconnections (vs. 22k in the fourth quarter and 29k in the third quarter of 2013, respectively), reflecting the success of the new "O_2 DSL All-in" portfolio and demand for higher speeds on VDSL technology.
- Telefónica Deutschland total revenues totalled EUR 1,122m (–8.8% year-on-year), driven by a continuation of trends in mobile and fixed service and declining handset revenues.
- Wireless service revenue ex-MTR decreased by 3.4% year-on-year (–3.6% year-on-year in reported terms); a similar performance as in the previous quarter, with increasing LTE adoption in the postpaid segment being offset by tariff renewals to lower price levels, acceleration of SMS declines and lower performance in the prepaid segment.
- Mobile data continued to be a main driver for revenue performance, reaching EUR 350m in the first quarter, with the accelerated decline of SMS revenues (–24.6% year-on-year) being the reason for an overall decline of data revenues

of 1.3% year-on-year. Non-SMS data revenues registered growth of 12.1% year-on-year in the first quarter, representing 72.0% of total data revenues in the quarter, a plus of 8.6 percentage points compared to prior year.

— Announcement of the refresh of the data centric “O_2 Blue All-in” portfolio: From April 8, 2014 LTE is included in all “O_2 Blue All-in” tariffs, attractive roaming packages are available and the “O_2 Blue All-in Premium” – a carefree tariff for high usage customers – was introduced. Attractive bundles with the latest LTE enabled smartphones complete the new offer.

— Launch of a revolutionary new proposition for the business segment from March 10, 2014: “O_2 Unite” – a single company tariff with a pool of minutes, SMS and data volume for all employees.

— OIBDA margin showed a moderate decline (1.8 percentage points year-on-year), mainly driven by increased commercial spend to drive commercial performance. OIBDA reached EUR 234m, a decline of 15.8% year-on-year.

— CapEx was lower year-on-year by 9.3%, totalling to EUR 132m, reflecting the focused investments into LTE network deployment and a different year-on-year phasing of investments.

— Free Cash Flow pre dividends (FCF) reached EUR 107m (from EUR 105m in 2013). The conversion from Operating Cash Flow to FCF was the result of a positive working capital development of EUR 17m, with silent factoring transactions executed in both years having a major role.

— Consolidated net financial debt increased moderately by EUR 13m to EUR 481m at the end of March 2014 due to a 500m second Eurobond issuance in February 2014. The effect was largely compensated by an increase in liquidity of EUR 477m, while financial assets declined by EUR 116m mainly due to lower “O_2 My Handy” receivables. The Company further early redeemed EUR 125m of its inter-company loan. The leverage ratio remained constant at 0.4x.

— Telefónica Deutschland continued its successful positioning in the debt capital market and achieved a very attractive funding and spread levels, with a 2.375% coupon in the 7-Year issuance in February. This transactions strengthened the Company’s liquidity position, extending its maturity profile while diversifying its investor base.

1. Fundamentals of the Group_

1.1 Business Model of the Group

1.1.1 Structure of Telefónica Deutschland Group

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 March 31, 2014, 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 March 31, 2014, 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 and/or contribution in kind (authorized capital 2012/I).

Furthermore, the share capital of Telefónica Deutschland Holding AG – as resolved upon by the extraordinary General Meeting on February 11, 2014 – is conditionally increased by up to EUR 558,472,700 by issuing of up to 558,472,700 registered shares (Conditional Capital 2014/I).

In the extraordinary General Meeting on February 11, 2014, 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 contribution with a subscription right of the shareholders, as well as the 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).

Telefónica Deutschland Holding AG is the parent company of the German Telefónica Deutschland Group. It is included in the condensed consolidated financial statements of the ultimate holding company, Telefónica, S.A., Madrid, Spain (Telefónica, S.A.). The parent company of Telefónica Deutschland Group is Telefónica Germany Holdings Limited, a subsidiary of O2 (Europe) Limited, Slough, UK (O2 (Europe) Limited) and an indirect subsidiary of Telefónica, S.A.

As of March 31, 2014, the companies included in the Interim Consolidated Financial Statements of Telefónica Deutschland Group were organized as shown in the organization chart on page 14.

On July 23, 2013, Telefónica Deutschland Holding AG, Telefónica, S.A. und 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 standard closing conditions. The closing of the transaction is expected in mid 2014 (section 5 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 governing bodies are determined by the German Stock Corporation Act (Aktiengesetz – AktG), the Articles of Association of the company and the by-laws of both the Management Board and the Supervisory Board.

Management Board
The members of the Management Board are appointed by the Supervisory Board for a maximum term of five years and may be re-appointed without limitation, in each case for a maximum of five years. The Supervisory Board may revoke the appointment of a Management Board member prior to the expiration of his or her term for good reason, such as the gross breach of fiduciary duties or if the General Meeting adopts a no-confidence resolution in relation to the Management Board member in question. There are further possibilities of termination, such as a mutual termination agreement. The Supervisory Board may 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 until September 17, 2015.

At the reporting date of March 31, 2014, the Management Board of the company consisted of two members:
— Rachel Empey, CFO (Chief Financial Officer)
— Markus Haas, CSO (Chief Strategy Officer)

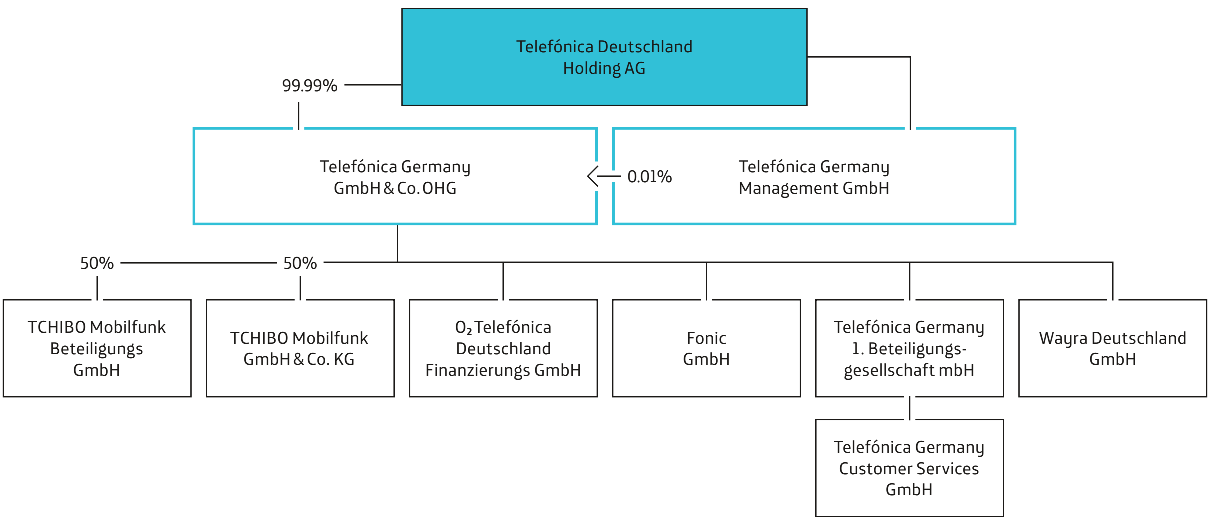
On January 31, 2014, René Schuster left in mutual agreement as CEO and member of the Management Board. Since February 1, 2014, Rachel Empey and Markus Haas have jointly taken over the responsibilities of the CEO in addition to their reponsibilities to date.

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 consists of twelve members, six of which are shareholder representatives and six of which are employee representatives. If the General Meeting does not set a shorter term 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 commencement of the term of office; the financial year in which the term 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.

1.1.2 Business activity

Telefónica Deutschland Group is the third largest telecommunications service provider in Germany (based on 2013 reported revenues), with 25 million customer accesses as of March 31, 2014. Telefónica Deutschland Group offers private and business customers voice, data and added value services in wireless communications and wireline networks. In



addition, 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 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 March 31, 2014. The expansion of our LTE network is in full swing and as of March 31, 2014 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 furthermore enables us to service almost 15 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 was approved by the Federal Network Agency on March 18, 2014. The contracts came into effect on this date. The Federal Cartel Office is also assessing the cooperation. A decision is expected for the end of June 2014.

Our sales and marketing approach is based on a strong multi-brand strategy that addresses a broad range of customer segments with our products and services. We offer the majority of our postpaid and prepaid wireless and wireline communications products and bundled offers via our core brand O_2. We continually strive for an improvement in the market positioning of O_2, particularly in order to gain premium customers in the private and business customer segment. 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 March 31, 2014 comprises already 71% of the O_2 postpaid customer base, generates above-average revenues 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 March 31, 2014, 21.2% of our O_2 prepaid customers are already using a smartphone. For this reason 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 "O_2 My Handy" model. Here the customer can choose whether to pay the entire price upfront or to make a down-payment and pay the remaining purchase price in 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, Sony and Huawei. Our focus with the "O_2 My Handy" model lies predominantly on the sale of smartphones with internet capability, which constituted 96% of the mobile phones sold by us to postpaid customers in the first quarter of 2014 (as of March 31, 2014). The proportion of smartphones with LTE capability amounted here to approximately 78%. In addition, the "O_2 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 O_2. Our secondary brands include the brands Fonic and netzclub, which are fully controlled by us, as well as brands from joint operations and strategic partnerships such as, for example, TCHIBO mobil. 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 as well as cable service providers. 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, for example, 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 O_2, large international businesses via the brand "Telefónica". We market our products via a diversified sales platform. This includes direct selling channels like our nation-wide network of independently operated O_2 franchise and premium partner shops, online and telesales as well as indirect selling channels like partnerships in retail trade/online retail trade and retailers/cooperations.

1.2 Goals and Strategies

Rapid technological progress and a sharply increasing digitalization are characteristic developments in the telecommunications market. We are convinced that this opens attractive business opportunities by aligning our offer so that it fits perfectly with our customers' needs. 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 support us in achieving 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 O_2 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 across all sales channels. To achieve this, we will use our customer insights 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 revenues.

We are expanding our online and e-care capacity, so that our customers can comfortably resolve their 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 O_2, to ramp up mobile service revenues 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 tariffs, 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 the 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 revenues.

We assume that there will be growing demand for converged product offerings. Therefore, in the future we would like to focus even stronger on 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 O_2 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 O_2 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 the first quarter 2014, we have achieved significant progress in the expansion of our LTE network. As of March 31, 2014, we are covering over 40% of the population with the new high-speed wireless communications technology. We will drive the expansion of our LTE network onwards and once again significantly increase the population coverage by the end of the year. 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 expenditures 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 (SoHo) as well as small, medium-sized (SME) and large national businesses with our core brand O_2. The brand “Telefónica”, in contrast, is aimed at large international customers. For our core brand O_2, 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 revenues 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 revenues 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.

2. Economic Report for the period January 1 to March 31, 2014_

2.1 Overall Economic and Sector-Specific Conditions

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. The upward trend in the German economy continued in the first quarter of 2014. The driving force here is the continued healthy domestic demand.

(Source: 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	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 mobile data usage and the increasing smartphone and tablet penetration enable the mobile 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 mobile data business will continue to gain strongly in significance for mobile 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 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 mobile telecommunications market is thus, measured by the number of customers, the biggest within the EU. The mobile penetration increased from the end of 2012 from 138% to 143% 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 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 mobile data services also showed itself in the strong growth of revenues from mobile data on the German market: In 2013, according to Analysys Mason, mobile data revenues increased by about 19% in comparison to the previous year. By contrast, revenues from mobile telephony and SMS declined, driven by price decline, regulatory effects and changed customer behavior.

The German mobile telecommunications market is an established market with four mobile telecommunications

network operators. As of December 31, 2013, the Telefónica Deutschland Group held, with 19.4m connections, a market share of 16.8%.
(Source: Company data, Analysys Mason, BITKOM)

The German fixed broadband market
Intense competition prevails on the German market for fixed 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 December 2013 to approximately 28.7m. The proportion of DSL connections here is 81%.
(Source: Analysys Mason: Telecoms Market Matrix Q4 2013, April 2014)

The largest DSL provider in Germany is the Deutsche Telekom AG in Bonn, the dominant telecommunications service provider. 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 Telefónica Deutschland Group

The following outlines the main amendments and new decisions made since the situation reported in the section "Regulatory influences on the Telefónica Deutschland Group" of the Group Management Report for the financial year ended December 31, 2013.

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 of the telecommunications industry and their members – among them 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 has been submitted to a hearing. Telefónica Deutschland Group as well as leading associations of the telecommunications industry submitted their comments at the end of March.

Telekom Deutschland GmbH's VDSL contingent model and planned expansion on 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 Telefónica Deutschland Group receives access to about 15m 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 shall 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 complies with the Telecommunications Act in its draft decision of December 17, 2013 and terminated the proceeding preliminarily. The draft decision was publicly reviewed and notified to the European Commission. The European Commission responded on March 13, 2014 and did not express serious doubts. The Federal Network Agency published thereafter its final decision on March 18, 2014 and confirmed its draft judgment from December 2013. With the final decision of the Federal Network Agency, the cooperation came into effect on March 18, 2014. The Federal Cartel Office is also reviewing the cooperation and a decision is expected by the end of June 2014. The commencement of the contract, however, is not subject to the decision of the Federal Cartel Office.

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. Comments regarding the draft could be submitted up to October 4, 2013. Telefónica Germany GmbH & Co. OHG also made use of this opportunity. The comments were published on the internet site of the Federal Network Agency.

In order to prepare for the decision in connection with the laws governing telecommunications for the envisaged merger between Telefónica Deutschland and E-Plus Mobilfunk GmbH & Co. KG a key elements paper was developed by the President's Chamber of the Federal Network Agency. In this key elements paper the Federal Network Agency states that an assignment process for the frequencies in the 900MHz and 1,800MHz bands as well as additional frequencies will start in December 2014 and that a decision regarding the directive and choice of the assignment process will be made already in the third quarter of 2014.
(Source: http://www.bundesnetzagentur.de/cln_1431/DE/Sachgebiete/Telekommunikation/Unternehmen_Institutionen/Frequenzen/OeffentlicheNetze/Mobilfunknetze/Projekt2016/projekt2016-node.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 should 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 assignments and the rules for frequency auctions. At the same time however, the package contains measures that have a direct negative effect on the revenues of network operators such as e.g. regarding roaming and international long distance calls 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 Parliament committees and those committees view the measures for the regulation of roaming, among other things, critically. As soon as the European Parliament has come to an agreement regarding its position, the voting result will be submitted to the European Council and the European Commission. Due to the elections for the European Parliament in May 2014 and the change of the presidency in mid 2014, it is not anticipated that the legislative procedure will be completed in 2014.

2.2 Overview of the first Quarter 2014

The first three months of operations in 2014 have not seen a significant change in the German mobile market dynamics. There is still a high level of competition around bundles of smartphone tariffs and devices with a clear focus on value maximisation leveraging increased customers' demand for LTE. The operating and financial performance of Telefónica Deutschland Group reflects the execution of its strategy in these market dynamics, and also the ongoing shift in communications' behaviour from customers, adopting a more digital lifestyle, and the current regulatory framework.

Wireless service revenues reached EUR 707m in the first quarter, showing a similar year-on-year decline of 3.4%, excluding the impact from mobile termination rate cuts in the last quarter of 2013. This year-on-year performance is completely in line with our expectations and the guidance given to the market.

Telefónica Deutschland Group is taking advantage from its value-for-money approach to premium LTE services and increased commercial activity. In line with our expectations, the resulting OIBDA margin in the first quarter of 2014 showed a moderate year-on-year decline of 1.8 percentage points to reach 20.9%.

In terms of investments, the LTE network rollout continued to be the main priority for Telefónica Deutschland in the first quarter of 2014, balancing investments from other areas. As expected, Capital Expenditures were lower year-on-year due to a different investment planning, and also taking into account the envisaged integration with E-Plus. CapEx totalled EUR 132m in the quarter, a decline of 9.3% year-on-year.

Significant events
Issue of a 7-year bond (Bond II)
On February 10, 2014, 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 O_2 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. O_2 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 have been 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 of 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 contribution with a subscription right of the shareholders, as well as the 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 the 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.

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 cash contribution 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 and March 24, 2014, Telefónica, S.A. shall acquire from KPN a share of 4.4% of Telefónica Deutschland for EUR 1.3bn. Furthermore, a call option agreement shall be 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 General Meeting approved the transaction with a large majority on October 2, 2013. Regarding the approval of the capital measures for the E-Plus transaction by the General Meeting of Telefónica Deutschland we refer to the previous item.

As of March 31, 2014 the execution of the transaction still required the approval of the competent authorities as well as further standard closing conditions. The completion of the transaction is expected in mid 2014.

Conclusion of contract to expand the wireline cooperation

In May 2013, Telefónica Deutschland Group via Telefónica Germany GmbH & Co. OHG concluded with Deutsche Telekom GmbH a "Memorandum of Understanding" to expand their wireline cooperation. This comprises the future intensified usage of the high-speed infrastructure of Telekom Deutschland GmbH by Telefónica Deutschland Group for its wireline products. Within the scope of this cooperation, Telefónica Deutschland Group will be able to implement the transition from the independent ADSL infrastructure through a sustainable NGA platform. In the future, Telefónica Deutschland Group intends to increasingly use VDSL and vectoring wholesale products provided by Telekom Deutschland GmbH. The transition should be fully completed in 2019. A binding agreement for the wireline cooperation with 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 (Bundesnetzagentur – BNetzA) has approved the cooperation in its preliminary draft decision in December 2013. The preliminary draft decision was publicly discussed at national level and with the European Commission. In its response from March 13, 2014, the European Commission did not express serious doubts. Consequently, the Federal Network Agency published its final decision on March 18, 2014 and confirmed its draft judgement from December 2013. With this decision the agreement concluded in December came into effect on March 18, 2014.

The cooperation is not subject to the approval of anti-trust authorities, however, is investigated with regard to general legal competition matters by the Federal Cartel Office. The result and decision with respect to this investigation is expected by the end of June 2014 at the latest. The decision has no impact on the commencement of the cooperation. If the Federal Cartel Office questions the cooperation in the agreed form, renegotiations will be necessary.

The performance of the business is further detailed in the following sections.

2.2.1 Results of operation

2.2.1.1 Revenues

In the first quarter of 2014 total revenues of EUR 1,122m were achieved. This corresponds to a reduction of EUR 108m or 8.8% in comparison to the prior year period. The decline in wireless business revenues is in particular due to lower handset revenues as well as a change in customer behaviour for wireless telephony services. The reduction of mobile termination rates (MTR) impacts the decline in revenues to a lower extent. Without the reduction in the MTR the decrease in total revenues in comparison to the prior year

2 — Consolidated Income Statement

	January 1 to March 31			
(Euros in millions)	**2014**	2013	Change	% Change
Revenues	1,122	1,230	(108)	(8.8)
Other income	21	16	5	32.3
Operating expenses	(909)	(967)	59	(6.1)
Supplies	(427)	(502)	74	(14.8)
Personnel expenses	(108)	(105)	(3)	2.8
Other expenses	(373)	(361)	(13)	3.5
Operating income before dereciation and amortization (OIBDA)	**234**	**278**	**(44)**	**(15.8)**
OIBDA margin	**20.9%**	**22.6%**		**(1.8%)-p.**
Depreciation and amortization	(267)	(280)	13	(4.7)
Operating income	**(33)**	**(2)**	**(31)**	**1,673.9**
Net financial income (expense)	(8)	(11)	3	(31.5)
Profit before tax for the period from continuing operations	**(40)**	**(13)**	**(27)**	**213.2**
Income tax	0	0	(0)	(22.3)
Profit for the period from continuing operations	**(40)**	**(13)**	**(27)**	**213.5**
Total profit for the period	**(40)**	**(13)**	**(27)**	**213.5**

period would have been slightly lower with 8.7%. In the wireline business lower revenues were realized as a result of a reduced DSL customer base. Revenues continued to be positively influenced by strong growth in the wireless data business.

Wireless business revenues

Wireless business revenues, comprising revenues from wireless communications services and hardware, amounted to EUR 827m in the first quarter of financial year 2014. This corresponds to a decrease by EUR 86m in comparison to the prior year period or 9.5%.

The wireless service revenues are largely generated by base fees and the fees levied for voice, short message, and wireless data services as well as the revenues from service contracts. Alongside roaming revenues, wireless service revenues include access and interconnection fees that were paid for by other service providers for calls and SMS delivered via our network.

In the first quarter of the financial year 2014 wireless service revenues amounted to EUR 707m and decreased compared to the previous year by EUR 27m or 3.6%. Adjusted for the impact of the MTR reduction, a lower decrease of 3.4% would have been recorded, which would represent a stabilization of the revenues decline compared to the previous quarter. With EUR 12.1, the average revenue per customer (ARPU) was lower than prior year's level (2013: EUR 12.5). On the one hand this is due to the demanding market and competitive environment, which led to decreasing revenues for voice telephony. On the other hand, the change in costumer behavior led to a lower number of text messages sent and received. Our constantly growing customer base in the valuable postpaid segment (plus 1.6% in comparison to the first quarter of 2013) had a positive effect as well as increasingly in the prepaid segment with a noted strong demand for data services (e.g. wireless internet, service applications and other data content). The successful continuation of the monetization of the data business was reflected in the growth in data revenues without SMS, which grew by 12.1% in the first quarter of the financial year 2014 and whose share of total data revenues reached 72.0% (2013: 63.4%). Our integrated portfolio of wireless service products is as a result of this development aligned with the growing importance of data tariffs.

Handset revenues reached EUR 120m in the first quarter of the financial year 2014 and decreased by EUR 60m or 33.2% compared to the prior year period. This is on the one hand due to special offers (e.g. 50% discount on selected mobile devices) and on the other hand due to lower sales volumes for mobile devices. Handset revenues include the income from the sale of mobile devices as part of the "O_2 My Handy" model as well as cash sales. In addition handset revenues include components from the wireless communications business such as activation fees (mainly postpaid), hardware for bundled products from prepaid SIM cards and mobile phone hardware or postpaid contracts as well as accessories.

Wireline business revenues

In the first quarter of the financial year 2014 revenues of EUR 293m were achieved in the wireline and DSL businesses. This corresponds to a decrease by EUR 22m or 7.0% in comparison to the prior year period. Good demand for our "O_2 DSL All-in" tariffs as well as the continuing positive customer development in the VDSL business partially offset the reduction in the customer base and the overall intensely competitive market conditions. Wireline revenues comprise mainly revenues from the DSL service business, revenues from the wireline business, activation fees from the DSL business as well as the sale of DSL hardware. Furthermore, they contain revenues from the DSL service business with large customers and from termination rates paid by other telecommunications companies.

3 —Breakdown of revenues

	January 1 to March 31			
(Euros in millions)	2014	2013	Change	% Change
Wireless business	**827**	**914**	**(86)**	**(9.5)**
Wireless service revenues	707	733	(27)	(3.6)
Handset revenues	120	180	(60)	(33.2)
Wireline business	**293**	**315**	**(22)**	**(7.0)**
Other revenues	**2**	**1**	**1**	**64.9**
Revenues	**1,122**	**1,230**	**(108)**	**(8.8)**

Other revenues

Other revenues relate to new business such as advertising and financial services, e.g. the wireless specials service "O_2 More Local" or the mobile payment system "mpass". This position increased in the first quarter of the financial year 2014 in comparison to the prior year period by 64.9% to EUR 2m in revenues, in particular due to the increase in wireless marketing activities.

Profit or loss for the period

In the first quarter of the financial year 2014 an OIBDA of EUR 234m was achieved. This corresponds to a decline of EUR 44m or 15.8% in comparison to the prior year period, which reflects the development of revenues. The OIBDA margin decreased slightly compared to the prior year period by 1.8% to 20.9%. The increased contribution from the wireless data business as well as the continued focus on efficiency had positive a positive effect on the operating income.

Operating expenses, comprising supplies as well as personnel expenses and other expenses, could be reduced by EUR 59m or 6.1% to EUR 909m in the first quarter of financial year 2014. The savings can be seen primarily in supplies, whereby the increased spending in the commercial area, in particular for special offers for mobile hardware and customer retention measures, were able to be compensated.

Supplies mainly include interconnection costs, which arise when our customers are connected with other wireless communications networks. Furthermore, this amount reflects the costs for sold devices, in particular the sales as part of the "O_2 My Handy" model. In addition, these line items contain the expenses for leased lines and the unbundled local loops (ULL) access charges as well as the costs for the leasing of space for network installations. In the first quarter of the financial year 2014 supplies amounted to EUR 427m. This corresponds to a decrease by EUR 74m or 14.8% in comparison to the prior year period. Due to lower sales volume of mobile devices the corresponding hardware cost of sales decreased. As a result of the decrease in wireless service revenues access and interconnection costs declined.

Personnel expenses increased in the first quarter of financial year 2014 by EUR 3m or 2.8% to EUR 108m as a result of general salary and wage increases.

Other expenses include primarily commission paid to retailers, marketing costs, expenses for customer service and the outsourcing of administrative tasks, expenses for hardware and the maintenance of the IT infrastructure, leasing expenses for facilities and space as well as energy costs. In the first quarter of the financial year 2014, other expenses amounted to EUR 373m, which corresponds to an increase of EUR 13m or 3.5% in comparison to the first quarter of the financial year 2013. The increase is due to higher costs for customer acquisition and customer retention measures.

Depreciation and amortization decreased in the reporting period in comparison to the prior year to EUR 267m (4.7%). This is due to already fully written off assets (mainly software). (For further information see details regarding the intangible assets and property, plant and equipment in section 2.2.3 Net assets).

In comparison to the prior year period the operating income declined by EUR 31m to EUR –33m (2013: EUR –2m).

The net financial income (expense) was EUR –8m (2013: EUR –11m) for the first three months of financial year 2014.

Telefónica Deutschland Group did not report material income tax expenses in the current three months reporting period nor in the comparative period.

As a result of the above mentioned effects, a loss from continuing operations of EUR 40m is recorded for the first three months of financial year 2014, a decrease by EUR 27m compared to the respective prior year figure.

2.2.2 Financial position

2.2.2.1 Finance analysis

4 — Net financial debt

(Euros in millions)	As of March 31 2014	As of December 31 2013	Change	% Change
Cash and cash equivalents	1,186	709	477	67.4
A Liquidity	**1,186**	**709**	**477**	**67.4**
B Current financial assets (2)	**99**	**188**	**(89)**	**(47.2)**
Current interest-bearing debt	7	102	(96)	(93.6)
Other current liabilities	1	2	(0)	(11.8)
C Current financial debt	**8**	**104**	**(96)**	**(92.3)**
D=C-A-B Current net financial debt	**(1,277)**	**(793)**	**(484)**	**61.0**
E Non-current financial assets	**57**	**83**	**(27)**	**(32.1)**
Non-current interest-bearing debt	1,813	1,343	471	35.1
Other non-current payables	1	1	(0)	(25.1)
F Non-current financial debt	**1,814**	**1,344**	**470**	**35.0**
G=F-E Non-current net financial debt	**1,758**	**1,261**	**497**	**39.4**
H=D+G Net financial debt[1]	**481**	**468**	**13**	**2.8**

1 Net financial debt includes all current and non-current interest-bearing financial assets and interest-bearing financial liabilities. Net financial debt is calculated as follows: non-current interest-bearing debt (EUR 1,813,396k in 2014 and EUR 1,342,584k in 2013) + non-current finance lease payables (EUR 1,004k in 2014 and EUR 1,340k in 2013) + current interest-bearing debt (EUR 6,547k in 2014 and EUR 102,059k in 2013) + current finance lease payables (EUR 1,454k in 2014 and EUR 1,649k in 2013) minus the non-current “O_2 My Handy” receivables (EUR 56,507k in 2014 and EUR 83,209k in 2013), and since June 2013 the current portion of “O_2 My Handy” receivables (EUR 98,943k in 2014 and EUR 188,013k in 2013) minus loan to third parties included in other current financial assets (EUR 504k in 2014 and EUR 458k in 2013) and minus cash and cash equivalents (EUR 1,185,937k in 2014 and EUR 708,545k in 2013).
Note: The current portion of “O_2 My Handy” receivables is shown under trade and other receivables in the Consolidated Statement of Financial Position and the non-current portion of “O_2 My Handy” receivables is shown under other non-current financial assets in the Consolidated Statement of Financial Position.

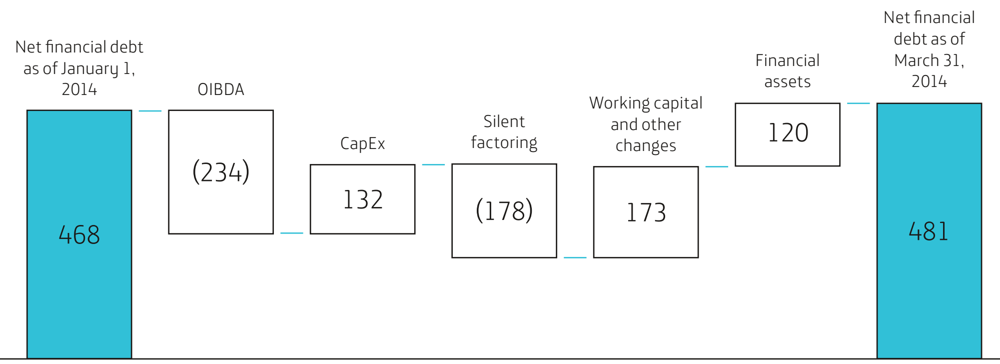
Net financial debt

The table shows the development of the net financial debt – i.e. loans minus cash and cash equivalents, financial assets and receivables. Net financial debt increased by EUR 13m to EUR 481m compared to December 31, 2013, resulting in a leverage ration of 0.4x.

In the first three months of 2014 net financial debt was impacted by the issue of a bond with a nominal value of EUR 500m in February 2014, which is reflected in the higher balance of cash and cash equivalents as of March 31, 2014. Additionally, a partial repayment of EUR 125m of a loan, which Telefónica Germany GmbH & Co. OHG concluded with Telfisa Global B. V. as lender, had a reducing effect on net financial debt.

The following chart illustrates the development of net financial debt in the first three months of the financial year 2014.

5 — Development of net financial debt (Euros in millions)



2.2.2.2 Liquidity analysis

6 — Consolidated Statement of Cash Flows

	January 1 to March 31	
(Euros in millions)	2014	2013
Cash and cash equivalents at the beginning of the period	**709**	**324**
Cash flow from operating activities from continuing operations	281	278
Cash flow from operating activities	**281**	**278**
Cash flow from investing activities from continuing operations	(174)	(172)
Cash flow from investing activities	**(174)**	**(172)**
Cash flow from financing activities from continuing operations	370	(1)
Cash flow from financing activities	**370**	**(1)**
Net increase/(decrease) in cash and cash equivalents	**477**	**104**
Cash and cash equivalents at the end of the period	**1.186**	**428**

Consolidated Statement of Cash Flows
The following is an analysis of Telefónica Deutschland Group's liquidity development for the first three months of the financial years 2014 and 2013. Total cash flows from operating, investing and financing activities comprise the respective cash flows from continuing operations.

Cash flow from operating activities
Cash flow from operating activities from continuing operations for the first three months of 2014 was EUR 281m and thus almost reached the level of the previous period (EUR 278m). The decrease in OIBDA could be compensated by a higher contribution from silent factoring transactions.

Cash flow from investing activities
Cash flow from investing activities from continuing operations amounted to EUR 174m in the first three months of 2014. Compared to March 31, 2013, the cash outflow increased by EUR 2m (2013: EUR 172m).

Capital expenditures (CapEx)[1] in the first three months of 2014 totaled EUR 132m (2013: EUR 146m). This corresponds to a decrease of 9,3%. The purpose of the investments is to ensure our future growth by expanding our LTE network (4G technology) and 3G capacities.

Cash flow from financing activities
Cash flow from financing activities from continuing operations amounted to EUR 370m in the first three months of 2014. The cash inflow rose by EUR 371m compared to the prior year period (2013: EUR –1m). The cash inflow from financing activities is mainly due to the bond issued in February 2014. This was offset mainly by cash outflows from the partial repayment of EUR 125m of the loan with an initial volume of EUR 1,250m, which Telefónica Germany GmbH & Co. OHG concluded with Telfisa Global B. V. as lender.

Cash and cash equivalents
As a result of the cash inflows/outflows described above, cash and cash equivalents amounted to EUR 1,186m as of March 31, 2014 to EUR 709m as of December 31, 2013 and to EUR 428m as of March 31, 2013, respectively.

1 The additions to property, plant and equipment and intangible assets (EUR 132m; 2013: EUR 146m) plus the change in liabilities for investments made (EUR 3m; 2013: EUR 21m) plus the change in reserves for investments (CapEx accruals: EUR 32m; 2013: EUR –2m) and plus changes in the liabilities from finance leases (EUR 0m; 2013: EUR 1m) result in the investment expenditure of EUR 167m (2013: EUR 166m) as of March 31, 2014.

7 — Reconciliation of cash flow and OIBDA minus CapEx

	January 1 to March 31			
(Euros in millions)	2014	2013	Change	% Change
OIBDA	**234**	**278**	**(44)**	**(15.9)**
– CapEx	(132)	(146)	14	(9.3)
= Operating cash flow (OpCF)	**102**	**133**	**(31)**	**(23.0)**
+ Silent Factoring[1]	178	129	49	37.5
+/– Other working capital movements	(161)	(146)	(15)	10.0
Change in working capital	**17**	**(17)**	**34**	**(201.9)**
+/– Gains (losses) from sale of companies, fixed assets and other effects	(0)	–	(0)	100
+/– Proceeds from sale of companies, fixed assets and other effects	1	–	1	100
+ Net interest payments	(4)	(4)	(1)	15.3
+ Payment on financial investments	(8)	(7)	(1)	17.4
= Free cash flow pre dividends from continuing operations[2]	**107**	**105**	**2**	**1.8**
= Free cash flow post dividends from continuing operations	**107**	**105**	**2**	**1.8**
= Total free cash flow post dividends	**107**	**105**	**2**	**1.8**

1 Full impact (YTD) of silent factoring in the three month period in 2014 of EUR 178m and EUR 219m in 2013 (transactions have been executed in January and March 2014 respectively in March, June and September 2013).
2 Free cash flow pre dividends from continuing operations is defined as the sum of cash flow from operating activities from continuing operations and cash flow from investing activities from continuing operations.

Free cash flow

Free cash flow pre dividends from continuing operations increased by EUR 2m and amounted to EUR 107m in the first three months of 2014. The operating cash flow (OpCF) reached EUR 102m and thus decreased by 23.0% compared to the first three months of 2013. The conversion of operating cash flow into free cash flow is the result of a positive change in working capital, which increased from EUR –17m in 2013 to EUR 17m in 2014. This is mainly due to two silent factoring transactions in the first three months of 2014 compared to one transaction in the prior year period.

2.2.3 Net assets

The following asset and capital structure analysis compares the existing assets and liabilities as of March 31, 2014 with the balances as of December 31, 2013.

As of March 31, 2014 the Group reported assets amounting to EUR 9,417m (2013: EUR 9,021m). This corresponds to an increase of 4.4%.

8 — Consolidated Statement of Financial Position

(Euros in millions)	As of March 31 **2014**	As of December 31 2013	Change	% Change
Goodwill and intangible assets	3,506	3,590	(84)	(2.9)
Property, plant and equipment	2,847	2,896	(48)	(1.7)
Trade and other receivables	1,104	1,035	69	6.7
Deferred tax assets	584	584	–	–
Other assets	189	209	(19)	(9.3)
Cash and cash equivalents	1,186	709	477	67.4
Total assets = Total equity and liabilities	**9,417**	**9,021**	**395**	**4.4**
Interest-bearing debt	1,820	1,445	375	26.0
Provisions	115	108	7	6.2
Trade and other payables	1,349	1,300	48	3.7
Deferred income	177	170	7	4.4
Equity	**5,956**	**5,999**	**(43)**	**(0.7)**

Intangible assets
Intangible assets including goodwill amounted to EUR 3,506m as of March 31, 2014. The decrease compared to the year end is EUR 84m and is mainly due to the amortization of intangible assets with a finite useful life. The amount of amortization was EUR 114m. On the other hand there were additions of EUR 30m (mainly additions to software of EUR 19m).

Property, plant and equipment
Property, plant and equipment amount to EUR 2,847m as of March 31, 2014. Hence, a decrease of 1.7% or EUR 48m is reported compared to year end. Additions to property, plant and equipment amounted to EUR 102m in the reporting period. These related mainly to investments for the transition to the 4G technology (LTE network), the expansion of the 3G technology capacities, improvement of performance as well as coverage of the wireless networks. The impact of the additions is offset by depreciation of EUR 153m.

Trade and other receivables
Trade and other reiceivables remained stable and with EUR 1,104m as of March 31, 2014 were slightly above the balance of EUR 1,035m as of December 31, 2013.

Other assets
Other assets decreased by 9.3% or EUR 19m compared to December 31, 2013 and amounted to EUR 189m as of March 31, 2014. The primary reason were lower non-current receivables by EUR 27m under the "O_2 My Handy" model, which decreased due to the use of silent factoring to EUR 57m as of March 31, 2014. Other assets comprise inventories and other financial assets.

Cash and cash equivalents
Cash and cash equivalents totaled EUR 1,186m as of March 31, 2014 (December 31, 2013: EUR 709m). The increase by 67.4% or EUR 477m is attributable to several effects. (For further information please refer to section 2.2.2.2 Liquidity analysis).

Interest-bearing debt
Interest-bearing debt increased from EUR 1,445m as of December 31, 2013 by EUR 375m to EUR 1,820m. The increase resulted in particular from the issue of a bond in February 2014 by O_2 Telefónica Deutschland Finanzierungs GmbH with a nominal value of EUR 500m. Telefónica Germany GmbH & Co. OHG repaid EUR 125m with respect to the loan agreement of September 12, 2012 with the financing entity Telfisa Global B. V. as lender.

Provisions
Compared to December 31, 2013, provisions increased by 6.2% or EUR 7m to EUR 115m. The increase is mainly attributable to the increase of pension provisions from EUR 5m to EUR 9m and the increase of provisions for dismantling and removal of assets from EUR 80m to EUR 83m.

Trade and other payables
Trade and other payables amounted to EUR 1,349m as of March 31, 2014. This corresponds to an increase of 3.7% or EUR 48m compared to December 31, 2013 (EUR 1,300m). The increase results from a rise of trade payables by EUR 62m to EUR 1,136m. Other payables decreased from EUR 222m as of December 31, 2013 to EUR 208m as of March 31, 2014.

Deferred income
Deferred income increased in comparison to December 31, 2013 by 4.4% or EUR 7m and amounted to EUR 177m as of March 31, 2014. This line item relates essentially to advance payments received on prepaid contracts amounting to EUR 103m.

Equity
As of March 31, 2014 equity decreased by 0.7% or EUR 43m to EUR 5,956m. The change in equity is primarly attributable to the loss after tax of EUR 40m and the remeasurement of defined benefit plans of EUR –3m.

3. Events after the Reporting Period_

Invitation to the Annual General Meeting
On April 9, 2014 the Management Board of Telefónica Deutschland called the Annual General Meeting. It is scheduled to take place on May 20, 2014. In addition to the discharge of the members of the Management Board and the members of the Supervisory Board as well as the appointment of the auditor for Telefónica Deutschland Holding AG and the Group for the financial year 2014, a resolution is proposed on dividend distribution of EUR 0.47 for each share which is entitled to dividends, in total EUR 524,964,338.00. Furthermore, an amendment of the Articles of Association in relation to the size of the Supervisory Board and the election of two further members of the Supervisory Board are proposed under agenda items 6 and 7.

In addition, it is intended as a precautionary measure to adopt a resolution (again) upon the increase of the share capital against cash contribution with shareholders‘ subscription rights by up to EUR 3.7bn in connection with the acquisition of E-Plus (hereinafter “Cash Capital Increase”) as well as related amendment of the Articles of Association. By this, it would be potentially possible to exercise the Cash Capital Increase beyond the validity period of respective positive resolution adopted by the extraordinary General Meeting on February 11, 2014 under agenda item 1, thus beyond August 10, 2014.

Contract to expand wireline cooperation
Effectively May 1, 2014 Telefónica Deutschland Group will increasingly utilize the high-speed infrastructure of Telekom Deutschland GmbH for its wireline products in connection with the binding agreement for the wireline cooperation signed on December 20, 2013, which came into effect as of March 18, 2014 – after clearance by the Federal Network Agency.

No other reportable events occurred in the period after the reporting date.

4. Risk and Opportunity Management_

As of the time of preparing this report, according to the assessment of our management, there are no material changes to the risks and opportunities presented in the Group Management Report for the financial year ended December 31, 2013, except for the change described below.

Wireline termination fees:
At the end of February 2014 a provisional decision by the Federal Network Agency was issued against Telefónica Germany GmbH & Co. OHG regarding the local FTR application from November 20, 2013 with a duration to November 30, 2014. As expected, the fee corresponds to the fee of Telekom Deutschland AG. Currently, the decisions against some other, alternative operators and the commercial implementation of the decision relating to the interconnection agreements with the respective network operator are outstanding; therefore, the economic effects of the decision can not be finally assessed.

Hence, there have been no relevant changes to the internally recorded risks and opportunities since the last Group Management Report as of December 31, 2013, except for the change relating to wireline termination fees.

5. Acquisition of E-Plus_

5.1 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 cash consideration 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 shall 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 and March 24, 2014, 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 shall be 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 Group would have served approximately 44 million aggregated mobile accesses[2] and recorded aggregated revenues of EUR 8.1bn (based on 2013 released revenues of Telefónica Deutschland Group and the E-Plus Group; prior to consolidation and homogenisation of accounting). In our view, the combination of Telefónica Deutschland Group 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.

5.2 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[3] as of December 31, 2013. Total revenue of the E-Plus Group amounted to EUR 3,197m[3] for 2013. EBITDA in the E-Plus Group amounted to EUR 963m[3] 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.

2 Aggregation of disclosed numbers for mobile customer accesses of the Telefónica Deutschland Group and the E-Plus Group as of December 31, 2013.
3 Press release E-Plus Mobilfunk GmbH & Co. KG from February 4, 2014.

5.3 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.

5.4 Estimated Synergy Effects

We estimate that the Transaction will realize significant synergy effects in the amount over EUR 5bn[4], 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 business 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.

5.5 Status of the Transaction

The Transaction was approved by the extraordinary General Meeting of KPN on October 2, 2013. The General Meeting of Telefónica Deutschland agreed to the capital measures concerning the transaction in February 11, 2014. 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 been filed at the end of October 2013. In December 2013, 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. The completion of the transaction is expected in mid-2014. The transaction requires the approval of the competent authorities and further standard closing conditions.

5.6 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 up 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

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.

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. In this case we would be obliged to pay KPN a break up fee. The business risks associated with the transaction are considered to be critical.

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 or which are only limited to the liability or warranty exemptions of the sales and purchase agreement. Additionally, different conclusions in view of interpretations of financial data might be caused by differently applied interpretations of accounting standards.

Due to the results provided for the purchase price adjustment according to the purchase price mechanism regulated in SPA with regard to the debt situation (working capital and net financial debt), it is not expected that purchase price will increase.

As of the time of publication of this report Telefónica Deutschland has no detailed information about risks of the E-Plus Group. Therefore, it is not possible to provide full information about risks of the future combined company.

5.7 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.

6. Outlook for Telefónica Deutschland Group_

6.1 Economic outlook for Germany until December 31, 2014

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 for 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 1.8%. Private consumption should remain an important driver considering continuing favorable general conditions for employment and income.

9 — GDP growth 2012–14 Germany and Euro area

In %	2012	2013	2014
Germany	0.7	0.4	**1.8**
Euro area	(0.7)	(0.4)	**1.0**

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

6.2 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 fixed network. The boom in smartphones and tablets as well as a growing demand for LTE are driving the growth in mobile data services. Thus the market for mobile internet will soon supersede mobile telephone calls as the most important driver of revenues for German mobile telecommunications service providers. At the same time the negative trend for mobile voice and SMS will continue through further price pressure and changed customer behavior.

The increasing demand for speed in wireless telecommunications and fixed networks with the strong demand for convergent solutions on the part of German consumers will similarly be a driver of growth.
(Source: Company data)

6.3 Expectations for Telefónica Deutschland Group

At the time of the publication of this interim report, the envisaged transaction with E-Plus is still subject to the closing of a number of conditions, in particular the merger control approval from the European Commission, which is expected within the second quarter of 2014. As such, the Company reiterates the fact that this transaction will likely change the scope of operations of Telefónica Deutschland from mid-2014 materially, and therefore we are, as yet, unable to provide an Outlook for the full year 2014.

After the first three months of operations in 2014, Telefónica Deutschland expects a continuation of trends seen in prior quarters in wireless service revenue for the first half of 2014, excluding the impact from mobile termination rate cuts. Moreover, the Company observes a significant increase in demand from existing and new customers for LTE enabled smartphones and associated tariffs, which is a tangible opportunity to enhance future trading performance in the Consumer and SME/Corporate segments thanks to its differential asset base.

The Company expects a limited year-on-year erosion of OIBDA margin in the first half of 2014, similar to the one seen in previous quarters (excluding capital gains), with potentially higher flexibility needed to accelerate commercial investments to capture additional opportunities. As such, OIBDA in the second quarter of 2014 (including potential one-off expenses related to the E-Plus transaction) is likely to be similar to the first quarter.

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 expects Capital Expenditures to show a moderate decline compared to the same period of the prior year (EUR 296m), owing to a different phasing of investments over the previous year, also taking into account the envisaged integration with E-Plus.

The Management Board of Telefónica Deutschland reiterates its intention to propose to the General Shareholders' Meeting to be held on the May 20, 2014 a cash dividend for the year ending on the December 31, 2013 of approximately EUR 525m, payable in 2014.

7. Material transactions with related parties_

For information on material transactions with related parties, please refer to the section “Related parties” in the Condensed Notes of the Interim Consolidated Financial Statements as March 31, 2014.

Munich, May 14, 2014

Telefónica Deutschland Holding AG

The Management Board

Rachel Empey

Markus Haas

Interim Consolidated Financial Statements_

for the period January 1 to March 31, 2014

Consolidated Statement of Financial Position_

Assets (Euros in thousands)	Note	**As of March 31 2014**	As of December 31 2013
A) Non-current assets		**7,011,825**	**7,167,703**
Goodwill		705,576	705,576
Intangible assets		2,800,655	2,884,200
Property, plant and equipment		2,847,425	2,895,617
Other non-current financial assets		74,646	98,787
Deferred tax assets		583,523	583,523
B) Current assets		**2,404,714**	**1,853,716**
Inventories		88,624	89,185
Trade and other receivables	[7]	1,104,165	1,035,234
Other current financial assets		25,987	20,751
Cash and cash equivalents		1,185,937	708,545
Total assets (A+B)		**9,416,539**	**9,021,419**

Equity and liabilities (Euros in thousands)	Note	**As of March 31 2014**	As of December 31 2013
A) Equity		**5,956,359**	**5,998,973**
Common stock		1,116,946	1,116,946
Additional paid-in capital		430	430
Retained earnings		4,837,301	4,879,914
Other components of equity		1,683	1,683
Equity attributable to owners of the parent		5,956,359	5,998,973
B) Non-current liabilities		**1,928,912**	**1,451,739**
Non-current interest-bearing debt	[7]	1,813,396	1,342,584
Other payables	[7]	4,288	4,809
Non-current provisions		111,227	104,346
C) Current liabilities		**1,531,268**	**1,570,707**
Current interest-bearing debt	[7]	6,547	102,059
Trade payables	[7]	1,136,260	1,074,038
Other payables	[7]	208,068	221,532
Current provisions		3,356	3,513
Deferred income	[7]	177,038	169,565
Total equity and liabilities (A+B+C)		**9,416,539**	**9,021,419**

Consolidated Income Statement_

(Euros in thousands)	Note	January 1 to March 31 2014	2013
Revenues	[8]	1,122,102	1,229,884
Other income	[8]	20,585	15,559
Supplies		(427,281)	(501,545)
Personnel expenses		(107,982)	(105,074)
Other expenses		(373,278)	(360,582)
Operating income before depreciation and amortization (OIBDA)		**234,145**	**278,242**
Depreciation and amortization		(266,861)	(280,086)
Operating income		**(32,716)**	**(1,844)**
Finance income		1,896	2,724
Exchange gains		130	126
Finance costs		(9,520)	(13,669)
Exchange losses		(48)	(192)
Net financial income (expense)	**[8]**	**(7,543)**	**(11,010)**
Profit before tax from continuing operations		**(40,258)**	**(12,854)**
Income tax		14	18
Profit for the period from continuing operations		**(40,244)**	**(12,836)**
Total profit for the period		**(40,244)**	**(12,836)**
Profit for the period attributable to owners of the parent		**(40,244)**	**(12,836)**
Profit for the period		**(40,244)**	**(12,836)**
Earnings per share			
Basic earnings per share in EUR		**(0.04)**	**(0.01)**
Diluted earnings per share in EUR		**(0.04)**	**(0.01)**

Consolidated Statement of Comprehensive Income_

		January 1 to March 31	
(Euros in thousands)	Note	2014	2013
Profit for the period		**(40,244)**	**(12,836)**
Other comprehensive income (loss)			
Items that may be reclassified subsequently to profit or loss		**–**	**–**
Gains/(losses) on measurement of available-for-sale investments		–	–
Income tax impact		–	–
Items that will not be reclassified to profit or loss		**(2,777)**	**–**
Remeasurement of defined benefit plans		(2,777)	–
Income tax impact		–	–
Total other comprehensive income (loss)		**(2,777)**	**–**
Total comprehensive income		**(43,022)**	**(12,836)**
Total comprehensive income for the period attributable to owners of the parent		(43,022)	(12,836)
Total comprehensive income		**(43,022)**	**(12,836)**

Consolidated Statement of Changes in Equity_

(Euros in thousands)	Common stock	Additional paid-in capital	Retained earnings	Other components of equity: Available-for-sale investments	Equity attributable to owners of the parent	Total equity
Financial position as of January 1, 2013	**1,116,946**	**430**	**5,309,936**	**1,481**	**6,428,793**	**6,428,793**
Profit for the period	–	–	(12,836)	–	(12,836)	(12,836)
Total comprehensive income	**–**	**–**	**(12,836)**	**–**	**(12,836)**	**(12,836)**
Other movements	–	–	–	–	–	–
Financial position as of March 31, 2013	**1,116,946**	**430**	**5,297,100**	**1,481**	**6,415,957**	**6,415,957**
Financial position as of January 1, 2014	**1,116,946**	**430**	**4,879,914**	**1,683**	**5,998,973**	**5,998,973**
Profit for the period	–	–	(40,244)	–	(40,244)	(40,244)
Other comprehensive income (loss)	–	–	(2,777)	–	(2,777)	(2,777)
Total comprehensive income	**–**	**–**	**(43,022)**	**–**	**(43,022)**	**(43,022)**
Other movements	–	–	408	–	408	408
Financial position as of March 31, 2014	**1,116,946**	**430**	**4,837,301**	**1,683**	**5,956,359**	**5,956,359**

Consolidated Statement of Cash Flows_

	January 1 to March 31	
(Euros in thousands)	**2014**	2013
Cash flow from operating activities		
Profit for the period	**(40,244)**	**(12,836)**
Adjustments to profit		
Net financial result	7,543	10,944
Gains on disposal of assets	(325)	–
Net income tax expense	(14)	(18)
Depreciation and amortization	266,861	280,086
Change in working capital		
Trade and other receivables	23,892	(33,831)
Inventories	560	(26,991)
Other current assets	32	(7,366)
Trade and other payables	(6,881)	41,186
Other current liabilities and provisions	7,723	7,877
Other non-current assets and liabilities	26,531	22,293
Interest received	1,790	2,402
Interest paid	(6,115)	(6,155)
Total cash flow from operating activities	**281,353**	**277,591**
Cash flow from investing activities		
Proceeds on disposals of property, plant and equipment and intangible assets	533	–
Payments on investments in property, plant and equipment and intangible assets	(166,662)	(165,525)
Payments made on financial investments not included under cash equivalents	(7,950)	(6,771)
Total cash flow from investing activities	**(174,079)**	**(172,296)**
Cash flow from financing activities		
Payments made on future capital increase	(2,471)	–
Proceeds from borrowing/debt	498,120	–
Repayment of borrowing/debt	(125,531)	(1,117)
Total cash flow from financing activities	**370,118**	**(1,117)**
Net increase (decrease) in cash and cash equivalents	**477,392**	**104,178**
Cash and cash equivalents at the beginning of the period	**708,545**	**323,666**
Cash and cash equivalents at the end of the period	**1,185,937**	**427,845**

Condensed Notes_
For the period January 1 to March 31, 2014

1. Reporting entity

The Condensed Interim Consolidated Financial Statements (hereinafter "Interim Consolidated Financial Statements") of Telefónica Deutschland Holding AG have been prepared for the period January 1 to March 31, 2014 and comprise Telefónica Deutschland Holding AG (hereinafter "Telefónica Deutschland") as well as its subsidiaries and joint operations (together referred to as "Telefónica Deutschland Group" or „group").

Telefónica Deutschland Holding AG 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) is DE000A1J5RX9. As of March 31, 2014, 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 (Telefónica Germany Holdings Limited). Each non-par share in general grants one vote at the General Meeting.

The share capital of Telefónica Deutschland Holding AG as of March 31, 2014 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 by up to a total of EUR 558,472,700 by issuing new no-par-value registered shares against cash or contribution in kind (authorized capital 2012/I).

Furthermore, the share capital of Telefónica Deutschland Holding AG – as resolved by the extraordinary General Meeting on February 11, 2014 – is conditionally increased by up to EUR 558,472,700 by issuing of up to 558,472,700 new registered no-par value shares (conditional capital 2014/I).

In the extraordinary General Meeting held on February 11, 2014 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 with a subscription right of the shareholders, as well as the 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).

For further information, please refer to Note 2, Significant events and transactions of the period.

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

Telefónica Deutschland Group is one of three integrated network operators in Germany having both a wireline and a wireless network. It offers its consumer retail and business customers postpaid and prepaid wireless communications products, along with wireless data services using Global Packet Radio Service (GPRS), Universal Mobile Telecommunications System (UMTS) and Long Term Evolution (LTE) technology as well as Digital Subscriber Line (DSL) wireline telephony and high-speed internet services.

Telefónica Deutschland Group markets its products under a multi-brand strategy and offers the majority of its wireless and wireline communications products as well as services via the core brand O_2.

With secondary and partner brands and via wholesale channels Telefónica Deutschland Group reaches further groups of customers to whom the core brand O_2 does not appeal. The secondary brands include the brands Fonic and netzclub, which are fully controlled, as well as brands from joint operations and strategic partnerships such as, for example, TCHIBO mobil. The Group also markets high-speed DSL internet access and wireline telephony. The multi-brand approach enables the Group to address a broad spectrum of customers and to maximize the sales range through customized product offers, sales and marketing.

As part of the wholesale business, Telefónica Deutschland Group offers wireless communications, wireline and added value services for customers such as 1&1, mobilcom/debitel, Drillisch, and wireline providers. In the wireline area the Group makes a range of so called “Unbundled Local Loop services” (ULL), including wireline telephony and high-speed internet, available to the wholesale partners. Furthermore, added value services such as e.g. billing services or the management of telephone numbers and SIP accounts are offered. This comprehensive portfolio enables the wholesale partners to independently service their end-customers and at the same time provides the Group the opportunity to increase its range and to achieve economies of scale.

2. Significant events and transactions of the period

a) Issue of a 7-year bond (Bond II)
On February 10, 2014, 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 O_2 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. O_2 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.

b) 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 have been 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.

c) 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 with a subscription right of the shareholders, as well as the 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 the 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.

d) 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 and March 24, 2014, 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.

Regarding the approval of the capital measures for the E-Plus transaction by the General Meeting of Telefónica Deutschland we refer to item c).

As of March 31, 2014 the execution of the transaction still required the approval of the competent author-ities as well as further standard closing conditions. The completion of the transaction is expected in mid-2014.

e) Conclusion of contract to expand the wireline cooperation

In May 2013, Telefónica Deutschland Group via Telefónica Germany GmbH&Co. OHG concluded with Deutsche Telekom GmbH a "Memorandum of Understanding" to expand their wireline cooperation. This comprises the future intensified usage of the high-speed infrastructure of Telekom Deutschland GmbH by Telefónica Deutschland Group for its wireline products. Within the scope of this cooperation, Telefónica Deutschland Group will be able to implement the transition from the independent ADSL infrastructure through a sustainable NGA platform. In the future, Telefónica Deutschland intends to increasingly use VDSL and vectoring wholesale products provided by Telekom Deutschland GmbH. The transition should be fully completed in 2019. A binding agreement for the wireline cooperation with 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 (Bundesnetzagentur – BNetzA) and the Federal Cartel Office. The Federal Network Agency has approved the cooperation in its preliminary draft decision from December 2013. The preliminary draft decision was publicly reviewed at national level and consulted with the European Commission. In its response from March 13, 2014, the European Commission did not express serious doubts. Consequently, the Federal Network Agency published its final decision on March 18, 2014 and confirmed its preliminary draft decision from December 2013. With this decision the agreement came into effect on March 18, 2014.

The cooperation is not subject to the approval of anti-trust authorities, however, is investigated with regard to general legal competition matters by the Federal Cartel Office. The result and decision with respect to this investigation is expected by the end of June 2014 at the latest. The decision has no impact on the commencement of the cooperation. If the Federal Cartel Office questions the cooperation in the agreed form, renegotiations will be necessary.

For further information, please refer to Note 10, Events after the reporting period.

3. Basis of preparation of the Interim Consolidated Financial Statements

These Interim Consolidated Financial Statements have been prepared in accordance with International Accounting Standard (IAS) 34 Interim Financial Reporting. Accordingly, the Interim Consolidated Financial Statements do not contain all of the information and disclosures required for a complete set of consolidated financial statements and should thus be read in conjunction with the Consolidated Financial Statements for the year ended December 31, 2013. Therefore for further information, please refer to the Consolidated Financial Statements for the year ended December 31, 2013 (Note 2, Basis of Preparation).

These Interim Consolidated Financial Statements for the period ended March 31, 2014 are unaudited.

Unless otherwise stated, the figures in these Interim Consolidated Financial Statements are rounded and refer to thousands of Euros (EUR k). The figures in these Interim Consolidated Financial Statements have been rounded according to established commercial principles. Additions of the figures can thus lead to amounts that deviate from those shown in the tables.

In preparing these Interim Consolidated Financial Statements, the Management Board had to make certain judgments, estimates, and assumptions related to both the application of accounting policies and the reported amounts of the company's assets, liabilities, income and expenses. A significant change in the facts and circumstances on which these estimates and assumptions and the respective judgments are based could have a material impact on Telefónica Deutschland Group's net assets, financial position and results of operations.

The material assumptions made by the management in applying Telefónica Deutschland Group's accounting policies and main causes of estimation uncertainty during the preparation of these Interim Consolidated Financial Statements were the same as those assumptions and causes of estimation uncertainty in the Consolidated Financial Statements for the year ended December 31, 2013 with the exception of the changes described below in Note 4, Accounting Policies.

For further information, please refer to the Consolidated Financial Statements for the year ended December 31, 2013 (Note 3, Accounting Policies).

4. Accounting policies

Starting January 1, 2014, Telefónica Deutschland Group applied the changes of IAS 32, Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities as well as amendments to IAS 36, Recoverable Amount Disclosures for Non-Financial Assets. These standards and amendmends were required to be adopted for financial years beginning on or after January 1, 2014.

These and additional standards and amendments which had to be adopted by January 1, 2014 had no or no material effect on the net assets, financial position and results of operations of the Group.

Accounting pronouncements announced by the publication date of the Interim Consolidated Financial Statements, which had not yet to be adopted are described below:

Standards and amendments		Mandatory adoption for financial years beginning on or after
Amendments to IAS 19	Defined benefit plans: Employee contributions	July 1, 2014*
Annual improvements to IFRSs 2010–2012 Cycle	Amendments to IAS 16, IAS 24, IAS 38, IFRS 2, IFRS 3, IFRS 8 and IFRS 13	July 1, 2014*
Annual improvements to 2011–2013 Cycle	Amendments to IAS 40, IFRS 1, IFRS 3 and IFRS 13	July 1, 2014*
IFRS 14	Regulatory deferral accounts	January 1, 2016*
IFRS 9 and amendments to IFRS 7	Financial instruments	January 1, 2018**

Interpretations		Mandatory adoption for financial years beginning on or after
IFRIC 21	Levies	January 1, 2014*

* Endorsement by EU still outstanding, information for first time adoption according to IASB.
** Expected first time adoption according to the IASB decision from February 2014.

For a comprehensive description of the new standards, amendments to standards and interpretations applicable for the Group, please refer to the disclosures in the Consolidated Financial Statements for the year ended December 31, 2013 (Note 3, Accounting Policies). An assessment is provided there on the estimated impact to the net assets, financial position and results of operations of the Group, which is still valid for the Interim Consolidated Financial Statements for the period ended March 31, 2014.

5. Comparative information

The Consolidated Statement of Financial Position presented in these Interim Consolidated Financial Statements compares figures as of March 31, 2014 and December 31, 2013. The Consolidated Income Statement and the Consolidated Statement of Comprehensive Income compare figures for the three-month periods ended March 31, 2014 and March 31, 2013. The Consolidated Statement of Cash Flows and the Consolidated Statement Changes in Equity compare figures for the three-month periods ended March 31, 2014 and March 31, 2013.

To date, the development of the results has not shown any indication that the business is subject to significant seasonal fluctuations.

6. Related parties

There have been no material changes in the nature and amount of Telefónica Deutschland Group's transactions with related parties as of March 31, 2014 compared to those reported as of December 31, 2013. For further details please refer to the Consolidated Financial Statements for the year ended December 31, 2013 (Note 24, Related Parties).

7. Selected explanatory notes to the Consolidated Statement of Financial Position

a) Trade and other receivables

The breakdown of this item of the Consolidated Statement of Financial Position is as follows:

(Euros in thousands)	**As of March 31 2014**	As of December 31 2013
Receivables from sales and services	943,749	968,993
Receivables from related parties	13,723	26,632
Other receivables	5,135	11,701
Prepayments	258,485	146,280
Provisions for bad debts	(116,928)	(118,371)
Total trade and other receivables	**1,104,165**	**1,035,234**

b) Trade payables, other payables and deferred income

Trade payables, other payables and deferred income comprise the following:

(Euros in thousands)	As of March 31 2014 Non-current	As of March 31 2014 Current	As of December 31 2013 Non-current	As of December 31 2013 Current
Trade payables against third parties	–	362,089	–	450,511
Accruals	–	557,946	–	403,569
Payables to related parties	–	216,226	–	219,958
Trade payables	**–**	**1,136,260**	**–**	**1,074,038**
Other payables	**4,288**	**208,068**	**4,809**	**221,532**
Deferred income	**–**	**177,038**	**–**	**169,565**

Accruals as part of trade payables mainly relate to outstanding invoices for goods and services. Current other payables include primarily liabilities for outstanding invoices for fixed assets and personnel related liabilities.

Deferred income mainly relates to advance payments received on prepaid contracts.

c) Non-current and current interest-bearing debt

Non-current interest-bearing debt includes the bonds, which were issued by Telefónica Deutschland Group with a nominal value of EUR 600,000k in November 2013 (please refer to the Consolidated Financial Statements for the year ended December 31, 2013, Note 1h, Reporting entity) and with a nominal value of EUR 500,000k in February 2014 (see Note 2, Significant events and transactions of the period). These bonds are accounted for by using the effective interest method after deduction of the disagio and incurred transaction costs.

In addition, a loan of EUR 1,250,000k is included, which was borrowed by Telefónica Germany GmbH & Co. OHG from Telfisa Global B.V. on September 12, 2012 (please refer to the Consolidated Financial Statements for the year ended December 31, 2013, Note 24, Related Parties). In 2013 a repayment of EUR 250.000k was made. Furthermore in 2013, EUR 150.000k and in 2014, EUR 125,000k were repaid prematurily due to obtaining financing through the bond. The remaining balance of EUR 725,000k as of March 31, 2014, is classified as non-current.

The current interest-bearing debt reflects the accrued interest for the non-current interest-bearing debt described above.

d) Valuation categories of financial assets and financial liabilities

In the following tables the fair values of all financial assets and financial liabilities of Telefónica Deutschland Group are disclosed in accordance with the valuation categories of IAS 39 considering the requirements of IFRS 13.

As of March 31, 2014 the carrying amounts of the financial assets and financial liabilities represent an appropriate approximation for their fair values (with the exception of the portion of the bond that is not hedged, see below).

For further information, please refer to the Consolidated Financial Statements for the year ended December 31, 2013 (Note 10, Financial Assets and Liabilities).

In addition, the tables show the categorization of the financial assets and liabilities in accordance with the importance of the input factors that were used for their respective valuation. For this purpose three levels or valuation hierarchies are defined:
— Level 1: Primary market value: Quoted prices (unadjusted) in active markets for identical assets and liabilities
— Level 2: Significant other observable input parameters: Inputs, either directly or indirectly observable, which are subject to certain limitations
— Level 3: Significant unobservable input parameters: All unobservable inputs which might include the entity's own data as a starting point and which should be adjusted, if reasonably available information indicates that other market participants would use different data.

	As of March 31, 2014									
	Financial assets									Non-financial assets
					Measurement hierachy					
(Euros in thousands)	Financial assets at fair value through profit or loss	Available-for-sale financial assets	Held-to-maturity assets	Loans and re-ceivables	Level 1 (Quoted prices)	Level 2 (Other directly observable market inputs)	Level 3 (Inputs not based on observable market data)	Total carrying amount	Total fair value	
Other non-current financial assets	–	6,273	–	68,373	–	6,273	–	74,646	74,646	–
Trade and other receivables (Note 7a)	–	–	–	840,545	–	–	–	840,545	840,545	263,621
Other current financial assets	–	–	–	25,987	–	–	–	25,987	25,987	–
Cash and cash equivalents	–	–	–	1,185,937	–	–	–	1,185,937	1,185,937	–
Total	**–**	**6,273**	**–**	**2,120,842**	**–**	**6,273**	**–**	**2,127,115**	**2,127,115**	**263,621**

	As of December 31, 2013									
	Financial assets									Non-financial assets
					Measurement hierachy					
(Euros in thousands)	Financial assets at fair value through profit or loss	Available-for-sale financial assets	Held-to-maturity assets	Loans and receivables	Level 1 (Quoted prices)	Level 2 (Other directly observable market inputs)	Level 3 (Inputs not based on observable market data)	Total carrying amount	Total fair value	
Other non-current financial assets	–	6,473	–	92,314	–	6,473	–	98,787	98,787	–
Trade and other receivables (Note 7a)	–	–	–	877,254	–	–	–	877,254	877,254	157,981
Other current financial assets	–	–	–	20,751	–	–	–	20,751	20,751	–
Cash and cash equivalents	–	–	–	708,545	–	–	–	708,545	708,545	–
Total	**–**	**6,473**	**–**	**1,698,864**	**–**	**6,473**	**–**	**1,705,337**	**1,705,337**	**157,981**

With respect to these financial assets there are no indications of circumstances that could have a negative impact on their value as at the respective reporting date.

The other non-current financial assets are classified as loans and receivables as well as available-for-sale financial assets in 2014 and 2013:

— The balance of these assets that are classified as loans and receivables essentially comprises the "O_2 My Handy" receivables as well as a deposit of EUR 11.6m (2013: EUR 8.9m). This deposit was pledged as collateral to cover the maximum risk from silent factoring to be borne by Telefónica Deutschland Group and the guarantee of the servicing of the receivables over the term of the sold receivables. Telefónica Deutschland Group receives a fixed interest for the deposit.

— The balance of these assets that are classified as available-for-sale financial assets comprises financial assets owned by Telefónica Deutschland Group to meet its pension obligations, but, in accordance with IAS 19, do not qualify as plan assets. The fair values recognized in level 2 are based on the values received from the insurance company, which are derived on the insurance company's internal calculation models.

Other current financial assets, which have been categorized as loans and receivables, mainly include security deposits for silent factoring amounting to EUR 25.5m (2013: EUR 20.3m).

The non-financial assets of trade and other receivables primarily relate to advance payments.

(Euros in thousands)	Financial liabilities at fair value through profit or loss	Financial liabilities at amortized costs	Finance leases	Financial liabilities held-to-maturity	Level 1 (Quoted prices)	Level 2 (Other directly observable market inputs)	Level 3 (Inputs not based on observable market data)	Total carrying amount	Total fair value	Non-financial liabilities
	As of March 31, 2014									
	Financial liabilities				Measurement hierachy					
Long-term loans (Note 7c)	345,737	1,467,659	–	–	–	345,737	–	1,813,396	1,814,480	–
Other non-current payables (Note 7b)	–	3,284	1,004	–	–	–	–	4,288	4,288	–
Short-term loans (Note 7c)	–	6,547	–	–	–	–	–	6,547	6,547	–
Trade payables (Note 7b)	–	1,136,260	–	–	–	–	–	1,136,260	1,136,260	–
Other current liabilities (Note 7b)	–	177,569	1,454	–	–	–	–	179,023	179,023	29,045
Total	**345,737**	**2,791,319**	**2,458**	**–**	**–**	**345,737**	**–**	**3,139,514**	**3,140,598**	**29,045**

(Euros in thousands)	Financial liabilities at fair value through profit or loss	Financial liabilities at amortized cost	Finance leases	Financial liabilities held-to-maturity	Level 1 (Quoted prices)	Level 2 (Other directly observable market inputs)	Level 3 (Inputs not based on observable market data)	Total carrying amount	Total fair value	Non-financial liabilities
	As of December 31, 2013									
	Financial liabilities				Measurement hierachy					
Long-term loans (Note 7c)	200,492	1,142,093	–	–	–	200,492	–	1,342,584	1,348,310	–
Other non-current payables (Note 7b)	–	3,469	1,340	–	–	–	–	4,809	4,809	–
Short-term loans (Note 7c)	–	102,059	–	–	–	–	–	102,059	102,059	–
Trade payables (Note 7b)	–	1,074,038	–	–	–	–	–	1,074,038	1,074,038	–
Other current liabilities (Note 7b)	–	195,986	1,649	–	–	–	–	197,635	197,635	23,897
Total	**200,492**	**2,517,645**	**2,989**	**–**	**–**	**200,492**	**–**	**2,721,126**	**2,726,851**	**23,897**

The long and short-term loans are primarily accounted for as financial liabilities at amortized cost (except for EUR 350m of the nominal value of the bonds).

A portion of the above-mentioned bonds (EUR 350m of the nominal value) together with an interest swap for each is subject to a fair value hedge and are therefore classified as financial liability at fair value through profit or loss.

In measuring the fair value of the swaps, all factors are included that market participants would consider, including the credit risks of the contract parties. The fair value of the interest swaps results from discounting the expected future payments over the remaining term of the contract using current market interest rates and yield curves.

The adjustments to the carrying amount of the financial liabilities result in a loss of EUR 3.3m, while the corresponding interest rate swaps result in a profit of EUR 3.9m. Thus, a net result, representing the ineffective part of the hedge relationship, in the amount of EUR 0.5m is recognized in the net financial result. Under the existing interest rate swaps, Telefónica Deutschland Group pays a variable quarterly interest rate amounting to the 3-month-Euribor and receives an average fixed interest rate of 0.927% and 1.268%, respectively. The hedged nominal value of the financial liabilities amount to EUR 350m. Hence, 19% (2013: 14%) of the bonds and debentures of the company were switched from fixed interest to variable interest. The fair value of the interest swaps used to hedge financial liabilities amount to EUR 1.3m and reduces the long-term loans.

The fair value of the bond is determined by discounting the expected future cash flows using currently applicable interest rates with comparable conditions and residual terms.

The non-financial liabilities of the other current liabilities mainly include other taxes and social security.

8. Selected explanatory notes to the Consolidated Income Statement

a) Revenues

The breakdown of revenues is as follows:

	January 1 to March 31	
(Euros in thousands)	**2014**	2013
Rendering of services	999,894	1,048,485
Other sales	122,207	181,399
Total revenues	**1,122,102**	**1,229,884**

Revenues from rendering of services include wireless service revenues as well as revenues from wireline business revenues. The other sales include handset revenues and other revenues.

None of Telefónica Deutschland Group's customers account for more than 10% of total revenue.

The breakdown of revenues by wireless and wireline business is provided in the following table:

	January 1 to March 31	
(Euros in thousands)	**2014**	2013
Revenues		
Wireless business	**827,081**	**913,504**
Wireless service revenues	706,618	733,164
Handset revenues	120,462	180,340
Wireline business	**293,276**	**315,322**
Other revenues	**1,745**	**1,058**
Total revenues	**1,122,102**	**1,229,884**

b) Other income

Other income comprises the following:

	January 1 to March 31	
(Euros in thousands)	**2014**	2013
Own work capitalized and ancillary income	20,053	15,559
Gains on disposal of assets	533	–
Other income	**20,585**	**15,559**

Own work capitalized mainly includes direct labor costs used as well as the allocable portion of indirect costs in connection with investments in non-current assets.

c) Net financial income (expense)

In the first three months of the current financial year the net financial income (expense) of Telefónica Deutschland Group amounted to minus EUR 7,543k (2013: minus EUR 11,010k).

The breakdown of the net financial income (expense) is as follows:

	January 1 to March 31	
(Euros in thousands)	**2014**	2013
Interest income from financial assets	1,896	2,724
Interest expenses from financial liabilities	(9,378)	(8,792)
Accretion of provisions and other liabilities	(142)	(4,877)
Other exchange gains (losses)	81	(66)
Net financial income (expense)	**(7,543)**	**(11,010)**

The interest income from financial assets mainly comprises the interest income in connection with “O_2 My Handy” receivables.

The interest expenses from financial liabilities mainly comprise the interest expenses for the loan granted from Telfisa Global B. V. in September 2012 and for the bonds issued in November 2013 and February 2014.

9. Contingent assets and liabilities

On October 16, 2013, the Federal Fiscal Court (Bundesfinanzhof) passed a judgment regarding the free-of-charge provision of wireless communication devices by intermediaries (reference XI R 39/12). With this, the device bonus, which is used by intermediaries to reduce prices and which is linked to transferring the IMEI number of the sold device (so-called IMEI provision), is considered to represent a fee from a third party for the supply of the wireless communication device. This interpretation results in the loss of the input tax deduction for these commission components for mobile telephone providers. The current Telefónica Deutschland Group standard sales model in any case deviates from the situation covered in the case law, as no IMEI commission is paid. Due to the complex and heterogeneous commission structure on the mobile telephone market, it is also not certain that this case law would have applied to Telefónica Deutschland Group for past situations; so it is not yet possible to quantify any theoretical effects on taxation. Furthermore, after industry discussions with the financial administration, Telefónica Deutschland Group is assuming that a transitional provision would apply in the event of the case law being published. It is deemed highly probable that the case law will have no negative impact on VAT for Telefónica Deutschland Group.

Telefónica Deutschland Group is, as part of its ordinary business, involved in various proceedings both in court and out-of-court. Possible effects are of minor significance for the net assets, financial position and results of operations.

10. Events after the reporting period

Invitation to the annual General Meeting
On April 9, 2014, the Management Board of Telefónica Deutschland called the annual General Meeting. It is scheduled to take place on May 20, 2014. In addition to the discharge of the members of the Management Board and the members of the Supervisory Board as well as the appointment of the auditor for the Group and Telefónica Deutschland Holding AG for the financial year 2014, a resolution is proposed for the dividend distribution of EUR 0.47 for each share entitled to dividends, in total EUR 524,964,338.00. Furthermore, an amendment of the Articles of Association in relation to the size of the Supervisory Board and the election of two further members of the Supervisory Board are proposed under agenda items 6 and 7.

In addition, it is intended as a precautionary measure to adopt a resolution (again) upon the increase of the share capital against cash contribution with shareholders‘ subscription rights by up to EUR 3.7bn in connection with the acquisition of E-Plus (hereinafter „Cash Capital Increase“) as well as the related amendment of the Articles of Association. Hereby the possibility is created to potentially implement the Cash Capital Increase beyond the implementation period, i. e. beyond August 10, 2014, according to the positive resolution adopted by the extraordinary General Meeting on February 11, 2014 under agenda item 1.

Conclusion of contract to expand wireline cooperation
Effective on May 1, 2014 Telefónica Deutschland Group will itensify usage of the high-speed infrastructure of Telekom Deutschland GmbH for its wireline products in connection with the binding agreement for the wireline cooperation signed on December 20, 2013, which came into effect as of March 18, 2014 – after clearance by the Federal Network Agency.

No other reportable events occurred in the period after the reporting date.

Munich, May 14, 2014

Telefónica Deutschland Holding AG

The Management Board

Rachel Empey

Markus Haas

Telefónica Deutschland Holding AG
Georg-Brauchle-Ring 23–25
80992 Munich
Germany
Phone: +49 89 2442 0
www.telefonica.de