Telefonica
Deutschland

# Interim Group Report_

for the Period from January 1 to September 30, 2014

# Portrait of Telefónica Deutschland_


**Thorsten Dirks (CEO), Rachel Empey (CFO), Markus Haas (COO) (from right to left)**

With more than 41 million[1] wireless connections, Telefónica Deutschland is the market leader among wireless providers in Germany. The company, which has also included the E-Plus Group since October 1, 2014, manages a total of 47 million[1] customer connections, making it one of the three leading integrated telecommunication providers on the German market. Revenues for the 2013 financial year amounted to 8 billion Euro[2].

Listed on the Frankfurt Stock Exchange since 2012, the company provides 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 providers.

Telefónica Deutschland is aiming to become Germany's leading digital telecommunications company. With the integration of the E-Plus Group, Telefónica Deutschland will systematically digitalize its business model while simultaneously providing customers and partners with optimal access to the digital world.

The company's high-profile core brands include $O_2$ and BASE. As part of its multi-brand strategy, Telefónica Deutschland also addresses additional customer groups through numerous secondary and partner brands, such as AY YILDIZ, blau.de, FONIC, netzclub, Ortel Mobile, simyo, TCHIBO mobil, and yourfone.de.

Thanks to its successful multi-brand strategy, the company is a leading provider of smartphone tariffs and products. Telefónica Deutschland sets new standards in the German telecommunications market with innovative and customer-friendly products.

Telefónica Deutschland is also a leading provider of wholesale services. Large multinational business customers can also make use of Telefónica's group-wide product and service offering.

The foundation for this is two wireless networks that are among the most advanced in Europe. As part of the merger with the E-Plus Group, the company is planning to combine the two existing networks to form an even more powerful shared wireless network. Since 2010, the company has also been expanding the new mobile communications standard LTE in Germany, which enables significantly faster mobile data transmission rates. The LTE network already covers almost 60 percent of the population. Since spring 2014, customers of the E-Plus Group have been able to use LTE in selected cities.

As an integrated operator, Telefónica Deutschland also offers wireline and DSL products. This includes high-speed VDSL access, which is provided through its long-term cooperation with Deutsche Telekom and covers almost 15 million German households.

Telefónica Deutschland aims to give people access to technology 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 around 2,400 projects in this field since 2010. As a socially responsible company, Telefónica Deutschland also seeks to shape wireless communication in Germany in a fair, environmentally sound and far-sighted manner.

1 As of December 31, 2013. Combined total for Telefónica Germany and the E-Plus Group
2 Combined pro forma total revenues of the independent Telefónica Deutschland and E-Plus Group as at December 31, 2013

# Acquisition of E-Plus Group completed_

## Telefónica Deutschland on the way to becoming the leading digital telecommunications company on the German market

The E-Plus Group has been part of Telefónica Deutschland Holding AG since October 1, 2014. The successful conclusion of the transaction paves the way for the creation of Germany's leading digital telecommunications company. The new Chief Executive Officer (CEO) was the existing CEO of E-Plus, Thorsten Dirks. He is joined on the Management Board by Markus Haas as Chief Operating Officer (COO) and Rachel Empey as Chief Financial and Strategy Officer (CFO).

"The merger of the two companies provides an unparalleled opportunity for us to systematically gear our business towards digitalization and generate unique added value for the company and its customers as a trailblazer within our competitive environment," commented CEO Thorsten Dirks. COO Markus Haas added: "Our focus is on the needs of our customers. We want to provide them with the best possible experience of our network, products and services from their perspective." CFO Rachel Empey commented on the advantages for shareholders: "The synergies generated from the merger of the two companies will also create added value for our shareholders. They will continue to benefit from an attractive dividend while Telefónica Deutschland retains its financial flexibility."

### The most wireless customers on the German market

The merger creates one of Germany's largest telecommunications providers, with 47 million customer connections and pro forma revenues of 8 billion Euro in the 2013 financial year. We are the market leader in terms of the number of wireless customers. The acquisition of the E-Plus Group will release synergies worth more than 5 billion Euro.

However, Telefónica Deutschland sees the transaction as more than just a merger for size's sake. The company is using the coming together of two strong partners as a unique opportunity to fundamentally change its business model through systematic digitalization. After all, the future of mobile communication is digital: customer behavior is rapidly shifting from conventional voice telephony to mobile data services.

Accordingly, the new Telefónica Deutschland has a clear vision: to create Germany's leading digital telecommunications company. Telefónica Deutschland is driving the process of digital change and providing all of its customers and partners with simple access to the digital world. Our basic mentality is still that of a challenger. Both companies have long been known for innovations that have established new trends on the market. This challenger mentality will remain one of the key factors in Telefónica Deutschland's success following the merger.

### Our principles: simplification and digitalization

Two overarching principles will guide us in this development process: simplification and digitalization. Telefónica Deutschland is using the merger as an opportunity to simplify its processes, structures and platforms considerably. We will also provide our customers with a clearly structured product portfolio and user-friendly, easily accessible services. We are also seeking to press ahead with digitalization rapidly and systematically. This will allow Telefónica Deutschland to meet its customers' needs in a targeted manner and permanently improve the user experience, as well as facilitating the establishment of streamlined, efficient platforms throughout the company's entire process chain.

### A clear strategy

Simplification and digitalization will make a major contribution in enabling Telefónica Deutschland to implement three core elements of its strategy that will decisively shape its development into the leading digital telecommunications company.

— **The best network experience**
Telefónica Deutschland wants to offer its customers the best network experience. We will ensure this by systematically focusing our network infrastructure on our customers' requirements. Customers should perceive our network quality as being at least as good as, if not better than, that of our competitors. This applies in particular to urban regions with a concentration of customers with particularly intensive data usage.

— **The best customer experience**
We have set ourselves the target of offering the best customer experience in all areas, from products, tariffs and devices through to services. The company will systematically focus its tariffs, hardware and services on its customers' needs, which it knows extremely well thanks to its digital business model. State-of-the-art devices and simple, comprehensible tariff structures make an important contribution to ensuring a positive customer experience and long-term customer satisfaction.

— **Cost leadership**
Telefónica Deutschland is striving to become the sustainable cost leader on the German market. The merger with E-Plus will allow the company to leverage considerable synergies and generate significant economies of scale in its operations. This applies to the network infrastructure as well as the sales organization, customer service and administration. The company's organization as a whole will remain streamlined and maintain its learned culture of cost discipline. Cost leadership will allow Telefónica Deutschland to offer its customers an excellent price-performance ratio across the board.

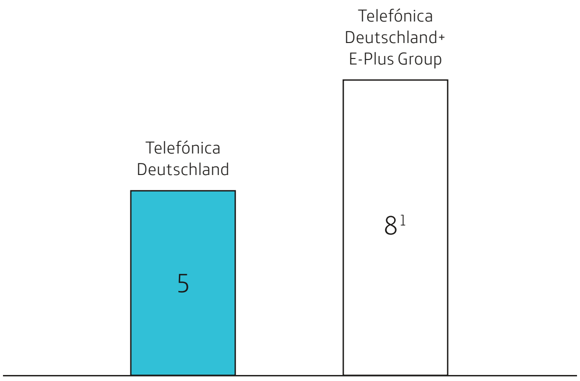
In implementing this strategy, Telefónica Deutschland is focusing on five factors for success: a coherent strategy for market leadership and sales, outstanding customer communications thanks to a detailed understanding of customer requirements, an even more high-performance network, a flexible IT architecture, and a clear challenger mentality within the competitive environment.

The basis for our economic success is the systematic monetisation of customers' growing data consumption accompanied by a streamlined organizational structure based on efficient processes and a high degree of digitalization. Telefónica Deutschland intends to sustainably improve its profitability and significantly increase its free cash flow between now and 2018, thereby laying the foundations for attractive dividend payments and long-term value for our shareholders.

**1 — Strong network infrastructure**
Population Coverage

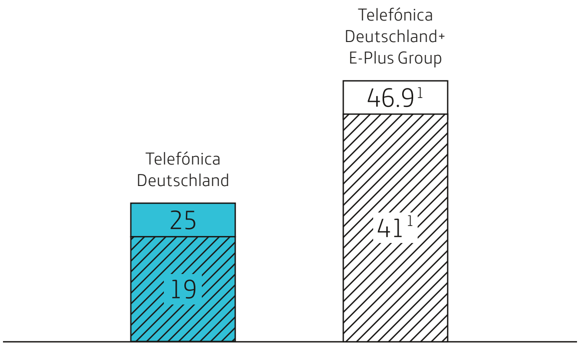
| Telefónica Deutschland | E-Plus Group |
|---|---|
| 2G > 99% | 2G – 99% |
| 3G > 76% | 3G > 92% |
| LTE-800 Roll-out – 60% | LTE-1800 – Roll-out |
| Total sites > 21.0 k | Total sites > 18.3 k |

**2 — Total revenue** (Euros in billions)
(FY 2013)




1 Combined total customer and revenue numbers based on pro-forma

**3 — Total accesses** (in millions)
(June 2014)




Mobile accesses

# 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) | 2014 | 2013 | % Change |
|---|---|---|---|
| | January 1 to September 30 | | |
| **Revenues** | 3,503 | **3,671** | **(4.6)** |
| Mobile service revenues | 2,189 | 2,246 | (2.6) |
| **Operating income before depreciation and amortization (OIBDA)** | 726 | **864** | **(16.0)** |
| OIBDA margin | 20.7% | 23.5% | (2.8%-p.) |
| **Operating income** | (53) | **22** | **>100** |
| **Profit for the period** | (79) | **(1)** | **>100** |
| **Basic earnings per share (in Euros)**[1] | (0.07) | **(0.00)** | **(0.1)** |
| **CapEx** | (411) | **(468)** | **(12.1)** |
| **Operating cash flow (OIBDA–CapEx)** | 315 | **396** | **(20.6)** |
| **Free cash flow pre dividends**[2] | 529 | **543** | **(2.7)** |
| | | | |
| **Total accesses (in thousands)** | 25,251 | **25,437** | **(0.7)** |
| Mobile accesses (in thousands) | 19,649 | 19,576 | 0.4 |
| **Postpaid (%)** | 54.3% | **52.7%** | **1.6%-p.** |
| | | | |
| **Total ARPU** | 12.4 | **12.7** | **(2.2)** |
| **Postpaid churn (%)** | 1.5% | **1.4%** | **0.1%-p.** |
| **(%) non-SMS data over total data revenues** | 72.8% | **65.5%** | **7.3%-p.** |
| **Employees** | 5,984 | **6,006** | **4.4** |

| | As of September 30 2014 | As of December 31 2013 | % Change |
|---|---|---|---|
| **Net financial debt**[3] | (3,096) | **468** | **>100** |
| Leverage[4] | (2.8x) | 0.4x | |
| **Adjusted net financial debt**[5] | 539 | **468** | **15.3** |
| **Adjusted leverage**[6] | 0.5x | **0.4x** | |

1 Basic earnings per share are calculated by dividing profit (loss) after taxes for the period by the weighted average number of ordinary shares of 1,166m for the nine month period 2014 and 1,117m for the nine month period 2013.
2 Free cash flow pre dividends is defined as the sum of cash flow from operating activities and cash flow from investing activities.
3 Net financial debt includes 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 1.588m in 2014 and EUR 1.343m in 2013) + non-current finance lease payables (EUR 44m in 2014 and EUR 1m in 2013) + current interest-bearing debt (EUR 243m in 2014 and EUR 102m in 2013) + current finance lease payables (EUR 15m in 2014 and EUR 2m in 2013) minus the non-current "$O_2$ My Handy" receivables (EUR 96m in 2014 and EUR 83m in 2013) and since June 2013 the current portion of "$O_2$ My Handy" receivables (EUR 149m in 2014 and EUR 188m in 2013) minus loans to third parties included in other current financial assets (EUR 1m in 2014 and EUR 0m in 2013) and minus cash and cash equivalents (EUR 4.741m in 2014 and EUR 709m 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 1.099m in 2014; EUR 1.237m in 2013) excluding non-recurring factors.
5 Adjusted net financial debt is defined as net financial debt excluding restricted cash on an escrow account amounting to EUR 3,636m.
6 Adjusted leverage is defined as adjusted net financial debt divided by LTM (Last Twelve Months) OIBDA (EUR 1.099m in 2014; EUR 1.237m in 2013) excluding non-recurring factors.

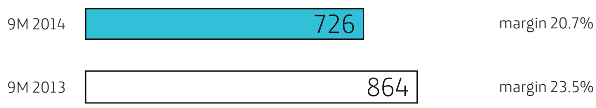
**Mobile Service Revenues**
(Euros in millions)

–2.6%


Non-SMS mobile data revenue remains the main driver for mobile service revenue, while trends in ARPU erosion per tariff renewal and SMS volume decline continued in the third quarter.

**OIBDA/OIBDA Margin**
(Euros in millions)

–16.0%




Decline of OIBDA and OIBDA margin mainly driven by the impact from lower revenues and higher commercial spend to drive trading performance as well as initial restructuring costs related with the acquisition of E-PLus Gruppe.

**Wireless Accesses**
(in thousands)

+0.4%


Increase of postpaid accesses by 3.3% year-on-year to 10.7 Million (54.3% share) compensates the decline of prepaid accesses.

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

+7.3%-p.

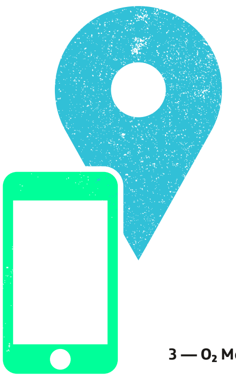

As a result of the successful execution of its data monetization strategy and the increasing demand for LTE, the share of non-SMS data revenues over total data revenues continued to increase.

# Highlights July–September 2014_

1 — iPhone 6 in $O_2$ Flagship-Store

## Wireless_

**1 — Successful launch of iPhone 6**
On September 19, Telefónica launched its sales of the new iPhone 6 and iPhone 6 Plus in Germany. Many $O_2$ stores opened their doors early in order to meet demand for the highly sought-after models. Because long lines formed in advance at some locations, a number of $O_2$ stores arranged competitions and entertainment to help customers pass the time. The $O_2$ flagship stores in Munich, Berlin and Cologne provided customers with free breakfast, while launch events were held at a further 14 stores. Premium hotline staff and $O_2$ gurus at 400 $O_2$ stores explained the new iOS 8 operating system to customers on request. $O_2$ is offering the new iPhones in attractive packages with a tariff or an $O_2$ My Handy payment plan.



3 — $O_2$ More Local

**3 — $O_2$ More Local: more than a million users**
More than a million customers are already using the location-based promotions from $O_2$ More Local. In mid-2013, Telefónica was the first network operator in Germany to introduce this free service, which provides registered customers with mobile, location-specific offers and interesting product information. Since then, more than 1,500 campaigns have been conducted with corporate clients from every industry, including Audi, Hugendubel, Starbucks and Süddeutsche Zeitung. Since September, $O_2$ More Local has also been offering weather-related promotions, meaning that registered customers receive not only location-based offers, but also promotions that are tailored to the current weather conditions. With this feature, Telefónica Deutschland is further expanding its position in the growth market of mobile advertising.

**2 — New $O_2$ prepaid tariffs**
In August, Telefónica introduced new $O_2$ prepaid tariffs in Germany that are particularly suitable for smartphone users. The tariffs allow customers to use mobile Internet without a contract while staying in full control of their costs. The unused monthly data volume can be rolled over to the next month. The new smartphone prepaid tariffs are available from entry-level packages to all-in offers for frequent users. Another new feature from $O_2$: since July, the Data Pack World has been even more affordable. This package allows customers to use a mobile data volume of up to 6 MB per day in countries outside Europe. Further improvements have also been made for young people and students: since September, all $O_2$ Blue All-in tariffs have given them twice as much data for mobile Internet as private customers.

**4 — The new $O_2$ Protect: improved security packages**
Security while surfing, whether on the computer or a mobile device, is becoming increasingly important for customers. In response to this, Telefónica Deutschland expanded its $O_2$ Protect security packages in September. Wireline customers can now secure not only their PC, but also their smartphones and tablets. Wireless customers can choose from three different security packages and have the option of protecting multiple devices if required. McAfee is the partner for mobile virus protection. The $O_2$ Protect app also allows customers to back up their data and locate their mobile device in case of theft or loss.

**4 — $O_2$ Protect**

## Wireline_

**5 — $O_2$ DSL All-in XL**

**5 — New wireline offer: high-speed surfing up to 100Mbit/s**
Since August, $O_2$ wireline customers have been surfing at speeds of up to 100Mbit/s with the $O_2$ DSL All-in XL tariff. The new VDSL package offers the fastest available download speeds and all the other benefits of a high-speed wireline connection. Data upload is also up to four times faster than with a comparable connection. Like all $O_2$ DSL All-in packages, the new XL offer also includes a flat rate for calls to all German networks. The $O_2$ DSL All-in XL package is based on an innovative VDSL connection using vectoring technology, which Telefónica Deutschland is providing as part of its network cooperation with Deutsche Telekom.

## Innovation_

**6 — Breakthrough in new VoLTE technology**
The technology for making telephone calls directly via Telefónica Deutschland's LTE network has been in place since July. This breakthrough was achieved by the company's network exports using "Voice over LTE" (VoLTE) technology. Previously, the new LTE network was only designed for high-speed data connections. Telephone calls had to be routed via the 2G or 3G wireless network as before. The new technology has made IP-based voice telephony over LTE possible for the first time. In future, this will significantly reduce call setup times and further improve sound quality – while high-speed data transfer continues in the background. This means an even better wireless experience for customers. However, the new technology will require several months of further testing before end customers get the chance to use VoLTE in practice.

**7 — $O_2$ Digital Workplace: digital solutions for business customers**

Since July, Telefónica has offered business customers in Germany an expanded range of digital workplace solutions. $O_2$ Digital Workplace now also incorporates the use of Microsoft Office 365 and cloud services for the shared editing and creation of content via Box. Customers can also use existing $O_2$ services such as mobile device management and the Digital Phone cloud telephone system. All of the products are easily scaled and include a comprehensive support package. With $O_2$ Digital Workplace, Telefónica offers business customers a complete mobile work package from a single source.

7 — $O_2$ Digital Workplace

**8 — $O_2$ Car Connection allows remote diagnostics for cars**

In September, Telefónica presented its latest digital product for networked cars in Germany: $O_2$ Car Connection allows customers to network their vehicle and control it using a smartphone app. Remote diagnostics are used to check the most important information – e.g. on the condition of the engine, battery voltage levels or if the vehicle needs to be taken to the shop – via smartphone. The vehicle finder helps if the car is stolen or the driver forgets where it is parked. The app can also be used to monitor driving behavior and fuel consumption. $O_2$ Car Connection consists of a plug-in module with a built-in GPS transmitter and is sold via $O_2$ Online and in-store.

9 — M2M World

**9 — New M2M solution for fleet management**

With Telefónica Fleet Monitor, the company has offered a new full-service solution for fleet management since September. The functions of the product include track/trace, geofencing, access control, driver identification and protection against theft. This allows companies from industries such as construction to efficiently manage their vehicle and machinery fleet. A networked box developed by the partner company Trackunit A/S and bearing the TÜV SÜD seal of quality is installed in the vehicles. Telefónica Fleet Monitor forms part of the Telefónica Group's global M2M partner program, in which the company cooperates with external companies in the area of Machine-to-Machine (M2M) solutions. 250 new partners from around the world came on board as technology specialists in the first six months of the year alone, including 30 German companies.

# Company_

**10 — Green light for E-Plus acquisition**

On August 29, 2014, Telefónica Deutschland received final approval from the European Commission for the acquisition of the E-Plus Group from the Dutch telecommunications group KPN. With this decision, the European Commission confirmed that the previously announced agreement between Telefónica Deutschland and Drillisch met the obligations for approval. On September 24, 2014, Telefónica Deutschland Holding AG also successfully concluded the cash capital increase for the partial financing of the acquisition of E-Plus as previously announced. The capital increase met with strong demand from investors, with the new shares enjoying a subscription ratio of 99.92%. The gross proceeds from the capital increase amounted to around 3.6 billion Euro. In addition, the capital increase against contribution in kind required to generate the 24.9% equity interest for KPN was entered in the Commercial Register on October 7, 2014, following a corresponding resolution by the Management Board and with the approval of the Supervisory Board. As a result, the new share capital of the company amounts to 2,974,554,993 Euro, divided into the same number of no-par value bearer shares. The acquisition of E-Plus was finalized effective October 1, 2014.

**10 — Final approval for acquisition of E-Plus Group**


**11 — #YouCanDo**

**11 — Successful #YouCanDo campaign**

The campaign launched in April to revitalize the core brand $O_2$ was a success with young target groups in particular: by mid-September, more than 1.6 million people had seen the first social biopic on the Internet, featuring the story of a customer's life as filmed by well-known director Christian Ditter. The short film depicted the events taking place in and around a wedding in Las Vegas and was also shown in cinemas and on TV. The second social biopic, which is being filmed by director Peter Thorwarth, was shown in cinemas in October. The films are the centerpiece of the #YouCanDo campaign, which encourages $O_2$ customers to fully utilize the available opportunities for digitalization.

**12 — $O_2$ offers workshops to customers throughout Germany**

In addition to receiving personalized advice, $O_2$ store customers have had the opportunity to participate in workshops since August. The aim of the free courses is to support customers in the digital world and provide assistance. Smartphone workshops teach interested parties about using their device and show them how to better harness the various features to meet their needs. Another workshop tells young people how to use social media safely. Each course is offered at three different levels in order to ensure that beginners and advanced users are supported equally. More than 50 workshops a month are offered at selected $O_2$ stores throughout Germany. With this offer, Telefónica Deutschland is expanding its $O_2$ guru concept, which is aimed at making it easier for customers to access the digital world.


**12 — $O_2$ Shop**

---

**13 — New accolades for $O_2$ and FONIC**

Telefónica products received further accolades in the third quarter: Readers of “Computer Bild” magazine voted $O_2$’s LTE as the best product in the high-speed tariff category. The $O_2$ tariff was also recognized as offering the best price-performance ratio. This confirms Telefónica Deutschland’s strategy of expanding its high-speed mobile communications network in a targeted manner where required. The $O_2$ Blue All-in L smartphone tariff was also singled out for praise, with the teltarif.de editorial team pronouncing it the best tariff for professional users for the fifth time in succession. The discount brand FONIC also received two accolades: in a product comparison by allnet-flat24.com, the FONIC All-Net Flat package was assessed “very good”, while FONIC was ranked second in the smartphone user category of news channel n-tv’s 2014 survey of wireless providers.

---

**14 — Telefónica Global Millennial Survey 2014**

**14 — Telefónica presents new survey on the millennial generation**

In September, Telefónica Deutschland presented the first results of its new global survey on the millennial generation. The survey, which Telefónica conducted globally for the first time in 2013, highlights the attitudes, desires and concerns of young adults who have grown up in the digital world. More than 6,000 young people in 18 countries were surveyed for the Telefónica Global Millennial Survey 2014. A focal point of the survey in Germany was the changes millennials have made to the world of work. Telefónica Deutschland presented the first results at ZEIT’s “Work & Society” conference. One of the main findings was that young adults work more autonomously and give equal weighting to their private and professional objectives. The full survey was published in October.

# Interim Group Management Report_ for the Period from January 1 to September 30, 2014

# Overview of the Period from January to September 2014_

— At the end of September 2014, Telefónica Deutschland customer accesses reached 25.3 million, almost stable year-on-year at –0.7% with the mobile access base standing at 19.6 million accesses (+0.4% year-on-year), whereas fixed accesses declined by 4.4% year-on-year to 5.6 million.

— Smartphone penetration improved by 4.2 percentage points year-on-year in the $O_2$ consumer postpaid segment to reach 74.1% at the end of September. As a result of the increasing demand for LTE both from new and existing customers, the share of LTE-enabled handsets continued to grow, representing 85.4% of total smartphones sold in the period.

— Retail fixed broadband accesses at the end of September stood at 2.2 million (–4.7% year-on-year). In the January to September 2014 period, 83 thousand net disconnections were registered, with an improving trend in the third quarter.

— Revenues totaled EUR 3,503m (–4.6% year-on-year) in the January to September 2014 period, further consolidating the improving year-on-year performance in the third quarter to –0.5% vs. –4.4% and –8.8% reported in the two preceding quarters.

— Mobile service revenues for the nine months period reached to EUR 2,189m, declining 2.4% year-on-year excluding the impacts from mobile termination rate cuts (–2.6% in reported terms). In the third quarter, mobile service revenues continued with their improving year-on-year performance being lower 1.3% excluding the impacts from mobile termination rate cuts (–2.5% and –3.4% in the second and the first quarter, respectively). Non-SMS mobile data revenue remained the main driver for mobile service revenue, while trends in ARPU erosion from tariff renewals and SMS volume decline continued in the third quarter.

— Handset revenues in the first nine months of 2014 declined by 7.9% year-on-year to reach EUR 444 million, with almost all handset sales made under the "$O_2$ My Handy" distribution model. The third quarter saw a significant increase of handset revenues (+22.1% year-on-year to EUR 180 million) following the launch of new devices and the company's strategy to offer attractive bundles with smartphone tariffs.

— Mobile data revenues totaled EUR 1,070m in the first nine months of 2014, lower 0.9% year-on-year, with a positive year-on-year development in the third quarter. Mobile data share of total mobile service revenues in the January to September 2014 period reached 48.9% (+0.8 percentage points year-on-year).

— Non-SMS data revenues amounted to EUR 778m in the first nine months of 2014, a year-on-year growth of 10.1%. As a result of the successful execution of its data monetization strategy, the company further grew the share of non-SMS data revenues over total data revenues to 72.8% (+7.3 percentage points year-on-year) for the nine months period.

— Operating Income before Depreciation and Amortization (OIBDA) reached EUR 726m in the first nine months of the year (a decline of 16.0% year-on-year). OIBDA margin in reported terms was down 2.8 percentage points year-on-year to stand at 20.7% for the nine months period. Excluding the impact from the initial restructuring costs related with the acquisition of the E-Plus Group (EUR 8m), the underlying OIBDA[1] performance in the third quarter (–15.1%) sustained the trends seen in prior quarters, with the underlying OIBDA margin standing at 20.3%, down 3.5 percentage points year-on-year. This is mainly influenced by the flow-through from revenues together with the increasing commercial spend to gain trading momentum in the market.

1 Underlying OIBDA is defined as OIBDA excluding restructuring expenses related to the E-Plus Integration.

— CapEx totaled EUR 411m for the first nine months of 2014, lower 12.1% year-on-year. This is reflecting the focused investments into LTE network deployment and a different year-on-year phasing of investments ahead of the E-Plus Group acquisition.

— Free Cash Flow pre dividends[2] (FCF) in the January to September period reached EUR 529m, a moderate decline from the 543 million Euro registered in 2013 due to lower OIBDA, partially offset by a positive working capital development from higher non-current deferred income from other advanced payments.

— Consolidated adjusted[3] net financial debt totaled EUR 539m compared to December 31, 2013 (EUR 468m), resulting in an adjusted leverage ratio[4] of 0.5 × compared to 0.4 × as of December 31, 2013.

— Telefónica Deutschland has completed the cash capital increase it announced on September 8, 2014 with gross proceeds of approximately EUR 3.6bn and a take-up of 99.92% equaling 1,116,068,883 rights. The new shares were offered in a ratio of 1:1 at a subscription price of EUR 3.24 per share and the take-up quota demonstrated strong investor support for the rights issue. The majority shareholder Telefónica S.A. exercised all of their respective rights. The new shares are included in the existing quotation for the company's listed bearer shares on the Frankfurt Stock Exchange since September 25, 2014.

2 Free cash flow pre dividends is defined as the sum of cash flow from operating activities and cash flow from investing activities.
3 Adjusted by the cash component of the consideration to be paid to KPN for the acquisition of E-Plus included within cash and cash equivalents of EUR 3,636m.
4 Adjusted Leverage is defined as Adjusted Net Financial Debt divided by last twelve months OIBDA excluding non-recurring factors.

# 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)892442-0; 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.

**Share Capital**

Following registration of the capital increases against cash and contribution in kind in the context of the acquisition of E-Plus (see further information in section 3 Events after the Reporting Period and section 5 Acquisition of E-Plus) the share capital amounts to EUR 2,974,554,993, divided into the same number of no-par value registered shares.

As of September 30, 2014 and following the registration of the cash capital increase in the context of the acquisition of E-Plus (see further information in section 5 Acquisition of E-Plus) on September 18, 2014 by which the share capital of EUR 1,116,945,400 was increased by EUR 1,116,945,400, the share capital amounted to EUR 2,233,890,800, divided into the same number of no-par value registered shares, each representing a notional amount of EUR 1.00 in the registered share capital.

Each non-par share in general grants one vote at the General Meeting.

**Authorized Capital**

As of September 30, 2014, the Authorized Capital of Telefónica Deutschland Holding AG allowed 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) and for a capital increase against contribution in kind by up to EUR 475,000,000 (Authorized Capital 2014/I).

For the capital increase against contribution in kind in the context of the acquisition of E-Plus (see further information in section 3 Events after the Reporting Period and section 5 Acquisition of E-Plus) the Management Board resolved on September 24, 2014 with approval of the Supervisory Board of the same day, to use the Authorized Capital 2014/I in full and the Authorized Capital 2012/I in the amount of EUR 265,664,193 in part (see further information in section 3 Events after the Reporting Period and section 5 Acquisition of E-Plus). Such capital increase against contribution in kind has been registered with the commercial register on October 7, 2014 under deletion of the Authorized Capital 2014/I and amendment of the Authorized Capital 2012/I.

Since this registration, Telefónica Deutschland Holding AG has an Authorized Capital 2012/I in the amount of EUR 292,808,507.

**Conditional Capital**

The share capital of Telefónica Deutschland Holding AG is conditionally increased by up to EUR 558,472,700 by issuing of up to 558,472,700 registered shares (Conditional Capital 2014/I).

**Group Structure**

Telefónica Deutschland Holding AG is the parent company of the Telefónica Deutschland Group. It is included in the condensed consolidated interim 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 September 30, 2014, the companies included in the Interim Consolidated Financial Statements of Telefónica Deutschland Group were organized as shown in the following organization chart.

On July 23, 2013, Telefónica Deutschland, 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 (see 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**

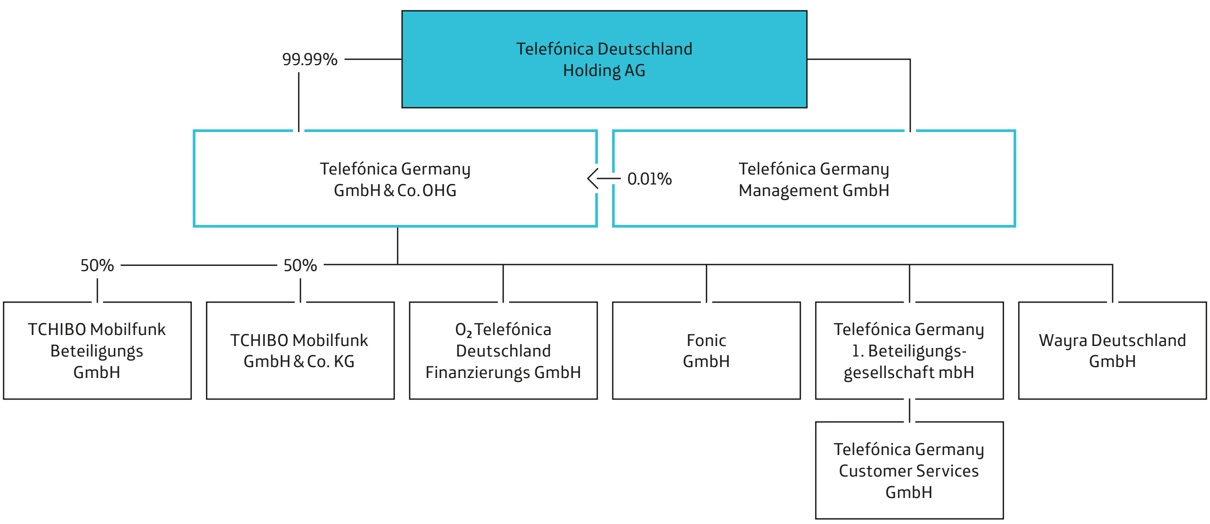
The members of the Management Board are appointed by the Supervisory Board for a maximum term of five years and may be re-appointed without limitation, in each case for a maximum of five years. The Supervisory Board may revoke the appointment of a Management Board member prior to the expiration of his 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.

At the reporting date of September 30, 2014, the Management Board of the company consisted of two members:

— Rachel Empey, CFO (Chief Financial Officer)
— Markus Haas, CSO (Chief Strategy Officer)

Since February 1, 2014, and up to the end of the reporting period, Rachel Empey and Markus Haas have jointly taken over the responsibilities of the CEO in addition to their responsibilities to date.

On July 2, 2014 the Supervisory Board of Telefónica Deutschland Holding AG resolved to nominate Thorsten Dirks as future chairperson of the management board/CEO and announced that Thorsten Dirks would start his office in context of closing of the acquisition of E-Plus by Telefónica Deutschland. The future Management Board consisting of Thorsten Dirks, Rachel Empey and Markus Haas would lead the company after closing of the acquisition. Markus Haas as COO will be in charge for joint operations and Rachel Empey as CFO will take responsibility for finance and strategy (see further information in section 3 Events after the Reporting Period).



**Supervisory Board**
Since the registration on September 18, 2014 of increase of the number of members of the Supervisory Board from twelve to 16 as resolved by the Annual General Meeting on May 20, 2014, and 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 (Mitbestimmungsgesetz), the Supervisory Board consists of 16 members, eight of which are shareholder representatives and eight of which are employee representatives.

The Annual General Meeting on May 20, 2014 elected for shareholder side Sally Anne Ashford and Antonio Manuel Ledesma Santiago as further members of the Supervisory Board of Telefónica Deutschland Holding AG. Their office started with the above-mentioned registration of the change of the Articles of Association.

Two further employee representatives of the supervisory board are in court election process (See further information in section 3 Events after the Reporting Period).

If the General Meeting does not set a shorter term at the election of shareholder representatives in the Supervisory Board, 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 current 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

As of September 30, 2014 Telefónica Deutschland Group is the third largest integrated network operator in Germany (based on 2013 reported revenues), with more than 25 million customer accesses. 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 approximately 76% with UMTS as of September 30, 2014. The expansion of our LTE network is in full swing we already have almost 60% 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. 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.

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 September 30, 2014 comprises already 74.1% 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 September 30, 2014, 22.2% 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. With the "$O_2$ My Handy" model we predominantly focus on the sale of smartphones with internet capability, which represents almost 98% of the mobile phones sold to our postpaid customers in the third quarter of the year of 2014. The share of LTE enabled smartphones for the same period amounted to approximately 88% of total smartphones sold. 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 entrylevel 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 Drillisch, Mobilcom/Debitel, United Internet (1&1) 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 entities (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 nationwide 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.

With the acquisition of the E-Plus Group, there will be further options to act in the market. The objectives and strategies of the enlarged company are described in more detail in section 1.2 Goals and Strategies.

## 1.2 Goals and Strategies

The merger of Telefónica Deutschland Group and the E-Plus Group with effect as of October 1, 2014 forms one of the leading telecommunication companies in the German market.

The new Telefónica Deutschland Group is already today market leader in the consumer segment in terms of mobile customer accesses. The aim of the enlarged company is to hold and further strengthen this position. The focus will be on customer retention via an improved network and overall customer experience as well a consistent monetization of growing data usage as well as future technologies such as LTE. In addition, we want to boost our market position with Small office/Home office (SoHo) and small and medium-size entities (SME) as well as making use of opportunities in the partner and wholesale segment. Overall, objectives and strategies of the combined company follow the overarching vision of **building the leading digital telecommunications company** in Germany.

**Building...**

Telefónica Deutschland Group considers the merger of both companies as a chance to build a new organization beyond realizing economies of scale. Rather, the acquisition allows to change fundamentally the business model and to actively shape the market.

Two overarching principles will govern the company's actions in this development process: simplification and digitalization. In the course of the merger, Telefónica Deutschland Group aims at radically simplifying processes, structures and platforms. Simple and flexible structures support in offering customers simple and custom-fit solutions, being able to react quickly and to be ahead of the competition. In addition, Telefónica Deutschland Group wants to offer a clearly structured product portfolio and easily accessible, user-friendly services.

With the strong challenger mind set inherited from the two companies, we continue striving for being a disruptive pacesetter in the industry. Both companies have an established reputation for innovation, and acted as trendsetters in the market. This included establishing multi-brand strategies or innovative tariff models as well as the launch and operation of brands for non-industry partners. This challenger mind set will remain a key factor for the success of Telefónica Deutschland Group after the merger.

**...the leading...**
The evolution towards the leading digital telecommunications company rests upon three core elements of our strategy. First, we want to offer our customers the best network experience where they need it. Second, we will turn customers into believers through an outstanding customer experience in all areas – from services, tariff plans and devices to customer support. Third, we strive for cost leadership to be able to make attractive offers at better value for money than our competition.

The company seeks to provide the best network experience by consistently aligning the network infrastructure to customer needs. From the customers' standpoint, the network quality must match or exceed that of the competition. This applies in particular to urban areas, which have the highest concentrations of customers with extensive data usage. Telefónica Deutschland Group will achieve this primarily through synergies resulting from the merger and smart investments in further network development. If the data usage patterns of customers change – e.g. if they consume higher data volumes – the company quickly reacts with a network capacity increase.

Attractive data services are the key element in providing the best customer experience. The tariffs, hardware and services that Telefónica Deutschland Group offers shall be designed along customer needs. In addition to the network experience, latest devices and simple, easy-to-understand tariff structures can be expected to be decisive factors in ensuring a positive customer experience and long-term customer satisfaction. From the very first contact with the company and throughout the customer relationship, customers shall experience outstanding service that is geared to their needs at all times.

The third core element of Telefónica Deutschland Group's strategy is sustained cost leadership. With the acquisition of E-Plus, the company aims at achieving synergies across-the-board and substantial economies of scale in its business operations. This applies to the network infrastructure as well as the sales organization, customer service, and administration. With an increasing shift of sales and service to digital channels, the costs for customer care are expected to also decrease over time. The company expects to manage the majority of customer contacts digitally within a few years. The overall organizational structure will remain lean, preserving the already engrained culture of cost discipline. Cost leadership will allow Telefónica Deutschland Group to offer consistently excellent value for money.

**...digital...**
The extended company will also use the unique opportunity of the merger to push ahead with the digitalization process faster and more decisively than the competition and thus to meet optimally evolving customer needs of future mobile communication. The digitalization shall bring about two significant advantages:

First, through digitalization, Telefónica Deutschland Group will increase its proximity to customers and their needs. With so many people using their smartphone as the hub of their digital lives, mobile communications providers can get closer to their customers than companies in almost any other sector. This supports the development of new and innovative offers that will differentiate Telefónica Deutschland Group from its competitors. Both merger parties have a strong track record as innovators, for example with mobile music and video streaming or with the world's first mobile communications partnership with the mobile communications service WhatsApp. Experience has shown: customers who experience the real benefits of these applications in their everyday lives will use them more and more over time. This results in increasing data volumes, from which Telefónica Deutschland Group will profit in the long term.

Moreover, digitalization allows establishing lean and efficient platforms along the entire process chain within the company. They shall rest upon simple, standardized structures and processes extending from the back end (service delivery) to the front end (the customer interface). This will enable Telefónica Deutschland Group to maintain cost leadership in the market and offer an excellent, individualized customer experience at attractive terms. For example, with regard to IT we want to establish state-of-the-art, flexible IT platforms. They shall be used by all three customer segments – B2C, B2B and B2P – as a joint "factory" with best-in-class operational stability, and may yield significant cost benefits. Moreover, they enable the company to develop and market new products and services within a short time. Another competitive advantage of the new IT infrastructure is the simple and efficient integration of partner brands.

As another example, the digitalization supports an in-depth understanding of customer needs. One aspect of Telefónica Deutschland Group's consistently digital business model will be a highly effective customer relationship management. The resulting insights benefit the company by enabling it to align offers closely with customer needs and to target its marketing activities more effectively. In addition, it enhances the information resources for key business decisions, e.g. investments in network infrastructure or location selection for points of sale.

**...telco**

We consider a high-quality network infrastructure as a key success factor in the future. After the merger of Telefónica Deutschland Group and E-Plus Group, the network will be developed in the coming years to provide optimal quality from a customer point of view combined with high efficiency. The core of the network infrastructure is an optimally scaled, high-performance mobile communications network. Telefónica Deutschland Group is convinced that – as many market studies indicate – the dynamic growth in the mobile utilization of data services will continue. In addition, the company offers further added value to customers if required through optional fixed network services.

The company is making intelligent investments in network development and is flexibly adapting network performance to future mass market requirements resulting, for example the ongoing national roll-out of LTE. For the operation and rollout of the network, Telefónica Deutschland Group will continue to use outsourcing partnerships to an appropriate extent to ensure a lean internal organization and underpin its cost leadership ambition. The company always maintains exactly the network structure required to meet current customer needs while offering the best network experience. In this way it achieves the objective of offering the best customer experience combined with attractive profitability.

With regard to brand management and sales, the company relies on a clear brand architecture and multi-channel sales mix designed according to customer needs. The brands shall address their respective target groups with clear and distinct performance claims. Through genuinely new products, innovative partnerships and a convincing value for money proposition, the brands will compete successfully to attract and retain customers. In marketing and sales, Telefónica Deutschland Group implements an optimized blend of digital and stationary channels. According to their preferences, customers can obtain information on products and tariff models, purchase devices, sign up for tariff plans or submit service queries online or in stores. All channels shall be closely interlinked so that customers can buy a smartphone or tablet online, for example, and then go to a store to pick it up and have it set up for them. New types of concept stores will strengthen the ties of customers to the brands. In marketing, the company uses all cross-media formats and channels, including innovative content platforms. Customers will also be able to access all customer care capabilities through online channels, which will be complemented by an appropriate store presence.

**Implementation of the strategic vision**

In order to succesfully implement the strategic vision in the required timeline, the company follows three strategic priorities momentum, integration and transformation ("**MIT**").

**Momentum**: the first priority remains a consequent focus on trading and customer interaction to successfully compete in the market place. Compared to the priorities in the stand-alone situation, the focus of the consumer segment in the combined company is increasingly avoiding churn rather than acquiring new customers.

**Integration**: in order to benefit from the new scale of the companies and achieve synergies as fast as possible, the internal integration begins already in the fourth quarter 2014 (see section 3 Events after the Reporting Period).

**Transformation**: simplification and digitalization initiatives as well as an evolution of the business model accompany integration and daily business, thus continously moving forward the evolution towards a digital telco.

# 2. Economic Report of the Period from January 1 to September 30, 2014_

## 2.1 Overall Economic and Sector-Specific Conditions

### 2.1.1 Economic environment

**Overall economic environment in Germany**

The German economy recorded stable development in 2013 with stronger economic growth than in other Euro countries. Real growth in German gross domestic product (GDP) amounted to 0.5% in 2013 considerably better than the negative growth of 0.3% throughout the European Union (EU) on average. After a strong first quarter and a more moderate second quarter 2014, economic growth in Germany stagnated in the third quarter 2014.
(Quelle: Economist Intelligence Unit, July 2014)

**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 strongly gain 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 113.6 million at the end of June 2013 to 116.6 million at the end of June 2014. 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 June 2013 from 141% to 145% at the end of June 2014. The customer growth in the second quarter 2014 is primarily attributed to the postpaid sector. Postpaid customers made up 49% of the total connections at the end of June 2014. At the end of the second quarter 2013 the proportion was still 48%.

The mobile telecommunications market was very dynamic in 2013 as well as in the nine months to September 2014 and characterized by intense competition, primarily driven by the strong demand for smartphones and the increasing number of smartphone tariffs. According to the industry association BITKOM, by May 2014 around 55% of all mobile phone owners aged 14 and older use a smartphone. At the same time, according to BITKOM, the number of tablets sold increased from 4.4 million in 2012 to around 8 million 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 until September 30, 2014. As of June 30, 2014, the Telefónica Deutschland Group held, with 19.4 million connections, a market share of 16.7%.
(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 3% and the customer base grew by the end of June 2014 to approximately 28.9 million. The proportion of DSL connections here is 81%.
(Source: Analysys Mason: Telecoms Market Matrix Western Europe Q2 2014, October 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.

**Decree of transparency by the Federal Network Agency**
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 now on the legal basis of section 45n of the Telecommunication Act 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 2014. The Federal Network Agency has revised the draft of the decree and maintains a dialogue with the industry. For its adoption, the decree requires the agreement with a number of federal ministries and the German Bundestag. It is expected that the decree will still come into effect in the year 2014. However, due to extended implementation deadlines, parts of the decree will only come into effect in the first half of the year 2015.

**Mobile Termination Rates (MTR)**
The mobile termination rates agreed by the Federal Network Agency concerning calls within the mobile network of the Telefónica Deutschland Group as well as of other mobile network provider expire at the end of November 2014. Telefónica Germany GmbH & Co. OHG submitted an application on April 28, 2014 to the Federal Network Agency concerning the authorization of new mobile termination rates for the consequent period following December 1, 2014. On September 3, 2014, the Federal Network Agency published its draft decision regarding preliminary MTR of 1.72 Euro-Cent per minute for the period from December 1, 2014 until November 30, 2015 and 1.66 Euro-Cent per minute for the period from December 1, 2015 until November 30, 2016. The rates are symmetric for all German network operators. The draft decision is currently submitted to public consultation and subject to an assessment of the EU Commission. An – at least preliminary – decision is expected not later than end of November 2014.

**Telekom Deutschland GmbH’s VDSL contingent model and 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 15 million 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 Group for its wireline products. As part of this cooperation, Telefónica Deutschland Group 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 Group 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. 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 opened an investigation concerning the cooperation with regard to general legal competition matters. A decision was made on November 5, 2014. As expected, the 7th decision division of the Federal Cartel Office determined that, due to current knowledge, no action is required by the decision division.

**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.

On July 25, 2014, the Federal Network Agency initiated a public consultation to all interested parties and has invited them to elaborate on their spectrum demand especially with regard to the new market structure and to update or notify by August 20, 2014 at the latest their expected spectrum demand in the bands of 700 MHz, 900 MHz, 1,800 MHz and 1.5 GHz as of 1 January, 2017 which Telefónica Deutschland Group has done in time. In temporal perspective, the Federal Network Agency has announced in the consultation that following the ongoing demand consultation it intends to define the further procedural steps for the spectrum allocation as provided for by law. Insofar, public consultations on the draft decisions of the President's Chamber under Sections 55(10), 61 of the Telecommunications Act on the order for and choice of spectrum allocation proceedings and on the rules for the allocation conditions and the auction rules should have been initiated in the third quarter of 2014 what, however, did not happen so far. Furthermore, it is intended to publish respective final decisions of the President's Chamber in the fourth quarter of 2014 and to commence with the spectrum allocation procedure still in the year 2014.

**"Digital Single Market" Initiative of the European Commission**

Under the catchphrase "digital single market", on September 11, 2013 the European 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 was commented upon by member states as well as businesses. It was also being discussed in European Parliament committees and those committees view the measures for the regulation of roaming, among other things, critically. Meanwhile the European Parliament has come to an agreement regarding its position and submitted the voting result to the European Council and the European Commission. On 23 September, 2014, the Italian Presidency of the European Council has submitted a compromise proposal with trimmed content and more detailed legal requirements. Due to the newly constituted EU Commission and its pending analysis of the submitted statements the completion of the legislative procedure is anticipated not before 2015.

## 2.2 Overview of the First Nine Months of the Year 2014

Telefónica Deutschland Group continued to execute its data monetization strategy in a market that has not seen significant changes of dynamics within the first nine months of operations in 2014. There is still a high level of competition around bundles of smartphone tariffs and devices with a clear focus on value maximization leveraging increased customers' demand for LTE. Following the launch of a unique new tariff model "$O_2$ Unite" for the business segment at the end of the first quarter and the refresh of the "$O_2$ Blue All-in" tariff portfolio for the consumer segment in April the company saw good commercial traction of these propositions in the market, increasing the share of gross additions from its core brand. 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' behavior from customers, adopting a more digital lifestyle and the current regulatory framework.

Mobile service revenues reached EUR 2,189m in the nine months period, declining 2.4% year-on-year ex MTR cut and 2.6% in reported terms. In the third quarter the company saw a further improvement of trends for mobile service revenues with a year-on-year decline of 1.3% ex MTR cuts compared with a decline of 2.5% in the second and 3.4% year-on-year in the first quarter, respectively.

Telefónica Deutschland Group is taking advantage from its value-for-money approach to premium LTE services and continued commercial investments to gain trading momentum in the market. Excluding the impact from the initial restructuring costs related with the acquisition of the E-Plus Group the resulting underlying OIBDA margin in the January to September period of 2014 showed a moderate year-on-year decline of 2.6 percentage points to reach 20.9% (–3.5 percentage points to 20.3% in the third quarter).

In terms of investments, the LTE network rollout continued to be the main priority for Telefónica Deutschland Group until September 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 acquisition of E-Plus. CapEx totaled EUR 411m, a decline of 12.1% year-on-year compared with the same period of 2013.

**Significant events**

Agreement on the acquisition of E-Plus and execution of the acquisition

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 approximately EUR 3.6bn in cash (cash consideration; subject to final price reduction) and newly issued shares.

The cash consideration to be paid to KPN was financed via a cash capital increase of Telefónica Deutschland (see section 5 Acquisition of E-Plus: Successful Cash Capital Increase).

The shares for issuance of further consideration to KPN are 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 (see section 3 Events after the Reporting Period and section 5 Acquisition of E-Plus: Capital Increase against Contribution in Kind).

Then Telefónica, S.A. acquires from KPN a share of 4.4% of the Telefónica Deutschland for EUR 1.3bn (see section 3 Events after the Reporting Period and section 5 Acquisition of E-Plus).

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 after the registration of the cash capital increase and the capital increase against contribution in kind 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%.

The closing of the transaction took place with effect as of October 1, 2014 (see section 3 Events after the Reporting Period and section 5 Acquisition of E-Plus).

Agreement on network access in view of the E-Plus acquisition

On June 25, 2014, Telefónica Deutschland Group signed an agreement with MS Mobile Services GmbH ("Drillisch"), a subsidiary of Drillisch AG, according to which Drillisch agreed to acquire, in addition to the capacity necessary to provide services to its existing customers already hosted on Telefónica Deutschland Group's or E-Plus' networks, 20% of the capacity of all mobile network capacity that is under the control of Telefónica Deutschland Group following the consummation of the acquisition of E-Plus Group. The 20% will be reached via a glide path mechanism over a period of five years. In addition, Drillisch shall have the right to acquire up to 10% additional capacity of those networks.

Telefónica Deutschland Group will grant Drillisch, via a Mobile Bitstream Access model, access to the future joint network of Telefónica Deutschland and E-Plus, as well as to the existing and future technology developments on that network, which Drillisch may offer to its customers.

The agreement has been entered into with a view to the decision by the European Commission in the merger control proceeding relating to the acquisition of E-Plus by Telefónica Deutschland (see section 5 Acquisition of E-Plus). By means of the agreement certain remedies shall be implemented, which Telefónica Deutschland offered during merger control proceedings in order to remove competition concerns of the European Commission.

The agreement with Drillisch became effective when the European Commission confirmed on August 29, 2014 that the agreement with Drillisch meets the conditions and obligations associated with the decision, as far as these have to be fulfilled before the closing of the transaction.

Change in the Management Board of Telefónica Deutschland

On January 31, 2014, René Schuster left in mutual agreement as chairperson of the Management Board (CEO). On January 29, 2014, the Supervisory Board of Telefónica Deutschland approved a respective termination agreement. Since February 1, 2014 until the end of the reporting period, 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 other responsibilities. Rachel Empey focused on the operative business and Markus Haas on the preparation for the E-Plus integration.

On July 2, 2014 the Supervisory Board of Telefónica Deutschland Holding AG resolved to nominate Thorsten Dirks as future chairperson of the Management Board/CEO. He will start his office in context of closing of the acquisition of E-Plus by Telefónica Deutschland. The Management Board will then consist of Thorsten Dirks, Rachel Empey and Markus Haas and lead the company after closing of the acquisition. Markus Haas as COO will be in charge for joint operations and Rachel Empey as CFO will take responsibility for finance and strategy (see section 3 Events after the Reporting Period).

Change in the Supervisory Board of Telefónica Deutschland

The Annual General Meeting on May 20, 2014 elected for shareholder side Sally Anne Ashford and Antonio Manuel Ledesma Santiago as further members of the Supervisory Board of Telefónica Deutschland Holding AG. Their office starts with the registration of the change of the articles of association on September 18, 2014, regarding the increase of the supervisory board from twelve to 16 members.

Two further employee representatives of the Supervisory Board are in court election process (see section 3 Events after the Reporting Period).

Decision of Federal Network Agency regarding return of frequencies of 900MHz and 1,800MHz

In the telecommunications law decision on the merger process of Telefónica Deutschland and E-Plus Mobilfunk GmbH & Co. KG on July 4, 2014, the President's Chamber of the Federal Network Agency has decided, in the event of the completion of the transaction, that Telefónica Deutschland Group and E-Plus Mobilfunk GmbH & Co. KG are obligated to return frequencies of 900MHz and 1,800MHz until December 31, 2015, for which they do not have an assignment at this time beyond the year 2016 (early return of 900/1,800MHz spectrum), and that the Federal Network Agency will examine in the context of an overall consideration, taking into account the future frequency equipment in the ranges of 900MHz and 1,800MHz if any action are required concerning the merger-related frequency spectrum, particularly in the area 2GHz (frequency distribution analysis). On August 4, 2014, Telefónica Deutschland Group filed a claim with the Administrative Court of Cologne (Verwaltungsgericht Köln) against the Federal Network Agency's decision of July 4, 2014, which has not been decided yet.

**General Meetings**

Extraordinary General Meeting

On February 11, 2014 an extraordinary General Meeting took place in which the following capital measures for the acquisition of E-Plus were approved:

— 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. The Authorized Capital 2014/I was registered on September 18, 2014 (for further information see section 1.1.1 Structure of Telefónica Deutschland Group and section 5 Acquisition of E-Plus).

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 (see also section 1.1.1 Structure of Telefónica Deutschland Group).

Annual General Meeting and dividend payment

On May 20, 2014, the second Annual General Meeting of Telefónica Deutschland Holding AG took place. In addition to the discharge of the members of the Supervisory Board and the members of the Management Board as well as the election of Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft with its registered office in Stuttgart, branch office Munich, as auditor for the Consolidated Financial Statements and Financial Statements of Telefónica Deutschland Holding AG for the financial year 2014, the General Meeting resolved to distribute a dividend of EUR 0.47 for each share entitled to dividends, in total EUR 524,964,338.

In addition, the increase of the share capital by up to EUR 3.7bn against cash contribution with a subscription right of the shareholders in connection with the acquisition of E-Plus (hereinafter „Cash Capital Increase“) as well as the related amendment of the Articles of Association was approved (see section 1.1.1 Structure of Telefónica Deutschland Group and section 5 Acquisition of E-Plus). Hereby the possibility is created to potentially implement the Cash Capital Increase beyond the implementation period of the resolution passed at the extraordinary General Meeting as of February 11, 2014 under agenda item 1, therefore beyond August 10, 2014.

Furthermore, it was resolved to increase the number of members of the Supervisory Board from twelve to 16 members and change the Articles of Association accordingly. The change of the Articles of Association was registered on September 18, 2014 in the commercial register. Subject to such registration of the change of the Articles of Association becoming effective, the General Meeting elected Sally Anne Ashford and Antonio Manuel Ledesma Santiago as members of the Supervisory Board of Telefónica Deutschland Holding AG).

### 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 7-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.

In this connection an interest rate swap was signed for a partial amount of EUR 150m of the bond’s nominal value. On the basis of the interest rate swap contract, Telefónica Deutschland Group pays a variable interest rate amounting to the 3-month Euribor on the nominal amount and receives a fixed interest rate of 1.268% on the same amount in return.

### Conclusion of contract to expand the wireline cooperation

In May 2013, Telefónica Deutschland Group via Telefónica Germany GmbH & Co. OHG concluded with Telekom Deutschland 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 (Bundeskartellamt – BKartA). The Federal Network Agency has approved the cooperation in its preliminary draft decision from 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 preliminary draft decision from December 2013. With this decision the agreement concluded in December with Telekom Deutschland GmbH came into effect on March 18, 2014.

The cooperation is not subject to the approval of antitrust authorities, however, was investigated with regard to general legal competition matters by the Federal Cartel Office. A decision was made on November 5, 2014. As expected, the 7th decision division of the Federal Cartel Office determined that, due to current knowledge, no action is required by the decision division. Effective on May 1, 2014, Telefónica Deutschland Group intensifies usage of the high-speed infrastructure of Telekom Deutschland GmbH for its wireline products in connection with the binding agreement.

### Proposal for the financial year 2014 dividend

On September 8, 2014 the management board of Telefónica Deutschland has resolved and published its intention to suggest to the general shareholders’ meeting a cash dividend for the financial year 2014 of at least EUR 700m, payable in 2015.

For details of the Telefónica Deutschland dividend policy, please refer to https://www.telefonica.de/investor-relations-en/share/dividends.html.

## 2.2.1 Results of operation

### 2.2.1.1 Revenues

In the first nine months of the year 2014 total revenues of EUR 3,503m were achieved. This corresponds to a reduction of EUR 168m or 4.6% in comparison to the prior year period. The decrease of revenues slowed down in the third quarter of 2014. The development in wireless business is in particular driven by a change in customer behavior for mobile telephony services as well as lower handset revenues. 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

Wireless business, comprising revenues from mobile services and hardware, amounted to EUR 2,633m in the first nine months of the financial year 2014. This corresponds to a decrease by EUR 96m in comparison to the prior year period or 3.5%.

The mobile service revenues are largely generated by base fees and the fees levied for voice, short message, and mobile data services as well as the revenues from service contracts. Alongside roaming revenues, mobile 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 nine months of the financial year 2014 mobile service revenues amounted to EUR 2,189m and decreased compared to the previous year by EUR 58m or 2.6%. Adjusted for the impact of the MTR reduction, a lower decline of 2.4% would have been recorded. In the third quarter of the financial year 2014 the decrease of mobile service revenues slowed down to 1.3% (adjusted for the impact of the MTR reduction). With EUR 12.4, the average monthly revenue per customer (ARPU) for the first nine months of the financial year 2014 was lower than prior year's level (2013: EUR 12.7), in the third quarter of the financial year 2014 ARPU amounted to EUR 12.7. On the one hand this decrease is due to the demanding market and competitive environment, which led to decreasing revenues for voice telephony.

### 4 — Consolidated Income Statement

| | January 1 to September 30 | | | |
|---|---|---|---|---|
| (Euros in millions) | 2014 | 2013 | Change | % Change |
| **Revenues** | **3,503** | **3,671** | **(168)** | **(4.6)** |
| Other income | 67 | 64 | 4 | 6.3 |
| Operating expenses | (2,844) | (2,870) | 26 | (0.9) |
| Supplies | (1,382) | (1,451) | 70 | (4.8) |
| Personnel expenses | (329) | (312) | (17) | 5.5 |
| Other expenses | (1,134) | (1,107) | (27) | 2.4 |
| **Operating income before depreciation and amortization (OIBDA)** | **726** | **864** | **(138)** | **(16.0)** |
| **OIBDA margin** | **20.7%** | **23.5%** | | **(2.8%-p.)** |
| Depreciation and amortization | (779) | (842) | 63 | (7.5) |
| **Operating income** | **(53)** | **22** | **(75)** | **>100** |
| Net financial income/(expense) | (26) | (23) | (3) | 14.0 |
| **Profit/(loss) before tax for the period** | **(79)** | **(1)** | **(78)** | **>100** |
| Income tax | 0 | 0 | (0) | (23.4) |
| **Total profit/(loss) for the period** | **(79)** | **(1)** | **(78)** | **>100** |

On the other hand, the ongoing change in customer behavior led to a lower number of text messages sent and received. This decrease in SMS is countervailed by the successful continuation of the monetization of the data business, which was reflected in the growth in data revenues without SMS. These grew by 10.1% in the first nine months of the financial year 2014 compared to the prior year period and reached a share of 72.8% of total data revenues (2013: 65.5%). Our integrated portfolio of wireless service products is a result of this development aligned with the growing importance of data tariffs, i.e. by upgrading of "$O_2$ Blue All-in" tariffs with LTE. Our growing customer base in the valuable postpaid segment (plus 3.3% in comparison to the first nine months of the year 2013) had a positive effect as well as a rising demand for data services products in the prepaid segment, for example the wireless internet, service applications and other data content.

Handset revenues are volatile depending particularly on the timing of new device launches. In the first nine months of the financial year 2014 handset revenues reached EUR 444m and decreased by EUR 38m or 7.9% compared to the prior year period. Due to a strong increase in sales volumes of mobile devices in the third quarter of the financial year 2014, for example caused by the launch of iPhone 6, lower handset revenues from the first half of the financial year 2014 could be partly compensated. 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 together with prepaid SIM cards or post-paid contracts as well as accessories.

**Wireline business**

In the first nine months of the financial year 2014 revenues of EUR 864m were achieved in the wireline and DSL businesses. This corresponds to a decrease by EUR 74m or 7.9% 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. Fixed 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.

**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". In the first nine months of the financial year 2014 revenues increased to EUR 6m in comparison the prior year period.

**5 — Breakdown of revenues**

| | January 1 to September 30 | | | |
|---|---|---|---|---|
| (Euros in millions) | 2014 | 2013 | Change | % Change |
| **Wireless business** | **2,633** | **2,729** | **(96)** | **(3.5)** |
| Mobile service revenues | 2,189 | 2,246 | (58) | (2.6) |
| Handset revenues | 444 | 482 | (38) | (7.9) |
| **Wireline business** | **864** | **938** | **(74)** | **(7.9)** |
| **Other revenues** | **6** | **4** | **1** | **28.2** |
| **Revenues** | **3,503** | **3,671** | **(168)** | **(4.6)** |

**2.2.1.2 Profit or loss for the period**

In the first nine months of the financial year 2014 an OIBDA of EUR 726m was achieved. This corresponds to a decline of EUR 138m or 16.0% in comparison to the prior year period, in particular driven by the adverse development of revenues as well as by increased commercial spend for customer acquisition in the market. Accordingly OIBDA margin decreased compared to the prior year period by 2.8 percentage points to 20.7%. The OIBDA in the third quarter of the financial year 2014 includes initial restructuring costs of EUR 7.9m related to the merger with E-Plus. Without the initial restructuring costs the decrease in OIBDA in comparison to the prior year period would have been 15.1% and the OIBDA margin 20.9%. The increased contribution from the wireless data business as well as the ongoing focus on efficient operations had a positive impact on the operating income.

Operating expenses, comprising supplies as well as personnel expenses and other expenses, have been reduced by EUR 26m or 0.9% to EUR 2,844m in the first nine months of financial year 2014. The savings can be seen primarily in supplies, while the increased spending in the commercial area, in particular for special offers for mobile hardware and customer acquisition and retention measures, were 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 nine months of the financial year 2014 supplies amounted to EUR 1,382m. This corresponds to a decrease by EUR 70m or 4.8% in comparison to the prior year period. In particular, the reduced number of text messages sent led to a decrease in access and interconnection costs. Due to higher sales volumes of mobile devices in the third quarter of the year 2014 the corresponding hardware cost of sales increased.

Personnel expenses increased in the first nine months of financial year 2014 by EUR 17m or 5.5% to EUR 329m as a result of general salary and wage increases as well as initial restructuring costs.

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 nine months of the financial year 2014, other expenses amounted to EUR 1,134m, which corresponds to an increase of EUR 27m or 2.4% in comparison to the first nine months of the financial year 2013. The increase is due to higher costs for customer acquisition and customer retention measures, slightly higher advertising expenses to strengthen the brand awareness as well as additional expenses related to the acquisition of the E-Plus Group.

Depreciation and amortization decreased by 7.5% to EUR 779m. This is mainly driven by fully written-off assets which are not in use anymore (mainly within software).

Operating income declined by EUR 75m to EUR –53m (2013: EUR 22m).

Net financial result as of September 30, 2014 amounted to EUR –26m (2013: EUR –23m).

Telefónica Deutschland Group did not report material income tax expenses in the nine months period ending September 30, 2014 nor in the comparative period.

As a result of the above-mentioned effects in the nine months period ending September 2014 profit after taxes was EUR –79m, compared to EUR –1m for the nine months period ending September 2013.

## 2.2.2 Financial position

### 2.2.2.1 Finance analysis

#### 6 — Consolidated net financial debt

| (Euros in millions) | As of September 30 2014 | As of December 31 2013 | Change | % Change |
|---|---|---|---|---|
| Cash and cash equivalents[1] | 4,741 | 709 | 4,032 | >100 |
| **A Liquidity** | **4,741** | **709** | **4,032** | **>100** |
| **B Current financial assets** | **149** | **188** | **(39)** | **(20.8)** |
| Current interest-bearing debt | 243 | 102 | 141 | >100 |
| Other current liabilities | 15 | 2 | 14 | >100 |
| **C Current financial debt** | **258** | **104** | **154** | **>100** |
| **D=C-A-B Current net financial debt** | **(4,632)** | **(793)** | **(3,839)** | **>100** |
| **E Non-current financial assets** | **96** | **83** | **13** | **15.4** |
| Non-current interest-bearing debt | 1,588 | 1,343 | 245 | 18.3 |
| Other non-current payables | 44 | 1 | 42 | >100 |
| **F Non-current financial debt** | **1,631** | **1,344** | **287** | **21.4** |
| **G=F-E Non-current net financial debt** | **1,535** | **1,261** | **275** | **21.8** |
| **H=D+G Net financial debt[2]** | **(3,096)** | **468** | **(3,564)** | **>100** |
| **I Restricted cash** | **3,636** | **–** | **3,636** | **100.0** |
| **J=H+I Adjusted net financial debt (excl. restricted cash)[3]** | **539** | **468** | **72** | **15.3** |

1 Cash and cash equivalents as of September 30, 2014 include EUR 3,636m restricted cash on an escrow account. This amount represents the cash component of the consideration to be paid to KPN for the acquisition of E-Plus.

2 Net financial debt includes 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 1.588m in 2014 and EUR 1.343m in 2013) + non-current finance lease payables (EUR 44m in 2014 and EUR 1m in 2013) + current interest-bearing debt (EUR 243m in 2014 and EUR 102m in 2013) + current finance lease payables (EUR 15m in 2014 and EUR 2m in 2013) minus the non-current "$O_2$ My Handy" receivables (EUR 96m in 2014 and EUR 83m in 2013) and since June 2013 the current portion of "$O_2$ My Handy" receivables (EUR 149m in 2014 and EUR 188m in 2013) minus loans to third parties included in other current financial assets (EUR 1m in 2014 and EUR 0m in 2013) and minus cash and cash equivalents (EUR 4.741m in 2014 and EUR 709m 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.

3 Adjusted net financial debt is defined as net financial debt excluding restricted cash on an escrow account amounting to EUR 3,636m.

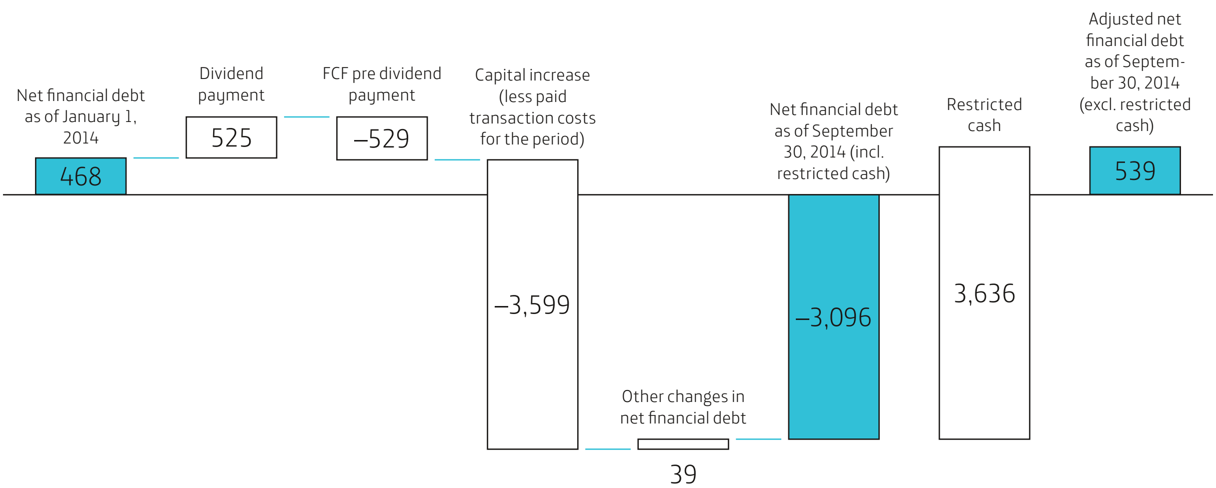
**Net financial debt**
The previous table shows the composition of net financial debt – i.e. interest-bearing debt less cash and cash equivalents, interest-bearing financial assets and receivables. Additionally a reconciliation to adjusted net financial debt is made which excludes the restricted cash as of September 30, 2014 deposited in an escrow account. Adjusted net financial debt increased by EUR 72m (15,3%) to EUR 539m compared to December 31, 2013, resulting in an adjusted leverage ratio[1] of 0.5x.

The increase in adjusted net financial debt over the nine months period was mainly attributable to the decrease of "$O_2$ My Handy"-receivables (EUR 39m) as well as the increase in lease liabilities (EUR 56m). The dividend payment of EUR 525m was completely compensated by the free cash flow pre dividends (EUR 529m).

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

1 Adjusted leverage ratio is defined as adjusted net financial debt divided by LTM (Last Twelve Months) OIBDA (EUR 1,099m in 2014; EUR 1,237m in 2013) excluding non-recurring factors.

**7 — Development of net financial debt** (Euros in millions)



### 2.2.2.2 Liquidity analysis

**Consolidated Statement of Cash Flows**

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

**Cash flow from operating activities**

Cash flow from operating activities for the first nine months of 2014 was EUR 982m and thus EUR 51m lower than the amount of the first nine months 2013 (EUR 1,033m). This decrease mainly results from a decline in OIBDA in the amount of EUR 138m in comparison to the prior year (2013: EUR 864m). This decrease is partially compensated by an improvement of working capital which is mainly due to the increase of non-current deferred income in an amount of EUR 262m caused by an increase of other advanced payments for future services to be received. This effect is partly offset by an increase in trade accounts receivables and other receivables.

**Cash flow from investing activities**

Cash flow from investing activities amounted to EUR –453m in the first nine months of 2014. Compared to September 30, 2013, the cash outflow decreased by EUR 37m (2013: EUR –490m).

Payments on investments in property, plant and equipment and intangible assets[2] in the first nine months of 2014 totaled EUR 451m (2013: EUR 475m). These are mainly related to investments for the rollout of the 4G network (LTE), the expansion of the 3G technology capacities, improvement of performance as well as improved coverage of the wireless networks.

**Cash flow from financing activities**

Cash flow from financing activities amounted to EUR 3,503m in the first nine months of 2014 (2013: EUR –756m). Thereby a cash inflow resulted which exceeds the prior year value by EUR 4,259m. The cash inflow from financing activities is mainly due to the cash capital increase in September 2014 as well as the bond issued in February 2014. This was mainly offset by cash outflows from dividend payments of EUR 525m and 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.

2 Investment expenditure respectively CapEx (EUR 411m; 2013: EUR 468m) plus the change in liabilities for investments made (EUR –12m; 2013: EUR –8m) plus the change in reserves for outstanding invoices for investments (EUR 52m; 2013: EUR 16m) and plus other changes (EUR 0m; 2013: EUR –1m) result in payments on investments in property, plant and equipment and intangible assets of EUR 451m (2013: EUR 475m) as of September 30, 2014.

**8 — Consolidated Statement of Cash Flows**

| | January 1 to September 30 | |
|---|---|---|
| (Euros in millions) | **2014** | 2013 |
| **Cash and cash equivalents at the beginning of the period** | **709** | **324** |
| Cash flow from operating activities | 982 | 1,033 |
| Cash flow from investing activities | (453) | (490) |
| Cash flow from financing activities | 3,503 | (756) |
| **Net increase/(decrease) in cash and cash equivalents** | **4,032** | **(212)** |
| **Less cash and cash equivalents attributable to assets and liabilities held for sale** | **–** | **(4)** |
| **Cash and cash equivalents at the end of the period[1]** | **4,741** | **108** |

1 Cash and cash equivalents as of September 30, 2014 include EUR 3,636m restricted cash on an escrow account. This amount represents the cash component of the consideration to be paid to KPN for the acquisition of E-Plus.

**Cash and cash equivalents**
As a result of the cash inflows/outflows described above, cash and cash equivalents amounted to EUR 4,741m[3] as of September 30, 2014 to EUR 709m as of December 31, 2013 and to EUR 108m as of September 30, 2013, respectively.

**Free cash flow pre dividends**
Free cash flow pre dividends (FCF) decreased by EUR 15m and reached EUR 529m for the nine months period 2014. Operating cash flow (OpCF) amounted to EUR 315m and therefore decreased by EUR 82m in comparison to the first nine months of 2013. The conversion of operating cash flow into free cash flow is the result of a positive development of working capital, which increased from EUR 177m in 2013 to EUR 226m in 2014. This is mainly due to the increase of non-current deferred income, mainly caused by other advanced payments for future service to be received.

3 Cash and cash equivalents include EUR 3,636m restricted cash on an escrow account. This amount represents the cash component of the consideration to be paid to KPN for the acquisition of E-Plus.

## 9 — Reconciliation of cash flow and OIBDA minus CapEx

| | January 1 to September 30 | | | |
|---|---|---|---|---|
| (Euros in millions) | 2014 | 2013 | Change | % Change |
| **OIBDA** | **726** | **864** | **(138)** | **(16.0)** |
| – CapEx | (411) | (468) | 57 | (12.1) |
| **= Operating cash flow (OpCF)** | **315** | **396** | **(82)** | **(20.6)** |
| + Silent factoring[1] | 234 | 266 | (32) | (12.1) |
| +/– Other working capital movements | (8) | (89) | 81 | (91.4) |
| **Change in working capital** | **226** | **177** | **49** | **27.9** |
| +/– Gains/(losses) from sale of companies, fixed assets and other effects | (0) | (0) | (0) | >100 |
| +/– Proceeds from sale of companies, fixed assets and other effects | 1 | – | 1 | 100.0 |
| + Net interest payments | (10) | (15) | 5 | (35.0) |
| + Payment on financial investments | (3) | (15) | 12 | (81.3) |
| **= Free cash flow pre dividends[2]** | **529** | **543** | **(15)** | **(2.7)** |
| +/– Equity movements[3] | (525) | (503) | (22) | 4.4 |
| **= Free cash flow post dividends** | **4** | **40** | **(37)** | **(90.8)** |

1 Full impact (YTD) of silent factoring in the nine months period in 2014 of EUR 234m and EUR 266m in 2013 (transactions have been executed in January, March and September 2014 respectively in March, June and September 2013).
2 Free cash flow pre dividends is defined as the sum of cash flow from operating activities and cash flow from investing activities.
3 Dividend payment of EUR 525m in May 2014. Dividend payment of EUR 503m in May 2013.

### 2.2.3 Net assets

The following analysis of the asset and capital structure compares the existing assets and liabilities as of September 30, 2014 with the balances as of December 31, 2013.

As of September 30, 2014 the Group reported assets amounting to EUR 12,803m (2013: EUR 9,021m). This corresponds to an increase of 41.9% and mainly results from the cash capital increase in September 2014 (see section 5 Acquisition of E-Plus).

**Intangible assets**
Intangible assets including goodwill amount to EUR 3,343m as of September 30, 2014. The decrease compared to the year end 2013 is EUR 247m and is mainly due to the amortization of intangible assets with a finite useful life. The amount of amortization was EUR 337m. On the other hand there were additions of EUR 91m (mainly additions to software of EUR 78m).

**Property, plant and equipment**
Property, plant and equipment amount to EUR 2,810m as of September 30, 2014. Hence, a decrease of 3.0% or EUR 85m is reported compared to year end 2013. Additions to property, plant and equipment amounted to EUR 320m in the reporting period. These related mainly to investments for the rollout of the 4G network (LTE), the expansion of the 3G technology capacities, improvement of performance as well as improved coverage of the wireless networks. The impact from the additions is offset by depreciation of EUR 442m. Furthermore, property plant and equipment increased by EUR 36m along with the increase of the obligation for dismantling and removal of assets.

**Trade and other receivables**
Trade and other receivables increased compared to December 31, 2013 by 7.5% or EUR 78m and amount to EUR 1,113m as of September 30, 2014. This is mainly due to the increase of gross trade receivables of EUR 57m and the increase of advanced payments made in an amount of EUR 33m.

**10 — Consolidated Statement of Financial Position**

| (Euros in millions) | As of September 30 2014 | As of December 31 2013 | Change | % Change |
|---|---|---|---|---|
| Goodwill and intangible assets | 3,343 | 3,590 | (247) | (6.9) |
| Property, plant and equipment | 2,810 | 2,896 | (85) | (3.0) |
| Trade and other receivables | 1,113 | 1,035 | 78 | 7.5 |
| Deferred tax assets | 584 | 584 | – | – |
| Other assets | 213 | 209 | 4 | 1.9 |
| Cash and cash equivalents[1] | 4,741 | 709 | 4,032 | >100 |
| **Total assets = Total equity and liabilities** | **12,803** | **9,021** | **3,782** | **41.9** |
| Interest-bearing debt | 1,831 | 1,445 | 386 | 26.7 |
| Provisions | 170 | 108 | 62 | 57.9 |
| Trade and other payables | 1,396 | 1,300 | 96 | 7.4 |
| Deferred income | 451 | 170 | 281 | >100 |
| **Equity** | **8,955** | **5,999** | **2,956** | **49.3** |

1 Cash and cash equivalents as of September 30, 2014 include EUR 3,636m restricted cash on an escrow account. This amount represents the cash component of the consideration to be paid to KPN for the acquisition of E-Plus.

**Other assets**
Other assets comprise inventories and other financial assets and increased slightly by 1.9% or EUR 4m compared to December 31, 2013 to EUR 213m as of September 30, 2014.

**Cash and cash equivalents**
Cash and cash equivalents totaled EUR 4,741m[4] as of September 30, 2014 (2013: EUR 709m) and comprise contributions in connection with the cash-pooling agreements with Telfisa Global B.V. in an amount of EUR 1,099m. This increase by 569.1% or EUR 4,032m results from several effects especially from the cash capital increase in September 2014. For further information please refer to section 2.2.2.2 Liquidity analysis.

**Interest-bearing debt**
Interest-bearing debt increased by EUR 386m from EUR 1,445m as of December 31, 2013 to EUR 1,831m. The increase mainly results from the issue of a bond in February 2014 by $O_2$ Telefónica Deutschland Finanzierungs GmbH with a nominal value of EUR 500m. Furthermore, Telefónica Germany GmbH & Co. OHG made a repayment of 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 57.9% or EUR 62m to EUR 170m. The provision for dismantling and removal of assets increased from EUR 80m to EUR 115m. The increase is mainly attributable to the plan that the dismantling of parts of the network of Telefónica Deutschland Group will be due earlier than expected. This change in parameters underlying the calculation leads to an additional increase of the provision of EUR 30m. Furthermore pension provisions increased by EUR 21m to EUR 26m.

**Trade and other payables**
Trade and other payables amount to EUR 1,396m as of September 30, 2014. This corresponds to an increase of 7.4% or EUR 96m compared to December 31, 2013 (EUR 1,300m). This increase results particularly from a rise in other payables from EUR 226m as of December 31, 2013 to EUR 290m as of September 30, 2014 mainly due to an increase of finance lease payables.

**Deferred income**
Deferred income increased in comparison to December 31, 2013 by 166.0% or EUR 281m and amounted to EUR 451m as of September 30, 2014. This is mainly due to the increase of non-current deferred income to EUR 262m resulting from other advance payments for future services to be received.

**Equity**
As of September 30, 2014 equity increased by 49.3% or EUR 2,956m to EUR 8,955m. The change in equity is primarily attributable to the cash capital increase amounting to EUR 3,620m which was registered in the commercial register as of September 18, 2014. This increase was partially compensated by the dividend payment from May 21, 2014 of EUR 525m as well as by the result of the period amounting to EUR –79m.

4 Cash and cash equivalents include EUR 3,636m restricted cash on an escrow account. This amount represents the cash component of the consideration to be paid to KPN for the acquisition of E-Plus.

# 3. Events after the Reporting Period_

**Capital Increase against Contribution in kind/ new share capital number**
In context with the acquisition of E-Plus the Management Board resolved on September 24, 2014 with the approval of the Supervisory Board, to increase the share capital of the company from EUR 2,233,890,800 by an amount of EUR 740,664,193 to EUR 2,974,554,993 by issuance of 740,664,193 new registered shares (capital increase against contribution in kind; see also section 5 Acquisition of E-Plus).

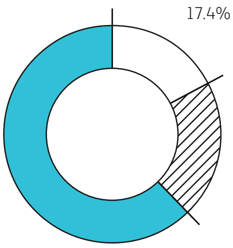
The capital increase against contribution in kind was registered in the commercial register on October 7, 2014. Therefore, the share capital amounts to EUR 2,974,554,993, divided in the same number of no-par value registered shares.

Furthermore, the Authorized Capital 2014/I was deleted due to full use. The Authorized Capital 2012/I exists in the amount of EUR 292,808,507 (see also section 1.1.1 Structure of Telefónica Deutschland Group).

**Closing of the E-Plus Acquisition**
The closing of the acquisition of E-Plus took place with effect as of October 1, 2014 (see section 5 Acquisition of E-Plus). Since this point of time next to the companies shown on page 18 E-Plus Mobilfunk GmbH & Co. KG and its direct and indirect affiliates belong to Telefónica Deutschland Group.

**New Shareholder Structure**
Following the capital increases against cash and contribution in kind in the context of the indirect acquisition of E-Plus and the acquisition of further 4.4% by Telefónica, S.A. from KPN Mobile Germany GmbH & Co. KG (KPN Mobile Germany) (see section 5 Acquisition of E-Plus) and according to respective shareholdings notifications received, Telefónica Deutschland has the following shareholder structure:

**11 — Shareholder structure** (in %)




1 Telefónica Germany Holdings Limited is an indirect wholly owned subsidiary of Telefónica, S.A.
2 According to the shareholdings notification as of October 20, 2014 the shares are now directly held by Koninklijke KPN N.V.

**Appointment of Management Board Members**
Thorsten Dirks has been appointed member of the Management Board and chairperson of the Management Board/CEO by resolution of the Supervisory Board as of October 9, 2014.

With resolution as of October 9, 2014 the Supervisory Board extended the period of office of Rachel Empey and Markus Haas. All members of the Management Board are appointed until September 30, 2017.

**Appointment of Supervisory Board Members**
Joachim Rieger and Jürgen Thierfelder were appointed by decision of the local court of Munich as of October 31, 2014 as further members of the Supervisory Board, employee representative side.

Thereby the supervisory board is completely staffed with its 16 members, eight of them being from shareholder side and eight from employee side.

**Integration of E-Plus**
Following the completion of the acquisition of E-Plus, the Management Board of Telefónica Deutschland announced as of October 17, 2014 first key parameters for the integration of E-Plus. The merger with E-Plus is a chance for Telefónica Deutschland Group to actively build the change in the telecommunication industry and to become the leading digital telecommunication company. With the objective of digital transformation of the business model and to contribute to achieving the announced synergies with a net present value of more than EUR 5bn, 1,600 of the current approximately 9,100 full-time positions are to be cut by 2018. This is mainly to abolish duplicate functions. In this process, Telefónica Deutschland intends to implement a severance pay scheme for employees leaving the company. The company strives to avoid compulsory redundancies wherever possible. The measures are subject to further negotiations with the Workers Council. Furthermore, management and supervisory board have resolved to contribute the limited partnership interest in E-Plus Mobilfunk GmbH & Co. KG into Telefónica Germany GmbH & Co. OHG until the end of business year 2014. They also resolved to change in the first quarter 2015 the legal form of E-Plus Mobilfunk GmbH & Co. KG into a limited liability company (“GmbH”) and to conclude a profit & loss transfer agreement with Telefónica Germany GmbH & Co. OHG.

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 cannot be finally assessed. Based on the volume of traffic affected and assuming that a significant lower termination rate is unlikely we see a moderate risk.

**Changes in regulation with regard to consumer protection**
Recently regulative initiatives on national and European level took place in order to strengthen the rights of consumers. Beside the potential impact of those initiatives especially on the roaming and termination fees, already described in previous management reports these initiatives also include additional requirements with regard to transparency on costs and terms of contract about telecommunication services. If we are unable to fulfill these requirements completely or not in time some of our distribution channels might face restrictions inheriting a high risk that we might not reach or only reach delayed our customer and revenue growth targets. To mitigate that risk we already initiated technical changes and prepared manual processes for us and the outsourcers used. Given the status of the mitigating actions we assume the risk to be low.

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 and the increased requirements for consumer protection.

For changes in risks and opportunities concerning the acquisition of E-Plus we refer to section 5 Acquisition of E-Plus.

# 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 of approx. EUR 3.6bn in cash (subject to a final price reduction) and shares equivalent to 24.9% of the enlarged company.

The cash component to be paid to KPN was financed via a cash capital increase of Telefónica Deutschland (see in the following). The shares that issued as a further consideration to KPN were generated via a capital increase against contribution in kind (see in the following).

Pursuant to the agreement as of July 23, 2013 in the amended version as of August 26 and 28, as well as of December 5, 2013 and March 24, August, 7 and September 30, 2014, and respective transfer agreement Telefónica, S.A. acquired from KPN a share of 4.4% of Telefónica Deutschland for EUR 1.3bn. This leads to a holding of Telefónica, S.A. in Telefónica Deutschland of 62.1% and of KPN of 20.5%. The free float amounts to 17.4% (see also section 3 Events after the Reporting Period)

Telefónica Deutschland is one of the three leading telecommunications providers in the German market. The company, to which the E-Plus Group also belongs (since October 1, 2014), serves a total of 47million customer accesses[5] and generated revenues of EUR 8bn[6] in financial year 2013. With around 41 million[7] mobile accesses, Telefónica Deutschland the leading mobile operator in the German market according to the number of accesses.

## 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 22,2 million[8] as of June 30, 2014. Total revenue of the E-Plus Group amounted to EUR 3,143m[9] for 2013. EBITDA in the E-Plus Group amounted to EUR 916m[10] for 2013. As of June 30, 2014, the E-Plus Group employed 4,347 full-time employees[11].

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.de), 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 was to be transferred to KPN prior to completion of the Transaction, it is agreed that Telefónica Deutschland after the transaction may continue to use the BASE brand in Germany.

5 Consolidated customer accesses based on pro-forma calculation as of December 31, 2013
6 Consolidated revenues based on pro-forma calculation
7 Consolidated customer accesses based on pro-forma calculation as of December 31, 2013
8 The number of customer accesses of the E-Plus Group determined on the basis of the definitions and calculation policies applied by Telefónica Deutschland in this regard
9 Total revenue taken from the Consolidated Financial Statements of E-Plus Mobilfunk GmbH & Co. KG as of December 31, 2013;
Total Revenue of the acquired E-Plus Group adjusted to the accounting standards of Telefónica Deutschland for the financial year 2013: EUR 3,252m (Source: prospectus for the capital increase as of September 9, 2014)
10 EBITDA taken from the Consolidated Financial Statements of E-Plus Mobilfunk GmbH & Co. KG as of December 31, 2013; EBITDA of the acquired E-Plus Group adjusted to the accounting standards of Telefónica Deutschland for the financial year 2013: EUR 688m (Source: prospectus for the capital increase as of September 9, 2014)
11 Source: prospectus for the capital increase as of September 9, 2014

## 5.3 Reasons for the Acquisition and Strategy

With the acquisition of the E-Plus Group, we intend to create the leading digital telecommunications company in the German market. Telefónica Deutschland Group considers the merger as the best way to compete effectively in the mid- and long term. We believe that the transaction will create a third market player that is well-positioned to create a superior digital customer experience. Despite the scale of the new company the challenger mindset shall be preserved to continue exploring new and innovative ways in the telecommunications industry. Please refer to section 1.2 Goals and Strategies for a detailed description of the strategy of the combined company. Furthermore, the acquisition is expected to generate significant synergies, strengthen the profitability and increase free cash flow. In this way we create conditions for attractive dividend payments and generate value for our shareholders.

## 5.4 Estimated Synergy Effects

We estimate that the transaction will lead to significant synergy effects of over EUR 5bn[12], particularly with respect to network, distribution and customer service, selling, general and administration as well as CapEx. Integration costs diminish the overall amount of cost synergies and are already included in the calculation of synergy effects. Furthermore, the overall calculated sum includes revenue and other synergies.

The vast majority of the estimated synergies is attributable to synergy effects expected to be realized only after completing the integration of the E-Plus Group, which is currently expected to occur by year five following the acquisition. The annual cash flow from synergies (pre-tax) will then amount to EUR 800m. Positive cashflows are already expected in the second year of the integration. In the fourth year we already aim to achieve 80% of the target run rate. We expect that the remedies the company offered to the European Commission in connection with the merger clearance will not have a significant impact on the cost-based synergy effects.

Telefónica Deutschland Group plans to achieve the synergies in the different areas via the following measures:

— Network synergies: Both existing networks shall be consolidated over the next years, including core, transport, and access networks. Overall, the combined new network will have 14,000 mobile base stations less than the two separate networks in total. The network integration leads to a reduction in operating costs (i.e. rents, electricity, maintenance, operations, transport, and overhead). Furthermore, the new size of the combined company allows increased efficiency by further leveraging the scalable cooperations with Deutsche Telekom GmbH with regard to mobile backhaul capacity and wireline services. The net present value of expected synergies amounts to EUR 1.7bn.
— Distribution and customer service synergies: we expect that the combination of both distribution networks and customer service organizations will increase efficiency and reduce costs by leveraging best practices and scale as well as channel management and overhead costs. We expect that we will be able to optimize the retail footprint for the combined company due to distribution network overlap, which will result in a decrease of rent and staff-related costs. Furthermore, the new company will aim for a higher share of digital channels. We expect synergies in online sales from a strong, joint multibrand proposition. The net present value of estimated synergies from distribution and customer service has been calculated with EUR 1.1bn.
— Selling, general and administration (SG&A) synergies: we expect synergies mainly in form of a cost reduction of IT, administration and rent. Additionally, we believe that the joint advertising and marketing expenses can be reduced significantly. The net present value of expected synergies in SG&A is approximately EUR 0.8bn.
— CapEx synergies: the capital expenditure of the new Telefónica Deutschland Group is expected to be reduced from former levels. Due to the network consolidation, the required investments for quality and capacity upgrades of the joint 3G network diminish, further supported by traffic offload to the quickly rolled-out 4G network. Overall, this new balance between traffic on 3G and 4G networks leads to optimized average production costs for data transmission. Further, we believe in reduced CapEx requirements due the reduction of mobile base stations and associated network equipment. Overall, estimated CapEx synergies amount to an NPV of EUR 1.9bn.
— Integration costs: calculated integration costs primarily relate to one-time payments such as rent cancellation fees, severance payments to employees, network and IT migration costs, as well as for the costs for rebranding and customer migration to target brands and network. The net present value of expected integration costs is EUR –0.9bn.

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

— Revenues and other synergies: this section comprises the expected revenue synergies as well as foreseeable impact from the remedies for the transaction. Due to the improved network quality, a higher customer satisfaction can be expected as well as further opportunities in the SoHo and SME segment. In addition, the enlarged customer base offers additional cross-selling opportunities for wireline broadband products, in particular into the mobile customer base of the E-Plus Group.

## 5.5 Status of the Transaction

The closing of the acquisition of E-Plus Group by Telefónica Deutschland Group took place with effect as of October 1, 2014. The main milestones were as follows:

**General Meetings**
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 execution of the transaction in February 11 and May 20, 2014 (see also in the following sections Successful Cash Capital Increase and Capital Increase against Contribution in Kind).

**Merger approval of the European Commission and Drillisch Agreement**
The transaction was in particular, conditional upon the clearance of the relevant antitrust authorities.

The prenotification process had commenced soon after the acquisition of the E-Plus Group by Telefónica Deutschland had been announced, and the formal notification had been filed at the end of October 2013.

In the course of the merger clearance process, Telefónica Deutschland Group has agreed a set of remedies which fully addresses the European Commission's competition concerns. In this regard, Telefónica Deutschland Group has committed to sell upfront 20% of its mobile network capacity via Mobile Bitstream Access to a Mobile Virtual Network Operator (MVNO) and give the opportunity to acquire up to 10% additional network capacity. Mobile Bitstream Access is a product where the MNO provides network capacity in the form of data throughput and data volume. This enables an MVNO to offer its own mobile services to customers.

Telefónica Deutschland Group had signed in this context a contract with Drillisch (see also section 2.2 Overview of the First Nine Months of the Year 2014: Significant Events) with the purpose to implement measures to be taken before the closing of the transaction.

On July 2, 2014, Telefónica Deutschland has received the European Commission's conditional clearance regarding the acquisition of the E-Plus Group from KPN.

On August 29, 2014 the European Commission confirmed that the agreement with Drillisch (see also section 2.2 Overview of the First Nine Months of the Year 2014: Significant Events) meets the conditions and obligations associated with the decision, as far as these have to be fulfilled before the closing of the transaction.

Furthermore, to enable a potential entry into the German market, Telefónica Deutschland Group will make available to an interested party a package of 2.1 and 2.6GHz frequencies, mobile sites, national roaming and a passive network sharing. In addition, existing contracts with wholesale partners will be extended until 2025 and the transition to a different guest network operator will be facilitated.

**Successful Cash Capital Increase**
To generate the cash component agreed with KPN as consideration for E-Plus (see above), Telefónica Deutschland executed a cash capital increase.

On basis of the authorization granted at the Annual General Meeting as of May 20, 2014 for a cash capital increase, the Management Board resolved with the approval of the Supervisory Board on September 8, 2014 to increase the share capital of EUR 1,116,945,400, divided into 1,116,945,400 registered shares, by EUR 1,116,945,400 to EUR 2,233,890,800 by issuance of 1,116,945,400 new shares. On September 18, 2014 such cash capital increase was registered.

The new shares were offered to the shareholders for subscription in the period from September 10 to September 23, 2014, with a subscription price of EUR 3.24 per share and at a ratio of 1:1 and with the further conditions as resolved by the Management Board as of September 8, 2014 with consent of the Supervisory Board and as published respectively.

On September 24, 2014, Telefónica Deutschland announced the successful completion of the cash capital increase.

The take-up quota for the offered new shares amounted to 99.92%, demonstrating strong investor support for the rights issue. The majority shareholder Telefonica, S.A. exercised all of its respective rights.

The new shares not placed as part of the subscription offer were sold by the banks involved in the rights offering the so-called Joint Bookrunners on September 24, 2014 through sales in stock exchange transactions or otherwise. All newly issued shares represent each a notional amount of EUR 1.00 in the registered share capital per share.

**Capital Increase against Contribution in Kind**
To generate the further consideration component for the acquisition of E-Plus, being the shareholding of 24.9 % in the enlarged company, the Management Board resolved on September 24, 2014 with the approval of the Supervisory Board to increase the share capital of EUR 2,233,890,800 by an amount of EUR 740,664,193 to EUR 2,974,554,993 by issuance of 740,664,193 new registered shares.

The new shares were subscribed by KPN Mobile Germany against contribution in kind of the limited partnership interest in E-Plus Mobilfunk GmbH & Co. KG.

The capital increase against contribution in kind was registered with the commercial register on October 7, 2014 (see section 3 Events after the Reporting Period).

**Closing of the acquisition**
The closing regarding the share purchase agreement as of July 23, 2013 in the amended version as of August 26 and 28, and of December 5, 2013 as well as March 24, August 7 and September 30, 2014, took place with effect as of October 1, 2014.

## 5.6 Risks from the Acquisition

**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. For the period after the transaction the management has developed a process ensuring the unaffected operation of the group companies by defining the first levels of management and end to end responsibilities.

The transaction could entitle customers, suppliers, service providers or other contractual partners to terminate their contracts with the E-Plus Group or result in contractually agreed restrictions for the Telefónica Deutschland Group.

The E-Plus Group is party to a number of agreements that contain a so-called change of control clause or other restrictive provisions. In addition, other agreements of the E-Plus Group may require the payment of certain specified amounts or the incurrence of other specified or unspecified liabilities in case of the occurrence of a change of control event. The Acquisition of E-Plus by Telefónica Deutschland Group qualifies as a change of control in the above-mentioned sense. In addition, certain agreements with wholesale partners contain restrictions on entering into similar agreements with certain specified competitors of the respective wholesale partners (including wholesale partners of Telefónica Deutschland). If, in such situation, the E-Plus Group was unable to obtain a waiver of such termination right, payment claim or contractual restriction, the change of control provision could lead to the loss of significant contractual rights, such as restrictions in actions vis-à-vis contractors, partners and vendors or in voting rights and benefits or the termination of joint venture or licensing agreements. Furthermore, the combination of the businesses of Telefónica Deutschland Group and the E-Plus Group could prevent the Telefónica Deutschland Group from renewing its existing contracts with wholesale partners, suppliers or service providers at adequate terms due to the fact that wholesale partners, suppliers or service providers could object to the combination based on competitive or other reasons which could have a material adverse effect on the Telefónica Deutschland Group's business, financial condition and results of operations.

Currently we are assessing all relevant contracts in order to identify legal and organizational possibilities to avoid or mitigate the risk. At the current stage of the project we assume the risk being moderate.

**Financial risks**
The structure of the Transaction could lead to the liability of the Telefónica Deutschland Group for tax liabilities of KPN Mobile Germany and liabilities under shareholder loans between KPN Mobile Germany on the one hand and KPN and/or companies affiliated with KPN on the other hand.

The restructuring of New E-Plus KG prior to closing of the Transaction included measures such as the corporate restructuring and merger of subsidiaries as well as the spin-off of all assets and certain liabilities of KPN Mobile Germany (formerly: E-Plus Mobilfunk GmbH & Co. KG) to a new holding company (founded under the name E-Plus Transition GmbH & Co. KG and subsequently renamed E-Plus Mobilfunk GmbH & Co. KG, i.e., New E-Plus KG). All shareholder loans existing between KPN Mobile Germany on the one side and KPN and companies affiliated with KPN on the other side, as well as all tax liabilities of KPN Mobile Germany relating to time periods prior to January 1, 2014, were contractually excluded from this spin-off and remain with KPN Mobile Germany. The same applies to a potential statutory liability of KPN Mobile Germany as a result of a previous spin-off from E-Plus Mobilfunk Geschäftsführungs GmbH. However, according to the German Transformation Act, New E-Plus KG is still (additionally) liable for these liabilities provided that these liabilities become due within a period of five years after the effectiveness of the spin-off. KPN Mobile Germany undertook in the spin-off agreement and KPN undertook in the acquisition contract to indemnify New E-Plus KG against such liabilities. However, in case KPN Mobile Germany and KPN fail to provide such indemnification in full or in part, New E-Plus KG and consequently the company would still be liable for these liabilities.

Considering the fact that the liability constitutes only in case of a non-ability of payment by the companies primarily liable and those to be seen as adequate solvent we assume the risk being low.

**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 anymore that purchase price will increase.

As of the time of publication of this report Telefónica Deutschland has still 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.

With regard to the last reporting for the period between January 1st and June 30th 2014 we have seen positive evolutions in the following risk factors:

The Risks that the transaction fails as well as the risk that the conditions and obligations imposed on the Telefónica Deutschland Group will hamper the execution of the transaction have disappeared.

The European Commission as the relevant cartel authority granted an unconditional clearance to the transaction. With the unconditional clearance on the Commission acknowledged the fulfillment of the conditions imposed on Telefónica Deutschland Group. The transaction was legally executed with effect as of October 1, 2014. As a consequence there is no longer a risk of payment of a break-up fee in case of failure nor the risk of reputational damage (e.g. on the share or bond market) in case the transaction would not take place.

By the date of drafting this report we still have no detailed, approved information on the risks of the E-Plus Group. Therefore it is not possible to include a complete list of relevant risks for the whole new company.

## 5.7 Opportunities of the Acquisition

The Telefónica Deutschland Group expects significant synergies and economies of scale from the merger, particularly in areas such as sales, service and network. Furthermore Telefónica Deutschland considers the merger of both companies as a chance to build a new organization beyond realizing economies of scale. Rather, the acquisition shall enable to change fundamentally the business model and to actively shape the market.

The new corporation would be well positioned to build one of the most modern high-speed wireless telecommunications networks in Germany offering its customers the best network experience as well as to simplify and digitize the business model to achieve sustainable cost leadership. Section 1.2 Goals and Strategies describes the opportunities from the acquisition in detail and how the combined company aims to leverage opportunities stemming for the merger for long-term profitable growth. An additional chance from the acquisition is an increase of revenues in the wholesale segment that arises from the innovative mobile bitstream access model (MBA-model), a strategic partnership that has been closed with Drillisch.

# 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 an economic slowdown in 2014. For the Euro area an economic growth of 0.8% is predicted for 2014. The top economic research institutes expect a slowdown of the German economic growth in their recent published bi-annual growth report. Economic activity has cooled down and domestic and foreign demand is currently weak. The economic research institutes are predicting a gross domestic growth rate of 1.3% in 2014.
(Source: Herbstgutachten – Joint Economic Forecast Autumn 2014)

## 6.2 Market Expectations

The market development in Germany, one of the biggest telecommunications markets in Europe, will be further driven by rising customer demand in wireless telecommunications and also in the fixed network for broadband and data services. 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 German market for mobile services is expected to show negative growth in the coming years, with service revenue expected to decrease by 2.4% annually until 2016.

The increasing demand of clients for connection speed in wireless telecommunications and fixed networks as well as the strong demand for convergent solutions will nevertheless be a driver of growth.
(Source: Company data, Analysys Mason)

## 6.3 Expectations for Telefónica Deutschland Group

After the successful completion of the acquisition of the E-Plus Group as of 1st October 2014, these operations are fully consolidated within Telefonica Deutschland.

For the fourth quarter of 2014, we expect the business to sustain a good mobile trading momentum, with mobile revenues benefitting from increased demand for LTE-enabled smartphones and higher usage of mobile data services, partially compensating the lower usage of traditional voice and SMS.

On a quarter-on-quarter comparison, we expect consolidated mobile service revenues to show a moderate decline over the combined[13] mobile service revenue of EUR 1,424m in the third quarter of 2014, mainly due to the usual phasing of usage of services between quarters.

We also expect consolidated underlying[14] OIBDA to reflect ongoing commercial investments in a competitive market and initial integration expenses. Therefore, from a combined underlying OIBDA of EUR 350m in the third quarter of 2014 (17.5% combined underlying margin on revenues), we expect fourth quarter consolidated underlying OIBDA to be slightly lower quarter-on-quarter, with a similar underlying margin on revenues.

Capital expenditures in the fourth quarter of 2014 will reflect the start of a new investment cycle into the new business, prioritizing LTE network deployment and initial works to integrate existing networks. Taking a combined CapEx of EUR 286m in the third quarter of 2014 as a basis for comparison, we expect consolidated CapEx in the fourth quarter of 2014 to be 1.5 times higher.

13 Combined means aggregated and consolidated figures from Telefónica Deutschland Group and E-Plus Group according to Telefónica Deutschland Group accounting policies.
14 Underlying criteria: Excluding one-offs. The base of calculation in the third quarter of 2014 excludes restructuring costs of EUR 14m.

# 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 of September 30, 2014.

Munich, November 13, 2014

Telefónica Deutschland Holding AG

The Management Board

Thorsten Dirks

Rachel Empey

Markus Haas

# Interim Condensed Consolidated Financial Statements_

## for the period from January 1 to September 30, 2014

# Consolidated Statement of Financial Position_

| **Assets** (Euros in millions) | Note | **As of September 30 2014** | As of December 31 2013 |
|---|---|---|---|
| **A) Non-current assets** | | **6,851** | **7,168** |
| Goodwill | | 706 | 706 |
| Intangible assets | | 2,637 | 2,884 |
| Property, plant and equipment | | 2,810 | 2,896 |
| Other non-current financial assets | [7] | 114 | 99 |
| Deferred tax assets | | 584 | 584 |
| **B) Current assets** | | **5,952** | **1,854** |
| Inventories | | 78 | 89 |
| Trade and other receivables | [7] | 1,113 | 1,035 |
| Other current financial assets | [7] | 21 | 21 |
| Cash and cash equivalents[1] | [7] | 4,741 | 709 |
| **Total assets (A+B)** | | **12,803** | **9,021** |

| **Equity and liabilities** (Euros in millions) | Note | **As of September 30 2014** | As of December 31 2013 |
|---|---|---|---|
| **A) Equity** | [7] | **8,955** | **5,999** |
| Common stock | | 2,234 | 1,117 |
| Additional paid-in capital | | 2,470 | 0 |
| Retained earnings | | 4,249 | 4,880 |
| Other components of equity | | 2 | 2 |
| Equity attributable to owners of the parent | | 8,955 | 5,999 |
| **B) Non-current liabilities** | | **2,056** | **1,452** |
| Non-current interest-bearing debt | [7] | 1,588 | 1,343 |
| Other payables | [7] | 47 | 5 |
| Non-current provisions | | 159 | 104 |
| Deferred income | [7] | 262 | – |
| **C) Current liabilities** | | **1,792** | **1,571** |
| Current interest-bearing debt | [7] | 243 | 102 |
| Trade payables | [7] | 1,106 | 1,074 |
| Other payables | [7] | 244 | 222 |
| Current provisions | | 11 | 4 |
| Deferred income | [7] | 189 | 170 |
| **Total equity and liabilities (A+B+C)** | | **12,803** | **9,021** |

1 Cash and cash equivalents as of September 30, 2014 include EUR 3,636m restricted cash on an escrow account. This amount represents the cash component of the consideration to be paid to KPN for the acquisition of E-Plus (see Note No. 2 Significant events and transactions of the period).

# Consolidated Income Statement_

| | | July 1 to September 30 | | January 1 to September 30 | |
|---|---|---|---|---|---|
| (Euros in millions) | Note | **2014** | 2013 | **2014** | 2013 |
| Revenues | [8] | 1,219 | 1,225 | 3,503 | 3,671 |
| Other income | | 24 | 25 | 67 | 64 |
| Supplies | | (499) | (477) | (1,382) | (1,451) |
| Personnel expenses | | (116) | (105) | (329) | (312) |
| Other expenses | | (389) | (378) | (1,134) | (1,107) |
| **Operating income before depreciation and amortization (OIBDA)** | | **240** | **292** | **726** | **864** |
| Depreciation and amortization | | (245) | (276) | (779) | (842) |
| **Operating income** | | **(5)** | **16** | **(53)** | **22** |
| Finance income | | 2 | 1 | 6 | 5 |
| Exchange gains | | 0 | 0 | 0 | 0 |
| Finance costs | | (10) | (8) | (30) | (28) |
| Exchange losses | | (1) | (0) | (2) | (0) |
| **Net financial income/(expense)** | [8] | **(10)** | **(6)** | **(26)** | **(23)** |
| **Profit/(loss) before tax** | | **(15)** | **9** | **(79)** | **(1)** |
| Income tax | | (0) | 0 | 0 | 0 |
| **Total profit/(loss) for the period** | | **(15)** | **9** | **(79)** | **(1)** |
| | | | | | |
| **Profit/(loss) for the period attributable to owners of the parent** | | **(15)** | **9** | **(79)** | **(1)** |
| **Profit/(loss) for the period** | | **(15)** | **9** | **(79)** | **(1)** |
| | | | | | |
| **Earnings per share** | | | | | |
| **Basic earnings per share in EUR** | | **(0.01)** | **0.01** | **(0.07)** | **(0.00)** |
| **Diluted earnings per share in EUR** | | **(0.01)** | **0.01** | **(0.07)** | **(0.00)** |

# Consolidated Statement of Comprehensive Income_

| | | July 1 to September 30 | | January 1 to September 30 | |
|---|---|---|---|---|---|
| (Euros in millions) | Note | **2014** | 2013 | **2014** | 2013 |
| **Profit/(loss) for the period** | | **(15)** | **9** | **(79)** | **(1)** |
| **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** | | **(16)** | **1** | **(27)** | **(9)** |
| Remeasurement of defined benefit plans | | (16) | 1 | (27) | (9) |
| Income tax impact | | – | – | – | – |
| | | | | | |
| **Total other comprehensive income/(loss)** | | **(16)** | **1** | **(27)** | **(9)** |
| **Total comprehensive income** | | **(31)** | **10** | **(107)** | **(10)** |
| | | | | | |
| Total comprehensive income for the period attributable to owners of the parent | | (31) | 10 | (107) | (10) |
| **Total comprehensive income** | | **(31)** | **10** | **(107)** | **(10)** |

# Consolidated Statement of Changes in Equity_

| (Euros in millions) | Common stock | Additional paid-in capital | Retained earnings | Other components of equity: Available-for-sale investments | Equity attributable to owners of the parent | Equity |
|---|---|---|---|---|---|---|
| **Financial position as of January 1, 2013** | **1,117** | **0** | **5,310** | **1** | **6,429** | **6,429** |
| Profit/(loss) for the period | – | – | (1) | – | (1) | (1) |
| Other comprehensive income/(loss) | – | – | (9) | – | (9) | (9) |
| **Total comprehensive income** | **–** | **–** | **(10)** | **–** | **(10)** | **(10)** |
| Dividends | – | – | (503) | – | (503) | (503) |
| **Financial position as of September 30, 2013** | **1,117** | **0** | **4,797** | **1** | **5,916** | **5,916** |
| **Financial position as of January 1, 2014** | **1,117** | **0** | **4,880** | **2** | **5,999** | **5,999** |
| Profit/(loss) for the period | – | – | (79) | – | (79) | (79) |
| Other comprehensive income/(loss) | – | – | (27) | – | (27) | (27) |
| **Total comprehensive income** | **–** | **–** | **(107)** | **–** | **(107)** | **(107)** |
| Dividends | – | – | (525) | – | (525) | (525) |
| Capital increase | 1,117 | 2,503 | – | – | 3,620 | 3,620 |
| Costs of capital increase | – | (33) | – | – | (33) | (33) |
| Other movements | – | – | 1 | – | 1 | 1 |
| **Financial position as of September 30, 2014** | **2,234** | **2,470** | **4,249** | **2** | **8,955** | **8,955** |

# Consolidated Statement of Cash Flows_

| (Euros in millions) | January 1 to September 30 2014 | 2013 |
|---|---|---|
| **Cash flow from operating activities** | | |
| **Profit/(loss) for the period** | **(79)** | **(1)** |
| **Adjustments to profit/(loss)** | | |
| Net financial result | 26 | 23 |
| Depreciation and amortization | 779 | 842 |
| **Change in working capital** | | |
| Trade and other receivables | (2) | 81 |
| Inventories | 12 | 7 |
| Other current assets | (5) | (8) |
| Trade and other payables | (8) | 58 |
| Other current liabilities and provisions | 27 | 6 |
| Other non-current assets and liabilities | 243 | 40 |
| Interest received | 6 | 5 |
| Interest paid | (15) | (20) |
| **Cash flow from operating activities** | **982** | **1,033** |
| | | |
| **Cash flow from investing activities** | | |
| Proceeds on disposals of property, plant and equipment and intangible assets | 1 | 0 |
| Payments on investments in property, plant and equipment and intangible assets | (451) | (475) |
| Payments made on financial investments not included under cash equivalents | (3) | (15) |
| **Cash flow from investing activities** | **(453)** | **(490)** |
| | | |
| **Cash flow from financing activities** | | |
| Payments made for capital increase costs | (20) | – |
| Proceeds from capital increase | 3,620 | – |
| Proceeds from borrowing/debt | 570 | – |
| Payments for repayment of borrowing/debt | (141) | (253) |
| Dividends paid | (525) | (503) |
| **Cash flow from financing activities** | **3,503** | **(756)** |
| **Net increase/(decrease) in cash and cash equivalents** | **4,032** | **(212)** |
| **Less cash and cash equivalents attributable to assets and liabilities held for sale** | **–** | **(4)** |
| | | |
| **Cash and cash equivalents at the beginning of the period** | **709** | **324** |
| | | |
| **Cash and cash equivalents at the end of the period (excluding cash and cash equivalents held for sale)[1]** | **4,741** | **108** |

1 Cash and cash equivalents as of September 30, 2014 include EUR 3,636m, which are held in an escrow account and where the Group cannot freely dispose of. This amount represents the cash consideration for the acquisition of E-Plus (please refer to Note 2, Significant events and transactions of the period).

# Condensed Notes_ for the period from January 1 to September 30, 2014

## 1. Reporting entity

The Interim Condensed Consolidated Financial Statements (hereinafter Interim Consolidated Financial Statements) of Telefónica Deutschland Holding AG have been prepared for the period from January 1 to September 30, 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 September 30, 2014, Telefónica Deutschland Holding AG has a share capital of EUR 2,233,890,800, which is divided into 2,233,890,800 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).

On September 8, 2014, the Management Board, in connection with the acquisition of E-Plus, with the approval of the Supervisory Board, resolved to increase the current share capital of the company of EUR 1,116,945,400 by EUR 1,116,945,400 (cash capital increase). As of September 30, 2014 and following the registration of the cash capital increase on September 18, 2014 the share capital amounts to EUR 2,233,890,800.

Each no-par share in general grants one vote at the General Meeting.

Following the registration of the cash capital increase on September 18, 2014 and the registration of the capital increase against contribution in kind on October 7, 2014 in the context of the acquisition of E-Plus (please refer to Note 2, Significant events and transactions of the period as well as Note 13, Events after the reporting period) the share capital as of October 7, 2014 amounts to EUR 2,974,554,993, divided into the same number of no-par value registered shares.

As of September 30, 2014, the authorized capital of Telefónica Deutschland Holding AG allowed 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 and/or contribution in kind (authorized capital 2012/I) as well to execute, with the approval of the Supervisory Board, a capital increase against contribution in kind buy up to EUR 475,000,000 (authorized capital 2014/I).

For the capital increase against contribution in kind in the context of the acquisition of E-Plus (please refer to Note 13, Events after the reporting period) the Management Board resolved on September 24, 2014 with approval of the Supervisory Board of the same day to use the authorized capital 2014/I in full and the authorized capital 2012/I in the amount of EUR 265,664,193 in part. Such capital increase against contribution in kind has been registered with the commercial register on October 7, 2014 under deletion of the cuthorized capital 2014/I and amendment of the authorized capital 2012/I.

Since this registration, Telefónica Deutschland Holding AG has an authorized capital 2012/I in the amount of EUR 292,808,507.

For further information, please refer to Note 2, Significant events and transactions of the period and Note 13, Events after the reporting period.

The share capital of Telefónica Deutschland Holding AG 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).

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. On July 23, 2013, Telefónica Deutschland, Telefónica, S.A. and Koninklijke KPN N.V., The Hague, Netherlands (KPN) concluded an agreement for the acquisition of KPN's German mobile business, E-Plus, by Telefónica Deutschland, which will amend the group structure after the end of this reporting period (please refer to Note 2, Significant events and transactions of the period and Note 13, Events after the reporting period).

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) Agreement on the acquisition of E-Plus and execution of the acquisition**
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 approximately EUR 3.6bn in cash (cash consideration; subject to a final price reduction) and newly issued shares.

The cash consideration to be paid to KPN was financed via a cash capital increase of Telefónica Deutschland (please refer to Note 1, Reporting entity).

The shares for issuance of further consideration to KPN are 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 (for further information please refer to Note 13, Events after the reporting period).

Then Telefónica, S.A. acquires 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 after the registration of the cash capital increase and the capital increase against contribution in kind 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%.

The closing of the transaction took place with effect as of October 1, 2014. For further information, please refer to Note 13, Events after the reporting period.

**b) Agreement on network access in view of the E-Plus acquisition**
On June 25, 2014, Telefónica Deutschland Group signed an agreement with MS Mobile Services GmbH ("Drillisch"), a subsidiary of Drillisch AG, according to which Drillisch agreed to acquire, in addition to the capacity necessary to provide services to its existing customers already hosted on Telefónica Deutschland Group's or E-Plus' networks, 20% of the capacity of all mobile network capacity that is under the control of Telefónica Deutschland Group following the consummation of the acquisition of E-Plus Group. The 20% will be reached via a glide path mechanism over a period of five years. In addition, Drillisch shall have the right to acquire up to 10% additional capacity of those networks.

Telefónica Deutschland Group will grant Drillisch, via a Mobile Bitstream Access model, access to the future joint network of Telefónica Deutschland Group and E-Plus, as well as to the existing and future technology developments on that network, which Drillisch may offer to its customers.

The agreement has been entered into with a view to the decision by the European Commission in the merger control proceeding relating to the acquisition of E-Plus by Telefónica Deutschland (refer to item a). By means of the agreement certain remedies shall be implemented, which Telefónica Deutschland offered during merger control proceedings in order to remove competition concerns of the European Commission. The agreement with Drillisch became effective when the European Commission confirmed on August 29, 2014 that the agreement with Drillisch meets the conditions and obligations associated with the decision, as far as these have to be fulfilled before the closing of the transaction.

**c) 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 Rachel Empey and Markus Haas, whereby Rachel Empey focused on the operative business and Markus Haas on the preparation for the E-Plus integration.

On July 2, 2014 the Supervisory Board of Telefónica Deutschland has resolved to nominate Thorsten Dirks as future chairperson of the Management Board/CEO. He will start his office in the context of the closing of the acquisition of the E-Plus Group by Telefónica Deutschland. The Management Board will then consist of Thorsten Dirks, Markus Haas and Rachel Empey and lead the company after closing of the acquisition. Markus Haas as COO will be in charge for joint operations and Rachel Empey as CFO will take responsibility for finance and strategy.

For further information, please refer to Note 13, Events after the reporting period.

**d) Changes in the Supervisory Board of Telefónica Deutschland**
The Annual General Meeting on May 20, 2014 elected for shareholder side Sally Anne Ashford and Antonio Manuel Ledesma Santiago as further members of the Supervisory Board of Telefónica Deutschland Holding AG. Their office started with the registration of the change of the Articles of Association on September 18, 2014 regarding the increase of the Supervisory Board from twelve to 16 members.

Two further employee representatives of the Supervisory Board are in court election process.

For further information, please refer to Note 13, Events after the reporting period.

**e) Decision of Federal Network Agency regarding return of frequencies of 900MHz and 1,800MHz**
In the telecommunications law decision on the merger process of Telefónica Deutschland and E-Plus Mobilfunk GmbH & Co. KG on July 4, 2014, the President's Chamber of the Federal Network Agency has decided, in the event of the completion of the transaction, that Telefónica Deutschland Group and E-Plus Mobilfunk GmbH & Co. KG are obligated to return those frequencies of 900MHz and 1,800MHz until December 31, 2015, for which they do not have an assignment at this time beyond the year 2016 (early return of 900/1,800MHz spectrum), and that the Federal Network Agency will examine in the context of an overall consideration, taking into account the future frequency equipment in the ranges of 900MHz and 1,800MHz if any action is required concerning the merger-related frequency spectrum, particularly in the area 2GHz (frequency distribution analysis). On August 4, 2014, Telefónica Deutschland Group filed a claim with the Administrative Court of Cologne (Verwaltungsgericht Köln) against the Federal Network Agency's decision of July 4, 2014, which has not been decided yet.

**f) General Meetings**

**Extraordinary General Meeting**

On February 11, 2014, an extraordinary General Meeting took place in which the following capital measures for the acquisition of E-Plus were approved:

- 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 475,000k 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. The authorized capital 2014/I was registered on September 18, 2014.

Furthermore, the extraordinary General Meeting resolved a new conditional capital 2014/I, whilst suspending the formerly conditional capital 2012/I. The new Conditional Capital 2014/I was registered in the commercial register on February 25, 2014, whilst suspending the formerly conditional capital 2012/I (please refer to Note 1, Reporting entity).

**Annual General Meeting and dividend payment**

On May 20, 2014, the second Annual General Meeting of Telefónica Deutschland Holding AG took place. In addition to the discharge of the members of the Supervisory Board and the members of the Management Board as well as the election of Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft with its registered office in Stuttgart, branch office Munich, as auditor for the Consolidated Financial Statements and Financial Statements of Telefónica Deutschland Holding AG for the financial year 2014, the General Meeting resolved to distribute a dividend of EUR 0.47 for each share entitled to dividends, in total EUR 524,964,338.

In addition, the increase of the share capital by up to EUR 3.7bn against cash contribution with a subscription right of the shareholders in connection with the acquisition of E-Plus (hereinafter “Cash Capital Increase“) as well as the related amendment of the articles of association was approved (refer to Note 1, Reporting entity). Hereby the possibility is created to potentially implement the Cash Capital Increase beyond the implementation period of the resolution passed at the extraordinary General Meeting as of February 11, 2014 under agenda item 1, therefore beyond August 10, 2014.

Furthermore, it was resolved to increase the number of members of the Supervisory Board from twelve to 16 and change the Articles of Association accordingly. The change in the Articles of Association was registered in the commercial register on September 18, 2014.

The General Meeting elected Sally Anne Ashford and Antonio Manuel Ledesma Santiago as members of the Supervisory Board of Telefónica Deutschland Holding AG subject to the registration in the commercial register.

For further information, please refer to Note 13, Events after the reporting period.

**g) Issue of a seven-year bond (Bond II)**

On February 10, 2014, Telefónica Deutschland Group issued a senior unsecured seven-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.

In this connection an interest rate swap was signed for a partial amount of EUR 150m of the bond's nominal value. On the basis of the interest rate swap contract, Telefónica Deutschland Group pays a variable interest rate amounting to the three-month Euribor on the nominal amount and receives a fixed interest rate of 1.268% on the same amount in return.

**h) Conclusion of contract to expand the wireline cooperation**
In May 2013, Telefónica Deutschland Group via Telefónica Germany GmbH & Co. OHG concluded with Telekom Deutschland 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 (Bundeskartellamt – BKartA). The Federal Network Agency has approved the cooperation in its preliminary draft decision from 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 preliminary draft decision 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, was investigated with regard to general legal competition matters by the Federal Cartel Office. A decision was made on November 5, 2014. As expected, the 7th decision devision of the Federal Cartel Office determined, that, due to current knowledge, no action is required by the decision devision. Effective on May 1, 2014, Telefónica Deutschland Group intensifies usage of the high-speed infrastructure of Telekom Deutschland GmbH for its wireline products in connection with the binding agreement.

**i) Proposal for the financial year 2014 dividend**
On September 8, 2014 the Management Board of Telefónica Deutschland has resolved and published its intention to suggest to the general shareholders' meeting a cash dividend for the financial year 2014 of at least EUR 700m, payable in 2015.

For details of the Telefónica Deutschland dividend policy, please refer to https://www.telefonica.de/investor-relations/share/dividends.html

## 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 September 30, 2014 are unaudited.

Unless otherwise stated, the figures in these Interim Consolidated Financial Statements are rounded and refer to millions of Euros (EUR m). 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, as well as a change in estimate for the dismantling of a part of Telefónica Deutschland Group's network, which will now be done earlier than originally expected. The latter results in an additional provision requirement of EUR 30m in the reporting period.

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 amendments were required to be adopted for financial years beginning on or after January 1, 2014.

Furthermore the Group adopted early IFRIC 21, Levies effective as of January 1, 2014. The European Union (EU) endorsed the interpretation with its regulation dated June 13, 2014 for annual periods beginning on or after June 17, 2014. Earlier application was permitted.

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 published at the date of preparation of the Interim Consolidated Financial Statements, but which had not to be applied mandatorily 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 IFRSs 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* |
| Amendments to IAS 16 and IAS 38 | Clarification of acceptable Methods of Depreciation and Amortisation | January 1, 2016* |
| Amendments to IFRS 11 | Accounting for Acquisitions of Interests in Joint Operations | January 1, 2016* |
| Amendments to IAS 16 and IAS 41 | Agriculture: Bearer Plants | January 1, 2016* |
| Amendments to IAS 27 | Equity Method in Separate Financial Statements | January 1, 2016* |
| Amendments to IFRS 10 and IAS 28 | Sale or Contribution of Assets between an Investor and its Associate or Joint Venture | January 1, 2016* |
| Annual improvements to IFRSs 2012–2014 Cycle | Amendments to IAS 19, IAS 34, IFRS 5 and IFRS 7 | January 1, 2016* |
| IFRS 15 | Revenue from Contracts with Customers | January 1, 2017* |
| IFRS 9 and amendments to IFRS 7 | Financial Instruments | January 1, 2018* |

* Endorsement by EU still outstanding, information for first time adoption according to IASB.

On May 6, 2014, the IASB published amendments to IFRS 11, Joint Arrangements in connection with the acquisition of interests in joint operations. The acquirer of an interest in a joint operation, which constitutes a business in accordance with IFRS 3, should apply the accounting principles of IFRS 3 as long as those principles do not conflict with the guidance in IFRS 11.

With the amendments to IAS 16, Property, Plant and Equipment and IAS 38, Intangible Assets published on May 12, 2014, the IASB provides additional guidance to determine an acceptable depreciation method. In particular a depreciation method that is based on revenues is not appropriate for property, plant and equipment and is allowed for intangible assets only in limited circumstances.

The amendments to IFRS 10/IAS 28, IFRS 11, IAS 16, IAS 27 and IAS 38 are effective for annual periods beginning on or after January 1, 2016. The Group does not expect an effect on its net assets, financial position and results of operations.

On May 28, 2014, the International Accounting Standards Board (IASB) issued IFRS 15, Revenue from Contracts with Customers with the objective to converge rules from different standards and interpretations across industries in a uniform standard. The new standard provides for a five-step model framework to determine the amount of revenues and the point in time of revenues recognition. Furthermore the standard includes additional guidance on more detailed questions. The standard is effective for periods beginning on or after January 1, 2017. Telefónica Deutschland Group currently analyzes the standard for its potential effects.

On July 24, 2014, the IASB issued IFRS 9, Financial Instruments regarding the comprehensive accounting rules for financial instruments. Compared to the previous standard, IAS 39, the new and in the most recent version of IFRS 9 revised classification model for financial assets should be highlighted. Also fundamentally new are the rules for the recognition of impairment losses which are based on tan expected loss model.

In addition, hedge accounting was reformed under IFRS 9 focusing on a closer reflection of the entity's risk management. The standard is effective for periods beginning on or after January 1, 2018. Telefónica Deutschland Group currently analyzes the standard for its potential effects.

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 September 30, 2014.

## 5. Comparative information

The Consolidated Statement of Financial Position presented in these Interim Consolidated Financial Statements compares figures as of September 30, 2014 and December 31, 2013. The Consolidated Income Statement and the Consolidated Statement of Comprehensive Income compare figures for the nine-month periods ended September 30, 2014 and September 30, 2013 and the figures for the third quarter in financial years 2014 and 2013. The Consolidated Statement of Cash Flows and the Consolidated Statement of Changes in Equity compare figures for the nine-month periods ended September 30, 2014 and September 30, 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 September 30, 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).

With effect as of October 1, 2014, the closing of the acquisition of E-Plus Mobilfunk GmbH & Co. KG, Duesseldorf, together with its direct and indirect subsidiaries was completed.

For further information, please refer to Note 13, Events after the reporting period.

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

## a) Trade and other receivables

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

| (Euros in millions) | **As of September 30 2014** | As of December 31 2013 |
|---|---|---|
| Receivables from sales and services | 1,026 | 969 |
| Receivables from related parties | 23 | 27 |
| Other receivables | 6 | 12 |
| Prepayments | 179 | 146 |
| Provisions for bad debts | (121) | (118) |
| **Trade and other receivables** | **1,113** | **1,035** |

## b) Cash and cash equivalents

| (Euros in millions) | **As of September 30 2014** | As of December 31 2013 |
|---|---|---|
| Bank balances and cash in hand | 3,641 | 8 |
| Cash pooling | 1,099 | 701 |
| **Cash and cash equivalents** | **4,741** | **709** |

As of September 30, 2014, cash and cash equivalents include EUR 3,636m, which are held in an escrow account and where the group cannot freely dispose of. This amount represents the cash consideration for the acquisition of E-Plus (please refer to Note 2, Significant events and transactions of the period).

## c) Equity

**Common stock**

On September 8, 2014, the Management Board, with the approval of the Supervisory Board, in connection with the acquistiion of E-Plus, resolved to increase the share capital of the company from initially EUR 1,117m, by an amount of EUR 1,117m (cash capital increase).

As of September 30, 2014 and after the cash capital increase was registered in the commercial register on September 18, 2014, the share capital of Telefónica Deutschland Holding AG thus amounts to EUR 2,234m, divided into 2,233,890,800 of no-par value registered shares, each representing a notional amount of EUR 1.00 in the registered share capital.

As of September 30, 2014, Telefónica Deutschland Holding AG did not hold any of its own shares. 23.17% of the shares are held in free float, the remaining 76.83% are held by Telefónica Germany Holdings Limited.

Each no-par share in general grants one vote at the General Meeting.

For further information, please refer to Note 13, Events after the reporting period.

**Additional paid-in capital**
In connection with the afore-mentioned cash capital increase, which was registered in the commercial register on September 18, 2014, additional paid-in capital increased by EUR 2,470m to the amount of EUR 2,470m as of September 30, 2014.

The increase in additional paid-in capital results from the total proceeds from the shares in the capital increase amounting to EUR 3,620m less the contribution to the share capital of EUR 1,117 and the costs of the capital increase of EUR 33m.

## d) Trade payables, other payables and deferred income

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

| | As of September 30 2014 | | As of December 31 2013 | |
|---|---|---|---|---|
| (Euros in millions) | Non-current | Current | Non-current | Current |
| Trade payables against third parties | – | 222 | – | 451 |
| Accruals | – | 694 | – | 404 |
| Payables to related parties | – | 190 | – | 220 |
| **Trade payables** | **–** | **1,106** | **–** | **1,074** |
| **Other payables** | **47** | **244** | **5** | **222** |
| **Deferred income** | **262** | **189** | **–** | **170** |

Deferred income mainly includes advance payments received on prepaid contracts as well as other advance payments for future services to be received. The latter are classified according to their expected utilization as current or non-current. Advance payments received on prepaid contracts are solely classified as current.

## e) 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 600m 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 500m in February 2014 (see Note 2, Significant events and transactions of the period). These bonds (except for EUR 350m of the nominal value of the bonds) are accounted for by using the effective interest method after deduction of the disagio and incurred transaction costs. A portion amounting to EUR 350m of the nominal value of the bonds together with interest swaps is subject to a fair value hedge and is therefore classified as liability at fair value through profit or loss.

In addition, a loan of EUR 1,250m 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 250m was made. Furthermore in 2013, EUR 150m and in 2014, EUR 125m were repaid prematurily due to obtaining other financing. Of the remaining balance of EUR 725m as of September 30, 2014, EUR 500m are classified as non-current and EUR 225m as current.

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

### f) 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 September 30, 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 bonds 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

| (Euros in millions) | Financial assets | | | | | | | | | Non-financial assets |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | Measurement hierarchy | | | | | |
| | 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 | |
| | | | | | | | | | | As of September 30, 2014 |
| Other non-current financial assets | – | 6 | – | 108 | – | 6 | – | 114 | 114 | – |
| Trade and other receivables (Note 7a) | – | – | – | 928 | – | – | – | 928 | 928 | 185 |
| Other current financial assets | – | – | – | 21 | – | – | – | 21 | 21 | – |
| Cash and cash equivalents (Note 7b) | – | – | – | 4,741 | – | – | – | 4,741 | 4,741 | – |
| **Total** | **–** | **6** | **–** | **5,797** | **–** | **6** | **–** | **5,804** | **5,804** | **185** |

| (Euros in millions) | Financial assets | | | | | | | | | Non-financial assets |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | Measurement hierarchy | | | | | |
| | 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 | |
| | | | | | | | | | | As of December 31, 2013 |
| Other non-current financial assets | – | 6 | – | 92 | – | 6 | – | 99 | 99 | – |
| Trade and other receivables (Note 7a) | – | – | – | 877 | – | – | – | 877 | 877 | 158 |
| Other current financial assets | – | – | – | 21 | – | – | – | 21 | 21 | – |
| Cash and cash equivalents (Note 7b) | – | – | – | 709 | – | – | – | 709 | 709 | – |
| **Total** | **–** | **6** | **–** | **1,699** | **–** | **6** | **–** | **1,705** | **1,705** | **158** |

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 12m (2013: EUR 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 20m (2013: EUR 20m).

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

| (Euros in millions) | 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 September 30, 2014** | | | | | | | | | |
| | **Financial liabilities** | | | | | | | | | **Non-financial liabilities** |
| | | | | | **Measurement hierarchy** | | | | | |
| Long-term loans (Note 7e) | 344 | 1,244 | – | – | – | 344 | – | 1,588 | 1,611 | – |
| Other non-current payables (Note 7d) | – | 3 | 44 | – | – | – | – | 47 | 47 | – |
| Short-term loans (Note 7e) | – | 243 | – | – | – | – | – | 243 | 243 | – |
| Trade payables (Note 7d) | – | 1,106 | – | – | – | – | – | 1,106 | 1,106 | – |
| Other current liabilities (Note 7d) | – | 182 | 15 | – | – | – | – | 197 | 197 | 46 |
| **Total** | **344** | **2,778** | **59** | **–** | **–** | **344** | **–** | **3,181** | **3,204** | **46** |

| (Euros in millions) | 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 December 31, 2013 | | | | | | | | | |
| | Financial liabilities | | | | | | | | | Non-financial liabilities |
| | | | | | Measurement hierarchy | | | | | |
| Long-term loans (Note 7e) | 200 | 1,142 | – | – | – | 200 | – | 1,343 | 1,348 | – |
| Other non-current payables (Note 7d) | – | 3 | 1 | – | – | – | – | 5 | 5 | – |
| Short-term loans (Note 7e) | – | 102 | – | – | – | – | – | 102 | 102 | – |
| Trade payables (Note 7d) | – | 1,074 | – | – | – | – | – | 1,074 | 1,074 | – |
| Other current liabilities (Note 7d) | – | 196 | 2 | – | – | – | – | 198 | 198 | 24 |
| **Total** | **200** | **2,518** | **3** | **–** | **–** | **200** | **–** | **2,721** | **2,727** | **24** |

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 is 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 cumulated loss of EUR 10m (EUR 4m loss in the three months of the third quarter and EUR 13m loss in the first nine months of 2014), wheras the corresponding interest rate swaps result in a cumulated gain of EUR 13m (EUR 5m gain in the three months of the third quarter and EUR 16m gain in the first nine months of 2014). Thus, a net result, representing the ineffective part of the hedge relationship amounting to EUR 3m (EUR 1m net result in the three months of the third quarter and EUR 2m in the first nine months of 2014) is recognized in the net financial result. There had been no effects until September 30, 2013. Under the existing interest rate swaps, Telefónica Deutschland Group pays a variable quarterly interest rate amounting to the three-month Euribor and receives an average fixed interest rate of 0.927% and 1.268%, respectively. The hedged nominal value of the financial liabilities amounts 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 13m as of September 30, 2014 (2013: EUR –3m) and reduces (increased) the long-term loans. The fair value of the bonds is determined by discounting the expected future cash flows using currently applicable interest rates with comparable conditions and residual terms.

The non-financial liabilities within 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:

| | July 1 to September 30 | | January 1 to September 30 | |
|---|---|---|---|---|
| (Euros in millions) | **2014** | 2013 | **2014** | 2013 |
| Rendering of services | 1,037 | 1,076 | 3,053 | 3,184 |
| Other sales | 182 | 149 | 450 | 487 |
| **Total revenues** | **1,219** | **1,225** | **3,503** | **3,671** |

Revenues from rendering of services include mobile 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 revenues.

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

| (Euros in millions) | July 1 to September 30 2014 | July 1 to September 30 2013 | January 1 to September 30 2014 | January 1 to September 30 2013 |
|---|---|---|---|---|
| **Revenues** | | | | |
| **Wireless business** | **934** | **912** | **2,633** | **2,729** |
| Mobile service revenues | 754 | 765 | 2,189 | 2,246 |
| Handset revenues | 180 | 147 | 444 | 482 |
| **Wireline business** | **283** | **311** | **864** | **938** |
| **Other revenues** | **2** | **2** | **6** | **4** |
| **Total revenues** | **1,219** | **1,225** | **3,503** | **3,671** |

### b) Net financial income/(expense)

In the first nine months of the current financial year the net financial income/(expense) of Telefónica Deutschland Group amounted to EUR –26m (2013: EUR –23m).

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

| (Euros in millions) | July 1 to September 30 2014 | July 1 to September 30 2013 | January 1 to September 30 2014 | January 1 to September 30 2013 |
|---|---|---|---|---|
| Interest income from financial assets | 2 | 1 | 6 | 5 |
| Interest expenses from financial liabilities | (10) | (7) | (30) | (23) |
| Accretion of provisions and other liabilities | (0) | (0) | (0) | (5) |
| Other exchange gains/(losses) | (1) | 0 | (1) | 0 |
| **Net financial income/(expense)** | **(10)** | **(6)** | **(26)** | **(23)** |

The interest income from financial assets mainly comprises the interest income in connection with "$O_2$ My Handy" receivables and cash-pooling balances with Telfisa Global B.V.

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. Leases and other obligations

### Finance Leases

Telefónica Deutschland Group's finance leases are recognized in the Interim Consolidated Financial Statements for the period ended September 30, 2014 in the position property, plant and equipment and comprise the following amounts:

| (Euros in millions) | As of September 30 2014 | As of December 31 2013 |
|---|---|---|
| Plant and machinery | 72 | 3 |
| **Net carrying amount of lease assets** | **72** | **3** |

The commitments from finance leases result mainly from agreements for network elements which were entered into in connection with sale and leaseback transactions und are classified as finance lease due to their contractual features.

The breakdown of minimum lease payment obligations is as follows:

| | As of September 30 2014 | | | As of December 31 2013 | | |
|---|---|---|---|---|---|---|
| (Euros in millions) | Minimum future lease payments obligation | Unamortized interest expense | Present value of minimum future lease payments obligation | Minimum future lease payments obligation | Unamortized interest expense | Present value of minimum future lease payments obligation |
| Due within one year | 16 | 1 | 15 | 2 | 0 | 2 |
| Due between 1 and 5 years | 46 | 2 | 44 | 1 | 0 | 1 |
| Due in more than 5 years | – | – | – | – | – | – |
| **Present value of minimum lease payments** | **62** | **3** | **59** | **3** | **0** | **3** |

Renewal and purchase options where the exercise is not expected are not considered in the calculation of the minimum lease payments.

### Purchase and other contractual obligations

The following expected maturities apply for purchase and other contractual obligations:

| (Euros in millions) | As of September 30 2014 | As of December 31 2013 |
|---|---|---|
| Less than 1 year | 245 | 185 |
| 1 to 5 years | 44 | 46 |
| Over 5 years | 713 | 81 |
| **Purchase and other contractual obligations** | **1,001** | **313** |

Purchase and other contractual obligations over five years increased in the reporting period compared to the Consolidated Financial Statements for the year ended December 31, 2013 mainly due to long-term purchase contracts with suppliers.

## 10. Earnings per share

Basic earnings per share are calculated by dividing the profit for the year after tax attributable to the ordinary shareholders of the parent company by the weigthed average number of ordinary shares outstanding during the reporting period.

Diluted earnings per share are calculated by adjusting the profit after tax attributable to the ordinary shareholders of the parent company and the weighted average number of ordinary shares outstanding in the reporting period for the effects of any dilutive effects inherent in converting potential ordinary shares.

Both basic as well as diluted earnings per share attributable to the ordinary shareholders of the parent company are calculated based on the following data in accordance with IAS 33.

| | July 1 to September 30 | | January 1 to September 30 | |
|---|---|---|---|---|
| (Euros in millions) | **2014** | 2013 | **2014** | 2013 |
| Profit attributable to ordinary equity holders of the parent | (15) | 9 | (79) | (1) |
| Dilutive effects of the conversion of potential ordinary shares | – | – | – | – |
| Total profit attributable to equity holders of the parent for diluted earnings | (15) | 9 | (79) | (1) |

In the reporting periods presented no equity instruments with dilutive effects were outstanding. Please refer to Note 7, Equity.

Furthermore, the share capital of Telefónica Deutschland Holding AG is conditionally increased (please refer to Note 7, Equity). Shares stemming from the conditional share capital of a stock corporation are not subject to the calculation of earnings per share as they are contingently issuable.

| (Number of shares in millions) | **As of September 30 2014** | As of December 31 2013 |
|---|---|---|
| Weighted average number of ordinary shares for basic earnings per share | 1,166 | 1,117 |
| Weighted average number of ordinary shares for diluted earnings per share | 1,166 | 1,117 |

In the reporting period 2014 with effect from September 18, 2014, the share capital of the company was increased from initially EUR 1,117m by issuing 1,116,945,400 new shares to EUR 2,234m (cash capital increase) resulting in the change of the weighted average number of ordinary shares In the reporting period. The cash capital increase was registered in the commercial register on September 18, 2014. Please refer to Note 7, Equity.

Basic and diluted earnings per share attributable to the ordinary shareholders of the parent company is as follows:

| | July 1 to September 30 | | January 1 to September 30 | |
|---|---|---|---|---|
| (Earnings per share) | **2014** | 2013 | **2014** | 2013 |
| Basic earnings per share in EUR | (0.01) | 0.01 | (0.07) | (0.00) |
| | | | | |
| Diluted earnings per share in EUR | (0.01) | 0.01 | (0.07) | (0.00) |

## 11. Business combinations

### Acquisition of E-Plus Group

Per sale and purchase agreement (SPA) dated July 23, 2013, as amended on August 26, 2013, August 28, 2013 December 5, 2013, March 24, 2014, August 7, 2014 and September 30, 2014 between Telefónica S.A., Madrid, Spain, Telefónica Deutschland Holding AG, Munich and Koninklijke KPN N.V., The Hague, Netherlands (KPN, and together with its direct and indirect subsidiaries, the KPN Group), Telefónica Deutschland Holding AG together with its direct and indirect subsidiaries acquired 100% of the voting equity interests in E-Plus Mobilfunk GmbH & Co. KG, Duesseldorf and its direct and indirect subsidiaries (E-Plus Group) as of October 1, 2014 and hence obtained control of the E-Plus Group. The E-Plus Group dates back to the founding of E-Plus Mobilfunk GmbH in 1993. It provides customers in Germany mainly with multi-brand mobile telecommunications services, offering post-paid and pre-paid services targeted at multiple customer segments. The increased market opportunities and the expected synergies are the main reasons for the acquisition.

The consideration paid comprises cash payments of EUR 3.6bn as well as equity instruments of EUR 3.1bn. The recognized goodwill of EUR 0.9bn, as difference between the consideration of EUR 6.7bn and the acquisition-date fair value of the E-Plus Group's identifiable net assets of EUR 5.8bn, mainly results from expected synergies in particular with respect to distribution, customer service and network infrastructure. As of acquisition date the total amount of goodwill that is expected to be deductible for tax purposes amounts to EUR 1.9bn.

The following table summarizes the consideration paid for the acquisition, the fair values of the identified assets and the liabilities assumed at the acquisition date. The purchase price allocation is not yet finalized as some valuation reports are still outstanding. Adjustments could result from the changes in the fair values of property, plant and equipment, intangible assets and contingent liabilities, respectively.

| (Euros in billions) | Preliminary fair values at acquisition date |
|---|---|
| Intangible assets | 4.4 |
| Property, plant and equipment | 1.9 |
| Trade and other receivables | 0.6 |
| Deferred tax assets | – |
| Other assets | 0.2 |
| Cash and cash equivalents | 0.4 |
| Provisions | 0.3 |
| Trade and other payables | 1.2 |
| Deferred income | 0.2 |
| Net assets | 5.8 |
| Goodwill | 0.9 |
| Preliminary Purchase price | 6.7 |

Acquisition-related costs of EUR 0.01bn for the nine months period ended September 30, 2014 and EUR 0.01bn for the twelve months period ended December 31, 2013 have been charged to other expenses in the Consolidated Income Statement.

The fair value of the EUR 3.1bn ordinary shares issued as part of the consideration (EUR 6.7bn) was based on the published opening share price on October 1, 2014. Issuance costs totaling EUR 0.03bn have been recognized without affecting net income.

Disclosures regarding the fair value of receivables:

| (Euros in billions) | Gross amount | Impairment | Preliminary fair value |
|---|---|---|---|
| Trade receivables | 0.3 | 0.1 | 0.2 |
| Other receivables | 0.3 | 0.0 | 0.3 |
| Lease receivables | 0.2 | 0.0 | 0.2 |

Had E-Plus Group been acquired on January 1, 2014, the consolidated statement of income of Telefónica Deutschland Group for the nine month period ended September 30, 2014 would show pro-forma revenues of EUR 5.8bn and a net loss of EUR 0.3bn.

In total EUR <0.1bn were recognized as contingent liabilities, of which a partial amount results from pending lawsuits in which E-Plus Group is a defendant.

## 12. Contingent assets and liabilities

As of September 30, 2014, the existing contingent assets and liabilities of the Telefónica Deutschland Group have not changed significantly compared to December 31, 2013. For further information please refer to the Consolidated Financial Statements for the year ended December 31, 2013 (Note 29, Contingent Assets and Liabilities).

## 13. Events after the reporting period

**Capital increase against contribution in kind/new share capital number**
In context with the acquisition of E-Plus the Management Board resolved on September 24, 2014 with the approval of the Supervisory Board, to increase the share capital of the company from EUR 2,233,890,800 by an amount of EUR 740,664,193 to EUR 2,974,554,993 by issuance of 740,664,193 new registered shares (capital increase against contribution in kind).

The new shares were subscribed by KPN Mobile Germany against contribution in kind of the limited partnership interest in E-Plus Mobilfunk GmbH & Co. KG, Duesseldorf, Germany (E-Plus Mobilfunk).

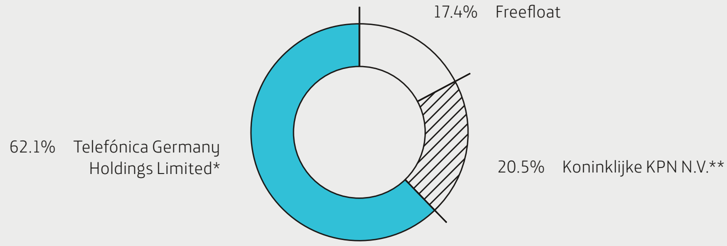
The capital increase against contribution in kind was registered in the commercial register on October 7, 2014. Therefore, the share capital amounts to EUR 2,974,554,993, divided in the same number of no-par value registered shares.

Furthermore, the authorized capital 2014/I was deleted due to full use. The authorized capital 2012/I exists in the amount of EUR 292,808,507 (please refer to Note 1, Reporting entity).

**Closing of the E-Plus acquisition**
The closing of the acquisition of E-Plus took place with effect as of October 1, 2014 (please refer to Note 1, Reporting entity). Since this point of time E-Plus Mobilfunk GmbH & Co. KG together with its direct and indirect subsidiaries belong to Telefónica Deutschland Group in addition to the existing entities.

### New shareholder structure

Following the capital increases against cash and contribution in kind in the context of the acquisition of E-Plus and the acquisition of further 4.4% by Telefónica, S.A. from KPN Mobile Germany (please refer to Note 2, Significant events and transactions of the period) and according to respective shareholdings notifications received, Telefónica Deutschland has the following shareholder structure:




* Telefónica Germany Holdings Limited is an indirect wholly owned subsidiary of Telefónica, S.A.
** According to the shareholdings notification as of October 20, 2014 the shares are now directly held by Koninklijke KPN N.V.

### Appointment of Management Board members

Thorsten Dirks has been appointed member of the Management Board and chairperson of the Management Board/CEO by resolution of the Supervisory Board as of October 9, 2014.

With resolution as of October 9, 2014, the Supervisory Board extended the period of office of Rachel Empey and Markus Haas. All members of the Management Board are appointed until the end of September 30, 2017.

### Appointment of Supervisory Board members

Joachim Rieger and Jürgen Thierfelder were appointed by decision of the local court of Munich as of October 31, 2014 as further members of the Supervisory Board, employee representative side.

Thereby the Supervisory Board is completely staffed with its 16 members, eight of them being from shareholder side and eight from employee side.

### Integration of E-Plus

Following the completion of the acquisition of the E-Plus Group, the Management Board of Telefónica Deutschland announced as of October 17, 2014 first key parameters for the integration of E-Plus. The merger with E-Plus is a chance for Telefónica Deutschland Group to actively build the change in the telecommunication industry and to become the leading digital telecommunication company. With the objective of digital transformation of the business model and to contribute to achieving the announced synergies with a net present value of more than EUR 5bn, 1,600 of the current approximately 9,100 full-time positions are to be cut by 2018. This is mainly to abolish duplicate functions. In this process, Telefónica Deutschland intends to implement a severance pay scheme for employees leaving the company. The company strives to avoid compulsory redundancies wherever possible. The measures are subject to further negotiations with the Workers Council. Furthermore, Management and Supervisory Board have resolved to contribute the limited partnership interest in E-Plus Mobilfunk GmbH & Co. KG into Telefónica Germany GmbH & Co. OHG until the end of the business year 2014. They also resolved to change in the first quarter 2015 the legal form of E-Plus Mobilfunk GmbH & Co. KG into a limited liability company (GmbH) and to conclude a profit and loss transfer agreement with Telefónica Germany GmbH & Co. OHG.

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

Munich, November 13, 2014

Telefónica Deutschland Holding AG

The Management Board

Thorsten Dirks

Rachel Empey

Markus Haas

# Glossary_

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

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

| | |
|---|---|
| Internet | Worldwide network of computers on the basis of an IP (Internet Protocol) without any central network management |
| IPO | Initial public offering |
| IT | Information Technology |
| Joint Venture | Two or more companies founding a new enterprise for cooperation |
| LAN | Local Area Network: a group of computers and associated devices that share a common communications line or wireless link |
| Libor | London Interbank Offered Rate |
| Live Check | Website and app which customers can use to get location-based information on the current quality of the $O_2$ mobile communications network |
| LTE | Long Term Evolution: further development of the UMTS/HSPA mobile communications standard |
| M2M | Machine-to-Machine communication, automatic exchange of information between machines |
| MMS | Multimedia Messaging Service |
| MNO | Mobile Network Operator |
| mpass | Mobile payment service |
| MTR | Mobile termination rates |
| Multi-brand strategy | Enables Telefónica Deutschland to provide customers in all segments offers that suit their exact needs through various own and partner brands |
| MVNO | Mobile Virtual Network Operator |
| NFC | Near Field Communication: a short-range wireless connectivity standard |
| NGO | Non Governmental Organization |
| n.m. | not measured |
| NRA | National Regulatory Authority |
| $O_2$ My Handy | Monthly payment model for mobile phones and other devices |
| OIBDA | Operating Income before Depreciation and Amortization |
| OTT | Over The Top |
| PBX | Private Branch Exchange: a telephone system within an enterprise that switches calls between enterprise users on local lines while allowing all users to share a certain number of external phone lines |
| PIP | Performance and Investment Plan |
| POS | Point of Sale |
| Prepaid/Postpaid | In contrast to postpaid contracts, prepaid communication services are services for which credit has been purchased in advance with no fixed-term contractual obligations |
| Retail | Sale of goods and services to end users; as opposed to resale or wholesale business |
| Roaming | Using a communication device or subscriber identity in a different network other than one's home network |

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

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