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Telefónica Deutschland – Preliminary results for January to June 2023

Telefónica Deutschland narrows FY23 outlook to upper-range on back of strong H1 23 performance and continued momentum

- **Achieved +302k mobile postpaid and +22k fixed BB net adds due to ongoing good commercial traction in combination with normalised churn rates**
- **Successfully introduced more-for-more 'O2 Mobile' tariff portfolio supported by strong brand momentum**
- **Delivered sustained revenue growth of +4.4% y-o-y underpinned by accelerated MSR momentum**
- **Generated strong OIBDA[1] growth of +2.7% y-o-y driven by enhanced MSR quality, leading to positive FCFaL already in H1 23**
- **Made excellent progress with 5G network coverage within normalised C/S envelope – achieved YE-target for 5G coverage of ~90% already at mid-year**
- **Extended ESG leadership and well on track to deliver a sustainable digital future**
- **Narrowing FY23 revenue and OIBDA outlook to 'upper-range of low single-digit % growth' on back of strong H1 23 results and continued momentum**

Operating performance

Telefónica Deutschland continued its robust growth path in Q2 23 with the company's more-for-more 'O_2 Mobile'-portfolio successfully launched in Apr-23. The innovative 'O_2 Mobile' tariffs are well received from customers. Hence, own-brand gross add momentum and normalized churn rates were the main drivers of good commercial traction in the quarter. At the same time, the company's focus is increasingly on value-over-volume with its more-for-more strategy underpinning FY23 growth ambitions.

In parallel, Telefónica Deutschland made excellent progress with the densification and further roll-out of its green 5G network. The company already delivered its YE23 5G pop coverage target of ~90% by mid-year and is well on track for nationwide coverage latest by YE25.

As part of its ESG-agenda, Telefónica Deutschland embraces digital skills and digital inclusion. The company joined the Bavarian State Ministry for Digital Affairs' initiative 'Alliance for Digital Skills' to promote equal and free of charge access to high-quality digital training for everyday life. Also, Telefónica Deutschland and the Wayra start-up, enna, now offer a solution for elderly people (hardware combined with simple apps) to support interaction with family and friends. It is the first product from the Wayra start-up portfolio which is now available in O_2's online sales channel.

Moreover, Telefónica Deutschland remains committed to its climate protection goals. The Company strives to reduce its Scope 1 & 2 emissions by 95% and ultimately neutralising them no later than 2025. Also, the company is taking concrete actions to be net CO_2 neutral along its entire value chain (Scope 3) by 2040.

[1] Adjusted for exceptional effects. In Q2 23 exceptional effects amounted to EUR -0m of restructuring costs (EUR -1m in Q2 22)

Mobile business

Mobile postpaid delivered +302k net adds in Q2 23 vs. +374k in Q2 22 (+670k in H1 23, up +1.4% y-o-y) on back of continued high O_2 brand appeal and a solid contribution of partner brands. Churn rates remained at the low levels achieved prior to the EECC-implementation in the German market. **O_2 postpaid churn** stood at a low rate of 0.8% in Q2 23 (1.0% in Q1 23) reflecting commercial success based on the high network and service quality in combination with the strong O_2 brand.

M2M reported +57k net additions in Q2 23 vs. +37k in Q2 22 (+98k in H1 23, up +38.1% y-o-y).

Mobile prepaid recorded -131k net disconnections in Q2 23 (+370k in Q2 22 including some revenue neutral reactivations; -484k in H1 23 vs. +271k in H1 22) mainly driven by the ongoing German market trend of prepaid to postpaid migration.

Overall, Telefónica Deutschland's **mobile customer accesses** was up +0.5% q-o-q[2] to 44.6m as of 30 Jun-23. The **mobile postpaid base** (ex M2M) continued its growth path, posting a strong increase of +4.8% y-o-y to 27.0m accesses (60.6% of total mobile access base, up +5.4 p.p. y-o-y) mainly reflecting own-brand gross add momentum in combination with normalised churn levels. **M2M accesses** grew +6.5% yoy to 1.8m whereas the **mobile prepaid base** accounted for 15.8m, a -17.9% y-o-y decline mainly on back of some revenue neutral technical[3] base adjustments in the prior year.

O_2 postpaid ARPU maintained its upward trend, posting +1.0% y-o-y growth in Q2 23 (+0.8% y-o-y in H1 23), reflecting customer demand for high value tariffs while partly offset by the reduction of MTRs as of 1 Jan-23; underlying[4] ARPU growth was even stronger at +1.6% y-o-y (+1.4% y-o-y in H1 23).

Fixed business

Fixed broadband net additions were +22k in Q2 23 vs. +5k in Q2 22 (+46k net additions in H1 23 vs. -6k net disconnections in H1 22) as Telefonica Deutschland's technology agnostic 'O_2 myHome' tariff portfolio remains in high customer demand.

Fixed churn improved 0.3 p.p. y-o-y to 0.8% in Q2 23, again confirming the return to the low levels reported prior to the EECC-implementation in the German market.

Fixed broadband customer base was up +3.7% y-o-y to 2.3m accesses as of 30 Jun-23, thereof 79% VDSL accesses (-2.0 p.p. y-o-y) as cable and fibre are gaining further momentum in customer demand.

Fixed broadband ARPU[5] continued to grow as a result of the increasing share of higher value customers in the base, +1.3% y-o-y to EUR 25.5 in Q2 23 (+1.7% to EUR 25.5 in H1 23).

[2] -4.5% y-o-y mainly on a revenue-neutral technical base adjustment in prepaid in Q4 22.

[3] Introduction of a stricter active SIM-card definition in Q4 22 post some revenue neutral reactivations of SIM-cards in the course of FY22.

[4] Excluding MTR-cut from EURc 0.55 to EURc 0.40 as of 1 Jan-23.

[5] Definition adjustment of fixed BB (FBB) ARPU calculation as of 1 January 2023 to fully reflect all fixed revenue streams; for comparability reasons including adjustment of previous year's values.

Financial performance

Revenues posted robust growth of **+4.4% y-o-y to EUR 2,091m** in Q2 23 (+6.2% y-o-y to EUR 4,192m in H1 23) driven by accelerated mobile service revenue momentum.

Mobile service revenues[6] trend continued its growth path, up **+4.3% y-o-y to EUR 1,463m** in Q2 23 (+4.3% y-o-y to EUR 2,871m in H1 23) fuelled by continued strong own-brand MSR-momentum and a solid contribution from partners; in combination more than offsetting the negative impact from the MTR glidepath[7].

Handset sales grew **+6.1% y-o-y to EUR 419m** in Q2 23 (+14.8% y-o-y to EUR 903m in H1 23) with high value smartphones remaining popular while the overall customer demand for 'O_2 myHandy' contracts somewhat softened post record sales in Q4 22 and Q1 23.

Fixed revenues improved **+2.1% y-o-y to EUR 206m** in Q2 23 (+2.5% y-o-y to EUR 409m in H1 23) with **fixed retail BB revenues** recording even stronger growth of **+4.5% y-o-y** in Q2 23 (+4.4% in H1 23).

Other income was EUR 36m in Q2 23 (EUR 70m in H1 23).

Operating expenses[8] were up **+4.7% y-o-y to EUR 1,482m** in Q2 23 (+7.6% y-o-y to EUR 3,005m in H1 23) mainly reflecting the anticipated inflationary impacts.

- **Supplies** were broadly flat y-o-y (-0.1% y-o-y) at EUR 628m in Q2 23 (+6.5% y-o-y to EUR 1,300m in H1 23) with volume related higher hardware cost of sales offsetting the positive effects from the MTR-cuts[7]. In Q2 23, connectivity-related cost of sales and hardware cost of sales accounted for 35% and 62% of supplies, respectively.
- **Personnel expenses** were up +9.9% y-o-y to EUR 164m in Q2 23 (+7.8% y-o-y to EUR 326m in H1 23) reflecting the general pay rise as of Sep-22 and the increase of statutory minimum wages mainly in customer service as of Oct-22 in combination with a slightly higher FTE-base driven by insourcing of key capabilities to support transformation and growth ambitions.
- **Other operating expenses** (other Opex) increased +9.2% y-o-y to EUR 669m in Q2 23 (+8.9% y-o-y to EUR 1,333m in H1 23) reflecting commercial activity in the quarter in combination with the launch of the more-for-more 'O_2 Mobile' portfolio, technology transformation as well as energy supplies for H1 22 already secured before energy price spikes. Commercial and non-commercial costs accounted for 65% and 31% of other Opex in Q2 23, respectively. Group fees were EUR 9m in Q2 23 (H1 23 EUR 18m vs EUR 17m in H1 22).

OIBDA[9] posted strong growth, **+2.7% y-o-y to EUR 646m** in Q2 23 (+2.2% y-o-y to EUR 1,258m in H1 23). Improved MSR quality on continued own brand momentum was partly offset by the anticipated and above mentioned increase in Opex. **OIBDA**[9] **margin at 30.9%** contracted -0.5 p.p. y-o-y in Q2 23 (30.0% in H1 23, -1.2 p.p. y-o-y) mainly as a result of the growth of broadly margin-neutral hardware revenues.

Depreciation & Amortisation was slightly higher y-o-y (+2.0%) at EUR 1,147m in H1 23.

Operating income was EUR +110m (+4.7% y-o-y) in H1 23.

Net financial expenses accounted for EUR -34m in H1 23.

[6] Mobile service revenue includes base fees and fees paid by the company's customers for the usage of voice, SMS and mobile data services; it also includes access and interconnection fees as well as other charges levied on partners for the use of the company's network.

[7] MTR-cut from EURc 0.55 to EURc 0.40 as of 1 Jan-23.

[8] Operating expenses include impairment losses in accordance with IFRS 9 in the amount of EUR 21m in Q2 23 and EUR 47m in H1 23 (EUR 24m in Q2 22 and EUR 44m in H1 22).

[9] Adjusted for exceptional effects. In Q2 23 exceptional effects amounted to EUR -0m of restructuring costs (EUR -1m in H1 23). In Q2 22 as well as in H1 22 exceptional effects amounted to EUR -1m of restructuring costs.

Income tax was at EUR +11m in H1 23.

As a result, **total profit for the period** improved to EUR +83m in H1 23, up +24.0% y-o-y.

CapEx[10] was lower -11.4% y-o-y at EUR 258m in Q2 23 (-9.4% y-o-y to EUR 504m in H1 23) with a **CapEx/Sales ratio** of **12.3%** (12.0% in H1 23)**.** Telefónica Deutschland continued to make excellent progress with densification and further 5G network roll-out within its normalised C/S envelope. The company already delivered its YE23 5G pop coverage target of ~90% by mid-year and is well on track for nationwide 5G coverage latest by year-end 2025.

Operating cash flow (OIBDA minus CapEx[10]) rose by +11.8% y-o-y to EUR 753m in H1 23 as a result of both, strong operating and financial performance as well as Capex normalisation post the successful completion of the Company's 'Investment-for-Growth' programme.

Free cash flow (FCF)[11] amounted to EUR 436m in H1 23 (EUR 373m in H1 22). Lease payments mainly driven by annual prepayments for antenna sites and leased lines amounted to EUR 424m in H1 23 (EUR 395m in H1 22). This reflects a combination of network densification including new BTS sites to cover white spots and some anticipated y-o-y increases. As a result, **FCFaL** shows the usual back-end loaded profile while turning positive already in H1 23 at EUR +12m (EUR -22m in H1 22).

Working capital movements were on similar levels as in prior year, EUR -291m in H1 23 vs. EUR -281m in H1 22. The development in H1 23 was mainly driven by a decrease in capex payables (EUR -183m) as well as other working capital movements of EUR -107m, mainly driven by an increase in inventories (EUR -50m) and higher pre-payments (EUR -68m).

Consolidated net financial debt[12] as of 30 Jun-23 increased to EUR 3,680m following the company's dividend payment of EUR 535m in May-23. Still, leverage ratio of 1.4x[13] remained well below the company's self-defined upper limit of 2.5x; leaving comfortable leverage headroom with regards to the company's BBB-rating with stable outlook by Fitch.

Financial Outlook FY23

Telefónica Deutschland continued its robust growth path in H1 23; as expected, delivering strong operational and financial performance with continued momentum and supported by good progress of its 5G network roll-out. The company has consistently implemented its 'more-for-more' strategy with new tariff portfolios underpinning its FY23 growth ambitions. Consequently, Telefónica Deutschland is narrowing its FY23 outlook for both, revenues and OIBDA, to 'upper-range of low single-digit % growth'.

[10] CapEx includes additions to property, plant and equipment and other intangible assets while investments for spectrum licenses and additions from capitalised right-of-use assets are not included.

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

[12] Net financial debt includes current and non-current interest-bearing financial assets and interest-bearing liabilities as well as cash and cash equivalents and excludes payables for spectrum.

[13] Leverage ratio is defined as net financial debt divided by OIBDA of the last twelve months adjusted for exceptional effects.

	ACTUAL 2022 (1)	Previous OUTLOOK 2023 (2)	ACTUAL H1 23	Updated OUTLOOK 2023 (2)
Revenues	EUR 8,224m	Low single-digit percentage year-on-year growth	EUR 4,192m, +6.2% y-o-y	Upper-range of low single-digit percentage year-on-year growth
OIBDA Adj. for except. effects	EUR 2,539m	Low single-digit percentage year-on-year growth	EUR 1,258m, +2.2% y-o-y	Upper-range of low single-digit percentage year-on-year growth
CapEx to Sales Ratio	14.7%	Around 14 %	12.0%	Around 14%

(1) Revenues and OIBDA include non-recurrent special factors in the amount of EUR +26m million in Q4 22.
(2) Incl. regulatory headwinds of ca. EUR -50m to -60m at revenue level and ca. EUR -10m to -15m at OIBDA level in FY23.

Link to detailed Data Tables

Further information

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