Telefónica

Deutschland

Be More

Annual Report

2 0 1 3

2013
More Ideas_
More Value_
More Success_

With more than 25 million customer accesses Telefónica Deutschland Group is the third largest integrated network operator in Germany.
Our products and services are in the centre of the digital life of millions of people. The basis for this is one of the best-performing mobile- and data-networks in Europe. With Telefónica Deutschland Group shareholders invest in the digital future.

www.annualreport.telefonica.de

Financial Highlights_

Financial Overview

(Euros in millions)	2013	2012	% Chg
	January 1 to December 31		
Revenues	**4,914**	**5,213**	**(5.7)**
Wireless service revenues	2,989	3,152	(5.2)
Operating income before depreciation and amortization (OIBDA)	**1,237**	**1,279**	**(3.3)**
OIBDA margin	25.2%	24.5%	0.6%-p.
Operating income	**105**	**146**	**(27.8)**
Profit for the year from continuing operations	**78**	**308**	**(74.7)**
Profit for the year from discontinued operations[1]	**0**	**1,027**	**(100.0)**
Total profit for the year	**78**	**1,335**	**(94.2)**
Basic earnings per share from continuing operations (in Euros)[2]	**0.07**	**0.28**	**(74.7)**
CapEx	**(666)**	**(609)**	**9.4**
Operating cash flow (OIBDA–CapEx)	**571**	**670**	**(14.8)**
Free cash flow pre dividends from continuing operations[3]	**699**	**676**	**3.3**
Total accesses (in thousands)	**25,167**	**25,373**	**(0.8)**
Mobile accesses (in thousands)	**19,401**	**19,300**	**0.5**
Postpaid (%)	**53.0%**	**52.4%**	**0.6%-p.**
Total ARPU	**12.7**	**13.8**	**(7.9)**
Postpaid churn (%)	**1.6%**	**1.5%**	**0.1%-p.**
(%) non-SMS data over total data revenues	**66.5%**	**56.7%**	**9.8%-p.**
Employees (FTE)[6]	**5,940**	**6,019**	**(1.3)**

	As of December 31		
	2013	2012	% Chg
Net financial debt[4]	**468**	**842**	**(44.5)**
Leverage[5]	0.4x	0.7x	(42.6)

1 No discontinued operations in 2013.

2 Basic earnings per share from continuing operations are calculated by dividing profit for the year from continuing operations by the weighted average number of ordinary shares of 1,117m.

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

4 Net financial debt includes all current and non-current interest-bearing financial assets and interest-bearing financial liabilities. Net financial debt is calculated as follows: non-current interest-bearing debt (EUR 1,342,584k in 2013 and EUR 1,000,000k in 2012) + non-current finance lease payables (EUR 1,340k in 2013 and EUR 4,985k in 2012) + current interest-bearing debt (EUR 102,060k in 2013 and EUR 251,000k in 2012) + current finance lease payables (EUR 1,649k in 2013 and EUR 3,964k in 2012) minus the non-current "O_2 My Handy" receivables (EUR 83,209k in 2013 and EUR 93,770k in 2012) and since June 2013 the current portion of "O_2 My Handy" receivables (EUR 188,013k in 2013 and EUR 0k in 2012) minus loan to third parties included in other current financial assets (EUR 458k in 2013 and EUR 101k in 2012) and minus cash and cash equivalents (EUR 708,545k in 2013 and EUR 323,666k in 2012).
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. Current portion of "O_2 My Handy" receivables in the amount of EUR 196,830k in 2012 has not been considered in the calculation of the net financial debt in the year 2012.

5 Leverage is defined as net financial debt divided by LTM (Last Twelve Months) OIBDA (EUR 1,237m in 2013; EUR 1,279m in 2012) excluding non-recurring factors.

6 FTE = Full-time equivalent.

Wireless Service Revenues
(Euros in millions)

–5.2%

2013	2,989
2012	3,152

Mainly due to regulatory influences, changed SMS usage patterns and a higher number of tariff migrations

OIBDA/OIBDA Margin
(Euros in millions)

–3.3%

2013	1,237	margin 25.2%
2012	1,279	margin 24.5%

Mainly due to evolution of service revenues, targeted commercial investments in growth and a special effect from the sales of assets in Q4

Wireless Accesses
(in thousands)

+0.5%

2013	19,401
2012	19,300

The postpaid segment stood at 10,300 accesses at the end of the year and was a significant growth factor (+1.8% compared with the previous year)

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

+9.8%-p.

2013	66.5
2012	56.7

Non-SMS data revenues were again a key growth driver, based on the increasing smartphone penetration and the increasing customer demand for mobile data services

— Contact for institutional investors:
ir-deutschland@telefonica.com

— Contact for private investors:
shareholder-deutschland@telefonica.com

Contents_

A
pp. 7–22

Information for our Shareholders_

B
pp. 23–78

Group Management Report_

C

pp. 79–168

Consolidated Financial Statements_

D

pp. 169–174

Further Information_

The figures in the following have been rounded in accordance with established commercial practice.
Figures or additions within a table may therefore result in sums different from those shown in the same table.

The Annual Report is available online
in German and in English:

www.annualreport.telefonica.de

Information for our Shareholders_

A

pp. 7–22

Information for our Shareholders_

Dear shareholders of Telefónica Deutschland,
Ladies and gentlemen,

Behind us lies one of the most relevant and exciting years in the history of our Company. In 2013, Telefónica Deutschland successfully completed its first year as a public listed company with a total shareholder return of 11.7%[1], which is a reflection of a consistent strategic approach to our market.

This year we witnessed German consumers, corporates and institutions enthusiastically embracing a more data-centric, mobile and digital lifestyle, accelerating fundamental changes in the way they interact, entertain and work. Telefónica Deutschland has been at the forefront of the market for more than three years with a clear vision to enhance customers' lives by always providing them the easiest access to the latest technology. This can only be based on an excellent customer insight and a strong combination of assets in place: the right network infrastructure (including premium spectrum in the 800 MHz band), a challenger approach and a highly motivated workforce.

Germany consolidated this year its number one position in a European telecommunication context. This was further confirmed by the increased investments made or committed by all network infrastructure operators in the market. The positive performance of service providers and mobile virtual network operators also confirmed the intrinsic rational structure of this unique and deeply segmented market.

The monetization of the increasing usage of mobile data services by customers and the higher penetration of smartphones were the main drivers for the different commercial activities launched by our competitors in 2013. This resulted in a very dynamic environment across segments. Telefónica Deutschland kept a leading position in a number of key indicators, including growth of mobile data revenues (excluding traditional messaging) of 22% over the previous year and a close to 100% uptake of data tariffs from new customers in our core O_2 postpaid brand. LTE adoption by our customers also accelerated in the year, with 80% of handsets sold in the last quarter being LTE-enabled.

The transition from a voice to a data-centric business model shaped our financial performance in 2013, in line with the market trends, with the accelerating substitution of traditional messaging (SMS) by messaging applications provided by different "Over-the-top" players being the most visible example.

Telefónica Deutschland increased its network investment in 2013, mainly focused on the deployment of our own LTE-800 network, reaching more than 40% of German population at the end of the year, while increasing network depth in our existing 3G mobile data network. Independent network tests already confirmed a significant improvement of quality over the previous year.

As a result of our consistent approach to the market, free cash flow grew in 2013, exceeding the already announced dividend of approximately 525 million Euro, payable in 2014.

On that basis, we are facing 2014 with renewed optimism, aiming to consolidate Telefónica Deutschland's leading role in the mobile data space, also to become the best value-for-money LTE player in the German market while exploiting additional opportunities in the Business segment and in the digital space.

1 Based on 12 months share performance until December 31, 2013 and a cash dividend of 45 Euro cents per share paid in May 2013

During the year, Telefónica Deutschland took a number of relevant strategic and commercial initiatives, like the launching of the first "All-in" smartphone tariff portfolio in the market or the important infrastructure partnership agreements signed with Deutsche Telekom and Versatel which will provide us with future-proof capabilities for high speed fixed access to end customers and backhaul connections for mobile base stations. Thanks to an already extensive partner relationship with Deutsche Telekom, Telefónica Deutschland will also be the first European alternative fixed operator to effectively leave the ULL regulated model.

The most important strategic decision taken in 2013 was, however, the signing of the agreement to acquire E-Plus. Its completion, subject to authority approvals and other customary closing conditions, is expected to happen by mid-2014.

We firmly believe in the positive effects of the integration of E-Plus by Telefónica Deutschland, which will benefit our customers, our shareholders and the German market in general. The transaction will improve our ability to effectively compete with the other two mobile infrastructure leaders in the German market.

Telefónica Deutschland aims to become a leading digital telecommunications company and to drive significant benefits from increased scale to customers and shareholders. We aim to build one of the most modern high-speed networks in Germany through the combination of a faster and broader LTE rollout with significant synergies from the rationalization of existing 2G/3G networks, extending also our current partnerships in the fixed business to an enlarged customer base. Customers will benefit from innovative products based on high-speed converged service platforms, a very efficient multi-brand approach and best-in-class customer service, increasing competition in all, but above all in some specific segments, such as corporate customers.

Our shareholders and our customers as well will clearly benefit from the accrual of more than 5bn Euro expected synergies (in net present value), the majority of them being network-related.

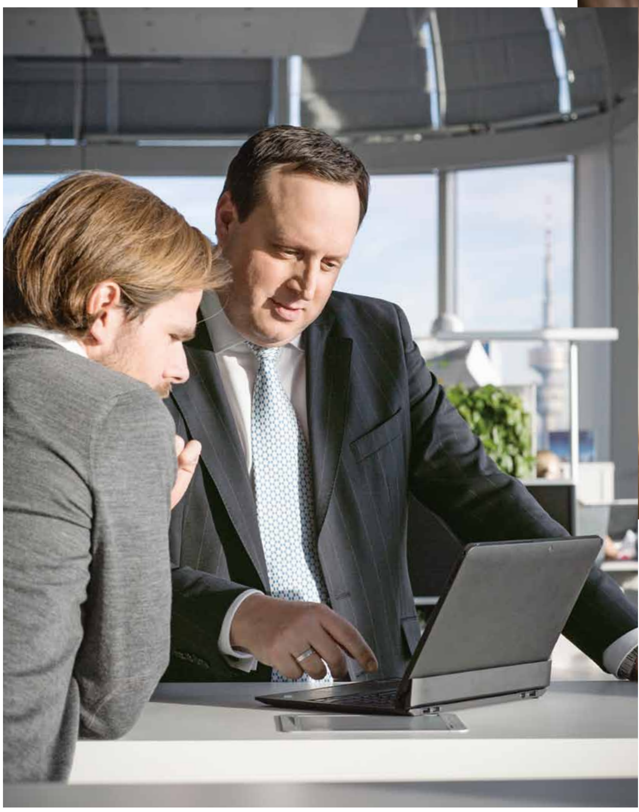
These achievements were only possible through the commitment and hard work of all our employees. As the Management Board of Telefónica Deutschland, we thank all employees for their dedication. We also thank our business partners and of course all our shareholders for their strong and continuous support.

Rachel Empey
Chief Financial Officer (CFO)

Markus Haas
Chief Strategy Officer (CSO)

Management Board_

Rachel Empey
Chief Financial Officer (CFO)



Markus Haas
Chief Strategy Officer (CSO)

Supervisory Board Report for the 2013 financial year_

**Eva Castillo Sanz,
Chairperson of the Supervisory Board of
Telefónica Deutschland Holding AG**

Dear Shareholders,

In the reporting period, the Supervisory Board of Telefónica Deutschland Holding AG responsibly performed its duties as set out by law, the Articles of Association and the by-laws. In terms of good corporate governance, the Supervisory Board collaborated well with the Management Board on basis of a trustful cooperation and fulfilled its controlling and consulting responsibilities. It has supported intensively the management of the company, in particular in connection with the planned acquisition of E-Plus.

Composition of the Supervisory Board

At the beginning of the 2013 financial year the Supervisory Board consisted of six members, being the shareholder representatives Eva Castillo Sanz, Angel Vilá Boix, María Pilar López Álvarez , Patricia Cobián González, Michael Hoffmann and Enrique Medina Malo. All shareholder representatives are generally appointed until the end of the General Meeting that resolves on the discharge for the financial year ending December 31, 2016.

On May 29, 2013 six employee representatives were newly and in addition elected to the Supervisory Board in accordance with the provisions of the German Co-Determination Act. These are Imke Blumenthal, Marcus Thurand, Thomas Pfeil, Dr. Jan-Erik Walter, Christoph Heil and Claudia Weber. For four of them, substitute members were appointed.

In the Supervisory Board meeting following the election of the employee representatives on June 18, 2013, Ms Eva Castillo Sanz was confirmed in her role as Chairperson of the Supervisory Board and Ms Imke Blumenthal was elected Vice Chairperson of the Supervisory Board.

The Supervisory Board of Telefónica Deutschland Holding AG thus now consists of twelve members of whom six members are shareholder representatives and six members are employee representatives.

The German Stock Corporation Act determines for listed companies that at least one independent member of the Supervisory Board must have expertise in the areas of accounting or auditing. In the Supervisory Board of Telefónica Deutschland Holding AG, Michael Hoffmann has the required expertise and independency and is the independent financial expert within the meaning of section 100 para. 5 German Stock Corporation Act (AktG).

Composition of the Management Board

In the 2013 financial year the Management Board consisted of the following members:
— René Schuster, Chief Executive Officer / CEO
— Markus Haas, Chief Strategic Officer / CSO
— Rachel Empey, Chief Financial Officer / CFO

With effect as of February 1, 2014, René Schuster left the Management Board by mutual agreement and Markus Haas and Rachel Empey took over the responsibilities of the CEO in addition to their other responsibilities.

The Supervisory Board thanks the former Management Board member René Schuster for the successful collaboration.

Cooperation between the Management Board and Supervisory Board

The Management Board provides the Supervisory Board with a monthly written report. These reports cover in particular relevant financial key performance indicators (KPIs).

The Chairperson of the Supervisory Board and the entire Management Board also were in constant contact outside Supervisory Board meetings in order to advise regarding the current position and the future development of the company as well as the progress of current projects – particularly the E-Plus transaction. The Chairperson of the Supervisory Board informed the other members of the Supervisory Board of the main issues discussed thereby.

The Management Board involved the Supervisory Board in due time in all actions requiring its approval. The Supervisory Board always referred to the documents and reports presented by the Management Board and – if required – external consultants.

Meetings of the Supervisory Board

In 2013 four ordinary meetings of the Supervisory Board took place, in concrete on March 22, June 18, July 30, and November 6, 2013. Meetings of the Audit Committee were also held on these days. In addition, there were five extraordinary meetings of the Supervisory Board, further informatory video and/or telephone conferences and resolutions of the Supervisory Board outside of meetings.

So far there have been three Supervisory Board meetings in 2014, two of them being extraordinary ones (on the evening of January 29, 2014 regarding the change in the Management Board and on March 6, 2014 for an update concerning the E-Plus transaction) and an ordinary meeting on March 18, 2014 (meeting on the financial statements for the 2013 financial year; Bilanzsitzung). On February 11, 2014 the annual Declaration of Compliance was resolved upon and on March 6, 2014 the management declaration as well as the Corporate Government Report. They were published on these days respectively.

Fundamental issues dealt with by the Supervisory Board

The first ordinary meeting of the Supervisory Board in the 2013 financial year on March 22, 2013 was the meeting regarding the financial statements for the 2012 financial year (Bilanzsitzung). Next to the items associated therewith, such as the approval of the financial statements and management reports (Group and corporation) for the 2012 financial year and other reporting by Management to Supervisory Board inter alia pursuant to section 90 German Stock Corporation Act (AktG), the agenda and proposed resolutions for the Annual General Meeting on May 7, 2013 were resolved upon.

The ordinary meeting on June 18, 2013 was the first Supervisory Board meeting following the election of the employee representatives with the new composition of the Supervisory Board with its twelve members. Thus in this meeting internal elections took place (including for the Chairperson and Vice Chairperson as well as Committee members). Furthermore, the working efficiency of the Supervisory Board, compliance and corporate governance were dealt with.

At the ordinary meeting on July 30, 2013, Management Board remuneration including change in the employment contracts with the Management Board members and the potential sale of assets as well as of holding (Telefónica Germany Online Services GmbH) were dealt with.

In the ordinary meeting on November 6, 2013 the improvement of data centers and network technology, as well as the planned dividend for the 2013 financial year were inter alia discussed. Furthermore, the first bond issue was dealt with.

At an extraordinary meeting of the Supervisory Board on July 22, 2013 the planned acquisition of E-Plus was approved. This issue was subsequently regularly discussed at the meetings of the Supervisory Board with changing focus (including also the convening of an extraordinary General Meeting on February 11, 2014).

Furthermore, at extraordinary Supervisory Board meetings information was provided regarding essential operational contracts and – if required – resolutions passed.

At every ordinary meeting, the financial situation of the company including the relevant financial reports, budget, business planning, the market positioning and the telecommunications business were examined and discussed.

All Supervisory Board members have participated in more than half of the meetings.

Outside of the meetings the Supervisory Board passed resolutions, to the extent required, for example electronically. The by-laws of the Management Board were amended in this way, a reporting directive and the (previous) declaration of compliance in accordance with section 161 German Stock Corporation Act (AktG) dated February 28, 2013 adopted.

Committees of the Supervisory Board

The Supervisory Board has a Nomination Committee, a Mediation Committee and an Audit Committee.

The Audit Committee is responsible for advice and the passing of resolutions in accounting matters. This includes questions regarding accounting, internal control system, risk management and internal revision and on the required independency of the external auditors and coordination with the external auditor. The Committee consists of four members. Up until the meeting on June 18, 2013, being the first meeting of the Supervisory Board in its full composition with twelve members including the employee representatives the Committee consisted of the following members:

— Michael Hoffmann (Chairperson)
— María Pilar López Álvarez
— Patricia Cobián González and
— Angel Vilá Boix.

Since June 18, 2013 the following members are members of the Audit Committee:

— Michael Hoffmann (Chairperson)
— María Pilar López Álvarez
— Thomas Pfeil and
— Christoph Heil.

In 2013 the Audit Committee met four times with all members being present. Hereby the issues of accounting, compliance, internal revision, risk evaluation and management, valuation issues as well as the financial, asset and earnings position were dealt with.

The following members belong to the Mediation Committee, constituted in the meeting on June 18, 2013, with the responsibilities in accordance with section 31 German Co-Determination Act:

— Eva Castillo Sanz (Chairperson)
— Imke Blumenthal
— Angel Vilá Boix and
— Marcus Thurand.

Furthermore, there is a Nomination Committee. The Nomination Committee has the task of suggesting suitable candidates to the Supervisory Board for election proposals to the General Meeting. Patricia Cobián González was elected as Chairperson of the Nomination Committee. The other members are María Pilar López Álvarez and Enrique Medina Malo.

Corporate Governance

The Supervisory Board and the Management Board are aware that good corporate governance is essential for corporate success and is therefore in the interest of the company's shareholders. Further details on the corporate governance of Telefónica Deutschland Holding AG can be found in the Management Declaration in accordance with section 289a German Commercial Code on page 19 ff. of the annual report or on the company's website at **WWW.TELEFONICA.DE/MANAGEMENT-DECLARATION** and in the Management Boards' Corporate Governance Report on page 16 ff. of the annual report or on the company's website at **WWW.TELEFONICA.DE/CORPORATE-GOVERNANCE-REPORT**.

On February 11, 2014 the Management Board and the Supervisory Board have approved the Declaration of Compliance in accordance with section 161 German Stock Corporation Act (AktG) and released it on the same day. This declaration can be viewed in the Annual Report on page 19 ff. Such and previous versions can be also found at the company's website at **WWW.TELEFONICA.DE/DECLARATION-OF-COMPLIANCE**

Five members of the Supervisory Board hold positions in the administrative, management and supervisory bodies of the majority shareholder or its affiliated companies. Both the Supervisory Board members and the Management Board members disclose potential conflicts of interest promptly to the Supervisory Board. In the reporting period, no conflicts of interest arose within the meaning of the German Corporate Governance Code.

Review of the Financial Statements 2013

The 2013 annual financial statements for Telefónica Deutschland Holding AG and the consolidated financial statements with the management reports for Telefónica Deutschland Holding AG and the group as presented by the Management Board were audited by the auditing company Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft with its seat in Stuttgart, branch Munich. Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft had been appointed (group) auditor for the financial year 2013 by resolution of the annual General Meeting on May 7, 2013.

The Telefónica Deutschland Holding AG's financial statements and the management report were prepared in accordance with the legal requirements of the German Commercial Code (HGB). The consolidated financial statements and the corresponding group management report were prepared in accordance with section 315a of the German Commercial Code (HGB) and Regulation (EC) no. 1606/2002 on the basis of the International Financial Reporting Standards (IFRS) as applicable in the European Union.

The auditor performed his audit on the basis of German generally accepted auditing principles as promulgated by the Institut der Wirtschaftsprüfer (IDW). The auditor issued an unqualified opinion (uneingeschränkter Bestätigungsvermerk) for the 2013 annual financial statements of Telefónica Deutschland Holding AG with management report and the consolidated financial statements and the group management report.

The financial statements of the corporation and the group and all related documents thereto as well as the Management Board's proposal for the distribution of profit and the respective auditor's reports were submitted to the Supervisory Board in due time prior to the meetings on March 18, 2014 (Bilanzsitzung). The audit committee and the Supervisory Board in its entirety thoroughly examined the reports and discussed them in detail together with the auditor on March 18, 2014.

The Supervisory Board acknowledged and approved the auditor's findings in the audit reports and had no objections.

At its meeting on March 18, 2014, the Supervisory Board approved the annual financial statements of Telefónica Deutschland Holding AG and the consolidated financial statements together with their respective management reports for the 2013 financial year; the financial statement of Telefónica Deutschland Holding AG is thereby adopted.

Relations to affiliated companies

The report on relations to affiliated companies (dependency report) as prepared by the Management Board pursuant to section 312 of the German Stock Corporation Act was also audited by the auditor. With respect thereto, the auditor issued the following unqualified opinion (uneingeschränkter Bestätigungsvermerk):

"Based on our audit and assessment, which were carried out in accordance with professional standards, we confirm that
1. the factual statements made in the report are correct,
2. the payments made by the company in connection with legal transactions detailed in the report were not unreasonably high,
3. there are no circumstances that would require a materially different assessment of the measures listed in the report than that of the Management Board."

The dependency report as prepared by the management board and audited by the auditor as well as the audit report on the dependency report were submitted to the Supervisory Board in due time. Having examined the dependency report and the corresponding audit report in accordance with section 314 of the German Stock Corporation Act, the Supervisory Board had no objections against the dependency report and the Management Board's declaration on the relations to affiliated companies contained therein and agrees with the auditor's findings.

The Supervisory Board thanks the members of the Management Board and all employees for their dedication and excellent work in the past year. With their commitment, which was in the reporting period in particular challenged by the competitive market environment and the E-Plus transaction, they have contributed to the success of the company.

Munich, March 18, 2014

On behalf of the Supervisory Board

Eva Castillo Sanz
Chairperson of the Supervisory Board of
Telefónica Deutschland Holding AG

Corporate Governance Report_

The German Corporate Governance Code establishes a standard for transparent control and management of companies. In the following Management Board and Supervisory Board of Telefónica Deutschland Holding AG inform according to 3.10 of the German Corporate Governance Code about Corporate Governance. This Corporate Governance Report is also published together with the Management Declaration in accordance with § 289a German Commercial Code (HGB) on our website at
WWW.TELEFONICA.DE/CORPORATE-GOVERNANCE-REPORT

Declaration of compliance

The Management Board and Supervisory Board of Telefónica Deutschland Holding AG feel committed to the principles of transparent corporate governance and regularly deal with the principles of the German Corporate Governance Code. They last submitted a declaration of compliance in accordance with section 161 German Stock Corporation Act (AktG) on February 11, 2014, the full text of which can be viewed also on the company's website at **WWW.TELEFONICA.DE/DECLARATION-OF-COMPLIANCE**

The company's governing bodies

As a German stock corporation, Telefónica Deutschland Holding AG has three governing bodies: the general shareholders' meeting, the Supervisory Board and the Management Board. Their duties and powers are substantially determined by the German Stock Corporation Act, the Articles of Association and the by-laws of both the Management Board and the Supervisory Board.

German corporate law provides for a clear separation of personnel between management and controlling bodies.

The managing body is the Management Board. It manages the company in own responsibility in the interest of the company with the object of sustainable value creation.

The Management Board is thereby controlled and advised by the Supervisory Board. Management Board and Supervisory Board work together closely in the interest of the welfare of the company. All transactions and decisions that are of fundamental or material importance to the company are carried out in close coordination between the Management Board and the Supervisory Board.

The Management Board informs the Supervisory Board regularly, promptly and comprehensively on all material questions regarding the company, especially on planning, business development, strategy, situation and management of risks as well as on compliance. Furthermore, the Management Board provides the Supervisory Board with information in case during the course of business deviations of plans or objectives may occur and what the reasons therefore are.

Details regarding the composition and the working procedures of the Management Board, the Supervisory Board and the Supervisory Board's committees can be found in the management declaration in accordance with section 289a of the German Commercial Code (HGB) (Erklärung zur Unternehmensführung) in the annual report or on the Telefónica Deutschland website under
WWW.TELEFONICA.DE/MANAGEMENT-DECLARATION

The Supervisory Board has specified concrete objectives regarding its composition (5.4.1, 2nd paragraph of the German Corporate Governance Code) considering the specifics of the company, its shareholders' group and the international activities and taking into account that half of the members of the Supervisory Board are elected by the employees pursuant to German Co-Determination law. In this context, the Supervisory Board has set the following objectives regarding its composition:

— The Supervisory Board has at least one independent member within the meaning of section 100 paragraph 5 of German Stock Corporation Act (AktG) and 5.4.2 sentence 2 German Corporate Governance Code and should not include any persons who hold an office (e.g. at a significant competitor) which may create a material and not only temporary conflict of interest.

- One third of the members of the Supervisory Board, however in any event at least one third of the Supervisory Board members to be elected by the General Meeting, should be female.
- At least one third of the Supervisory Board members to be elected by the General Meeting should have international business experience abroad, knowledge of the English language as well as an understanding of global economic contexts (“internationality”).

The Supervisory Board considers these concrete objectives as currently fulfilled.

The Supervisory Board has refrained from implementing a concrete objective regarding an age limit and has in this regard made a declaration of deviation in the Declaration of Compliance.

Relationship to shareholders and the General Meeting

The shareholders are generally informed four times a year about the financial and earnings situation and business development (quarterly financial reports). The company provides for further information on its website (WWW.TELEFONICA.DE/INVESTOR-RELATIONS), especially the financial calendar. Furthermore, analyst conferences and meetings take place.

The shareholders exercise their rights according to law and the Articles of Association before and during the annual General Meeting, especially by exercising their voting rights.

The annual General Meeting resolves amongst others about profit distribution, discharge of the Supervisory and Management Board and the election of the auditor.

Compliance

The credibility, integrity and reputation of Telefónica Deutschland are keys to the company’s success. Telefónica Deutschland is committed to comply with the applicable laws, regulations, processes, rules and enactments for all its business activity. Therefore, the company has a group-wide compliance organization that is continuously improved.

The compliance programme focuses on antitrust, anti-corruption and ethically appropriate behavior. These topics are covered by mandatory online trainings, as are the areas of data protection, anti-discrimination and information security. Each employee is regularly required to complete certain mandatory training sessions based on his or her job responsibilities. At the end of each year, a Compliance Certificate in respect of the success of training and compliance activities is produced and processed as part of the Corporate Responsibility Report.

The company has a compliance team, appointed by the Management Board. The compliance team deals with the maintenance and enhancement of the compliance organization in the company and regularly reports to the Management Board. To ensure constant monitoring, awareness, prevention and detection of potential issues the major units responsible for executing controls such as compliance, internal audit (incl. risk management), fraud, physical and information security, SOX compliance, intervention and data protection meet on a regular basis as compliance forum (an inter-departmental, operational supervisory committee) and are in constant exchange concerning potential failures or risk factors.

In this whole context, the company of course also maintains insider lists wherein any persons who act for the company and have intended access to insider information are enlisted (following respective instructions regarding their duties by insider law).

The Management Board – as well as the Supervisory Board – regularly deals with the topic “compliance”.

Transparency and communication

Telefónica Deutschland shareholders can receive information on the company on its website. This includes press releases, corporate news and ad-hoc news. The company’s Articles of Association are also published on the website.

Relevant shareholdings of Management and Supervisory Board

None of the members of the Management Board held or holds shares or options on shares of Telefónica Deutschland Holding AG.

As per December 31, 2013, the Supervisory Board held approximately 0.0018% of the shares of Telefónica Deutschland Holding AG. These shareholdings were obtained through the stock market and are listed as directors’ dealings.

Directors' Dealings

According to section 15a of the German Securities Trading Act (WpHG), members of the Management and Supervisory Boards and related parties are obliged to disclose directors' dealings in Telefónica Deutschland shares if the value of these transactions reaches EUR 5,000 within a calendar year.

Further information can be found on the Telefónica Deutschland website at **WWW.TELEFONICA.DE/DIRECTORSDEALINGS**

Accounting and auditing

Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft with seat in Stuttgart, branch Munich, has been appointed (group) auditor for the financial year 2013 by resolution of the annual General Meeting on May 7, 2013.

Management Declaration_

in accordance with section 289a of the German Commercial Code (HGB)

1. Declaration of compliance in accordance with section 161 of the German Stock Corporation Act (AktG)

Under section 161 of the German Stock Corporation Act (AktG), the management board and the supervisory board of a listed stock corporation are required to declare annually that the company has complied and is complying with the recommendations of the "Government Commission for the German Corporate Governance Code", as published in the official part of the Federal Gazette by the Federal Ministry of Justice, or, alternatively, are to declare which recommendations the company has not followed or does not follow and why not. The declaration shall be published permanently on the company's website.

On February 11, 2014, the Management Board and Supervisory Board issued a declaration of compliance pursuant to section 161 German Stock Corporation Act (AktG):

"The Management Board and Supervisory Board of Telefónica Deutschland Holding AG (in the following also referred to as "the company") last submitted a declaration of compliance pursuant to section 161 (1) German Stock Corporation Act (AktG) on February 28, 2013. From this date until June 10, 2013 the present declaration of compliance refers to the German Corporate Governance Code in the version dated May 15, 2012 and for the period as of June 11, 2013 to the version of the German Corporate Governance Code dated May 13, 2013 and published in the Federal Gazette on June 10, 2013.

The Management Board and Supervisory Board of Telefónica Deutschland Holding AG hereby confirm pursuant to section 161 (1) of the German Stock Corporation Act (AktG) that since the issuance of the last compliance declaration, Telefónica Deutschland Holding AG has complied, and will comply in the future, with the recommendations of the German Corporate Governance Code, with the following exceptions:

1. In section 4.2.1 sentence 1, the German Corporate Governance Code recommends that the Management Board consist of multiple persons and have a chairperson or speaker. Since the end of the appointment of the previous Management Board chairperson, effective January 31, 2014, Telefónica Deutschland Holding AG has deviated from this recommendation, because no other Management Board member has been appointed chairperson or speaker of the Management Board. The Management Board and Supervisory Board consider this necessary to make it clear that the two remaining Management Board members are equal in rank and that the additional responsibilities undertaken by them since the departure of the previous Management Board chairperson are of equal value.

2. In determining the total remuneration, according to section 4.2.2 (2) sentence 3 German Corporate Governance Code (in the version dated May 13, 2013), the Supervisory Board is to consider the relationship of Management Board remuneration to the remuneration of senior management and employees of the company as a whole, including the trend over time. The Supervisory Board is to determine how senior management and the relevant employees are to be differentiated in compensation. The Supervisory Board deviated from this recommendation with respect to the salary increases for the two members of the Management Board decided on January 29, 2014 and effective February 1, 2014. The Supervisory Board and the Management Board are of the opinion that the recommended comparison cannot lead to meaningful results if Management Board members are granted a salary increase because they assume additional duties for which the previous Management Board chairperson was responsible.

3. The recommendation in section 4.2.3 (2) sentence 4 German Corporate Governance Code that both positive and negative developments be taken into account with respect to the structure of the variable remuneration components has not been and will not be followed. The Management Board and the Supervisory Board are of the opinion that the remuneration of the Management Board is nonetheless oriented towards a sustainable company development.

The remuneration consists of fixed as well as of short- and long-term variable components. The relevant parameters for the determination of the variable compensation are overall oriented towards sustainable development and structured in a way that they, as a whole, do not provide incentives for business decisions which are opposed to the interests of the company.

4. Section 4.2.3 (3) sentence 2 of the German Corporate Governance Code dated May 15, 2012 recommended that share-based and performance-based remuneration components shall relate to rigorous and relevant comparison parameters. In section 4.2.3 (2) sentence 7 of the German Corporate Governance Code dated May 13, 2013, it is recommended that variable portions of compensation relate to rigorous, relevant comparison parameters. A partial derogation from this recommendation has been and will be made. The amount of the annual bonus also depends to a small extent on key figures from Telefónica Europe and Telefónica, S. A. In addition, a part of the long-term remuneration components is dependent on the total shareholder return of the Telefónica, S. A. shares. The Management Board and the Supervisory Board are of the opinion that no miscredited incentives are created thereby.

5. Section 4.2.3 (2) sentence 6 of the German Corporate Governance Code (dated May 13, 2013) recommends that remuneration as a whole and with respect to its variable portions of compensation should have upper limits in amount. There is some deviation from this recommendation, because no upper limits in amount are defined for the stock option programme and the deferred bonus. This is to give the Supervisory Board the necessary discretion to ensure balance between short- and long-term variable remuneration components. Moreover, the exact amount of pension expenditures by the company cannot be derived from one of the two Management Board service contracts. It is not possible for the company to unilaterally adjust the Management Board service contract, so pension expenditures can only be stipulated in amount in future Management Board service contracts.

6. The recommendation in section 4.2.3 (3) sentence 3 of the German Corporate Governance Code (version dated May 15, 2012) or section 4.2.3 (2) sentence 8 (version dated May 13, 2013) that forbids a retroactive change of performance objectives or comparison parameters has not been and will not be followed. The service contracts partially allow a retroactive change of the criteria for the variable remuneration. From the Management Board's and Supervisory Board's view, this is necessary because the company is active in an extremely volatile and innovative market environment, and a change of corporate strategy in the interest of a sustainable company development must also be possible within the calculation period for the variable remuneration components. Such changes of corporate strategy necessary with a view to reasonable company interests shall not be hindered or delayed due to monetary interests of members of the Management Board. Thus, in particular the Supervisory Board is of the opinion that flexibility is required as to performance objectives and comparison parameters.

7. In deviation from the recommendation in 4.2.3 (4) GCGC, no formal severance payment cap in the event of premature termination of the Management Board mandate is agreed in the service contracts. A combination of various mechanisms in the service contracts ensures that a member of the Management Board in the event of premature termination of the mandate as a general rule receives less, and in no event more than the amount that is recommended by the GCGC as a severance payment cap.

8. The recommendation in 4.2.5 (2) German Corporate Governance Code that the compensation report shall also include information on the nature of fringe benefits provided by the company has only been followed in part. The General Meeting on October 5, 2012 resolved pursuant to § 286 (5) German Commercial Code, to dispense with disclosure of the compensation of individual Management Board members for the period of 5 years. Therefore the fringe benefits provided by the company are only disclosed to the extent they are provided to all Management Board members. Where fringe benefits are only provided to individual Management Board members, these are not shown. The Management Board and Supervisory Board take the view that the individualization involved in the disclosure of these individual benefits would contradict the resolution of the General Meeting and anyway would represent too large an intrusion on the private sphere of the relevant Management Board members.

9. Contrary to the recommendation in section 5.1.2 (2) sentence 3 German Corporate Governance Code, the company has not determined any age limit for Management Board members. A fixed age limit for Management Board members is not appropriate in the view of Telefónica Deutschland Holding AG, since the ability to successfully run a company is not necessarily restricted by reaching a certain age. Rather it may be necessary where appropriate in the interest of the company to appoint persons of advanced age with extensive experience even after they reach a particular age limit. In addition the setting of a fixed age limit could also constitute discrimination.

10. Pursuant to section 5.4.1 (2) German Corporate Governance Code, the Supervisory Board is to stipulate specific objectives for its composition, taking into account an age limit. The Supervisory Board has set specific objectives regarding its composition, but with no specific objective regarding a fixed age limit for its members. Just as for Management Board members, a fixed age limit for Supervisory Board members is inappropriate in the view of Telefónica Deutschland Holding AG, since the ability to control and supervise the Management Board is not necessarily restricted by reaching a certain age. Indeed, it may be necessary in the interest of the company in some cases to appoint persons of advanced age with extensive experience even after they reach a particular age limit. Moreover, setting a fixed age limit might also constitute discrimination.

11. Notwithstanding the recommendation in section 5.4.6 (1) sentence 3 German Corporate Governance Code (version dated May 15, 2012) or section 5.4.6 (1) sentence 2 German Corporate Governance Code (version dated May 13, 2013) that the chair and membership in committees is also to be taken into account in the compensation of the Supervisory Board members, only the chair of the audit committee receives an additional compensation. The company believes that this reasonably accounts for the current composition of the Supervisory Board."

This and previous declarations of compliance are available on the company's website at **WWW.TELEFONICA.DE/DECLARATION-OF-COMPLIANCE**

2. Relevant disclosures of management practices

Telefónica Deutschland Holding AG and its administrative bodies are committed to efficient, sustainable and transparent corporate management as well as to values that form the basis of common business principles described in the company's code of ethics called "Our business principles". This code includes various fundamental principles and guidelines aimed to direct both management and employees in their daily work. It provides valuable help, particularly with respect to business situations in which legal and/or ethical conflicts of interest arise so that decisions can be taken with integrity and professionalism, both in the design and implementation of work processes and in the manner in which the company interacts with customers, shareholders, employees, suppliers and other stakeholders.

The company's business principles are available on the company's web site at **WWW.TELEFONICA.DE/GESCHAEFTSGRUNDSAETZE**

Compliance with the business principles is of eminent significance since Telefónica's reputation is built on and affected by decisions and actions taken by its administrative bodies and employees. It is therefore carefully monitored by means of close cooperation between the compliance team, human resources management and the departments internal audit, fraud and legal affairs.

The company's compliance program includes the main areas of anti-corruption with clear guidelines and procedures and an external whistle-blower system (**WWW.TELEFONICA.DE/OMBUDSMANN**), competition law and ethically appropriate behavior. The company's data protection officer ensures compliance with data protection legislation. This is a top priority for the company. Group compliance and data protection (both grouped in a single compliance office together with information security), the internal audit department and the legal department report directly to the Management Board.

Further details regarding the compliance organization of the company are explained in the Corporate Governance Report which forms a part of the Annual Report and can also be found on the company's web site at **WWW.TELEFONICA.DE/CORPORATE-GOVERNANCE-REPORT**

3. Composition and working procedures of the Management Board, Supervisory Board and the Supervisory Board's committees

In the reporting period, there were three members on the Telefónica Deutschland Holding AG Management Board: CEO René Schuster, Rachel Empey and Markus Haas. Since February 2014, the Management Board consists of Rachel Empey and Markus Haas, therefore of two members. Further information on this can be found in the Report of the Supervisory Board. The Management Board has sole responsibility for managing the company's business with the objective of creating sustainable value in the company's interest, taking into consideration the concerns of its shareholders, employees and other stakeholders of the company. The work of the Management Board is governed in particular by the by-laws of the Management Board enacted with Supervisory Board approval and by the company's Articles of Association. The Management Board is responsible for corporate strategy, coordinating this regularly with the Supervisory Board, and also ensures its implementation.

Each Management Board member is responsible for managing the area of business assigned to it, but without prejudice to their joint responsibility for managing the company as a whole. All matters of fundamental or material importance for the company and/or its affiliates, in particular matters regarding organization, company policy, investment and financial planning as well as all investments significantly exceeding the annual budget approved by the Supervisory Board are decided by the entire Management Board.

Furthermore, every Management Board member can submit matters to the full board for decision. Transactions and measures of particular significance are also subject to the prior approval by the Supervisory Board.

Management Board sessions are held regularly, generally once per week. Meetings may also be held by phone or video conference, and resolutions of the Management Board may also be passed outside of meetings, in particular in writing, by fax or e-mail.

The Management Board reports regularly to the Supervisory Board on the company's course of business, inter alia by providing the Supervisory Board with written reports each month covering key performance indicators for the company's business. Moreover, the Management Board must report to the Supervisory Board any transactions of possible material significance to the company's profitability or liquidity. Finally, the Management Board must report to the Supervisory Board any important events or affairs subject to section 90 para. 1 sentence 3 of the German Stock Corporation Act (AktG). The Management Board performs these measures as required by law.

Following the election of six employee representatives on May 29, 2013, the company's Supervisory Board consists of twelve members with six shareholder and six employee representatives. The current members of Supervisory Board are Chairperson Eva Castillo Sanz, Deputy Chairperson Imke Blumenthal and the Supervisory Board Members María Pilar López Álvarez, Angel Vilá Boix, Patricia Cobián González, Enrique Medina Malo, Michael Hoffmann, Marcus Thurand, Thomas Pfeil, Christoph Heil, Claudia Weber and Dr. Jan-Erik Walter. Further information on this can be found in the Report of the Supervisory Board.

The Supervisory Board advises and monitors the Management Board in the management of the company on an ongoing basis and must be consulted in all matters outside the ordinary course of business which are of particular importance to the company. The Supervisory Board appoints and dismisses the members of the Management Board and determines the remuneration of the Management Board. The Supervisory Board chairperson coordinates the activities of the Supervisory Board and cooperation with the Management Board. The principles governing the work of the Supervisory Board and its cooperation with the Management Board are essentially described in the by-laws for the Supervisory Board and in the company's Articles of Association.

The Supervisory Board holds at least two meetings in a calendar half-year. Meetings of the Supervisory Board may also be held by phone or video conference, and resolutions of the Supervisory Board may also be passed outside of meetings, in particular in writing, by fax or e-mail.

Composition and work of the committees of the Supervisory Board

In order for the Supervisory Board to carry out its tasks in an optimal manner, the by-laws for the Supervisory Board provide for three fixed committees. The Supervisory Board receives regular reports on the work of the committees.

The audit committee is responsible for preparing the decision of the Supervisory Board regarding the approval of the financial statements, discussing the quarterly reports with the Management Board, monitoring the accounting processes and internal control systems (including compliance, risk management and internal audit systems) and the auditor's review. It furthermore is responsible for the coordination with the auditor for the audit of the financial statements. The following members are currently in the audit committee:

— Michael Hoffmann (Chairperson)
— María Pilar López Álvarez
— Thomas Pfeil and
— Christoph Heil.

The nomination committee is responsible for proposing suitable candidates to the Supervisory Board for election proposals to the Annual General Meeting. Patricia Cobián González was elected chairperson of the nomination committee. The other members are María Pilar López Álvarez and Enrique Medina Malo.

The mediation committee with the responsibilities as defined in section 31 Co-Determination Act (MitbestG) consists of the following members:

— Eva Castillo Sanz (Chairperson)
— Imke Blumenthal
— Angel Vilá Boix and
— Marcus Thurand.

2014, March 6

Group Management Report_

for the financial year ended December 31, 2013

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pp. 23–78

Group Management Report_

Overview of the 2013 Financial Year_

The operating and financial performance of Telefónica Deutschland Group in 2013 reflects the execution of its strategy in a very dynamic competitive environment, with a clear focus on mobile data monetization. The strong conversion of operating results into free cash flow exceeded the proposed dividend of EUR 525m for financial year 2013.

Full year 2013 financial highlights:

— Telefónica Deutschland Group total revenues amounted to EUR 4,914m, a decrease of 5.7% year-on-year, of which EUR 2,989m were wireless service revenues (minus 5.2% year-on-year; minus 1.5% excluding mobile termination rate cuts).

— OIBDA reached EUR 1,237m, 3.3% below 2012 and minus 9.2% year-on-year if adjusted for capital gains of EUR 76.2m from the sale of assets in the fourth quarter of 2013. As a result, OIBDA margin was 25.2% (23.6% if adjusted for capital gains, minus 0.9 percentage points year-on-year).

— CapEx increased 9.4% year-on-year to EUR 666m, and after a net positive contribution of EUR 127m from Working Capital and other effects, free cash flow pre-dividends increased 3.3% year-on-year to EUR 699m.

— Net debt decreased year-on-year by EUR 375m to reach EUR 468m at the end of December, 2013, with a leverage ratio of 0.4x. The Company successfully debuted in the debt capital market with a 600 million 5-year Eurobond issuance in mid-November 2013, followed by a 500 million 7-year Eurobond at the beginning of February, 2014.

Summary of achievements on 2013 Strategic Priorities for the business:

1.
Capitalize on our multi-brand portfolio & superior customer satisfaction, driving additional efficiencies for the business.

— Tariff portfolio updates for a more smartphone-centric customer demand: "O_2 Blue All-in" for the consumer postpaid segment; "O_2 Loop Smart" and "Fonic Smart S" tariffs for prepaid customers.

— Development of new distribution channels and special propositions for digital customers: O_2 Facebook shop launch, online tariffs for specific segments (e.g. "young people").

— Further development of a fixed-mobile convergent approach, also leveraging Telefónica Deutschland Group's strong partnership with Deutsche Telekom in fixed access: improved "Kombi-Vorteil", new "O_2 DSL All-in" portfolio.

2.
Monetize the data opportunity in all segments through innovative products, digital services & LTE network.

— Consolidation of "O_2 My Handy" handset model with the design of specific bundles to foster LTE adoption (summer campaign "Alles Drin" and Christmas campaign "Hol alles raus" with one year access to LTE when selecting the "O_2 Blue M" tariff).

— Key partnerships in the Digital space to foster penetration and usage of mobile data: "Games Flatrate", "Napster Music-flat", new "O_2 Protect".

— New financial services, such as "O_2 Wallet" and "O_2 Smartphone Insurance", digital advertising solutions ("O_2 More", "O_2 Pad") and machine-to-machine developments, such as "Telefónica Insurance Telematics".

3.

Maintain a competitive 3G network while delivering LTE technology to urban areas.

— Acceleration of LTE network deployment: all planned high speed areas on air, reaching more than 40% population coverage at the end of 2013, with a much focused investment approach in the areas where most O_2 customers live.

— Delivering online, accurate information to customers on network quality and geographical network availability ("Live check" smartphone application): solid position in mobile data quality as per recent independent network tests (e.g. "Chip", "Connect").

— Further densification of the 3G network with the enhancement of HSPA+ technology with Dual Cell deployment in selected areas (up to 42Mbps down-stream speed).

1. Fundamentals of the Group_

1.1 Business Model of the Group

1.1.1 Structure of the Telefónica Deutschland Group

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

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

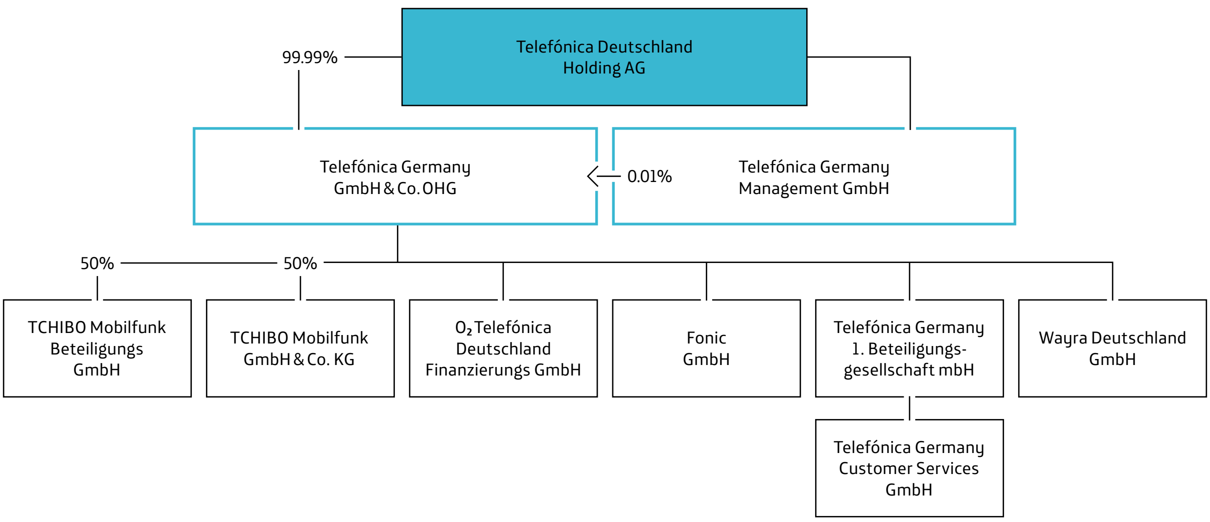
The financial year of the company corresponds to the calendar year (January 1 to December 31).

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

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

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

It is included in the consolidated accounts of the ultimate holding company, the Telefónica, S. A., Madrid, Spain



(Telefónica, S.A.) as of December 31, 2013 (Telefónica, S.A. Group). The parent company of the Telefónica Deutschland Group is the Telefónica Germany Holdings Limited, a subsidiary of the O2 (Europe) Limited, Slough, UK (O2 (Europe) Limited). As of December 31, 2013, the companies included in the consolidated accounts of the Telefónica Deutschland Group were organized as shown in the organization chart on page 28.

In the reporting period, with Articles of Association as of February 26, 2013, the Telefónica Deutschland Finanzierungs GmbH, with its registered office in Munich, was founded and registered in the commercial register of the local court in Munich on March 14, 2013. It is a subsidiary of the Telefónica Germany GmbH & Co. OHG. Effective from November 7, 2013, Telefónica Deutschland Finanzierungs GmbH changed its name to O_2 Telefónica Deutschland Finanzierungs GmbH.

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

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

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

Management and governing bodies

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

Management Board

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

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

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

Supervisory Board

Pursuant to the Articles of Association of the company, sections 95, 96 of the German Stock Corporation Act and section 7 of the German Co-Determination Act, the Supervisory Board comprises twelve members, of whom six are representatives of shareholders and six representatives of employees. If the General Meeting does not set a shorter period of office at the election of shareholder representatives, then the Supervisory Board members and potential substitute members are elected until the end of the General Meeting that resolves on the discharge of the Supervisory Board for the fourth financial year after the start of the period in office; the financial year in which the period of office begins is not counted.

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

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

1.1.2 Business activity

The Telefónica Deutschland Group is the third largest telecommunications service provider in Germany (based on 2013 reported revenues), with 25.2 million customer connections as of December 31, 2013. The Telefónica Deutschland

Group offers private and business customers voice, data and added value services in wireless communications and wireline networks. In addition, the Telefónica Deutschland Group is among the leading wholesale providers in Germany. We offer our wholesale partners access to our infrastructure and to our services. We are a part of the Telefónica, S. A. Group, one of the biggest telecommunications corporations in the world.

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

Our sales and marketing approach is based on a strong multi brand strategy that adresses a broad range of customer segments with our product and services. We offer the majority of our postpaid and prepaid wireless and wireline communications products and bundled offers via our core brand 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 area. For a number of years our strategic focus has particularly been the sale of wireless postpaid sevices to smartphone users. This group of customers, which as of December 31, 2013 comprises 69% of the O_2 postpaid customer base, generates above-average sales figures in comparison to users without a smartphone through the use of mobile data services and an elevated interest in the new wireless communications standard LTE. The interest in smartphones and the use of wireless data is also growing in the prepaid area. As of December 31, 2013, 31% of our prepaid customers are already using a smartphone and it is for this reason that we also offer special prepaid tariffs for smartphone users.

For several years we have been selling mobile phones and other hardware independently of wireless communications charges at fixed prices via our successful "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 transparancy to the customer with regards to the cost of both the mobile phone and the wireless communications services. Customers have a large choice of mobile phones, including the latest premium devices, with attractive payment conditions. Our main suppliers of mobile phones are Samsung, Apple, Nokia, HTC and Sony Mobile Communications. Our focus with the "O_2 My Handy" model lies predominantly on the sale of smartphones with internet capability, which constituted 98% of the mobile phones sold by us to postpaid customers in the 2013 financial year (as of December 31, 2013). Particularly worthy of note here is the development of the proportion of smartphones with LTE capability. While in January 2013, only 4% of the smartphones sold by us to postpaid customers had LTE capability, the proportion was already around 80% in December 2013. In addition, the "O_2 My Handy" model is also used by customers of our secondary brands and our wholesale partners. We are serving the growing demand for wireless data services in these customer segments via a large range of cheap entry-level smartphones.

With secondary and partner brands and via our wholesale channels we reach further groups of customers, whom we do not appeal with our core brand O_2. Our secondary brands include the brands Fonic and netzclub, which are fully controlled by us, as well as brands from joint operations and strategic partnerships such as, for example, TCHIBO mobil and Türk Telekom Mobile. We also market high-speed DSL internet access and wireline telephony. Our multi brand approach enables us to address a broad spectrum of customers and to maximize our sales range through customized product offers, sales and marketing.

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

Small office / home office (SoHo) as well as small and medium-size business customers (SME) are addressed via our core brand O_2, large international businesses via the brand "Telefónica Multinational Solutions". We market our products via a diversified sales platform. This includes direct selling channels like our nation-wide network of independently operated O_2 franchise and premium partner shops, online and tele-sales as well as indirect selling channels like partnerships in retail trade/online retail trade and retailers/ cooperations.

1.2 Goals and Strategies

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

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

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

Our goal is to strengthen our position in the German telecommunications market with our core brand O_2 and with a strong portfolio of secondary and partner brands. Furthermore, we are continuously analyzing potential strategic partnerships in order to address special niche markets or customer segments with new brands.

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

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

We are expanding our online and e-care capacity so that our customers can comfortably resolve their own questions and problems via various channels. This includes our internet portal, the wireless portal, the support community, self-service, and social media. For this we are strengthening the digital services in our customer loyalty, telesales and service teams and also enhance the online systems in our shops. In addition, we are supporting a change of thinking to essentially digital behavior. So, as to support this process, we have developed a new multi-channel comprehensive customer-journey as a strategic manual for interaction with our customers. This will increase customer satisfaction and, in addition, minimize customer service costs.

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

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

We intend, primarily with our core brand O_2, to ramp up mobile service revenue through increasing data use due to the quickly growing number of smartphone users. In this way we will compensate for losses in the classic communications services such as telephony and SMS due to price slumps, regulatory effects and substitution with other services. The central criteria for success in this connection are the expansion of our LTE network, which is progressing, and our portfolio of plans, which is designed for data use and aligns itself with the individual data demand of our postpaid and prepaid customers.

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

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

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

Differentiate O_2 as the best value-for-money LTE brand in the German market

We assume that, due to the broad offering of LTE capable devices, LTE use will significantly increase in Germany in 2014. The LTE technology significantly enhances the wireless user experience. The reasons for this are the maximal download speed of currently up to 75Mbit/s, shorter reaction times and unrestricted surfing through improved latency as well as better coverage in internal spaces due to the 800MHz frequency. That gives us the opportunity to target quality-oriented high-value customers. At the moment we are positioning LTE within our O_2 premium tariffs with a surcharge compared to 3G tariffs in order to fully exhaust the potential. Due to the improved user experience, LTE customers are prone to significantly higher data usage than 3G customers, which in turn enables new monetizing approaches such as e.g. the targeted upselling of data packages in excess of the data volume contained in the contract.

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

Seize opportunities in the Business Segment and for Digital Services

We address freelancers as well as small, medium-sized and large national businesses with our core brand O_2. The brand “Telefónica Multinational Solutions”, in contrast, is aimed at large international customers. For our core brand O_2, it is our goal to be perceived by our customers more strongly as a business customer brand as well. We want to increase our market share and our revenue by even more effectively monetizing wireless data use which is also growing strongly in the BSB segment and to distinguish ourselves from our competitors via powerful marketing, innovative products (among others selected cloud, security and IT services), the best cost-performance ratio as well as strong customer service.

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

1.3 Management System

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

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

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

The Management of the Telefónica Deutschland Group has introduced a comprehensive internal management system for the control of the Group, which primarily comprises the following components:

- Process for strategic goal-setting
- Integrated budgeting and planning system
- Finance-related and operative performance indicators
- Monthly reporting to Management Board and Supervisory Board
- Continual opportunity and risk management
- Leadership by agreements on goals at all levels of the organization

1.3.1 Strategic setting process

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

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

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

1.3.2 Description of the management system

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

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

Revenue and operating result

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

By the use of the OIBDA margin, which expresses as a percentage the relationship of the operating result before depreciation and amortization (OIBDA) on total revenue, we measure the profitability of our operative business. The OIBDA margin as a fundamental monitoring parameter enables a comparison of the operative performance that was achieved in the individual reporting periods and businesses. The implementation of the OIBDA to calculate the figure of the OIBDA margin is advantageous, as this variable eliminates potential differences that can be caused by variations in the tax positions (for example on a change of the effective tax rates or deferred taxes and their effect on individual periods or businesses), depreciation and other positions. Thus, the OIBDA margin is often used to compare the business activity of telecommunications corporations. However, as other corporations possibly use a different basis of calculation for OIBDA, it is possible that our representation of the OIBDA margin is not comparable with other corporations.

Investment activity

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

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

Free cash flow

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

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

Net leverage ratio

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

As part of its dividend policy, Telefónica Deutschland has therefore also decided to refrain from paying dividends distributing capital or capital reserves in cash or buying back shares if the net leverage ratio materially and consistently exceeds the target leverage of less than 1.0x.

Postpaid net adds
New contractual customers for the period less those contractual customers leaving are designated as the postpaid net additional customers (net adds). A continually positive number of net adds leads to a growing customer base and reflects successful customer management. The number of postpaid net adds is influenced by many factors. More new customers can be won with a highly attractive product portfolio and a high level of customer satisfaction among existing customers leads to a lower churn rate. The goal of this KPI is, among other things, the evaluation of customer retention and customer acquisition measures in the valuable postpaid segment.

Customer satisfaction
Customer satisfaction is among the most important priorities of our business. Thus we continually strive for a better positioning of our core brand O_2 in order to gain premium consumer and business customers for wireless telecommunications products, wireline products and convergent services in the postpaid sector. We claim to be the most popular brand with the most satisfied customers on the German telecommunications market. This means that we create customer-oriented offers and provide oustanding services on all our customer interfaces. We are convinced that our high level of customer satisfaction has a positive impact on churn rates and increases recommendation rates.

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

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

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

1.3.3 Budgeting and planning system

The integrated planning system is based on strategic and operative goals. The Telefónica Deutschland Group sets internal objectives for the Group with regards to all relevant performance indicators – which are described in section 1.3.2. To develop a long-term three-year plan, the anticipated market development as well as internal expectations with regards to progress in the areas of growth and efficiency evolution are discussed once a year. The first plan year is depicted on a monthly basis in order to establish a detailed budgeting. For reasons of control the budget is updated twice a year. Alongside the results that have already been achieved and which will be analyzed as part of the monthly reporting, the current market development and the additional opportunities or risks that are known at the relevant point in time are taken into account in the updating. This prognosis is then used in order to introduce operative improvements or in order to seize new opportunities that offer themselves to the Group.

1.4 Product Development and Innovation Management

Product development
Innovative and customer-oriented products form the basis of our sustainable growth in turnover and results. For this reason we are continually expanding and improving our product portfolio. With a comprehensive analysis of our customer groups we have gained important knowledge in the past year, in order to exactly tailor our product and services offering as part of our multi-brand strategy to the needs of the relevant target group. Thus, in spring we completely re-aligned the O_2 tariff portfolio. With the new O_2 Blue tariffs our customers only choose between various data volumes – telephone calls and the sending of SMS in all German networks is included. Through the speedy dissemination of smartphones these tariffs optimally match the changed usage patterns of our customers and their desire for an offer comprised of integrated voice and data services. In the high-value smartphone tariffs of the O_2 core brand we offer customers access to our high-speed LTE network and enable additional offers like multi-card and roaming offers.

We also introduced an attractive All-In offer in October 2013 in the wireline area. With the new O_2 DSL All-In Portfolio our customers can make unlimited telephone calls to wirelines and all German wireless telecommunications networks. With the VDSL variety it is possible, with up to 50Mbit/s, to surf the internet with up to three times the speed of a conventional DSL connection. Since 2012 we have been working successfully with Telekom Deutschland GmbH as part of the VDSL contingent model. On December 20, 2013 we concluded a contract with Telekom for the expansion of the wireline network cooperation. This is subject to the final approval from the supervisory authorities. For our wireline products we will in future increasingly use the high-speed infrastructure of Telekom. In this way our customers will receive an even better performing and future-proof wireline offer.

With the expansion of our product portfolio we are developing attractive offers with high levels of customer use and tapping new fields of business. Here, mobile payments are a focal point where we are taking a clear leading role. In 2013 we introduced the first alternative mobile payment process with “mpass”, which allows payments both in fixed retail stores as well as over the internet, and it enables our customers to carry out money transfers directly from smartphone to smartphone. In addition, in February 2013 we presented the new electronic "O_2 Wallet" as a test version. The "O_2 Wallet" is a type of digital wallet with which our customers can use both our own payment service, "mpass", as well as other bank cards and rebate cards and vouchers and, by means of the transfer standard NFC, can pay directly at the cash register in fixed retail stores or e.g. can redeem vouchers. In doing so, the user's bank details and customer data are protected with high security standards.

A further product development in the area of wireless shopping is "O_2 More Local". The new service offers customers, who take up the offer, attractive priority offers in their direct vicinity via SMS or MMS. The offers or vouchers can be redeemed directly when shopping in the relevant store. The service is free and works with all commercially available mobile telephones. This location-related service has also been available to our network club customers since August 2013.

Against the background of the increasing security requirements for many customers, in October 2013 we brought "O_2 Protect" onto the market. With this product we offer our customers comprehensive all-round protection for smartphones, tablets and PCs. The package contains effective anti-virus protection as well as regular data backups. If lost or stolen, devices can be located and blocked; personal data can be deleted via remote access.

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

New tariffs and products for business customers

In the course of the year we have also further developed the tariffs for our business customers. Thus all business customer tariffs have LTE capability. With the new O_2 combination advantage, all telecommunications needs can be covered at attractive conditions by a single source. For business travel to foreign countries the new "EU+ Travel Option" offers effective cost control with all-inclusive prices. In addition, business customers who need a wireline number in a foreign country can now book this to their wireless telecommunications contract.

As well as attractive tariffs, we offer our business customers a multitude of services. Internationally active businesses can link their branches in over 170 countries, prioritize data flows and optimize their entire digital communications with the new "Telefónica Global mWAN" offer. With the new "O_2 Mobile Device Management" we make it easier to administer mobile end-devices in businesses. Those responsible for IT can centrally configure and administer smartphones and tablets that are used differently in the business via a new web platform and thus bring the "bring your own device" trend into harmony with the existing security guidelines.

A further product innovation is the "O_2 Signal Box", a small UMTS wireless telecommunications cell with which business customers can smooth out reception difficulties in buildings and ensure optimal wireless telecommunications reception. Our new "Promotion Pad" from O_2 links cloud technology and wireless telecommunications to a new form of advertising. Retail traders and other tradespersons can present advertising content and customer information on digital screens in their selling spaces. The complete solution, which is easy to operate, is delivered with an advertising configurator with which the customer can quickly and professionally create advertisements without any previous knowledge.

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

Innovation management

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

A focus of our research and development in the previous year was the new wireless telecommunications standard LTE, which enables significantly faster data transmission. In February 2013, we were the first network operator worldwide to successfully transfer telephone conversations from the LTE network without interruption to the UMTS network. This so-called "handover" is particularly important when driving so that conversations do not break off. Further advantages are shorter call connection times and longer battery life.

In addition, Germany's currently fastest LTE wireless telecommunications cell has been running in test mode since November 2013 at our company building in Munich. It enables download speeds of up to 225Mbit per second. With that, the same services can be used on a smartphone or tablet that up to now have only been possible on fixed devices with WLAN.

A further novelty in the network technology area is the "Live Check" service, which we have been offering since February 2013. With this customers can quickly and easily check the quality and functional capability of the O_2 wireless telecommunications network in the internet at their location or any other location in Germany. Customers can log disturbances via a service App and receive notification as soon as they are cleared.

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

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

Involving our customers more in product development and thus accelerating market introduction are among our most important priorities. The "O_2 Ideas Forum", which was launched in 2010, provides customers with the opportunity to submit suggestions to us for new products and services. The ideas are then discussed and prioritized by other customers on the O2.de portal. Around 1,600 ideas have been submitted by customers in this process. In addition, since 2011 we have been operating the "O_2 Ideas Laboratory". Here we introduce new concepts and products to our customers at an early stage of development and receive their direct feedback. Around 1,300 customers and further interested users have registered themselves on the ideas portal. By implementing selected ideas from the "O_2 Ideas Forum" and the "O_2 Ideas Laboratory" we not only improve our products but rather we also deliver credible proof of our excellent customer orientation.

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

2. Economic Report_

2.1 Overall Economic and Branch-Related Conditions

2.1.1 Economic environment

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

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

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

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

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

General trends on the German telecommunications market
In the German telecommunications sector, alongside continuing customer demand for more bandwidth, various other trends can be observed. Thus convergent products and services are becoming ever more popular. The strong demand for wireless data usage and the increasing smartphone and tablet penetration enable the wireless telecommunications network operators' further opportunities for growth, which will also continue into the future. Smartphones and tablets are becoming the trailblazers for the digital revolution in Germany. At the same time, the monetization of the wireless data business will continue to gain strongly in significance for wireless telecommunications providers. The increasing availability of cloud services is responsible, according to the industry association BITKOM, for a profound change in information technology. With Cloud Computing the use of IT services occurs according to demand via decentralized computers that are connected via data networks (in the "Cloud") instead of on local computers. A further trend is the growing market of machine-to-machine communication (M2M) with countless application possibilities.

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

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

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

The German wireless telecommunications market is an established market with four wireless telecommunications network operators. As of December 31, 2013, the Telefónica

Deutschland Group held, with 19.4m accesses, a market share of 16.8%.
(Source: Business data, Analysys Mason, BITKOM)

The German wireline market
Intense competition prevails on the German market for wireline broadband services as well. The number of subscriber lines increased in comparison to the previous year by approximately 2% and the customer base grew by the end of September 2013 to approximately 28.5m. The proportion of DSL connections here is 81%.
(Source: Analysys Mason: Telecoms Market Matrix Q3 2013, January 2014)

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

2.1.2 Regulatory influences on the Telefónica Deutschland Group

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

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

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

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

While the majority of the new provisions came into force in May 2012, for some of them there were transition deadlines. Worthy of mention in this connection are the provisions regarding the free queue, the regulations regarding a change of service provider and standards regarding the transparency of end-customer contracts.

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

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

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

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

The Federal Network Agency confirmed that the cooperation accords with the Telecommunications Act in its draft judgment of December 17, 2013, and provisionally stayed proceedings. The cooperation still requires a final decision of the Federal Network Agency, which will only be made following national consultation as well as a consultation with the European Commission. This final decision is expected in the first half of 2014.

Roaming III

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

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

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

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

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

MTR

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

The provisional decision was notified to the European Commission together with the regulatory order, which was also issued to Telefónica Germany GmbH & Co. OHG on July 19, 2013 and which forms the legal basis of the ex ante price regulation. As part of the notification process the European Commission expressed significant misgivings about the fee method and the fee level. Telefónica Germany GmbH & Co. OHG filed suit on August 16, 2013 against the MTR decisions with the goal of achieving higher termination rates.

FTR

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

Decisions regarding the fees for the subscriber line (SL)

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

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

The future development of the GSM licenses
The GSM licenses, which authorize the use of the frequency spectrum in the frequency sectors 900MHz and 1,800MHz, expire at the end of 2016. The Federal Network Agency is currently working on a decision about the future of these frequencies. In November 2012 the Federal Network Agency released an information paper in which four possible scenarios with regard to the future of the spectrum were illustrated. The possibilities extend from an extension to an isolated allocation of the GSM licenses through to scenarios in which the allocation of the GSM spectrum is made together with additional spectra, which are expected to be available in the coming years. The Federal Network Agency has released a draft decision on the basis of the submissions on the information paper. Opinions regarding the draft could be submitted up to October 4, 2013. Telefónica Germany GmbH & Co. OHG also made use of this opportunity. The opinions were published on the internet site of the Federal Network Agency. (Source: www.bundesnetzagentur.de/cln_1931/DE/Sachgebiete/Telekommunikation/Unternehmen_Institutionen/Frequenzen/OeffentlicheNetze/Mobilfunknetze/Projekt2016/Projekt2016.html)

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

2.2 Overview of the 2013 Financial Year

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

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

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

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

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

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

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

Significant events
On July 23, 2013 Telefónica Deutschland, Telefónica, S. A. and Koninklijke KPN N.V. (KPN) concluded an agreement regarding the acquisition of KPN's German mobile business E-Plus by Telefónica Deutschland. In our view, the combination of Telefónica Deutschland and the E-Plus Group will establish a wireless network operator generating significant economies of scale and with high potential in Europe's largest economy with a clear vision and commitment to compete against the incumbent market leaders across all segments. As of December 31, 2013, the execution of the transaction still required the approval of the General Meeting of the Telefónica Deutschland and the competent authorities as well as further standard closing conditions. The completion of the transaction is expected mid-2014 (section 5 Report on Events after the Reporting Period).

In the fourth quarter of the financial year 2013 we sold Telefónica Germany Online Services GmbH (TOS) and GKHH Fibre Optic GmbH (Note 19 Discontinued Operations and Disposal Groups) in order to focus even more on our core business going forward.

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

On February 26, 2013 we founded the Telefónica Deutschland Finanzierungs GmbH, Munich, and renamed it to O_2 Telefónica Deutschland Finanzierungs GmbH with effect as of November 7, 2013. Via our subsidiary, O_2 Telefónica Deutschland Finanzierungs GmbH, we issued a senior unsecured 5-year bond in November 2013 with a nominal value of EUR 600m and a maturity on November 22, 2018 in the regulated market of the Luxembourg Stock Exchange. The net proceeds generated from the bond will be used for general corporate purposes.

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

On November 7, 2013 we resolved and announced that it is intended to propose a cash dividend of approx. EUR 525m to the next ordinary General Meeting for the 2013 financial year.

The business development is further detailed in the following sections.

2.2.1 Results of operations

For the illustration of the business development in comparison to the previous year see table 2, p. 42.

2.2.1.1 Revenues

In the 2013 financial year total revenues of EUR 4,914m were achieved. This corresponds to a reduction of EUR 299m or 5.7% in comparison to the previous year. The reduction in revenues is, on the one hand, partly explained by a decrease in wireless service revenues driven by the reduction of mobile termination rates (MTR) as well as through generally changed utilization of wireless telephony services. Due to a reduced DSL customer base, on the other hand, lower wireline service revenues were realized from wireline / DSL. Without the reduction in the MTR the decrease in total revenues in comparison to the previous year would have been significantly lower, with 3.5%. Revenues continued to be positively influenced by strong growth in the wireless data business.
— Tab. 3, p. 43

Wireless service revenues

Wireless service revenues, comprising revenues from wireless communications services and handset revenues, amounted to EUR 3,673m in the 2013 financial year. This corresponds to a decrease of EUR 172m in comparison to the previous year or 4.5%. However, without the reduction of the MTR the decrease would have been only 1.5%.

In the 2013 financial year the wireless service revenues (for more information, please consult section 1.3.2 Description of the management system) reached EUR 2,989m and decreased compared to the previous year by EUR 163m or 5.2%. Adjusted for the impact of the MTR reduction, a lower decrease would have been recorded (minus 1.5%). With EUR 12.7, the average revenue per customer (ARPU) was less than previous year's level (2012: EUR 13.8). On the one hand this is due to the demanding market and competitive environment, which led to decreasing revenues for voice telephony. On the other hand, the change in consumer communication behavior led to a lower number of text messages sent. Our constantly growing customer base in the valuable postpaid segment (plus 1.8% in comparison to the 2012 financial year) partially offsets these effects, their sustained strong demand for data services (e.g. mobile internet, service applications and other data content) had a positive influence on wireless service revenues. The successful continuation of the monetization of the data business was reflected in the growth in data revenues by 3.7%. The growth driver here is the non-SMS data business, which grew by 21.7% in the 2013 financial year and whose share of total data revenues reached 66.5% (2012: 56.7%). In accordance with this development, in the 2013 financial year the portfolio of integrated wireless communications products was renewed in order to further progress the increasing use of data – both with the postpaid tariffs "O_2 Blue All-in",

"O_2 Blue Basic" and the "Young People" specials, and in the prepaid area with the "O_2 Loop Smart" tariff.

Handset revenues in the 2013 financial year reached EUR 684m, a reduction of EUR 9m or 1.4% in comparison to the previous year due to lower sales for mobile devices. Handset revenues include the income from the sale of mobile phones as part of the "O_2 My Handy" model as well as cash sales. In addition handset revenues include components from the wireless business such as activation fees (mainly postpaid), hardware for bundled products from prepaid SIM cards and mobile devices or postpaid contracts as well as accessories.

Wireline revenues / DSL

In the 2013 financial year revenues of EUR 1,235m were achieved in the wireline and DSL businesses. This corresponds to a reduction of EUR 128m or 9.4% in comparison to the previous year. 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 contraction in the customer base and the overall intensely competitive market conditions. Wireline and DSL 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, from termination rates paid by other telecommunications companies and from hosting services.

Other revenues

Other revenues relate to new business such as advertising and financial services, e.g. the mobile offer service "O_2 More Local" or the mobile payment system "mpass". This position increased in the 2013 financial year in comparison to the previous year by 28.3% to a revenue of EUR 6m in particular through the increase in wireless marketing activities.

2.2.1.2 Operating income before depreciation and amortization (OIBDA) / Annual surplus

In the 2013 financial year an OIBDA of EUR 1,237m was achieved. This corresponds to a reduction of EUR 42m or 3.3% in comparison to the previous year. However, the OIBDA margin improved in comparison to the previous year by 0.6% points to 25.2%. The OIBDA includes one-off gains of EUR 76m from the sale of Telefónica Germany Online Services GmbH (TOS) and GKHH Fibre Optic GmbH in the fourth quarter of the 2013 financial year, which partially offset the effect of regressive revenues on the results. The increased contribution from the wireless data business as well as the continual focus on efficiency also had positive further effects on the operative result.

The operating expenses, comprising supplies as well as personnel expenses and other expenses, were able to be reduced in the financial year by EUR 149m or 3.7% to EUR 3,846m. The savings can be seen primarily in supplies, whereby the increased spending in the commercial area, in particular for targeted offers for mobile hardware and customer retention measures, were able to be compensated.

2 — Consolidated income statement

	January 1 to December 31			
(Euros in millions)	**2013**	2012	Change	% Chg
Revenues	**4,914**	**5,213**	**(299)**	**(5.7)**
Other income	169	61	108	>100.0
Operating expenses	(3,846)	(3,995)	149	(3.7)
Supplies	(1,958)	(2,131)	173	(8.1)
Personnel expenses[1]	(419)	(422)	3	(0.7)
Other expenses[1]	(1,469)	(1,442)	(27)	1.9
Operating income before depreciation and amortization (OIBDA)	**1,237**	**1,279**	**(42)**	**(3.3)**
OIBDA margin	**25.2%**	**24.5%**		**0.6%-p.**
Depreciation and amortization	(1,132)	(1,133)	1	(0.1)
Operating income	**105**	**146**	**(41)**	**(27.8)**
Net financial income (expense)	(27)	(6)	(21)	>100.0
Profit before tax from continuing operations	**78**	**140**	**(61)**	**(43.9)**
Income tax	(1)	168	(168)	>100.0
Profit for the year from continuing operations	**78**	**308**	**(230)**	**(74.7)**
Profit for the year from discontinued operations[2]	**0**	**1,027**	**(1,027)**	**(100.0)**
Total profit for the year	**78**	**1,335**	**(1,257)**	**(94.2)**

1 Reclassification of external personnel expenses into other expenses in 2013 and 2012. For further details we refer to the Consolidated Financial Statements as of December 31, 2013.

2 No discontinued operations in 2013.

Supplies mainly include interconnection costs, which arise when our customers are connected with other wireless communications networks. Furthermore, this position 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 2013 financial year supplies amounted to EUR 1,958m. This corresponds to a decrease of EUR 173m or 8.1% in comparison to the previous year. Due to the reduction in the MTR, the fees payable for the transmission of calls to third-party networks decreased. This effect is partly offset by higher costs for sold end-devices.

Personnel expenses were reduced in the 2013 financial year by EUR 3m or by 0.7% to EUR 419m. Here the general increases in wages were able to be absorbed through the disposal of parts of the business and the consequential reduced number of employees.

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 2013 financial year other expenses amounted to EUR 1,469m, which corresponds to an increase of EUR 27m or 1.9% in comparison to the previous year. Here lower requirements for bad debts counter an increase in the costs for customer retention measures.

With EUR 1,132m, depreciation remained stable in the reporting period in comparison to the previous year (minus 0.1%). (For further information see details regarding the intangible assets and property, plant and equipment in section 2.3.3 Asset position).

In comparison to the previous year the operating result fell by EUR 41m or 27.8%. to EUR 105m (2012: EUR 146m).

The 2013 financial result was minus EUR 27m (2012: minus EUR 6m). The predominant cause of this was the capital structure of the corporation, which was changed in September 2012.

The Telefónica Deutschland Group once again did not record any positive taxable income in 2013 and as a result will not pay any income tax. The tax expenses in the financial year thus relate predominantly to changes in the deferred taxes.

In 2013, EUR 1m was incurred in deferred taxes. In the previous period a gain of EUR 168m resulted from deferred taxes.

A result of EUR 78m from continuing operations is mainly due to the above-mentioned effects for the current financial year in comparison to the value for the previous year of EUR 308m.

2.2.2 Financial position

2.2.2.1 Principles and goals of financial management

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

3 — Revenue breakdown

	January 1 to December 31			
(Euros in millions)	2013	2012	Change	% Chg
Revenues	**4,914**	**5,213**	**(299)**	**(5.7)**
Wireless business	**3,673**	**3,845**	**(172)**	**(4.5)**
Wireless service revenues	2,989	3,152	(163)	(5.2)
Handset revenues	684	693	(9)	(1.4)
Wireline business	**1,235**	**1,363**	**(128)**	**(9.4)**
Other revenues	**6**	**5**	**1**	**28.3**

2.2.2.2 Finance

Long-term finance agreements
On September 12, 2012, our subsidiary Telefónica Germany GmbH & Co. OHG signed a loan agreement with the finance company of the Telefónica, S. A. Group, the Telfisa Global B.V., as a lender. Under the agreement, Telfisa Global B.V. grants a credit facility (in the following: the credit facility) with an initial amount of EUR 1.25bn, with an interest rate equal to the three-month Euribor, plus a margin of initially 120 basis points, increasing by 40 basis points each year. The repayment schedule provides for annual repayments until 2017, each being 20% of the original total loan amount of EUR 1.25bn.

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

Taking into account the loan granted by Telfisa Global B.V. on September 12, 2012 of EUR 1.25bn and the annual repayment of EUR 0.25bn in September 2013 and the early repayment of EUR 0.15bn in December 2013, our future repayment obligations from long-term financial agreements are configured as illustrated in table 4 (as of: December 31, 2013). **— Tab. 4**

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

Bonds
In November 2013, O_2 Telefónica Deutschland Finanzierungs GmbH issued a bond with a nominal value of EUR 600m and a term of five years. The bond pays an annual coupon of 1.875%. The bond was issued at a price of 99.162% resulting in a total yield of 2.053% p.a. The bond has been approved for trading on the Luxembourg Stock Exchange by the Commission de Surveillance du Secteur Financier of the Grand Duchy of Luxembourg (CSSF). Telefónica Deutschland Holding AG guarantees the punctual payment of interest, capital and any other amounts payable under the bond. The issuer transferred the net issuing proceeds of the bond to its shareholder Telefónica Germany GmbH & Co. OHG as part of a loan contract. Telefónica Germany GmbH & Co. OHG will use the net proceeds for general business financing.

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

4 — Long term financing arrangements

	Payment due by period				
(Euros in millions)	2014	2015	2016	2017	2018
Senior credit facilities	100	250	250	250	0
Debt relating to finance leases	2	1	0	0	0
Bond	0	0	0	0	600
Total (nominal value)	**102**	**251**	**250**	**250**	**600**

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

The agreements regarding deposits and liquidity management are automatically extended each calendar year unless terminated by one of the contracting parties before expiry of the contractual year within a 30 business days' notice. Under certain circumstances the agreements can also be terminated immediately – for example if the contractually agreed payments are not made or if we have reason to assume that our contractual right to repayment cannot be fully met. In accordance with the deposit and liquidity management agreement and subject to compliance with the legal framework conditions that apply to the set-off of receivables, rights to repayment with respect to the deposits can be set off against liabilities from loans granted to us by Telfisa Global B.V. In the case of Telefónica Germany GmbH & Co. OHG this also includes the outstanding amount of EUR 0.85bn from the existing credit facility, that was granted by Telfisa Global B.V. on September 12, 2012 with an initial amount of EUR 1.25bn. In addition, as part of the agreements about deposits and liquidity management, we are granted comprehensive rights to information with regards to the financial position of the Telefónica, S. A. Group and Telfisa Global B.V are granted to us.

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

Silent Factoring

In connection with the monthly payments for the "O_2 My Handy" model, we have concluded factoring agreements with certain credit institutions regarding the sale of receivables in order to strengthen our working capital. That means that the payments for the "O_2 My Handy" models are made to us without delay if we have concluded a factoring agreement with the credit institutions for these receivables. In the 2013 financial year, three factoring transactions with a net effect of EUR 73.6m, EUR 70.9m and EUR 74.9m were concluded. The assigned receivables were derecognized from our balance sheet other than a small proportion due to a continuing involvement. Further information regarding the silent factoring can be found in the Notes to the Consolidated Financial Statements for the year ended December 31, 2013 (Note 8 Trade and Other Receivables).

2.2.2.3 Finance analysis

Net financial liabilities

Table 5, p. 46 shows the development of the net financial liabilities.
The net financial liabilities declined slightly year-to-year by EUR 375m to EUR 468m as of December 31, 2013, which resulted in a leverage ratio of 0.4x.
Chart 6, p. 46 shows the development of net financial liabilities in the 2013 financial year.

Off balance sheet obligations

In table 7 our contractual obligations as of December 31, 2013 are illustrated. The informations in this table are based on corporate management estimates with regards to the contractual maturity of our obligations. These could vary significantly from the actual maturity dates. **— Tab. 7, p. 46**

2.2.2.4 Liquidity analysis

Table: Consolidated Statement of Cash Flows **— Tab. 8, p. 47**
Chart: Reconciliation of cash flow **— Chart 9, p. 48**

Statement of cash flows

The following analysis is dedicated to the liquidity development of the Telefónica Deutschland Group in the 2013 and 2012 financial years. The cash flows from operational activities, investment activities and financing activities include the relevant cash inflows/outflows from continuing operations and in the 2012 financial year from discontinued operations as well. The cash flows from discontinued operations include the cash inflows of the following companies that were disposed of as of October 1, 2012 and thus no longer belonged to the Telefónica Deutschland Group: Group 3G UMTS Holding GmbH, Quam GmbH and Telefónica Global Services GmbH, Telefónica Global Roaming GmbH and Telefónica Compras Electronicas S.L.

Cash flow from operational activities

The cash flow from operational activities from continuing operations was EUR 1,270m in the 2013 financial year and thus almost reached the level of the previous year (EUR 1,283m). The reduction in OIBDA (corrected for the effect on results from the sale of assets and a company) and the increase in the net interest payments were able to be compensated for to a large extent through a positive development in the working capital.

Cash flow from investment activities

The cash flow from investment activities from continuing operations amounted to minus EUR 572m in the 2013 financial year. Compared to the previous year the cash outflow decreased by EUR 35m or 5.8% (2012: minus EUR 607m).

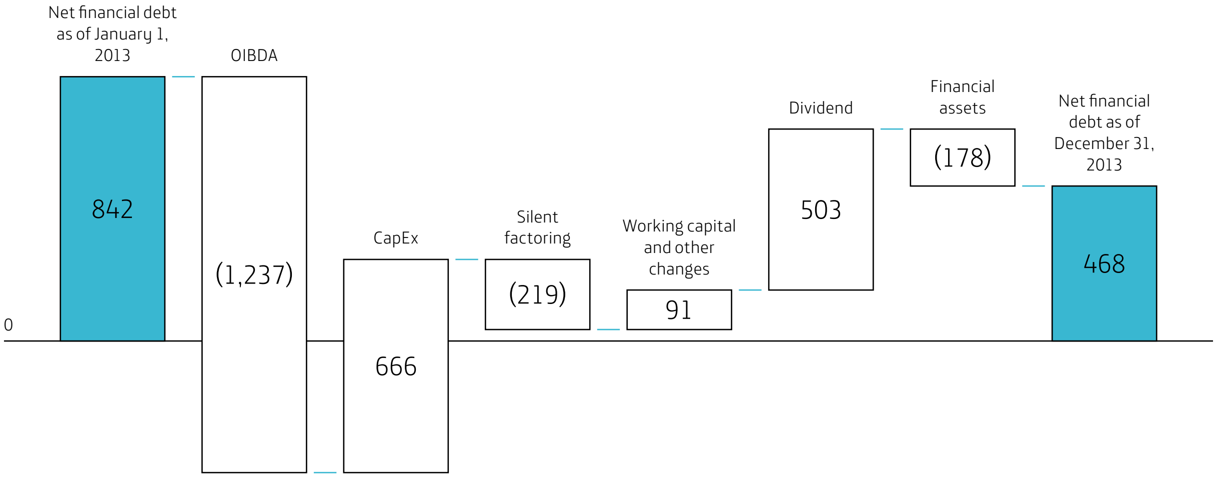
5 — Consolidated net financial debt evolution

(Euros in millions)	As of December 31 2013	2012	Change	% Chg
Cash and cash equivalents	709	324	385	>100.0
A Liquidity	**709**	**324**	**385**	**>100.0**
B Current financial assets[2]	**188**	**0**	**188**	**100.0**
Current interest-bearing debt	102	251	(149)	(59.3)
Other current liabilities	2	4	(2)	(58.4)
C Current financial debt	**104**	**255**	**(151)**	**(59.3)**
D=C−A−B Current net financial debt	**(793)**	**(69)**	**(724)**	**>100.0**
E Non-current financial assets	**83**	**94**	**(11)**	**(11.3)**
Non-current interest-bearing debt	1,343	1,000	343	34.3
Other non-current payables	1	5	(4)	(73.1)
F Non-current financial debt	**1,344**	**1,005**	**339**	**33.7**
G=F−E Non-current net financial debt	**1,261**	**911**	**350**	**38.4**
H=D+G Net financial debt[1]	**468**	**842**	**(375)**	**(44.5)**

1 Net financial debt includes all current and non-current interest-bearing financial assets and interest-bearing financial liabilities. Net financial debt is calculated as follows: non-current interest-bearing debt (EUR 1,342,584k in 2013 and EUR 1,000,000k in 2012) + non-current finance lease payables (EUR 1,340k in 2013 and EUR 4,985k in 2012) + current interest-bearing debt (EUR 102,060k in 2013 and EUR 251,000k in 2012) + current finance lease payables (EUR 1,649k in 2013 and EUR 3,964k in 2012) minus the non-current "O_2 My Handy" receivables (EUR 83,209k in 2013 and EUR 93,770k in 2012) and since June 2013 the current portion of "O_2 My Handy" receivables (EUR 188,013k in 2013 and EUR 0k in 2012) minus loan to third parties included in other current financial assets (EUR 458k in 2013 and EUR 101k in 2012) and minus cash and cash equivalents (EUR 708,545k in 2013 and EUR 323,666k in 2012).
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.

2 Current portion of "O_2 My Handy" receivables in the amount of EUR 196,830k in 2012 has not been considered in the calculation of the net financial debt in the year 2012.

6 — Net financial debt evolution (Euros in millions)



7 — Operating lease obligations, purchase obligations and other contractual obligations

(Euros in millions)	Payment due by period: Less than 1 year	1–5 years	Over 5 years	Total
Operating lease obligations	316	804	790	1,910
Purchase obligations and other contractual obligations	185	46	81	313
Total	**501**	**851**	**871**	**2,223**

The additions to plant and equipment (CapEx)[1] amounted to EUR 666m in the 2013 financial year (2012: EUR 609m). This corresponds to an increase of 9.4%. The increased investments were for the expansion of the LTE network and our 3G capacity to ensure our future growth.

The growth in CapEx was compensated for by the sale of assets respectively companies in the financial year 2013 to the level of EUR 107m.

Cash flow from financing activities

The cash flows from financing activities from continuing operations amounted to minus EUR 314m in the reporting year. The cash outflows thus reduced in comparison to the previous year (minus EUR 3,054m) by EUR 2,740m.

The cash outflows from the financing activities in connection with the continuing operations were mainly attributable to the partial repayment in the amount of EUR 400m of the loan from credit agreements with an original total amount of EUR 1.250m, that Telefónica Germany GmbH & Co. OHG concluded with Telfisa Global B.V. as lender. The significant cash inflows in this area are due to the bond issued in November 2013.

Cash and cash equivalents

Due to the cash inflows/outflows described above the cash and cash equivalents increased in comparison to the reporting date of the previous year by EUR 385m. The cash and cash equivalents amounted to EUR 709m as of December 31, 2013 (2012: EUR 324m).

Free cash flow

The free cash flow before dividend payments from continuing operations increased by EUR 23m and was EUR 699m in the 2013 financial year. The Operating cash flow (OpCF) reached EUR 571m and sank thereby by 14.8% in comparison to the previous year. The strong transformation of the operating cash flow into free cash flow is the result of a positive development in working capital, which increased from EUR 19m in 2012 to EUR 132m in 2013. This is partly due to extended payment terms for suppliers. In addition the sale of assets respectively companies has a positive effect on the free cash flow during the financial year. In 2013, a net interest payment of EUR 21m (2012: net interest receipt of EUR 1m) was recorded as well as a payment of EUR 14m for a term deposit that is being resolved pro rata. **— Tab. 10, p. 48**

The free cash flow after dividend payments primarily concerned the change in equity of minus EUR 503m from the dividend payment during the 2013 financial year (2012: minus EUR 4,300m).

The free cash flow after dividend payments from discontinued operations was EUR 907m in the previous year and is mainly attributable to the net inflow from the disposal of discontinued operations of EUR 557m.

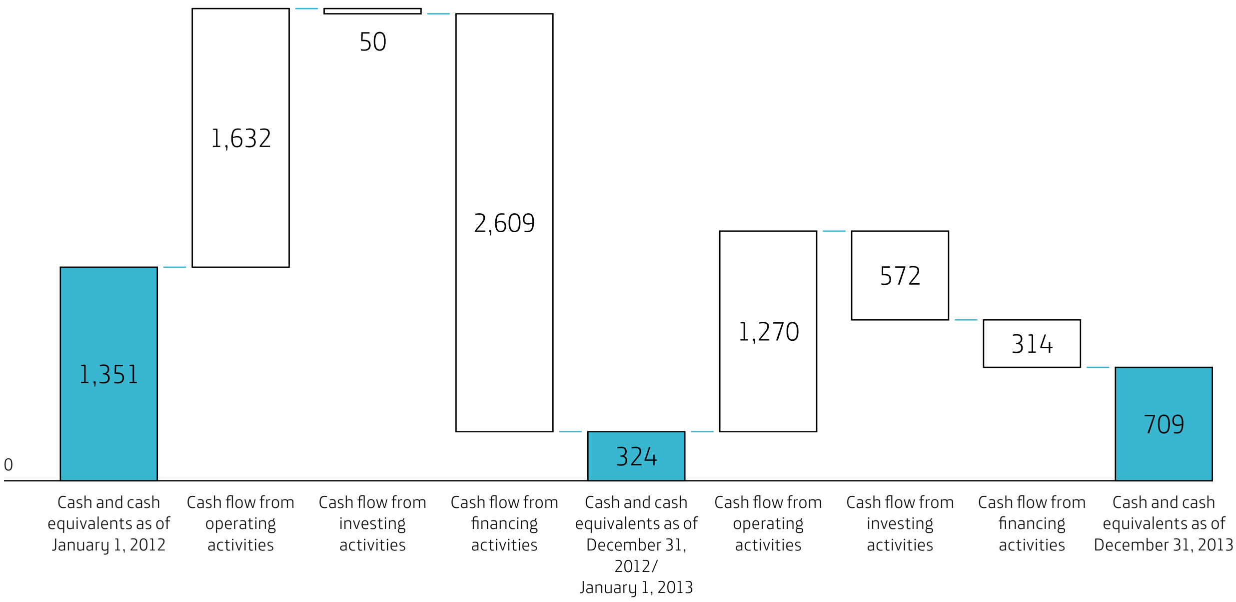
1 The additions to property, plant and equipment and intangible assets (EUR 666m; 2012: EUR 609m) plus the change in liabilities for investments made (minus EUR 23m; 2012: EUR 37m) plus the change in reserves for investments (minus EUR 31m; 2012: minus EUR 22m) and plus changes in the liabilities from finance leases (EUR 6m; 2012: minus EUR 1m) result in the investment expenditure of EUR 664m (2012: EUR 593m) as of December 31, 2013.

8 — Consolidated statement of cash flows

	January 1 to December 31	
(Euros in millions)	**2013**	2012
Cash and cash equivalents at the beginning of the period	**324**	**1,351**
Cash flow from operating activities from continuing operations	1,270	1,283
Cash flow from operating activities from discontinued operations[1]	0	349
Cash flow from operating activities	**1,270**	**1,632**
Cash flow from investing activities from continuing operations	(572)	(607)
Cash flow from investing activities from discontinued operations[1]	0	557
Cash flow from investing activities	**(572)**	**(50)**
Cash flow from financing activities from continuing operations	(314)	(3,054)
Cash flow from financing activities from discontinued operations[1]	0	445
Cash flow from financing activities	**(314)**	**(2,609)**
Net increase/(decrease) in cash and cash equivalents	**385**	**(1,027)**
Cash and cash equivalents at the end of the period	**709**	**324**

1 No discontinued operations in 2013.

9 — Reconciliation of cash flow (Euros in millions)



10 — Reconciliations of cash flow and OIBDA minus CapEx

	January 1 to December 31			
(Euros in millions)	2013	2012	Change	% Chg
OIBDA	**1,237**	**1,279**	**(42)**	**(3.3)**
– CapEx	(666)	(609)	(57)	9.4
= Operating cash flow (OpCF)	**571**	**670**	**(99)**	**(14.8)**
+ Silent factoring[1]	219	302	(83)	(27.4)
+/– Other working capital movements	(87)	(284)	197	(69.4)
Change in working capital	**132**	**19**	**113**	**>100**
+/– (Gains) losses from sale of companies, fixed assets and other effects	(76)	1	(77)	>(100)
+/– Proceeds from from sale of companies, fixed assets and other effects	107	0	107	100.0
+ Net interest payments	(21)	1	(22)	>(100)
+ Payment on financial investments	(14)	(15)	1	(4.5)
= Free cash flow pre dividends from continuing operations[5]	**699**	**676**	**23**	**3.3**
+/– Equity movements[3]	(503)	(4,300)	3,797	(88.3)
= Free cash flow post dividends from continuing operations	**196**	**(3,624)**	**3,820**	**>(100)**
+ Free cash flow post dividends from discontinued operations[2,4]	0	907	(907)	(100.0)
= Total free cash flow post dividends	**196**	**(2,717)**	**2,913**	**>(100)**

1 Full impact (YTD) of silent factoring in the twelve month period in 2013 of EUR 219m and EUR 302m in 2012 (transactions have been executed in March, June and September 2013 respectively in March and September of the year 2012).
2 No discontinued operations in 2013.
3 Pre-IPO dividend in 2012 of EUR 4.3bn. Dividend payment of EUR 503m in May 2013.
4 Free cash flow post dividends from discontinued operations in 2012 consists of EUR 349m plus net cash flow from the sale of discontinued operations of EUR 703m minus cash and cash equivalents of EUR 145m.
5 Free cash flow pre dividends from continuing operations is defined as the sum of cash flow from operating activities from continuing operations and cash flow from investing activities from continuing operations.

2.2.3 Asset position

In the analysis of the asset and capital structure the assets and liabilities in existence as of December 31, 2013 are compared with the figures as of December 31, 2012. **— Tab. 11**

As of December 31, 2013 the Group has assets of EUR 9,021m (2012: EUR 9,070m). This corresponds to a reduction of 0.5%.

Intangible assets
The intangible assets including the goodwill amounted to EUR 3,590m as of December 31, 2013. The reduction in comparison to the previous year was EUR 393m and was mainly due to the depreciation of intangible assets with a limited useful life. The level of this depreciation was EUR 528m. Countering this there are additions of EUR 142m (essentially software additions of EUR 124m). Property, plant and equipment departures from the sale of disposal groups amounted to EUR 8m.

Property, plant and equipment
Property, plant and equipment amounted to EUR 2,896m as of December 31, 2013. In comparison to the previous year a reduction of 2.6% or EUR 78m was thus recorded. In the reporting period there were additions of EUR 524m to property, plant and equipment, which related mainly to investments for the transition to 4G technology, to expansions of the capacity of the 3G technology and to improve elements in the performance as well as the coverage of the wireless communications networks. Depreciation of EUR 604m offsets the effect from the additions. In addition, the departures of property, plant and equipment from the sale of disposal groups at the level of EUR 20m offsets other movements of EUR 23m.

Trade receivables and other receivables
The trade receivables and other receviables remained stable and, with EUR 1,035m as of December 31, 2013, were slightly above the previous years (2012: EUR 1,009m).

Deferred tax assets
The deferred tax assets of EUR 584m remained stable in comparison to the previous year (2012: EUR 581m).

Other assets
The other assets remained at the level of the previous year with a slight increase of 4.7% or EUR 9m and thus as of December 31, 2013 amounted to EUR 209m. The other assets include inventories and other financial assets.

Cash and cash equivalents
The cash and cash equivalents totalled EUR 709m as of the end of the year (2012: EUR 324m). The increase of 118.9% or EUR 385m is attributable to several effects (further information in section 2.2.2.4 Liquitdity analysis).

Interest-bearing debt
In comparison to December 31, 2012, the interest-bearing debt grew from EUR 1,251m by EUR 194m to EUR 1,445m as of December 31, 2013. O_2 Telefónica Deutschland Finanzierungs GmbH issued a bond with a nominal value of EUR 600m in the reporting year. Telefónica Germany GmbH & Co. OHG repaid EUR 400m of the loan concluded on September 12, 2012 with the financing company Telfisa Global B.V. as lender.

11 — Consolidated statement of financial position

	As of December 31			
(Euros in millions)	**2013**	2012	Change	% Chg
Goodwill and intangible assets	3,590	3,983	(393)	(9.9)
Property, plant and equipment	2,896	2,973	(78)	(2.6)
Trade and other receivables	1,035	1,009	26	2.6
Deferred tax assets	584	581	2	0.4
Other assets	209	199	9	4.7
Cash and cash equivalents	709	324	385	>100
Total assets = Total equity and liabilities	**9,021**	**9,070**	**(48)**	**(0.5)**
Interest-bearing debt	1,445	1,251	194	15.5
Provisions	108	89	18	20.7
Trade and other payables	1,300	1,147	154	13.4
Deferred income	170	154	16	10.1
Equity	**5,999**	**6,429**	**(430)**	**(6.7)**

Provisions
The provisions increased in comparison to the previous year by 20.7% or EUR 18m to EUR 108m. This development is mainly attributable to a significant increase in the provision for the estimated cost for the dismantling and removal of assets, which increased by EUR 24m to EUR 80m in the reporting year. This increase was partially offset by the reduction in the pension provision by EUR 3m to EUR 5m as well as the reduction in the provision for onerous contracts by 3m to EUR 23m.

Trade payables and other payables
Trade payables and other payables amounted to EUR 1,300m as of the end of the year. This corresponded to an increase of 13.4% or EUR 154m compared to the previous year (EUR 1,147m). The trade payables increased by EUR 156m to EUR 1,074m. The other payables reduced from EUR 228m as of December 31, 2012 to EUR 226m as of December 31, 2013.

Deferred income
Deferred income increased in comparison to the previous year by 10.1% or EUR 16m and amounted to EUR 170m as of December 31, 2013. Essentially the line item includes down payments received for prepaid credit of EUR 106m.

Equity
The equity decreased in the 2013 financial year by 6.7% or EUR 430m to EUR 5,999m (2012: EUR 6,429m). The change in equity is mainly due to the dividend distribution of EUR 503m which was resolved by the General Meeting on May 7, 2013. The decrease through the dividend distribution as well as through other movements (EUR 5m) was offset by the profit for the period of EUR 78m.

3. Employees_

The telecommunications market finds itself in continuous transition, which again and again poses new challenges for our employees as well. For this reason we specifically promote measures to impart the required capabilities and skills to our employees and to regularly further educate them. We also give our employees the freedom to further develop their own capabilities. In this way we ensure that the skills of the business always correspond with the requirements of the market. We promote an open working environment based on equal opportunity. In addition, we are committed to ensuring that our employees can combine the requirements of career and family with one another. For that reason the Telefónica Deutschland Group is one of the most attractive employers in Germany, which is documented and substantiated by many surveys and awards.

Important areas of personnel management

Business Transformation

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

Culture Change

Our employees contribute significantly to the sustainable success of our business. With Culture Change we have established a program in order to align the behavior of all employees even more strongly with our strategic goals within the next twelve months.

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

Employee Proposition

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

Operational Excellence

It is our goal to permanently optimize HR services and HR processes with standardized methods so that we achieve the highest possible quality at low cost. Our HR systems (such as e.g. our personnel management system Chorus) should make our employees' lives easier and save time in the normal working day. All inquiries to our so-called European People Services Centre (EPSC), the first personal contact point for all HR relevant inquiries, should in addition be answered where possible upon the first query. In 2013 we furthermore introduced the HR portal in the intranet, an online portal that every employee can consult before contacting the EPSC in Dublin. The HR portal has comprehensive search functions thanks to which one can find information on most HR issues. If an answer is not helpful, the employees can leave feedback, which is immediately processed. In this way the HR portal is continuously improved and better aligned with the needs of the users. Following the introduction of the HR portal the number of calls to the EPSC in the second half of 2013 reduced by an average of 27% compared with the same months in the previous year.

Number of employees and staff structure
At the end of 2013 the Telefónica Deutschland Group employed 5,940 employees. The number of employees thus increased by 1.3% compared with the previous year (2012: 6,019 employees). The basis for these calculations can be viewed in the consolidated accounts as of December 31, 2013 (Note 27 Information Regarding Employees). The fluctuation rate was 8.6% (2012: 10%).

12 — Employees on average

The business has a relatively young workforce. The average age of our employees in 2013 was around 37.5 years (2012: approx. 37). In total 931 employees, i.e. around 15.7% of the workforce, worked part time in 2013 (2012: 896 employees, 14.6%).[2]

Diversity Management
In accordance with our corporate principles we are expressly committed to diversity and equal opportunity in our business. By naming a diversity officer in 2010 we anchored this commitment solidly in our organizational structure. With the execution of the Memorandum for Women in Leadership (Memorandum für Frauen in Führung – MFF) in 2011 we undertook to specifically support women in positions of leadership.

The proportion of our female employees in 2013 was 35.8% and thus approximated the level of the previous year (2012: 36.2%). In the 2013 financial year six women in leadership positions were represented in the business-leading Senior Management which corresponds to a proportion of 8.7% (2012: nine females in leadership positions; 14.5%). In the Women-on-Board Index II 2013 we achieved third place out of 160 listed German corporations.[2]

At the end of 2013 workers of 77 different nationalities were employed with the Telefónica Deutschland Group. People with disabilities are also welcome in our corporation. Because we take the obligation of inclusion very seriously we have opened a barrier-free career portal, which went online at the end of 2012. In this way we create direct access for and to qualified persons as part of our "Employer Branding". In addition, since 2009 we have been working with the Stiftung Pfennigparade (Penny Parade Foundation) and providing a work-related perspective to people with disabilities. At the end of 2013 113 employees with disabilities were employed in our business, which corresponds to a slight increase of approx. 5% over the previous year.[2]

Employee satisfaction and employer appeal
We would like to be one of the most attractive employers in Germany. Because, at the end of the day, qualified and motivated employees are a fundamental pre-requisite for the realization of our strategic goals. For this reason we offer our employees a whole series of additional benefits. These include flexible working hours, voluntary programs and countless opportunities to combine work and family in a healthy ratio to one another.

Several independent employer rankings and awards speak for the success of our efforts. Thus since 2009 we have been represented in the upper ranks of the independent "Great Place to Work" survey (for businesses with over 5,000 employees). In the current "Great Place to Work" survey 73% of our employees stated that they are proud to work for the Telefónica Deutschland Group (2012: 74%). In total 87% praised the friendly workplace atmosphere and 78% stated that work is for them something special and not just a job (2012: 81%).

We regularly carry out internal surveys of employee satisfaction. In this questionnaire employee satisfaction with managerial behavior, working conditions and their opportunities for development with the Telefónica Deutschland Group were recorded, among other things. In the current financial year we achieved an index value of 76 percentage points from 100 possible points (2012: 76 points).

We participate in a "berufundfamilie" (work and family) audit in order to optimize the programs that we offer as a family-aware employer. In the first quarter of 2012 we started the analysis process and received the corresponding certification at the end of 2012. Beginning with the results of the audit we have started further developing and optimizing our programs and processes and aim to further develop these up to the end of 2015.

Our staff management has focused on the compatibility of work and family since the year dot. There are many programs that support our employees before and during parental leave and subsequently ease their return to work. In addition we offer, in cooperation with external partners, a comprehensive service offering for families. Thus we support our employees in the search for the right childcare or for care opportunities for relatives and broker private tuition or household help. At regular intervals we offer our employees motivational talks on various topics as well as free workshops in the evening.

2 without TCHIBO Mobilfunk Beteiligungs GmbH, TCHIBO Mobilfunk GmbH & Co. KG, Telefónica Germany 1. Beteiligungsgesellschaft mbH, Wayra Deutschland GmbH, Telefónica Deutschland Finanzierungs GmbH

All these initiatives increase the satisfaction of our employees, promote their loyalty to our corporation and ensure that our employees are happy to work for us.

Training and further education

The continuous further development of the skills of our employees is one of the most important goals of staff management. In 2013 the Telefónica Deutschland Group invested a total of EUR 4.6m in the training and further education of its employees. This represents a decrease of around 16% of the expenditure in this area compared with the previous year (2012: EUR 5.5m). In 2013 a total of 5,100 employees participated in one of our further education courses (2012: 4,200 employees). The number of course hours taken up amounted to 173,000 hours in the reporting year (2012: 162,000).[3]

Depending on the qualification and function we offer our employees both internal as well as external further education opportunities. Our employees can also attend the "Telefónica University" which maintains a broadly diverse course program with international orientation at the ready.

With our "Experts as Trainers" Program (EasT) we use the knowledge of our employees and managers, who act as experts as part of the program and school their colleagues and fellow workers – with magnificent feedback. In 2013 92 employees were schooled within this program. This has not only a great motivational effect but also reduces the schooling costs without having to make any compromises in terms of quality.[3]

Apprenticeship and integrated study

Through the training of young employees we secure our future and at the same time do justice to the social responsibility that we have as an employer. Telefónica Deutschland Group offers traineeships primarily in commercial and technical areas (retail dealer, IT specialist, office management assistant, sales person for dialogue marketing, etc.).

In the 2013 financial year we prepared 113 young people for their future working life in our corporation. Here it is our declared goal to take on the apprentices in a fixed employment relationship following their successful graduation. In 2013 we were able to offer 15 of 19 apprentices (79%), who had successfully completed their examinations, permanent employment. In 2012, 27 young people successfully completed their apprenticeship, 21 (78%) of them were employed by us.[3]

Further, we offer those starting study the opportunity of combining their studies with practical training. These students can attend integrated courses at various universities of cooperative education or attend occupational practical studies in different locations. Subject areas are, for example, business administration, electrical engineering and information technology, computer science, business informatics or international management. In 2013, 54 students have taken up this opportunity (46 in the previous year).[3]

3 without TCHIBO Mobilfunk Beteiligungs GmbH, TCHIBO Mobilfunk GmbH & Co. KG, Telefónica Germany 1. Beteiligungsgesellschaft mbH, Wayra Deutschland GmbH, Telefónica Deutschland Finanzierungs GmbH

4. Corporate Responsibility_

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

- Enabling better lives – we aim to make our customers' working and living world easier and more sustainable by providing smart digital solutions.
- Transforming society – we aim to utilize the power of technology to promote a more prosperous, healthier and more inclusive society by supporting and developing voluntary commitment through digital communication, and supporting social and community innovations.
- Caring for the planet – we aim to make a sustainable lifestyle possible for all of our customers with digital products and services, while consistently optimizing resource conservation and efficiency in internal processes.

CR Management

We have defined clear management responsibilities. The Corporate Responsibility department works across all areas and coordinates CR activities. Together, the CR Team and the departments formulate clear goal setting agendas and key monitoring figures as the basis for our CR management. These are then approved by the Management Board and are integrated corporate-wide into key management processes. Performance is reviewed regularly. Group-wide key monitoring figures are defined for the issues: employees, customers, environment, corporate management, health and security in the workplace, society and suppliers. These key figures are verified externally on an annual basis.

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

Stakeholder Dialogue

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

- For our customers, shops and the hotline are important contact points. With the "O_2 Customer Forum" we are providing an additional online platform for customers to communicate with each other and with employees.
- For communicating with our employees, we use various channels. We obtain important insights through regular surveys regarding employee satisfaction.
- Telefónica Germany's representative office in Berlin acts as an interface to politics, economy and associations. It accompanies relevant legislation and policy-making, allowing us to bring our technical know-how into the political process. Our corporate principles ban donations to any political parties.

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

Social Responsibility

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

Think Big

As in previous years, our youth program Thing Big was at the center of our social responsibility activities. Together with Fundación Telefónica and the Deutsche Kinder- und Jugendstiftung (German Children and Youth Foundation), we are making Thing Big a reality. The goal of the program is to provide young people with the skills to implement their own non-for-profit projects and while doing so, to further develop their digital expertise. Since the start of the program in 2010, approximately 40,000 young people have implemented around 2,000 projects. A few examples are creating an App for traineeship, youth radio or a donation project for the homeless. In 2013 around 13,000 participants committed themselves to 669 projects.

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

Think Big School

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

Further commitment

Alongside Think Big we support various programs and initiatives in the area of digital life and media expertise, for example the mobile phone video clip competition “Ohrenblick mal” (Listen up) from the JFF Institute for media pedagogy or the search machine suitable for children fragFINN (askFINN). In addition, in 2013 Telefónica Deutschland supported the development of learning materials for the teaching of media expertise, which can be used in school classes as Open Educational Resources. Moreover, we have also been actively involved in the work of the “Zentrum für Kinderschutz im Internet” (Centre for the Protection of Children in the Internet), a Think Tank founded by the Federal Ministry for Families for youth media protection. In Spring 2013 we received the title IT-Stifter (IT Benefactor) 2013. Via the portal Stifter-helfen.de we have made around 3,000 O_2 product bundles, each with a value of EUR 150, available to non-profit organizations.

During the devastating floods in Summer 2013 we initiated a donation campaign for employees, customers and business partners via the online donation platform betterplace.org – Telefónica Deutschland Group employees coordinated delegations of helpers on site and young people from the Think Big Program were actively involved in the flood assistance. We started a further online donation campaign because of typhoon “Haiyan” in the Philippines. In total 452 donors have collected EUR 25,476. Telefónica Germany added a further EUR 25,000 to that. In 2013 countless employees, customers and business partners were involved in the donation and volunteer campaigns initiated by us for the victims of the floods in Summer 2013 and typhoon “Haiyan” in the Philippines. **— Tab. 13**

Environment and Climate Protection

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

Resource Efficiency

Through exchanging outdated printers for more efficient models, we were able to reduce the number of printers by 75% and energy consumption by approximately 70% at the end of 2013. This means that around 380 tons of CO_2 were saved. Through further procedural improvements, 13m sheets of paper were also saved. In addition, all printers were technically modified for recycled paper. All internal printers were equipped with recycled paper in 2014. Since

13 — Society

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

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

2013, AfB (Arbeit für Menschen mit Behinderung – Work for People with Disabilities) Social & Green IT, a non-profit GmbH (Gesellschaft mit beschränkter Haftung – company with limited liability), recycles a substancial part of our decommissioned IT hardware.

Our mobile phone recycling initiatives were an important contribution to the saving of resources in 2013. With 16,520 recycled mobile phones and 3,033 mobile phones in the trade-in program, we achieved our recycling goals. In order to motivate our customers to return unused devices, the profits from the recycling of mobile phones go to non-profit environmental projects, selected by O_2 customers. In 2013 we donated EUR 46,000 to Naturefund e.V., Plant-for-the-Planet Foundation and for an environmental project in a SOS Children's Village. In 2013 we participated once again in the collection campaign "Clever entsorgen – Handy, Laptop & Co." (Clever disposal – Mobile, Laptop & Co) (**WWW.HANDY-CLEVERENTSORGEN.DE**) under the auspices of the Bavarian Environmental Ministry; and we are committed to the "Sustainability" Task Force of the IZMF e. V. (Informationszentrum Mobilfunk e. V. – Information Centre Mobile Telecommunications Association).

Awareness Building for Environmental Issues and Future Challenges

As a sign of increasing environmental awareness, in our O_2 shops we use only environmentally friendly paper shopping bags, instead of plastic bags. We participated in Earth Hour and switched off all lights in the O_2 Tower and in all shops. The symbolic action on March 23 was to increase awareness for the need of more climate protection. Since 2011, we especially promote the ECO-Index with which information about ecological and social sustainability from end-devices is communicated in our shops.

Digitalization and telecommunications play a central role in the configuration of a sustainable future. Digitalization also shows its added value in the protection of the environment e.g. in the M2M sector, or data communication between machines. With the O_2 Fleet Store it is possible to reduce e.g. the CO_2 emissions of a fleet of vehicles by up to 10%. M2M will play a key role in the energy transition. There is great potential for energy management in buildings, as well as the intelligent interlinkage between electricity consumers and producers.

14 — Environment

	Unit	2012	2013
CO_2 emissions through electricity consumption and vehicle fleet[1]	Tons	237,790	**239,380**
CO_2 emissions through business travel[2]	Tons	3,990	**3,389**
Total electricity consumption	MWh	486,029	**489,634**
of that network	MWh	462,644	**467,907**
of that offices, shops, call center	MWh	23,385	**21,727**
Proportion of electricity consumption from renewable energy[3]	Per cent	70	**58**
Water consumption	Cubic meters	92,160	**93,059**
Paper consumption[4]	Tons	673	**585**
Number of old mobile phones received at O_2[5]	Number	47,898	**43,906**
Proportion of Eco Index reviewed mobile phones	Per cent	78.72	**75.68**

1 Calculation of CO_2 emissions in accordance with Group-wide standards by Telefónica, S. A. in accordance with ISO 14.064, Greenhouse Gas Protocol (Scope 1+2) & ITU-T L.1420; some results for 2012 were updated due to the updating of CO_2 emission factors.
2 Other indirect emissions through business travel (Scope 3) changed in this year because we no longer include travel by car.
3 Our proportion of electricity consumption from renewable energy sank in comparison to 2012 to 58% because, since 2013, Deutsche Telekom no longer uses green energy certificates. Accordingly, our green electricity proportions that are related to the Telekom main distributor drop out of our calculation.
4 Paper consumption continues to sink as part of the internal digitalization and the further forcing of the adjustment to online billing. In addition in 2013 no account enclosures were produced.
5 The number of old mobile phones includes mobile phones that are directed to the recycling process and are reworked in the "Re-Use" process or are accepted through our mobile phone trade-in program.

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

In total, the consumption of electricity and subsequently CO_2 emissions have increased slightly at Telefónica Deutschland in comparison to the previous year. This can be attributed to the network expansion and the increase in customer connections. 58% of the total electricity demand came from renewable sources. 100% green electricity is used at O_2's owned shops and all office buildings. To further reduce CO_2 emissions, we participate in the German Post DHL's "GoGreen" Program and have off-set mail, in order to become almost CO_2-neutral.

5. Report on Events after the Reporting Period_

Issue of a 7-year bond (Bond II)
On February 10, 2014 the Telefónica Deutschland Group issued a senior unsecured 7-year bond with a nominal value of EUR 500m. The bond has a maturity on February 10, 2021 and was issued by O_2 Telefónica Deutschland Finanzierungs GmbH, Munich, and is guaranteed by Telefónica Deutschland Holding AG. The coupon for the fixed interest bond is 2.375% and the issue price 99.624%. The issue spread was 100 basis points over the seven-year Euro Midswap Rate, resulting in a yield of 2.434%. The bond has a denomination of EUR 1,000 and was issued on the basis of a bond security prospectus. O_2 Telefónica Deutschland Finanzierungs GmbH, Munich, has transferred the net proceeds of the bond to Telefónica Germany GmbH & Co. OHG, Munich, in the form of a loan. The net proceeds generated by the bond will be used for general corporate purposes.

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

Extraordinary General Meeting
On December 30, 2013 the Management Board of Telefónica Deutschland called an extraordinary General Meeting, which took place on February 11, 2014. In such extraordinary General Meeting, the General Meeting of Telefónica Deutschland approved the following capital measures for the E-Plus transaction:
— Increase in the share capital by up to EUR 3.7bn against cash contributions with a subscription right of the shareholders, as well as a related amendment of the Articles of Association;
— Authorization of the Management Board, with the approval of the Supervisory Board, to execute a capital increase against contribution in kind by up to EUR 475m and the related amendment of the Articles of Association (authorized capital 2014/I).

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

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

6. Risk and Opportunity Management_

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

6.1 Risk Management and Financial Instruments

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

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

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

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

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

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

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

Interest risk
Interest risks arise predominantly from cash pooling accounts and deposits of the Telefónica Deutschland Group as well as through loan agreements as borrower and interest swaps. The Telefónica Deutschland Group deposits cash surpluses almost exclusively in cash pooling and deposit accounts with Telfisa Global B.V. These accounts and the bank accounts pay a variable interest rate. The loan agreements of the Telefónica Deutschland Group as borrower carry a variable interest rate. In November 2013 an interest rate swap was signed in connection with the issuance of the bond for a partial amount of the bond's nominal value. On the basis of this interest rate swap contract the Telefónica Deutschland Group pays a variable interest rate on a nominal amount and receives a fixed interest rate on the same amount in return. This interest swap compensates, to the level of its nominal amount, the effects of future market interest rate changes on the fair value of the underlying fixed interest financial liabilities from the issuance of the bond (fair value hedge).

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

Credit risk

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

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

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

Liquidity risk

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

Capital management

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

6.2 Risk Management and Risk Reporting

Fundamental risk management principles

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

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

Risk management is an immanent component of the decision-making process with the Telefónica Deutschland Group. The process ensures that risk evaluations are taken into account for the decision-making and measures are taken early to minimize and deal with the risks. As a result the evaluation, communication and management of risks is the task of all managers of the corporation. The risk management department compiles the corporation's risk registry, which also covers the subsidiaries. As part of the creation of the risk registry it is ensured that risks of a similar type or of cumulative effect are aggregated and thus provided for overall consideration. In addition the so-called bottom-up approach, i.e. the identification of risks through the operative units, is complemented by the so-called top-down approach, in order to ensure a cross-business perspective of risk. The purpose of the top-down approach is to ensure that risks that can only be identified at the highest management level or on the basis of a group-wide consideration, are discussed with the operationally responsible units in order to enable a full classification as well as integrated management and to evaluate the relevance for future reporting. Here the role is continually in contact with all areas of the corporation and our risk coordinators in order to progressively pursue and evaluate risks and their management and development. Responsible employees are individually trained in order to ensure a uniform, structured process of risk identification and evaluation. In addition, fundamental training is available for participation by all employees in order to sensitize them generally to the management of risks.

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

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

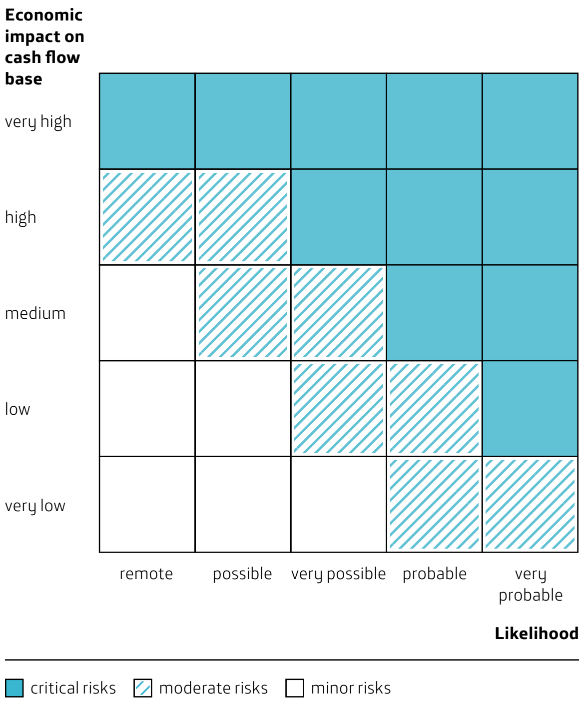
Opportunities are not captured in the risk management system.

Risk evaluation

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

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

15 — Risk profile



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

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

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

6.3 Risks

Business risks

Competitive markets and changing customer demands

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

Regulatory environment

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

Licenses and frequencies

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

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

The Telefónica Deutschland Group constantly evaluates opportunities to realize increases in efficiency and operative profit also through cooperations, additional purchases and fusions. Agreements between corporations who are active in the same or neighboring substantive markets are subject to the supervision and by and large to the requirement for approval from the responsible cartel authorities (EU Commission, Federal Cartel Office, Federal Network Agency). Furthermore it is possible to issue approvals only on certain conditions. The withholding of approval or the stipulation of extensive conditions carries the critical risk that the profitability of the agreement is reduced, planned savings, synergies and growth expectations cannot be generated to the full extent or the possibility that contractual damages become due.

Termination fees wireless communications

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

Termination fees wireline

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

Other regulatory influences on fees

Other price-regulated services include international roaming, SMS and data services. The European Parliament and the European Council have approved the Roaming III Regulations. This sets fee caps for the period from July 2012 to July 2014 for voice and SMS services at the level of the end-customer and large customers and moreover provides for further reductions. In addition, Roaming III regulates the data roaming prices at the level of the end-customer and large customers and establishes rules to increase price transparency and to better explain fees to roaming customers. Since July 1, 2012, MVNOs have had the right to use the networks of other operators at large customer fees in order to offer roaming services. From July 2014 wireless telecommunications network operators must separate the sale of roaming services and domestic wireless telecommunications services. That gives customers the opportunity to choose another network operator for calls in other member states. It is not currently foreseeable how customers and competitors will react to this situation. The products arising could endanger our margins on roaming services. The regulatory authorities can take additional measures at any time in order to curtail roaming tariffs and wireline or wireless telecommunications termination fees. They could similarly oblige us to grant third parties access to our networks at reduced prices. There is the moderate risk that further reductions of these tariffs and fees could prejudicially affect our business activity, our financial situation and our operating result.

In order to guard against these regulatory risks the Telefónica Deutschland Group maintains close communications with the decision makers on a national and international level in order to bring our interests and standpoint into the decision-making process in good time. Moreover, we review and use legal protective mechanisms against decisions of the regulatory authorities in order to actively foster positive changes for us.

Insurance

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

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

Macro-economic factors

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

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

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

Operational Risks

Service quality

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

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

Supplier defaults

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

Legal risks

In the course of our business activity we collect and process customer data and other personal data. Misuse or the loss of such data could represent a breach of the relevant laws and provisions and result in fines, loss of reputation and the migration of customers. In addition we could be confronted with lawsuits that relate to the breach of third party intellectual property rights. Equally we are possibly not capable of appropriately protecting our own proprietary rights.

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

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

Personnel

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

Financial risks

Taxes

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

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

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

Liquidity

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

Other (global) risks

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

6.4 Opportunity Management

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

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

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

Opportunities

Greater demand for wireless data, LTE and convergent products

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

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

Cooperation with Telekom Deutschland GmbH in the wireline network

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

Expansion of our LTE network

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

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

B2B market

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

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

Digital innovation

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

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

Belonging to the Telefónica, S.A. Group

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

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

6.5 Summary of the Risk and Opportunities Position

According to our evaluation the greatest potential effects result from the intensive competition on the German telecommunications market, the regulatory environment and from the issue of ensuring a qualitatively high value service. Compared to the previous year we see the most prominent positive development in the risk position in the positive development of the macro-economic environment in Germany. With regards to our own measures in the previous financial year we note a reduction of the risks in relation to our ability to make technologically competitive, innovative products available in a timely fashion and to market these via adequate channels of distribution. The risk in connection with the introduction of SEPA (Single Euro Payments Area) mentioned in previous publications is no longer relevant for reporting purposes following the implementation of the internal projects and successful first payment processes.

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

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

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

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

7. Acquisition of E-Plus_

7.1 Overview

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

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

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

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

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

7.2 Business of the E-Plus Group

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

7.3 Reasons for the Acquisition and Strategy

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

7.4 Estimated Synergy Effects

We estimate that the Transaction will realize significant synergy effects in the amount over EUR 5bn[4], particularly with respect to distribution, customer service and network synergies, with incremental value from financial and tax synergies as well as additional revenue and other synergies.

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

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

7.5 Status of the Transaction

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

The Transaction is, in particular, conditional upon the approval of the relevant antitrust authorities. The prenotification process commenced soon after the sale of the E-Plus Group to Telefónica Deutschland was announced of, and the formal notification has already been filed. The European Commission has initiated the so-called “second-phase investigation”.

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

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

7.6 Risks from the Acquisition

Business risks

Risks if the transaction fails

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

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

Risks of cartel law approval with conditions

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

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

Operational risks

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

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

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

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

Further risks of the transaction

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

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

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

7.7 Opportunities of the Acquisition

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

8. Essentials of the Remuneration System_

Remuneration of Management Board members
Due to the resolution of the General Meeting on October 5, 2012 in accordance with section 314 para. 2 sentence 2 and section 286 para. 5 HGB Telefónica Deutschland Holding AG did not publicize the additional information for listed companies limited by shares in accordance with section 314 para. 1 no. 6a sentences 5 to 8 HGB (Handelsgesetzbuch – German Commercial Code). In this section the essentials of the remuneration system for the Management Board will be illustrated with the above-mentioned limitation.

In accordance with section 314 para. 1 no. 6a HGB, the total remuneration granted to the Management Board of Telefónica Deutschland Holding AG for the financial year ended December 31, 2013 amounted to EUR 3,718k.

For the financial year ended December 31, 2012 the following applied: the employment contracts for the Management Board members of Telefónica Deutschland Holding AG were concluded on September 18, 2012 and will fundamentally end on September 17, 2015. Up until September 26, 2012 the Management Board members were, together with other persons, also the directors of Telefónica Germany Verwaltungs GmbH, which was converted into Telefónica Deutschland Holding AG through the resolution of September 18, 2012 and entry in the company registry on September 26, 2012. The Management Board members were and are, together with other persons, also directors of Telefónica Germany Management GmbH and received (up until September 17, 2012) their remuneration from Telefónica Germany Management GmbH, the managing shareholder of Telefónica Germany GmbH & Co OHG and in September 2012 became a subsidiary of Telefónica Deutschland Holding AG. In accordance with section 314 para. 1 no. 6a HGB the total remuneration granted to the Management of Telefónica Germany Verwaltungs GmbH, now Telefónica Deutschland Holding AG, from Telefónica Germany Management GmbH and Telefónica Deutschland Holding AG for the financial year ended December 31, 2012 is EUR 6,876k. This total remuneration for the financial year ended December 31, 2012 includes the remuneration of nine further former directors of Telefónica Germany Verwaltungs GmbH, who were no longer directors of Telefónica Germany Verwaltungs GmbH before its conversion to Telefónica Deutschland Holding AG. The above-mentioned total earnings for the financial year ending December 31, 2012 include the total remuneration of EUR 822k that has been granted to the Management Board members of Telefónica Deutschland Holding AG for the period since the conversion.

The total remuneration of the Management Board members comprises a fixed salary, variable cash remuneration and long-term remuneration components, company car, life and accident insurance, contributions to pension insurance, non-monetary benefits such as, among others, fixed travel allowances, rental allowance, the reimbursement of the cost of British social insurance, reimbursement of moving costs, flights home, school fees, employer expenditures, tax compensation and compensation for exchange rate losses. Not all Management Board members receive these benefits. For further information reference is made to the Notes to the Consolidated Financial Statements for the year ended December 31, 2013 (Note 25 Transactions with Management Board and Supervisory Board).

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

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

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

1) The first variable portion of the remuneration is an annual cash bonus ("Bonus I"). Bonus I is calculated in accordance with the formula target bonus times business performance times individual performance. The target bonus is set as a percentage of the relevant annual fixed salary.

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

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

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

In accordance with the PIP, members of the Management Board with the approval of the Supervisory Board are allocated a certain number of performance shares as a bonus (award). The number of performance shares is calculated by dividing an amount that corresponds to a certain proportion of the fixed annual salary of the relevant Management Board member by the average listed price of Telefónica, S. A. shares (Core Award). After three years the performance shares give the right to (free) acquisition of the corresponding number of Telefónica, S. A. shares if the relevant person still works for a company in the Telefónica, S. A. Group at the end of the time period and the price of Telefónica, S. A. shares over the "vesting period" together with the associated dividend distributions in the period (Total Shareholder Return Telefónica, S. A.) corresponds to at least the median of the Total Shareholder Return (share yield) of a reference index from worldwide telecommunications corporations. 30% of the performance shares awarded "vest" if Telefónica, S. A.'s Total Shareholder Return corresponds to the median of these corporations. The number of "vested" shares increases to 100% if Telefónica, S. A.'s Total Shareholder Return is in the upper quartile of the reference index. If Telefónica, S. A.'s Total Shareholder Return lies between the upper quartile and the median, the number of allocated shares is calculated on a linear proportionate basis. If Telefónica, S. A.'s Total Shareholder Return lies under the median of the reference index then the entitlements are forfeited.

In addition to the Core Award there is an "Enhanced Award". The condition for this is that a Management Board member acquires a certain number of shares in Telefónica, S. A. at their own cost. The own investment is capped at 25% of those performance shares that are allocated under the Core Award. If the objectives with regards to Telefónica, S. A.'s Total Shareholder Return are achieved then the Management Board member receives shares in Telefónica, S. A. in the amount of 30% or 100% of the shares that they acquired with their own funds. The number of these shares is limited to 25% of the Core Award. For further information reference is made to the Notes to the Consolidated Financial Statements for the year ended December 31, 2013 (Note 26 Share-based Payments).

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

Remuneration of Supervisory Board members

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

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

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

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

Please refer to the Notes to the Consolidated Financial Statements for the year ended December 31, 2013 for further information (Note 25 Transactions with Management Board and Supervisory Board).

9. Internal Control and Risk Management System

Related to the Process of Group Accounting_

The risk management and internal control system in relation to the corporate financial reporting process of the Telefónica Deutschland Group is a fixed component of the general risk management process and thus is closely interconnected with it with regards to reporting and the associated activities. It includes the organizational structure as well as the control and monitoring structures with which we ensure that corporate issues are captured, treated and analyzed in accordance with the law and are subsequently taken up in the IFRS consolidated accounts.

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

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

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

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

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

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

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

10. Other Declarations_

10.1 Report on Relations with Affiliated Companies

Telefónica Deutschland Holding AG was, in the period from January 1 until December 31, 2013, a directly dependent company of Telefónica Germany Holdings Limited, Slough, United Kingdom, within the meaning of section 312 AktG. In addition, Telefónica Deutschland Holding AG was an indirectly dependent company of O2 (Europe) Limited, Slough, United Kingdom and of Telefónica, S. A., Madrid, Spain, within the meaning of section 312 AktG. There is neither a domination agreement nor a profit and loss transfer agreement between Telefónica Deutschland Group and the previously mentioned companies.

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

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

10.2 Management Declaration pursuant to Section 289a of the HGB

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

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

Composition of the subscribed capital
Telefónica Deutschland Holding AG has a share capital of EUR 1,116,945,400. The share capital is divided into 1,116,945,400 no-par value registered shares each with a proportionate share of the share capital of EUR 1.00 ("shares"). The share capital is fully paid. As of December 31, 2013 and at establishment of this Management Report Telefónica Deutschland Holding AG did not hold any of its shares. In accordance with section 6 para. 2 of the Articles of Association the shareholders have no right to securitize shares. Every share in general grants one vote at the General Meeting. The shares are freely transferable.

Voting restrictions and restrictions on the transferability of shares
There are no general limitations on voting rights. We are not aware of any contractual agreements with Telefónica Deutschland Holding AG or other agreements about limitations on voting rights or the transferability of shares. Other than the statutory insider-trading provisions there are no internal governance provisions that provide for further lockout periods associated with the publication of quarterly and annual results for the purchase and sale of shares by Management Board members or employees.

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

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

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

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

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

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

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

Changes to the Articles of Association
In accordance with section 179 para. 1 sentence 1 AktG any change to the Articles of Association of Telefónica Deutschland Holding AG requires a resolution of the General Meeting. In accordance with section 27 of the Articles of Association together with section 179 para. 2 sentence 2 AktG, resolutions of the General Meeting of Telefónica Deutschland regarding changes to the Articles of Association are passed with simple majority of the votes cast and by simple majority of the share capital represented at the passing of the resolution. If the law mandates a higher majority of votes or capital then this majority must be applied. In connection with changes that only affect the wording of the Articles of Association, the Supervisory Board is entitled to make changes in accordance with section 179 para. 1 sentence 2 AktG together with section 17 para. 3 of the Articles of Association.

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

Authorization of the Management Board to issue shares is governed by section 4 of the Articles of Association in conjunction with the statutory provisions. As of December 31, 2013, the following authorizations of the Management Board for the issuing of shares exist:

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

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

By resolution at the General Meeting of October 5, 2012 the Management Board has been authorized until October 4, 2017 and subject to the approval of the Supervisory Board to, on one or more occasions, issue convertible bonds, warrant bonds, profit participation rights and/or participating bonds (and/or combinations of such instruments) (together "bonds") in bearer and/or registered form with or without

limited maturity in an aggregate nominal value of up to EUR 1,500,000,000 and to grant and/or impose on the holders or creditors of bonds conversion or option rights to shares in the company representing a total notional amount in the share capital of up to EUR 558,472,700 (in words: five hundred fifty-eight million four hundred and seventy-two thousand and seven hundred Euro), subject to the more detailed terms and conditions of issue of such bonds. Shareholders shall in principle be granted a right to subscribe for the bonds. The authorization provides that subject to the approval of the Supervisory Board, the subscription right of the shareholders can, however, be excluded
a) for fractional amounts; furthermore
b) provided that the issue price is not substantially lower than the market value of the bonds with conversion and/or option rights or option obligation and the shares issued or to be issued in order to satisfy the conversion and option rights or conversion obligation do not exceed in total 10% of the share capital;
c) to the extent profit participation rights or participating bonds are issued without conversion rights or obligations or an option right, provided the interest rate and the issue price of the profit participation rights or participating bonds correspond at the date of issue to current market values; and
d) to the extent the bonds are issued in written form contributions in kind for the purpose of directly or indirectly acquiring companies, parts of companies, participations in companies or other assets and the value of the contribution in kind is reasonably proportionate to the value of the bonds.

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

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

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

11. Outlook for Telefónica Deutschland Group_

11.1 Economic Outlook for Germany

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

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

16 — GDP Growth 2012–14 Germany and Euro area

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

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

11.2 Market Expectations

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

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

11.3 Expectations for Telefónica Deutschland Group

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

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

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

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

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

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

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

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

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

Munich, March 7, 2014

Telefónica Deutschland Holding AG

The Management Board

Rachel Empey

Markus Haas

Consol- idated Financial State- ments_

for the year ended December 31, 2013

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pp. 79–168

Consolidated Financial Statements_

Consolidated Statement of Financial Position_

Assets (Euros in thousands)	Note	As of December 31 2013	2012
A) Non-current assets		**7,167,703**	**7,652,337**
Goodwill	[4]	705,576	705,576
Intangible assets	[5]	2,884,200	3,277,456
Property, plant and equipment	[6]	2,895,617	2,973,440
Other non-current financial assets	[10]	98,787	114,675
Deferred tax assets	[18]	583,523	581,191
B) Current assets		**1,853,716**	**1,417,469**
Inventories	[7]	89,185	84,671
Trade and other receivables	[8]	1,035,234	1,009,031
Other current financial assets	[10]	20,751	101
Cash and cash equivalents	[9]	708,545	323,666
Total assets (A+B)		**9,021,419**	**9,069,807**

Equity and liabilities (Euros in thousands)	Note	As of December 31 2013	2012
A) Equity	**[11]**	**5,998,973**	**6,428,793**
Common stock		1,116,946	1,116,946
Additional paid-in capital		430	430
Retained earnings		4,879,914	5,309,936
Other components of equity		1,683	1,481
Equity attributable to owners of the parent		5,998,973	6,428,793
B) Non-current liabilities		**1,451,739**	**1,091,576**
Non-current interest-bearing debt	[10]	1,342,584	1,000,000
Other payables	[12]	4,809	9,193
Non-current provisions	[13]	104,346	82,382
C) Current liabilities		**1,570,707**	**1,549,438**
Current interest-bearing debt	[10]	102,059	250,878
Trade payables	[12]	1,074,038	918,458
Other payables	[12]	221,532	219,130
Current provisions	[13]	3,513	7,000
Deferred Income	[12]	169,565	153,972
Total equity and liabilities (A+B+C)		**9,021,419**	**9,069,807**

Consolidated Income Statement_

(Euros in thousands)	Note	January 1 to December 31 2013	2012
Revenues	[14]	4,913,881	5,212,838
Other income	[14]	169,022	60,806
Supplies		(1,957,980)	(2,130,869)
Personnel expenses[1]	[15]	(418,647)	(421,764)
Other expenses[1]	[16]	(1,469,176)	(1,441,938)
Operating income before depreciation and amortization (OIBDA)		**1,237,100**	**1,279,074**
Depreciation and amortization	[5], [6]	(1,131,749)	(1,133,183)
Operating income		**105,351**	**145,891**
Finance income		6,349	15,678
Exchange gains		635	715
Finance costs		(33,409)	(21,385)
Exchange losses		(548)	(1,132)
Net financial income (expense)	**[17]**	**(26,972)**	**(6,123)**
Profit before tax from continuing operations		**78,379**	**139,768**
Income tax	[18]	(567)	167,756
Profit for the year from continuing operations		**77,813**	**307,523**
Profit for the year from discontinued operations	**[19]**	**–**	**1,027,030**
Total profit for the year		**77,813**	**1,334,553**
Profit for the year attributable to owners of the parent		**77,813**	**1,334,553**
Profit for the year		**77,813**	**1,334,553**
Earnings per share	**[20]**		
Basic earnings per share in EUR		**0.07**	**1.20**
– from continuing operations		0.07	0.28
– from discontinued operations		–	0.92
Diluted earnings per share in EUR		**0.07**	**1.20**
– from continuing operations		0.07	0.28
– from discontinued operations		–	0.92

1 Reclassification of external personnel expenses into other expenses in 2013 and 2012. Refer to Note No. 15 Personnel Expenses.

Consolidated Statement of Comprehensive Income_

		January 1 to December 31	
(Euros in thousands)	Note	**2013**	2012
Profit for the year		**77,813**	**1,334,553**
Other comprehensive income (loss)			
Items that may be reclassified subsequently to profit or loss		**202**	**136**
Gains/(losses) on measurement of available-for-sale investments	[13]	297	199
Income tax impact		(95)	(63)
Items that will not be reclassified to profit or loss		**(6,436)**	**(2,392)**
Remeasurement of defined benefit plans	[13]	(9,447)	(3,882)
Income tax impact		3,011	1,490
Total other comprehensive income (loss)		**(6,234)**	**(2,256)**
Total comprehensive income		**71,579**	**1,332,297**
Total comprehensive income for the period attributable to owners of the parent		71,579	1,332,297
Total comprehensive income		**71,579**	**1,332,297**

Consolidated Statement of Changes in Equity_

(Euros in thousands)	Common stock	Additional paid-in capital	Retained earnings	Other components of equity: Available-for-sale investments	Equity attributable to owners of the parent	Total equity
Financial position as of January 1, 2012	**1,116,946**	**–**	**11,164,353**	**1,345**	**12,282,644**	**12,282,644**
Profit for the year	–	–	1,334,553	–	1,334,553	1,334,553
Other comprehensive income (loss)	–	–	(2,392)	136	(2,256)	(2,256)
Total comprehensive income	**–**	**–**	**1,332,162**	**136**	**1,332,297**	**1,332,297**
Dividends	–	–	(7,185,897)	–	(7,185,897)	(7,185,897)
Contribution in kind	–	430	(430)	–	–	–
Repayment of capital reserves	–	–	(251)	–	(251)	(251)
Financial position as of December 31, 2012	**1,116,946**	**430**	**5,309,936**	**1,481**	**6,428,793**	**6,428,793**
Financial position as of January 1, 2013	**1,116,946**	**430**	**5,309,936**	**1,481**	**6,428,793**	**6,428,793**
Profit for the year	–	–	77,813	–	77,813	77,813
Other movements	–	–	(6,436)	202	(6,234)	(6,234)
Total comprehensive income	**–**	**–**	**71,377**	**202**	**71,579**	**71,579**
Dividends	–	–	(502,625)	–	(502,625)	(502,625)
Other movements	–	–	1,226	–	1,226	1,226
Financial position as of December 31, 2013	**1,116,946**	**430**	**4,879,914**	**1,683**	**5,998,973**	**5,998,973**

Consolidated Statement of Cash Flows_

(Euros in thousands)	January 1 to December 31 2013	2012
Cash flow from operating activities		
Profit for the year	**77,813**	**1,334,553**
Adjustments to profit		
Net financial result	26,972	5,707
Gains on disposal of assets	(76,149)	(492,121)
Net income tax expense	567	(167,756)
Depreciation and amortization	1,131,749	1,135,751
Change in working capital		
Trade and other receivables	(36,334)	(40,172)
Inventories	(4,514)	(14,272)
Other current assets	–	(5,594)
Trade and other payables	168,818	(105,573)
Other current liabilities and provisions	16,471	(25,126)
Other non-current assets and liabilities	(13,950)	4,681
Interest received	7,005	15,615
Interest paid	(28,196)	(13,871)
Total cash flow from operating activities	**1,270,252**	**1,631,823**
Cash flow from operating activities from discontinued operations	**–**	**349,070**
Cash flow from operating activities from continuing operations	**1,270,252**	**1,282,754**
Cash flow from investing activities		
Proceeds on disposals of property, plant and equipment and intangible assets	69,088	1,978
Payments on investments in property, plant and equipment and intangible assets	(664,153)	(594,120)
Proceeds on disposals of companies, net of cash and cash equivalents disposed	37,596	557,446
Payments made on financial investments not included under cash equivalents	(14,252)	(14,930)
Total cash flow from investing activities	**(571,721)**	**(49,626)**
Cash flow from investing activities from discontinued operations	**–**	**557,170**
Cash flow from investing activities from continuing operations	**(571,721)**	**(606,797)**
Cash flow from financing activities		
Repayment of capital reserves	–	(251)
Payments made on future capital increase	(2,143)	–
Proceeds from borrowing/debt	594,972	2,398,060
Repayment of borrowing/debt	(403,856)	(706,991)
Dividends paid	(502,625)	(4,300,000)
Total cash flow from financing activities	**(313,652)**	**(2,609,182)**
Cash flow from financing activities from discontinued operations	**–**	**445,060**
Cash flow from financing activities from continuing operations	**(313,652)**	**(3,054,242)**
Net increase (decrease) in cash and cash equivalents	**384,879**	**(1,026,985)**
Cash and cash equivalents at the beginning of the period	**323,666**	**1,350,651**
Cash and cash equivalents at the end of the period	**708,545**	**323,666**

Notes to the Consolidated Financial Statements_ for the year ended December 31, 2013

1. Reporting Entity

The Consolidated Financial Statements of Telefónica Deutschland Holding AG have been prepared as of and for the year ended December 31, 2013 and comprise Telefónica Deutschland Holding AG (also referred to as "Telefónica Deutschland", formerly: "Telefónica Germany Verwaltungs GmbH") and its subsidiaries as well as joint operations (together referred to as "Telefónica Deutschland Group" or "Group").

Telefónica Deutschland Holding AG is a corporation (AG) incorporated under German law.

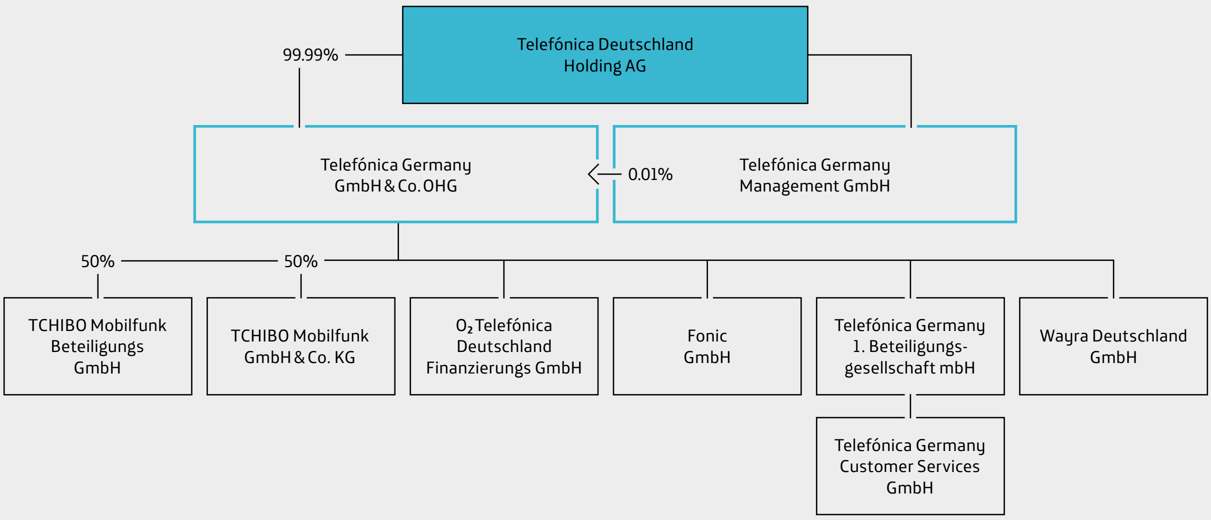
The company's name is "Telefónica Deutschland Holding AG". The company's registered office is located in Munich, Germany. Telefónica Deutschland Holding AG is registered in the commercial register of the local court in Munich under registration number HRB 201055. The company's business address is Georg-Brauchle-Ring 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 December 31, 2013, Telefónica Deutschland Holding AG has a share capital of EUR 1,116,945,400. It is divided into 1,116,945,400 registered shares with no-par value each representing a notional amount of EUR 1.00 in the registered share capital. 23.17% of the shares are in free float, the remaining 76.83% are held by Telefónica Germany Holdings Limited, Slough, United Kingdom (Telefónica Germany Holdings Limited). Each non-par share in general grants one vote at the General Meeting.

Telefónica Deutschland Holding AG is the parent company of the German Telefónica Deutschland Group. It is included in the Consolidated Financial Statements (Telefónica, S. A. Group) of the ultimate holding company, Telefónica, S. A., Madrid, Spain (Telefónica, S. A.) as of December 31, 2013. The parent company of Telefónica Deutschland Group is Telefónica Germany Holdings Limited, a subsidiary of O2 (Europe) Limited, Slough, United Kingdom (O2 (Europe) Limited).

As of December 31, 2013 the companies included in the Consolidated Financial Statements of Telefónica Deutschland Group were organized as shown in the following organization chart:



During financial year 2013 Telefónica Germany Online Services GmbH and GKHH Fibre Optic GmbH were sold and thus do no longer belong to the Group (see Note No. 19 Discontinued Operations and Disposal Groups).

As of December 31, 2013, Telefónica Deutschland Group has, according to IFRS 8, only the reportable segment Telecommunications. Up until September 30, 2012 Telefónica Deutschland Group consisted of two reportable segments: Telecommunications and Global Services (see Note No. 21 Segment Reporting and Reconciliation). The companies of the segment Global Services as well as Group3G UMTS Holding GmbH (G3G) and Quam GmbH (Quam) were sold as of October 1, 2012 in the previous year (see Note No. 19 Discontinued Operations and Disposal Groups).

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 and Türk Telekom Mobile. 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, Kabel Deutschland and Unitymedia KabelBW. In the wireline area the Group makes a range of 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.

Significant Events and Transactions in the Financial Year

a) Agreement on the acquisition of E-Plus

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

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

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

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

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

For further information see Note No. 32 Events after the Reporting Period.

b) Sale of Telefónica Germany Online Services GmbH (TOS)

For further information see Note No. 19 Discontinued Operations and Disposal Groups.

c) Versatel and Telefónica Deutschland enter into long-term fiber optic cooperation agreement

For further information see Note No. 19 Discontinued Operations and Disposal Groups.

d) Conclusion of contract to expand the wireline cooperation

In May 2013, Telefónica Deutschland Group via Telefónica Germany GmbH & Co. OHG concluded with Deutsche Telekom GmbH a “Memorandum of Understanding” to expand their wireline cooperation. This comprises the future intensified usage of the high-speed infrastructure of Telekom Deutschland GmbH by the 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 to a sustainable NGA platform. In future, Telefónica Deutschland intends to increasingly use VDSL and vectoring wholesale products provided by Telekom Deutschland GmbH. The transition should be fully completed in 2019. A binding agreement for the wireline cooperation with Telekom Deutschland GmbH was concluded on December 20, 2013.

The cooperation includes regulating aspects which are subject to an inspection by the Federal Network Agency (Bundesnetzagentur – BNetzA) and the Federal Cartel Office. The Federal Network Agency has approved the cooperation in their preliminary draft decision, but their final decision will be provided after consultation with the European Commission. This decision is expected for the first half of 2014.

In the event of the authorities failing to sanction the cooperation, this could necessitate further investments in the Group's own wireline structure or might restrict the ability to offer technically competitive products in the future.

e) Formation and change of name of O_2 Telefónica Deutschland Finanzierungs GmbH
Telefónica Germany GmbH & Co. OHG founded Telefónica Deutschland Finanzierungs GmbH, Munich, pursuant to its Articles of Association on February 26, 2013. The company was entered into the commercial register on March 14, 2013 with share capital of EUR 25k.

With effect as of November 7, 2013 Telefónica Deutschland Finanzierungs GmbH was renamed to O_2 Telefónica Deutschland Finanzierungs GmbH.

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

g) Dividend for the 2013 financial year
On November 7, 2013, the Management Board of Telefónica Deutschland resolved and announced that it is intended to propose a cash dividend of approx. EUR 525m to the next ordinary General Meeting for the 2013 financial year.

h) Issue of a 5-year bond
In November 2013 Telefónica Deutschland Group, via its subsidiary O_2 Telefónica Deutschland Finanzierungs GmbH, Munich, issued a senior unsecured 5-year bond (Senior Unsecured Bond) with a nominal value of EUR 600m and a maturity on November 22, 2018 in the regulated market of the Luxembourg Stock Exchange. The bond is guaranteed by Telefónica Deutschland Holding AG. The annual nominal interest rate of the bond is 1.875%. Based on the issue price of 99.162%, the bond yields an annual return of 2.053%. O_2 Telefónica Deutschland Finanzierungs GmbH, Munich, has transferred the net issuing proceeds of the bond to Telefónica Germany GmbH & Co. OHG, Munich, in the form of a loan. The net issuing proceeds generated by the bond will be used for general corporate purposes.

2. Basis of Preparation

The Consolidated Financial Statements of Telefónica Deutschland Holding AG have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). In addition, the accounting policies are the same as those used to prepare the published prior year Consolidated Financial Statements for the year ended December 31, 2012, with the exception of the changes to IFRS as described in Note No. 3 Accounting Policies.

Furthermore, the additional requirements of German commercial law pursuant to section 315a (1) HGB (German Commercial Code) have been applied.

The Consolidated Financial Statements of Telefónica Deutschland Holding AG were forwarded to the Supervisory Board on March 7, 2014.

Functional currency and presentation currency
These Consolidated Financial Statements are presented in Euro, which is the functional currency of Telefónica Deutschland Group. The Euro (EUR) is the functional currency of all Telefónica Deutschland Group companies.

Other
The Consolidated Statement of Financial Position is structured in current and non-current in accordance with IAS 1. The Consolidated Income Statement was prepared using the nature of expense method.

The figures in these 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.

3. Accounting Policies

The principal accounting policies used in preparing the accompanying Consolidated Financial Statements are as follows:

a) Goodwill

For business combinations occurring after January 1, 2010, the effective date of revised IFRS 3-Business Combinations, goodwill represents the excess of acquisition costs over the fair values of identifiable assets acquired and liabilities assumed at the acquisition date. Acquisition date is the date on which control is transferred to Telefónica Deutschland Group. Cost of acquisition is the sum of the fair value of consideration delivered and the value attributed to existing non-controlling interests. For each business combination, Telefónica Deutschland Group determines the value of non-controlling interests at either their fair value or their proportional part of the net identifiable assets acquired. After initial measurement, goodwill is recognized less any accumulated impairment losses. Whenever an equity interest is held in the acquiree prior to the business combination (business combinations achieved in stages), the carrying value of such previously held equity interest is remeasured at its acquisition-date fair value and the resulting gain or loss, if any, is recognized in profit or loss. Transaction costs in connection with business combinations are expensed as incurred.

For business combinations that occurred after January 1, 2004, the date of the transition to IFRS, and before January 1, 2010, the effective date of revised IFRS 3-Business Combinations, goodwill represents the excess of the acquisition costs over the acquirer's interest, at acquisition date, in the fair values of the identifiable assets, liabilities and contingent liabilities of the acquired business. After initial measurement goodwill is carried less any accumulated impairment losses.

In all cases, goodwill is recognized as an asset denominated in the currency of the company acquired.

Goodwill is not amortized, but tested for impairment annually or more frequently if there are certain events or changes in circumstances indicating the possibility that the carrying amount is higher than the recoverable amount (see Note No. 4 Goodwill).

b) Intangible assets

Intangible assets are carried at acquisition or production cost, less any accumulated amortization and any accumulated impairment losses. Subsequent expenditure is capitalized only for existing intangible assets if it increases the future economic benefit embodied in the asset to which it relates. All other expenditure on internally generated goodwill and brands is recognized in the Consolidated Income Statement as incurred.

The useful lives of intangible assets either finite or indefinite are assessed individually. Telefónica Deutschland Group has not recognized intangible assets with an indefinite useful lives. Intangible assets with finite useful lives are amortized systematically over the economic useful life and are assessed for impairment if events or circumstances indicate that their carrying amount may not be recoverable. Intangible assets that are not yet available for use are subject to an impairment test in the event of indications that their carrying amount may not be recoverable.

Residual values of assets, useful lives and amortization methods are reviewed annually at year end and, where appropriate, adjusted prospectively.

Licenses

Mainly the acquisition costs of the licenses granted by public authorities to provide telecommunications services are subsumed here as well as values allocated to licenses held by certain companies at the time they were included in Telefónica Deutschland Group.

These licenses are amortized on a straight-line basis starting from the moment commercial operation begins.

Other intangible assets

This item primarily represents the allocation of acquisition costs attributable to customers acquired in business combinations, as well as the acquisition value of this type of assets in a third-party transaction for good and valuable consideration. Amortization is on a straight-line basis over the estimated period of the customer relationship (ten years).

Software

Software is carried at cost and amortized on a straight-line basis over its useful life; generally estimated to be between two and five years.

c) Property, plant and equipment

Property, plant and equipment are carried at cost less accumulated depreciation and any accumulated impairment losses. Land is not depreciated. Cost includes external and internal costs comprising warehouse material used, direct labor used in installation work and the allocable portion of indirect costs required for the related investment. The latter two items are recorded as revenues in Other Income – Own Work Capitalized.

Cost includes in addition, where appropriate, the estimate of the costs at initial recognition for dismantling and removing the item and restoring the site on which it is located, the obligation which the entity incurs either when the item is acquired or as a consequence of having used it. Any corresponding valuation changes in subsequent years are allocated to the respective asset.

The costs of expansion, modernization or improvement leading to increased productivity, capacity and efficiency or to an extension of the useful lives of assets are capitalized when the recognition criteria are met.

Upkeep and maintenance costs are expensed as incurred.

If an asset within property, plant and equipment consists of multiple components with different useful lives, each part of the asset having a significant acquisition value is assessed and depreciated separately over the term of the useful life of the individual component (component approach).

Telefónica Deutschland Group assesses the need to write down the carrying amount of each item of property, plant and equipment to its recoverable amount, whenever there are indications that the carrying amount of the asset exceeds the higher of the fair value less costs of disposal and its value in use. The impairment charge is reversed if the factors giving rise to the impairment no longer exist (see Section d)).

Telefónica Deutschland Group depreciates its property, plant and equipment once they are in full working condition using the straight-line method based on the following estimated useful lives of the assets. The useful lives are calculated in accordance with technical studies which are reviewed periodically and, where appropriate, revised based on technological advances and the rate of dismantling:

	Estimated useful life (in years)
Buildings	5–20
Plant and machinery (incl. Telephone installations, network and subscriber equipment)	5–20
Furniture, tools and other items	2–10

The estimated residual values of assets, depreciation methods and useful lives are regularly reviewed and, where appropriate, adjusted prospectively at each financial year end.

d) Impairment of property, plant and equipment, goodwill and intangible assets

Goodwill is tested for impairment annually at the reporting date or if there are any indications. Property, plant and equipment and intangible assets with a finite useful life are only tested for impairment if any indications of impairment exist at the reporting date. Assets are tested for impairment either individually or on the level of the cash-generating unit to which the asset belongs; goodwill is always tested on the level of a cash-generating unit to which it was allocated or groups of cash-generating units. An impairment is required, if the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount. The recoverable amount is determined as the higher of the fair value less costs to sell and the value in use.

The impairment test for goodwill is performed at the lowest level within the entity at which the goodwill is monitored for internal management purposes, but must be at least performed at segment level. If the recoverable amount of a cash-generating unit to which goodwill is allocated is less than the carrying amount of the unit, an impairment loss shall be recognized corresponding to the difference. If the impairment loss exceeds the carrying amount of the goodwill, the remainder shall be allocated pro rata on the basis of the respective carrying amounts of the other assets.

If the carrying amount of an asset exceeds its recoverable amount, the carrying amount written down to its recoverable amount and the resulting loss is recognized in the Consolidated Income Statement. Future depreciation or amortization charges are adjusted for the asset's new carrying amount over its remaining useful life.

If new events or changes in circumstances indicate that an impairment loss recognized for an asset no longer exists or may have decreased, a new estimate of the recoverable amount of the asset will be determined. A previously recognized impairment loss shall be reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If this is the case, the carrying amount of the asset shall be increased to its recoverable amount. The reversal is limited to the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for the asset in prior years. The amount of the reversal is recognized in profit or loss, and the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount on a systematic basis over its remainning useful life. An impairment loss recognized for goodwill shall not be reversed in subsequent reporting periods.

As of December 31, 2013, Telefónica Deutschland Group comprises one single cash-generating unit, the reportable segment Telecommunications.

Telefónica Deutschland Group in principle determines the recoverable amount of a cash-generating unit based on its fair value less costs to sell.

The fair value is determined based on the market capitalization of the Telefónica Deutschland Holding AG as of the reporting date. Costs to sell contain costs such as legal and consulting fees that can be directly allocated to the sale of the cash-generating unit.

e) Investments in Joint Operations

Telefónica Deutschland Group's interests in companies over which it has joint control with third parties are recognized in accordance with the guidelines based on relation to its interest in the joint operation. Thus Telefónica Deutschland Group's respective share of the assets and the liabilities of the joint operations are included in the Consolidated Financial Statements. The share of expenses incurred atTelefónica Deutschland Group in connection with the joint operations and its share of the revenues are recognized in the Consolidated Income Statement.

f) Foreign currency transactions

Transactions denominated in a foreign currency are translated to Euro at the exchange rate prevailing on the transaction day. At the end of the reporting period, monetary assets and liabilities denominated in a foreign currency are translated at the exchange rate applicable at the reporting date.

The following exchange rates have been used for the respective Consolidated Financial Statements:

	Exchange Rate		Average Rate	
(EURO/Foreign Currency)	As of December 31, 2013	As of December 31, 2012	2013	2012
USD	1.379	1.319	1.327	1.285
GBP	0.834	0.816	0.849	0.811
BRL	2.343	2.703	2.158	1.954
CHF	1.228	1.207	1.231	1.205

All realized and unrealized foreign exchange gains and losses are included in the Consolidated Income Statement.

g) Inventories

Inventories are stated at the lower of cost and net realizable value and are written down in this regard, if necessary. Cost is determined on the basis of weighted average cost and comprises direct materials and where applicable, direct labor cost that have been incurred in bringing the inventory to its present location and to condition. Estimates of the net realizable value are based on the most reliable evidence available at the time of the estimates are made of the amount the inventories are expected to realize. These estimates take into consideration the fluctuations of price or costs and the purpose for which the inventory is held.

If the circumstances that previously caused inventories to be written down to an amount below cost no longer exist the amount of the write-down is reversed, so that the new carrying amount is the lower of cost and revised net realizable value.

The Group's inventory mainly consists of merchandise intended for sale to end customers. At the time of the sale or transfer of the risk to the customer, inventory is reduced accordingly through profit and loss. The change in inventory is recognized within supplies.

h) Financial instruments

A financial instrument, according to IAS 39, is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Financial instruments are recognized as soon as Telefónica Deutschland Group becomes a party to the contractual provisions of the financial instrument. All regular way purchases and sales of financial assets are recognized in the statement of financial position on the trade day, i.e. the date that Telefónica Deutschland Group commits to purchase or sell the financial asset. Upon initial recognition financial instruments are measured at fair value. Transaction costs directly attributable to the acquisition or issuance are considered in determining the carrying amount if the financial instruments are not measured at fair value through profit or loss.

For the purpose of subsequent measurement, financial instruments are allocated to the following categories:

- financial assets or financial liabilities at fair value through profit or loss
- held-to-maturity investments
- loans and receivables
- available-for-sale financial assets
- financial liabilities measured at amortized cost.

Telefónica Deutschland Group does not allocate financial instruments to the category financial assets or financial liabilities at fair value through profit or loss and to the category held-to-maturity in the reporting period.

Financial assets
The financial assets mainly include trade and other receivables, other financial assets as well as cash and cash equivalents.

Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market (such as trade and other receivables). After initial recognition, loans and receivables are subsequently carried at amortized cost using the effective interest method less any impairment losses. Gains and losses are recognized in the Consolidated Income Statement when the loans and receivables are derecognized or impaired. Interest effects from the application of the effective interest method are also recognized in profit or loss.

Available-for-sale financial assets
Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or that cannot be classified in any of the other categories. This category includes assets incurred by Telefónica Deutschland Group to meet its pension obligations but which do not qualify as plan assets in accordance with IAS 19.

After initial measurement, available-for-sale financial assets are measured at fair value, with unrealized gains and losses being recognized in other comprehensive income. If objective evidence of impairment exists, these changes are recognized in the Consolidated Income Statement. Upon the disposal of financial assets, the accumulated gains and losses recognized in other comprehensive income/loss resulting from measurement at fair value are recognized in profit or loss.

Impairment of financial assets
At each reporting date, the carrying amount of financial assets other than those measured at fair value through profit or loss are assessed to determine whether there is objective evidence of impairment. Objective evidence may, for example, exist if a debtor faces serious financial difficulties or is unwilling to pay.

Loans and receivables
The amount of impairment loss on loans and receivables is measured as the difference between the carrying amount of the asset and the present value of the expected future cash flows (excluding expected future credit losses that have not been incurred), discounted at the original effective interest rate of the financial asset. The amount of the impairment is recognized in the Consolidated Income Statement. If, in a subsequent reporting period, the amount of impairment loss decreases and the decrease can be attributed objectively to an event occurring after the impairment was recognized, the impairment loss recorded in prior periods is corrected and recognized in the Consolidated Income Statement. The impairment losses of loans and receivables (e.g. trade receivables) are recorded using allowance accounts. When receivables are assessed as uncollectible, the impaired asset is derecognized.

Available-for-sale financial assets
If an available-for-sale financial asset is impaired, the difference between its cost (less any principal payments and amortization) and its current fair value (less any impairment loss previously recognized in the Consolidated Income Statement) is reclassified from other comprehensive income to the Consolidated Income Statement. Reversals with respect to equity investments classified as available-for-sale are recognized in the other comprehensive income. Reversals of impairment losses on debt instruments are recorded in the Consolidated Income Statement if the increase in fair value of the instrument can be objectively attributed to an event occurring after the impairment losses were recognized in the Consolidated Income Statement.

For financial assets classified as available-for-sale, objective evidence for impairment exists if there is a significant (>20%) or prolonged decline (over a period of six months) in the fair value of the instrument.

Financial liabilities

Financial liabilities primarily include trade liabilities, interest-bearing debt, bonds as well as other liabilities.

Financial liabilities at fair value through profit or loss

A financial liability is measured at fair value through profit or loss if it is held for trading or is designated as fair value through profit or loss on initial recognition. They are presented as current or non-current liabilities depending on their maturity.

Financial instruments included in this category are recorded at fair value on initial recognition and on every subsequent reporting date. Any realized and unrealized gains or losses are recognized in the Consolidated Income Statement.

The company classifies *derivative financial instruments* as held for trading unless they are designated as hedging instrument (hedge accounting). The fair value used of listed derivatives is equal to their positive or negative market value. If a market value is not available, fair value is calculated using standard financial valuation models, such as discounted cash flow or option price models. Derivatives are presented as assets if their fair value is positive and as liabilities if their fair value is negative. Changes in the fair value of derivative financial instruments are recognized periodically in the Consolidated Income Statement.

In the current financial year, Telefónica Deutschland Group has an interest rate swap (derivative financial instrument) to hedge interest rate risks.

Hedging transactions: if the effectiveness of a hedging relationship can be demonstrated and documented accordingly, Telefónica Deutschland Group forms a hedge comprised of the hedged item and the corresponding hedging instrument.

If the company hedges a fair value (fair value hedges), the portion of profit or loss attributable to the hedged risk is allocated to the carrying amount of the hedged item. The carrying amount of the hedged item is increased or decreased by the profit or loss that is attributable to the hedged risk. For hedged items that are recorded at amortized cost, the increase or decrease of the carrying amount is completely released at maturity of the hedged item. When hedging pending transactions, the company increases or decreases the initial carrying amount of the assets or liabilities that result from the fulfillment of the pending transactions by the accumulated changes in the fair value of financial assets or liabilities that were previously separately recognized.

From the date the hedging instrument expires, is sold, terminated or exercised, the accounting of the hedging relationship also ends. The same applies if there is no longer a hedging transaction within the meaning of IAS 39 or Telefónica Deutschland Group ends the designation.

Financial liabilities measured at amortized cost

After initial recognition, financial liabilities are subsequently measured at amortized cost using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the interest rate that exactly discounts the estimated future cash payments through the expected life of the financial liability, or where appropriate, a shorter period to the net carrying amount on initial recognition. The interest expense is recognized on an effective interest basis.

Derecognition of financial assets and liabilities

Financial assets are derecognized when the rights to receive cash flows from the assets expire or the financial assets are transferred and Telefónica Deutschland Group has transferred substantially all the risks and rewards of ownership of the financial assets. On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of consideration received including the cumulative gains or losses that had been recognized directly in equity, is recognized in the Consolidated Statement of Comprehensive Income. If Telefónica Deutschland Group does not retain or transfer substantially all risks and rewards, and retains control, it continues to recognize the transferred asset to the extent of its continuing involvement. Financial liabilities are derecognized when the obligation specified in the relevant contract is discharged, cancelled or expired. The difference between the carrying amount of the financial liability derecognized and the consideration paid is recognized in profit or loss.

i) Provisions

Pensions – Defined benefit plans
Telefónica Deutschland Group's obligations under defined benefit pension plans are determined using the projected unit credit method and are in principle recognized as personnel expenses unless otherwise stated below.

Telefónica Deutschland Group determines the net interest expense (net interest income) by multiplying the net defined benefit liability (asset) at the beginning of the period by the interest rate used to discount the defined benefit obligation at the beginning of the period.

The discount rate is determined by reference to market yields at the end of the reporting period on high quality corporate bonds.

The net defined benefit liability (asset) is determined at every reporting date on the basis of an actuary report based on assumptions that are explained as follows.

If the plan assets less the defined benefit obligation results in a surplus, then the level of the reported net defined benefit asset is limited to the present value of economic benefits associated with the plan asset surplus in the form of refunds from the plan or on the basis of reduced future contributions. In addition, in the event of a surplus of the plan the new valuation components include the change in the net defined benefit asset from the application of the asset ceiling, to the extent not taken into account in the net interest component.

As part of the determination of the present value of economic benefits associated with the plan asset surplus, any existing minimum funding requirements are taken into account.

The remeasurement component includes on the one hand the actuarial gains and losses from the valuation of the defined benefit obligation and on the other hand the difference between actual return on plan assets and the amounts contained in the net interest on net defined benefit liability (asset).

The company recognizes all remeasurement effects in other comprehensive income, whereas the remaining components of the net pension expense (service cost and net interest) are recognized in the Consolidated Income Statement.

Other provisions
Provisions are recognized when Telefónica Deutschland Group has a present (legal or constructive) obligation, as a result of a past event that can be estimated reliably and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. If the effect of the time value of money is material, provisions are discounted and the corresponding increase in the provision due to the passage of time is recognized as interest expense. For the purpose of discounting, the group applies non-risk market interest rates before tax which are matched to the duration. Potential risks are fully taken into account in determining the settlement amount. When Telefónica Deutschland Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset, but only when the reimbursement is virtually certain. The expense relating to any provision is presented, if applicable net of any reimbursement, in the Consolidated Income Statement.

Provisions for restructuring are recognized if there is a detailed, formal plan that provides for the individual measures and has been adopted by the appropriate managing bodies. In addition, implementation is expected to begin as soon as possible and a valid expectation has been raised in those affected that the restructuring will be carried out.

Provisions for the costs of decommissioning or dismantling and retirement are recognized if Telefónica Deutschland Group has a legal or constructive obligation to dismantle the relevant items after their utilization. The estimated costs are recognized as an asset and a provision. Changes in the timing or estimation of the costs are reflected in the asset and in the provision, respectively.

j) Revenues and expenses

Revenues and expenses are recognized in the Consolidated Income Statement in line with the accrual basis of accounting (i.e. when the goods or services represented by them take place) regardless of when actual payment or collection is being made.

Telefónica Deutschland Group principally obtains revenues from providing the following telecommunications services: traffic, connection fees, regular (normally monthly) network usage fees, interconnection services, network and equipment leasing, handset sales, added value services (e.g. text and data messaging) and maintenance. Products and services may be sold separately or in promotional packages (bundled services).

Revenues from calls carried on Telefónica Deutschland Group networks (traffic) include an initial call establishment fee plus a variable call rate, based on call length, distance and type of service. Both wireline and wireless traffic is recognized as revenue as service is provided. For prepaid calls, the amount of unused traffic generates deferred revenue that is recognized in deferred income in the Consolidated Statement of Financial Position. Prepaid cards generally expire within twelve months and any deferred revenue from prepaid traffic is recognized directly in the Consolidated Income Statement when the card expires as Telefónica Deutschland Group has no obligation to provide service after this date.

Revenues from traffic sales and other services generated at a fixed rate over a specified period of time (flat rate) are recognized on a straight-line basis over the term covered by the rate paid by the customer.

Initial call establishment fees are recognized in deferred income and are subsequently realized in profit or loss for the period over the average estimated term of the customer relationship, which may vary according to the type of service. All related costs, with the exception of expenses for the network expansion and general administration costs and overheads, are recognized in profit or loss for the period in which they incurred.

Installment fees are taken to the Consolidated Income Statement on a straight-line basis over the related period. Income from the equipment leasing and other services are taken to profit or loss as they are consumed.

Interconnection revenues from wireline-wireless and vice versa calls and other customer services are recognized in the period in which the calls are made.
Revenues from handset and equipment sales are recognized once the sale is considered complete, i. e. generally when delivered to the end customer. Revenues from installment sales are recognized in the amount of the discounted future receipts. The amount is discounted based on a typical market interest rate.
The Group offers bundle packages which combine multiple elements from the wireline, wireless and internet business. They are assessed to determine whether it is necessary to separate the separately identifiable elements and apply the corresponding revenue recognition policy to each element. Total package revenues are allocated among the identified elements based on their respective fair value (i.e. the fair value of each element in relation to the total fair value of the package).

As connection fees or initial activation fees, or upfront non-refundable fees are not separately identifiable elements in these types of packages, any revenues received from the customer for these items are allocated to the remaining elements. However, amounts contingent upon delivery of undelivered elements are not allocated to delivered elements.

All expenses related to bundled promotional packages are recognized in the Consolidated Income Statement as incurred.

k) Income tax

Income tax includes both current and deferred taxes. Current and deferred tax is recognized in the Consolidated Income Statement except to the extent that they relate to business combinations or items directly recognized in equity or in other comprehensive income.

Current tax assets and liabilities for the current period and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. To calculate the amount tax rates and tax laws applicable or enacted on the reporting date are used.

Telefónica Deutschland Group determines deferred tax assets and liabilities by applying the tax rates that will be effective when the corresponding asset is received or the liability is settled. Tax rates and tax laws that are enacted (or substantively enacted) at the reporting date are used.

Deferred tax assets and liabilities are not discounted to present value and are classified as non-current, irrespective of the date of their reversal.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that a sufficient taxable income will be available to allow all or part of the deferred tax asset to be utilized. Unrecognized deferred tax assets are reassessed at each reporting date and recognized to the extent that it has become probable that a future taxable income will allow the deferred tax asset to be recovered.

Deferred tax liabilities on investments in subsidiaries, branches, associates and joint operations are not recognized if the parent company is in a position to control the timing of the reversal and if the reversal is unlikely to take place in the foreseeable future.

To the extent that deferred taxes relate to items directly recognized in equity these are also recognized in equity. Deferred tax assets and liabilities arising from the initial recognition of the purchase price allocation of business combinations impact the amount of goodwill. However, subsequent changes in tax assets acquired in a business combination are recognized as an adjustment to profit or loss.

Deferred tax assets and liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

l) Discontinued operations and disposal groups

Components of the company that meet the criteria of IFRS 5 are classified as discontinued operations and are presented separately in the Consolidated Income Statement and the Consolidated Statement of Cash Flows, if they meet the definition of a major line of business under IFRS 5. All changes made in the current reporting period to amounts that are directly related to the sale of discontinued operations in one of the prior reporting periods are likewise presented within this separate category. If a component of the company is no longer classified as held for sale, the profit or loss of this component, which had previously been presented within discontinued operations, is reclassified as continuing operations in all presented reporting periods. If supply of goods and services between continued and discontinued operations also continue after disposal, these supplies are recorded prior to consolidation in the Consolidated Income Statement.

Disposal groups, if their carrying amount will be recovered principally through a sale transaction rather than through continuing use, are classified accordingly if the criteria of IFRS 5 are met. The disposal groups are measured at the lower of carrying amount and fair value less costs to sell and are classified as held for sale. Individual assets of the disposal group are no longer depreciated or amortized. If an impairment loss is recognized for the disposal group, then on any subsequent increases in the fair value less costs to sell the previously recognized impairment loss has to be reversed. The reversal of the impairment is limited to the cumulative impairment loss that was recognized for the respective disposal group previously. The assets and liabilities of the disposal group are presented separately in the Consolidated Statement of Financial Position.

m) Share-based payments

Telefónica, S.A. grants employees of Telefónica Deutschland Group share options. The determination of fair value is based on the performance of the shares of Telefónica, S.A. Some of the share option plans are cash-settled whereas others are equity-settled.

For cash-settled share-based transactions the total cost of the rights granted is recognized as an expense in the Consolidated Income Statement over the vesting period with recognition of a corresponding liability. The total cost of the share options is measured initially at fair value at the grant date using statistical techniques, taking into account the terms and conditions established in each share option plan. At each subsequent reporting date, the Group reviews its estimate of the fair value and the number of options expected to be exercised and remeasures the liability, with changes in fair value recognized in the Consolidated Income Statement.

For equity-settled share option plans, fair value at the grant date is determined by applying statistical techniques or using a benchmark securities model. The costs and the corresponding increase in equity are recognized as expenses over the vesting period.

n) Lease contracts

The determination of whether an agreement is, or contains a lease, is based on the substance of the agreement and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset and the agreement conveys a right to Telefónica Deutschland Group to use the asset.

Leases where the lessor does not transfer substantially all the risks and rewards of ownership of the asset are classified as operating leases. Operating lease payments are recognized as an expense on a straight-line basis over the term of the lease in the Consolidated Income Statement.

Leases are classified as finance leases when the terms of the lease transfer substantially all risks and rewards incidental to ownership of the leased item to Telefónica Deutschland Group. These are classified at the inception of the lease, in accordance with its nature and the associated liability, at the lower of the present value of the minimum lease payments or the fair value of the leased object. Lease payments are apportioned between finance costs and reduction of the principal of lease liability so as to achieve a constant interest rate on the remaining liability balance over the period. Finance costs are recognized over the term of the lease in the Consolidated Income Statement.

In sale and leaseback transactions resulting in a finance lease, the asset sold is not derecognized and the funds received are considered financing for the asset during the term of the lease. However, when the sale and leaseback transaction results in an operating lease, and it is clear that both the transaction and subsequent lease income are established at fair value, the asset is derecognized and any gain or loss generated on the transaction is recognized.

o) Use of estimates, assumptions and judgments

The key assumptions concerning the future and other relevant sources of uncertainty in estimates at the reporting date that could have a significant impact on the Consolidated Financial Statements within the next financial year are discussed below. The estimated and associated assumptions are based on historical experience as well as other factors considered to be relevant.

A significant change in the facts and circumstances on which these estimates and related judgments are based could have a material impact on Telefónica Deutschland Group's net assets, financial position and earnings.

Unforeseeable development outside management's control may cause actual amounts differ from the original estimates. In this case the underlying assumptions, and if necessary the carrying amounts of the pertinent assets and liabilities, will be adjusted accordingly.

Changes in estimates are recognized in the period in which they occur, and also in subsequent periods if the changes affect both the reporting period and the subsequent periods.

Pensions – defined benefit plans
The determination of the present value of defined benefit obligations involves the application of actuarial assumptions.

To determine the interest rate for the defined benefit pension plans first the so-called bond universe is established on the basis of the AA corporate bonds available on the reporting date. On the basis of these bonds an interest structure curve is calculated. Then a uniform average interest rate is calculated with a cash flow that corresponds to the duration of Telefónica Deutschland Group. This latter interest rate is the actuarial discount rate used.
The determination of the expected increase in pensions is aligned with the long-term inflation expectations in the Euro area.

The assumption on the fluction of the respective employees is based on historical experience.

The mortality rate underlying the calculation of the present value of the defined benefit obligation is based on official statistics and mortality tables. The mortality tables underlying the actuarial calculation of the defined benefit obligations (DBO) as of the reporting date are the Heubeck Mortality Tables 2005 G (Heubeck Richttafeln 2005 G).

Property, plant and equipment, intangible assets and goodwill
Accounting for investments in property, plant and equipment and intangible assets involves the use of estimates to determine the useful life for depreciation and amortization purposes and to assess the fair value of assets acquired in a business combination at the acquisition date.

Determining the useful life requires making estimates in connection with future technological developments and alternative uses for assets. There is a significant element of judgment involved in making technological development assumptions, since the timing and scope of future technological advances are difficult to predict.

When an item of property, plant and equipment or an intangible asset is considered to be impaired, the impairment loss is recognized in the Consolidated Income Statement for the period. The decision to recognize an impairment loss involves estimates of the timing and amount of the impairment, as well as an analysis of the reasons for the potential loss. Furthermore, additional factors, such as technical obsolescence, the suspension of certain services and other circumstantial services are taken into account.

Telefónica Deutschland Group evaluates its cash-generating unit's performance regularly to identify potential goodwill impairment. Determining the recoverable amount of the cash-generating unit to which goodwill is allocated also entails the use of assumptions and estimates and requires a significant element of judgment.

Deferred income taxes
Telefónica Deutschland Group assesses the recoverability of deferred tax assets based on estimates of future earnings. The ability to recover these taxes depends ultimately on Telefónica Deutschland Group's ability to generate taxable income over the period for which the deferred tax assets remain deductible. This analysis is based on the estimated schedule for reversing deferred tax liabilities, as well as estimates of the taxable income, which is based on internal projections and are continuously updated to reflect the latest trends.

The recognition of tax assets and liabilities depends on a series of factors, including estimates with respect to timing and the realization of deferred tax assets and the projected tax payment schedule. Actual income tax receipts and payments of Telefónica Deutschland Group could differ from the estimates made by Telefónica Deutschland Group as a result of changes in tax legislation or unforeseen transactions that could affect tax balance.

Provisions
Both the recognition and the valuation of provisions involve judgments to a high extent. The amount of the provision is determined based on the best estimate of the outflow of resources required to settle the obligation, bearing in mind all available information at the reporting date, including the opinions of independent experts such as legal counsel or consultants.

Given uncertainties inherent in the estimates used to determine the amount of provisions, the actual outflows of resources may differ from the amounts recognized originally on the basis of the estimates.

Revenue recognition

Connection fees

Initial connection fees are deferred and recognized as revenue over the average estimated term of the customer relationship.

The estimate of the average estimated customer relationship period is based on the recent history of customer churn. Potential changes in estimates could lead to changes in both the amount and timing of future recognition of revenue.

Bundled offers

Bundled offers that combine different elements are assessed to determine whether it is necessary to separate the different identifiable components and apply the corresponding revenue recognition policy to each element. The total package revenues are allocated among the identified elements based on their respective fair values.

Determining fair values for each identified elements requires estimates that are complex due to the nature of the business.

A change in the estimates of the fair value could affect the allocation of revenues among the elements and, as a result, the date at which the revenues are recognized.

Joint Operations

The classification of interests in businesses as joint operations or as joint ventures requires partly a certain degree of judgment. The classification is made in accordance with the contractual and actual circumstances.

p) Consolidation methods

The consolidation methods applied are as follows:

— Full consolidation method for companies where Telefónica Deutschland Group has control. Control is assumed if Telefónica Deutschland Group is exposed to variable returns or has rights to these returns. In addition, the ability must exist to use its power over the investee to affect the returns.
— Proportionate consolidation of the attributable assets, liabilities as well as expenses and income for companies jointly controlled with third parties (Joint Operations). Similar line items are combined so that the corresponding share of total assets, liabilities, expenses and income as well as the cash flows of these companies is integrated in the corresponding items in the Consolidated Financial Statements.

All material receivables and liabilities and transactions between the consolidated companies were eliminated in consolidation. The returns generated on transactions involving capitalizable goods or services by subsidiaries with other Telefónica Deutschland Group companies were also eliminated in consolidation.

The financial statements of the consolidated companies are prepared using the same accounting policies and have the same financial year-end as the parent company's individual financial statements. In the case of Group companies whose accounting and valuation methods differ from those of Telefónica Deutschland Group, adjustments are made in consolidation in order to present the Consolidated Financial Statements on a consistent basis.

The Consolidated Income Statement and Consolidated Statement of Cash Flows include the revenues and expenses as well as the cash flows of companies that are no longer in the Telefónica Deutschland Group up to the date on which the related interest was sold or the company was liquidated.

Revenues and expenses as well as the cash flows of new Group companies are included from the date on which the interest was acquired or the company was established until the end of the year.

q) Accounting policies adopted as of December 31, 2013

The accounting policies applied for the preparation of the Consolidated Financial Statements for the financial year ending December 31, 2013 correspond to those that were applied for the financial year ending December 31, 2012. Exceptions to this are the new standards adopted as at January 1, 2013 as well as changes to the standards and interpretations as published by the International Accounting Standards Board (IASB) and the IFRS Interpretations Committee (IFRS IC) and endorsed for implementation by the European Union (EU):

Presentation of financial statements
In June 2011 the IASB issued Presentation of Items in Other Comprehensive Income (amendments to IAS 1), which was endorsed by the EU with the resolution of June 2012. Entities need to group items presented in other comprehensive income on the basis whether they are potentially reclassifiable to profit or loss subsequently. This is to be applied for financial years that began on or after July 1, 2012. Telefónica Deutschland Group has applied the change to IAS 1 since January 1, 2013. Consequently, the form of presentation of the Consolidated Statement of Comprehensive Income has been adjusted.

Defined benefit plans
In June 2011 the IASB published the changes to IAS 19, Employee Benefits, which were endorsed by the EU in June 2012. Telefónica Deutschland Group applies IAS 19R, Employee Benefits, since January 1, 2013.

IAS 19R contains various new regulations in the area of accounting and reporting of employee benefits. For Telefónica Deutschland Group it was particularly significant that the interest cost and the expected return on plan assets are replaced by a net interest amount. This is calculated by multiplying the net pension obligation or the net defined benefit liability with the discount rate set at the beginning of the period. The net pension obligation results from subtracting the fair value of plan assets from the present value of the defined benefit obligation. In addition, with the introduction of IAS 19R unrecognized past service cost are from now on immediately recognized in the Consolidated Income Statement.

The first time application of IAS 19R as of January 1, 2013 has no significant effect on the net assets, financial position and earnings, the amount of the balance sheet line item for pensions, the amount of equity or the amount of other comprehensive income (see Note No. 13 Provisions).

Thus the change to IAS 19R has no significant effect on the Consolidated Financial Statements. Therefore it was determined not to be applied retrospectively.

Fair value measurement
In May 2011 the IASB published the standard IFRS 13 – Fair Value Measurement, which provides a single source of fair value measurement and disclosure requirements for use across IFRS. The EU endorsed the standard with a resolution in December 2012. The standard defines fair value as the price that would be received to sell an asset or paid to settle a liability in an orderly transaction on a defined market. It indicates that fair value refers to a market based and not a business specific valuation figure. The standard specifies that in general a certain asset or a certain liability serves as a basis of assessment unless a business manages its net risk at the portfolio level and reports it at the portfolio level. In this case it can under certain conditions elect to make price adjustments at the portfolio level. The standard also introduces new information and improves the information content of existing disclosures. The first application must occur on January 1, 2013 whereby an earlier application is permitted. IFRS 13 must be prospectively applied from this date. The first use of IFRS 13 in the reporting period had no significant effects on the measurement of fair value carried out by Telefónica Deutschland Group.
The information obligations of IFRS 13 do not have to be applied to comparative information that was provided for periods before the first use of this standard. Telefónica Deutschland Group makes use of the relief with regards to the comparative period and has not changed the presentations as of December 31, 2012.

Consolidated Financial Statements
As at January 1, 2013 Telefónica Deutschland Group introduced IFRS 10 – Consolidated Financial Statements, which was published by the IASB in May 2011 and was endorsed by the EU in December 2012. IFRS 10 is applicable to all types of companies and is based on the existing principle that a company must consolidate all companies that it controls. The definition of control in IFRS 10 requires power and variable returns for the existence of control. Power is the ability to direct the relevant activities of the investee that significantly affect the variable returns. IFRS 10 also requires considerable adjudication ability to determine whether a company has to be consolidated or not. The application of IFRS 10 does not impact the net assets, financial position and earnings of the Group.

Joint arrangements
In May 2011 the IASB published IFRS 11 – Joint Arrangements, which replaces IAS 31 – Interests in Joint Ventures. The standard was likewise endorsed by the EU in December 2012. The focus when classifying a joint arrangement in accordance with IFRS 11 no longer lies on the legal structuring of the joint arrangement but rather on the way in which the rights and obligations are distributed to the partners to the joint arrangement. The application of the classification guidelines in IFRS 11 led to the result that both joint ventures of the Telefónica Deutschland Group to date, TCHIBO Mobilfunk GmbH & Co. KG, Hamburg and TCHIBO Mobilfunk Beteiligungs GmbH, Hamburg, were classified as joint operations within the meaning of IFRS 11. This therefore results in the same accounting treatment as the proportional consolidation method used to date under IAS 31.

At the same time as IFRS 10 and IFRS 11, with IFRS 12 the disclosures in the notes in relation to the interest held in subsidiaries, joint arrangements, associated businesses as well as non-consolidated structured companies were introduced. The standard requires a number of additional statements that were implemented accordingly.

Likewise at the same time as the introduction of IFRS 10, IFRS 11 and IFRS 12, the changes resulting from IAS 27 – Separate Financial Statements – and IAS 28 – Investments in Associates and Joint Ventures – were implemented. The use of the revised standards has no influence on the net asset, financial position, and earnings of the company. The first time application of the new standards IFRS 10, IFRS 11 and IFRS 12 as well as the changes to IAS 27 and IAS 28 must be implemented within the EU at the latest by January 1, 2014. Earlier application was permitted.

Annual improvements to the IFRSs 2009 – 2011 Cycle (May 2012)
The annual improvement project offers the opportunity to undertake non time-critical but necessary changes to the IFRSs in that inconsistencies are removed and wordings are clarified. The application of these improvements has no influence on the net assets, financial position and earnings of the company.

Further standards or changes to standards that had to be implemented by January 1, 2013, have no effect on the net assets, financial position and earnings of the Group.

r) New standards and IFRIC interpretations issued, but not yet effective as at December 31, 2013

At the time of publication of the Consolidated Financial Statements, the following standards and interpretations were published, but their application was not mandatory.

Standards and Amendments		Compulsory application for financial years beginning on or after
IFRS 9 and amendments to IFRS 7	Financial instruments	*
Amendments to IFRS 10, IFRS 12 and IAS 27	Investment entities	January 1, 2014
Amendments to IAS 32	Offsetting financial assets and financial liabilities	January 1, 2014
Amendments to IAS 36	Disclosures of recoverable amounts for non-financial assets	January 1, 2014
Amendments to IAS 39	Novation of derivatives and continuing hedge accounting	January 1, 2014
Amendments to IAS 19	Defined benefits plans: Employee contributions	July 1, 2014**
Annual Improvements to the 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 the IFRSs 2011–2013 Cycle	Amendments to IAS 40, IFRS 1, IFRS 3 and IFRS 13	July 1, 2014**

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

* The compulsory application date for IFRS 9 has not yet been set. However, it is expected to be announced shortly following finalization of the last points.
** Resolution of adoption by the EU is still outstanding, statement of compulsory application according to IASB.

In November 2009, the IASB published IFRS 9, Financial Instruments. This standard contains the first of three phases of the IASB project for replacing the existing IAS 39, financial Instruments: recognition and measurement. IFRS 9 changes the recognition and measurement requirements of financial assets, including various hybrid agreements. It applies a single approach to determine whether a financial asset should be recognized at amortized cost or at fair value. The definition depends on how a company controls its financial instruments (its business model) and the characteristics of the contractually agreed cash flows of the financial asset. In October 2010, the requirements of IAS 39 regarding financial liabilities were mainly adopted into IFRS 9. In December 2011, IFRS 9 was amended in that effect that for the first-time adoption no restatement of prior financial statement is necessary, additional disclosure requirements are to be fulfilled, and the obligatory transition period has been deferred to financial years that commence on or after January 1, 2015. Pursuant to the ongoing project “Classification and measurement: limited amendments to IFRS 9”, in July 2013 the IASB however provisionally decided to defer the obligatory time of first adoption once again, and leave it open until the limited changes have been established and the second phase of the IFRS 9 for impairment methodologies has been concluded. An early adoption is still allowed. The European Financial Reporting Advisory Group has deferred the recommendation to adopt the currently published IFRS 9 in the EU. On November 19, 2013, the IASB published IFRS 9 Financial Instruments (hedge accounting and changes to IFRS 9, IFRS 7 and IAS 39) and, with that, IFRS 9 is to be recognized in other comprehensive income with regard to the adoption of the new model for the general hedge accounting, the approval of the early adoption of the provision, changes to the fair value calculation from own credit risks for liabilities which are assessed for the fair value calculation in recognition of the changes in the profit and loss account; and has changed the date of obligatory first-time adoption of January 1, 2015. Due to the continuous amendments to IFRS 9, the company’s test what impact the application of IFRS 9 will have on the Consolidated Financial Statements has not been completed.

The changes to IAS 32 Offsetting financial assets and financial liabilities, which were published on December 16, 2011 by the IASB and endorsed on December 13, 2012 by the EU do not intrinsically alter the present offsetting model of the IAS 32, but provide additional support and clarification by adding implementation guidelines.

The changes to IAS 36 Recoverable amount disclosures for non-financial assets, which were published in May 2013, on the one part restrict the currently valid mandatory information required regarding the recoverable amount, but also increase the scope of the information that is to be specified in the case of a value decrease or value increase.

In June 2013, the IASB adopted IAS 39 Novation of derivatives and continuation of hedge accounting. Here, under certain circumstances, despite a novation derivatives remain designated as hedge instruments in continued hedging relationships.

In its official journal, published December 20, 2013, the European Union endorsed the changes to IAS 36 as well as the changes to IAS 39, and approved the obligatory application for the financial year commencing January 1, 2014.

On November 21, 2013, the IASB published a slight amendment to IAS 19 Defined benefit plans: Employee Contributions. This change represents a relief for the company with regard to recording employee or third-party contributions to a pension plan. As a result of this change to IAS 19.93, it is permitted for a company to record contributions from employees or third-parties in the periods in which the associated performance is rendered as a reduction in the current service costs, provided the contributions are independent of the number of years of service.

In May 2013, the IASB published IFRIC 21. This interpretation is a clarification for taxes which are levied by a government authority and do not fall in the scope of another IFRS as to how and when these obligations are to be carried as a liability in accordance with IAS 37. The overriding factor is the event that triggers the payment obligation (obligating event).

According to information currently available, the Group is assuming that the application of the standards (with the exception of IFRS 9), the changes and the interpretations of their implementation will have no or only a negligible influence on the net assets, financial position and earnings. The Group is planning to implement the changes pursuant to the mandatory application. As already stated, the IFRS 10, IFRS 11 and IFRS 12 standards which were to be applied for the first time in the EU on January 1, 2014, as well as the associated amendments to IAS 27 were applied prospectively on January 1, 2013.

4. Goodwill

In 2013 and 2012 there was no change to goodwill. The carrying amount corresponds to the initial recognition of EUR 705,576k.

The acquired and reported goodwill is comprised of the following two components:

- The carrying amount of the goodwill in the amount of of EUR 423,081k resulted from the acquisition of MediaWays GmbH by HighwayOne Germany GmbH, a subsidiary of Telefónica, S. A., which was executed on September 30, 2002. On October 2, 2002 HighwayOne Germany GmbH and MediaWays GmbH merged into Telefónica Deutschland GmbH. On March 23, 2011, Telefónica Deutschland GmbH was changed to Telefónica Germany Customer Services GmbH;
- The remaining carrying amount of the goodwill (EUR 282,495k) resulted from the acquisition of HanseNet Telekommunikation GmbH by Telefónica Germany Customer Services GmbH from Telecom Italia Deutschland Holding GmbH, Hamburg, on February 16, 2010. Under the agreement dated March 4, 2011, and as of the agreed merger date on January 1, 2011, Telefónica Germany Customer Services GmbH has transferred the carrying amount of goodwill to Telefónica Germany GmbH & Co. OHG.

The annual impairment test for goodwill was carried out in December 2013. The impairment test carried out at the level of the cash-generating unit Telecommunications does not result in a need to recognize any write-downs to goodwill as of the end of 2013, because the recoverable amount of EUR 6,672m, based on the fair value less costs to sell, was higher than the carrying amount. No write-downs occurred in financial year 2012 either.

The impairment test is described in Note No. 3 Accounting and Valuation Principles.

5. Intangible Assets

The intangible assets comprise the following:

	As of December 31, 2013		
(Euros in thousands)	**Gross cost**	**Accumulated amortization**	**Net intangible assets**
Licenses	9,830,811	(7,456,564)	2,374,247
Software	1,330,972	(1,037,734)	293,238
thereof internal captalized expenditure	*161,359*	*(110,180)*	*51,179*
Other intangible assets	357,399	(161,569)	195,830
Prepayments on intangible assets	20,886	–	20,886
Net intangible assets	**11,540,068**	**(8,655,868)**	**2,884,200**

	As of December 31, 2012		
(Euros in thousands)	Gross cost	Accumulated amortization	Net intangible assets
Licenses	9,830,811	(7,184,958)	2,645,853
Software	1,334,818	(954,071)	380,747
thereof internal captalized expenditure	*138,836*	*(93,579)*	*45,257*
Other intangible assets	373,423	(136,010)	237,413
Prepayments on intangible assets	13,443	–	13,443
Net intangible assets	**11,552,495**	**(8,275,039)**	**3,277,456**

(Euros in thousands)	**As of January 1, 2013**	**Additions**	**Amortization**	**Disposals**	**Transfers**	**Disposal of subsidiaries**	**As of December 31, 2013**
Licenses	2,645,853	–	(271,581)	–	(25)	–	2,374,247
Software	380,747	123,724	(217,962)	–	6,993	(264)	293,238
thereof internal captalized expenditure	*45,257*	*27,268*	*(21,346)*	–	–	–	*51,179*
Other intangible assets	237,413	4,221	(38,351)	(7)	24	(7,471)	195,830
Prepayments on intangible assets	13,443	14,336	–	–	(6,890)	(3)	20,886
Net intangible assets	**3,277,456**	**142,281**	**(527,894)**	**(7)**	**102**	**(7,738)**	**2,884,200**

(Euros in thousands)	As of January 1, 2012	Additions	Amortization	Disposals	Transfers	Disposal of subsidiaries	As of December 31, 2012
Licenses	2,917,434	–	(271,581)	–	–	–	2,645,853
Software	444,633	155,350	(217,617)	–	302	(1,921)	380,747
thereof internal captalized expenditure	*43,921*	*24,365*	*(23,029)*	–	–	–	*45,257*
Other intangible assets	279,668	261	(42,516)	–	–	–	237,413
Prepayments on intangible assets	20,756	100	–	–	(7,026)	(387)	13,443
Net intangible assets	**3,662,491**	**155,711**	**(531,714)**	**–**	**(6,724)**	**(2,308)**	**3,277,456**

Licenses
As of December 31, 2012 and 2013, licenses consist primarily of the licenses listed below:

In May 1997, Telefónica Germany GmbH & Co. OHG acquired a GSM License (Global System for Wireless Communications) (2G). As of December 31, 2013 the carrying amount of the license was EUR 1,325k (2012: EUR 1,660k). The GSM License expires on December 31, 2016. The remaining amortization period is three years.

In August 2000 and in May 2010 Telefónica Germany GmbH & Co. OHG acquired UMTS Licenses (3G) that expire on December 31, 2020. In May 2010, the company acquired additional UMTS licenses that expire in December 2025. As of December 31, 2013, the carrying amount was EUR 1,296,871k (2012: EUR 1,478,447k), the remaining amortization period is seven years and twelve years, respectively.

In May 2010 Telefónica Germany GmbH & Co. OHG acquired LTE Licenses (4G) that expire in 2025. The carrying amount as of December 31, 2013 was EUR 1,076,051k (2012: EUR 1,165,722k). The remaining amortization period is twelve years.

Software
Software mainly includes licenses for office and IT applications. The software is amortized on a straight-line basis over its useful life, which is generally estimated to be between two to five years. In the financial years 2013 and 2012 there were no significant individual additions to software.

Other intangible assets
The other intangible assets represent primarily the customer base.

The amortization of intangible assets comprises the following:

	As of December 31, 2013			
(Euros in thousands)	**Licenses**	**Software**	**Other intangible assets**	**Amortization intangible assets**
Amortization continuing operations	271,581	217,962	38,351	527,894
Amortization discontinued operations	–	–	–	–
	271,581	**217,962**	**38,351**	**527,894**

(Euros in thousands)	Licenses	Software	Other intangible assets	Amortization intangible assets
				As of December 31, 2012
Amortization continuing operations	271,581	215,306	42,516	529,403
Amortization discontinued operations	–	2,311	–	2,311
	271,581	**217,617**	**42,516**	**531,714**

6. Property, Plant and Equipment

Property, plant and equipment as of December 31, 2013 and 2012 is made up as follows:

(Euros in thousands)	Gross cost	Accumulated depreciation	Net PP&E
	As of December 31, 2013		
Land and buildings	680,860	(430,703)	250,157
Plant and machinery	5,760,596	(3,239,182)	2,521,413
Furniture, tools and other items	261,902	(206,634)	55,268
Total PP&E in service	**6,703,357**	**(3,876,519)**	**2,826,838**
PP&E in progress	68,779	–	68,779
Net PP&E	**6,772,136**	**(3,876,519)**	**2,895,617**

(Euros in thousands)	Gross cost	Accumulated depreciation	Net PP&E
	As of December 31, 2012		
Land and buildings	673,951	(373,533)	300,418
Plant and machinery	5,393,282	(2,861,853)	2,531,429
Furniture, tools and other items	302,272	(223,741)	78,531
Total PP&E in service	**6,369,505**	**(3,459,127)**	**2,910,378**
PP&E in progress	63,062	–	63,062
Net PP&E	**6,432,567**	**(3,459,127)**	**2,973,440**

(Euros in thousands)	As of January 1, 2013	Additions	Depreciation	Disposals	Transfers	Disposal of subsidiaries	Others	As of December 31, 2013
Land and buildings	300,418	7,519	(69,817)	–	5,220	(12,683)	19,501	250,157
Plant and machinery	2,531,429	486,149	(497,119)	(6)	792	(3,377)	3,544	2,521,413
Furniture, tools and other items	78,531	16,634	(36,918)	(17)	963	(3,924)	–	55,268
PP&E in service	**2,910,378**	**510,301**	**(603,855)**	**(23)**	**6,976**	**(19,984)**	**23,045**	**2,826,838**
PP&E in progress	63,062	13,302	–	–	(7,077)	(508)	–	68,779
Net PP&E	**2,973,440**	**523,603**	**(603,855)**	**(23)**	**(102)**	**(20,492)**	**23,045**	**2,895,617**

(Euros in thousands)	As of January 1, 2012	Additions	Depreciation	Disposals	Transfers	Disposal of Subsidiaries	Others	As of December 31, 2012
Land and buildings	40,476	11,682	(76,571)	–	324,831	–	–	300,418
Plant and machinery	2,917,077	430,856	(482,061)	(849)	(333,594)	–	–	2,531,429
Furniture, tools and other items	101,834	33,131	(45,405)	(919)	(9,860)	(250)	–	78,531
PP&E in service	**3,059,387**	**475,669**	**(604,037)**	**(1,768)**	**(18,623)**	**(250)**	**–**	**2,910,378**
PP&E in progress	59,983	(22,264)	–	–	25,347	(4)	–	63,062
Net PP&E	**3,119,370**	**453,405**	**(604,037)**	**(1,768)**	**6,724**	**(254)**	**–**	**2,973,440**

The additions to property, plant and equipment for 2013 of EUR 523,603k and for 2012 of EUR 453,405k primarily relate to investments for the migration to 4G technology, for the expansion of the capacity of the 3G technology to improve the performance as well as the coverage of the wireless networks.

Property, plant and equipment deriving from finance leases amounted to EUR 3,026k as of December 31, 2013 and EUR 8,948k as of December 31, 2012. The most significant finance leases are disclosed in Note No. 30 Lease and Sublease Agreements.

Depreciation of property, plant and equipment for the 2013 and 2012 financial years comprises the following:

	As of December 31, 2013				
(Euros in thousands)	**Land and buildings**	**Plant and machinery**	**Furniture, tools and other items**	**PP&E in progress**	**Total depreciation PP&E**
Depreciation continuing operations	69,817	497,119	36,918	–	603,855
Depreciation discontinued operations	–	–	–	–	–
	69,817	**497,119**	**36,918**	**–**	**603,855**

	As of December 31, 2012				
(Euros in thousands)	Land and buildings	Plant and machinery	Furniture, tools and other items	PP&E in progress	Total depreciation PP&E
Depreciation continuing operations	76,571	482,061	45,148	–	603,780
Depreciation discontinued operations	–	–	257	–	257
	76,571	**482,061**	**45,405**	**–**	**604,037**

7. Inventories

As of December 31, 2013 inventories amount to EUR 89,185k (2012: EUR 84,671k).

The total cost of inventories recognized as an expense in the Consolidated Income Statement was EUR 648.026k (2012: EUR 616.240k) in financial year 2013.

As is typical for the industry, the suppliers of the inventories hold title retention to the inventories.

8. Trade and Other Receivables

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

	As of December 31	
(Euros in thousands)	**2013**	2012
Receivables from sales and services	968,993	966,441
Receivables from related parties (Note No. 24 Related Parties)	26,632	26,773
Other receivables	11,701	4,583
Prepayments	146,280	141,628
Provisions for bad debts	(118,371)	(130,394)
Total trade and other receivables	**1,035,234**	**1,009,031**

The breakdown of trade receivables is as follows:

	As of December 31	
(Euros in thousands)	**2013**	2012
Trade receivables billed	748,589	760,355
Trade receivables unbilled	220,404	206,086
Total	**968,993**	**966,441**

The following table shows the development of the allowances for the years ending as of December 31, 2013 and 2012, respectively.

(Euros in thousands)	
Allowances as of December 31, 2013	**(118,371)**
Additions	(56,303)
Reductions	5,472
Utilized	61,206
Disposals of subsidiaries	1,648
Allowances as of December 31, 2012	**(130,394)**
Additions	(70,335)
Reductions	–
Utilized	53,102
Withdrawals from discontinued operations	4,154
Allowances as of December 31, 2011	**(117,315)**

In 2013 and 2012 Telefónica Deutschland Group sold "O2 My Handy" receivables in order to optimize the working capital and to access an alternative source of funding. The nominal value of the receivables transferred in 2013 was EUR 320.2m (2012: EUR 370.4m) and carrying amount was EUR 311.6m (2012: EUR 364.2m). The buyer of the receivables bears the majority of the risk of these receivables. A small portion (2013 less than 5%, 2012 less than 5%) of the sold receivables was not derecognized at the time of the sale due the continuing involvement. The carrying amount of these assets, which Telefónica Deutschland Group continues to recognize, was EUR 26.5m as of December 31, 2013 and EUR 16.0m as of December 31, 2012. A liability in the same amount is recognized. The continuing involvement that is recognized is the maximum risk that would have to be borne by Telefónica Deutschland Group and essentially results from a possible default of the receivables. Between now and the end of 2015, the company could be obligated to repurchase EUR 22.2m if customers should default on their respective debts. The actual defaults are compared to the originally expected ones every month to monitor the associated risk.

In addition, Telefónica Deutschland Group records a provision in the amount of the fair value of the guarantees given of EUR 1.4m (2012: EUR 0.9m).

The total loss as of the date of the transfer of the receivables in 2013 was EUR 1.14m (2012: EUR 1.24m).

After the completion of the transactions, the impact on profit and loss from continuing involvement comprises a loss of EUR 0.3m in 2013 and a loss of EUR 1.1m in 2012.

9. Cash and Cash Equivalents

	As of December 31	
(Euros in thousands)	**2013**	2012
Cash at bank and in hand	7,997	15,512
Cash pooling	700,548	308,154
Total	**708,545**	**323,666**

The cash and cash equivalents line item mainly includes deposits in connection with cash pooling agreements with Telfisa Global B.V. (up until September 30, 2012 the cash pooling agreement existed with Telefónica Finanzas S. A.), receivables from banks, with an original term of up to three months and cash-on-hand.

10. Financial Assets and Liabilities

In the following tables the fair value of all financial assets and financial liabilities of Telefónica Deutschland Group are disclosed in accordance with the valuation categories from IAS 39 considering the requirements of IFRS 13. As of December 31, 2013 the carrying amount of the financial assets and financial liabilities represents an appropriate approximation for the fair value (with the exception of the portion of the bond that is not hedged – see below).

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 observable, either directly or indirectly, 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.

Financial assets

As of December 31, 2013

(Euros in thousands)	Financial assets				Measurement hierarchy					Non-financial assets
	Financial assets at fair value through profit or loss	**Available-for-sale financial assets**	**Held-to-maturity assets**	**Loans and receivables**	**Level 1 (Quoted prices)**	**Level 2 (Other directly observable market inputs)**	**Level 3 (Inputs not based on observable market data)**	**Total carrying amount**	**Total fair value**	
Other non-current financial assets	–	6,473	–	92,314	–	6,473	–	98,787	98,787	–
Trade and other receivables (Note No. 8)	–	–	–	877,254	–	–	–	877,254	877,254	157,981
Other current financial assets	–	–	–	20,751	–	–	–	20,751	20,751	–
Cash and cash equivalents (Note No. 9)	–	–	–	708,545	–	–	–	708,545	708,545	–
Total financial assets	**–**	**6,473**	**–**	**1,698,864**	**–**	**6,473**	**–**	**1,705,337**	**1,705,337**	**157,981**

As of December 31, 2012

(Euros in thousands)	Financial assets				Measurement hierarchy					Non-financial assets
	Financial assets at fair value through profit or loss	Available-for-sale financial assets	Held-to-maturity assets	Loans and receivables	Level 1 (Quoted prices)	Level 2 (Other directly observable market inputs)	Level 3 (Inputs not based on observable market data)	Total carrying amount	Total fair value	
Other non-current financial assets	–	5,759	–	108,916	–	5,759	–	114,675	114,675	–
Trade and other receivables (Note No. 8)	–	–	–	862,821	–	–	–	862,821	862,821	146,210
Other current financial assets	–	–	–	101	–	–	–	101	101	–
Cash and cash equivalents (Note No. 9)	–	–	–	323,666	–	–	–	323,666	323,666	–
Total financial assets	**–**	**5,759**	**–**	**1,295,504**	**–**	**5,759**	**–**	**1,301,263**	**1,301,263**	**146,210**

The ageing structure of the financial assets that are overdue and not impaired is as follows:

	As of December 31	
(Euros in thousands)	**2013**	2012
overdue since 1–90 days	42,385	14,998
overdue since 91–180 days	4,247	3,963
overdue more than 180 days	20,815	20,025
Total	**67,447**	**38,986**

With regards to these trade and other receivables there are no indications of circumstances that could have a negative impact on their value as of the respective reporting date.

The other long-term financial assets are classified as loans and receivables as well as available-for-sale financial assets in 2013 and 2012:

— The proportion 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 8.9m (2012: EUR 14.9m). 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 (see Note No. 8 Trade and Other Receivables). Telefónica Deutschland Group receives a fixed interest for the deposit.

— The proportion of these assets that are classified as available-for-sale financial assets comprises financial assets incurred by Telefónica Deutschland Group to meet its pension obligations, but, in accordance with IAS 19, do not qualify as plan assets. In 2013 and 2012, Telefónica Deutschland Group realized net gains from available-for-sale financial assets of EUR 297k and EUR 199k, respectively, that were directly recognized in other comprehensive income for the period. The fair values recognized in level 2 are based on the values received from the insurance company, which are based on the insurance company's internal calculation models.

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

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

Financial liabilities

	As of December 31, 2013									
	Financial liabilities									Non-financial liabilities
					Measurement hierarchy					
(Euros in thousands)	Financial liabilities at fair value through profit or loss	Liabilities at amortized costs	Finance Leases	Liabilities held-to-maturity	Level 1 (Quoted prices)	Level 2 (Other directly observ-able market inputs)	Level 3 (Inputs not based on observ-able market data)	Total carrying amount	Total fair value	
Long-term loans	200,492	1,142,093	–	–	–	200,492	–	1,342,584	1,348,310	–
Other non-current payables (Note No. 12)	–	3,469	1,340	–	–	–	–	4,809	4,809	–
Short-term loans	–	102,059	–	–	–	–	–	102,059	102,059	–
Trade payables (Note No. 12)	–	1,074,038	–	–	–	–	–	1,074,038	1,074,038	–
Other current liabilities (Note No. 12)	–	195,986	1,649	–	–	–	–	197,635	197,635	23,897
Total Financial Liabilities	**200,492**	**2,517,645**	**2,989**	**–**	**–**	**200,492**	**–**	**2,721,126**	**2,726,851**	**23,897**

	As of December 31, 2012									
	Financial liabilities									Non-financial liabilities
					Measurement hierarchy					
(Euros in thousands)	Financial liabilities at fair value through profit or loss	Liabilities at amortized cost	Finance Leases	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	
Long-term loans	–	1,000,000	–	–	–	–	–	1,000,000	1,000,000	–
Other non-current payables (Note No. 12)	–	4,209	4,984	–	–	–	–	9,193	9,193	–
Short-term loans	–	250,878	–	–	–	–	–	250,878	250,878	–
Trade payables (Note No. 12)	–	918,458	–	–	–	–	–	918,458	918,458	–
Other current liabilities (Note No. 12)	–	46,219	3,964	–	–	–	–	50,183	50,183	168,947
Total Financial Liabilities	**–**	**2,219,764**	**8,948**	**–**	**–**	**–**	**–**	**2,228,712**	**2,228,712**	**168,947**

The long and short-term loans primarily are accounted for as financial liabilities at amortized cost (except for EUR 200m of the nominal value of the bond).

This includes the bond that Telefónica Deutschland Group issued in November 2013 with a nominal value of EUR 600m (refer to Note No. 1 Reporting Entity). This bond is accounted for by using the effective interest method after deduction of the disagio and transaction costs.

A portion of the above-mentioned bond (EUR 200m of the nominal value) together with an interest swap is subject to a fair value hedge (see Note No. 28 Financial Instruments and Risk Management) and is therefore classified as liability at fair value through profit or loss.

In measuring the fair value of the swap, all factors included in that market participants would consider, including the credit risks of the contract parties. The fair value of the interest swap results from discounting of 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 resulted in a profit of EUR 2.9m, while the corresponding interest rate swap resulted in a loss of EUR 2.7m. Thus, a net result, representing the ineffective part of the hedge relationship, in the amount of EUR minus 0.2m (2012: EUR 0m) was recognized in the net financial income (expense). Under the interest rate swap, Telefónica Deutschland Group pays a variable quarterly interest rate amounting to the three-month Euribor and receives an average fixed interest rate of 1.875%. The hedged nominal value of the financial liabilities amounts to EUR 200m. Thus, 14% (2012: 0%) of the bonds and debentures of the company were switched from fixed interest to variable interest. The fair value of the interest swap used to hedge financial liabilities amounted to EUR 2.7m.

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

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 (Refer to Note No. 24 Related Parties). In 2013, EUR 250m was repaid as scheduled and EUR 150m was repaid unscheduled due obtaining financing through the bond. Of the remaining EUR 850m of the loan, EUR 750m is classified as long-term as of December 31, 2013.

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

11. Equity

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

In accordance with section 6 para. 2 of the Articles of Association the shareholders have no right to securitize shares. Each share in general grants one vote at the General Meeting. The shares are freely transferable.

In 2012, O2 (Europe) Limited increased the share capital of Telefónica Deutschland by EUR 100 to EUR 1,116,945,400 based on a capital increase resolution on September 18, 2012, entered in the commercial register on September 26, 2012, in return for a contribution in kind. The increase in the share capital was made through the issue of a new share with a nominal value of EUR 100, which was subscribed by O2 (Europe) Limited. The capital increase in kind was made in full through the contribution of all shares in Telefónica Germany Management GmbH into Telefónica Deutschland within a common control transaction.

Authorized capital

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

Conditional capital

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

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

a) for fractional amounts; furthermore

b) provided that the issue price is not substantially lower than the market value of the bonds with conversion and/or option rights or option obligation and the shares issued or to be issued in order to satisfy the conversion and option rights or conversion obligation do not exceed in total 10% of the share capital;

c) to the extent profit participation rights or participating bonds are issued without conversion rights or obligations or an option right, provided the interest rate and the issue price of the profit participation rights or participating bonds correspond at the date of issue to current market values; and

d) to the extent the bonds are issued in written form contributions in kind for the purpose of directly or indirectly acquiring companies, parts of companies, participations in companies or other assets and the value of the contribution in kind is reasonably proportionate to the value of the bonds.

For further details, see Note No. 32 Events after the Reporting Period.

Capital promise

On March 28, 2003 and April 30, 2004 O2 (Europe) Limited issued a declaration of obligation to Telefónica Deutschland under which O2 (Europe) Limited obliged itself to provide Telefónica Deutschland by way of voluntary shareholder contribution with an amount of EUR 4,650m and EUR 500m. These amounts were to be paid on first demand by Telefónica Deutschland and the obligations were not limited in time. In 2011 O2 (Europe) Limited made cash payments under the declaration of obligation of EUR 2,264,104k, the remaining amount of EUR 2,885,897k was settled in 2012 through the offsetting of a receivable due from O2 (Europe) Limited.

Additional paid-in capital

The additional paid-in capital of Telefónica Deutschland Holding AG remains unchanged at EUR 430k. The contribution occurred in accordance with a contribution contract dated September 18, 2012 in connection with a contribution in kind.

Retained Earnings

Legal reserve

Retained earnings contain a legal reserve in accordance with Section 150 (2) of the German Stock Corporation Act (Aktiengesetz – AktG) of EUR 14k (2012: EUR 14k).

First ordinary General Meeting and dividend distribution in 2013

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

Pre-IPO dividend in 2012

The shareholders' meeting of Telefónica Deutschland declared on September 14, 2012 to make a pre-IPO dividend to O2 (Europe) Limited of EUR 7,186m. Thereof, EUR 4,300m have been considered as cash payments and EUR 2,886m were offset against the above mentioned capital promise.

Dividend for the financial year 2013

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

12. Trade Payables, Other Payables and Deferred Income

The composition of trade payables, other payables and deferred income is as follows:

	As of December 31			
	2013		2012	
(Euros in thousands)	Non-current	Current	Non-current	Current
Trade payables against third parties	–	450,511	–	379,402
Accruals	–	403,569	–	328,254
Payables to related parties (Note No. 24 Related Parties)	–	219,958	–	210,802
Trade payables	**–**	**1,074,038**	**–**	**918,458**
Other payables	**4,809**	**221,532**	**9,193**	**219,130**
Deferred income	**–**	**169,565**	**–**	**153,972**

Accruals relate mainly to outstanding invoices for goods and services.

Deferred income includes principally advance payments received on prepaid contracts.

The other payables comprise the following:

	As of December 31	
(Euros in thousands)	**2013**	2012
Other creditors non-trade	56,577	63,665
Capital creditors	109,798	78,870
Other taxes and social security	22,933	41,535
Current other payables to related parties (Note No. 24 Related Parties)	30,575	31,096
Finance leasing (Note No. 30 Lease and Sublease Agreements)	1,649	3,964
Total current other payables	**221,532**	**219,130**
Other creditors non-trade	3,469	4,208
Finance leasing (Note No. 30 Lease and Sublease Agreements)	1,340	4,985
Total non-current other payables	**4,809**	**9,193**
Total other payables	**226,341**	**228,323**

Current other creditors non-trade consist mainly of liabilities due to personnel. Non-current other creditors non-trade mainly consist of liabilities for deferred rent-free units (non-current portion).

Capital creditors comprise essentially liabilities for outstanding invoices for non-current assets.

13. Provisions

The provisions were created with the following amounts:

	As of December 31	
(Euros in thousands)	**2013**	2012
Pensions	4,660	7,459
Other provisions	99,686	74,923
Total non-current provisions	**104,346**	**82,382**
Other provisions	3,513	7,000
Total current provisions	**3,513**	**7,000**
Total provisions	**107,858**	**89,382**

Pensions

IAS 19R introduces changes with regards to the recognition, valuation and presentation as well as the disclosure of post-employment benefits. For further information see Note No. 3 Accounting Policies.

Telefónica Deutschland Group has defined benefit plans. These include defined benefit rights against an external support fund (Gruppen-Unterstützungskasse), which is managed in accordance with its Articles of Association and from direct commitments. Currently, no direct commitments are provided to new employees.

The overriding investment policy and strategy for the defined benefit plans are based on the goal of generating returns from the plan assets as well as from the reimbursement rights deriving from reinsurance policies which, together with the contributions, are sufficient to meet the pension obligations.

The investemend in the plan assets is carried out in reinsurance policies that are taken out directly by Telefónica Deutschland Group or indirectly by the support fund. The reimbursement rights from reinsurance policies result from reinsurance policies, which were not pledged to the employees.

The requirements for the financing of pension obligations arise from the financing strategy of the support fund and are anchored in its guidelines. The guidelines define that the expected defined benefit obligation will be settled by the support fund. They are fully financed by Telefónica Deutschland Group. Telefónica Deutschland Group provides the support fund with the necessary financial resources.

However, under its Articles of Association the fund must cease or reduce its payments if the company does not make or no longer makes the necessary financial resources available to the fund. In this case the employees can bring their legal right to post-employment benefits against Telefónica Deutschland Group.

The amount of the committed benefits for the defined benefit pension plans essentially depends on the basic salary of the individual employee during the period of employment. The benefits paid include old age pensions, payments for the inability to work and benefits in the event of death to surviving relatives.

In order to minimize the biometric risks of the committed benefits (such as an early benefits claim through invalidity or death of the beneficiary) the pension or promised retirement capital is covered to the full extent (congruent) or in part by reinsurance policies. In addition, the pledging of the reinsurance policies to the pension beneficiary acts as security for the claims of the beneficiary in the event of the insolvency of the sponsoring company.

This defined benefit plan is subject to actuarial and financial risks such as life expectancy and interest rate risk.

In the 2013 financial year the employer's share of the statutory pension insurance amounted to EUR 28.1m (2012: EUR 28.4m).

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

	As of December 31	
(Euros in thousands)	**2013**	2012
Defined benefit obligation from funded plans	(82,663)	(71,927)
Defined benefit obligation from unfunded plans	(10,387)	(8,781)
Present value of the defined benefit obligation	**(93,050)**	**(80,708)**
Plan assets	91,132	73,389
Surplus / (deficit)	**(1,918)**	**(7,319)**
Effect of the asset ceiling	(2,741)	(140)
Net defined benefit liability	**(4,660)**	**(7,459)**
Reimbursement Rights	**6,473**	**6,690**

The development in the present value of the defined benefit obligation in 2013 and 2012 is as follows:

(Euros in thousands)	2013	2012
Defined benefit obligation as of January 1	**(80,708)**	**(55,739)**
Current service cost (personnel expenses)	(3,014)	(2,347)
Interest income/expense (financial result)	(3,367)	(2,944)
Remeasurement of defined benefit obligation	(5,877)	(21,380)
thereof: actuarial gains and losses arising from changes in demographic assumptions	*34*	–
thereof: actuarial gains and losses arising from changes in financial assumptions	*(7,969)*	–
thereof: experience gains and losses	*2,058*	–
Benefits paid	769	1,126
Changes in business combinations and disposals	191	851
Others	(1,044)	(275)
Defined benefit obligation as of December 31	**(93,050)**	**(80,708)**

The present value of the defined benefit obligation is distributed as follows across the individual groups of those entitled to pensions:

	As of December 31	
(Euros in thousands)	2013	2012
Amounts owing to active members	(39,575)	(32,087)
Amounts owing to deferred members	(43,408)	(40,191)
Amounts owing to retirees	(10,068)	(8,431)
Defined benefit obligation	**(93,050)**	**(80,708)**

The fair value of the plan assets developed as follows in 2013 and 2012:

(Euros in thousands)	2013	2012
Fair value of plan assets as of January 1	**73,389**	**73,465**
Return on plan assets excluding amounts included in interest income	(266)	(2,386)
Interest income (Net financial income / expense)	3,221	3,638
Employer contributions	14,504	311
Benefits paid	(555)	(906)
Changes in business combinations and disposals	(261)	(858)
Others	1,099	125
Fair value of plan assets as of December 31	**91,132**	**73,389**

The return from plan assets would have been EUR 240k higher and the amount recorded directly in equity would have been EUR 240k lower if we had used the same interest rate in 2012 as that used in the valuation of the pension obligations.

If the company had not applied IAS 19R in 2013, the expected return from plan assets for financial year 2013 would have been higher than the interest calculated based on IAS 19R. Accordingly, the actuarial gains recognized in the other comprehensive income would have been lower. Based on the expected return from the plan assets as of December 31, 2012, the effect for the financial year 2013 would have amounted to EUR 19k (before taxes).

The effect of the asset ceiling developed as follows in 2013 and 2012:

(Euros in thousands)	2013	2012
Effect of the asset ceiling as of January 1	**140**	**17,050**
Change of the effect of asset ceiling	2,601	(16,910)
Effect of the asset ceiling as of December 31	**2,741**	**140**

The fair value of the reimbursement rights from insurance contracts developed in 2013 and 2012 as follows:

(Euros in thousands)	2013	2012
Fair value of reimbursement rights as of January 1	**6,690**	**6,425**
Return on reimbursement rights excluding amounts included in interest income	(63)	199
Interest income	281	257
Employer contributions	23	23
Benefits paid	(223)	–
Others	(234)	(192)
Fair value of reimbursement rights as of December 31	**6,473**	**6,690**

The net pension expense recognized in the Income Statement is comprised as follows:

	As of December 31	
(Euros in thousands)	2013	2012
Current service costs (personnel expenses)	3,014	2,347
Interest expense (income) (net financial income / expense)	146	(694)
Total amount of expense	**3,160**	**1,653**

The actual returns from plan assets for the financial year ending December 31, 2013 were EUR 2,955k and for 2012 EUR 1,252k.

The main actuarial assumptions on which the determination of the present value of the defined benefit obligation as of the reporting date are based are provided in the following (information in the form of average factors).

	As of December 31	
(In percent)	2013	2012
Discount rate	3.80%	4.20%
Nominal rate of pension payment increase	2.00%	2.00%
Fluctuation rate	[0% – 20%]	[0% – 20%]

The mortality rate underlying the calculation of the present value of the defined benefit obligation is based on official statistics and mortality tables. The mortality tables on which the actuarial calculation of the DBO as at the reporting date is based are the Heubeck Mortality Tables 2005G (Heubeck Richttafeln 2005G).

	As of December 31	
(In years)	**2013**	2012
Life expectancy at age 65 for a retiree currently	21	21
Life expectancy at age 40 for a deferred member currently	24	24

An increase or decrease in the main actuarial assumptions would have had the following effects on the present value of the defined benefit obligation as of December 31, 2013:

(Euros in thousands)		
Discount rate (+0.25% / −0.25%)	(5,104)	5,503
Nominal rate of pension payment increase (+0.50% / −0.50%)	4,740	(4,312)
Fluctuation rate (+1.00% / −1.00%)	(47)	47
Life expectancy (+1 year)	3,195	–

Increases and reductions in the discount rate and increases to pension payments do not have the same level of effect on the determination of the DBO due to the interest effects. If several assumptions are changed at the same time the overall effect will not necessarily correspond to the sum of the individual effects due to the changes in the assumptions. In addition, the sensitivity of a change in the DBO only reflects each specific order of magnitude in the change of assumptions (for example 0.25%). If the assumptions change by a different order of magnitude, the effect on the DBO does not necessarily have to be linear.

The following table contains information regarding the weighted average term of the present value of the defined benefit obligation as well as the analysis of the due date of expected payments:

(Euros in thousands)	**January 1 to December 31, 2013**
Benefits expected to be paid within 1 year	658
Benefits expected to be paid within 2 years	1,090
Benefits expected to be paid within 3 years	1,199
Benefits expected to be paid within 4 years	1,357
Benefits expected to be paid within 5 years	1,518
Benefits expected to be paid within 6 years and 10 years	10,611

The average of the expected term of the defined benefit obligation is 22 years.

The best estimate of the contributions that will be paid into the plan in the financial year ending December 1, 2014 amounts to EUR 7,994k.

Other provisions

Other provisions include provisions for dismantling, onerous contracts and other provisions.

The movement is as follows:

(Euros in thousands)	Dismantling	Onerous contracts	Other	Total
As of January 1, 2013	**55,694**	**26,000**	**229**	**81,923**
Additions	5,521	–	62	5,583
Utilization	(6,292)	(7,241)	–	(13,533)
Reversal	(43)	–	–	(43)
Transfers	–	–	–	–
Other	23,045	–	–	23,045
Unwinding of discount	1,631	4,593	–	6,224
As of December 31, 2013	**79,556**	**23,352**	**291**	**103,199**
thereof non-current	*79,556*	*19,839*	*291*	*99,686*
thereof current	*–*	*3,513*	*–*	*3,513*
As of January 1, 2012	**58,602**	**51,954**	**–**	**110,556**
Additions	157	6,952	–	7,109
Utilization	(6,739)	(22,755)	–	(29,494)
Reversal	–	–	–	–
Transfers	–	(10,151)	229	(9,922)
Unwinding of discount	3,674	–	–	3,674
As of December 31, 2012	**55,694**	**26,000**	**229**	**81,923**
thereof non-current	*55,694*	*19,000*	*229*	*74,923*
thereof current	*–*	*7,000*	*–*	*7,000*

The provisions for dismantling obligations comprise the estimated costs for the dismantling and removal of assets (e.g. mobile masts and other fixed assets), based on the respective agreements.

The onerous contracts provision essentially includes expected losses from the sub-letting of leased objects. The expected utilization covers short and mid-term periods of time depending on the date of the rent payment and the rental income.

14. Revenues and Other Income

Revenues

Revenues are comprised as follows:

(Euros in thousands)	January 1 to December 31 2013	2012
Rendering of services	4,224,252	4,515,041
Other sales	689,629	697,797
Total revenues	**4,913,881**	**5,212,838**

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

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

The breakdown of revenues according to wireless business and wireline business is shown in the following table:

	January 1 to December 31	
(Euros in thousands)	**2013**	2012
Revenues		
Wireless business	3,673,043	3,845,053
Wireless service revenues	2,989,294	3,151,838
Handset revenues	683,749	693,215
Wireline business	1,234,958	1,363,203
Other revenues	5,880	4,582
Total revenues	**4,913,881**	**5,212,838**

Wireless service revenues

The wireless service revenues are largely based on the basic fee and the fees levied for voice (including incoming and outgoing calls), text messages (including SMS and MMS) and wireless data services as well as the revenues from service contracts. The wireless service revenues include, alongside roaming revenues, access and connection fees that were paid by other service providers for calls and SMS messages which were delivered via the group's network.

Handset revenues

Handset revenues include income from the sale of mobile phones as part of the "O_2 My Handy" model as well as cash sales.

The customer can choose with the "O_2 My Handy" model whether to pay the entire price of the mobile phone up front or to make an initial payment to start with and pay the remaining purchase price in twelve or 24 monthly installments.

Revenues from the "O_2 My Handy" model are discounted according to their term. In addition, the revenues include one-off payments such as activation fees from the wireless communications business (mainly postpaid), hardware for bundled products from prepaid SIM cards and wireless communications hardware or postpaid contracts as well as accessories.

Wireline business revenues

Wireline business revenues mainly include revenues from DSL services for private customers, DSL activation fees for private customers, revenues from DSL hardware and non-recurring items (e.g. fees for change of address, number transfers, etc.), services and hardware revenues from pay TV, revenues from wholesale ULL, also called wholesale DSL, revenues from the sale of the company's own DSL network, from services and from hardware to other service providers who re-bundle these and sell them on to end customers, data traffic revenues from carriers in connection with the sale and trade of minutes between carriers to connect their customer calls via the networks of other operators as well as revenues from the hosting of customer content on the company's own computer center infrastructure and from associated administrative services such as the use of this infrastructure to host applications that were developed and are operated by third parties. In addition, DSL revenues also include fixed line revenues.

Other revenues

Other revenues relate to new business, such as advertising and financial services, e.g. “O_2 More Local” mobile location-based services or “mpass” mobile payment system.

Other income

Other income comprised the following in 2013 and 2012:

	January 1 to December 31	
(Euros in thousands)	**2013**	2012
Own work capitalized and ancillary income	92,843	60,596
Gain on disposal of assets	76,179	210
Other income	**169,022**	**60,806**

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

The gain on disposal of assets mainly includes the gains of EUR 76,163k from the sale of Telefónica Germany Online Services GmbH (TOS) and GKHH Fibre Optic GmbH. For further information see Note No. 19 Discontinued Operations and Disposal Groups.

15. Personnel Expenses

In financial year 2013, personnel expenses amounted to EUR 418,647k (2012: EUR 421,764k). Personnel expenses from share-based payments is presented in Note No. 26 Share-based Payments; personnel expenses relating to pension plans are presented in Note No. 13 Provisions.

Since January 1, 2013 as well as in the comparative prior year period Telefónica Deutschland Group has reported expenses for external personnel services in other expenses whereas these expenses were recorded within the personnel expenses in the short-term employee benefits line item in the Consolidated Financial Statements for the financial year ending December 31, 2012. In 2013 expenses for external personnel services of EUR 46,429k were incurred (2012: EUR 42,769k). The presentation used improves the clarity of the information provided in the Consolidated Financial Statements.

16. Other Expenses

The other expenses mainly comprise of costs for sales and marketing, infrastructure, administration and other external services.

17. Net Financial Income / (Expense)

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

	January 1 to December 31	
(Euros in thousands)	2013	2012
Interest income from financial assets	6,349	12,068
Other interest income	–	3,610
Interest expenses from financial liabilities	(28,955)	(18,622)
Accretion of provisions and other liabilities	(4,453)	(2,763)
Other exchange gains (losses)	87	(416)
Net financial income (expense)	**(26,972)**	**(6,123)**

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

The interest expenses from financial liabilities mainly includes the interest expense for the loan granted from Telfisa Global B. V. in September 2012 (see Note No. 24 Related Parties).

18. Income Taxes

Consolidated income tax group

The consolidated income tax group comprised six companies as of December 31, 2013 (six in 2012).

Current and deferred taxes

The income taxes recorded in the Consolidated Income Statement essentially comprise deferred taxes. The reported current taxes relate to capital gains tax refunds from previous years:

	January 1 to December 31	
(Euros in thousands)	2013	2012
Current tax (expense)	17	–
Deferred tax (expense)	(584)	167,756
Income tax (expense)	**(567)**	**167,756**

The movements in deferred taxes are as follows:

(Euros in thousands)	2013	2012
Balance as of January 1	**581,191**	**412,033**
Deferred tax expense	(584)	167,756
Movement in deferred taxes recognized directly in equity as shown in the consolidated statement of comprehensive income	2,916	1,427
Other	–	(25)
Balance as of December 31	**583,523**	**581,191**

Tax loss carry forwards and temporary differences

Tax losses carried forward for which no deferred tax asset was reported as of December 31, 2013, amounted to EUR 12,000,260k for corporate income tax and EUR 11,976,350k for trade tax (2012: EUR 11,222,741k and EUR 11,239,147k). For temporary differences of EUR 353,771k in 2013, EUR 565,122k in 2012, no deferred tax asset were recognized.

Temporary differences arise due to the difference between the tax bases of the assets and liabilities and their respective carrying amounts. Deductible temporary differences and tax losses carried forward give rise to deferred tax assets in the Consolidated Statement of Financial Position. Taxable temporary differences in tax bases give rise to deferred tax liabilities in the Consolidated Statement of Financial Position.

The breakdown of deferred tax assets and tax liabilities from temporary differences and tax losses carried is as follows:

	As of December 31			
	2013		2012	
(Euros in thousands)	**Deferred tax assets**	**Deferred tax liabilities**	Deferred tax assets	Deferred tax liabilities
Goodwill and intangible assets	**906,353**	**(163,432)**	891,684	(80,486)
Tangible assets	71,017	(343,755)	–	(327,255)
Trade and other receivables	4,946	(24,401)	116,446	(441)
Other current financial assets	10,494	(4,328)	11,413	(49,564)
Debt, trade and other payables	6,607	(11,290)	1,138	(114,675)
Provisions including pension provisions	28,607	(1,327)	34,410	(5,173)
Other current financial liabilities	2,296	(3,866)	4,210	(2,319)
Tax loss carryforwards	105,604	–	101,802	–
Tax assets (liabilities)	**1,135,924**	**(552,400)**	**1,161,103**	**(579,913)**
Set off of tax	(552,400)	–	(579,913)	579,913
Tax assets (liabilities)	**583,523**	**–**	**581,191**	**–**

Reconciliation of profit before tax to taxable income

The reconciliation between profit before tax and taxable income for 2013 and 2012 is as follows:

	As of December 31	
(Euros in thousands)	2013	2012
Profit before tax from continuing operations	**78,379**	**139,768**
Tax expense at prevailing statutory rate (32%)	(25,081)	(44,628)
Non-deductible expenses	(9,500)	(9,429)
Tax free income	–	85,095
Change in unrecognized temporary differences and tax loss carryforwards	36,759	135,571
Other	(2,744)	1,147
Income tax (expense)	**(567)**	**167,756**
Current tax expense	17	–
Deferred tax (expense)	(584)	167,756
Total income tax (expense)	**(567)**	**167,756**

19. Discontinued Operations and Disposal Groups

a) Disposal group in 2013 Sale of Telefónica Germany Online Services GmbH (TOS)

On September 12, 2013, Telefónica Germany GmbH & Co. OHG and Host Europe GmbH entered into an agreement regarding the sale of Telefónica Germany Online Services GmbH (TOS). TOS is a provider of managed hosting and cloud services for business customers. In this context, the domination agreement and the profit and loss transfer agreement between TOS and Telefónica Germany GmbH & Co. OHG were mutually terminated on September 30, 2013.

With the fulfillment of all the necessary closing conditions, the shares in TOS were transferred to the Host Europe Group on October 31, 2013.

The sale of TOS impacted the financial position of the Group with effect from October 31, 2013 as follows:

(Euros in thousands)	As of October 31, 2013
Intangible assets	267
Property, plant and equipment	5,194
Trade and other receivables	3,713
Financial assets	1,379
Deferred tax assets	0
Trade and other payables	(2,187)
Deferred tax liabilities	(94)
Provisions	(66)
Prepaid expenses and deferred income	(290)
Net assets and liabilities	**7,916**
Cash consideration received, satisfied in cash	42,000
Cash and cash equivalents disposed of	(4,404)
Net cash inflow	**37,596**

In connection with the sale of TOS, a gain on disposal of EUR 30.0m was recognized in the Consolidated Income Statement within other income.

b) Disposal group in 2013
Versatel and Telefónica Deutschland agree long-term fiber optics cooperation

On December 30, 2013, Versatel Holding GmbH took over all shares in GKHH Fibre Optic GmbH pursuant to the share purchase and transfer agreement dated October 16, 2013. By means of a spin-off for new foundation out of Telefónica Germany GmbH & Co. OHG in accordance with section 123 (3) no. 2 of the German Transformation Act (Umwandlungsgesetz – UmwG), GKHH Fibre Optic GmbH was created with registration in the commercial registry on December 4, 2013. Thus, Telefónica Deutschland's fiber optic network in the Hamburg city area with approx. 93,000 kilometers of fiber and accordingly 1,000 cable kilometers, a newly built computer center as well as selected wholesale and business customer contracts were spun out of Telefónica Germany GmbH & Co. OHG.

The sale of GKHH Fibre GmbH impacted the financial position of the Group with effect from December 30, 2013 as follows:

(Euros in thousands)	As of December 30, 2013
Intangible assets	7,471
Property, plant and equipment	15,298
Trade and other receivables	2,042
Provisions	(21)
Financial assets	(6,081)
Other payables	(33)
Prepaid expenses and deferred income	(75)
Net assets and liabilities	**18,601**
Cash consideration received, satisfied in cash	69,072
Cash and cash equivalents disposed of	0
Net cash inflow	**69,072**

In connection with this sale, a gain on disposal of EUR 46.2m was recognized in the Consolidated Income Statement within other income.

c) Discontinued operations in 2012

In financial year 2012, Telefónica Deutschland Group sold with effective date October 1,
as part of a single sale transaction
— its entire Global Services Segment as well as
— the legal entities Group3G UMTS Holding GmbH and Quam GmbH.

The companies in the Global Services reportable segment (comprising Telefónica Global Services GmbH (TGS), Telefónica Global Roaming GmbH (TGR), Telefónica Compras Electronicas S.L. and the 40% interest in Adquira España, S. A.) as well as the Group3G UMTS Holding GmbH (G3G) and Quam GmbH (Quam) were sold as of October 1, 2012. All shares in these companies were held by Telefónica Global Activities Holdings B.V. (formerly: Telefónica Chile Holding B.V.). Before the IPO, Telefónica Deutschland Holding AG sold all shares in Telefónica Global Activities Holdings B.V. to Telfisa Global B.V., a company in the Telefónica, S. A. Group. Following the sale, Telefónica Global Activities Holdings B.V. and all other companies referred to above were no longer Group companies.

On July 1, 2012, Management committed to the plan to sell these areas following the strategic plan to focus on the key competencies of the Group – the telecommunications business in Germany. The companies included in the transaction were classified in 2012 as discontinued operations.

For the first nine months of the 2012 financial year, the discontinued operations of Telefónica Deutschland Group were reported in the Consolidated Financial Statements separately from the continuing operations. The following table shows the breakdown of the result of the discontinued operations:

(Euros in thousands)	January 1 to December 31, 2012
Revenues	412,629
Other income	8,401
Finance income	24,826
Supplies	(409)
Personnel expenses	(17,092)
Other expenses	(11,696)
Depreciation and amortization	(2,574)
Finance costs	(22,928)
Profit before tax from discontinued operations	**391,157**
Income tax	143,962
Profit for the year from discontinued operations	**535,119**
Gain (loss) recognized on the measurement to fair value less costs to sell	–
Gain (loss) recognized on the disposal of the disposal group constituting the discontinued operations	491,911
Related income tax expenses	–
Profit from discontinued operations	**1,027,030**

The reported business activities include all global procurement activities. Telefónica Global Services GmbH acted as an agent for all companies on group-level by pooling the composite demand of each group entity. This bargaining power opposite to the suppliers generates for the Group economies of scale. To ensure a group-wide smoothly running tender and proposal proceeding, Telefónica Global Services GmbH and its suppliers are able to use an electronic data processing system provided by Telefónica Compras Electronicas S.L. Telefónica Global Services GmbH received commissions from the suppliers depending on the order volume for the service offered. The handling of the purchasing process, meaning delivery and payment, was settled between the supplier and the individual entity of Telefónica Deutschland Group.

Adquira España S. A. was established in 2000 by four Spanish companies (Telefónica, BBVA, Iberia, Repsol), in order to bundle and optimize their purchasing process.

Over the last decade, Adquira has developed into a specialist in the area of e-commerce. Adquira focuses on the support and optimization of the buying process by using its data platform and keeping it updated. The company is able to revert to a comprehensive data base with more than 4,500 suppliers in Spain. Thus every customer of Adquira can select its products from a broad range and thus maximize economies of scale.

Telefónica Global Roaming GmbH is responsible for the international business of the Telefónica, S. A. Group and delivers integrated fixed, mobile and IT services. The company manages the roaming business of the Group with the goal of being able to offer customers optimal and individually tailored roaming services.

The disposal of the discontinued business segments affected the financial position of the Group as follows:

(Euros in thousands)	As of December 31, 2012
Intangible assets	2,308
Property, plant and equipment	254
Non-current financial assets	2,794
Inventories	28
Trade and other receivables	379,628
Cash and cash equivalents	145,554
Deferred tax assets	155,000
Trade and other payables	(444,217)
Provisions	(29,457)
Deferred tax	(803)
Net assets and liabilities	**211,089**
Cash consideration received, satisfied in cash	703,000
Cash and cash equivalents disposed of	145,554
Net cash inflow	**557,446**

20. Earnings per Share

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

Diluted earnings per share are calculated by adjusting the profit after tax attributable to the ordinary shareholders of the parent company and the weighted average number of ordinary shares outstanding in the reporting period for the effects of any dilutive effects inherent in converting potential ordinary shares. During the reporting period there were no dilutive equity instruments outstanding.

The share capital of Telefónica Deutschland Holding AG is conditionally increased by up to EUR 558,472,700 by issuing new registered shares (see Note No. 11 Equity). Shares from the conditional capital of a stock corporation are not part of the calculation of the earnings per share as they can be contingently issued.

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.

	January 1 to December 31	
(Euros in thousands)	**2013**	2012
Profit attributable to ordinary equity holders of the parent from continuing operations	77,813	307,523
Profit attributable to ordinary equity holders of the parent from discontinued operations	–	1,027,030
Total profit attributable to equity holders of the parent for basic earnings	77,813	1,334,553
Dilutive effects of the conversion of potential ordinary shares	–	–
Total profit attributable to equity holders of the parent for diluted earnings	77,813	1,334,553

	As of December 31	
(Number of shares in thousands)	**2013**	2012
Weighted average number of ordinary shares for basic earnings per share	1,116,945	1,117,001
Telefónica Deutschland Group share option plan	–	–
Weighted average number of ordinary shares for diluted earnings per share	1,116,945	1,117,001

Basic and diluted earnings per share attributable to the ordinary shareholders of the parent company can be broken down by continuing and discontinued operations as follows:

	January 1 to December 31	
(Earnings per share)	**2013**	2012
Basic earnings per share in EUR	**0.07**	**1.20**
– from continuing operations	0.07	0.28
– from discontinued operations	–	0.92
Diluted earnings per share in EUR	**0.07**	**1.20**
– from continuing operations	0.07	0.28
– from discontinued operations	–	0.92

21. Segment Information and Reconciliation

General information

As of December 31, 2013, Telefónica Deutschland Group only has the reportable segment Telecommunications in accordance with IFRS 8. Up until September 30, 2012 Telefónica Deutschland Group consisted of two reportable segments: Telecommunications and Global Services. The companies of the Global Services segment and Group3G UMTS Holding GmbH (G3G) as well as Quam GmbH (Quam) were sold in the previous year with effect of October 1, 2012 (see Note No. 19 Discontinued Operations and Disposal Groups).

The measurement principles that were used by Telefónica Deutschland Group in this segment reporting are based on IFRS. These principles are also the basis for the segment performance assessment. Because Telefónica Deutschland Group operates exclusively in the Federal Republic of Germany, a geographic segmentation is not suitable for the Group.

The Management Board of Telefónica Deutschland Holding AG acts as the chief operating decision-maker on a group-wide basis, and it assesses performance and allocates resources on Group level. The chief operating decision-maker controls the performance by OIBDA of the Group as a performance indicator.

Telecommunications segment

Telefónica Deutschland Group offers its German customers wireless communications, wireline and internet services and offers its wholesale partners in Germany in addition access to its infrastructure and services.

Telefónica Deutschland Group markets its products as part of a multi brand strategy and offers the majority of its wireless communications products, wireline products and services under the core O_2 brand. With secondary and partner brands as well as wholesale channels, the Telefónica Deutschland Group reaches further customer groups to whom the core O_2 brand does not appeal. The secondary brands include the fully controlled brands Fonic and netzclub as well as brands from joint operations and strategic partnerships such as for example TCHIBO mobil and Türk Telekom Mobile. In addition, the Group 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 its wholesale business, Telefónica Deutschland Group offers wireless communications, wireline and added value services for customers such as 1&1, mobilcom /debitel, Drillisch, Kabel Deutschland and Unitymedia KabelBW. In the wireline area, the Group makes a range of Unbundled Local Loop services (ULL), including wireline telephony and high-speed internet available to wholesale partners. Further, added value services such as e.g. invoicing 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 expand coverage and achieve economies of scale.

It is the goal of Telefónica Deutschland Group to provide its customers with access to telecommunications and information areas and thus to offer technology, multimedia, information and entertainment.
In addition, associated services such as the sale of hardware are offered. Telefónica Deutschland Group promotes the sale of hardware via its core brand O_2 with the “O_2 My Handy” models (since 2009). So that a broad hardware spectrum such as mobile phones, wireless communications hardware and other technical accessories can be offered, the customers can avail themselves of attractive payment methods such as payment by installments over twelve or 24 months. This generates price transparency with respect to costs.

Disposal of the Global Services segment in 2012

Legally effective as of October 1, 2012, the Global Services segment was sold. Details are provided in Note No. 19 Discontinued Operations and Disposal Groups.

Operating income before depreciation and amortization (OIBDA) and the operating income before depreciation and amortization and before Group fees (adjusted OIBDA)

Operating income before depreciation and amortization (OIBDA), which the Group uses as a performance indicator, is calculated as operating income before income tax, financial result and depreciation of intangible assets and property, plant and equipment and measures the earnings power of the operative business. The advantage of this key figure is the elimination of potential differences that can be caused by fluctuations in the tax positions (for example on a change of effective tax rates or deferred taxes and their effect on individual periods of companies), depreciation, financial result and other positions. Thus OIBDA and the OIBDA margin derived therefrom are often called upon as a performance figure in order to compare the business activity of telecommunications companies.

In addition the adjusted OIBDA is used as an additional figure to measure the performance of the company as well as to set operative and strategic goals. The adjusted OIBDA is calculated in the same way as the OIBDA, however it does not include Group fees. This makes a better period comparison of the operating performance possible. The adjusted OIBDA is a common figure in reports and is widely used by analysts, investors and other interested parties in the telecommunications branch, although it is not explicitly defined in IFRS and thus cannot necessarily be compared with similar indicators of other companies. The adjusted OIBDA should not be seen as an alternative to the operative result as a key indicator of the operative activity or as an alternative to cash flow from current operations as a key indicator of liquidity.

Group fees are fees that were paid to Telefónica, S. A. Group as part of a number of agreements, including management and consultancy services, licenses, cost allocation and other services.

The following tables show each reportable segment and the reconciliation of profit for Telefónica Deutschland Group for the 2013 and 2012 years ended December 31.

Key figures from the reportable segments

(Euros in thousands)	January 1 to December 31, 2013 **Tele-communi-cations = Group**	January 1 to December 31, 2012 Telecommu-nications	Global Services (discontinued)	Total	Reconciliations	Group
Revenues	4,913,881	5,212,838	412,629	5,625,467	(412,629)	5,212,838
thereof: Revenues from external customers	*4,913,881*	*5,212,838*	*394,958*	*5,607,796*	*(394,958)*	*5,212,838*
thereof: Revenues from transactions with other operating segments	–	–	*17,671*	*17,671*	*(17,671)*	–
Adjusted OIBDA	1,308,029	1,351,385	411,184	1,762,570	(411,192)	1,351,377
CapEx	665,884	608,838	275	609,114	(275)	608,838

Reconciliation

Revenue reconciliation (Euros in thousands)	January 1 to December 31 **2013**	2012
Total revenues of reportable segments	4,913,881	5,625,467
– Elimination of intersegmental revenues (from discontinued operations)	–	17,671
– Other eliminations of discontinued operations	–	394,958
= Consolidated revenues	4,913,881	5,212,838

Income reconciliation (Euros in thousands)	January 1 to December 31 **2013**	2012
Adjusted OIBDA of reportable segments	1,308,029	1,762,570
+/– Adjusted OIBDA of other activities (G3G and Management GmbH)	–	8
– Adjusted OIBDA from discontinued operations	–	411,176
= Adjusted OIBDA of group (continuing operations)	**1,308,029**	**1,351,385**
– Group fees	(70,929)	(72,311)
= OIBDA of group (continuing operations)	**1,237,100**	**1,279,074**
– Depreciation and amortization	(1,131,749)	(1,133,183)
= Operating income (continuing operations)	**105,351**	**145,891**
+/– Net financial income (expense)	(26,972)	(6,123)
= Profit before tax from continuing operations	**78,379**	**139,768**

Capital expenditure (CapEx)

The net additions are comprised as follows:

Capital expenditure reconciliation (Euros in thousands)	2013	2012
Total CapEx for reportable segments	665,884	609,114
– CapEx for discontinued operations	–	275
– Eliminations	–	–
= CapEx total	**665,884**	**608,838**
+ Non-recurring investments	–	–
= Additions fixed assets / intangibles	**665,884**	**608,838**

22. Group Companies of the Telefónica Deutschland Group

The following table lists the companies comprising Telefónica Deutschland Group as of December 31, 2013:

Company name, registered office	Country	As of December 31, 2013
Parent company		
Telefónica Deutschland Holding AG, Munich	Germany	n/a
Subsidiaries		
Telefónica Germany Management GmbH, Munich	Germany	100%
Telefónica Germany GmbH & Co. OHG, Munich[1]	Germany	100%
Telefónica Germany 1. Beteiligungsgesellschaft mbH, Munich	Germany	100%
Telefónica Germany Customer Services GmbH, Munich	Germany	100%
Wayra Deutschland GmbH, Munich	Germany	100%
Fonic GmbH, Munich	Germany	100%
O_2 Telefónica Deutschland Finanzierungs GmbH, Munich (former: Telefónica Deutschland Finanzierungs GmbH)	Germany	100%
Joint operations		
TCHIBO Mobilfunk Beteiligungs GmbH, Hamburg	Germany	50%
TCHIBO Mobilfunk GmbH & Co. KG, Hamburg	Germany	50%

1 Telefónica Germany GmbH & Co. OHG, Munich, is availing itself of the exemption provisions governing disclosures pursuant to section 264b HGB.

23. Joint Operations

Telefónica Germany GmbH & Co. OHG jointly controls TCHIBO Mobilfunk Beteiligungs GmbH, Hamburg, and TCHIBO Mobilfunk GmbH & Co. KG, Hamburg. In application of IFRS 11.17 and the respective application guidelines, the companies were classified as joint operations considering other facts and circumstances.

The business objective of TCHIBO Mobilfunk Beteiligungs GmbH is the holding of interests in other companies. The business objective of TCHIBO Mobilfunk GmbH & Co. KG, where TCHIBO Mobilfunk Beteiligungs GmbH is its personally liable shareholder, is the marketing and sales of wireless communications services to be rendered by third parties and the marketing and sales of hardware.

As part of the joint operation in TCHIBO Mobilfunk GmbH & Co. KG, Telefónica Germany GmbH & Co. OHG reimburses the company for sales and marketing services provided by the latter, on the one hand and otherwise supplies the company with wireless communications devices. Telefónica Germany GmbH & Co. OHG has committed to provide the company with capital amounting to up to EUR 6m, if needed. As of December 31, 2013, EUR 1.4m of that amount was still outstanding.

The share of the assets, liabilities and expenses and income to be attributed to Telefónica Deutschland Group from both companies corresponds in each case to 50%. Thus the actual share is identical to the contractually agreed share of voting rights.

The shares of assets, liabilities, income and expenses before consolidation for the 2013 and 2012 years are comprised as follows:

TCHIBO Mobilfunk GmbH & Co. KG (Euros in thousands)	**2013**	2012
Financial Position:		As of December 31
Current assets	15,534	44,814
therein cash and cash equivalents	*6,266*	*8,148*
Non-current assets	332	261
Current liabilities	(11,496)	(41,227)
Non-current liabilities	–	–
Income Statement:		January 1 to December 31
Revenues and other income	28,908	26,091
Expenses	(28,394)	(25,598)
thereof: amortization and depreciation	*(166)*	*(146)*
Operating income	514	493
Net financial income/(expense)	10	6
Income tax	(3)	–
Profit for the year	522	499

TCHIBO Mobilfunk Beteiligungs GmbH (Euros in thousands)	**2013**	2012
Financial Position:		As of December 31
Current assets	100	72
therein cash and cash equivalents	*28*	*21*
Non-current assets	–	–
Current liabilities	(81)	(54)
Non-current liabilities	–	–
Income Statement:		January 1 to December 31
Revenues	1	–
Expenses	–	–
Operating income	1	–
Profit for the year	1	–

24. Related Parties

The transactions with related parties include transactions between Telefónica Deutschland Group and Telefónica, S.A. Group. In addition the transactions with related parties also include transactions between the Telefónica Deutschland Group and the members of the Management Board and Supervisory Board of Telefónica Deutschland and their close close family members (for definition of key management personnel in 2012, see item b)).

Telefónica Germany Holdings Limited, Slough, United Kingdom, a subsidiary of O2 (Europe) Limited, itself a subsidiary of Telefónica, S.A., is the parent company of Telefónica Deutschland Holding AG. Telefónica, S.A. Group is a related company because Telefónica, S.A. (the ultimate parent company) controls Telefónica Deutschland Group.

Transactions with Telefónica, S.A. Group
Telefónica Deutschland Group has entered into a series of contractual relationships that are considered to be transactions with related parties.

In accordance with a service agreement with O2 Holdings Limited dated August 12, 2002, Telefónica Germany GmbH & Co. OHG receives consulting and support services from companies of Telefónica, S.A. Group in the United Kingdom and Spain.

As part of a license agreement with Telefónica, S.A. dated January 1, 2011, Telefónica Germany GmbH & Co. OHG is permitted to use the brand “Telefónica” in return for payment of a licensing fee.

In addition Telefónica Germany GmbH & Co. OHG uses the core brand O_2 (as well as all brands that have a relationship to the O_2 brand) of O2 Holdings Limited as part of a license agreement and participates in the costs as part of a Group cost sharing agreement with O2 Holdings Limited and other companies in the Telefónica, S.A. Group. Both contracts were concluded on October 15, 2007. O2 Holdings Limited holds the rights to the core brand O_2 and all brands that have a relationship to the O_2 brand and bears the responsibility and the cost for the central administration and development and the protection of the O_2 trademark rights.

Telefónica, S.A. Group has established several departments called “innovation fields”, that are working on the development of new business opportunities and technology in the following areas: cloud computing, propagation of video and digital content via home networks, machine to machine communication, applications, financial services, wireless security solutions and e-health. As part of a cost sharing agreement, Telefónica Germany GmbH & Co. OHG participates in the associated development and coordination costs, which are apportioned to the companies belonging to Telefónica, S. A. Group that benefit from these developments.

Further, Telefónica Germany GmbH & Co. OHG concluded a service agreement with Telefónica Global Roaming GmbH (TGR) that became effective on December 5, 2009. TGR administers the wholesale roaming business with third parties as well as the mutual roaming rebates for the Group companies of the Telefónica, S.A. Group. For the roaming agreements with all companies of the Telefónica, S.A. Group, Telefónica Germany GmbH & Co. OHG concluded international roaming agreements.

Telefónica Deutschland Group benefits from international sales and marketing activities that are coordinated by Telefónica Multinational Solutions (TMS), a global Telefónica, S.A. Group business unit. TMS has its own central budget and employees on the level of the Telefónica, S.A. Group. Further, all participating companies of the Telefónica, S.A. Group make an array of employees and resources available for the activities of TMS.

With effect as of May 17, 2013, a contract (Master Service Agreement) was concluded between Telefónica Germany GmbH & Co. OHG and Telefónica International Wholesale Services, S.L. (TIWS). The contract governs the conditions for the procurement of VPN site networking via TIWS as part of the global mWAN project.

On December 13, 2010, Telefónica Germany GmbH & Co. OHG concluded a development and service contract with Telefónica Global Technology S.A.U. (TGT) regarding the introduction of a SAP system. TGT grants the companies licenses for various functions of the SAP software. In addition TGT provides among other things development services as well as master data management, user support services and access services. On May 3, 2011 a further agreement with TGT regarding the provision and operation of an integrated desktop workspace and e-mail system for the business was concluded. In accordance with this agreement, TGT makes software as well as tools, network linking and IP communication services available to the business.

In addition, on August 1, 2011 Telefónica Germany GmbH & Co. OHG concluded a contract with Telefónica Global Applications S.L. (TGA) under which TGA is contracted by the business to be responsible for cooperation with the developers in connection with the development, marketing and sales of wireless communications applications. The contract was terminated with effect as of June 30, 2013.

Two further contracts were concluded with Telefónica Czech Republic, a.s. (Telefónica Czech). In accordance with these, Telefónica Czech renders monitoring services for Telefónica Germany GmbH & Co. OHG's wireline networks; Telefónica Germany GmbH & Co. OHG renders monitoring services for Telefónica Czech's wireless communications network. Both contracts date from August 29, 2011.

As part of an interconnection contract with the Telefónica Group company Telefónica Digital Inc. (formerly Jajah, Inc.), Telefónica Digital Inc. was connected to the Group's network and Telefónica Germany GmbH & Co. OHG to the network of Telefónica Digital Inc. The goal is the scheduling of voice and data traffic in the relevant networks as well as the transfer to the network of a third party where the third party's network is connected to that party's network.

On October 24, 2010, Telefónica Germany GmbH & Co. OHG concluded a service contract with the Irish Telefónica Europe People Services Limited, which provides for the rendering of services in the area of operative personnel management as well as wage and employment related services. A new contract is currently being negotiated.

In addition, on January 1, 2010 Telefónica Germany GmbH & Co. OHG concluded a framework contract with Telefónica Global Services GmbH (TGS) and on October 20, 2010 a framework contract with TGR. Telefónica Germany GmbH & Co. OHG in this respect has individual service agreements with TGR and TGS under which it renders central services and operative support for TGR and TGS.

As part of the service agreement with TGS dated October 6, 2010, Telefónica Germany GmbH & Co. OHG has outsourced its procurement process to TGS. TGS carries out the purchasing of various goods and services on behalf of the company and is responsible for everything associated with the procurement processes including tenders, evaluations and negotiations.

As part of a purchasing contract dated September 27, 2012 which entered into force on October 1, 2012 at 0:00 a.m., Telefónica Germany GmbH & Co. OHG sold all its shares in Telefónica Global Activities Holding B.V. (formerly Telefónica Chile Holding B.V.) to Telfisa Global B.V., a subsidiary of the Telefónica, S. A. The total purchase price was EUR 703m. Following this sale, Group 3G UMTS Holding GmbH (G3G), Quam GmbH and TGS, together with their subsidiaries TGR, Telefónica Compras Electronica S.L. and the indirect 40% stake in Adquira España S. A., were no longer Group companies of the Telefónica Deutschland Group.

Before the sale of all of its shares in Telefónica Global Activities Holdings B.V., Telefónica Germany GmbH & Co. OHG (i) contributed all its rights and obligations under a loan contract with G3G via TGS to TGR and (ii) contributed to Telefónica Global Activities Holdings B.V. all its shares in its direct and indirect subsidiaries (G3G, Quam and TGS, together with its subsidiaries TGR, Telefónica Compras Electronicas S.L. and the indirect 40% share in Adquira España S. A.).

As of September 30, 2012 at 12:00 p.m., all existing profit and loss transfer agreements between Telefónica Germany GmbH & Co. OHG and G3G, Quam, TGS and TGR were terminated. The creditors of G3G, Quam, TGS and TGR are entitled to demand from Telefónica Germany GmbH & Co. OHG the provision of security for receivables from these companies that arose before registration of the termination of the relevant profit and loss transfer contract in the Company Registry. Before the termination of the contract, prepayments of expected profits of EUR 854.5m were made in 2012 as part of these contracts (less a prepayment from an expected obligation to assume a loss from these profit and loss transfer agreements). In accordance with the share sale agreement with Telfisa Global B.V., which is the corporate law basis for the termination of the profit and loss transfer agreements, the total net amount of each additional profit payment to Telefónica Germany GmbH & Co. OHG, just like the total net amount of every repayment or additional assumption of loss by Telefónica Germany GmbH & Co. OHG, is neutralized from a financial viewpoint in that a corresponding purchase price adjustment for the shares in Telefónica Global Activities Holdings B.V. is made. In 2013 this resulted in a repayment claim of in total EUR 7.2m to Telefónica Germany GmbH & Co. OHG. This was settled with effect as of December 30, 2013 by Telfisa Global B.V.

With effect as of October 31, 2013, Telefónica Germany GmbH & Co. OHG sold its shares in Telefónica Germany Online Services GmbH (TOS) to Host Europe GmbH. With effect as of September 30, 2013, the existing profit and loss transfer agreement between Telefónica Germany GmbH & Co. OHG and TOS was terminated.

Telefónica Germany GmbH & Co. OHG maintains insurance policies from Telefónica Insurances S. A., an insurance company in the Telefónica, S. A. Group registered in Luxemburg, for insurance against damage to property and business interruption (including Internet risks and criminality), for general public liability insurance, insurance for pure financial loss and public liability insurance for media content. The insurance program is administered and carried out by Pleyade Peninsular Correduria de Seguros, S. A. in Madrid, which likewise belongs to the Telefónica, S. A. Group. On the recommendation of the insurance broker, the existing insurance contracts with Telefónica Insurance S. A. for general liability, financial loss and media content as well as damages resulting from a breach of patent, employment law and pension related disputes were terminated with effect as of June 30, 2013. The policies for the above-mentioned risks were then concluded with a non-Group third party insurance company (Mapfre Global Risks S. A.) with effect as of July 1, 2013. The existing contract, which covers all risks for telecommunications operators, continues unchanged with Telefónica Insurance S. A. The costs arising in 2013 were reimbursed to Telefónica Germany GmbH & Co. OHG by Telefónica Europe plc.

In the framework of cash pooling and deposit agreements, Telefónica Deutschland Holding AG and its subsidiaries are included in the cash management system of Telefónica, S. A. Group. The cash funds of the Telefónica, S. A. Group are centralized via these agreements. In this way the economics of scale of the entire Telefónica, S. A. Group can be used, and use can likewise be made of the internal administration of the receivables and liabilities between Telefónica Deutschland Group and the participating Group companies of Telefónica, S. A. Group. As part of the cash pooling agreements, the total cash surpluses in the bank accounts of the companies in the cash pool are automatically transferred daily to master accounts of Telfisa Global B.V. (in the previous year to master accounts of Telefónica Finanzas S. A. up until September 30, 2012), which is a subsidiary of Telefónica, S. A.

On September 12, 2012, Telefónica Germany GmbH & Co. OHG concluded a loan contract with Telfisa Global B.V., a company in the Telefónica, S. A. Group, as lender, under which Telfisa Global B.V. grants a credit facility (facility) in the amount of EUR 1.25bn; this facility carries interest at the level of the three-month Euribor plus a margin of 120 basis points, increased annually by 40 basis points. The interest is calculated daily from the date of drawdown of funds, whereby a year is recorded as 360 days. The facility is repayable until 2017 at the level of 20% annually. Telefónica Germany GmbH & Co. OHG is entitled to fully or partially repay the facility with repayments of at least EUR 100k on each interest date or on condition that a market-based break fee is paid. In 2013 EUR 250m was repaid.

In addition the facility is subject to an obligatory early repayment if Telefónica Germany GmbH & Co. OHG obtains financing that is repayable after September 13, 2017. In this event, 25% of the proceeds of the financing must be used for early repayment of the facility. An unscheduled repayment of EUR 150m was made in 2013. If Telefónica Germany GmbH & Co. OHG does not comply with its payment obligations under the loan contract, default interest of an additional two percentage points above the relevant interest rate will be due. The loan contract contains certain restrictive clauses, for example, for the disposal of assets, the granting of charges or for mergers and consolidations.

On September 12, 2012, Telefónica Germany GmbH & Co. OHG concluded a loan contract with Telfisa Global B.V. as lender for a short-term loan. In the framework of this loan contract, Telefónica Germany GmbH & Co. OHG obtained a loan of EUR 703m from Telfisa Global B.V., which was fully repaid as of October 1, 2012.

In preparing for the IPO, Telefónica Deutschland concluded an indemnity and cost sharing agreement with Telefónica Germany Holdings Limited. Under this contract, Telefónica Germany Holdings Limited is obliged to indemnify Telefónica Deutschland against certain liability risks and to bear the transaction costs that arise from or in connection with the stock market listing. The costs of the IPO were invoiced in the reporting year.

On July 23, 2013, Telefónica Deutschland, Telefónica, S. A. and Koninklijke KPN N.V. (KPN) entered into a notarized agreement (Share Purchase Agreement) of which the subject matter is the acquisition of E-Plus by Telefónica Deutschland. The Share Purchase Agreement was amended and supplemented on August 26, August 28 and December 5, 2013. Telefónica Deutschland agreed to pay KPN a break-up-fee of EUR 100m in the event that the relevant merger control authorities do not approve the transaction.

In addition, Telefónica Deutschland must pay KPN a break-up fee of EUR 50m if it has not registered its share capital increase in the commercial register as part of the transaction before March 1, 2015. Details of the transaction are explained in Note No. 1 Reporting Entity.

With the contract dated November 14, 2013, Telefónica Germany GmbH & Co. OHG concluded an agreement with Telefónica Insurance S. A. and ACE European Group Limited for the sales and marketing of mobile phone insurance via the O_2 channels (Distribution Agreement). Telefónica Germany GmbH & Co. OHG offers its customers this insurance and makes use of Telefónica Insurance S. A. as the insurance company. ACE European Group Limited acts here as the re-insurer. The contract replaces the contract that was in place up until November 13, 2013 between Telefónica Germany GmbH & Co. OHG and Telefónica Insurance S. A.

Receivables and liabilities as against the Telefónica, S. A. Group

The Telefónica Deutschland Group reports the following receivables and liabilities as against the companies belonging to Telefónica, S. A. Group:

	As of December 31	
(Euros in thousands)	**2013**	2012
Receivables from Telefónica, S. A. Group	**727,180**	**335,028**
that are recognized in the following items in the Consolidated Statement of Financial Position:		
Cash and cash equivalents (cash pooling)	700,548	308,154
Trade and other receivables	26,632	26,874
Liabilities to Telefónica, S. A. Group	**1,101,267**	**1,492,776**
that are recognized in the following items in the Consolidated Statement of Financial Position:		
Trade payables	219,958	210,802
Other payables	30,575	31,096
Interest-bearing debt	850,734	1,250,878

Cash and cash equivalents (cash pooling)
The receivables due from Telefónica, S. A. Group from cash pooling in 2013 relate to the cash pooling agreement with Telfisa Global B.V. (up until September 30, 2012 the cash pooling agreement existed with Telfisa Global B.V. and Telefónica Finanzas S. A.).

Trade and other receivables
These receivables result mainly from transactions with goods and services between Telefónica Deutschland Group and Telefónica, S. A. Group. As of the reporting dates of December 31, the line item contains receivables due from Telefónica, S. A. of EUR 1,831k in 2013 and of EUR 262k in 2012.

Trade payables
This item primarily relates to liabilities sold by the suppliers of Telefónica Germany GmbH & Co. OHG to Telefónica Factoring España, S. A., in which Telefónica, S. A. has an interest.

Other payables
These liabilities primarily result from transactions involving goods and services between Telefónica Deutschland Group and Telefónica, S. A. Group. As of the reporting dates on December 31, the item included liabilities of EUR 5,879k in 2013 (2012: EUR 5,836k).

Interest-bearing debt
The interest-bearing debt relates to the loan agreement with Telfisa Globe B. V.

Revenues, other income and expenses with Telefónica, S. A. Group
Telefónica Deutschland Group reports the following revenues, other income and expenses with companies belonging to Telefónica, S. A. Group:

	Revenues and other income		Expenses	
	January 1 to December 31		January 1 to December 31	
(Euros in thousands)	**2013**	2012	**2013**	2012
Telefónica, S. A. Group	44,675	193,868	(150,832)	(139,561)

Revenues were generated primarily from the sale of goods and services. The figure also includes interest income from cash pooling amounting to EUR 0.4m (2012: EUR 6.5m).

Expenses include group fees totaling EUR 70.9m in 2013 and EUR 72.3m in 2012, together with expenses relating to the purchase of goods and services, as well as other expenses in connection with transactions with Telefónica, S. A. Group.

Transactions with Joint Operations

Telefónica Deutschland Group reports the following assets and debts relating to the joint operations TCHIBO Mobilfunk GmbH & Co. KG and TCHIBO Mobilfunk Beteiligungs GmbH:

	As of December 31	
(Euros in thousands)	**2013**	2012
Receivables from TCHIBO Mobilfunk GmbH & Co. KG	2,571	4,876
Liabilities to TCHIBO Mobilfunk GmbH & Co. KG	1,270	1,004

(Euros in thousands)	As of December 31 2013	2012
Receivables from TCHIBO Mobilfunk Beteiligungs GmbH	3	2
Liabilities to TCHIBO Mobilfunk Beteiligungs GmbH	–	–

Telefónica Deutschland Group reports the following revenues, other income and expenses with the joint operations TCHIBO Mobilfunk GmbH & Co. KG and TCHIBO Mobilfunk Beteiligungs GmbH:

	Revenues and other income		Expenses	
	January 1 to December 31		January 1 to December 31	
(Euros in thousands)	2013	2012	2013	2012
TCHIBO Mobilfunk GmbH & Co. KG	7,672	8,209	20,371	23,067

	Revenues and other income		Expenses	
	January 1 to December 31		January 1 to December 31	
(Euros in thousands)	2013	2012	2013	2012
TCHIBO Mobilfunk Beteiligungs GmbH	–	6	223	–

Transactions with other related persons

a) Management in 2013:
In the 2013 financial year, the members of Key Management Personnel comprise the following members of the Management Board:
— René Schuster (CEO) (for more details, see Note No. 32 Events after the Reporting Period),
— Rachel Claire Empey (CFO),
— Markus Haas (CSO).

In the financial years to which the accompanying Consolidated Financial Statements relate, the members of the Management Board have not carried out any transactions with the Telefónica Deutschland Group other than as part of the normal trading and business activity of the Telefónica Deutschland Group.

For further details, see Note No. 25 Transactions with Management Board and Supervisory Board.

b) Management in 2012:
In 2012, the Key Management Personnel of the Telefónica Deutschland Group included by definition persons who, as part of their function, have the authority and responsibility for the planning, leadership and control of the activities of Telefónica Deutschland Group.

In financial year 2012, the operating business of the Telefónica Deutschland Group was conducted by Telefónica Germany GmbH & Co. OHG. In financial year 2012, its top management mainly comprised the Managing Directors of its partner, Telefónica Germany Management GmbH.

In the financial years to which the accompanying Consolidated Financial Statements relate, the members of Management have not carried out any transactions with the Telefónica Deutschland Group other than as part of the normal trading and business activity of the Telefónica Deutschland Group.

In 2012, management comprised the following persons:

Name	Position
Telefónica Germany GmbH & Co. OHG and Telefónica Germany Management GmbH:	
René Schuster	Chief Executive Officer (CEO)
Markus Haas	Chief Strategy Officer (CSO)
Rachel Clare Empey	Chief Financial Officer (CFO)
Joachim Kugoth	Managing Director Human Resources
Peter Alec Rampling	Managing Director Marketing
Michiel van Eldik	Managing Director Wholesale & Partner Management
Dr. Eckart Pech	Managing Director Service Technology
Andrea Fabiana Folgueiras	Managing Director Network Technology
John Gerald McGuigan	Managing Director Consumer Sales
Marc Irmisch	Vice President Small & Medium Enterprises & SoHo, Acting Lead of Business Unit
Carsten Wreth	Managing Director Service Technology
Johannes Pruchnow	Management Director Business & Wholesale Service

With effect from January 1, 2012 onwards, Telefónica Germany Verwaltungs GmbH – which was changed into Telefónica Deutschland Holding AG by entry in the commercial register dated September 26, 2012 while preserving its identity – had been a directly dependent subsidiary of O2 (Europe) Limited, Slough, United Kingdom, and an indirectly dependent subsidiary of Telefónica, S.A., Madrid, Spain. Between September 26 and December 31, 2012, Telefónica Deutschland Holding AG was a directly dependent subsidiary of Telefónica Germany Holdings Limited, Slough, United Kingdom; moreover, Telefónica Deutschland Holding AG was an indirectly dependent subsidiary of O2 (Europe) Limited, Slough, United Kingdom, and of Telefónica, S.A., Madrid, Spain.

The management boards of these companies are comprised of the following members:

Name	Position
Telefónica, S.A.:	
César Alierta Izuel	Board Member Telefónica, S.A., Chairperson
Isidro Fainé Casas	Board Member Telefónica, S.A., Vice Chairperson
Julio Linares López	Board Member Telefónica, S.A., Vice Chairperson
José María Abril Pérez	Board Member Telefónica, S.A., Vice Chairperson
José Fernando de Almansa Moreno-Barreda	Board Member Telefónica, S.A.
José María Álvarez-Pallete López	Board Member Telefónica, S.A., (COO)
Eva Castillo Sanz	Board Member Telefónica, S.A.
Carlos Colomer Casellas	Board Member Telefónica, S.A.
Peter Erskine	Board Member Telefónica, S.A.
Alfonso Ferrari Herrero	Board Member Telefónica, S.A.
Luiz Fernando Furlán	Board Member Telefónica, S.A.
Gonzalo Hinojosa Fernández de Angulo	Board Member Telefónica, S.A.
Pablo Isla Álvarez de Tejera	Board Member Telefónica, S.A.
Antonio Massanell Lavilla	Board Member Telefónica, S.A.
Ignacio Moreno Martínez	Board Member Telefónica, S.A.
Francisco Javier de Paz Mancho	Board Member Telefónica, S.A.
Chang Xiaobing	Board Member Telefónica, S.A.
Santiago Fernández Valbuena	Board Member Telefónica, S.A.

Name	Position
O2 (Europe) Limited:	
Robert John Harwood	Director
María Pilar López Álvarez	Director
Enrique Medina Malo	Director
Francisco Jesus, Perez de Uriquen Muinelo	Director
David Melcon Sanchez-Friera	Director

Name	Position
Telefónica Germany Holdings Limited:	
Robert John Harwood	Director
María Pilar López Álvarez	Director
Enrique Medina Malo	Director
Francisco Jesus, Perez de Uriquen Muinelo	Director

c) Salaries and other benefits paid to the Management Board in 2013 and 2012:
Salaries and other benefits that were granted to the Management Board members or members of Management (until September 26, 2012) are made up as follows:

	January 1 to December 31	
(Euros in thousands)	2013	2012
Total remuneration	**3,718**	**6,876**
thereof:		
Short-term Employee benefits	3,308	6,647
Other long-term employee benefits	295	226
Share-based payments	115	3
Defined benefit obligation	**22**	**560**

The defined benefit obligation totaled EUR 167k in 2013 and EUR 19,737k in 2012.

For more details of the pension obligations of Telefónica Deutschland Group, please refer to Note No. 13 Provisions.

d) Share options held by members of Management in 2013 and 2012:
The following changes have occurred in the share options for the Management Board members and members of Management (up to September 26, 2012):

(In units)	2013	2012
Share options as of January 1	**271,176**	260,117
Forfeited of share options	**(54,095)**	(93,350)
Addition of share options	**53,364**	104,409
Change in Key Management	**(111,153)**	–
Share options as of December 31	**159,292**	271,176

25. Transactions with Management Board and Supervisory Board

1. Management Board
According to ashareholders' resolution adopted on October 5, 2012, Telefónica Deutschland does not disclose the additional disclosures for listed stock corporations (Aktiengesellschaften) in accordance with section 314 (1) no. 6 a) section 5 to 8 German Commercial Code (Handelsgesetzbuch – HGB).

The current employment contracts of the members of the Management Board of Telefónica Deutschland Holding AG were concluded on September 18, 2012 (last amended by the third amendment agreement dated July 30, 2013) and will fundamentally expire on September 17, 2015. Up until September 26, 2012, the members of the Management Board, together with the other members of Management before the IPO, were also directors of Telefónica Germany Verwaltungs GmbH, which was transformed into Telefónica Deutschland Holding AG with resolution of September 18, 2012 and the entry in the commercial register on September 26, 2012. The Management Board members, together with the other members of Management before the IPO, were and are also directors of Telefónica Germany Management GmbH and received (up until September 17, 2012) direct remuneration from Telefónica Germany Management GmbH, which is the managing shareholder of Telefónica Germany GmbH & Co. OHG and became a legal subsidiary of Telefónica Deutschland Holding AG in September 2012.

In accordance with section 314 (1) no. 6a German Commercial Code (Handelsgesetzbuch – HGB) the total remuneration granted to the Management Board of Telefónica Deutschland Holding AG for the financial year ended December 31, 2013 amounted to EUR 3,718k. The fair value of the share-based payments was EUR 515k for 53,364 share options.

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

The total remuneration of the Management and Management Board in 2012 was EUR 6,876k. The fair value of the share options was EUR 1,021k for a quantity of 105,806. This total remuneration for the reporting period ended December 31, 2012 includes the remuneration of nine other, former directors of Telefónica Germany Verwaltungs GmbH, who had already resigned as directors before the conversion of Telefónica Germany Verwaltungs GmbH into Telefónica Deutschland Holding AG.

In the 2013 and 2012 financial years, the total remuneration expenses for former directors and their surviving dependents was EUR 199k in 2013 and EUR 0 in 2012.

As of December 31, 2013 and 2012 the pension obligations for former directors and their surviving dependents were EUR 22,972k and EUR 20,391k, respectively.

For more details of the pension obligations of Telefónica Deutschland Group, please refert to Note No. 13 Provisions.

2. Supervisory Board
Members of the Supervisory Board

Name	Member of the Supervisory Board of the listed AG
Eva Castillo Sanz	since October 5, 2012
María Pilar López Álvarez	since September 18, 2012
Angel Vilá Boix	since September 18, 2012
Patricia Cobian González	since September 18, 2012
Michael Hoffmann	since October 5, 2012

Enrique Medina Malo	since September 18, 2012
Imke Blumenthal	since June 3, 2013
Thomas Pfeil	since June 3, 2013
Jan-Erik Walter	since June 3, 2013
Marcus Thurand	since June 3, 2013
Christoph Heil	since June 3, 2013
Claudia Weber	since June 3, 2013

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

Members of the Supervisory Board who are also employees of Telefónica Deutschland Group also receive remuneration from their employment relationship, including entitlements from share-based payment agreements, subject to compliance with the requirements for participation in each individual case, and from service cost relating to pension schemes. This remuneration comprises the following with effect from appointment to the Supervisory Board:

(Euros in thousands)	January 1 to December 31, 2013
Total remuneration	**424**
thereof:	
Short-term employee benefits	422
Share-based remuneration	2
Service cost	**5**

Currently, Telefónica Deutschland Group has not granted its Supervisory Board members any securities or loans and has not assumed any guarantees for them.

26. Share-based Payments

As of December 31, 2013 Telefónica Deutschland Group had made the following agreement regarding share-based payments:

Description of the share-based remuneration plans

Performance Share Plan (equity-settled)
The Performance Share Plan is a long-term incentive plan for the managers and executives of Telefónica, S.A. and of other companies in the Telefónica, S.A. Group, including Telefónica Deutschland Group.

Under this plan, selected participants who meet the qualifiying requirements receive a certain number of Telefónica, S.A. shares as variable compensation. The shares are delivered by Telefónica, S.A. This is the ultimate parent company which undertakes the settlement.

The plan is divided into five phases, each three years long, whereby the first phase began on July 1, 2006 and ended on June 30, 2009 and the fifth phase began on July 1, 2010 and ended on June 30, 2013. At the beginning of each phase the number of shares of to be awarded to each each plan beneficiary is determined by dividing the amount that corresponds to a certain proportion of the fixed annual salary by the average share price of Telefónica, S. A. shares in the 30 days before the start of the phase. The shares are delivered on the last day of a phase if certain exercise conditions are fulfilled:

— The beneficiary is still employed by a company in the Telefónica, S. A. Group at the end of the three-year phase period.
— The actual number of the shares awarded at the end of the phase is calculated by multiplying the maximum number of shares assigned to each beneficiary at the beginning of the phase by a percentage that reflects the performance of the Telefónica, S. A. share. The performance is measured by comparing the total shareholder return (TSR – comprising both share price and dividends) of Telefónica, S. A. with the TSR of the comparison group. The comparison group comprises several listed telecom companies. The allocation is 100%, if the TSR of Telefónica, S. A. is equal to or better than the TSR of the third quartile of the comparatison group, and 30% if the TSR of Telefónica, S. A. corresponds to the median. The percentage increases linearly for all points between these two benchmarks. If the TSR of Telefónica, S. A. is below the median, no shares are awarded.

The fourth phase of the plan ended on June 30, 2012. The TSR of Telefónica, S. A. was below the median for the comparison group and included the following number of options that have forfeited:

Phase	No. of shares forfeited	Grant date fair value per unit	End date
4th phase July 1, 2009	287,828	8.41	June 30, 2012

The fifth phase of the plan ended on June 30, 2013. The TSR of Telefónica, S. A. was below the median for the comparison group and included the following number of options that have forfeited:

Phase	No. of shares forfeited	Grant date fair value per unit	End date
5th phase July 1, 2010	119,557	9.08	June 30, 2013

The fair value of the equity instruments that were granted to plan beneficiaries is measured using the share price of the Telefónica, S. A. shares at grant date under consideration of market conditions.

The plan has been valued using the Monte Carlo method, thereby incorporating the performance target as a market condition. This method involves generating share prices and TSRs for each company, based on its dividend yield and volatility, taking into account the cross correlations between stocks. The model is used to define the probability for the shares to vest and establish share price growth associated with different ranking positions.

The non market-related vesting condition which requires that the beneficiary must be employed by a company in the Telefónica, S. A. Group until the end of the vesting period is taken into account in determining the number of the equity instruments under consideration at grant date. The amount to be recognized is thus based on the number of ultimately exercisable equity instruments.

No compensation is paid for expected dividends from shares that the employee does not receive before physical delivery of the shares. This fact was taken into account in determining the fair value at grant date.

Because this is a plan with settlement by equity instruments and because Telefónica, S. A. undertakes the settlement, the personnel expenses are recognized on a pro rata temporis basis over the vesting period with a corresponding entry in the equity of Telefónica Deutschland Group.

There is a recharge agreement in place between Telefónica, S. A. and the Telefónica Deutschland Group in relation to the shares that are delivered to employees in Germany. This recharge is done by reducing equity and a corresponding increase of the liabilities to Telefónica, S. A.

(In units)	2013	2012
Share options as of January 1	**141,316**	**358,642**
Change in Employee	(21,759)	70,502
Forfeited of share options	(119,557)	(287,828)
Share options as of December 31	**–**	**141,316**

Performance and Investment Plan (equity-settled)
This plan became effective following completion of the Performance Share Plan and includes the directors and executive officers of the Telefónica, S. A. Group.

The plan is divided into three phases, each three-years long, whereby the first phase began on July 1, 2011 and will end on June 30, 2014 and the third phase began on July 1, 2013 and will end on June 30, 2016. At the beginning of each phase the number of shares for each plan beneficiary is determined by dividing the amount that corresponds to a certain proportion of the fixed annual salary by the average share price of Telefónica, S. A. shares during the 30 days before the start of the phase. The shares are delivered on the last day of each phase.

The shares are delivered by Telefónica, S. A. This is the ultimate parent company which undertakes the settlement.

The method of calculation for determining the Telefónica, S. A. shares that must actually be delivered is similar to the method used for the Performance Share Plan. The vesting condition for this plan that every plan beneficiary must be employed with the Telefónica, S. A. Group at the delivery date of each phase also applies.

In addition, all plan beneficiaries have the opportunity to co-invest. In accordance with the co-investment condition, the plan beneficiary must personally own 25% of the number of Telefónica, S. A. shares allocated to him or her under the Performance and Investment Plan. These shares must be so owned at the first anniversary (or for the first cycle only within fifteen months) of the beginning of each cycle and the participant must hold them up until the vesting date in order to be entitled to receive a further 25% of the number of the originally held Telefónica, S. A. shares. Thus the plan beneficiary receives, conditional on the performance of the company, one free Telefónica, S. A. share for every co-invested Telefónica, S. A. share.

The first allocation of share options of Telefónica, S. A. shares as part of this plan occurred on July 1, 2011. The maximum number of shares of Telefónica, S. A. assigned (including the amount of co-investment) under the plan was, as of December 31, 2013:

Phase	Maximum number of share options still to granted	Fair value per unit when granted	End date
1st phase July 1, 2011	106,128	8.28	June 30, 2014

Phase	No. of shares co-investment	End date
1st phase July 1, 2011	17,599	June 30, 2014

Phase	Total	End date
1st phase July 1, 2011	123,727	June 30, 2014

The second allocation of share options under this plan occurred on July 1, 2012. The maximum number of shares of Telefónica, S. A. assigned under this plan (including the amount of co-investment) as of December 31, 2013 is as follows:

Phase	Maximum number of share options still to granted	Fair value per unit when granted	End date
2nd phase July 1, 2012	215,596	8.28	June 30, 2015

Phase	No. of shares co-investment	End date
2nd phase July 1, 2012	28,079	June 30, 2015

Phase	Total	End date
2nd phase July 1, 2012	243,675	June 30, 2015

The last allocation of share options of Telefónica, S. A. shares as part of this plan occurred on July 1, 2013. The maximum number of shares of Telefónica, S. A. assigned under this plan (including the amount of co-investment) is as of December 31, 2013 as follows:

Phase	Maximum number of share options still to granted	Fair value per unit when granted	End date
3rd phase July 1, 2013	206,350	6.40	June 30, 2016

Phase	No. of shares co-investment	End date
3rd phase July 1, 2013	51,588	June 30, 2016

Phase	Total	End date
3rd phase July 1, 2013	257,938	June 30, 2016

The fair value of the equity instruments that were granted to employees is determined using the share price of the shares of Telefónica, S. A. at grant date of the grant under consideration of market conditions.

The market condition that requires the Telefónica, S.A. shares to reach a prescribed performance goal was incorporated by means of the Monte Carlo method described above in determining the fair value.

The service condition which requires that the plan beneficiary must be employed by a Telefónica, S.A. company until the end of the vesting period is considered in determining the number of equity instruments to be taken into account at the grant date. The amount to be recognized is thus based on the number of ultimately exercisable equity instruments.

The co-investment condition, being a non-vesting condition, is taken into account in determining the number of equity instruments to be considered. In addition in determining the fair value, a further non-vesting condition is taken into account, which provides that the shares must be held until the vesting date.

No compensation is paid for expected dividends from the shares that the employees do not receive before physical delivery of the shares. This fact was taken into account in determining the fair value.

Because this is a plan with settlement through equity instruments and because Telefónica, S.A. undertakes the settlement, the personnel expenses are recognized with a corresponding entry in the equity of the Telefónica Deutschland Group.

There is a recharge agreement between Telefónica, S.A. and Telefónica Deutschland Group in relation to the shares that are delivered to employees of the Telefónica Deutschland Group. This recharge is done by reducing equity and a corresponding increase of the liabilities to Telefónica, S.A.

(In units)	2013	2012
Share options as of January 1	**400,068**	**92,767**
Addition of share options	206,350	262,007
Change in Employee	(78,344)	45,294
Share options as of December 31	**528,074**	**400,068**

Performance Cash Plan (cash-settled)
The plan is operating under the same vesting conditions as the Performance Share Plan. The plan involves the delivery of a certain number of theoretical shares in Telefónica, S.A. to key personnel that are, if applicable, settled in cash at the end of each phase. The payment is equivalent to the market value of Telefónica, S.A. shares on the settlement date up to a maximum of three times the notional value of the shares on the delivery date.

The payment is made by the respective legal entity of Telefónica Deutschland Group, which undertakes the settlement.

The value of the theoretical shares is established as the average share price in the period of 30 days immediately before the start of a phase; except for the first phase, where the average share price during the 30 days before May 11, 2006 (EUR 12.83) was used as the reference.

The duration of the plan is seven years, with six phases, each of three years, beginning in 2006, whereby the first phase began on July 1, 2006 and ended on June 30, 2009. The sixth phase began on July 1, 2011 and will end on June 30, 2014.

Like the Performance Share Plan, the basis for the performance-based rate for the payments is the TSR of Telefónica, S.A. shares compared to the TSR of the comparison group, in line with the same criteria.

As of December 31, 2013 the fair value of the shares that were delivered in each phase in force at that time was EUR 11.84 per share (December 31, 2012: EUR 10.19 per share). The value is calculated by using the price of a Telefónica, S. A. share as the basis and in addition taking into account the estimated TSR. This value is updated in each case at the end of the year.

The market condition which implies that the Telefónica, S. A. shares must reach a prescribed performance target was taken into account by means of the Monte Carlo method described above in determining the fair value.

The service condition that requires that the plan beneficiary must be employed by a Telefónica, S. A. company until the end of the vesting period is considered in determining the number of equity instruments to be taken into account at grant date.

Because this plan is a cash-settled plan, it was accounted for by recording personnel expenses and a corresponding liability.

(In units)	2013	2012
Share options as of January 1	**200,431**	**313,414**
Change in Employee	(13,640)	(12,843)
Forfeited of share options	(95,051)	(100,140)
Share options as of December 31	**91,740**	**200,431**

Global Employee Share Plan (equity-settled)
This plan is a share incentive plan for all employees of the Telefónica, S. A. Group, with certain exceptions. Under this plan, participants who meet the qualifying requirements are offered the opportunity to acquire shares of Telefónica, S. A. and to receive the same number of shares free of charge at the end of the period.

The shares are delivered by Telefónica, S. A. This is the ultimate parent company, which carries out settlement.

The duration of the plan is two years. Employees who participate in the plan can acquire Telefónica, S. A. shares through monthly installment payments of up to EUR 100 and up to a maximum of EUR 1,200 for a twelve-month period (acquisition period). The shares are purchased at fair value on the acquisition date. The employees who participate in the plan have are entitled to dividend payments with respect the acquired shares. The first delivery of shares occurred on September 1, 2012, whereby the following vesting conditions had to be fulfilled:

— The beneficiary must be continuously employed during the two-year duration of the plan with a Telefónica, S. A. company (consolidation period), with the exception of employees leaving for a good cause.
— The beneficiary must retain the acquired shares for an additional twelve months after the end of the acquisition period.

The vesting period for this plan ended on August 31, 2012. 141,135 shares were delivered to 2,198 plan participants:

As of December 31	No. of shares delivered	Weighted average of grant date fair value per unit
2012	141,135	10.01

In December 2012 a further phase began. The acquisition period for this plan will end on November 30, 2014. The number of pre-emptive rights to be issued as of December 31, 2013 is as follows:

As of December 31	Maximum no. of pre-emptive rights to be issued	Weighted average of grant date fair value per unit
2013	150,417	11.01

The fair value of the equity instruments granted to employees is determined by means of the share price of the Telefónica, S.A. shares at grant date.

The non market-related vesting condition that provides that the beneficiary must be employed by a company in the Telefónica, S.A. Group until the end of the vesting period is considered in determining the number of equity instruments to be taken into account at grant date. The amount to be recognized is thus based on the number of ultimately exercisable equity instruments.

In determining the fair value, the holding condition was taken into account, which is a non-vesting condition.

No compensation is paid for expected dividends from shares that the employee does not receive before physical delivery of the shares. This fact was taken into account in determining the fair value.

The Global Employee Share Plan is an equity-settled plan and is accounted for by a debit to personnel expenses and a credit to equity.

There is a recharge agreement between Telefónica, S.A., and Telefónica Deutschland Group in relation to the shares that are delivered to employees of the Telefónica Group. This recharge is done by reducing equity and a corresponding increase of the liability to Telefónica, S.A.

(In units)	2013	2012
Share options as of January 1	**14,438**	**47,045**
Addition of share options	135,979	108,528
Exercise of share options	–	(141,135)
Share options as of December 31	**150,417**	**14,438**

Personnel expenses resulting from share-based payment transactions
In the financial year ending December 31, the following personnel expenses resulting from share-based payment transactions were recorded:

	January 1 to December 31	
(Euros in thousands)	2013	2012
Personnel expenses arising from share-based payment transactions	2,105	2,576
thereof from cash-settled plans	*178*	*(615)*
thereof from equity-settled plans	*1,927*	*3,191*

27. Information Regarding Employees

In the following table presents the breakdown of Telefónica Deutschland Group's average headcount in 2013 and 2012 grouped with respect to their status under labor law:

Average headcount	**2013**	2012
Office staff	5,461	5,599
thereof from Joint Ventures	9	8
Temporary staff	521	613
Total	**5,982**	**6,212**

28. Financial Instruments and Risk Management

General

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

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

If such financial risks occur, could they may lead to negative impacts on the net assets, financial position, earnings and the cash flows of Telefónica Deutschland Group.

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

Market risk

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

Currency risk

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

Derivatives are contracted with Telefónica, S. A. Group Treasury to hedge against key identified currency risks.

The effects before taxes on the Consolidated Income Statement and thus equity of a simultaneous, parallel increase in the Euro of 10% as against all foreign currencies in the financial years 2013 and 2012 would be as follows:

	January 1 to December 31			
	2013		2012	
(Euros in millions)	Risk	+10%	Risk	+10%
USD	–	–	(36.8)	3.3
GBP	–	–	(21.5)	2.0

Because the Telefónica Deutschland Group does not use cash flow hedge accounting the effect of the sensitivities would only affect the Consolidated Income Statement.

Interest rate risk

Interest risks arise predominantly in connection with the cash pooling accounts and deposits of Telefónica Deutschland Group, as well as through loan agreements where the company acts as borrower, and with interest swaps. Telefónica Deutschland Group deposits cash surpluses almost exclusively in cash pooling deposit accounts with Telfisa Global B.V. These accounts and the bank accounts pay a variable interest rate. The loan agreements where Telefónica Deutschland Group is the borrower carry a variable interest rate. In November 2013 an interest rate swap was signed in connection with the issue of the bond for partial amount of the bond's nominal value. On the basis of this interest swap contract, Telefónica Deutschland Group pays a variable interest rate on a nominal amount and receives a fixed interest rate on the same amount in return. This interest rate swap compensates, to the level of its nominal amount, the effects of future market interest rate changes on the fair value of the underlying fixed-interest financial liabilities from the bond issue (fair value hedge).

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

The net risk position for variable interest for Telefónica Deutschland Group as of the reporting dates December 31, 2013 was minus EUR 341,455k and in 2012 minus EUR 926,334k, respectively, which is essentially attributable to the loan, the interest swap and the cash and cash equivalents deposited with Telfisa Global B. V.

In the reporting periods, Telefónica Deutschland Group has concluded only one interest rate swap as a hedging instrument in the financial year 2013 (see Interest Risk Management below).

The effects before taxes on the Consolidated Income Statement of a change in the interest rates of variable interest-bearing financial instruments of +/– 100 basis points as of the reporting dates December 31, 2013 and 2012 are shown below. There is no impact recognized directly in equity. This analysis assumes that all other variables remain unchanged.

	January 1 to December 31	
(Euros in thousands)	**2013**	2012
+ 100bp	(3,415)	(9,263)
– 100bp	8,047	12,133

Credit risk

Credit risk describes the risk of financial losses from the inability of contractual partners to repay or service debts in accordance with the contract. Telefónica Deutschland Group's maximum credit risk corresponds with the carrying amount of the financial assets (without considering any guarantees or securities).

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

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

The financial assets where the Telefónica, S. A. Group is a counterparty amounted to EUR 727m as of December 31, 2013 and EUR 335m as of December 31, 2012, respectively.

Liquidity risk

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

In August and September 2012 Telefónica Germany GmbH & Co. OHG concluded agreements with various banks for revolving credit facilities. As a result Telefónica Germany GmbH & Co. OHG has, as of the reporting date December 31, 2013, undrawn committed credit lines in a total amount of EUR 710m with a maturity beyond one year. In all agreements the interest yield corresponds to the sum of margin and Euribor.

Telefónica Deutschland Holding AG has authorized capital which allowing the Management Board, upon approval of the Supervisory Board, to increase the share capital up until September 2017 for against cash and / or contribution in kind once or several times by a total of up to EUR 558,472,700 by issuing new registered shares with no-par value (see Note No. 11 Equity and Note No. 32 Events after the Reporting Period).

Cash and cash equivalents amounted to EUR 709m as of December 31, 2013 and EUR 324m as of December 31, 2012.

The following table shows the maturity profile of the financial liabilities of Telefónica Deutschland Group on the basis of the contractual undiscounted payments:

	As of December 31, 2013				
			remaining term		
(Euros in thousands)	**Total carrying amount**	**Gross cash outflow**	**< 1 years**	**1–5 years**	**> 5 years**
Non-current loans	1,342,584	1,445,404	–	1,445,404	–
Non-current other payables	4,809	4,836	–	4,836	–
Current loans	102,059	118,536	118,536	–	–
Current trade payables	1,074,038	1,074,038	1,074,038	–	–
Current other payables	197,635	197,718	197,718	–	–
Total financial liabilities	**2,721,125**	**2,840,531**	**1,390,292**	**1,450,240**	**–**

	As of December 31, 2012				
			remaining term		
(Euros in thousands)	Total carrying amount	Gross cash outflow	< 1 years	1–5 years	> 5 years
Non-current loans	1,000,000	1,063,217	–	1,063,217	–
Non-current other payables	9,193	9,335	–	9,335	–
Current loans	250,878	270,940	270,940	–	–
Current trade payables	918,458	918,458	918,458	–	–
Current other payables	50,183	50,183	50,183	–	–
Total financial liabilities	**2,228,712**	**2,312,133**	**1,239,581**	**1,072,552**	**–**

Capital management

Telefónica Deutschland Group strives to guarantee the sustainability of its business and to maximize the business value. Here it monitors its capital costs with the goal of an optimal capital structure. In particular, Telefónica Deutschland Group monitors its equity ratio and OIBDA. As of December 31, 2013, the equity ratio was 66.5% and 70.9% in 2012. The OIBDA from continuing operations was EUR 1,237m in 2013 and EUR 1,279m in 2012, respectively.

Interest rate risk management

The interest rate risk results from the sensitivity of financial assets and liabilities in relation to changes in the market interest rates. The corporation strives to limit such risks by using interest swaps.

Fair Value Hedge for fixed interest financial liabilities

In November 2013 an interest swap of EUR 200m was signed in connection with the bond issue. On the basis of the existing interest swap contract, Telefónica Deutschland Group pays a variable interest rate on a nominal amount and in return receives a fixed interest rate on the same amount as consideration. This interest swap compensates for the effects of future market interest rate changes on the fair value of the underlying fixed-interest financial liabilities. Telefónica Deutschland Group records the interest swap in the Consolidated Statement of Financial Position at fair value. The company recognizes the corresponding portion of the fixed-interest financial liabilities that are thereby hedged as the sum of their carrying amount and a value adjustment. The value adjustment corresponds to the change in the fair value of the financial liabilities on the basis of the relevant hedged interest risk. Changes in the fair value of the interest swap as well as the changes in the adjustment to the carrying amount of the hedged portion of the fixed-interest financial liabilities are recognized in the financial income/(loss) in the Consolidated Income Statement.

29. Contingent Assets and Liabilities

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

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

30. Lease and Sublease Agreements

Finance leases

Telefónica Deutschland Group's finance leases are recognized in the Consolidated Financial Statements as of December 31, 2013 in the position property, plant and equipment (see Note No. 6 Property, Plant and Equipment) and comprise the following amounts:

	As of December 31	
(Euros in thousands)	**2013**	2012
Plant and machinery	3,026	8,948
Net carrying amount of lease assets	**3,026**	**8,948**

These commitments mainly result from lease agreements for IT equipment and network technology for internal use. There are no options to renewal and purchase options are not already reflected in the minimum lease payment obligations.

The breakdown of minimum lease payment obligations is as follows:

	As of December 31, 2013		
(Euros in thousands)	**Minimum future lease payments obligation**	**Unamortized interest expense**	**Present value of minimum future lease payments obligation**
due within one year	1,732	83	1,649
due between 1 and 5 years	1,367	27	1,340
due in more than 5 years	–	–	–
Present value of minimum lease payments	**3,099**	**110**	**2,989**

	As of December 31, 2012		
(Euros in thousands)	Minimum future lease payments obligation	Unamortized interest expense	Present value of minimum future lease payments obligation
due within one year	4,162	198	3,964
due between 1 and 5 years	5,127	142	4,985
due in more than 5 years	–	–	–
Present value of minimum lease payments	**9,289**	**340**	**8,949**

Operating leases

The following expected maturity dates apply for the obligations from operating leases, purchase and contractual obligations:

	As of December 31	
(Euros in thousands)	**2013**	2012
Less than 1 year	315,954	300,347
1 to 5 years	804,409	821,735
Over 5 years	790,020	829,204
Total operating lease obligations	**1,910,383**	**1,951,286**

	As of December 31	
(Euros in thousands)	**2013**	2012
Less than 1 year	185,390	125,932
1 to 5 years	46,164	49
Over 5 years	81,000	–
Total purchase and other contractual obligations	**312,554**	**125,981**

The following amounts are recognized in the Consolidated Income Statement:

	January 1 to December 31	
(Euros in thousands)	**2013**	2012
Operate lease expenses	341,303	312,295

The expenses for operating leases include essentially rental expenses (i.e. office building and shops), antenna sites, cars and network equipment (i.e. leased lines and cell sites).

Telefónica Deutschland Group provides guarantees to secure rental obligations primarily for antenna sites. These guarantees were granted by external financial counterparts and are offered in the course of normal commercial activity.

The guarantees as of December 31, 2013 amount to EUR 37.2m and EUR 37.6m in 2012, respectively.

Subleases of operating leases

Telefónica Deutschland Group entered into various sublease agreements for office buildings, cell sites and shops. The estimated payment schedule for subleases is as follows:

	As of December 31	
(Euros in thousands)	**2013**	2012
Less than 1 year	25,817	21,248
1 to 5 years	77,434	78,962
Over 5 years	39,085	56,141
Total sublease income	**142,336**	**156,351**

The following amounts are recognized in the Consolidated Income Statement:

	January 1 to December 31	
(Euros in thousands)	**2013**	2012
Sublease income	24,347	24,314

31. Total Auditor's Fees

In the financial years 2012 and 2013, the services listed below performed by the Group's auditor, Ernst & Young, were recognized in the Consolidated Income Statement.

Because Telefónica Deutschland Group conducts all of its business in Germany, the entire amount was incurred in Germany.

	January 1 to December 31	
(Euros in thousands)	**2013**	2012
Type of fees:		
Audit fees	1,572	1,333
Other audit-related services	150	2,301
Total fees	**1,722**	**3,634**

The audit fees include primarily the fees for auditing the Consolidated Financial Statements of Telefónica Deutschland Holding AG and the companies included in the Consolidated Financial Statements. The other audit related-services essentially include fees for comfort letter and in the previous year the fees in connection with the IPO.

32. Events after the Reporting Period

Issue of a 7-year bond (Bond II)

On February 10, 2014, Telefónica Deutschland Group issued a senior unsecured 7-year bond with a nominal value of EUR 500m. The bond has a maturity on February 10, 2021 and was issued by O_2 Telefónica Deutschland Finanzierungs GmbH, Munich, and is guaranteed by Telefónica Deutschland Holding AG. The coupon for the fixed interest bond is 2.375% and the issue price 99.624%. The issue spread was 100 basis points over the seven-year Euro Midswap Rate, resulting in a yield of 2.434%. The bond has a denomination of EUR 1,000 and was issued on the basis of a bond security prospectus. O_2 Telefónica Deutschland Finanzierungs GmbH, Munich, has transferred the net issue proceeds of the bond available to Telefónica Germany GmbH & Co. OHG, Munich, in the form of a loan. The net proceeds generated by the bond will be used for general corporate purposes.

Change in the Management Board of Telefónica Deutschland

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

Extraordinary General Meeting

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

— increase in the share capital by up to EUR 3.7bn against cash with a subscription right of the shareholders, as well as a related amendment of the Articles of Association;
— authorization of the Management Board, with the approval of the Supervisory Board, to execute a capital increase against contribution in kind up to EUR 475m and the related amendment of the Articles of Association (authorized capital 2014/I).
  The resolution passed by the General Meeting on the authorization to increase share capital by up to EUR 3.7bn was registered in the commercial register on February 25, 2014.

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

33. Declaration of Compliance with the German Corporate Governance Code

On February 11, 2014, the Management Board and Supervisory Board of Telefónica Deutschland Holding AG issued a latest declaration of compliance in accordance with section 161 of the German Stock Corporation Act (Aktiengesetz – AktG) that is available on the company's website for the shareholders.
— WWW.TELEFONICA.DE/DECLARATION-OF-COMPLIANCE

Munich, March 7, 2014

Telefónica Deutschland Holding AG

The Management Board

Rachel Empey

Markus Haas

Telefónica Deutschland Holding AG
Declaration of the Statutory Representatives

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

Munich, March 7, 2014

Telefónica Deutschland Holding AG

The Management Board

Rachel Empey   Markus Haas

Audit opinion

We have audited the consolidated financial statements prepared by Telefónica Deutschland Holding AG, Munich, comprising the consolidated statement of financial position, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of cash flows, the consolidated statement of changes in equity and the notes to the consolidated financial statements, together with the group management report for the fiscal year from 1 January 2013 to 31 December 2013. The preparation of the consolidated financial statements and the group management report in accordance with IFRSs as adopted by the EU, and the additional requirements of German commercial law pursuant to Sec. 315a (1) HGB ["Handelsgesetzbuch": "German Commercial Code"] are the responsibility of the parent company's management. Our responsibility is to express an opinion on the consolidated financial statements and on the group management report based on our audit.

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

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRSs as adopted by the EU, the additional requirements of German commercial law pursuant to Sec. 315a (1) HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Munich, 18. March 2014

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft

Dahmen	Vogel
Wirtschaftsprüfer	Wirtschaftsprüferin
[German Public Auditor]	[German Public Auditor]

Further Information_

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pp. 169–174

Further Information_

Glossary_

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

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

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

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

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

Investor Relations
Telefónica Deutschland Holding AG
Investor Relations
Georg-Brauchle-Ring 23–25
80992 München
Phone: +49 89 2442 1010
E-mail private investors: shareholder-deutschland@telefonica.com
E-mail institutional investors: ir-deutschland@telefonica.com
www.telefonica.de/investor-relations

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