Telefónica

Deutschland

Separate Combined Non-Financial Report

Telefónica Deutschland Holding AG for the reporting year 2017

Contents

About this report

Telefónica Deutschland Holding AG prepared a separate combined non-financial report for the financial year 2017 in accordance with the "Act to strengthen non-financial reporting by companies in their management reports and group management reports" (CSR Directive Implementation Act, CSR-RUG), which contains the information of the Telefónica Deutschland Group as well as that of Telefónica Deutschland Holding AG. This report was published at the following online address on 5 March 2018: www.telefonica.de/nfe

The non-financial report was audited by the external audit firm Pricewaterhouse-Coopers GmbH with "limited assurance".

In preparing the non-financial report, we based our descriptions of the concepts and presentation of the various key performance indicators (KPIs) in particular on the GRI standards. References to disclosures made outside of the Combined Management Report relate to supplementary information and do not constitute part of the separate combined non-financial report.

For comprehensive sustainability reporting in accordance with the GRI standards ("Comprehensive" option), please see our Sustainability Report, which will be available at www.telefonica.de/verantwortung from June 2018.

Business activities of the Telefónica Deutschland Group

With over 47.6 m customer connections as of 31 December 2017 the Telefónica Deutschland Group is one of the three leading integrated network operators in Germany. In the mobile market, we are also leading with a total of 43.2 m mobile connections as of 31 December 2017 and are thereby serving the growing demand for mobile services resulting from the digitalisation of more and more areas of life. We belong to Telefónica, S.A. Group, one of the world's largest telecommunications companies.

The Telefónica Deutschland Group's business model is described in detail in the *"Basic Information on the Group" section of the Combined Management Report 2017.*

Identification of the material non-financial topics and risks

The corporate responsibility strategy of the Telefónica Deutschland Group

The Telefónica Deutschland Group's corporate responsibility strategy enshrines corporate responsibility (CR) in all the company levels, taking into account the impacts and risks all along the value chain. Responsible corporate governance is based on the three CR focal areas which are directly related to the impact the business activities have: "responsible business", "strengthening life in the digital world" and "environmental and climate protection".

It is the job of the Corporate Responsibility department to develop and implement the CR strategy in line with the corporate strategy and the global CR strategy of the Telefónica, S.A. Group. Under the leadership of the Chief Officer for Legal and Corporate Affairs of Telefónica Deutschland Holding AG, the department oversees all the CR activities, monitors target attainment in this area and initiates new projects. The CR department communicates closely with the other departments to this end, in particular using the cross-divisional CR Committee. The CR goals are considered and approved by the full Management Board.

The Telefónica Deutschland Group serves its stakeholders as a fair and trustworthy partner. Transparent communication and dialogue with customers, employees, suppliers and all other stakeholders are very important to the company. This applies in particular to the regular further development of the CR strategy. These guiding principles are also set out in the company's business principles and ethical standards, which shape the company's day-to-day actions. They are based on the three fundamental values of integrity, reliability and transparency.

Process of preparing the non-financial report

To prepare the non-financial report, we set up a separate internal process in 2017 to analyse and evaluate sustainability issues in terms of the legal requirements. Of all the material CR topics, those were chosen that are relevant in terms of the company's impact on the respective CR aspects and on the course of business, the business result and the situation of the Telefónica Deutschland Group.

The process also involved identifying and analysing what the Group perceived to be material risks for the financial year in terms of their relevance to the matters of importance for the non-financial report. Pursuant to CSR-RUG, from the financial year 2017 risk scenarios also have to be taken into account that represent the impacts of the business activities on non-financial aspects.

Materiality analysis and Responsible Business Plan 2020

The starting point for the process was the materiality analysis conducted in 2015; this saw a structured method used to identify 25 material issues for the Telefónica Deutschland Group and then assign them to a materiality matrix . The analysis reflected the results of a stakeholder survey, a statistical analysis of the impacts of the Telefónica Deutschland Group all along the value chain, workshops with the senior management and company-, market- and sector-specific studies.

In 2016 we formulated overarching goals up to 2020 in relation to these material issues in our Responsible Business Plan 2020. Clear commitments were formulated for each issue, structured management processes were put in place, concrete goals were formulated as measures and KPIs were developed. The CR Report 2016 covered the Responsible Business Plan 2020 in detail.

Reviewing and updating the material issues with regard to CSR-RUG

Impact analysis

In 2017 we took another critical look at the issues and results identified in the materiality analysis, on the one hand to ensure that the topics identified were still up to date and complete, and on the other hand to record any changes in terms of their impacts and relevance. Among other things, this was achieved by means of CR department workshops run with all the other relevant departments and by means of a comparison with sector activities and studies.

In the next step, these issues were rated primarily with regard to the following aspects:
– Significance of the impacts of the Telefónica Deutschland Group
– Ability of the Telefónica Deutschland Group to influence the impacts
– Consequences of the impacts for the Telefónica Deutschland Group
In the impact analysis, we identified 15 of the 25 issues within the materiality analysis upon which the Telefónica Deutschland Group has a significant influence.

Analysis of business relevance

Following the impact analysis, we used set evaluation aspects to determine the relevance to business of the issues identified as material. The relevant internal stakeholders were involved here.

Six issues were identified as being material in this analysis, four of which can be categorised as relevant in terms of environmental, social and employee aspects or anti-corruption/anti-bribery. The topics of customer satisfaction, data protection and information security were also identified for and incorporated into the non-financial report. These additional topics are highly relevant to the Telefónica Deutschland Group's business, and the company has relevant impacts on these topics.

For example, a high level of customer satisfaction is crucial to the success of the Telefónica Deutschland Group. At the same time, our services and products have substantial impacts on our customers. We aim to live up to this responsibility with a reliable and quality network and customer service (see section Customer satisfaction). Additionally, our business model is based on the use of data. It is immensely important to us that we protect all the data entrusted to us in accordance with and above and beyond the legal requirements (see section Data protection and information security).

G 01/ Identification of the material non-financial topics

Issues material to Telefónica Deutschland Group as per CSR-RUG
Customer satisfaction
Data protection and information security
Climate protection
Attractiveness as an employer
Sustainable innovations
Anti-corruption

We rated the aspect of human rights as not material for presentation in the non-financial report. This is because our company operates in Germany and can therefore essentially rule out any violations of human rights by complying with the laws that are in place. The majority of our direct suppliers are based or rather operate in Germany, and, as such, human rights violations can essentially be ruled out here too on the basis of their compliance with the law.

Identifying the material risks

We aim to generate positive impacts on the individual aspects and minimise negative consequences as much as possible. We pay particular attention to the risks associated with the material issues and effectively reducing them by means of our management concepts.

For the financial year 2017 the risks perceived to be material by the Group were analysed in terms of their relationship with the issues relevant to the non-financial report. This was followed by an assessment of the risk scenarios in terms of their probability of occurrence and their potential to have a detrimental impact on the non-financial issues as defined above.

We considered the risks from a net perspective, in line with the criteria of the established risk management *(a detailed description can be found in the "Report on Risks and Opportunities" section of the Combined Management Report 2017).* Based on the probability of occurrence already determined, a conservative approach was adopted in which risks were considered with a probability of occurrence deemed to be "likely" or "highly likely".

The potential for the risks to have a detrimental impact on the relevant aspects was determined on the basis of the criteria relating to the severity of the impacts on an aspect, the number of people actually or potentially affected and the possibility of restoring the original condition before the impact occurred.

In this risk assessment, we only identified the potential for material risks pursuant to CSR-RUG in the area of customer satisfaction, which we addressed with comprehensive measures (see section Customer satisfaction).

Material non-financial issues

In accordance with the legal requirements regarding materiality and risk analyses, we identified the following issues as being relevant for the non-financial report: customer satisfaction, data protection and information security, climate protection, attractiveness as an employer, sustainable innovations and anti-corruption.

Customer satisfaction

Digitalisation offers great growth and prosperity opportunities. As a digital telecommunications provider, we want to enable everyone to be a part of digital life and use the achievements of digitalisation as it best suits their wishes, preferences and habits. We see this as the foundation of customer satisfaction, which is crucial to the success of our company. We are therefore systematically pursuing our goal of offering one of the best customer service offerings in the industry, with a high level of customer satisfaction.

To achieve this, we aim to perfectly align our brands with customer needs and win over new private, partner and business customers for our products and services. Treating our customers fairly and with respect is especially important to us. This equally applies with regard to the current challenges such as customers' greater need for information and longer hotline waiting times caused by the migration of the BASE and E-Plus brands. We therefore intensively worked on and improved the availability of our mobile telecommunications hotline in 2017.

We use the Net Promoter Score (NPS) and the Customer Satisfaction Index (CSI) as key indicators of our performance in the area of customer satisfaction. The NPS represents a customer's willingness to recommend a brand to others and therefore reflects overall satisfaction with the brand and its products and services. The NPS is determined by our brand's image, network quality, service quality, value for money, the attractiveness of the product and service portfolio and the degree of innovation attributed to the brand. These factors influence the measures we plan.

As this KPI is so important, we created an NPS task force in summer 2017 in order to continuously improve our NPS. An extensive set of measures for optimising our NPS was then developed, with the individual measures' statuses and successes being discussed, evaluated and followed up accordingly on a regular basis by the B2C management.

The second key indicator, the Customer Satisfaction Index (CSI), is based on an externally conducted phone survey of our private customers and those of our competitors. This data is collected several times a year on the basis of clearly defined criteria. The discrepancy between the customer requirements and their perception of the service actually provided can be measured with the arithmetic mean when three questions are answered. The scale ranges from 1, very low customer satisfaction, to 10, very high customer satisfaction.

We are aiming to stabilise the 2017 CSI figure of 7.18 and then increase it annually in the long term. Due to the merger of E-Plus and Telefónica, our focus in 2017 was once again customer migration, integration and network reorganisation, which to some extent involved unavoidable negative impacts on customer satisfaction. In spite of the challenges of the business combination, we were able to keep the customer churn rate stable in comparison with the previous year (2016: 1.6%), which we likewise record as a key indicator of our customer satisfaction performance.

T 01/ Customer satisfaction

	Unit	2017
Customer satisfaction index (CSI)	Index	7.18
Post-paid churn rate (churn for post-paid connections) excl. M2M	Per cent	1.6

We use other metrics in addition to the performance indicators mentioned above, such as the customer satisfaction during their last contact, the proportion of customers with resolved issues, the friendliness of the customer service managers and the comprehensibility of the information provided. We continually review the suitability of the performance indicators for analysing customer satisfaction and further develop our measurement methods.

Network and customer service quality is decisive

We consider good customer service and a mobile telecommunications and fixed line network which is available around the clock to be key factors that boost customer satisfaction. After all, our private and business customers place their trust in our services being reliable and, in particular, in network failures being resolved quickly. There is otherwise the risk of there being negative impacts, either tangible or intangible, for our customers. This results in low customer satisfaction and can lead to customer churn and a drop in turnover.

We minimise these risks by ensuring that our network elements are comprehensively monitored and by continuing to invest in the network infrastructure. In the interests of customer satisfaction, we focus not only on network quality, value for money and product quality, but also on our offering of innovative brands and good service quality. We are therefore optimising not only the quality of our customer service but also our customers' contact options and are driving digitalisation. We are constantly expanding the self-care services we offer, both on our websites and within our apps, are analysing the possibility of using new and innovative channels and are steadily implementing our programme of digital measures.

Network integration was systematically expedited in 2017 and network optimisation measures are being realised with the aim of creating a fully integrated, mobile high-speed network. Network integration is already very advanced in many towns, cities and regions. The top priority for the Telefónica Deutschland Group during the integration work is to keep the impact this work has on customers to an absolute minimum. However, it is not always possible to avoid temporary service restrictions at the local level due to the complexity of the technical work required at the individual mobile telecommunications sites. The aim is for the new Telefónica Deutschland Group mobile telecommunications network to use the best sites and improve the supply quality. The ultimate goal is to establish an optimum network infrastructure that systematically delivers customer benefits. With our network measures, we want to offer our customers a more powerful mobile telecommunications network for mobile calls and surfing.

Our priorities in 2017

We worked hard once again in 2017 to continuously improve customer satisfaction and boost our CSI and NPS ratings.

Technical expertise for an efficient network
A specialist department is responsible for efficiently monitoring the mobile telecommunications and fixed line network and resolving any problems. Its main responsibilities include keeping the impact that working on the network has on the customers to a minimum, analysing customer complaints and remedying network outages as quickly as possible. The internal processes are continuously improved by the individual departments, taking into account the technical parameters. We are seeking to increase the degree of automation, for example in the area of customer complaints processing.

We are using a new measurement tool to analyse and rate the quality of the network. This tool developed by our business partner Huawei allows us to gain a better technical and qualitative understanding of our customers' use of data – in real time and across the board. This information enables us to identify the cause of poor reception or greater capacity requirements at a particular mobile telecommunications site more quickly and to then directly implement measures. Compliance with the data protection requirements, including anonymisation, is a matter of course for us within these processes.

Customer service and feedback optimised across all the available channels
Whatever their service issue, we want our customers to be able to choose their preferred contact channel, be it online, over the phone, by post, chat, face to face or via social-media platforms. We aim to process complaints as quickly as possible upon receipt and in accordance with our quality standards. We obtain direct feedback regarding our customer service online via the FIT survey (Feedback & Insight Tool). This allows us to enquire directly about satisfaction and enter into direct communication with the customer.

In the case of complaints received over the phone, we analyse and identify the reasons for the call and the customer requirements by means of automated voice analysis. This makes it possible for the reasons for calls to be systematically recorded and resolved. Dialogue with the customer is followed by a process that allows staff to record improvement suggestions and the customer requirements within the company. These are then analysed and their feasibility is examined as part of a continuous improvement process.

To tackle unresolved customer issues as the biggest driver of dis-satisfaction, we developed a FIT return call process in 2016 which has already been implemented in some areas and is currently being tested in others. This involves an automated return call being made to customers who state in the FIT satisfaction survey that their issue has not been resolved.

To improve the customer experience, we have worked on standard-ising and simplifying communications throughout the customer relations life cycle. This has involved identifying and defining the individual stages of this "customer life cycle", prioritising them and systematically determining the customer needs for improvement.

With the introduction of a callback engine, for example, we have added a return call function at the customer's preferred time to our existing contact channels in all matters relating to mobile tele-communications contracts. We trialled this with selected post-paid customers in 2017.

Data protection and information security

Millions of customers use the Telefónica Deutschland Group's communication networks and place their trust in our services every day. We are therefore committed to helping our customers maintain control of their data and confidently shape their digital life. To this end, we protect their data and those of our employees, partners and investors within our products and processes. Through the employment of appropriate systems, we intend to ensure that the Telefónica Deutschland Group acts transparently and in accordance with data protection requirements.

Data protection, information security and compliance with the relevant laws and regulations are key components and conditions of our business activities. We safeguard these by additionally establishing internal rules and standards. This brings with it various challenges, such as implementing ever-changing regulatory requirements. In 2018 this will include implementation of the EU's General Data Protection Regulation, in particular regarding data portability.

Our privacy policy contains clearly defined requirements for the protection of personal data that to some extent go above and beyond the statutory specifications. All employees are required to complete mandatory annual training in this area using online courses developed by us and personal training sessions.

We also make a commitment in our business principles to observing information security. We handle sensitive data confidentially and prevent it from being accessed by unauthorised persons, for example with modern encryption processes or with geographically spread data centres in the event of a failure at a specific location. All employees are required to complete an online training in information security at least every two years. We also conduct classroom training in various information security issues on a quarterly basis.

As far as possible, we want to prevent legal proceedings being initiated against us due to the violation of data protection regulations. We also aim to keep the ratio of proceedings initiated on the basis of the suspicion of a violation to actual violations of legal requirements as low as possible.

In the financial year 2017 one proceeding was initiated due to data protection violations and infringement of the legal requirements in this area.

No sanctions were imposed in the form of fines as a result of data protection violations.

In the area of information and network security, there were nine registrable security violations and/or incidents in 2017 relating to confidentiality, availability or integrity.

No sanctions were imposed in the form of fines because of security violations or other incidents relating to network security.

T 02/ Data protection and information security

In number	2017	2016	2015
Procedures initiated due to privacy/data protection breaches (109a TKG)	1	4	3
Penalties in the form of fines due to breaches of privacy/data protection during the year	0	1	3
Registrable breaches/incidents related to information security and cybersecurity	9	8	4
Penalties in the form of fines paid in relation to information security breaches or other network security incidents	0	0	0

Managing data protection and information security systematically and in accordance with the law

We have efficient structures and processes in place which are designed to ensure that there are no violations in the areas of data protection and information security. These include our company-wide data protection and information security management systems (DPMS and ISMS) used to manage the processes relating to standards, targets, responsibilities, training and regular checks on the measures implemented. This area is the responsibility of the Data Protection Officer and the Chief Security Officer, who report directly to the CEO and to the Management Board of the Telefónica Deutschland Group.

We actively engage in dialogue within our data protection forum, where the relevant internal stakeholders are represented, and with external partners such as Germany's Federal Network Agency (BNetzA) and the Federal Commissioner for Data Protection and Freedom of Information (BfDI) as the relevant authorities.

We perform both internal audits and external audits at our service providers' premises to ascertain whether data protection regulations are being complied with. In this area, we have established clear processes and rules for incorporating subcontractors as well as appropriate contractual provisions (commissioned data processing).

All employees are obliged to observe data and telecommunications secrecy, and they receive regular training on the topics of data protection and information security.

We act in accordance with strict rules regarding the reporting of data protection incidents for all stakeholders. Our data protection hotline serves as a possible point of contact for reporting incidents. Our suppliers and their employees can report complaints concerning data protection via the supplier portal of the Telefónica Deutschland Group. We endeavour to answer all data protection enquiries quickly and clearly.

We perform standardised checks before incorporating data into IT development and analysis processes. Additionally, our TÜV-certified data anonymisation platform (DAP), which is part of a three-stage anonymisation process, ensures that all personal references within data are removed prior to the data's statistical analysis.

The implementation of data protection and information security is governed and guaranteed by various company guidelines. The authoritative frameworks include the Group-wide standard regarding data protection as the basis of the data protection management system and our data protection guidelines, where we make known our principles regarding the handling of data and in communication with our customers and the public. We also act in accordance with our internal security rules (Security Global Policy) and company-wide minimum security requirements (Corporate Rule on Minimum Controls). These are complemented by many other guidelines, standards and procedural instructions that bindingly stipulate how various data protection aspects are to be handled.

Our priorities in 2017

In 2017 we focused in the area of data protection in particular on implementing the requirements of the EU's General Data Protection Regulation and launched a company-wide project to this end. Using gap analyses and assessments, we ascertained the status quo of our data protection management and compared this with the target of having complied with the new provisions by May 2018 as is required. The first technical and process-related requirements were met in 2017.

In conjunction with implementation of the General Data Protection Regulation, we have also been fundamentally overhauling the governance structure of our data protection management system. This is scheduled to be completed in the first half of 2018, after which the new structure will be rolled out throughout the company.

Another focus of our activities in 2017 was on early and comprehensive internal project consultancy. The Data Protection Officer's department was involved in the planning of new products and processes right from the start and advised the other departments on how to manage things in the interests of and in accordance with data protection requirements. In particular in relation to the founding of our subsidiary Telefónica NEXT, there were additional areas in which advice was needed, such as smart data analytics, technical data protection and the Internet of Things (IoT).

We continued to engage in constructive dialogue with external stakeholders such as Germany's Federal Network Agency (BNetzA) and the Federal Commissioner for Data Protection and Freedom of Information (BfDI). Lengthy proceedings with the authorities, for example regarding data retention, are expected to be concluded in 2018.

Our priorities include providing regular, targeted and comprehensible information about how we process data. To this end, we have, in particular, standardised our privacy policies and have incorporated the appropriate information into the websites of our Group's brands.

In the area of corporate security, we focused in 2017 on the one hand on implementing and optimising an information security management system (ISMS) for the merged company based on the ISO 27001:2013 standard. On the other hand, we focused on setting up a fully functional governance structure with overarching specification documents and defined processes.

The monitoring and reporting process for overseeing and managing information security was also further improved. We expanded the Corporate Security Emergency Center (CSEC) as a new means of reporting security incidents of any kind. The security assessments used to check the systems and processes within the Telefónica Deutschland Group as well as those of service providers and suppliers were likewise expanded.

Climate protection

The Telefónica Deutschland Group has set itself the goal of reducing the impact its business activities have on the environment and of protecting the climate. To save energy and reduce greenhouse gas emissions, we invest in energy-efficient technology and buildings, use renewable energies, promote low-pollutant mobility and offer our customers sustainable products and services.

Our company's greatest consumption of resources is in the area of energy. Energy efficiency and carbon reduction are therefore two of our key environmental approaches within the value chain, and they have clear goals attached to them:

By 2020 we aim to have reduced our direct and indirect CO_2 emissions by 11% compared with 2015.

Our most important lever when it comes to reducing energy consumption and CO_2 emissions is our network technology, which accounts for most of our electricity consumption (almost 94%). We intend to reduce our energy consumption per data volume by 40% by 2020 compared with 2015. Our energy consumption per data volume totalled 0.25 GWh/PB in 2017.

We already purchase 100% of our energy from green electricity sources – without having to acquire any compensation certificates. This relates to the energy we source and control ourselves, for example for the network, offices, call centres, shops and data centres. In terms of our total electricity consumption, which also includes third parties, we are on a par with the previous year, with the proportion of renewable energies at 71%[1].
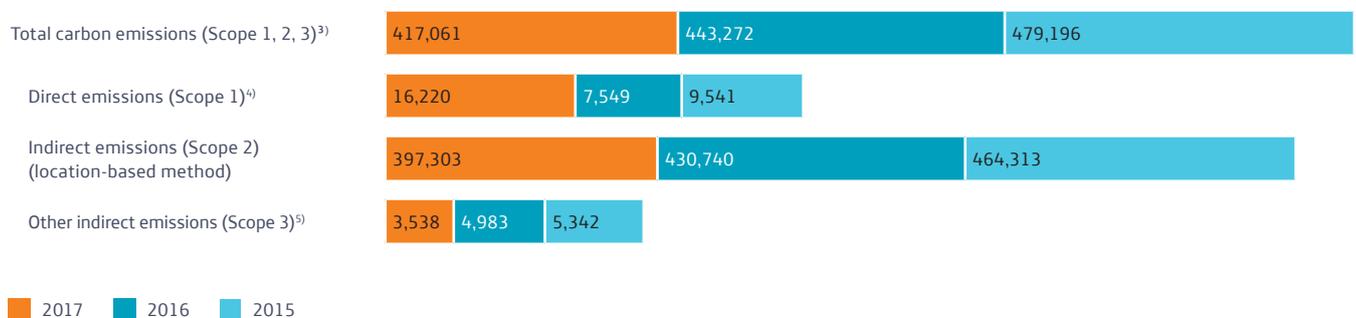
T 03/ Climate protection: energy consumption

	Unit	2017	2016	2015
Total energy consumption per data volume	GWh/PB	0.25	0.30	0.41
Share of total electricity consumption from renewable sources	Per cent	71	74	74
Share of green electricity in own procured and controlled energy	Per cent	100	100	100

In the area of mobility, we are seeking to reduce the average fleet emissions to 95 g CO_2/km for the company cars approved as of 2020 with the help of incentives. We want to reduce the CO_2 emissions caused by business travel by 10% by 2018 compared with the basis year 2015.

G 02/ Climate protection: greenhouse gas emissions

In tonnes of CO_2 equivalent (tCO$_2$eq[2])

	2017	2016	2015
Total carbon emissions (Scope 1, 2, 3)[3]	417,061	443,272	479,196
Direct emissions (Scope 1)[4]	16,220	7,549	9,541
Indirect emissions (Scope 2) (location-based method)	397,303	430,740	464,313
Other indirect emissions (Scope 3)[5]	3,538	4,983	5,342

■ 2017   ■ 2016   ■ 2015

[1] Through efficiency gains in the network, it was possible to lower electricity consumption in 2017. As the electricity in this area is procured from renewable energy sources, there is a slight decrease in the percentage of green electricity used in this reporting year in the overall balance.

[2] CO_2eq = CO_2, CH_4 und N_2O.

[3] Carbon emissions (including Scope 1 and Scope 2 in graphic 02) are calculated on the basis of ISO 14064, the Greenhouse Gas Protocol and ITU-T L.1420. A standard Germany-wide conversion factor is used to convert electricity consumption to carbon emissions, irrespective of the fact that 71% of this was sourced from renewable energy sources (previous year: 74%). The Telefónica Deutschland Group uses the electricity conversion factors of the Umweltbundesamt, the German Environmental Protection Agency, (527 g CO_2 per kWh for 2017; 535 g CO_2 per kWh for 2016; 569 g CO_2 per kWh for 2015). This has, however, not resulted in fundamental changes in trends.

[4] The reason for the rise in our Scope 1 CO_2 emissions is a new method regarding the high estimation of the use of fluorinated greenhouse gases (F-gases).

[5] Due to business travel (flight and railway journeys).

In achieving our goals, we not only expect to see a positive effect on the environmental balance but also on our business figures. After all, the savings made through increased energy efficiency in operating business activities (opex) are expected to amount to 15 million euros by 2020.

We use environmental and energy management systems to manage the environmental aspects of our activities. The Telefónica Deutschland Group's offices and own shops have now been certified in accordance with ISO 14001 and ISO 9001 since 2004. Our company also has an energy management system in place which was awarded ISO 50001 certification in 2016. The compliance of Telefónica Deutschland Holding AG's three management systems as mentioned above with the globally applicable standards was confirmed again in 2017 through external audits. To manage these topics, we created the internal position of Energy and Environmental Management Systems Officer and set up an internal Environmental Committee. Environmental issues and goals and the related measures are subject to an annual management review.

Binding environmental and energy policy

We established a binding company-wide environmental and energy policy to serve as the basis of our activities. Our environmental policy pursuant to ISO 14001 is enshrined in our environmental guidelines and is founded on the following principles:

We strictly comply with all relevant laws and standards at the local and the global level. Our environmental management system serves to prevent and minimise the potential negative environmental impact of our activities and infrastructures.

We aim to continuously improve the environmental performance of our company and of its products and services on the basis of the energy and CO_2 targets set out in the Responsible Business Plan 2020. We intend to guarantee this first and foremost with the systematic assessment of our performance based on the defined targets.

We seek to reduce our environmental footprint, for example by making efficient use of natural resources and by applying environmental criteria to our procurement processes. We generally aim to promote low-carbon business by reducing our greenhouse gas emissions and to develop products and services that make it easier for our customers to act sustainably.

Our company acts in accordance with ISO 50001 on the basis of its own energy guidelines. These are based on the environmental guidelines and set out the principles of environmental management in the area of energy. This includes the ongoing improvement of energy efficiency with the help of switching to energy-saving components throughout the company.

We set ourselves binding targets for reducing our energy consumption and CO_2 emissions, and make sure the necessary resources are available. To promote the use of renewable energies, our electricity is already 100% green. We are committed to establishing general energy management standards and to the gradual implementation of energy management systems that contribute to reducing consumption and to boosting the efficiency of our processes.

In the interests of environmental and climate protection, we enter into partnerships with our stakeholders, including within the Bavarian Environmental Pact and the Munich Business Climate Pact.

T 04/ Climate protection: energy consumption

In GWh	2017	2016	2015
Total energy consumption	791	843	859
Total electricity consumption[1]	752	803	817
of which by the network and data centres	722	775	776
of which by offices, shops, call centres	30	28	41
Total fuel consumption[2]	39	40	42
Energy from renewable energy sources	536	591	602

[1] Electricity consumption equals the quantities consumed that were actually accounted for and partly predicted for 2017 per consumption point.
[2] Fuel consumption (in the form of diesel, natural gas and district heating) comprises the units provided via a direct contract between a supplier and Telefónica.

Our priorities in 2017

The merger between the Telefónica Deutschland Group and the E-Plus Group has resulted in us currently above all tackling the challenges of a sustainable network and office consolidation by means of various measures. With regard to the network, which is one of our biggest energy consumers, we have pressed on with an array of important energy efficiency measures that are scheduled to be completed by either 2018 or 2020. These include modernisation of the 2G and 3G networks, which we anticipate will save us 6 GWh and 1.5 GWh respectively by the end of 2018. We expect to make savings of approximately 202 GWh thanks to the network consolidation which will run until the end of 2018 involving the deactivation and demolition of some 14,000 sites and modernisation of the network infrastructure. Further savings of 50 GWh should come from the deactivation of the DSL main distribution frames leading up to 2020.

In the area of CO_2 management and mobility, we are planning the following measures in order to achieve the goals set for 2018 and 2020: we want to focus on systematically providing greater incentives within the company to limit the number of vehicles with high CO_2 emissions and to financially encourage the use of electric cars. We will review our travel guidelines with a view to avoiding travel and to promoting greater use of videoconferences and train travel rather than flying. We are also actively promoting working from home and are developing a new concept for reduced-emission journeys to work and back home, which is set to be realised by the end of 2018.

Attractiveness as an employer

Our employees are a decisive factor when it comes to our success and we will only manage to transform into a digital telecommunications provider with the commitment of our staff. The commitment we made in the Responsible Business Plan 2020 was therefore this: "We will position ourselves internally and externally as an attractive employer and achieve generally good to very good results in our employee surveys".

We want to recruit the most talented individuals in a tough labour market and motivate our employees to grow with us. In this respect, the things that are particularly important to us are treating each other fairly, respectfully and on the basis of trust, a high level of employee commitment and a good work climate.

Our HR strategy is based on our corporate strategy and on the corporate targets. The focal areas here include dialogue, flexible working hours, health management, training and professional development, various flexible learning and development opportunities and our framework redundancy package. Details of the diversity concept can be found in the Management Declaration in the Combined Management Report 2017.

Each year, we conduct an online, anonymous and voluntary survey among all the Telefónica Deutschland employees to measure their commitment and the general work climate ("employee satisfaction"). The results of this survey are used for in-depth and frank dialogue within the divisions and teams. Wherever prudent, we derive improvement measures for the company as a whole and within the individual teams, and then we implement these. The findings are also incorporated into our HR strategy and the related activities. Internal targets help us further boost and steer employee satisfaction.

The survey response rate is an important indicator. In 2017 this was 68%, meaning it continuously increased. Our target is to raise the response rate to 70% by 2020.

To this end, we ensure that the Management Board members give advance notice of the employee survey via various communication channels and ask all the employees for their frank and honest feedback. The Management Board members are given feedback on the participation rate in the course of the survey and, if necessary, can remind the employees to take part, guaranteeing at all times that participation is both voluntary and anonymous.

To assess the Telefónica Deutschland Group's attractiveness as an employer, we use the development in the number of external applicants per position advertised and per year. In 2017 we registered 11.9 applicants per position advertised. This figure is still too low for us. We therefore aim to increase it. Our greatest challenge in the area of recruiting is filling the vacancies in the technology and sales areas. To tackle this, we are drawing on new recruitment measures such as datathons, meet-ups and base camps. To win over talented young people, we use new HR marketing channels such as Snapchat and conduct targeted social-media campaigns. We have also introduced mobile and video recruiting, enabling candidates to apply at any time and from any location.

T 05/ Attractiveness as an employer

	Unit	2017	2016	2015
Employee satisfaction: result for working atmosphere and engagement	Per cent	67	61	67
Employee survey return rate	Per cent	68	65	64

Number of external applicants per job advertisement in 2017:	11.9

Handling integration responsibly

We focused on company integration again in 2017 which had a substantial influence on employee satisfaction and our attractiveness as an employer. It is incredibly important to us that all the measures relating to integration and transformation are as socially acceptable as possible and that, at the same time, we have high-quality rules in place and achieve the best possible security for existing jobs.

We are handling the restructuring constructively and on the basis of trust by means of the framework redundancy package that applies until 2018 and together with the departments and the employee representation bodies. This is aided by transparent communication within the company – in addition to the existing points of contact within our HR organisation and the works council.

With the conclusion of the integration process in mind and to safeguard the company's future, the HR strategy was revised in 2017 and brought into line with the current corporate goals.

Our priorities in 2017

In addition to conducting the employee survey, the focuses included the subsequent frank dialogue that constituted part of the action planning for which our executives were responsible.

In the course of the company integration, we paid particular attention to proactively and swiftly communicating changes within the company in order to guarantee complete transparency regarding plans and decisions. The focus here was on giving our executives training in communicating appropriately and in involving the employees in change processes.

There were additional projects that helped to increase employee satisfaction and our attractiveness as an employer in 2017. These included the development of new agile forms of organisation in order to promote interdisciplinary cooperation and quick decision paths. These are characterised by dynamic structures such as flat hierarchies, independent teams and project-based work. We also further developed working hours which are flexible in terms of time and location, and put the technology required for this in place.

With the virtual learning hub for improved talent nurturing, we created a platform that makes formal and informal learning possible in real time from any location. It is available to all Telefónica Deutschland Group employees. In addition, the recruitment criteria for top talent were redefined and management guidelines were developed for specific situations and divisions.

We also prioritised the issue of leadership in the digital age in 2017. With the working world becoming increasingly virtual and more complex, what is needed is less routine and more agility. We want to enable our executives to independently contribute to shaping our digital strategy, the transformation of our company and their own development.

Development of digital leadership skills expedited

With the help of extensive data analysis, the Telefónica, S.A. Group developed a digital transformative profile that highlights the skills needed by the executives to shape the digital transformation. Senior employees at all the national companies and in Germany participated in this measure. The meta-analysis of 2,300 executives identified core skills such as digital experience and affinity with digital technologies, transformation skills and learning agility. Based on this, personal development plans were drawn up in the course of "digital development festivals" and a global online learning hub was established as a learning community. The programme offered at the Telefónica, S.A. Group's corporate university in Barcelona rounds off the learning opportunities for our executives at the global level.

Another focal area is making our executives proficient with regard to project work. To achieve this, we use innovative team set-ups and processes, and flat hierarchies. Executives and project managers are additionally supported with various formats and tools relating to change management, for example with leadership workshops, team motivation formats, individual and team coaching, and specific training.

Sustainable innovations

We want our digital products and services to make people's lives simpler, safer, healthier and more environmentally friendly. One of the keys to this is sustainable innovations – an area in which we focus on analysing large volumes of data and on intelligent devices and connected objects. We aim to support our customers in the realisation of new products and business models in order to give all areas of society access to digital products.

We have pooled the growth areas of advanced data analytics and the Internet of Things within our subsidiary Telefónica Germany Next GmbH. With our advanced data analytics line of business, we are seeking to access the potential offered to all areas of life by data analysis, from mobility to private consumption. We can also contribute to answering key questions for the future with our innovative products and services. For example, urban traffic can be made more environmentally friendly by carefully analysing anonymised and aggregated mobile telecommunications data. The company also developed an IoT software platform, which helps other companies offer intelligent products for consumers.

The entire Telefónica Deutschland Group and the subsidiary Telefónica NEXT are endeavouring to fulfil their own aspirations with sustainable innovations: "We will push technologies to simplify linking up people, devices and machines in the private and business world. The goal is to support our customers in the realisation of new products and business models in order to give all areas of society access to digital products."

With all our products and technologies, our top priority is complying with the strict data protection requirements. One example here is our data anonymisation process, which has TÜV Saarland certification and which prevents data taken from digital sources such as mobile telecommunications or Wi-Fi from being matched up with a specific individual.

We measure the success of our products and services such as our new IoT platform developed by Telefónica NEXT (cf. "Our priorities in 2017") internally on the basis of financial and non-financial — indicators as well as Telefónica NEXT's total sales. Telefónica NEXT is already generating stable sales, for example in the areas of data analysis and mobile advertising.

Efficient communication and innovative partnerships

Telefónica NEXT's business plan is drawn up as part of the strategy development process in close cooperation with the Supervisory Board and Management Board of the Telefónica Deutschland Group. The data protection requirements applicable throughout the Group are observed at all times. The key performance indicators are tracked at the operational level on a monthly basis. When developing its strategy for sustainable innovations, Telefónica NEXT also communicates closely with the Telefónica Deutschland Group's CR department.

Close coordination is additionally guaranteed on the basis of defined reporting channels within the Telefónica Deutschland Group. For example, the CEO of Telefónica NEXT reports to the Chief Partner and Business Officer.

At the same time, Telefónica NEXT maintains an array of partnerships at the project level, for example with the South Pole Group, which specialises in sustainability solutions, the data analysis experts Teralytics AG, the transport planning experts at Intraplan Consult GmbH and the consortium partners within the ProTrain project sponsored by Germany's Federal Ministry of Transport and Digital Infrastructure (BMVI).

Our priorities in 2017

The portfolio of digital solutions at Telefónica NEXT comprises five areas: transport analytics (understanding movement patterns in Germany), the consumer Internet of Things (developing connected products for the end customer market quickly and easily), retail solutions (understanding and serving target customer groups better), smart media (accurately targeted mobile communication with customers) and the data anonymisation platform (securely anonymising and protecting data). In the areas of transport analytics and the consumer Internet of Things, the focus in 2017 was on the following sustainability topics; in relation to these, projects were developed or implemented with the aim of directly bringing about benefits for society:

– Promoting flowing and environmentally friendly urban traffic based on the targeted analysis of traffic flows
– Improving senior citizens' quality of life by developing a digital infrastructure with intelligently connected sensors and applications
– Increasing general awareness of health by connecting devices used to measure people's health.

We realised pilot projects in Nuremberg, Stuttgart and the Berlin metropolitan area that used mobile telecommunications data to intelligently measure traffic flows, thereby providing important starting points for improving air quality and transport planning. Within the Berlin project, big data analyses are used to determine in detail the actual and the expected demand for regional transport in order to be able to respond proactively. Additionally, the passengers are to be provided with real-time information about alternative connections and available seats.

An IoT platform was launched as an alpha version for developers in 2017. The platform can digitally combine devices and applications, and it pools the skills of various partners such as developers, manufacturers and designers. The user maintains control over their data by being required to approve each instance of their data being shared and by being able to revoke their consent at any time. The purpose of this platform is for IoT products for end customers to be brought on to the market even more quickly and more cost-effectively, for example in the area of assistance for senior citizens and healthcare. It could be used to bring together switchable sockets or connected blood pressure monitors as a smart care system, thereby enabling people in need of care to live their lives more independently.

Anti-corruption

Our aim is to maintain and increase the trustworthiness of the Telefónica Deutschland Group. Our company's good reputation is founded on the integrity and sense of responsibility of all the staff. We therefore undertake to act in accordance with all laws, societal guidelines and values.

We reject all forms of corruption. Our compliance management system focuses on combating corruption and on preventing unfair competition and conflicts of interest. With this system, we establish a company-wide framework for reliably identifying cases of corruption and preventing them as far as possible with suitable measures. No cases of corruption were recorded in 2017.

T 06/ Anti-corruption

In number	2017	2016	2015
Total number of cases of corruption[1]	0	0	0

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[1] Confirmed suspected cases that led to measures related to labour law or sanctions.

Established processes and guidelines for combating corruption

In order to avoid financial losses or the loss of reputation due to compliance infringements, the Telefónica Deutschland Group uses an integrated compliance management system to oversee compliance with the requirements. Overall responsibility lies with the Compliance, Corporate Security and Data Protection Director. The Management Board and Supervisory Board of the Telefónica Deutschland Group receive a regular report on the compliance activities, in particular regarding further development of the compliance management system.

Complaints can be made anonymously using the confidential hotline. In consultation with the Internal Audit department, we defined our own process for looking into suspected cases of non-compliance and corruption. We also require all our staff to undergo regular compliance training. We regularly review our training concept and adapt it to the current requirements. We overhauled and updated our company-wide training programme in 2017.

We also perform ad hoc and process-related checks and consultations regarding possible corruption risks. The compliance management system and the measures for preventing corruption are regularly checked by the Internal Audit department and external auditors. Additionally, the staff are surveyed regarding the quality and effectiveness of the compliance management system.

We oblige our suppliers and business partners to sign a declaration to observe the laws and provisions regarding anti-corruption as applicable. This is an integral part of our supply chain processes.

In addition, our company has established clear guidelines and specifications for day-to-day activities in relation to the key compliance issues. Alongside the business principles which were revised in 2017 these include the guidelines for preventing corruption and regarding competition law which were introduced in the financial year and guidelines on how to handle invitations, gifts and conflicts of interest, as well as incentives with a view to procuring services. The documented procedure for handling service providers falls into this category too.

Our priorities in 2017

In addition to drawing up the new anti-corruption guidelines, we implemented other measures in 2017. Our employees can now use an intracompany app on smartphones and tablets to obtain important information, news and contact details relating to, among other things, compliance. We have also introduced new tools for the qualitative measurement of compliance awareness among the employees such as the internal survey tool Integrity Compass. In addition, we are working on continuously improving our compliance management system and are striving for external certification in accordance with the IDW auditing standard 980 by 2020. The first stage of certification has already been initiated.

Audit opinion

Independent Practitioner's Report on a Limited Assurance on Non-financial Reporting

To Telefónica Deutschland Holding AG, Munich
We have performed a limited assurance engagement on the separate combined non-financial report pursuant to §§ (Articles) 289b Abs. (paragraph) 3 and 315b Abs. 3 HGB ("Handelsgesetzbuch": "German Commercial Code") of Telefónica Deutschland Holding AG, Munich, (hereinafter the "Company") for the period from 1 January to 31 December 2017 (hereinafter the "Non-financial Report").

Responsibilities of the Executive Directors
The executive directors of the Company are responsible for the preparation of the Non-financial Report in accordance with §§ 315b and 315c in conjunction with 289c to 289e HGB.

This responsibility of Company's executive directors includes the selection and application of appropriate methods of non-financial reporting as well as making assumptions and estimates related to individual non-financial disclosures which are reasonable in the circumstances. Furthermore, the executive directors are responsible for such internal control as they have considered necessary to enable the preparation of a Non-financial Report that is free from material misstatement whether due to fraud or error.

Independence and Quality Control of the Audit Firm
We have complied with the German professional provisions regarding independence as well as other ethical requirements.

Our audit firm applies the national legal requirements and professional standards – in particular the Professional Code for German Public Auditors and German Chartered Auditors ("Berufssatzung für Wirtschaftsprüfer und vereidigte Buchprüfer": "BS WP/vBP") as well as the Standard on Quality Control 1 published by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany; IDW): Requirements to quality control for audit firms (IDW Qualitätssicherungsstandards 1: Anforderungen an die Qualitätssicherung in der Wirtschaftsprüferpraxis – IDW QS 1) – and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

Practitioner's Responsibility
Our responsibility is to express a limited assurance conclusion on the Non-financial Report based on the assurance engagement we have performed.

Within the scope of our engagement we did not perform an audit on external sources of in-formation or expert opinions, referred to in the Non-financial Report.

We conducted our assurance engagement in accordance with the International Standard on Assurance Engagements (ISAE) 3000 (Revised): Assurance Engagements other than Audits or Reviews of Historical Financial Information, issued by the IAASB. This Standard requires that we plan and perform the assurance engagement to allow us to conclude with limited assurance that nothing has come to our attention that cause us to believe that the Company's Non-financial Report for the period from 1 January to 31 December 2017 has not been prepared, in all material aspects in accordance with §§ 315b and 315c in conjunction with 289c to 289e HGB.

In a limited assurance engagement the assurance procedures are less in extent than for a reasonable assurance engagement, and therefore a substantially lower level of assurance is obtained. The assurance procedures selected depend on the practitioner's judgment.

Within the scope of our assurance engagement we performed amongst others the following procedures and further activities:

– Obtaining an understanding of the structure of the sustainability organization and of the stakeholder engagement
– Inquiries of personnel involved in the preparation of the Non-financial Report regarding the preparation process, the internal control system relating to this process and selected disclosures in the Non-financial Report
– Identification of the likely risks of material misstatement of the Non-financial Report
– Analytical evaluation of selected disclosures in the Non-financial Report
– Inspection of additional documents and supportive systems
– Comparison of selected disclosures with corresponding data in the financial statements and in the combined management report
– Evaluation of the presentation of the non-financial information
– Use of the work of a practitioner's verification of energy consumption and greenhouse gas emission indicators according to ISO 14064.

Assurance Conclusion
Based on the assurance procedures performed and assurance evidence obtained, nothing has come to our attention that causes us to believe that the Company's Non-financial Report for the period from 1 January to 31 December 2017 has not been prepared in all material aspects in accordance with §§ 315b and 315c in conjunction with 289c to 289e HGB.

Intended Use of the Assurance Report
We issue this report on the basis of the engagement agreed with the Company. The assurance engagement has been performed for purposes of the Company and the report is solely intended to inform the Company about the results of the limited assurance engagement. The report is not intended for any third parties to base any (financial) decision thereon. Our responsibility lies only with the Company. We do not assume any responsibility towards third parties.

Munich, 14 February 2018
PricewaterhouseCoopers GmbH
Wirtschaftsprüfungsgesellschaft

Michael Conrad   ppa. Annette Daschner
Wirtschaftsprüfer
[German public auditor]

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This report is also available in German.
If in doubt, refer to the German version, which is binding.

The non-financial report is available online at
www.telefonica.de/nfe

The Annual Report is available online at
www.telefonica.de/annualreport2017

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