

Telefonica

Creating a Leading Digital Telco in Germany

23 July 2013

Telefónica, S.A.
Investor Relations

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Transaction Summary

Key Terms

- Total consideration of €5bn in cash and a 17.6% stake in the enlarged Telefónica Deutschland, as a result of two subsequent steps:
 - 1 Acquisition of E-Plus by Telefónica Deutschland for a combination of cash and a stake in the enlarged Telefónica Deutschland
 - (i) €3.70bn of cash
 - (ii) 24.9% stake in the enlarged Telefónica Deutschland (after capital increase)
 - 2 Telefónica subsequently to acquire a 7.3% stake from KPN for €1.30bn in order to maintain a 65% ownership in the enlarged Telefónica Deutschland
- Transaction to unlock significant value, with synergies of €5.0–5.5 bn NPV

Recommended Transaction

- Recommended transaction approved by Telefónica's Board of Directors and Telefónica Deutschland's Supervisory Board
- Transaction has support from KPN's Board of Management, and from KPN's Supervisory Board

Key Dates

- KPN shareholders' approval required at KPN's General Meeting in H2 2013
- Telefónica Deutschland shareholders' approval required at Telefónica Deutschland's General Meeting in H2 2013
- Transaction expected to close in mid 2014, following clearance from relevant authorities

Transaction Structure

Transaction Summary

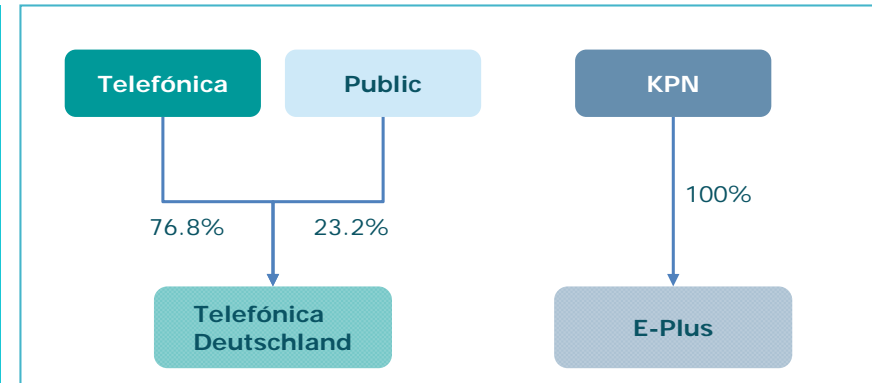
Total consideration of €5 Bn in cash and a 17.6% stake

Two Step Structure

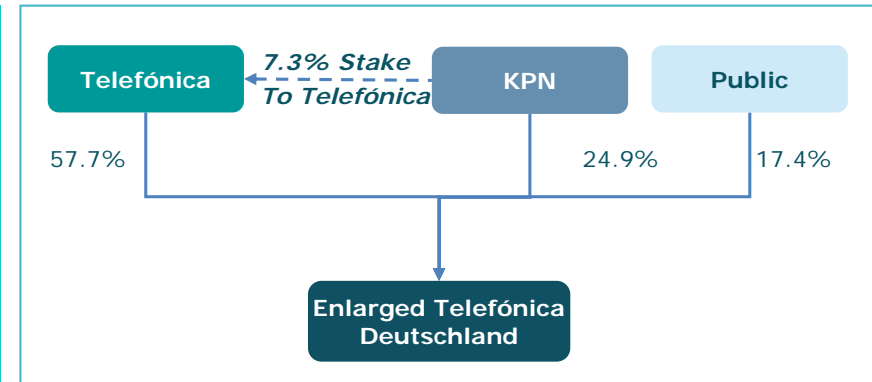
- 1 Acquisition of E-Plus by Telefónica Deutschland for a combination of cash and a stake in the enlarged Telefónica Deutschland
 - i. €3.70bn of cash, financed through a rights issue fully underwritten by Telefónica and a group of banks
 - ii. 24.9% stake in the enlarged Telefónica Deutschland (after capital increase)

- 2 Telefónica subsequently to acquire a 7.3% stake of the enlarged Telefónica Deutschland from KPN for €1.30bn, post-transaction, in order to maintain a 65% ownership in the enlarged Telefónica Deutschland

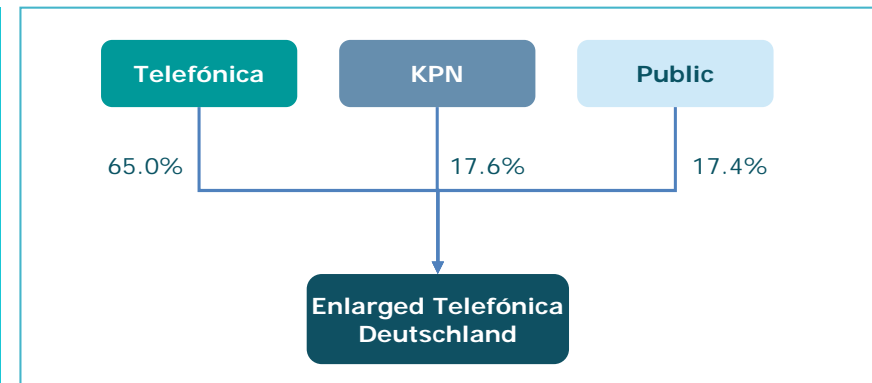
Pre-Transaction Structure



Intermediate Structure



Final Ownership Structure



Transaction Rationale

1

Creation of a Leading Digital Telco

- A leading player with a combined customer base of 43m, 42% in postpaid
- Strong scale benefits with combined mobile revenue market share of 32%
- Driving mobile market growth in Germany since 2010:
 - ▶ +2.2pp in postpaid customer share
 - ▶ +5.8pp in prepaid customer share
- Strong capabilities in mobile data

2

Value Crystallization Through Significant Synergies

€5.0–5.5bn

- NPV of synergies of €5.0–5.5bn, net of integration costs
 - ▶ Net savings from year 2
 - ▶ Annual run-rate synergies of approx. €800 m; 75% of run-rate synergies by year 4
- Incremental value from additional revenues, financial and tax synergies
- Highly experienced management team with a proven track record of integration

3

Enhanced Profitability & FCF in Germany

- Improved profitability and enhanced cash flow generation
- Stronger competitive position from increased scale

Source: Company data, broker research

Transaction Rationale (Cont'd)

4

Creating a Superior Customer Experience

- Customers to benefit from the best high speed mobile and fixed experience from a single LTE network and access to future-proof DT NGA network
- Strong multi-brand portfolio across segments
- Offering ICT / cloud solutions for business customers
- Best distribution channel and outstanding customer service
- Ready for convergence through cross-selling / up-selling opportunities
- Leveraging Telefónica's global capabilities: Digital innovation, Scale,...

5

Value Creation for Telefónica Deutschland Shareholders

- Unlocks significant value for Telefónica Deutschland shareholders
- Increases financial flexibility (improving leverage) while maintaining an attractive shareholder remuneration
 - ▶ Conservative pro forma balance sheet
- EPS and FCF accretive from first year of full operation 1⁽¹⁾

6

Value Creation for Telefónica Shareholders

- Unlocks significant value for Telefónica shareholders
- Investing in future growth while improving leverage
- Reinforced geographical diversification, increasing exposure to an attractive market
- Positive impact on Telefónica's cash flow generation profile
- EPS and FCF accretive from year 1⁽¹⁾
- Credit friendly financing structure, allowing leverage ratios to improve

1. Based on run-rate synergies before integration costs

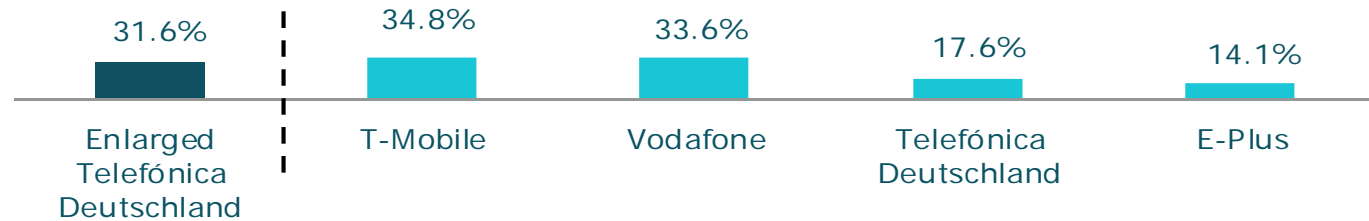
1 Creation of a Leading Digital Telco

Creation of a Leading Mobile Operator in Germany

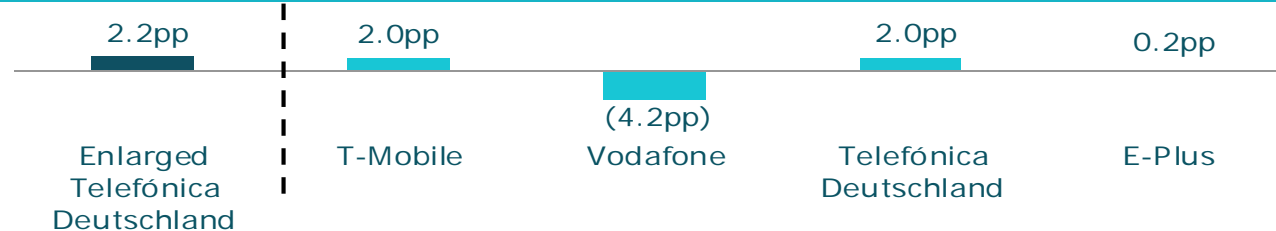
Leading Postpaid Subscriber Growth

Leading Prepaid Subscriber Growth

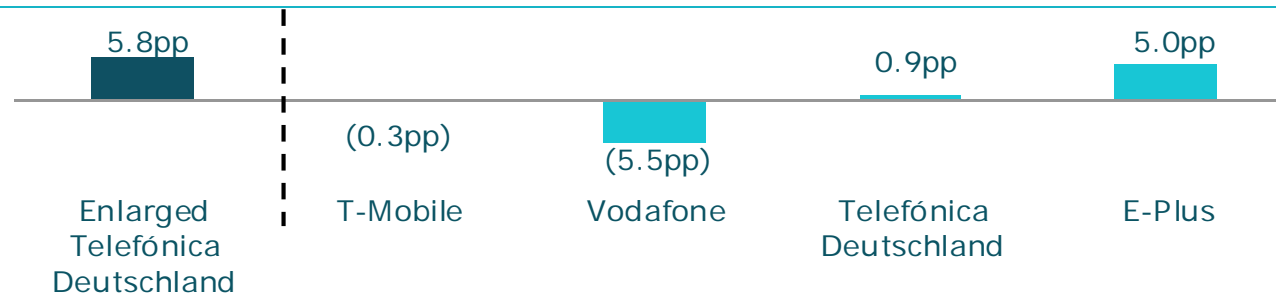
Q1 2013 Mobile Revenue Market Share (%)



2010 – 2012 Postpaid Mobile Market Share Growth (pp)



2010 – 2012 Prepaid Mobile Market Share Growth (pp)



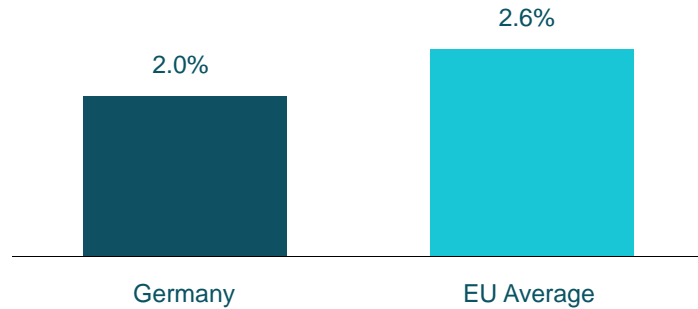
- Combining Telefónica Deutschland and E-Plus's track records of growth with Telefónica Deutschland's capacity for MBB

Source: Company data, broker research

1 Highly Attractive Mobile Market

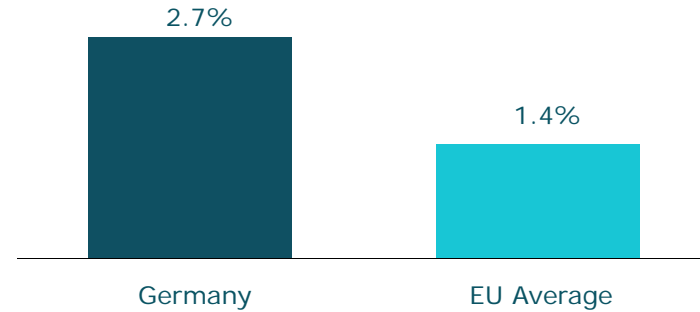
Relatively Low Churn

Monthly Churn, 2012



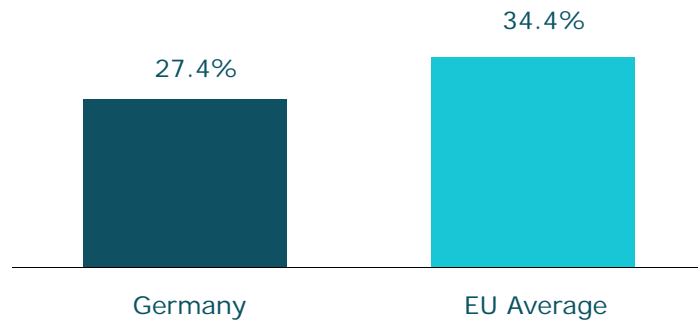
Strong Subscriber Base Growth

2013E YoY Growth



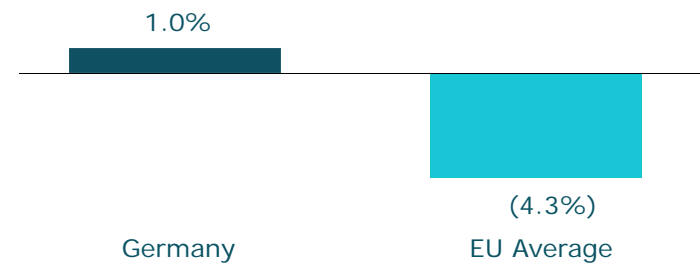
Smartphone Penetration Upside

Smartphone Connections as % of Mobile Connections, 2012



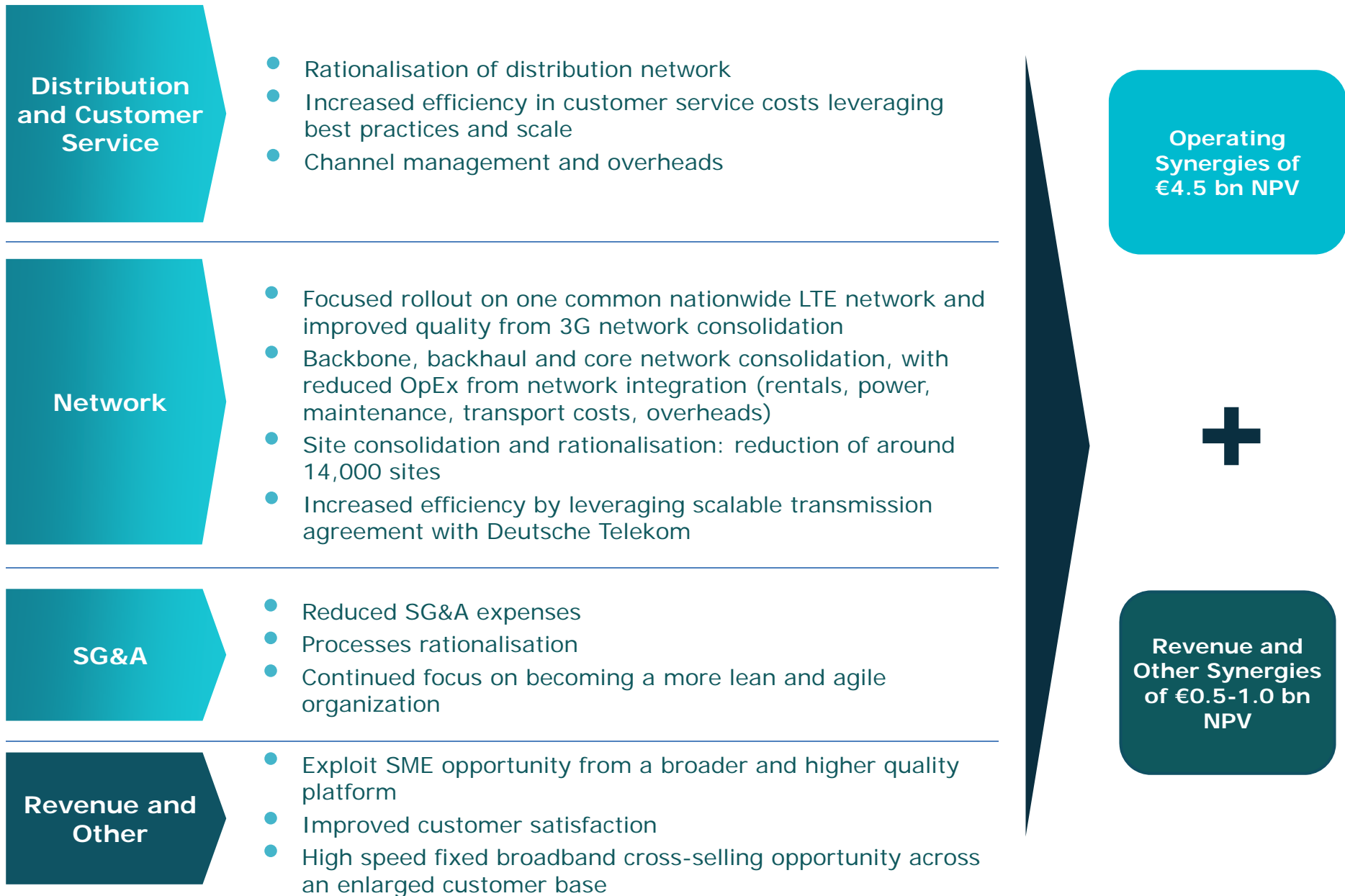
EBITDA Growth

2009 – 2013E CAGR

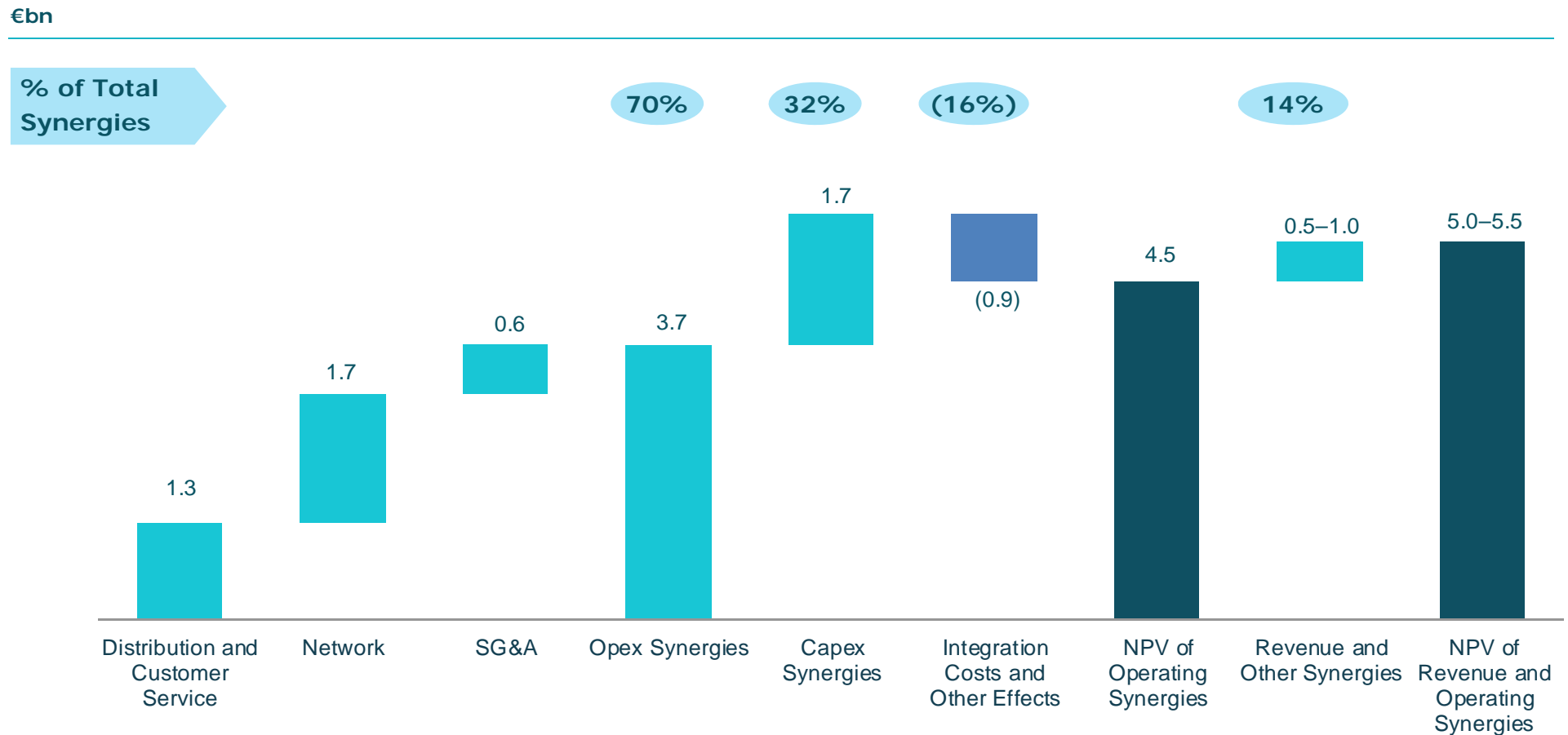


Source: WCIS, broker research

2 Identified and Realisable Synergies of €5.0 – 5.5 bn NPV



2 Synergies Value of €5.0 - 5.5 bn NPV



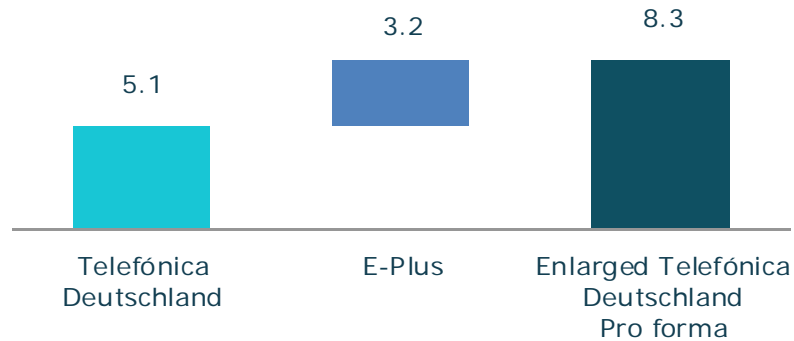
- **NPV €5.0-5.5bn:**
 - ▶ Net savings from year 2
 - ▶ Run-rate synergies approx. €800 m from year 5; 75% of run-rate synergies by year 4
- Incremental value from additional revenues, financial and tax synergies

3 Stronger Competitive Position from Increased Scale in Germany

Based on Consensus Forecasts

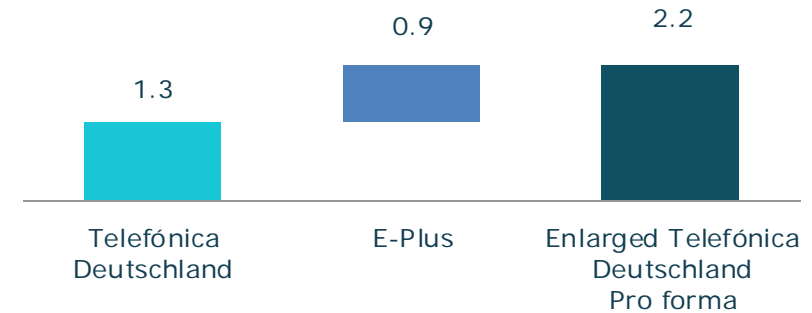
2013 Revenue

€bn



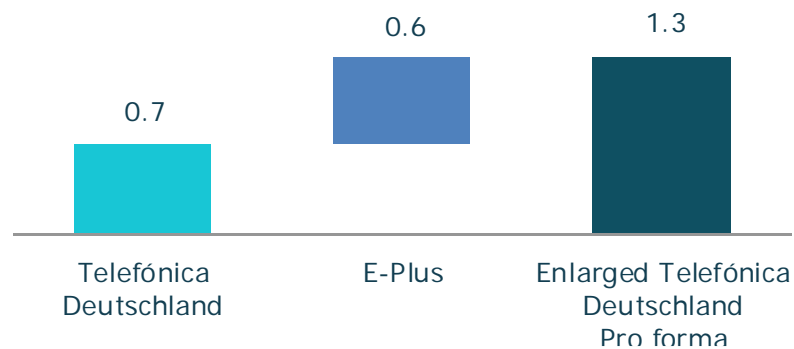
2013 OIBDA

€bn



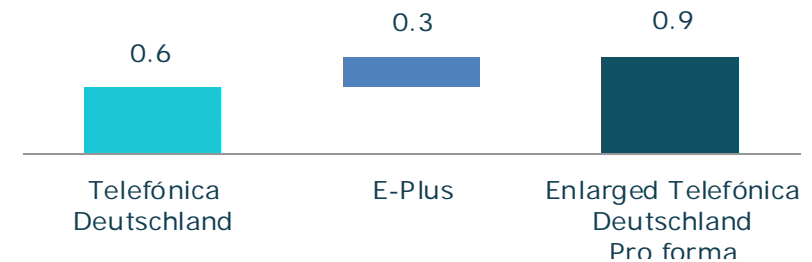
2013 Capex

€bn



2013 OpFCF⁽¹⁾

€bn

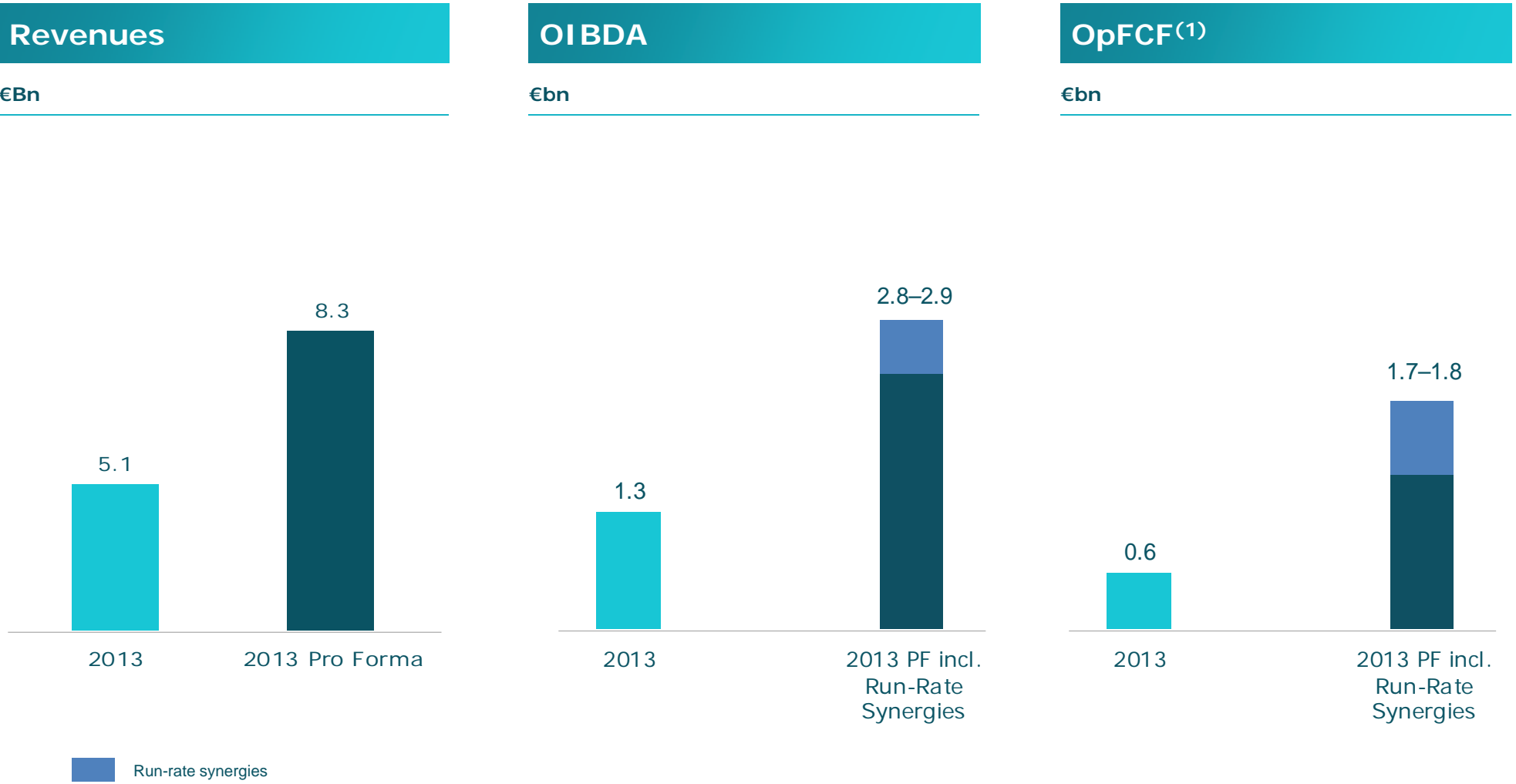


Source: Broker consensus. Not adjusted for accounting differences, pre-synergies

1. Defined as OIBDA-Capex

3 Enhanced Profitability and Cash Flow Generation in Germany

Pro forma Financial Impact on Telefónica Deutschland, based on Consensus Forecasts



- **EPS and FCF Accretive from first year of full operation⁽²⁾**

Source: Broker consensus, not adjusted for differences in accounting policies

1. Defined as OIBDA-Capex
2. Based on run-rate synergies before integration costs

4 Creating a Superior Customer Experience

Single LTE Network to Deliver the Best Mobile Broadband Experience

- Strong commitment to invest in the German market
- Spectrum and network capacity to cope with growing data volumes
- Access to fibre backhaul
- Environmental benefits through reduction of sites
- Improved situation in the business sector
- Improved network quality for E-Plus subscribers through access to Telefónica Deutschland's state-of-the-art network

Best Distribution Channel

- Over 1,800 points of sale to serve our customers directly
- Outstanding customer service to provide the best digital experience

Multi-brand & Innovative Commercial Offer

- Combination of the most creative players in the market
- Tariff innovation, voice & mobile data bundling
- Multi-brand strategy to better serve different customer needs
- Innovative propositions to offer ICT / cloud solutions for business customers

Additional Opportunity from Convergence Strategy

- Increased up-selling and cross-selling potential extended to E-Plus customer base
- Significant tangible benefits such as churn reduction

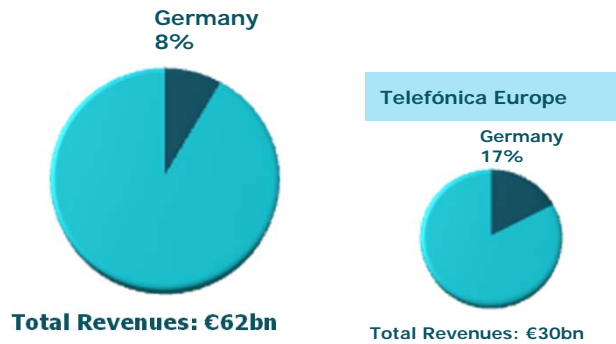
Leveraging Telefónica's Global Capabilities

- Benefits from leveraging Telefónica's best practices
- Innovation through Telefónica Digital
- Global capacity: Data Centers, scale benefits and shared services

6 Enhancing Telefónica's Geographic Diversification

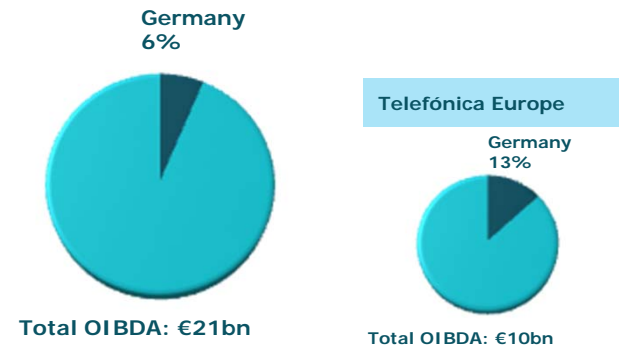
Telefónica Revenue Breakdown

Telefónica Standalone, 2012

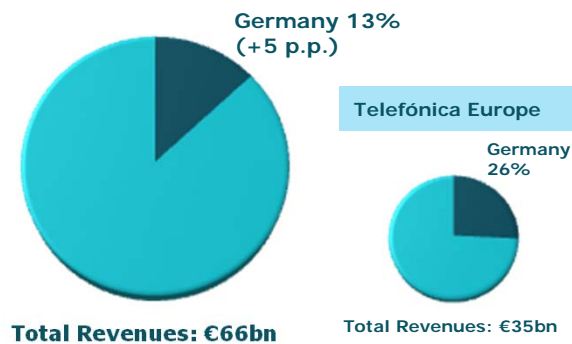


Telefónica OIBDA⁽¹⁾ Breakdown

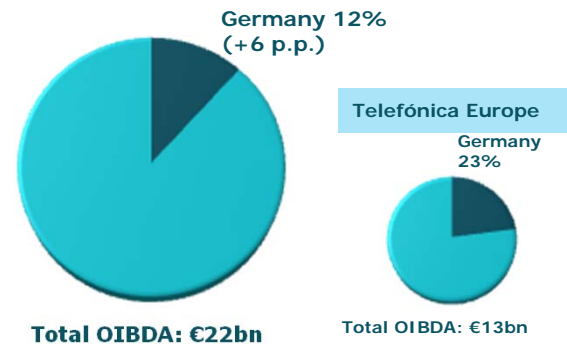
Telefónica Standalone, 2012



Pro-forma Telefónica (Pre-Synergies), 2012



Pro-forma Telefónica (Pre-Synergies), 2012

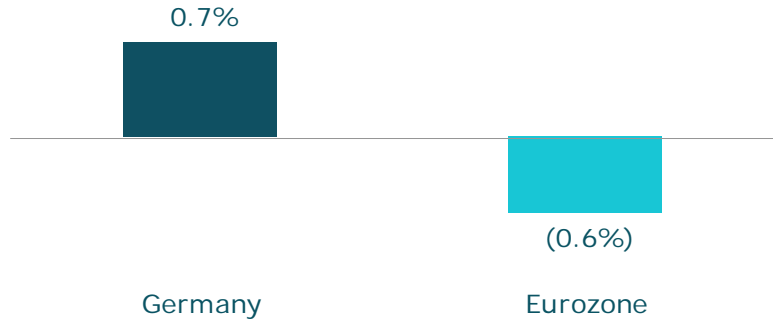


1. Underlying OIBDA

6 Building a Stronger Competitor in the Attractive German Market

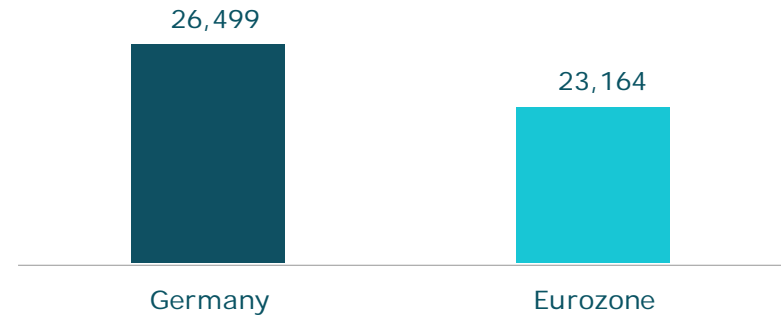
2011 – 2013E Real GDP CAGR

%



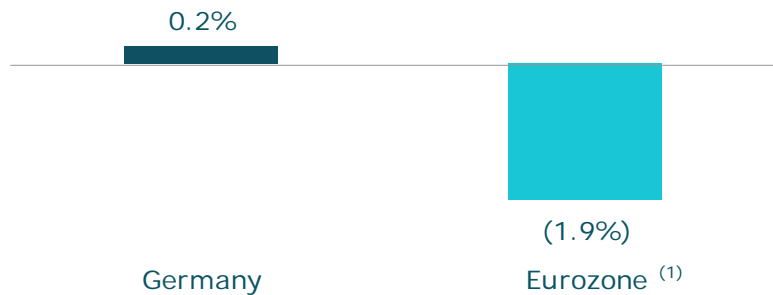
2012 GDP per Capita

€



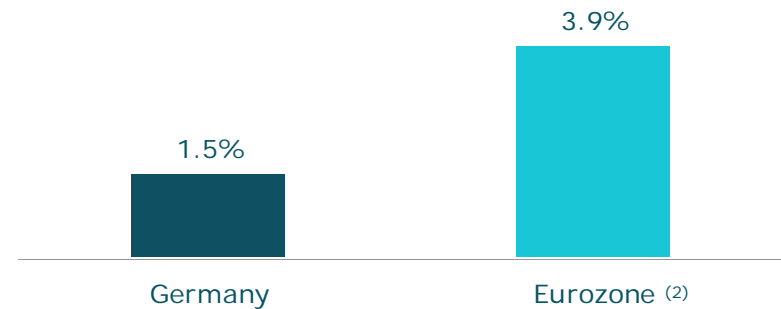
2011 – 2013E Telecom Market CAGR

%



Sovereign Debt Yield

%



- The largest Telecom market in Europe with revenues of €36bn

Source: Global Insight, IMF, IDC

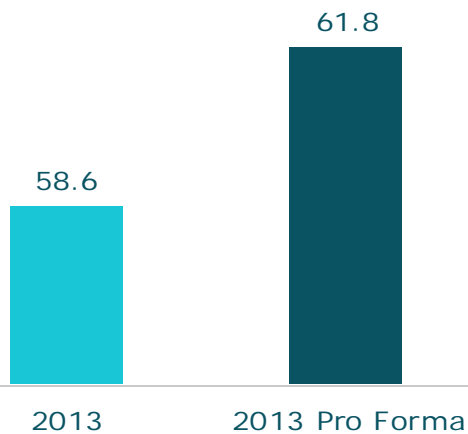
1. Excludes Cyprus, Luxembourg and Malta for which data is not available
 2. Average 10Y Government Bond Yield of Eurozone country members as of 17 July 2013

6 Attractive Transaction for Telefónica Shareholders

Pro forma Financial Impact on Telefónica Group, based on Consensus Forecasts

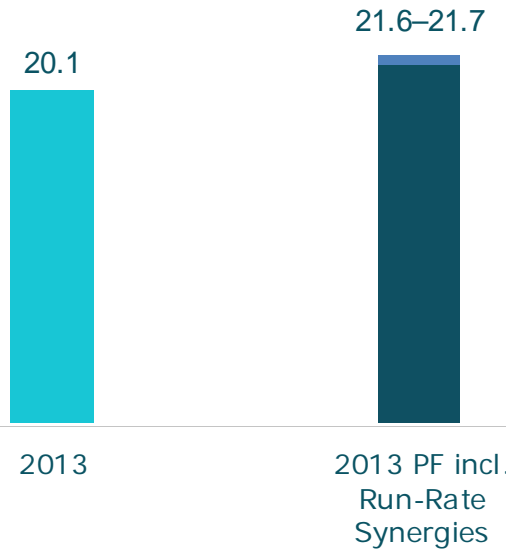
Revenues

€Bn



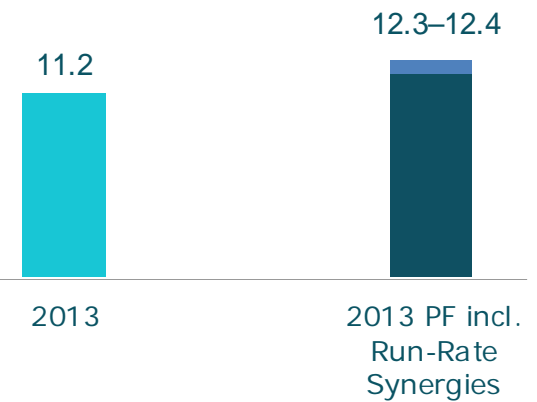
OIBDA

€bn



OpFCF⁽¹⁾

€bn



Run-rate synergies

- **EPS and FCF Accretive from first year of full operation⁽²⁾**

Source: Broker consensus, not adjusted for differences in accounting policies

1. Defined as OIBDA-Capex

2. Based on run-rate synergies before integration costs

6 Financing Without Increasing Leverage

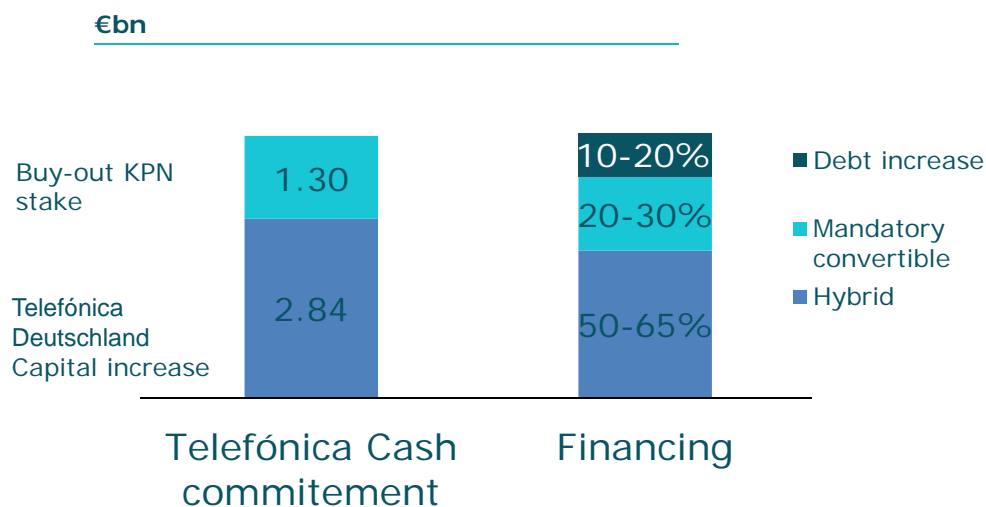
Telefónica Cash Commitment

- Rights Issue in enlarged Telefónica Deutschland of €3.70bn. Telefónica subscribes pro-rata to its stake of 76.8%, €2.84bn
- €1.30bn to KPN for 7.3% stake in the enlarged Telefónica Deutschland

Financing without Increasing Leverage

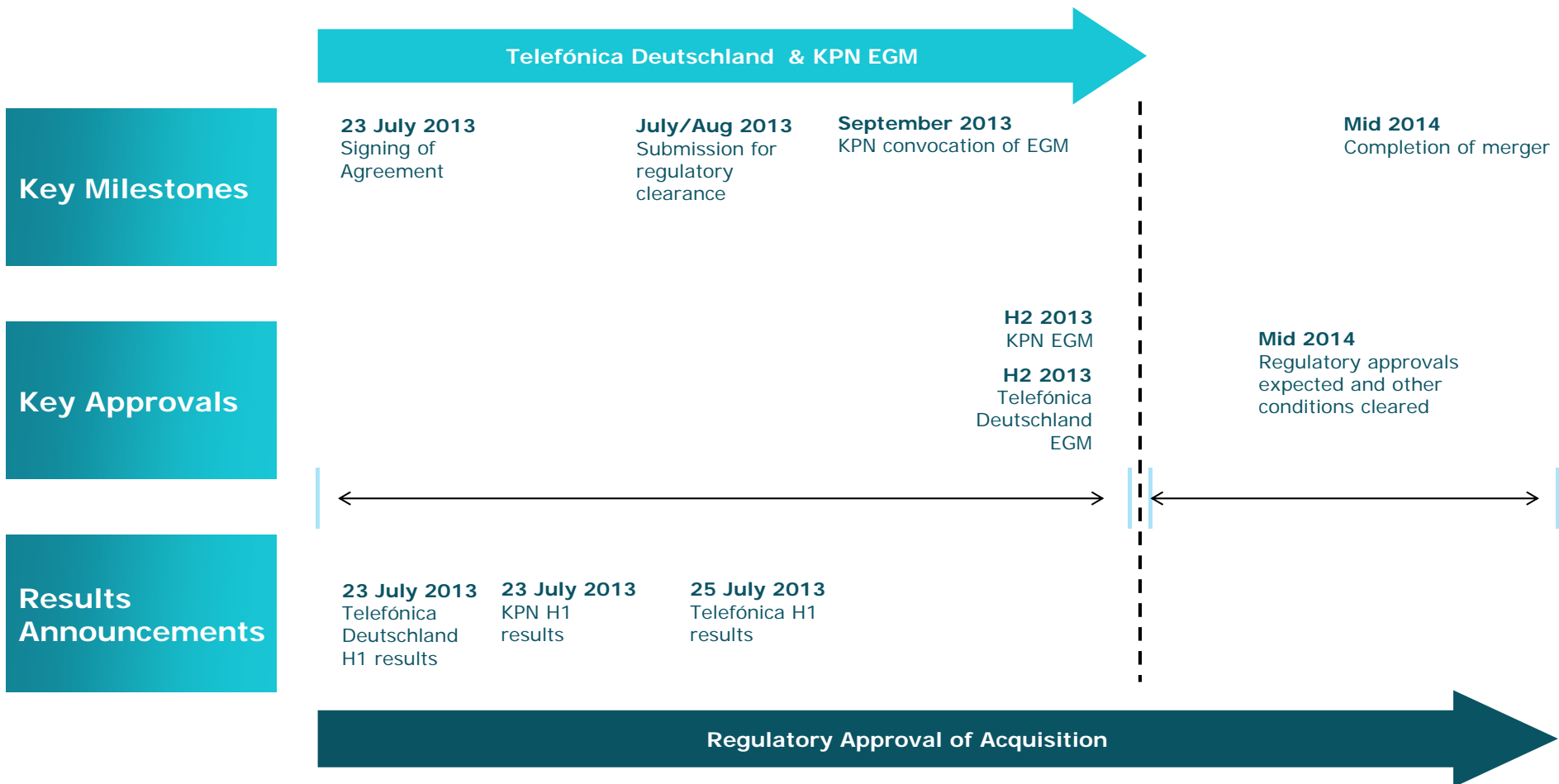
- Total financing required of €4.14bn
 - ▶ 50-65% Hybrid, 100% equity under IFRS/ 50% equity for credit rating agencies
 - ▶ 20-30% Mandatory Convertible, 100% treated as equity under IFRS & credit rating agencies
 - ▶ 10-20% Incremental debt, in addition to the debt component of the hybrid bond

Cash Payment to KPN



- Limited debt increase
 - ▶ 1/3 long term financing considered
 - ▶ Weighting around 2x incremental OIBDA, excluding synergies
- Neutral to positive metric impact in short term
 - ▶ Net debt/ratio preserved
 - ▶ Keeping strong liquidity to maintain 24 months maturities covered
- Alternative financing in process to further soften impacts
- FCF generation till deal completion adding headroom

Expected Transaction Timetable



Closing Remarks

- Post transaction, Telefónica would have the second largest subscriber base in Europe
- In each of its top 3 markets (Spain, Brazil and Germany), Telefónica would be the leader in terms of subscribers and network quality
- A natural strategic move for Telefónica Deutschland to create a leading Digital Telco focused on mobile data and LTE enhancement
- Significant value creation through €5.0 – 5.5 bn NPV synergies crystallization
- Reinforces Telefónica's geographical diversification towards Germany
- Germany is the largest mobile market in Europe and is the most advanced in data monetisation
- Substantial value creation for Telefónica and Telefónica Deutschland Shareholders
 - ▶ Investing in future growth while improving financial flexibility
 - ▶ Enhancing cash flow generation profile
 - ▶ Accretive for Telefónica and Telefónica Deutschland EPS and FCF from year 1
- Reiterated commitment to leverage targets and remuneration policy

Telefónica
