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Deutsche Telekom AG (DTE.DE)

Business Update Call - IFRS

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and welcome to Deutsche Telekom's Conference Call. At our customer's request, this conference will be recorded and uploaded to the Internet.

May I now hand you over to Mr. Hannes Wittig.

Hannes C. Wittig

Senior Vice President Investor Relations, Deutsche Telekom AG

Good afternoon, everyone, and welcome to our webinar regarding IFRS 16 which is another fun accounting subject of the IFRS 15. With me today are Guillaume Maisondieu, he's our Head of Group Accounting and Customer Finance; and Michael Wilkens, who heads our Group Controlling. After their presentations, we will have time for Q&A.

Before I hand over to Guillaume, please pay attention to our usual disclaimer which you will find in the presentation. And now it's my great pleasure to hand over to Guillaume.

Guillaume Maisondieu

Head of Group Accounting & Customer Finance, Chief Executive Officer, Deutsche Telekom Services Europe, Deutsche Telekom AG

Merci, Hannes. Merci bonjour. So, good afternoon, everybody. Let me start with a quick overview. In 2019 we see another big change to the accounting word at Deutsche Telekom after we had the pleasure to introduce you to IFRS 15 last year. As you probably are all aware, IFRS 16 is the market leader and is going to replace the current standard on lease accounting, IAS 17. The introduction will affect the balance sheet, P&L, cash flow statement, and especially net debt, EBITDA, and free cash flow, of course not only on the group level but also on a segment level.

More importantly and simply for you is a modified retrospective method with which we implement our IFRS16 does not envision a restatement in the accounts for the year 2018 or earlier periods. The effort to restate the financial years or earlier – of 2018 or earlier would just have been too time consuming and costly.

too time consuming and costly. However, in order to provide you with the necessary comparable figures for 2019 and beyond, we have decided to introduce a set of new KPIs, including adjusted EBITDA and free cash flow after leases.

This approach has been coordinated with our big European peers which also were disclosed such figures. To first reporting date under the new standard will be with our Q1 results at the end of May 2019. Nevertheless, you should be aware that the guidance respectively the outlook we'll be giving with the full-year results at the end of the month will already be based on the new KPIs after leases. In this webinar, we would like to give you an overview of how IFRS 16 is expected to influence our financials, familiarize you with the concept of after leases KPIs and last but not the least, give you a short overview of the impact on our figures.

And with this, I would move to slide 4. Within the leasing population in the Deutsche Telekom Group as of today, we have a quite large set of different leasing assets, as you can see on the slide. These range from the leasing of land and rooftop cell site space to construct masts and towers; to the leasing of offices, network equipment, routers and servers. The majority of these leasing contracts is geographically located in the U.S. and structurally related to the mobile business where we, again, especially in the U.S., are leasing space on third-party cell sites. By the way,

there are also transactions where Deutsche Telekom acts as a lessor, the population of which is also subject to change. However, the impact on the financials will not be significant.

All right. Now, if we – by the way, you can find the slides on our IR website. Yeah. If you haven't got them now.

All right. If we now move to slide 5. And here, we just have a brief look at leases of accounting for us of today. In general, leases mentioned on the previous page, [indiscernible] 00:04:47 as a finance lease or as an operating lease. However, the majority of the real estate leases, including the certified leases are operating leases today. The determining factor is a risk/reward profile of the agreement. If the lessee has a majority of the risks and rewards, it is deemed to be a finance lease otherwise we are talking about an operating lease. Operating and finance leases today will acquire a different accounting treatment. And as a result, have a different impact on the P&L and the balance sheet, and also of course on the cash flow statement.

As you know, for a finance lease, a financial liability and a corresponding asset are recorded on the balance sheet. The ongoing lease payments are being allocated between, on the one hand, interest payments that are presented in the DTE group in the cash generated from operations. And on the other hand, the repayment of the financial liability which is presented in the section cash flow from financing activities. Standard P&L expenses are derived from two components. First, there is interest expense from the liability, and second the depreciation expense from the finance lease asset. Although there is a finance lease asset created on the balance sheet, this is not viewed as an investment from a cash perspective and as such is not included in cash CapEx.

In case of an operating lease, the accounting treatment is straightforward. The lease payments are considered to be OpEx and as such included in EBITDA, either reduced EBITDA. From a free cash flow perspective, these payments reduced cash generated from operations as a result to also reduce free cash flow. In general, neither a liability nor an asset is recognized on the balance sheet and we see there is some exception.

In terms of operating lease pay commitments, I would like to point out and as most of you are aware there is a disclosure maturity schedule of future reasonably certain payouts, so lease commitments in the notes to the financiers as well as a disclosure of the yearly operating lease expenses in the P&L included in the annual report. Both of which give you a sense of the magnitude of our operating lease population, and it is for us very mature.

Now if we move to the next slide, slide 6. It's here what is going to change with the implementation of IFRS 16. First, I will point out what we'll discuss today entirely the effects on the lessee side since the implementation of IFRS has no material effect on the lessor side. So under IFRS 16 where Deutsche Telekom entities are lessees,

there will be no longer any distinction between finance leases and operating leases. Every lease will be treated in the same way and basically very similar to how finance leases were previously accounting for. It means we create a so-called right-of-use asset and a lease liability on the balance sheet. So we'll have a large prolongation, so today, of our balance sheet.

The lease liabilities are financed liabilities. It means it will increase net debt. The asset is depreciated regularly and interest expense is recorded on the remaining lease liability. The cash payments are allocated to interest and repayment of the financial liability. So the obvious consequence of this new accounting treatment is that EBITDA and free cash flow will increase and so will our net debt. Michael will go deeper into these details later.

With this, I move to slide 7. Let us have a closer look at what happens precisely on the balance sheet at the time of transition, which is now 1st of January 2019. There is a requirement under IAS 17, so the former standard, to straight line the lease expense which requires recording accrued non-financial liabilities, also called deferred rent balances on the balance sheet. Straight lining the expenses achieved an even distribution of the leasing costs over the duration of the lease in the P&L. This effect occurs when the leasing contract includes six future rent increases, sometimes called step rents and this over the last time off-the-lease. Of course, the same happened in the opposite direction. When the rent is paid entirely [indiscernible] 00:10:34 in advanced, one has to record a deferred asset on the balance sheet, so to record the advanced non-refundable cash payments.

These advanced lease payments are then allocated over the lease term in the P&L which also achieved a straight lining off of the leasing costs over the term. I know it's not very simple. But to summarize, certain IAS 17 operating lease-related balance sheet accounts exist, and the rules to eliminate them have been transitioning to IFRS 16 because of course, they're no longer belong there since the operating lease concept is being replaced by finance lease concepts. So we are talking about kind of recycling of these positions.

So let's look at the step by step, we have three steps. On this one slide, you see the first step. On January 1, 2019, under the so-called modified retrospective method in the first step, the value of the right of use assets and corresponding liabilities being determined. And there should be of equal size. But here is to the deeper rent liability. But the risk to the different liability and other balance sheet accounts from prior years, which IFRS 16 requires that these accounts be eliminated by adjusting them again to right of use assets created in step 1.

And with this, I move to the next slide, slide 8. And you're seeing the DT Groups, the second step is a revaluation or recast of the deferred rent liability, such as it agrees with the length of the leased terms applied in IFRS 16.

This portion of the deferred rent balance is recorded against equity with the result that equity will increase. The remaining amount of deferred rent is adjusted together with all other balance sheet accounts in a short step including the deferred prepayments, against the right of use assets with the overall net [ph] result 00:12:50 that's a right of use assets is reduced.

To summarize, as a result of taking these steps, the following will happen: First, which is an increase in equity; and second, will end up with the right of use asset, but is lower than the corresponding lease and liability.

So now, let's move to the next slide that is slide 9. On this slide, let me briefly explain what Policy Elections we have chosen for Deutsche Telekom. As already mentioned, we have decided to use the modified retrospective approach, meaning, there won't be any restatement for 2018 or earlier, due to the complexity and costs because of the multiple changes to our [ph] sell-side 00:1341:contracts over time, we have refrained from trying to restate our historical financials. We fully introduced IFRS 16 now. Theoretically, we would have had the option to exclude short-term and low value leases from being recognized under IFRS and we could have refrained from evaluating

whether our existing lease contracts meet the definition of IFRS 16. We have decided to process short-term and low value lease in our T-system since excluding them from our databases and creating exceptions, we have been more costly than processing them all. In addition, the low value exception does not apply under U.S. GAAP and we would have had a GAAP difference is U.S. and this we want to avoid. Hopefully, you would agree with us doing it. Otherwise, it would have added more complexity and cost and not being really had for.

We did not apply IFRS 16 for leases of intangible assets because we currently have well-established processes under IAS 38, so standard for intangible assets for the accounting of intangibles including leases for intangible so we have it already on the balance sheet. It's also very time consuming in certain cases to determine whether a contract is a lease or a license. Furthermore, we have decided on a separate presentation of lease, assets and liabilities on the balance sheet to give us the highest degree of transparency on this issue.

And last but not least, we have also chosen not to apply IFRS 16 for group intercompany leases because [indiscernible] 00:15:40 intercompany transactions by IFRS 16. We did not want the segments EBITDA to be inflated by group internal leasing agreements. For instance, between Group Development with its tower business and the Germany segment. We believe you share our view that this approach is the right one.

So, now we move to slide 10. That is quite crowded and a lot of course goes through all [ph] provisions 00:16:08. Now before handing over to Michael, we make a deep dive into the impacts on EBITDA, free cash flow and net debt and the after lease KPIs. Let me conclude my remarks with this overview page.

Quite frankly, the only area where we expect only let's say negligible impact is the net income and the cash flow from investing activities which should not see any impact at all on more or less all other relevant financial of DTE. And you see each year IFRS 16 we have a significant impact.

With that, I would like to hand over to my dear friend Michael who will now dig a bit deeper into the details of the expected changes on our major steering KPIs. Thanks.

Michael Wilkens

Head of Group Controlling

Thank you, Guillaume, and also good afternoon to everybody from my side. Hope you can still stay with us on this wonderful topic. By the way, last year IFRS 15 Guillaume mentioned it this year IFRS 16. We're looking already forward to next year's IFRS 17. But bear with me for now. It was a joke. Let us do a little bit of a deep dive how the introduction of IFRS 16 will impact our current – major steering KPIs as Guillaume introduced me already.

So, in the P&L on page 11, we will see a shift of current indirect costs mainly in the leasing expenses, expenses of the current operating leases to depreciation and interest result. This means that the EBITDA to a lesser extent the EBIT will benefit substantially compared to current accounting. If you would have IFRS 16 already in 2018, we estimate that the benefit on the EBITDA would have been around €3.4 billion.

On the net income level and consequently on the level of EBIT EPS which is the basis of our dividend policy, we would expect the impact to be slightly negative due to the front line effect of interest accruals partly offset by a reduction of lease terms at TMUS. However, the impact is not big enough to change our mid-term guidance on adjust EPS but I will come back to that once – anyhow later.

If you move with me to the middle part of this page, let me deep dive with you into the free cash flow which is defined as cash generated from operating activities minus cash outflows for the acquisition of tangible and

intangible assets excluding spectrum of cost and plus the cash inflows from the sale of tangible and intangible assets.

We'll also benefit from the introduction of IFRS 16 as the operating lease payments which as of today are part of the cash generated from operations will partially be moved to the cash flow from financing activities as repayment of financial liabilities.

And we estimate that the benefit of the cash flow would have been around €2.5 billion on our 2018 full year results. And despite that fact that on the balance sheet, we are seeing assets being added to cash CapEx from a cash flow from investing perspective will obviously remain unchanged.

So let us now have a deeper look on what happens on the net debt right part of the have a deeper look on what happens on the net debt, right part of this page. So currently, finance leases are part of our net debt whereas operating leases are not. And in the new accounting world, these lease liabilities will become financial liabilities and obviously increase on that debt. In our 2017 Annual Report, we've mentioned €15.1 billion of lease liabilities which is a good starting point to assess the impact. But please keep in mind though that this is an undiscounted value under IFRS 16, the liability is discounted. So we would expect for the opening balance of the year 2019 the net debt impact of around €15.4 billion. Also worth mentioning is the fact that we would not expect that our rating that will change significantly as the rating agencies already include lease liabilities and more in the definition of net debt.

So that brings me then to page 12. It should be clear from what I have mentioned so far that a comparison of the years 2018 and 2019 will be rather difficult as in many aspects figures would deviate strongly from the previously disclosed ones and Guillaume mentioned that already. Another aspect from the steering perspective is that lease costs being outside to EBITDA could create wrong steering incentives. That is the reason why we have decided to introduce a new set of new KPIs to make sure that you are in a position to track the underlying operating performance of our business units as well as we do of course. So we will use these KPIs for internal steering purposes but also in our quarterly discloser for you as a basis and also for our guidance which comes end of February.

The concept of these KPIs has been discussed with our bigger European peers and we assume that all of us will use these on a coherent definition for our financial communication in 2019 and going forward. We all think that the closer proximity to the cash generator makes these KPIs very valuable.

But we in principle do with EBITDA or indirect cost after leases is rather simple. We are adding back the lease costs, which under the new accounting standard are in the lines depreciation respectively interest result back to the EBITDA. We will do that for the year 2018 as well as for the years 2019 and beyond.

Now, you could expect that that EBITDA after lease, as we call it from now on, will be the same as the adjusted EBITDA you have known until today. However, that will not be entirely the case.

The reason for that is threefold. During IFRS 16 conversion, [indiscernible] 00:22:43 decided to verify their assumptions about the extension of lease terms. And as a result, the average lease term has been reduced from approximately 8 to 9, down to 4 to 5 years. This has a positive impact on the EBITDA after lease KPI due to a lower depreciation base for the right-of-use assets. Counteracting effect is the front load effect of the interest accruals for the lease liability. In early periods of the lease lifetime, the interest accrual is higher than in the later.

And the third reason is the finance lease. As in 2019 and beyond, we will no longer be able to differentiate between finance lease and operating lease for the group excluding the U.S. That means that consequently also, we have to add back depreciation and interest of former finance leases in 2018 to the EBITDA or any other measure that is tracked according to the after-lease methodology. For TMUS, we are still able to differentiate between finance lease and operating lease, but I will come back to that one in a minute.

Let us first go jointly to page 13. Let's move on to FCF. Principally, the approach is similar to the one with the EBITDA I've just explained to you. We're adding back the cash payments for our leases to the free cash flow. As with the EBITDA, we no longer can differentiate between operating leases and finance leases, and we will add back all lease payments, the result being the free cash flow after leases for 2018 will not be identical with the free cash flow as per – let's call it old accounting standard in 2018.

The benefit of this new KPI is that if you does take into consideration also the finance lease and provide an even more cash-oriented view compared to the previous one. I should mention here that there's as always an exception to the rule. In this case, it's TMUS where we will not add back the finance leases.

Explain on page 14. We have a breakout for you here and let's go deep dive into that one. Initially, it was planned to more or less have the same treatment of leases in U.S. GAAP and under IFRS. However, what we are seeing today is that the European IFRS standardization bodies and the U.S. accounting standardization bodies and the principals basically are not aligned anymore. So, though under U.S., GAAP, TMUS will also take our leases on the balance sheet, and the subsequent treatment in the P&L, and in the cash flow statement, it's different. U.S. GAAP will continue to differentiate between finance lease and operating lease. And the principal mechanisms of today's accounting will remain in place.

So under U.S. GAAP, it's important to know and understand no change to the EBITDA and obviously then, no change to the free cash flow. Which introduces a new problem into the whole discussion, namely we then will be seeing a growing GAAP between the TM US results according to U.S. GAAP and the results according to IFRS.

And in order to avoid exactly that problem and to create as little confusion as possible, we have decided that in the calculation of the adjusted EBITDA after lease for the operating segment TM US, we will not deduct the depreciation and interest for finance lease. This obviously, will also affect the group's result and the FCF after lease for the group as we do not consider the operating leases anymore, then we will not take the depreciation and the interests for TM US finance lease into account.

On the other hand, we have a break in the accounting logic in the group. And on the other hand, we have valued the comparability of the U.S. GAAP results to the IFRS results higher than the consistency within the group. We hope and we believe that you will share our logic here.

That brings me to page 15. Now let's have a little bit of a first look how we expect 2018 results to look like on an after-lease basis. Overall, we expect a small deviation from previously-disclosed figures, as we have not published any of the [ph] 20 results 00:27:33 yet, we have to base this assessment on the guidance we have provided to you in the year 2018. As you know, we are expecting based on the guidance currency exchange rate and adjusted EBITDA of around €23.6 billion. We would believe that this figure on an after-lease base would be some €300 million lower at a level of around €23.3 billion. As you can see on the slide, we expect the impact to come from the group excluding the U.S. where the U.S. is expected to be rather unchanged at a level of \$11.7 billion.

The positive impact of the reduction of the average lease term will be counterbalanced by the front load effect of the interest accrual. There's no impact due to the previous finance leases. The deviation in the adjusted EBITDA consequently also translated into a decline of the free cash flow where we expect our related decline of around €0.2 billion from €6.3 billion as per our guidance to a level of €6.1 billion euros. Going forward, we estimate the EBITDA after leases for our ex-U.S. operations to be in the range of €0.2 billion to €0.3 billion. When evaluating this impact, please also take into account that net debt is also impacted if you move to the so-called after lease KPI.

And that brings me to page 16. Now, let us type a little bit deeper into the composition of the adjusted EBITDA excluding the US and have a look where the €0.3 billion deviation is coming from. Also here, we would not expect to see a significant deviation from the figures as you know them, anyhow. You can see on the chart that the values for group development systems are for group development and T-Systems are first slide unchanged whereas the Germany and Europe figures there's some €0.1 billion AL each. The missing piece then to come to open €3 billion apparently as [indiscernible] 00:29:43 for which we have not set up any specific guidance.

The other segments also have some IFRS 16 effect. However, they are too small to change the rounded figure. On the first slide, it looks as if there would not be any impact on the results in the segment group development and T-systems and basically all the effect in Germany and Europe.

The underlying picture is a touch more complicated. Let me explain that, out of the €0.1 billion deviation Germany roughly 50% is directly IFRS 16 related and the rest is due to internal cost reallocations between Germany and the segments T-systems and [indiscernible] 00:30:25

In other words, Germany has a headwind of some € 50 million whereas T-Systems and [indiscernible] 00:30:31 benefit on underlying basis. And on the group level, these structural changes are of course neutral.

And that brings me to slide 17 which is the last slide to make some additional remarks. When it comes to the term more importantly to net debt over EBITDA ratio, this will be tackled later on the basis of our IFRS 16 results, meaning we would take net debt including lease liabilities and divided by the headline adjusted EBITDA.

This logic is difficult to the one that some of our peers will use. They will take the net debt without leases and divided by the EBITDA after leases. However, we want to use the IFRS 16 to bring our net debt to closer to the rating agencies definition of net debt – of debt, sorry.

Therefore, we decided not to take the method that some of our peer feels and instead use the net debtPeers use and instead, use the net debt including lease liabilities as we believe this is the more accurate one. As a result, we also have to adjust our net debt over EBITDA ratio corridor to mirror the changes triggered by the new accounting. And we will update you in due course on the new corridor.

However, for valuation purposes and to ensure also for you, comparability with our peers, we will also communicate a net debt figure without leases as our peers do.

Finally, let me remind you, although I'm sure you're all aware of that, that our guidance for 2019 will include 12 months of Tele2 and 12 months of UPC in Europe.

With that, I would like to thank you all for your attention and we are now looking forward to all of your questions. Back to Hannes.

QUESTION AND ANSWER SECTION

Hannes C. Wittig

Senior Vice President Investor Relations, Deutsche Telekom AG

A

Okay, thank you very much Michael or Michelle, and Guillaume and we don't have a German version for that, but speaks for itself. Now we can start with the Q&A part. [Operator Instructions] And you can send us questions also per e-mail or via webcast, as some of you have done. So while we were waiting for questions from the audience, let me, maybe start with a question I've had from Fred at Bank of America.

Fred Boulan asked, how much did you say the positive impact on ad adjusted EBITDA would be?

So we said that in the – Mike has said it in his comments, and he said, the headline adjusted EBITDA impact, if we apply the IFRS 16 standards retrospectively. But 2018 is estimated to be around €3.4 billion. And next, we also have another question by e-mail from [indiscernible] 00:33:47 and I would like Guillaume to answer that question, please.

Guillaume Maisondieu

Head of Group Accounting & Customer Finance, Chief Executive Officer, Deutsche Telekom Services Europe, Deutsche Telekom AG

A

Yeah, [ph] Thibaut [indiscernible] 00:33:56 Good question. Thank you. So you asked in the first step of slide 7, so it was about putting our leasing CapEx on the balance sheet. How do we capitalize the leases? Do you use multiple, which multiple?

In fact, we take some of our obligations and we discount them to the net present value. That is the method behind.

And then the second question is why is there an impact of the net income level? Is it the timing effect?

Yeah. I mean, first it's not visible, as I said, so very little impact we're talking about and it's mainly a timing effect because we front load here our interest accruals here because they have a digressive corrector. That is the main reason.

And the third question and it's also a good question. What do we mean with no grandfathering of existing lease contracts?

Grandfathering is an option given by the standard where you say, okay, the ordered is accounted with the old method. So you will have a hybrid procedure the ordered being still accounted to the end of the leasing contract after the old standard and the new contracts with the new standard. And we decided to have a clear cut off and to take the

and to take the whole old word, so to say, into the new standard. So all our contracts, our whole history, is recycled after the new leasing standard. So clear cut year and you don't have any hybrid procedure. Thanks.

Hannes C. Wittig

Senior Vice President Investor Relations, Deutsche Telekom AG

A

Thank you, Guillaume. The next question is from Ulrich Rathe at Jefferies, please.

Ulrich Rathe



...I have three, hopefully just short ones. And the first one is I understand the tower companies talking to operators suggesting contract structures that would keep things off-balance sheet. Are you aware of that and will Deutsche Telekom be using that? That would be my first question.

The second one, I understand under IFRS 16 you have to actually make an assessment of how likely you're going to use these assets after any current contract expire. So I was wondering, you mentioned that we have full disclosure in the Annual Report of the actual contract but how much more would be sort of indicatively come in from the assessment of continuing to use it beyond the contract when you actually put it on the balance sheet?

And my last question on this whole T-Mobile sort of different treatment, I mean at a very high level, do I understand you correctly that what you're trying to get to is that when we get the group free cash flow after lease in your definition for the group, that we can simply subtract the T-Mobile U.S. GAAP free cash flow and then get a true ramp on free cash flow? Is that the reason for all these sort of complications that you essentially – when we create a situation where we can just subtract the TMUS U.S. GAAP number out of the group number and then we end up with a reasonable number? Is that actually what's going on? Thank you.



Thank you, Ulrich. I'll start with the first one. I will also give some preliminary answer on the third one. And then, Michael and Guillaume can add their thoughts and answer the second one. So on the first one, are we aware that certain tower companies are discussing contract structures that would keep things off balance sheet. Yes, we are. I think probably, the way or the thought behind the question is whether these changes, the way we will, let's say, manage our tower unit and structurally consider our tower unit. And at this point, I don't think there's anything new to disclose here, and we don't think the situation is fundamentally changed.

Then, on the third question, why do we have a different treatment for T-Mobile. Well, as Michael said in his text, the point is that we would like to keep the IFRS translation, IFRS U.S. GAAP translation to a minimum because it is not very transparent, and we would like to keep the reporting of T-Mobile and the reporting of Deutsche Telekom as closely aligned as possible. So, that's the reason why we talk about this. Michael, you might want to add before Guillaume, I think, you will take the second question.

Michael Wilkens

Head of Group Controlling



Yes. Maybe just to add. Ulrich, it's very simple. We have two reasons. A) We don't want to overcomplicate the infrastructure which is already not a very simple one; and B) we are staying to as we did before. And because the U.S. GAAP standardization differentiates, here we have the chance to differentiate as we did before between [indiscernible] 00:39:12 and finances. So, the cash flow definition from this is the same, but you cannot deduct the U.S. cash flow from the group cash flow. That doesn't work.



Yeah. And you asked here about

Guillaume Maisondieu

Head of Group Accounting & Customer Finance, Chief Executive Officer, Deutsche Telekom Services Europe, Deutsche Telekom AG

A

Yeah. And you asked here about the assessment of continuing here to utilize assets beyond the contracts. And this is a good point because this is something that is also regulated here by the standards. You go for an assessment. And the question is, is it reasonably certain that you will go for prolongation and reasonably certain is a very high probability threshold, so between 80% and 85% roughly. And when you look at the exercise we made for instance in the U.S., you finally have here an assessment leading to an average lease term of roundabout five years but is very much in line with our peers in CS. Thanks.

A

Okay. Thank you, Guill. And the next question is from Jakob Bluestone at Credit Suisse. Jakob?

Jakob Bluestone

Q

Hi. Good afternoon. Back at your Investor Day in May, I think you outlined a sort of long-term net debt to EBITDA comfort zone of 2 to 2.5 times. Could you maybe provide us with what your new long-term leverage comfort zone would be on your sort of new net debt to EBITDA definition? Thank you.

A

Jakob, we have said that we will provide this in due course. What we have provided today is guidance for the headline impact of net debt and EBITDA on a pro forma basis for 2018. And if you let's say use that and let's say superimpose it on our existing rating comfort zone, then you will not be far off directionally from where we will be. But given that we're still sort of in the process of getting into the new accounting, we think there is – we will take a little bit more time to come back with a very precise notion but I think the direction should be very clear. With that, the next question goes to Mathieu Robilliard at Barclays please.

Mathieu Robilliard

Q

Good afternoon. Thank you for the clear presentation. So, first something about the length of the lease contract, I didn't completely heard it. You said you had shortened the length of the lease and therefore this had an impact on the D&A. If you can maybe explain that, that would be very helpful.

Also you said you did change though the length of the contracts. Does it mean that all the leases now has kind of the same length and the renewal is going to be on one go or it's got very different lenses among the different leases and then – and therefore it can create a little bit of volatility I guess when you redo a lease and you have backhaul the liability, et cetera, et cetera. So, I wanted to understand that too. Hopefully the question is clear.

And then third, you said that you are not going to restate the numbers. You do helpfully give some pro forma numbers for 2018. Are you going to give those pro forma numbers for all the quarters as you publish Q1 2019 and Q2, et cetera or is it just going to be that – just the full year pro forma 2018? Thank you.

Michael Wilkens

Head of Group Controlling

A

Mathieu, let me take the last one first. So, yes, we will do pro forma 2018 numbers and we will do it also per quarter. So, in order to make your life as easy as possible.

Guillaume Maisondieu

Head of Group Accounting & Customer Finance, Chief Executive Officer, Deutsche Telekom Services Europe, Deutsche Telekom AG

A

Yeah. Mathieu, looking here at the length. In fact first, I mean, you have to look at it contract by contract. So, it's not one then going to apply it for all the leading obligations we have. First you are the ones that you have in the contract that is firm that is given that is an obligation with this trade.

And then the question is are you going to prolong or not. And then we have to apply here what is given by the standard, is it reasonably certain that we'll have a prolongation or not. And it's reasonably certain, I mentioned before, is a threshold between 80% and 85%. So I mean obviously in most cases, it is not reasonably certain so you will have here of the leverage you have in the contract. For instance, for our TMUS and this is the main part of the leading obligation, we're talking about an average lease term of five years. And once again, when you look at our peers in the U.S., it's going to be very similar. Thank you.

Hannes C. Wittig

Senior Vice President Investor Relations, Deutsche Telekom AG

A

Okay. The next question is from Ottavio Adorisio at SocGen please.

Ottavio Adorisio

Q

Hi. Thank you for taking – a couple of questions. The first, a follow up from the very first question in terms of the capitalization of the lease. You said that you discount – to capitalize the lease and to show that in your balance sheet, you discount it. So I'll be interested to know what is the discount rate you're using it? And second, that means that your guidance will be dependent on discount rates going forward? And third, how the discount rate you're using compares with the one used by the agencies?

The second one is basically on – you provided today a bit of color about how you're going to guide going forward, so the EBITDA after leases, but you haven't said what the net debt after leases will look like. Will it be the same as it is today or there will be also changes? Thank you.

as this today or there will be also changes? Thank you.

A

Yeah. Thank you. Good questions. You also – yeah, I mean, as you said rightly, so we have some of our obligation and we discount them to a net present value. And here, it's very much related to the exercise done by the rating agencies, very comparable and in the end of course it needs to be approved by our auditors. But I would say it's quite a standard method here of discounting to net present value, so there is nothing special in there. And yeah, I would say, this is the main answer to this.

A

Yeah. I can take the question on the guidance. It's irrelevant because we basically guide ex-lease, so that should be out by itself. And the last one, the answer is yes. The net debt ex- – or after lease will look the same as now.

A

Okay. So, I've had – we'll be having additional question from Fred at Bank of America. You're on the call Fred.

Q

Yes, I am. So, it's a good – just on a quick follow up on the free cash flow. So, if you could run through again the delta between your current and the free cash flow after leases. I understand it's a repayment of lease liabilities. So, is this a structural difference? Is this the relocation of where you were booking those liabilities before, i.e., out of your free cash flow scope into that free cash flow. Because I guess some of a pure cash perspective this account move shouldn't change anything. So, if you could just clarify a little bit the driver again. Thank you.

A

Not sure

whether I got it. Maybe you can – Fred, maybe you repeat your question.

Q

Yeah. If you could just reclarify the change in your free cash flow after leases which are going to be lower than the current free cash flow. I understand from your slide 13, it's down to the repayment of lease liabilities, and is this for structural change or it's more of a one-off depending on that to your delta in the size of the liability that you took on board? Thank you.

A

Yes. It's a structural change so this is why we all also explain that the new, let's call it the new SCF after lease figure brings you closer to a let's call it real cash logic.

A

Okay. Thanks, Michael. Next, we've had a bunch of questions by mail from Akhil at JPMorgan. So he said, you've had – one question you've had detailed conversation with other telcos. Do you expect most to take the same decision as you on the application of short-term and low-value leases? So I'm not sure if that was being discussed. But Michael, if you could maybe answer?

Michael Wilkens
Head of Group Controlling

A

Yes. It was discussed. Let's wait until the other operators come finally out I think or just due tomorrow. Vodafone obviously later from my understanding but we all have to double check together. We believe that we are together in the same analysis and what we apply at Vodafone. I'm not sure we are together with Telefónica because let me discuss over the last time that it has not decided yet and I'm also sure that we are in the same ballpark but we have to understand jointly once they're on.

A

The next question from [ph] Achilles 00:49:11. You tend to provide full year guidance on organic growth rates. Will you do this on a reported or lease-adjusted basis? So we will guide based on like-for-like, as always. So like-for-like for us means we use last year's average exchange rates. We use – we adjust for changes in the scope of consolidation. And we will also this year then of course adjust for the move to [ph] EBITDARL 00:49:40 because that's our new key KPI for the purposes of guidance and steering.

And the next question from [ph] Achilles 00:49:52 as well is based on the net debt-to-EBITDA impact, would it be accurate to estimate that IFRS 16 will lead your leverage ratio post-IFRS 16 basis to rise by around 0.3 times? So like previously, we've given some ways of thinking about this so I will not specifically comment on that calculation. It's not obviously inconsistent with my previous comment.

Okay. So I think we have no more questions over the telephone line now. So maybe one final call for questions before we wrap up the call. Of course we can also take – you can also call us at the IR department for like a more deeper discussion of these issues and our presentation will be available on our website.

Unverified Participant

So since there are no more questions, I would say thank you all very much. Thank you, Michael and thank you, Gillaume. It's actually a lot of work for our accountants, hot on the hills of 15 and as far as I'm aware, there is no IFRS 17 coming next year. So just to be clear that

we were trying to approach this on a humorous note as much as one can, and the – yeah. Any further questions, please contact us at the IR department. And with that, I hand back to the operator.

Operator: So, we like to thank you for participating at this conference. The recording of this conference will be available for the next seven days by dialing +49-1805-204-7088 via number 522497#. We are looking forward to hear from you again. Thank you and goodbye.

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