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PRESENTATION

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 Wittig - *Deutsche Telekom - SVP IR*

Good afternoon, everybody, and welcome to our webinar on accounting and other reporting changes that you should be aware of in 2016. With me is Andreas Puy, who will later help me in answering your questions. As always, I would also like to draw your attention to the disclaimer which can be found in the presentation.

The major focus of today's session is to familiarize you with the accounting treatment of two very special items in the US that, while being already introduced in 2015, will play a more significant role in 2016 for our business in the US and, consequently, also will have an impact on the Group results as well.

After that, we will also focus on some smaller accounting changes that are in the pipeline for 2016, as well as the impact of some deconsolidation effects you should be aware of before we start to go into our Q4 results end of February.

I think we will need about 20 to 30 minutes to run you through the slides and we'll have about 30 minutes thereafter for your questions. As always, we have also provided for the opportunity to ask questions via email or Twitter.

So starting on slide 3, we start in the United States and let us start here with the accounting treatment of the bigger of two items we want to talk about, the JUMP! on Demand device lease program. As many of you are, hopefully, aware, T-Mobile US initiated a JUMP! on Demand device leasing program in June 2015, as part of their many Uncarrier initiatives.

It basically includes three elements. Customers with qualifying credit scores can lease a device for zero out-of-pocket expense. In contrast to the equipment installment program model, the EIP model which stood for the vast majority of our net adds historically, it is really zero out of pocket for the customer, as EIP was considered a purchase with the full sales tax due upon signing.

Secondly, comparable to the EIP, the customer is paying monthly lease fees. However, the standard period of the lease terms is 18 months, whereas under EIP it is 24 months.

And third, the customer has the choice to upgrade to a new device whenever he or she likes, up to three times a year. Note that for both EIP and JUMP! on Demand, depending on the credit score, customers may have to do an additional down payment at the beginning that can also reduce the working capital impact accordingly. But today's examples that we will show you will be more simplified than that.

At the end of the lease contract, the customer has three choices. First, he or she can return the device; or secondly, return the device and sign a new lease contract; or third, make a final payment for the residual value and acquire ownership of the device.

As the residual value of the device plays an important role in the financial considerations, the device range eligible for JUMP! on Demand includes only the highest-end devices, i.e., those with comparatively high residual value.

The crucial difference to EIP, which results in a different accounting treatment which we want to talk about today, is the fact that with EIP the customer becomes an owner of the device, whereas in JUMP! on Demand ownership of the device stays with T-Mobile.

Moving on to slide 4, let us now have a look at what is different in the accounting treatment of EIP versus JUMP! on Demand, if you look at the individual line items of the P&L, balance sheet and cash flow statement.

First on the revenue, JUMP! on Demand is straightforward. The monthly recurring fees are revenues. The potential terminal payment by the customer at the end of the lease term is also revenue. There is no timing difference between cash and revenue.

EIP is a little bit more complicated. The revenue is essentially recorded upfront at the time of sale and the cash is collected in monthly installments. A receivable is required to bridge the gap between revenue and cash, with the receivable being drawn down over time as cash is collected. In more simple words, compared to EIP, JUMP! on Demand results in lower revenues in year one but leads to higher revenues in year two.

Second, on OpEx, under EIP the treatment is straightforward, as the cost of the device is OpEx. Under JUMP! on Demand, the cost of the device is not OpEx, as it is being regarded as an asset and, therefore, it is capitalized on the balance sheet and subsequently depreciated below the EBITDA line. As always, there's an exception to this rule, to which we come later.

The different treatment, however, has obviously consequences on the number three line item, which the EBITDA. Whereas under EIP, in a simplified world and assuming no subsidies, the handset transaction would not have any effect on the EBITDA as revenues would equal OpEx, in JUMP! on Demand, there will be a boost to EBITDA because there is no OpEx and the monthly lease revenue has a 100% EBITDA margin.

What can be seen is that lease revenues is a good proxy for the impact on reported EBITDA. What also should be obvious, again in a simplified accounting world, is that on the EBIT level both transactions are equally neutral.

This brings me to the fourth item, the cash flow treatment of these two transaction types. The good news is that it does not make a difference on cash generated from operations or free cash flow, whatever transaction type you model. So no impact, just to summarize the last two items, on either EBIT or on free cash flow. Under EIP, the cash paid for the device is OpEx and, as such, is being included in cash EBITDA and in the cash flow statement.

Under the headset lease scenario, the cash paid is a working capital item. As a consequence, you will find the result in different line items of the cash flow statement, but the impact on cash generated from operations, or free cash flow, is the same with the cash generated from operations occurring over time as monthly payments are received.

Finally, the number five item, CapEx. You may recall that I have mentioned that, under handset lease, the device is being capitalized and depreciated. This means that the so-called book CapEx will be higher than in an EIP transaction, but it does not affect the cash CapEx.

As said before, the purchase of the device for JUMP! on Demand is a working capital item and is reported within the cash generated from operations and it stays there.

Finally, on the balance sheet, the device is transferred from inventories to PP&E and constitutes the mentioned book CapEx.

Moving on to slide 5. So after having gone through the line items, let us now have a look at an example of the accounting treatment of the two different models over the lifetime using a working example. Please be aware, it's a rather simplified example that neglects details like the possible phone upgrades, allowances for bad debt or accelerated depreciation of the device, which would additionally impact the accounting.

We are assuming for both transactions in the simplified example that the cost of the device is $650 and the customer fully pays for the device over its lifetime. The left-hand side of the slide 5 is related to EIP and the right-hand side shows the JUMP! on Demand device lease program.

Under EIP, equipment installment program, in year 1 we have a $325 cash inflow from the 12 monthly installments, we have $650 cash outflow to our supplier, and we are recording the full $650 of the 24 monthly installments as revenue and the full $650 for the device as OpEx. And, obviously, this results in zero EBITDA and a negative drag on the free cash flow of $325.

In year 2 under EIP nothing happens on the P&L. We receive the 12 monthly installments, in total $325, and release the receivable. After 24 months the result is that we have $650 of revenues, we have $650 of OpEx and $650 of cash inflow versus $650 of cash outflow.

Looking now at the handset lease scenario. As with EIP, the cash balance in year 1 is negative as we collect $325 in cash and pay $650 for the device. In terms of revenues, we only record 12 monthly installments, or $325, but have no OpEx and, therefore, an EBITDA of $325. We then record the device as an addition to assets worth $650 and start to depreciate.

In year 2 under the handset lease scenario we continue to record six monthly installments as revenue and six monthly installments as cash inflow. This equals $162 cash in, revenue and EBITDA.

Now we have approached the end of the lease contract and the customer decides to acquire the device for a terminal payment of $163. The interesting thing is that on this occasion the standard requires us to record the residual value of the device as OpEx, as this is now being considered a classical handset sale business, with the result that there is no positive effect on the EBITDA.

Thus, in total, in this example we have $650 in cash inflow, $650 in cash outflow. We have a positive EBITDA contribution of $487 and zero EBIT contribution as the device is fully depreciated, with the exception of the residual value that goes into cost of goods sold over the period.

The most important things to take away from this example are first, the enormous boost to the EBITDA in the handset lease scenario compared to EIP; secondly, the different phasing of the revenues; and third, the impact on cash flows is identical.

The final observation is that the best way of modeling operating free cash flow for the US is to calculate cash EBITDA and subtract cash CapEx. And as we have previously said, leasing revenues are a good proxy for the difference between reported and cash EBITDA.

So moving on from handset lease to a second item, as we said at the beginning of the call, we will invite questions at the end of the teach-in. So we now want to move on from the handset lease to the data stash, which partially offsets the positive effect from the handset lease on the EBITDA.

The data stash is also known as the data rollover and was introduced in December 2014 with the Uncarrier 8. The original data stash announcement incorporated two elements, and we are now on page 6.

First, a free gift of 10 gigabytes of high-speed data for eligible customers. And secondly, the opportunity to roll over unused data to the next month, so a gift and a free rollover, free and unlimited rollover. It is important to understand two things. First, the rollover data stash only kicked in after the free gift had been consumed, and second, that the gift expired on December 31, 2015.

In 2016 the gift has expired so it will not have an impact. We will review the mechanics of the gift so that its impact on 2015 is understood.

Moving on to slide 7. In order to illustrate how it is being accounted for and why it makes a difference when we move into 2016, we have compiled three examples of a customer on a $60 plan with 3 gigabytes of monthly high-speed data allowance but with a different usage pattern.

So I will take you through those three examples on page 7, 8 and 9, and try to do that quickly. Hopefully, the principle is pretty clear.

In example one, on page 7, we are looking at a customer use exactly this 3 gigabytes of monthly data allowance and who has received the 10 gigabyte gift at January 1. We further assume that the value of the gift is $1 per gigabyte.

What we see is that in the first quarter we are receiving the expected $180 in cash inflow. The revenue, however, is only $170, which, obviously, then impacts EBITDA. The reason is that we have to accrue for the $10 gift as a liability to the customer.

As you can see, nothing further happens in the quarters 2 and 3. The liability is where the remaining gift is unchanged as the customer simply continues to consume his or her 3 gigabytes.

With Q4 the scenario changes. We received the standard $180 quarterly fee. The revenue, however, is $190 as the unused gift expires and the liability is released. From a full-year perspective, the gift does not have an impact on the EBITDA.

Moving on to slide 8 and the second scenario. The standard customer with 3 gigabytes of allowance uses 4 gigabytes of data per month until October when the gift has been used up and then falls back to the standard consumption of 3 gigabytes.

In the first quarter we, obviously, again, have $180 of cash coming in. We have the liability of $10 for the gift but, as 3 gigabytes of the gift already have been consumed, the resulting liability is only $7 and the recorded revenue is $173.

In quarters 2 and 3 he or she continues to use 1 gigabyte per month from the gift and, as a result, the revenue in each month are EUR3 -- $3 higher than the cash received. In the fourth quarter, the remaining 1 gigabyte from the gift is being used, and as a consequence, the revenue is $1 higher than the cash in.

Both scenarios, so the one on page 7 and the one on page 8, have in common that, from a full-year perspective, there's no impact on revenue. Following that on EBITDA, it's as we stated at the announcement, more a question of phasing of quarterly EBITDA than anything else.

Now let us have a look what the customer needs to do to have an impact on the EBITDA. Again, we are taking our standard customer $60 and 3 gigabyte allowance. This customer uses the entire monthly allowance and the 10 gigabyte of gift already in Q1 and, in the quarters thereafter, reduces the consumption to 2 gigabytes of data and starts to roll over.

In Q1, it's a straight forward accounting, $180 cash in, [$100] revenue as the gift is being used up, and no liability is required. In quarters 2 to 4, the customer rolls over 1 gigabyte of data per month, with the result that, at the end of the year, there is a $9 liability and $9 less in recorded revenue in this year.

Moving to slide 10, a few things are obvious from these examples. First, the data stash/data rollover does not impact cash flow. Second, in 2015 it was more a question of the quarterly phasing of the EBITDA, rather than an impact on the EBITDA from a full-year perspective, as customers utilize the 10 gigabyte gift. Third, from a customer lifetime perspective, it doesn't have any impact at all.

Some of these parameters will slightly change in 2016. The most important change is that there is no expiring free gift any more, which means customers can immediately start to rollover the data. The free gift, from an accounting perspective, provided a nice protection against the revenue and EBITDA impact.

On the other hand, the data stash, which was unlimited previously, is now been capped at 20 gigabytes per month. Despite this cap, we nevertheless expect a bigger impact on the EBITDA from the data stash and rollover, compared to 2015, in 2016. And the EBITDA effect on the data stash, unlike the handset leasing, will also feed through to the bottom line.

This brings me to the next slide and summary, if you want, on the financial impact for the US business. As we have stated a couple of times, we want to be as transparent as possible to you when talking about the impact of these accounting treatments on our results.

For the fourth quarter, we have said that we expect a positive net contribution of the two-mentioned effects on our US reported EBITDA in a magnitude of between $150 million and $225 million. From a full-year 2015 perspective, we have said that we expect a positive net contribution of between $50 million and $150 million. This is lower than the Q4 effect because we had a negative impact from the data stash in Q1, which we also disclosed.

The numbers that I've mentioned related to the full year and fourth quarter effects were disclosed by T-Mobile at their Barcelona conference in November. Actual reporting of this effect will occur with the full-year results of T-Mobile in February.

The 2016 guidance, and the actual reporting in 2016, will include the expected/respectively actual impact from data stash and the JUMP! on Demand device leasing program on our results. So we will provide an estimate of what we think the impact will be at the beginning of the period, and we will clarify what the impact has been at the end of the period.

What we will further do is to collect consensus data, including and excluding these effects, on the results, both on the T-Mobile US and at the Group level, in order to provide you with a transparent and accurate consensus on T-Mobile US. T-Mobile US has already distributed such a consensus.

While precise magnitudes of the impact are difficult to anticipate upfront, it is very likely that the effect from the handset leasing will be far greater than the effects from the data rollover. While in full year 2015, the effects on the data gift and rollover is expected to be less than $100 million, we expect it to be somewhat higher in 2016, but only somewhat higher due to the 20 gigabyte cap introduced in November.

The JUMP! on Demand effect, however, will be of a very significant magnitude, and many analysts have already provided estimates for this magnitude. The ultimate impact will then, of course, depend on the take-up of leasing in 2016 and beyond.

These were the remarks we had regarding to accounting changes in the US. Let us now continue with some changes affecting the Group, excluding the US. Somewhat less convoluted, this section. On page 12, with the first quarter 2016, we will move from cost of sales to total cost accounting. Let's say we will move back.

We will reallocate the P&L line from the scheme of cost of sales, selling expenses, general administrative expenses, and other operating expenses, to goods and services purchased, personnel expenses, other operating expenses and depreciation and amortization.

There will be no impact on KPIs like earnings before tax, EBIT, EBITDA and free cash flow. And also, the previously disclosed values for depreciation and amortization and personnel expenses will not change.

While this is quite some work for our accounting folks, it will not be a very material change for you. If you are looking at the backups as of today, there will only be two slides that will be affected; the Group P&L, as reported, and the one adjusted for special factors.

Secondly, we will reallocate some revenues in the German segment, from wholesale revenues to other revenues, starting in the first quarter 2016. The revenues affected by this are generated from areas like maintenance and customer support for T-Systems' customers in Germany.

The reallocation may amount to around [EUR85 million] in the year 2016 and beyond. We will not do a formal restatement; however, we will provide you with the corresponding values for 2015 on demand.

Thus, if you are modeling the Germany segment down to the level of wholesale and other revenues, it is a good idea to reduce wholesale by the mentioned amount, so around [EUR20 million] per quarter and correspondingly increase others by [EUR20 million]. The guidance for flat wholesales revenues that we provided at the Capital Markets Day will not change, but of course the baseline will be impacted.

Third, on page 12 you're also going to see a new charging scheme for the provisioning of internal IT service from [Tel-IT], our IT division, to the rest of the Group in Germany. The reason for doing this is to simplify the management of the delivery of products and services that are being provided to the rest of the Group.

In a nutshell, Tel-IT will, with all new contracts, stop charging for sub-license software to other Group units in Germany. The result of this being that the EBIT of Tel-IT will be affected negatively, whereas the EBIT of Germany, the market unit, and GHS will benefit accordingly. Net-net, the EBIT of T-Systems will be affected negatively, while Germany and GHS will benefit correspondingly.

The change will have a rather limited impact in 2016, less than double digit, but this will ramp up more in the outer years. EBITDA will not be affected. On the Group level, this change is entirely neutral; however, there will be a preliminary negative impact on the EBIT of our results under German GAAP, which forms the basis of taxation.

Finally on page 12, while this is still early days, we would like to inform you that unfortunately, from after 2016, we will no longer disclose mobile data revenues and data ARPUs in Germany. As many of our peers, we also feel that this KPI becomes more and more obsolete, as more and more data is being bundled in the monthly recurring charges, and the allocation to what is voice and SMS and what is data is more and more an artificial one. What we will rather do is, going forward, to disclose the revenues that are bundled and unbundled.

Finally, and not on this page, but just so you are aware, we are also contemplating currently a further accounting change to the equipment revenues in Germany, or more precisely, the accounting of spot market handset deals.

In 2015, as you may recall, revenues in Germany were artificially boosted by so-called spot market deals, where we sell in special deals sizeable amounts of surplus handsets on the handset spot markets in Europe. The reason for this handset business can be [many-fold]. One of the major drivers is that ordering higher volumes improves the economic terms, even considering the following spot market deals.

In the past, these deals were recorded as revenues and contributed a tiny margin to our business. Where the contracts allow it, we will, in 2016, move to an accounting where we just record the margin of these transactions.

However, to be clear, the transformation is still discussed with the auditors, and we will inform you in due course on the outcome. But be aware that this could have an impact on our reported handset revenues in 2016, and impact the revenues that we showed for spot market deals, which we, I think, quantified in 2015 in the order of magnitude of around [EUR0.5 billion].

Finally, on page 13, having gone through accounting changes in the US, and then accounting changes for the Group outside of the US, is a number of changes in the scope of consolidations. They are all well-known, but it's just for reason of completeness and awareness that we want to mention two transactions.

One is T-Online, which was sold to Stroer, and deconsolidated from November 2015. Some of you may remember that we quantified an EBITDA loss on an annualized basis to be approximately [EUR25 million].

Of bigger importance is the impact of the merger between BT and EE, where today the antitrust authority in the UK has given final green light. While revenue is not affected, the change in ownership will impact our GHS unit, which will lose some EBITDA from the brand and management fee it had previously has received from EE, contributing in the past around [EUR60 million] in annual EBITDA.

More importantly, from today's point of view we will also see a bigger impact on the operating cash flow, as we will additional lose the EE dividend that is not fully compensated by the BT dividend as of today.

In 2016, we will still receive a final dividend from EE, but miss out on the BT interim dividend. In subsequent years, we will receive the BT dividend, but no longer the EE dividend. And of course, you may have your own forecast for the BT dividend.

In total, we are expecting that the changes in the scope of consolidation will lead to a loss of around [EUR100 million] of revenues and adjusted EBITDA, and a few hundred millions of free cash flow, depending on the difference in prospective EE and BT dividend.

With that, I'm at the end of my remarks and the teach-in presentation and I would like to thank you for listening. And now Andreas and I are looking forward to your questions.

QUESTIONS AND ANSWERS

Hannes Wittig - *Deutsche Telekom - SVP IR*

Sorry I forget to mention, please press star 1 on the touchtone telephone. I will announce your name when it's your turn to ask a question. Should you require to cancel your question, please press star 2. Alternatively, you can send us questions via webcast; just type your question into the box below the stream. Mathieu Robilliard, Barcap.

Mathieu Robilliard - *Barclays - Analyst*

Three questions, please. The first one, with regards to the reporting of data output that you say will be discontinued, will you in exchange, or in a different form, provide data about precisely data growth or data volume so that we can track how at least the volumes are doing? So that's the first question.

Second question, with regards to the split that you show in terms of data stash, how it panned out in -- at the different options that you lay out in your presentation, can you give us maybe a breakdown between A, B, C, how it turned out to be in 2015 in terms of how people used the data stash?

And finally, with regards to free cash flow. So you highlight that the change in the scope of consolidation of GHS will lead to the loss of a few hundred million euros of free cash flow, if I understand correctly. Can you confirm that that was already included in the Capital Markets Day guidance and, therefore, it doesn't change your guidance in absolute terms? Thank you.

Hannes Wittig - *Deutsche Telekom - SVP IR*

Thank you, Mathieu. So just let me try to answer your three questions. The first one was on whether now we will report data volumes in our German business, going forward. We've tried to provide data volume developments in the past, as you know, on request but not as a standard KPI. Of course, we will make an attempt also to make that part of our standard reporting, going forward.

Secondly, the question regarding to how the data stash usage actually panned out. If you followed the T-Mobile disclosure during the year, they quantified the effect as being just over [EUR100 million] negative in Q1 and then it was around a fairly small number in both Q2 and Q3, so quite consistent with the examples as we have described them.

As for Q4, we, of course, can't disclose it at this point. You can try to do some reversing out from the guidance numbers that I have mentioned, but you would normally expect that Q4 will see some recovery of the initial EUR100 million, what is a cumulative round about EUR100 million negative effect that the data stash and rollover had, up to that point in time.

And, as I said, we will, in the US, disclose what the EBITDA would have been without the impact from handset leasing or JUMP! on Demand and data stash and data rollover. So therefore, with the information I've provided to you, you can, so to speak, estimate how many customers fitted the third pattern and are customers where the effect is not fully neutralized. Also customers -- and, of course, you will be able to keep those two effects effectively apart.

And third, regarding the impact related to BT and EE, strictly speaking, of course, at the time of the Capital Markets Day, we could not assume that necessarily this transaction would be cleared and, therefore, this transaction was not part of our guidance.

Although, when you look forward, I think our guidance is unspecific enough in terms of our 10% free cash flow CAGR over the years 2014 to 2018 to say that we did not really take a strong view on whether the EE dividend in 2018, for instance, would necessarily be greater than the BT dividend in 2018 and, from today's point of view, that's also rather speculative.

So I would say the impact on brand management fees you could take out of the baseline, but I think the orders of magnitude are such that we would not want to adjust. But strictly speaking, it's a delta case. I just don't think it's significant enough to really impact the basic parameters of our guidance as we have reiterated at the Q3 results.

Okay. Let's see, next question is, I think, from Simon from Citi. Simon, I'm not sure if you're on the call. I think that's a question that we have received in writing so I'll read it out. Simon's question is, can you factor receivables under JUMP! on Demand accounting, assuming that it's meaningful? If you could, would you?

I would say that I don't see why not at this point. We would not necessarily expect a major difference in the cash flows related to working capital. Therefore, there would also not be a major difference in how we would treat the cash movement and how we would approach the subject of factoring. But you really have to ask T-Mobile US related to their factoring policies, if that's all right.

Andreas, do you want to add something to that?

Andreas Puy - *Deutsche Telekom - VP IR*

No, I wanted to go over to the next question from Walter Piecyk from BTIG via email. And his question was, what are the bad debt assumptions; are you making for repayment lease and leasing plans? Are those assumptions different? And how has bad debt been performing thus far against your bad debt reserves for [these] phone programs?

Indeed, we are making some kind of bad debt assumptions for the handset lease programs. If you look at the -- for monthly installments we are basically having 75% of the retail price of the phone and the monthly installments over 18 months lease term. The depreciation, in fact, is a little bit higher so it's around the 80% level, so in fact, we're taking certain provisions there.

Compared to the EIP, this provision is rather a touch smaller than it is with EIP and what concerns the question on the bad debt and how has bad debt been performing so far in the lease program. First of all, it's very early days and we are not having our Q4 disclosure here yet available, but I guess it's something which T-M US will answer on their conference call.

Hannes Wittig - *Deutsche Telekom - SVP IR*

Are there any more questions? Of course, beyond this conference call, we will be available for individual explanations of any items that we have not been able to suitably address today. And, of course, we also have our US colleagues who have had their own statements on the matter and which will provide a disclosure and are closer to, of course, the precise magnitudes of the business and will report before us in February.

So maybe another call to questions.

Okay, if there are no further questions, then we will now end the conference call. As I said, should you have any further questions on these issues that probably will keep us busy for a while, I expect, we kindly ask you to contact our Investor Relations department or our colleagues in the US.

So thank you very much for your attention, and I pass back to the operator.

Operator

We'd 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 2047 088 via reference number 479021[#]. We are looking forward to hear from you again. Goodbye.
