

Deutsche Telekom  
Report for the 1st Quarter of 1998  
January 1 to March 31, 1998



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# Highlights

- Strong growth in volume and revenue
- Positive development in first-quarter results
- Improvements in loss-making business areas
- Workforce reduction and debt repayment continuing according to plan
- Plan to establish accruals as of June 30, 1998 for cable TV business
- Other regulatory decisions still to come, representing considerable influence on results
- Further competitors entering the market, in particular fourth mobile communications operator

# Ladies and Gentlemen, Dear shareholders,

As part of our efforts to ensure greater transparency and provide more information, we would like to present for the first time a report on developments in the first quarter of the year.

## Business trends

Despite the full liberalization of the German telecommunications market on January 1, 1998, the first 3 months of the 1998 financial year were a period of continued and strong growth for Deutsche Telekom, with an increase in revenue of 6% to DM 17.3 billion (DM 16.3 billion in the first quarter of 1997). Competition in the fixed network was hesitant to begin with in the period under review. The effect of our tariff reductions on March 1 was only felt in the last month of the quarter. We must therefore expect the Company's revenue growth to slow in the remainder of the financial year in spite of the well above-average growth of the telecommunications sector compared to the economy as a whole. The market entry both of more new competitors in the fixed network and the fourth mobile communications provider will also contribute to this effect.

Deutsche Telekom's focus is on increasing the traffic volume in its networks. In particular, we intend to achieve this with:

1. Continued strong growth of ISDN accesses (10% increase in first quarter of 1998) and the introduction of new technologies (such as broadband accesses in T-DSL technology to transmit large amounts of data) in 8 German cities in the second half of this year.
2. Further improvements and expansion of services ranging from directory inquiries to the answering-machine function in the fixed network ("T-Net Box").

3. Substantial tariff cuts, e.g. for non-local telephone calls lasting longer than 10 minutes ("10plus tariff"), which were implemented on March 1. In addition, the charge for accessing the Internet via T-Online was reduced to 5 pfennigs per minute. A wider range of bonus tariffs for local calls completes this tariff package.
4. Combined offers for mobile- and fixed-network communications (Personal Communication Systems, or "PCS"), which will also be available to residential customers from autumn onwards.
5. Entry to the world of mobile communications made easier for newcomers with the improved prepaid card.

On May 1, 1998, we reduced the tariffs for calls from Deutsche Telekom's fixed network to the Mannesmann mobile network to the level charged for calls to our own mobile networks since March 1, 1998.

Furthermore, together with France Telecom, we intend to participate in the capital measures being undertaken by Sprint in their PCS mobile communications operations in the USA.

### Numbers of customers in selected services

millions	March 31, 1998	Dec. 31, 1997	change in %
Telephone lines (incl. ISDN channels)	45.4	45.2	0.5
of which: ISDN channels	8.0	7.3	10
T-Online customers	2.1	1.9	11
Mobile phone customers (T-D1 and T-C-Tel)	4.1	3.8	8
Paging and other mobile communications customers	1.0	1.1	-10
Cable connections	17.4	17.3	1

# Results

Income before taxes grew by approximately 9 % to DM 2.4 billion (DM 2.2 billion in first quarter of 1997). Income after taxes rose by 18 % to DM 1.0 billion (DM 0.85 billion in first

quarter of 1997) as a result of lower tax expenses, particularly due to the abolition of on capital employed as of January 1, 1998.

billions of DM	1st quarter revenue	income before taxes *
Fixed-network communications	12.5	2.8
Mobile-network communications	1.3	0.25
<b>Subtotal - Network communications</b>	<b>13.8</b>	<b>3.05</b>
Cable TV / Broadcasting	0.9	-0.3
Terminal equipment	0.8	-0.05
Special services (directory inquiry, public pay phones, etc.)	0.9	0
Other services (T-Online, etc.)	0.3	0
International activities (consolidated)	0.6	0.1
Subsidiaries and related companies (unconsolidated)	-	-0.4
<b>Subtotal</b>	<b>3.5</b>	<b>-0.65</b>
<b>Total</b>	<b>17.3</b>	<b>2.4</b>

\* This information has not been audited by an auditor and is based on internal figures.

The measures undertaken to improve results in individual business areas will increasingly bear fruit during 1998. Improvements can already be seen, for example, in the areas of terminal equipment and special value-added services (in particular directory inquiries and public payphones). Our cable business will be spun off to form a separate company on January 1, 1999. The establishment of regional companies will create the necessary conditions for the participation of partners.

In line with our announced goals, the workforce was reduced by 3,000 to 188,000 employees (excluding MATAV) compared with December 31, 1997.

Debt (excluding MATAV) was reduced by DM 1.4 billion to DM 85 billion as scheduled.

# Outlook

There are, however, several major areas of uncertainty regarding the results for 1998 as a whole:

1. It is not possible to forecast how competition will develop based merely on the first quarter of 1998.
2. The impact of the economic crises in South-East Asia on our subsidiaries and related companies cannot yet be definitely assessed.
3. The decisions by the Regulatory Authority which are disputed or still outstanding will have a considerable impact on the results for 1998 and successive years.

The Regulatory Authority decreed on April 30, 1998 that part of the price increase for our loss-making cable business must be reversed as of January 1, 1999. Associated with this decision is also the requirement that future increases in efficiency be passed on to the customer in the form of price

cuts. Due to this decision, Deutsche Telekom, against the background of the competition-related requirement to spin off its cable TV business to form separate cable companies, expects to have to establish accruals of between DM 3.5 and 4.5 billion by June 30, 1998, which will have a direct impact on results. In addition, we await, in particular, the regulatory decision regarding the charge for access to unbundled local subscriber lines and a clarification on the classification of competitors either as carriers or as resellers. These decisions will also have direct implications for Deutsche Telekom's earning power.

With these factors in mind, we are currently not in a position to make any statement concerning the results and dividend for the 1998 financial year.

# An overview of the consolidated financial statements as at March 31, 1998

In principle, the Deutsche Telekom quarterly financial statements have been prepared in accordance with the requirements of the German Commercial Code (Handelsgesetzbuch - HGB) and the German Stock Corporation Law (Aktiengesetz - AktG).

The listing of its shares on the New York Stock Exchange and the related requirement for Deutsche Telekom to file financial statements with the U.S. Securities and Exchange Commission (SEC), have led the Company to prepare its consolidated financial statements in conformity with international financial reporting standards. Accordingly, the Company uses accounting and valuation principles in line with those of U.S. GAAP applicable at the balance sheet date, provided options exist under German GAAP to permit such

an approach. This also serves to minimize differences between results reported in the reconciliation of German GAAP to U.S. GAAP.

These consolidated financial statements differ from financial statements prepared in accordance with U.S. GAAP only in those instances where the divergent requirements cannot be conformed to U.S. GAAP. These differences between German GAAP and U.S. GAAP are shown in a separate reconciliation.

This quarterly report has not been audited. Furthermore, data for comparison in the statement of income for the first quarter of 1997 are based on internal figures.

## Consolidated statement of income

	1st quarter 1998 millions of DM	1st quarter 1997 millions of DM	Total year 1997 millions of DM
<b>Net revenue</b>	<b>17,324</b>	<b>16,336</b>	<b>67,552</b>
Increase in inventories and other own capitalized costs	371	624	2,960
<b>Total operating performance</b>	<b>17,695</b>	<b>16,960</b>	<b>70,512</b>
Other operating income	629	496	3,746
Goods and services purchased	(2,957)	(2,549)	(12,137)
Personnel costs	(4,516)	(4,595)	(18,340)
Depreciation and amortization	(4,160)	(4,296)	(18,597)
Other operating expenses	(2,460)	(2,062)	(10,161)
Financial income (expense) net	(1,872)	(1,774)	(7,827)
of which: interest expenses	(1,555)	(1,621)	(6,368)
<b>Results from ordinary business activities</b>	<b>2,359</b>	<b>2,180</b>	<b>7,196</b>
Taxes	(1,224)	(1,260)	(3,608)
<b>Income after taxes</b>	<b>1,135</b>	<b>920</b>	<b>3,588</b>
Income applicable to minority shareholders	(97)	(63)	(285)
<b>Net income</b>	<b>1,038</b>	<b>857</b>	<b>3,303</b>

Net income in accordance with U.S. GAAP was DM 997 million in the first quarter of 1998.

# Revenue

Consolidated balance sheet	31.03.1998 Mio. DM	31.12.1997 Mio. DM
<b>Assets</b>		
Noncurrent assets	134,537	137,017
Current assets <sup>2</sup>	29,350	25,801
<b>Balance sheet total</b>	<b>163,887</b>	<b>162,818</b>
<b>Shareholders' equity and liabilities</b>		
Shareholders' equity <sup>1</sup>	49,213	48,144
Liabilities <sup>2</sup>	114,674	114,674
<b>Balance sheet total</b>	<b>163,887</b>	<b>162,818</b>
<sup>1</sup> including proposed dividend payments		
<sup>2</sup> including prepaid expenses, deferred charges and deferred taxation		

On March 31, 1998, shareholders' equity in accordance with U.S. GAAP was DM 52,172 million.

Consolidated statement of cash flows	1st quarter 1998 millions of DM	Total year 1997 millions of DM
<b>Net cash provided by operating activities</b>	<b>5,760</b>	<b>22,641</b>
<b>Net cash used for investing activities</b>	<b>(3,227)</b>	<b>(10,569)</b>
<b>Net cash provided by (used for) financing activities</b>	<b>(1,542)</b>	<b>(13,759)</b>
<b>Effect of foreign exchange rate changes on cash and cash equivalents (life-time up to 3 months)</b>	<b>0</b>	<b>(6)</b>
<b>Net increase (decrease) in cash and cash equivalents (life-time up to 3 months)</b>	<b>991</b>	<b>(1,693)</b>

Revenue by business area <sup>1</sup> :	1st quarter 1998 millions of DM	1st quarter 1997 millions of DM	change in %
Fixed-network communications	12,489	11,974	4.3
Mobile-network communications	1,332	1,147	16.1
<b>Subtotal - Network communications</b>	<b>13,821</b>	<b>13,121</b>	<b>5.3</b>
Cable TV / Broadcasting	844	802	5.2
Terminal equipment	751	815	-7.9
Special services (directory inquiry, public pay phones, etc.)	930	867	7.3
Other services (T-Online, etc.)	340	183	85.8
International activities	638	548	16.4
<b>Subtotal</b>	<b>3,503</b>	<b>3,215</b>	<b>9.0</b>
<b>Total</b>	<b>17,324</b>	<b>16,336</b>	<b>6.0</b>
<sup>1</sup> Revenues are reported in line with the organizational structure of group business areas in the 1998 financial year. The prior year figures have been restated to reflect the new structure.			

In the first quarter of 1998, Deutsche Telekom generated consolidated revenues of DM 17,324 million. This equates to an increase of DM 988 million, or 6.0 %, over the same period last year. Growth was particularly strong in fixed-network and mobile-network communications. Fixed-network communications contributed DM 515 million to the rise in revenue. The decisive factors here were the growth in tele-

phone network communications and major increases in data communications and systems solutions. The group business area for mobile-network communications grew and recorded an increase in revenue of DM 185 million, or 16.1 % over the same period last year. The revenue growth in other services is to a considerable extent due to the positive development of T-Online.

# Personnel

Personnel costs	1st quarter 1998 millions of DM	1st quarter 1997 millions of DM	Total year 1997 millions of DM
	4,516	4,595	18,340

Personnel costs in the Deutsche Telekom Group amounted to DM 4,516 million in the first quarter of 1998 and thus fell by DM 79 million or 1.7 % in the period under review compared to the same period last year. The decrease in personnel costs, due to a decline in the workforce, was partly offset by wage and salary increases under collective agreements of 1.5 % as from January 1, 1998, increases in personnel costs in our dynamically growing subsidiaries, a remuneration adjustment related to

the east German collective agreements of 4 percentage points and an increase in social security contributions. The average number of employees (excluding MATAV as well as trainees and student interns) was decreased by consistently applying a socially conscious workforce reduction program by 2,792 or 1.5 % to 188,242 employees on March 31, 1998. On this date, there were 164,637 employees at Deutsche Telekom AG.

Number of employees (reporting date)	March 31, 1998 Number	March 31, 1997 Number	Dec. 31, 1997 Number
Deutsche Telekom Group <sup>1</sup>	188,242	199,402	191,034
Changes in the composition of the Deutsche Telekom Group in prior years (in particular MATAV)	17,801	19,473	18,261
Deutsche Telekom Group	206,043	218,875	209,295
Trainees and student interns	5,922	5,749	6,711
<b>Total Deutsche Telekom Group</b>	<b>211,965</b>	<b>224,624</b>	<b>216,006</b>

<sup>1</sup> before changes in the composition of the Deutsche Telekom Group

Number of employees (average)	1st quarter 1998 Number	1st quarter 1997 Number	Total year 1997 Number
Deutsche Telekom Group <sup>1</sup>	188,765	199,667	196,943
Changes in the composition of the Deutsche Telekom Group in prior years (in particular MATAV)	17,991	19,375	19,138
Deutsche Telekom Group	206,756	219,042	216,081
Trainees and student interns	6,087	6,489	6,178
<b>Total Deutsche Telekom Group</b>	<b>212,843</b>	<b>225,531</b>	<b>222,259</b>

<sup>1</sup> before changes in the composition of the Deutsche Telekom Group

# Depreciation and amortization

	1st quarter 1998 millions of DM	1st quarter 1997 millions of DM	Total year 1997 millions of DM
	4,160	4,296	18,597

In the period under review depreciation and amortization decreased by 3.2 % in line with expectations compared to the first quarter of 1997. At approximately DM 4 billion, this

depreciation and amortization is almost exclusively the result of depreciation of technical equipment and machinery.

# Change in Results

Income before taxes rose by DM 179 million to DM 2,359 million. This growth is largely due to the DM 988 million increase in revenue and the reduction of personnel costs by DM 79 million. The result of the first quarter of 1998 was

negatively affected by increased costs of goods and services purchased, in particular due to the increased cost of network access charges to other domestic carriers and the development of net financial income and expenses.

	millions of DM
Growth in revenue	988
Increase in costs of goods and services purchased (incl. payments to other carriers)	(408)
Reduction in personnel costs	79
Change in net financial income and expenses	(98)
of which: change in interest expenses	66
Change in other cost and earnings positions	(382)
	<b>179</b>

In total, and with a decreasing tax rate, tax expenses remain almost unchanged and result in a considerably improved level of net income of DM 1,038 million in the first quarter of 1998.

# Investments

	1st quarter 1998 millions of DM	Total year 1997 millions of DM
Intangible assets	52	585
Property, plant and equipment	1,404	13,300
Financial assets	745	1,580
	<b>2,201</b>	<b>15,465</b>

Investment in property, plant and equipment, made mostly by Deutsche Telekom AG, amounted to DM 1,404 million in the first quarter of 1998. The volume of investment fell as the digitization of switching and transmission equipment and the development program

for eastern Germany were completed by the end of 1997. Additions to financial assets totaled DM 745 million by March 31, 1998. Of this total, investment in associated companies and other investments accounted for DM 640 million.

# Financial liabilities

	March 31, 1998 millions of DM	December 31, 1997 millions of DM
Debt	86,482	87,891
Debt excluding MATAV	85,043	86,435

The repayment of debt continued according to plan. At the end of March 1998, debt totaled around DM 86.5 billion, compared with DM 87.9 billion at the end of 1997.

Net financial liabilities amounted to DM 71.5 billion at the end of the first quarter. Debt repayment will continue according to plan in the future.

Bonn, June 1998  
Deutsche Telekom AG

Board of Management

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The Quarter-Report and up-to-date information on Deutsche Telekom can also be accessed via T-Online and the Internet:  
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