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# Deutsche Telekom AG (DTE.DE)

Q3 2013 Earnings Call

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## MANAGEMENT DISCUSSION SECTION

### Unverified Participant

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**Operator:** Thank you for your attention. May I now hand you over to Mr. Stephan Eger?

[ooM8GX-M Stephan Eger]

Well, good afternoon and good morning to our listeners in the U.S. We're here to discuss our third quarter results with you and I'm more than happy to have with me three members of our board, at least two existing and one future member of our board. We have with us René Obermann hopefully shortly, our CEO who is on his way down here, and we've got Tim Höttges, our Group CFO with us and we've got also Thomas Dannenfeldt with us, who is currently the CFO of our German Operation and he is the CFO incoming for the group from January 1 onwards.

And Thomas would be obviously more than happy to also tackle some of the more detailed questions on the operating segment of Germany.

And so as always, I would suggest that we start with a quick introduction on our presentation started by René and then followed after by Tim Höttges. And then about at half time we would be delighted to go into the Q&A, and both René and Tim will be happy to answer your questions.

Having said that, I would like to hand over to René.

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## René Obermann

*CEO & Chairman-Management Board, Deutsche Telekom AG*

Thank you very much, Stephan. Good afternoon to all of you. Good morning in the U.S. The third quarter of 2013 at DT continued the positive momentum, which we already saw in our key markets in Germany and the U.S. in the second quarter. First of all, we are satisfied with our operational performance and particularly with the customer numbers in the second quarter. In the second quarter in a row we won almost 1.3 million new postpaid customers, 152,000 new TV customers, and some broadband net adds, 21,000 in the group in Q3.

Our revenues grew organically by 2.4%, which is a slight improvement versus the 2% in the second quarter. Both the EBITDA and the free cash flow in the quarter are also slightly ahead of capital market expectation and they are fully in line with our full-year guidance.

In Germany, we again delivered good results, particularly if you compare our results to competition who published this morning. We kept good traction in mobile, winning 470,000 of which more than 160,000 were under our own brand, new contract customers. And in fixed line we got an additional 119,000 fiber customers in retail and wholesale combined. Revenues for the segment Germany were again solid even though down by some 1.2%, but again that's a very small decline and we hope to keep improving that. The main positive driver was a better performance in our fixed-network revenues, whereas mobile service revenues ex-MTR cuts came in slightly weaker at minus 1% underlying, thereby still significantly outperforming the overall markets. On the profitability side, we performed very strong, with an EBITDA margin close to 42%.

In the States, we continued the very strong performance from the second quarter into the third quarter. You all saw the numbers from T-Mobile USA. In Q3 by over 1 million, of which 648,000 were branded postpaid net adds. And that's clearly the result of a continued success of our Un-carrier consumer proposition. This is the second quarter in row that we had more than 1 million net adds if you exclude the MetroPCS consolidation in Q2.

The branded postpaid churn slightly up versus Q2, which is due to normal Q3 seasonality. However, year-on-year was reduced by 60 basis points to 1.7%, and that does reflect the improving customer quality and satisfaction of T-Mobile US. On the back of the strong result, we have now increased our forecast for branded postpaid net adds for the full year from 1 million to 1.2 million to a now new range of 1.6 million to 1.8 million customers.

Revenues grew by 38% year-on-year and organically, i.e., without the impact of the Metro consolidation, by 12.4% in the quarter. And service revenues at T-Mobile US have also improved significantly, versus Q2 the trends here have improved significantly. Despite higher branded postpaid gross adds, the adjusted EBITDA at T-Mobile US grew year-on-year by 15% due to improving SAC and CPGA.

Europe in a still tough economic environment. We again delivered good customer numbers for our main growth areas, in particular more than 100,000 new TV adds, 68,000 broadband adds and 178,000 mobile contract net adds. Organic revenue trends improved, even though still somewhat negative, but they improved further in Q3 to

minus 3.4%, whereas the organic adjusted EBITDA was clearly was affected by the change in revenue mix as well as higher market invest in some of our countries. Please remember that we deconsolidated Hellas Sat as of April 1 and our Bulgarian business Globul and Germanos as of August 1.

Third point, Systems Solutions. The order entry for T-Systems increased by almost 12% year-on-year to €1.8 billion and the market unit returned to an organic growth rate of 2.7%, driven by the public area and large accounts. Overall, T-Systems revenues increased by 1.8%, also driven by the anticipated and flagged catch-up effect at Telekom IT.

Organic revenue growth excluding the impact of deconsolidated businesses and currency would have been 5%. A significant improvement was also delivered on the EBITDA side, with the margin improving to almost 9% on the back of strict cost discipline and the conclusion of the [ph] cost in transition (9:21) and transformation phase in several of our big deals.

A few brief remarks on our headline financials. Revenues and adjusted net profit grew for the first nine months of 2013 with the revenue growth accelerating in Q3. The EBITDA declined almost half versus the previous quarter, driven by a strong performance, particularly in Germany and Systems Solutions. The free cash flow is clearly down for the quarter compared with an exceptionally free cash flow which was strong in the third quarter last year, but it came in slightly ahead of capital market expectation and we are really well on track to reach our full-year guidance of around €4.5 billion.

And as flagged, our net debt clearly was reduced to below €40 billion from the Q2 peak. Since this is my last presentation to all of you of the quarterly results and the next quarter will already be presented by Tim early 2014, I would like to thank you all very much for a very good and – a good communication and good relationship. And I'm pretty sure that Deutsche Telekom under the leadership of Tim will continue to be very strong.

Thank you very much and hope to see you soon in a different environment.

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## Unverified Participant

I think I'll miss you.

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## Timotheus Höttges

*CFO & Deputy Chairman-Management Board, Deutsche Telekom AG*

Thank you, René. You have never been so quick by the way, seven minutes. So with this, I'm just heading into the German business here. And very clearly we are pleased with our operational and the financial performance in Germany in the third quarter. Revenues declined by 1.2% year-on-year. Main positive driver were core fixed line revenues, which declined at 2.7%, thereby showing an improvement versus the previous quarters.

The mobile service revenues declined underlying including ex-MTR cuts by 1%, thereby still significantly outperforming the overall market. The slight deterioration versus the second quarter is a result of [ph] the select (11:29) intense competition as well as new EU roaming cuts in the summer and less visitor revenues being billed specifically in Q3. We expect an improvement for the fourth quarter on the basis of what we are seeing so far.

Wholesale revenues at minus 5% year-over-year were pretty much in line with the underlying trend of the second quarter. Adjusted for regulation, the underlying revenues were down by 4.7% year-over-year in the quarter. The

adjusted EBITDA declined by 1.1% year-over-year, resulting in a strong margin of 41.9%. The main driver here was the OpEx reduction of almost 2% year-over-year, despite rising personnel and energy costs.

In German fixed, we saw all-in-all another satisfying quarter in line with previous quarter. I would like to highlight a few things. An improvement in line losses despite 21,000 LTE wireless broadband customers added in Q3, continued strong growth of new fiber customers, with 119,000 net new additions of which 50,000 came from wholesale driven by our [ph] contingent model (12:50), which is developing nicely. Broadband net adds were still negative at minus 47,000, burdened by the normal seasonal churn increase of the max tariff of broadband customers coming up for renewal, a late start of our Entertain to go product and a slower start into the cooperation with Sky.

This is clearly not satisfying and we will tackle this with the following initiatives. First, push Entertain. We have to be more agile in promoting our new product feature, Entertain to go. The Sky cooperation after a slow start in August is now running already on full speed. And an optimization of customer retention, as mentioned already at the Q2 results. And thirdly, as of 2014 an increased focus on VDSL and later on vectoring.

Turning to mobile. The German mobile market service revenues decreased by 4.7% year-over-year in Q3 according to our market estimates. This is a clear deterioration versus the previous quarter. Despite us still outperforming the competition, our underlying service revenues in the quarter decreased slightly by 1% for the following reasons: intense competition, as already flagged at our Q2 results, new roaming cuts implemented in summer, SMS revenue decline accelerating to 30% year-over-year, significant lower visitor revenues billed in Q3 versus Q2, and due to the seasonality and timing of the billing with other operators, this shift from one quarter to another can result in almost €10 million service revenue swing in one quarter.

On the other hand, we had a very strong increase of almost 31% in our mobile data revenue driven by the increased smartphone penetration and an increasing number of LTE customers with new data tariff. By the end of Q3, we already had over 2.1 million LTE customers on our network, an increase of over 2 million year-on-year. Operationally, we continued our strong performance with 470,000 mobile contract net adds, of which 164,000 were own branded net adds. The continued smartphone momentum with almost 1.2 million sales including strong sales of Android and iOS devices and the best-in-class contract churn at 1.1%.

Coming to the US. We are very satisfied with another very strong quarter at team US, winning 648,000 branded postpaid net adds, an improvement of more than 1.1 million net adds versus last year. With 643,000 branded postpaid phones net adds T-Mobile US lead the U.S. wireless industry again. Overall we added more than one million of new customers, with both prepaid and wholesale net adds contributing positively to this number. In the third quarter alone we sold 5.6 million smartphones, a new record at T-Mobile US, ending the quarter with over 16.5 million smartphone users, or 77% of the total base.

As indicated, the branded postpaid churn increased slightly quarter-over-quarter, but the impact was much smaller than anticipated. Year-over-year the churn rate declined by 60 bps to 1.7%, reflecting the improving customer quality at T-Mobile US. Let me give you some more KPIs on customer quality in the third quarter. With 53% of our equipment installment plans, receivables are regarded as prime, up from 43% by the year end 2012.

The bad debt expenses decreased by 32% year-over-year and the average application credit score is up 31% year-over-year. And, importantly, the porting ratios against all major competitors in the market continues to be strong. The adjusted EBITDA increased year-over-year and quarter-over-quarter also on a pro forma basis despite the higher branded postpaid process, mainly driven by improving SACs and CPGA trends. Please note that due to the different jump accounting under IFRS and U.S. GAAP, there is quite a difference between the IFRS EBITDA and the U.S. EBITDA, with IFRS being even higher.

Branded postpaid ARPU decreased by 7.8% year-over-year due to the rapid customer shift to Simple Choice and Value Plans, which now account for already 61% of the branded postpaid base, up from 50% at the end of last quarter. The branded prepaid ARPU continued to grow by 30% year-over-year and driven by the inclusion of the MetroPCS customers, who have a higher ARPU.

Let me provide you also with a bit of detail on the underlying development ex-MetroPCS in that quarter. Underlying T-Mobile US revenues excluding the impact of the first-time [ph] consolidation (19:03) of MetroPCS increased by 12.4%, driven by stronger handset sales but also a significant improvement in service revenue. However, also the underlying service revenue saw a significant improvement, declining by 4.8% versus 8.3% in Q2. This is a reflection of the better customer growth offsetting the impact from the continuing immigration to Simple Choice and Value Plans. Underlying EBITDA excluding the impact of Metro was down 16.7%, again driven by firing on all cylinders with our Un-carrier strategy and the strong customer growth.

Let me give you an update on two of our core initiatives in the US, which were quite relevant for us during the course of the communication, the rollout of our LTE network and the MetroPCS integration. By the end of Q3 we already have covered 202 million POPs in 233 metro areas in the US, thereby achieving our initial 200 million POPs coverage goals one quarter earlier. We have modernized over 25,000 sites and cover already 91 of the top 100 markets in the US with our superfast LTE network.

The MetroPCS integration also is ahead of plan. Our TMUS colleagues reflected this in their synergy outlook update for 2013 on Tuesday already. Network CapEx synergies are on track to beat plan by \$200 million to \$250 million for May to December. OpEx synergies are on track to beat the plan by \$50 million to \$100 million, and integration expenses, mostly CapEx in this regard, are on track to be plan by \$100 million to \$125 million. We have launched 15 new Metro markets with more than 1,300 distribution points in these markets by the end of Q3 under the so-called Apollo 15 program. And 4G LTE spectrum covering approximately 15% of MetroPCS network POPs will be refarmed by the end of 2013.

On November 21, T-Mobile plans to launch the Metro brand in 15 additional new markets, bringing the total of expansion markets then already to 30, which is significantly above our original plan. Finally, let me also remind you that we were able to refinance \$5.6 billion of the Deutsche Telekom debt in T-Mobile at attractive conditions on the debt market. This is another important step to transform T-Mobile into a self-funding platform.

Let's move to Europe. Revenues in our European segment declined organically by 3.4% in Q3, the best performance since Q1 2012, by the way. The underlining decline ex-deconsolidation, regulatory effects, foreign exchange, special taxes, consolidation and one-timers improved to minus 4.6%. The negative mobile regulation effects were driven mostly by Poland, Greece and the Netherlands. The decline in the traditional Telekom business, mainly voice and SMS, was partly compensated by higher device revenues, particular in Poland, the Czech Republic and the Netherlands.

Still, the single biggest negative impact for the Europe segment revenues came from Greece, with declines in the fixed and mobile voice business. However, underlying trends actually sequentially increased in Greece supported by significant trend improvements in fixed revenues as well as in mobile service revenues. Also, the operational performance was very strong in the quarter here in Greece. OTE [indiscernible] (23:41) reached 218,000 TV customers by the end of Q3, much above the original expectation, 12,000 retail broadband net adds and an LTE coverage already reaching 50% of the pot.

The adjusted EBITDA in the segment was stronger than in Q2, mainly driven by the following reasons. An increased market invest in Netherlands which resulted in strong operational KPIs, like 57,000 contract net adds,



thereby again outperforming the incumbent, and a highly competitive market environment in the Czech Republic and Croatia, where the revenue decline couldn't be compensated sufficiently with cost savings yet.

This is clearly not a satisfying performance and we will have to work much harder on cost discipline in some of our countries, especially in Croatia, on the indirect costs in order to compensate for the difficult macroeconomic environment and the revenue shortfall. We continue demonstrate good momentum in our growth areas in Europe, which is very important for us. We showed again good growth in TV with 110,000 net adds, now reaching almost 3.5 million TV customers including newly consolidated 251,000 digital TV customers in Slovakia. We delivered 68,000 broadband net adds in that quarter, mobile contract net adds of 178,000 and mobile data revenues growth accelerated again to almost 15% excluding currency effects, thereby overcompensating the decline in SMS revenues.

Let me give you again a quick update on the progress being made on the revenue as well as the technology and cost transformation in the segment Europe in that quarter. We made again progress on the revenue transformation. The share of total revenues from our growth areas increased by 3 percentage points year-over-year to 22% now. The share of the fixed revenues from Connected Home grew by 0.6 percentage points year-over-year to 21%, driven by TV revenues. The share of mobile data revenues of overall mobile revenues grew by 3 percentage points to 17% and the share of B2B ICT revenues as of total revenues increased by 0.4 percentage points to almost 3%.

Progress on the cost and efficiencies side included the all-IP share of all fixed-network access lines grew by 10 percentage points to 26%, mainly driven by Croatia, Slovakia and Hungary. LTE size in service more than tripled year-over-year to 2,800. We have LTE networks in commercial use now in six countries already and homes connected with Fiber to the Home grew by 33% year-over-year to around 160,000. And the number of full-time employees was reduced by almost 7% year-over-year to 55,000, which however included the deconsolidation of the Bulgarian business with 1,900 people. So what you could say is we are very focused, working on improving our situation in Europe.

Turning to Systems Solutions, Q3 results showed some solid improvements. The revenue increase of 1.8% was driven by the return to organic revenue growth of 2.7% at the market unit, and the expected and flagged catch-up at Telekom IT. Order entry was strong, up almost 12% to \$1.8 billion. Also the adjusted EBITDA and EBIT showed a continued improvement driven by successful efficiency measures and the conclusion of the cost-intensive transition and transformation phase in several of our big deals. With EBIT margin of Systems Solution improved to 2.3% in the quarter, the EBIT margin of the market unit to 3.8%. As planned and communicated, Telekom IT delivered on reducing the IT cost. For the first nine months, the IT spent was reduced here internally at Deutsche Telekom by €250 million.

Let's move now to the group financials and turning to free cash flow. Actual free cash flow at €1.4 billion is down compared to last year. Main drivers here were cash generated from operations declining stronger than the EBITDA due to the working capital impact of €500 million mainly from the Value Plans in the US. The cash CapEx increase of €350 million, driven by the LTE network roll out in the US. And the adjusted net income decreased by 11.4% year-over-year in the quarter, with the main drivers being a decline in financial result driven by currency translation and devaluation of financial instruments as well as the interest being impacted by the high-yield debt of Metro and the tax increase versus the low tax rate in Q3 2012 following the unwinding of T-Mobile US as asset held for sale at that point in time.

Compared to the negative return on capital employed in Q3 2012, as a result of the impairment at T-Mobile US, we saw a good improvement for the group return on capital employed to 5.1% at the end of Q3, driven by a significant improvement of the NOPAT, net operating profit after tax, year-over-year after the impairment last



year, a decrease of the net operating assets on average by €6.2 billion. Earnings per share improved as well slightly year-over-year by almost 2% to €0.55 with the main drivers being the well flagged lower depreciation and amortization in our business.

As flagged and expected, the free cash flow in the third quarter and the sale of the Bulgarian asset Globul and Germanos led to a sequential reduction of the net debt to again below €40 billion. The €492 million (sic) [€496 million] (31:11) Other position included €200 million dividend payment to minorities and €107 million spectrum payment in Poland.

Turning to our balance sheet ratio. Net debt to adjusted EBITDA decreased again slightly to 2.3 times as a result of reduction of the net debt. The equity ratio also improved to 27.8% due to the slightly lower asset base and the increased shareholders' equity. With regard to our comfort zone ratios we are in the green with regard to all ratios. And our rating remains stable at BBB+ level with the major agencies and stable outlooks. As a result, we continue to get excellent funding conditions in the debt capital markets. And, as we already said, we confirm our guidance on all items laid out.

With this, René and I are now ready for your questions.

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## QUESTION AND ANSWER SECTION

Stephan Eger

*Head of Investor Relations, Senior Vice President, Deutsche Telekom AG*

A

Thank you very much, Tim. Now we start with the Q&A part, just about half-time as I promised. [Operator's Instructions]

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**Operator:** This is Robin Bienenstock from Bernstein. You may ask your question, please.

Robin A. Bienenstock

*Analyst, Sanford C. Bernstein Ltd.*

Q

Yeah, hello. Thanks very much and congratulations, René. It's nice to see that at your last set of results that your prices are at a more reasonable place. Two questions if I may. First I'd like to know what you think about Spark and its ability to restore Sprint's competitiveness in the US. And separately, I'd like to know a little bit about what you think about the necessity of FTTH in Germany given that vectoring and pair bonding and G.fast seem increasingly to be offering faster speeds and reasonably reliable ones. I'm just wondering if you have any new thoughts on that. Thanks very much.

René Obermann

*CEO & Chairman-Management Board, Deutsche Telekom AG*

A

Okay. On the first part, Robin, thanks by the way for the appreciation. On the first part, I don't think I should talk about this new reselling model there. I think it's something you should talk to John about. He probably has also more insight into this competitive impact than I have and I also shouldn't talk about T-Mobile US and that over here. For Germany, the current situation is really FTTH is not that aggressively sold yet. VDSL is meeting much better acceptance than FTTH so far. So customers' readiness or the private customers' needs seem not yet as developed that people are really crying out, many people are crying out for FTTH.

I think most people are happy when they have like 60 megabit and beyond. With 50 megabit, we can currently serve most needs of customers. Yes, there are some exceptions, but the majority is really still fine with it. This will change over time over the next couple of years. So we are well advised to keep building it out and from a VDSL - well-built out VDSL network take the next step then but not at this point of time. It's not such a big problem yet.

Timotheus Höttges

*CFO & Deputy Chairman-Management Board, Deutsche Telekom AG*

A

Let me add one point, Robin. Definitely we are working on all the same ways to improve the speed for our customers. On the mobile side, it is on the handset side it is cut four and even cut six. We have MIMO as one technology which we test in the field and on the fixed line side we have now the vectoring which is under deployment which is coming.

We even know about let's say G.fast as one technology which brings the fiber even closer to the household. I think if you wouldn't only focus on FTTH at that point in time, it would take too long by the way to get a high propagation across our customer base. So the fastest and most effective way is now moving the fiber more and more closer to the customer and that is what we are doing. And by the way with full speed next year, everything is under preparation, even our hybrid routing services and so that is I'd say plan and I think that is absolutely right thing to do.

**Operator:** Mr. Jonathan Dann from Barclays. May we have your question, please?.

Jonathan R. Dann

*Analyst, Barclays Capital Securities Ltd.*

Q

Hi there. Just one question from me. At the end of the T-Mobile call it became clear that they filed to raise debt or equity. As T-Mobile's biggest shareholder, can you just update us with your thoughts?

Timotheus Höttges

*CFO & Deputy Chairman-Management Board, Deutsche Telekom AG*

A

Look, this is Tim here. I think this is absolutely consistent with what public company peers are doing. The T-Mobile is filing S3 shelf registration statement to facilitate potential excess of the capital market in the future. That is what we're looking for. On the debt side, we've always said it should be a self-funding business. So they should carry what their debts are on their own. And the second one, when it comes to the equity side, the question is if there might be opportunities upcoming with regard to spectrum that might occur, which we then going to be able to refinance from the standalone perspective.

**Operator:** Mr. Justin Funnell from Credit Suisse. May we have your question, please?

Justin B. Funnell

*Analyst, Credit Suisse Securities (Europe) Ltd.*

Q

Thank you. Yes, back to Germany, two sort of topics really. The first is again the pricing question. Liberty Global seems to be trying to lead the market up on price and talks about that as really a medium-term strategy would like to move the market more into – business more into more of a mix of market share and price increasing.

So the question I've asked a few times now, just wondering how your thinking is evolving in this area? And any comments on the recent court's decision that the change in the contracts on data caps where it might be not legal in the due of that course. And secondly, any more updates on the All-IP strategy in Germany, when could you start actually moving lines over to All-IP and start to get the cost savings from that, please?

## René Obermann

*CEO & Chairman-Management Board, Deutsche Telekom AG*

A

Okay. Let me start with this court decision. I think there is an opportunity in there because, first of all, it's not the data caps are illegal, it's just that the court has ruled that flat rates in fixed line need to be either flat or they are not allowed to be called flat rates. And customers need to be provided more clarity. And, quite frankly, we look at this from a customer point of view and try to figure out where the opportunities are in there, because it's not just us being affected, it's the entire industry.

And if you think about it, I think it can provide guidelines to redesign not only tariffs, but more importantly the marketing programs around it. And ultimately I don't think it is possible to provide ever more capacity in volume, data volume, and speed for ever lower prices. But it may well be that tariff names and product names are being restructured and ultimately customers will be provided more clarity, but not just from telecom, but from the entire industry.

So I think there is an opportunity in there. We haven't yet published our final answer, but amongst us here, and we're clearly a small group of people, only 100 people on the call, we are not necessarily challenging this decision. We will probably turn it into a marketing opportunity. But soon more details.

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## Timotheus Höttges

*CFO & Deputy Chairman-Management Board, Deutsche Telekom AG*

A

Your question with regard to Liberty Global and their attempt in Germany. First, what you should take into consideration is that the cable operators are today more expensive for the end customer than our proposition because our proposition is fully integrated already, it's one price. They have even an additional fee which is paid to the landlord. And so that is something we expect.

The second thing is I think what the cable operators are facing is the build out which we are doing even especially in their areas, and what they even see is that we are coming with more attractive offers as well in this triple and even potentially in the quadruple play area. So, therefore, I would not be so worried about their attempt. They definitely have to do something future-wise, but don't forget, even these guys have to earn back their capital costs and the money which has been paid. So, therefore, I'm not worried. On the opposite, we are quite confident that with vectoring and with what we are delivering in this areas where we cannot compete today, that we are quite competitive and quite strong.

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## Thomas Dannenfeldt

*CFO, German Operation, Deutsche Telekom AG*

A

Good afternoon. This is Thomas Dannenfeldt speaking on the third question was update on All-IP in Germany. I think, firstly, it's important to note again that All-IP is a very important element for network transformation to move over into a much leaner and more agile and efficient infrastructure. So, that's really important for us in terms of transformation of the company.

Detailed figures in Germany, we're expecting for this year roughly 1.5 million customers, consumer customers being migrated on IP and also speeding up, by the way, in the next year to do as fast as possible migration of the customers and come to that leaner and more agile infrastructure.

Cost savings, unfortunately, before you'll see that that cost savings you need to invest, that's what we're doing right now. To migrate the customers, you need to add costs here by switching customers, by putting the right network infrastructure in place. And so for the time being, what we do see is not a cost saving, but an increase of

costs embedded in the figures you see right now. And obviously we're doing that to gain cost savings then on a mid-term perspective.

**Operator:** Mr. Polo Tang from UBS. May we have your question, please?

Polo Tang

*Analyst, UBS Ltd. (Broker)*

Q

Yeah, hi, actually I've got two questions. So the first one is on T-Mobile US. Strategically, is T-Mobile US core to the group, or would you consider crystallizing the value and selling down? Because if you look at what you've done by selling down the T-Mobile into company debt, with T-Mobile making their shelf filing, doesn't this give you more flexibility for M&A? So that's the first question.

And the second question is really on German mobile. Your guidance implies flat mobile service revenues in Q4. So I'm just trying to understand the moving parts that give you the confidence that service revenue growth can recover in Q4 in Germany. Thanks.

Thomas Dannenfeldt

*CFO, German Operation, Deutsche Telekom AG*

A

This is Thomas again. I think I'll start with the second question and then Tim might take over or René. Let me be clear, first of all, in terms of the guidance, in terms of mobile service revenues, it's not about Q4 being flat, but it's about the overall year being flat. That's our guidance underlying across the whole year. So that means more positive development in Q4 as well, but the guidance is not on Q4, it's the overall year.

And as Tim mentioned already in his short speech, we see some seasonalities in here, especially on the digital side, but nothing we are worried about. So we are extremely confident that based on the huge differentiation we see right now in terms of network quality on one hand, that's what we see in all the tests being performed by third parties in the marketplace. But as well as on the service side, the differentiation that takes place, the customers are being convinced, churn is in a very, very positive situation position here. So we are very convinced that we can get to that mobile service revenue flattening across the year based on that.

René Obermann

*CEO & Chairman-Management Board, Deutsche Telekom AG*

A

With regard to the shelf registration here, I think I said that it's consistent with the public company peers here, what we are doing. Never forget we even have a lock-up period for our stock here if you bet on that one. Coming back to our strategy in the US, look, we started one year ago with the market share of [ph] \$15, \$60 (45:12) in the US market. Developing it with a great management, with a great new marketing story, with huge investment into LTE build out, and even a good handset lineup into a very value creation story. And if you would take the \$22 billion and take the \$18.2 billion on top of that, this company is from an enterprise value in the vicinity of \$40 billion. Just remember that is the value which we had when we talked about the AT&T deal at that point in time.

Our story has driven value creation in the US. That is I'd say the story that we are talking about and that is I'd say what we're bringing forward. We have sufficient capacity at that point in time. We have sufficient megahertz per POP for our current market approach in the US situation. And therefore, our story is about value creation in the US.

We always have said that on a mid to long-term perspective, this market needs more consolidation in the US. When it comes additional capacity and we see the bifurcation in that market from AT&T and Verizon being very

strong in their footprint. So, if there is the opportunity and the possibility for consolidation in the mid to long-term perspective, we always said that we are open for this.

**Operator:** Mr. Ryan Fox from Morgan Stanley. Your line is open.

Ryan A. Fox

*Analyst, Morgan Stanley & Co. International Plc*

Q

Thanks. I've got two questions. Firstly on Germany and on margins in the domestic business. You said the OpEx was down 2% year-on-year. Could you please give some more color on the moving parts there and how much [ph] girth (46:55) there is for further OpEx reductions going forward? And secondly, just on the group strategy, could you please give an update on how the review process is going for Everything Everywhere and Scout24? Thanks very much.

Timotheus Höttges

*CFO & Deputy Chairman-Management Board, Deutsche Telekom AG*

A

I'm going to start with the EE question. And, look, the first thing is we are very satisfied and happy with the development in the UK. Just remember where we are coming from as Deutsche Telekom with let's say a more or less stranded asset on the number four position in the UK market and now being the market leader. Just this week, a very prominent [ph] drive test (47:44) voted as number one in the London area for the first time in history. So, therefore, our LTE build out is paying off. We have more than 1 million customers than other next follower on [ph] this few project services here (48:00). And what you even have seen is that we are working very hard on further cost reductions to improve the margin in this market, and over the last quarter we were quite successful on that one.

That said, and we said this business is on a strategic evaluation, because we have two shareholders here sitting on that business. And it is a value creation story. And do we have to sell the business? Do we have to IPO the business? No. It's a question what is the best time for creating value out of this entity. And that is something which is under observation together with our shareholders. There is no must sell situation for the Deutsche Telekom. We are following on the situation. I could say this year nothing is going to happen on EE. With regard to next year, we will decide on few operating performance of that business and we will even decide on the windows in the markets we might see whether we consider any kind of strategic step for our UK business.

René Obermann

*CEO & Chairman-Management Board, Deutsche Telekom AG*

A

On the first question around the Germany margins, we said last year in December in the Capital Market Day is that we want to achieve a margin of around 40%. I think we're doing pretty well so far. And obviously looking at the OpEx, the main focus area for us is the indirect OpEx, it's not the direct OpEx. Just to [ph] cut down market and that's (49:38) an easy one, but unfortunately not in long run the right way to do it.

So it's about the indirect OpEx. And we do know that especially looking at topics like energy tax and all that kind of stuff where we see increases, we need to push forward in all the areas where we can really improve. And that's what we've done so in the last quarter as well, in areas like logistics, like platform efficiencies and all that kind of stuff. And that's where some areas – or some areas where we've been very successful to compensate that kind of increase is indirect OpEx. So, but again basically it's about keeping the margin around that 40% level and I think that's working well so far.

## Timotheus Höttges

*CFO & Deputy Chairman-Management Board, Deutsche Telekom AG*

A

There was one missing part in my answer with regard to the Scout business. Let me say it this way. I hope that Deutsche Telekom and its team here deserves some credit for M&A activities. I think we should not put ourselves under pressure. We have said we have the strategic evaluation. There was a lot of noise in the market with regard to a potential sale of the business. Yes, definitely we are in discussion with partners on that one, but we do this kind of negotiations under value and not under any kind of timing constraints. And, therefore, it is moving in the right direction and I hope to inform you shortly on the next steps here.

**Operator:** Mr. Ottavio Adoriso from Société Générale. May we have your question, please?

## Ottavio D. Adoriso

*Analyst, Société Générale SA (Broker)*

Q

All right, good afternoon. This is Ottavio Adoriso from Société Générale. Couple of questions. The first is on cash and the second is on European operations. The one on cash, you basically clearly stated that the rationale to dispose T-Mobile, that was to make the asset self-financing. So, the question is that what you do with the liquidity given the low return on cash and the fact that you have enough liquidity to finance that maturity, as you stated in the slide number 18?

And moving to Europe. In the recent quarter, trends in European operations have partly negated improvements you record in Germany and the U.S. Now, most of these operations were acquired a long time ago. And I was wondering if you still consider all these operation as core? And given a rising appetite to sell assets, would you consider at some stage to carry a review of the asset portfolio in Europe to assess portfolio in Europe to assess monetization through asset sales might generate more value than the current status quo? Thanks.

## René Obermann

*CEO & Chairman-Management Board, Deutsche Telekom AG*

A

Look, I think I understand your question such that you're asking whether we would dispose of European assets. And the answer is that we have made it clear that over time we look at each portfolio item with regards to potential ROCE improvement or the need of ROCE improvement. But this is not to say that we look at things only short term. We are in the infrastructure business, and particularly in those markets where we have strong position already, at some stage the economic crisis may improve and then we will emerge from the crisis as a much stronger player, particularly in those markets where we are both in fixed line and in wireless and where we have significant shares. But anything else would lead into some speculation, which I would not want to trigger. But the one thing you can be certain is we look at items, portfolio items, with a view to over time improve its return on capital and each item has an obligation to improve, which is not yet satisfying, it has to improve.

## Timotheus Höttges

*CFO & Deputy Chairman-Management Board, Deutsche Telekom AG*

A

Let me answer your question with regard to the T-Mobile US. And by the way, it's even not a US-specific question, it's even a philosophical question with regard to Deutsche Telekom's approach towards [indiscernible] (53:56). Remember OTE. We have said we have minority shareholders in that business and it should mean that the OTE is sacrificing its refinancing costs by asking the headquarters to do this. Therefore, we pushed OTE that time to improve their cash position, to sell non-core assets as they did [indiscernible] (54:24) with Bulgaria and with Germanos in the satellite business. And at the end of the day, OTE is today a fully refinanced business on a standalone perspective.



The same holds true for the T-Mobile US business. And we always said our strategy is self-funding and de-risking. And, therefore, we have said, look guys, at the time of the business combination, it was not reasonable for T-Mobile US to fund US\$11.2 billion in the high-yield market. So, we gave our T-Mobile US some time to gain traction in the market to build the credibility and even the professionalism behind that one, and now the US high-yield market is in a very good shape. And we kept that market with this \$5.6 billion note doing exactly what we always have said. Self-financing platform in the US and derisking of DT, this is the way going forward, and this was executed. So I hope you understand a little bit of that philosophy of what we've done and why we did it. And I think it is good that the US business feels the pressure from the investments and from the operational framework in which they're working.

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René Obermann

*CEO & Chairman-Management Board, Deutsche Telekom AG*

A

And just, Ottavio, for clarification. There is no liquidity inflow in that sense. The net debt doesn't change at all on the DT level. So that's not that we now have \$5.6 billion cash inflow at DT which we would then have to look at what to do with that. That's maybe for clarification. Let's move on.

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**Operator:** Mr. Tim Boddy from Goldman Sachs. May we have your question, please?

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Tim D. Boddy

*Analyst, Goldman Sachs International*

Q

Yes, thanks. I wanted to ask a bit more about broadband in Germany, where obviously there was a slightly weaker trend this quarter. Could you talk a bit about your market share in broadband within the cable footprint compared to outside the cable footprint? And it would also be really helpful to understand whether you've seen much better share trends in areas where you've already rolled out VDSL or whether there's not a material difference.

And then just can you guys talk about Netherlands? You obviously decided to do an MVNO partnership with Tele2. Clearly, MVNOs have been, should we say, arguably contributed to a lot of the pressures the mobile industry is seeing in a number of markets. Can you talk about your decision to offer that MVNO? Thanks very much.

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Thomas Dannenfeldt

*CFO, German Operation, Deutsche Telekom AG*

A

Let's start with the first question in terms of broadband in Germany. Yes, there is a difference in terms of the market share within the cable footprint and outside. But it's not a huge difference. It's a small and slight difference. I think what we do see looking at our Q3 figures, we have that kind of natural – not natural but seasonality we see every year in Q3 a little bit.

And as Tim mentioned already, some activities undertaken to change the numbers and then bring them upwards again in terms of product effectiveness, in terms of promotional activity. But I think the most important one is the integrated network strategy. And that's the strategy which in a very fast way enable ourselves to offer higher bandwidth, be it by mobile or by fixed plan or by a combination, as we call it, hybrid.

So that's what René said already, along that line of a slight increase, but an increase of demand in terms of bandwidth, not talking about hundreds of megabits like FTTH, but what we can offer in the integrated network strategy, that is what we see and that is why the VDSL areas where we improve there in terms of the gross adds and the net adds. So we think it's the right time now to foster that area and to roll out as fast as we can. That's

what we will do. So we'll see this year another million roughly households being supported by VDSL and strong uptake within the year 2014 and 2015, as announced last year in the Capital Market Days.

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**René Obermann**

CEO & Chairman-Management Board, Deutsche Telekom AG

**A**

Yeah, I think the, if you take a step back and look at the overall market, I think it's clear that cable has now grown by about 200,000, if I'm not mistaken, year-on-year, and they are now at four point some million connection spots; we are at 12.4 million. So overall, we're still very strong in the market and we're improving from somewhat 40% VDSL coverage to 65% VDSL coverage.

That means in all those areas where we have VDSL, and then coupled with vectoring even, we're highly competitive. And if you look at the overall vector offering from installation to customer care to various services with our Sky and so forth packages, I think we're very competitive. And, therefore, overall our market strength will continue and I believe we can fight cable very effectively.

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**Timotheus Höttges**

CFO & Deputy Chairman-Management Board, Deutsche Telekom AG

**A**

I agree. Let me answer the question on Tele2. In August 2013, we signed an agreement to share antenna sites in the Netherlands for 10 years. And we extended the existing MVNO roaming agreement for 2G and 3G for a period of five years. Now you might question why we're doing that. This is a high competitive market. This is, let's say, a market where our return on capital employed isn't satisfying. This is a market where scale matters from a cost perspective and whatever we could save is possible to improve, let's say, from a competitiveness or even from a network coverage perspective.

With this deal, our first estimation shows that a successful passive network sharing can result in potential benefits accounting for almost 30% of site cost over a 10-year period. And I think this is quite significant from the economic perspective, and that's the reason that we went into the Tele2 transaction.

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**Operator:** Mr. Dominik Klarmann from HSBC. Your line is open.

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**Dominik Klarmann**

Analyst, HSBC Trinkaus & Burkhardt AG (Broker)

**Q**

Hi, thank you. Firstly, on regulation and the European single-market package. I understand the industry is currently in discussions with Brussels about filling that draft with real tangible details. Now, I'm wondering how you would describe the dialogue at this stage. Is it constructive, do you oppose it? And, if so, what are the potential deal-breakers in your view?

And then, secondly, on the fiber migration in Germany. Do you have a target you're prepared to share with us in terms of fiber subscribers say end of next year? Looking at the 1.4 million you have today, is something like 2 million for end of next year a good, reasonable target or are you even more aggressive than that? That'd be helpful. Thank you.

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**René Obermann**

CEO & Chairman-Management Board, Deutsche Telekom AG

**A**

This is René speaking. Look, you know me for being critical vis-a-vis these regulations since many years. And I must say that we are seeing some improvements in the approach. But, it's clearly still a mixed bag. There are some positive elements and there are some negative elements. Clearly, negative is there are further attempts to cut into

the revenue and profit pool of the industry, i.e., by cutting international calls and international roaming prices further.

With regards to roaming, personally I feel somewhat mixed. I still think we should as an industry be more customer-friendly and over time that would pay back positively. But clearly, I consider it utmost unnecessary to make further cuts into international calls. That just takes away potential revenues which we could need to reinvest.

More on the positive side, though long-term, are the ideas around spectrum. I think it's good to harmonize the spectrum approach across Europe in a very reasonable way. Also, the allowance of QoS, Quality of Service management on the side of partnering with internet companies as well as the confirmation of the intention to stabilize unbundled local loop fees to foster investments. So it's a mix bag. To be approved before April 2014 and before the new election of the European Parliament seems ambitious.

Generally speaking, I think the pressure on politicians to stimulate broadband investments is still growing. And you see some encouraging early thoughts, for instance, also in the what we are hearing from the German negotiations in the coalition with regards to their willingness to support broadband investments and business environment for broadband investors. But let's wait for the final outcome. So it's a mixed bag. I am slightly positive. I am not enthusiastic, but I'm slightly positive, and I'm also positive about our future ability to compete with our VDSL/vectoring investment program.

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**Thomas Dannenfeldt**

*CFO, German Operation, Deutsche Telekom AG*

A

Yeah, and based on that and adding to it the question about fiber migration in Germany. What I don't want to do is disclose our numbers for year-end 2014. We will talk about 2014 I think in the first quarter next year. What we do and very aggressively do is what we announced last year in the Capital Market Days, we will spend roughly an additional €1 billion next year for the integrated network strategy. And I think that's very aggressive in terms of rolling out and, obviously, then also looking out for the customers in the marketplace to make sure that we get a good utilization on that investment. Yeah.

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**Operator:** The last question for today is coming from Mr. Frederic Boulan from Nomura. May we have your question, please?

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**Frederic E. Boulan**

*Analyst, Nomura International Plc*

Q

Hi. Good afternoon. Just two questions, please. Firstly, on Germany, talk a bit about what's happening on the fixed line side. We're seeing some small progress in terms of revenue performance. We are actually seeing a couple of incumbents now in Europe starting to grow fixed EBITDA or even revenues. So could you comment specifically on, in your case, considering that the ramp up in VDSL, the vectoring and the headwinds on line loss and [ph] broke the (1:05:40) momentum and when do you think growth is possible?

And secondly just on your overall mid-term guidance, so I know it's not the usual forum for that, but the guidance provided at the CMB last year is coming from revenue growth and EBITDA growth in 2014. So if you could comment on how you feel about that considering the current performance and some of the question for the €6 billion free cash flow guidance here for 2015? Thank you very much.

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## Thomas Dannenfeldt

*CFO, German Operation, Deutsche Telekom AG*

A

First of all, kind of a reflection on what you said about Capital Market Day. What we announced there is that we will see a stabilization in 2014 of revenues, not a growth. Nevertheless, we would like to see a growth, don't get it wrong. But we said we were committed to stabilize them and a part of the stabilization is and was, A, to see in mobile a slight increase in growth on one hand in the service revenues and, B, in the Connected Home revenues, and an increase of around 2%, that was what we guided for 2015 related to 2012, and we're still committed to do so. And this is why Tim mentioned a minute ago that we're doing some activities and measures here and additionally to the integrated network strategy and the roll out, to keep the products attractive and make customers happy with the product.

## Timotheus Höttges

*CFO & Deputy Chairman-Management Board, Deutsche Telekom AG*

A

Let me spend a sentence on 2013 and even 2014. First, you know, I think we're in a very good way to deliver on the 2013 targets which we have laid out, the €4.5 billion and the €17.5 on the EBITDA side. So, this is well on track, and we reiterate that we will do that. Even on the higher customer growth number, which we're achieving in the US, because we could compensate that with better synergies and lower OpEx, as we have laid out. So, I think that is the first question.

And this is the starting point then for 2014 and beyond. And what we see today is there's no reason nor any kind of news that what we have said on the Capital Markets Day that we're going to change that. I think in principle, what we're seeing is a very strong growth momentum in our use operations, a good track, unbroken from what we see. Moving on in 2014, what we see is a stabilization almost in our German environment, which is to say a leading position, both on mobile and on the fixed line in its markets, and to say a good answer, even from a market perspective, we're doing well on the net add trends here looking forward and even from the network quality and we have significantly improved the Systems business. Look at the numbers, we have an improvement of 18.5% on the EBITDA side, even here our OpEx and our CapEx is much better under control.

The more challenging environment is Europe. There is a lot of macroeconomic things which are hitting us, and even the regulators are here to a certain extent a little bit unreasonable. So, therefore, and we have to fight against that. We have to adjust our cost structure policies, revenue developments in these areas. And what we even have to do is that we focus on the areas so we could win. And this is why we're even stressing this in our presentations and in the areas, being it TV, being it mobile data, or being it the B2B area. In these areas, I think we made a good progress. And that is for us I think a sign that in this difficult environment we even find a way to fight back on the current trend. And with this, I think what we have said on the Capital Market Day stays the relevant KPIs, even for your intention for the future.

## Stephan Eger

*Head of Investor Relations, Senior Vice President, Deutsche Telekom AG*

Thanks, Tim. And that is basically the end of today's conference call. I know that there were key people still in the waiting line. You'll be called up in the next 15 minutes to 20 minutes by myself and the IR Department. In the case of any further questions, ones who haven't handed in questions, please contact ourselves and IR department. Thank you very much, and speak to you soon. Bye-bye.

**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 country code 4918-052-043-089. Your reference number, 445799#. We're looking forward to hear from you again. Goodbye.

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