

Tear Sheet:

Deutsche Telekom AG

November 11, 2024

Deutsche Telekom AG's (DT) revised financial policy should result in leverage at around 3.0x on an S&P Global Ratings adjusted basis. During its Capital Markets Day in October 2024, DT announced a revised financial policy, introducing a target of at or below 2.75x (translating to an S&P adjusted leverage of about 3.0x), replacing its prior leverage corridor of between 2.25x-2.75x. At the same time, the company said its defined leverage target was reached in third-quarter 2024 after being outside of its targeted leverage since the Sprint acquisition in 2020. In our view, this means DT has reached its leverage comfort level, and it will not prioritize further deleveraging. We expect the company will prioritize its available cash flow toward investments, shareholder returns, and a continued T-Mobile U.S. (TMUS) ownership increase. DT has indicated a desired stake of between 50% and the high 50s; it owns 50.5% currently. With annual free operating cash flow (FOCF) after leases expected to reach €21 billion in 2027, up from €16 billion in 2023, DT will have sufficient headroom to cater for an increase in shareholder returns, committed investments, as well as unexpected opportunities or outlays.

Continued investments in infrastructure to spur growth opportunities. We expect a ratio of capital expenditure (capex) to sales of 14%-15% for the group over the forecast period. The same ratio for its German-European arm is projected at about 18%-19% whereas the U.S. division will stand at only 11%. As such, we believe the U.S. arm will drive the expected improvement in FOCF to a large extent over the same period. Since its previous Capital Markets Day in 2021, DT has invested €71 billion in its networks, which, in our view, has resulted in well-invested mobile networks, creating a competitive advantage. Meanwhile DT's fiber-to-the-home (FTTH) coverage in Germany--set to reach 10 million households in 2024 (about 25% of German homes)--lags comparable incumbents in Europe. We attribute the low coverage to (1) weak demand due to relatively strong alternative networks (take-up rate in Germany at about 20% compared with the EU average of 50%); and (2) regulatory requirements that make the roll-out relatively costly and slow. In the rest of Europe, DT covers another 10 million households, with a take-up rate of 35%, which is stronger than the German footprint but still behind the EU average, indicating there are growth opportunities as well as investments to be made. DT targets to build out its FTTH coverage by 2.5 million in Germany and 1.0 million in Europe annually until 2027. We also expect continued investments in the densification of DT's mobile networks in Germany and the U.S., while continue to build out 5G in Europe (currently at 78% coverage). Furthermore, TMUS will allocate US\$10 billion to its recently announced acquisitions and joint-venture partnerships, relating primarily to expanding its FTTH footprint.

AI and digitalization to drive internal efficiencies and external growth opportunities in B2B. The overall cost savings related to AI adaptation in the organization are estimated at €1 billion

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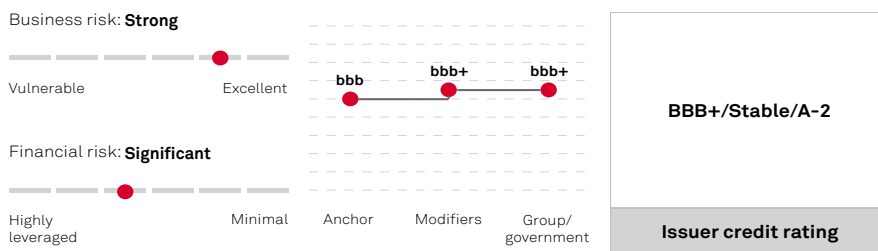
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by 2027 (€800 million relates to operating expenditure and €200 million to capex). Most efficiencies are expected to come from digitalization of the organization, enhanced productivity, and improved customer satisfaction, with the aim of 90% of resolutions made without human interaction. AI is also expected to play a role in future revenue growth opportunities, for example through its usage in autonomous networks and in its product portfolio relating to areas such as cloudification and security. This aligns with DT's growth strategy in B2B, with the ambition of becoming a one-stop shop for SMEs, while focusing on targeted verticals for larger enterprises to regain market share lost in Germany in recent years and to seize growth opportunity in the public sector.

Ratings Score Snapshot



Recent Research

- Industry Credit Outlook Update Europe: Telecommunications, July 18, 2024,
- Industry Credit Outlook Update North America: Telecommunication, July 18, 2024
- Deutsche Telekom AG, June 18, 2024

Company Description

DT is one of the world's largest telecom operators, with headquarters in Bonn, Germany. It offers fixed and mobile telecom services to retail and business customers, as well as information technology services. The company's geographic EBITDA split in 2023 was about 24% in Germany, 10% in Europe, and about 65% in the U.S. DT's largest shareholder is the Federal Republic of Germany, which as of June 30, 2024, held a stake of 27.8% through its own holdings as well as holdings by the German government-owned bank KfW.

Outlook

The stable outlook indicates our expectation that DT will expand its adjusted EBITDA margin above 40%, while capex will be managed at about 15% of sales, which in our view should lead to annual adjusted FOCF of about €20 billion and leverage comfortably below 3.5x.

Downside scenario

We could lower the rating if DT fails to sufficiently strengthen credit metrics so that leverage rebounds above 3.5x. This could stem from a more aggressive financial policy than we currently foresee, or any material operational setbacks.

Upside scenario

We could raise the rating if DT's cash flow metric improves to the extent that funds from operations (FFO) exceed 30% of debt and free cash flow exceeds 15% of debt, while leverage reduces to below 3.0x.

Key Metrics

Deutsche Telekom AG--Forecast summary

Period ending	Dec-31-2020	Dec-31-2021	Dec-31-2022	Dec-31-2023	Dec-31-2024	Dec-31-2025	Dec-31-2026	Dec-31-2027
(Mil. EUR)	2020a	2021a	2022a	2023a	2024e	2025f	2026f	2027f
Revenue	100,999	108,794	114,197	111,970	114,703	116,449	118,404	120,319
Gross profit	56,325	59,111	61,271	64,769	68,866	71,272	73,335	75,004
EBITDA (reported)	36,972	40,538	43,047	44,759	48,368	50,461	52,176	53,502
Pension & other postretirement expense	(215)	(87)	37	31	31	31	31	31
Stock compensation expense	628	540	655	674	674	674	674	674
EBITDA - Gain/(Loss) on disposals of PP&E	368	161	(92)	42	0	0	0	0
EBITDA - Business Divestments	(10)	(214)	(2,732)	(239)	0	0	0	0
EBITDA - Other	(2707)	(2,640)	(1,057)	(157)	(100)	(100)	(100)	(100)
EBITDA	35,036	38,298	39,858	45,110	48,973	51,066	52,781	54,107
Less: Cash interest paid	(7,586)	(5,241)	(5,669)	(6,136)	(6,427)	(5,293)	(5,259)	(5,525)
Less: Cash taxes paid	(690)	(893)	(902)	(1,312)	(5,395)	(6,123)	(6,405)	(6,635)
Funds from operations (FFO)	26,760	32,164	33,287	37,662	37,151	39,650	41,117	41,947
EBIT	9,082	10,666	12,382	18,637	24,633	25,951	26,864	27,895
Interest expense	5,157	5,307	5,720	7,021	6,653	5,544	5,517	5,782
Cash flow from operations (CFO)	24,361	31,868	35,805	37,255	39,451	40,720	42,679	44,511
Capital expenditure (capex)	18,360	26,154	23,989	17,659	15,979	16,478	17,695	18,435
Free operating cash flow (FOCF)	6,001	5,714	11,816	19,596	23,472	24,242	24,984	26,076
Dividends	3,067	3,145	3,385	4,027	7,229	8,563	9,419	9,915
Discretionary cash flow (DCF)	2,934	2,569	8,431	15,569	7,043	4,429	1,315	2,511
Debt (reported)	107,108	111,466	113,030	104,523	102,722	109,080	114,939	125,032
Plus: Trade receivables sold	2,173	2,265	2,154	1,990	1,990	1,990	1,990	1,990
Plus: Lease liabilities debt	32,715	33,134	38,792	40,793	40,793	39,569	37,986	36,467
Plus: Pension and other postretirement debt	7,036	5,877	4,057	3,962	3,962	3,962	3,962	3,962
Plus: ARO debt adjustment	1,906	2,051	1,277	1,172	1,172	1,172	1,172	1,172

Deutsche Telekom AG--Forecast summary

Less: Accessible cash and liquid Investments	(10,918)	(5,509)	(5,325)	(7,473)	(4,024)	(4,024)	(4,024)	(4,024)
Debt - Other	(5,864)	(5,616)	(5,234)	(3,485)	0	0	0	0
Debt	134,156	143,668	148,751	141,482	146,616	151,749	156,026	164,599
Equity	72,550	81,468	87,320	91,237	88,069	83,217	75,167	67,757
FOCF (adjusted for lease capex)	(8,277)	228	1,303	13,446	18,982	20,693	21,392	21,991
Interest expense (reported)	4,638	5,052	5,679	6,588	6,220	5,111	5,084	5,349
Capex (reported)	18,694	26,365	24,114	17,866	16,186	16,685	17,902	18,642
Cash and short-term investments (reported)	12,939	7,617	5,772	7,280	5,000	5,000	5,000	5,000
Adjusted ratios								
Debt/EBITDA (x)	3.8	3.8	3.7	3.1	3.0	3.0	3.0	3.0
FFO/debt (%)	19.9	22.4	22.4	26.6	25.3	26.1	26.4	25.5
FFO cash interest coverage (x)	4.5	7.1	6.9	7.1	6.8	8.5	8.8	8.6
EBITDA interest coverage (x)	6.8	7.2	7.0	6.4	7.4	9.2	9.6	9.4
CFO/debt (%)	18.2	22.2	24.1	26.3	26.9	26.8	27.4	27.0
FOCF/debt (%)	4.5	4.0	7.9	13.9	16.0	16.0	16.0	15.8
DCF/debt (%)	2.2	1.8	5.7	11.0	4.8	2.9	0.8	1.5
Annual revenue growth (%)	25.4	7.7	5.0	(2.0)	2.4	1.5	1.7	1.6
Gross margin (%)	55.8	54.3	53.7	57.8	60.0	61.2	61.9	62.3
EBITDA margin (%)	34.7	35.2	34.9	40.3	42.7	43.9	44.6	45.0
EBITDA/cash interest (x)	4.6	7.3	7.0	7.4	7.6	9.6	10.0	9.8
EBIT interest coverage (x)	1.8	2.0	2.2	2.7	3.7	4.7	4.9	4.8
Exchange rate EUR/USD (Annual)	1.14	1.18	1.05	1.08	1.1	1.14	1.17	1.17

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. e--Estimate. f--Forecast. EUR--euro.

Financial Summary

Deutsche Telekom AG--Financial Summary

Period ending	Dec-31-2018	Dec-31-2019	Dec-31-2020	Dec-31-2021	Dec-31-2022	Dec-31-2023
Reporting period	2018a	2019a	2020a	2021a	2022a	2023a
Display currency (mil.)	EUR	EUR	EUR	EUR	EUR	EUR
Revenues	75,656	80,531	100,999	108,794	114,197	111,970
EBITDA	24,715	27,080	35,036	38,298	39,858	45,110
Funds from operations (FFO)	19,481	22,055	26,760	32,164	33,287	37,662
Interest expense	3,404	3,230	5,157	5,307	5,720	7,021
Cash interest paid	4,537	4,267	7,586	5,241	5,669	6,136
Operating cash flow (OCF)	19,934	22,832	24,361	31,868	35,805	37,255
Capital expenditure	12,202	14,014	18,360	26,154	23,989	17,659
Free operating cash flow (FOCF)	7,732	8,818	6,001	5,714	11,816	19,596

Deutsche Telekom AG--Financial Summary

Discretionary cash flow (DCF)	3,387	5,008	2,934	2,569	8,431	15,569
Cash and short-term investments	3,679	5,393	12,939	7,617	5,772	7,280
Gross available cash	4,333	6,333	13,820	8,586	7,596	9,285
Debt	80,179	85,323	134,156	143,668	148,751	141,482
Common equity	43,437	46,231	72,550	81,468	87,320	91,237
Adjusted ratios						
EBITDA margin (%)	32.7	33.6	34.7	35.2	34.9	40.3
Return on capital (%)	6.9	7.3	5.4	4.9	5.4	8.0
EBITDA interest coverage (x)	7.3	8.4	6.8	7.2	7.0	6.4
FFO cash interest coverage (x)	5.3	6.2	4.5	7.1	6.9	7.1
Debt/EBITDA (x)	3.2	3.2	3.8	3.8	3.7	3.1
FFO/debt (%)	24.3	25.8	19.9	22.4	22.4	26.6
OCF/debt (%)	24.9	26.8	18.2	22.2	24.1	26.3
FOCF/debt (%)	9.6	10.3	4.5	4.0	7.9	13.9
DCF/debt (%)	4.2	5.9	2.2	1.8	5.7	11.0

Peer Comparison

Deutsche Telekom AG--Peer Comparisons

	Deutsche Telekom AG	Verizon Communications Inc.	AT&T Inc.	Orange S.A.	Vodafone Group PLC
Foreign currency issuer credit rating	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB/Stable/A-2	BBB+/Stable/A-2	BBB/Stable/A-2
Local currency issuer credit rating	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB/Stable/A-2	BBB+/Stable/A-2	BBB/Stable/A-2
Period	Annual	Annual	Annual	Annual	Annual
Period ending	2023-12-31	2023-12-31	2023-12-31	2023-12-31	2024-03-31
Mil.	EUR	EUR	EUR	EUR	EUR
Revenue	111,970	119,765	110,021	44,122	36,717
EBITDA	45,110	47,030	47,908	14,174	14,704
Funds from operations (FFO)	37,662	38,486	38,200	11,922	11,675
Interest	7,021	7,685	7,659	1,467	2,826
Cash interest paid	6,136	6,424	8,261	1,124	2,305
Operating cash flow (OCF)	37,255	36,359	37,189	12,226	11,940
Capital expenditure	17,659	15,334	15,361	7,910	6,860
Free operating cash flow (FOCF)	19,596	21,026	21,828	4,316	5,080
Discretionary cash flow (DCF)	15,569	11,052	9,467	1,982	2,390
Cash and short-term investments	7,280	1,868	6,081	5,505	11,275
Gross available cash	9,285	1,868	6,081	8,183	11,302
Debt	141,482	148,100	170,443	40,950	47,599
Equity	91,237	82,504	92,647	33,565	65,495

Deutsche Telekom AG--Peer Comparisons

EBITDA margin (%)	40.3	39.3	43.5	32.1	40.0
Return on capital (%)	8.0	11.5	9.4	7.1	3.5
EBITDA interest coverage (x)	6.4	6.1	6.3	9.7	5.2
FFO cash interest coverage (x)	7.1	7.0	5.6	11.6	6.1
Debt/EBITDA (x)	3.1	3.1	3.6	2.9	3.2
FFO/debt (%)	26.6	26.0	22.4	29.1	24.5
OCF/debt (%)	26.3	24.6	21.8	29.9	25.1
FOCF/debt (%)	13.9	14.2	12.8	10.5	10.7
DCF/debt (%)	11.0	7.5	5.6	4.8	5.0

Rating Component Scores

Foreign currency issuer credit rating	BBB+/Stable/A-2
Local currency issuer credit rating	BBB+/Stable/A-2
Business risk	Strong
Country risk	Very Low
Industry risk	Intermediate
Competitive position	Strong
Financial risk	Significant
Cash flow/leverage	Significant
Anchor	bbb
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Strong (no impact)
Management and governance	Positive (no impact)
Comparable rating analysis	Positive (+1 notch)
Stand-alone credit profile	bbb+

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology: The Impact Of Captive Finance Operations On Nonfinancial Corporate Issuers, Oct. 23, 2023
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015

Deutsche Telekom AG

- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Jan. 07, 2024
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

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