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MANAGEMENT DISCUSSION SECTION

Hannes C. Wittig

Analyst, JPMorgan Securities Ltd.

Okay. Hello, this is Hannes Wittig. I'm the head of the European telecoms team at J.P. Morgan. I have the great pleasure of welcoming Tim Höttges, the CFO of Deutsche Telekom to this conference. He is also in charge of one of the most exciting wireless operators in the United States. So I would like to, as I say, welcome him, but also give him an opportunity maybe just to explain how he is looking at the situation after a pretty decent first quarter, what are sort of the main issues that he would see at this point in time. And then we'll ask him some questions. Tim?

Timotheus Höttges

Chief Financial Officer, Deutsche Telekom AG

Thank you, Hannes. Good morning, everybody. Great honor being here today. So maybe give you an overview about the priorities and the biggest levers for Deutsche Telekom in this current environment. First, the most important thing is that we have an organic path towards improving the situation of our T-Mobile U.S. business here in the mobile business, with a clear way forward on the LTE build out and the challenges that reroute attractive prices.

The second priority is about the non-organic moves here in the U.S. about, let's say, whether we could generate additional value by concentrating in the market and realizing either synergies gaining spectrum, generating economies of scale of our network.

The third priority of Deutsche Telekom is in Germany. The biggest asset Deutsche Telekom owns is 60% of enterprise value is the German entity fixed mobile market leader. Here I think the biggest task for us is improving on the T-Mobile on the mobile business, on the retail side especially with regard to revenues.

The fourth priority of Deutsche Telekom is finding the appropriate answer on the cable challenge in the German environment. This is more a strategic question on how we could invest into the fiber infrastructure in Germany with a decent return on capital employed.

The fifth priority is around Europe. Most of the European companies are doing pretty well in its total performance. There is one asset we need to focus, which is Greece. In Greece, the target is the independent refinancing capability of the entity, which Deutsche Telekom owns by 40%, and to safeguard, the future of this entity in its difficult environment.

The sixth priority on Deutsche Telekom is being – absolutely safeguarding the long-term sustainability with regard to the cash flow because stable cash flow is definitely, let's say, the main focus for Deutsche Telekom, covering the dividend on the one side. We have a three-year guidance for our dividend and we are one of the, let's say, last men standing in the European environment not cutting the dividend and we believe there's no need to do that because of, let's say, a very reasonable payout ratio around 50%. And keeping the very good covenants, which we have, and the good rating situation, refinancing capability, which we currently hold and the high liquidity pulls at the same times.

So overall, I think Deutsche Telekom had a very good head start in 2012. We have seen improvements in almost every business apart from priorities I've mentioned already. And we are keeping the guidance of €18 billion of EBITDA and €6 billion of free cash flow including, let's say, our commitment to the financial strategy. So, that's where we are. And I don't want to go into too many details because I think we should have even your Q&As here.

Hannes C. Wittig

Analyst, JPMorgan Securities Ltd.

Thanks, Tim. That was a great overview. So, maybe keeping in mind that a lot of audience questions will focus on the U.S., maybe I'll just ask a couple of questions on Europe. Right now, the European business are usually stable, but they are also usually declining at a certain manageable rate. Do you see a way for that business to return to a more stable top line and what would it take? Would it involve greater investments from your side? Is there something that you can see it that you could invest and would, let's say, improve to top line performance in the European part of the business?

Timotheus Höttges

Chief Financial Officer, Deutsche Telekom AG

First, every single market we are in, and we are covering market leaders from Poland down to Greece, is in a different macroeconomic environment. To paint the picture, I would say we have no further decline in the markets from a macroeconomic term. We have stabilization at a low level overall. But it had not worsened over the last quarters in the Eastern European part of the business.

Nevertheless, talking about the good ones, I think Poland is doing quite nicely with this macroeconomic trend. We have a mobile market leader down there. Talking about the environment of the Czech market, talking about the environment of the Netherlands, talking about the environment of Austria, even Croatia which is a little bit weaker, the situation is, for the telecommunication, quite okay. Romania is recovering overall. So that's good because it's a big market for us and we adjusted the beginning of penetrating telecommunication services especially in the mobile side. The biggest worry on the macroeconomic trend is Europe.

We haven't seen a revenue growth. The overall revenue trend in the first quarter was minus 2.6% year-over-year. But the organic revenue – so if you take out currency impacts from the Poland and from the zloty, and if you exclude the impact from regulations on MTR and on interconnection prices, the overall revenue developed quite nicely, almost stable.

So, therefore our focus is definitely, let's say, to recover over time and 2013, 2014 to see an improvement here. Today, our focus is on stable cash flow because that is for us at that point in time the name of game in European footprint and our projections towards this one are fine.

Maybe some final remark at the sideline here, we had an increase on our revenues in the Greek mobile business. So this was a little bit of surprise, honestly speaking, and I know this was not due to our great strategy. I think we were only lucky in this regard because our competitors Wind and even Vodafone they suffered big time in the competition. And we regained market share and revenue market share in this difficult environment.

Hannes C. Wittig

Analyst, JPMorgan Securities Ltd.

So it's not because you re-denominated your revenues in drachma over this. No, but, the second question on the European side is related to your investment levels in, let's say, the broader European footprint including Germany. So specifically with regard to Germany, of course, you face very dynamic and growing cable competition. Do you feel that it's enough, you spent enough money on CapEx and is there a risk that sort of Deutsche Telekom or an opportunity for Deutsche Telekom to change investment levels in order to improve the situation?

Timotheus Höttges

Chief Financial Officer, Deutsche Telekom AG

If you're talking about changing investments level, we should talk about Germany as we took a decision on that one already, so it's part of the guidance. And we talk about U.S. and the market got guidance on that one as well with an increase for the next years on the refarming of our LTE spectrum. For Europe, we did or we do every year benchmarking on CapEx. And by the way, we're not doing that on cash. We're doing that on how fast are we with regards to the LTE built out, how competitive is our network. Deutsche Telekom, we are German engineers and therefore we love good technology. So you might criticize us for investing sometimes a little too much on networks. But for us, the basis for all business is the network.

And therefore, in all of the markets we're talking about, there's not a single market except Greece where we are not at par level with or even better, most markets we are better with regard to our network deployment. Fixed line is a little bit different as I mentioned in Greece because we have a little bit reduced our CapEx level in Greece because the refinancing and the reduction of the debts of OTE is the main objective at that point in time.

So there's nothing we would lose with the current CapEx levels in the European environment. And by the way, you could see that as well on the numbers we have presented to our owners here. The new products, smartphones, the new products entertain triple play offers The products around mobile data and mobile broadband on iPads, all these things growing very nicely, stronger than – in most of the market stronger than our competition and by the way not only this quarter. So therefore, I think just take an example, 12% increase on a broadband and TV access in Europe, take an increase on the smartphone share of 43% between or even on the contract subscribers we grew in this market environment by more than 3%. So therefore, you see that it is not that we are weakening on the gross add on the subscriber and the customer market share, in the future areas, especially mobile data, all business developing nicely.

Hannes C. Wittig

Analyst, JPMorgan Securities Ltd.

And specifically in Germany, of course, you have very dynamic cable competition. Going back to that theme, do you think there is more investment required in the German fixed line business to cope with sort of may be a growing requirements for bandwidth, growing demand for bandwidth or do you think that the cost-cutting that you are doing can basically mitigate the kind of the level off losses that you have today and that's more efficient strategy to deal with that's situation?

Timotheus Höttges
Chief Financial Officer, Deutsche Telekom AG

There are some very well known sell side analysts in this world who sometimes write intelligent reports about investing more into Germany. So honestly speaking, we have to differentiate the businesses. In mobile Germany, we are investing at maximum speed. It is impossible at that point n time to open up more sites on LTE. I'll give you one example construction and the allowance from the regulator who has to check the sale at the mobile sides before they go on out due to interference issues. They have started hiring external engineers for us to prove all the sites, which are going to in the last quarters.

Only in this quarter, we have improved the LTE footprint to 25% top cover to Germany. In this quarter, 11% increase and there's no limitation on expanding the LTE coverage during the course of this year. We have increased our CapEx by 50% on mobile. We are investing in the vicinity of €600 million only into LTE, into coverage and into 4G deployment. This is the biggest portion which have seen over the last 12 years since I'm with the company. At the same time, we have the last years, we have invested into connecting all our sites 3G to fiber backhaul, which is honesty from a quality perspective, the most relevant factor because the digestion of traffic that is what drives quality on the network. And there is not a single operator in Germany who has this backhaul capacity today. We have now assigned a wholesale deal with Telefonica that they could use parts of the fiber backhaul. So we have a network from a backhauling, but as well from a coverage prospective, which is expanding at maximum speed.

So therefore, this is a differentiator and we had the last eight consecutive tests from different journalists and from experts like [indiscernible] (15:09) and others. We have gained in all categories number one positions. Only to give you an example, I'm not sure whether Vodafone is here today, but the YouTube downloads speed in our network is double as fast as the one of Vodafone, who is our main competitor in the German environment.

So your question is more relating to attacking the cable operators. And the question of, do we have to extend our broadband speed on the wireline? And I think long term, yes. Short term, not automatically needed, because we have already a coverage with 50 meg with VDSL of 35% of the population in Germany, which is compared to other European telcos already bigger. Long term, the cable operators are offering with [indiscernible] (16:11) bi-directional services with 100 megabit and especially in areas where we cannot deliver on VDSL, we have to expand our graph. VDSL expansion is one name of the game because that is not so expensive. Fiber investment is needed. Any economy in the world needs fiber for future prosperity. But we do not have the right political end regulatory environment at that point in time. And therefore, we are expanding very slowly on fiber investment at that point in time. I think we have to attack cable in different ways than just putting billions into the ground not knowing whether we ever earned a decent profit on that one.

Hannes C. Wittig
Analyst, JPMorgan Securities Ltd.

You've mentioned LTE, that's obviously also a focus in the United States. Maybe you can, to be clear, say a few words on how that maybe improves your position in the U.S. before we open for questions?

Timotheus Höttges
Chief Financial Officer, Deutsche Telekom AG

For us, for everybody being involved, you could imagine the breakup of the AT&T deal. This was a big, big frustration for all people being involved because for both parties, I think that was a one lifetime opportunity. For us from the strategic opportunity would have had after that gaining all these proceeds, we would have been definitely one of the strongest European telco, not only from its market but as from its balance sheet perspective.

After the breakup, we spend a lot of time on saying what is now the right answer for the U.S.? And if you go out of a process where you sell an asset, there's always a perception that if these guys are selling an asset, it must be a problem child. And after looking into the breakup fee, cash and especially even the spectrum, we found all of that we have a very clear way going forward. It is not a problem child for us and that is due to the fact that we have a clear path towards LTE. It is definitely a big opportunity in the marketplace.

Yes, we are small, no doubt, but with the spectrum of AT&T, we are now refarming all the spectrum which we have into the standard common LTE band. And therefore we could even use the iPhone, which we couldn't use in the past on our – a separate chipset was required for our services. So therefore, we could tap even this market in the future. We took the decision to use cash flow, which we generate in the U.S. It's not money coming from Europe. It is all self-funding here in the U.S., cash flow from the U.S. to modernize and to refarm the spectrum. So, we are now building for all of our markets, we are building an LTE network. And by the way, at the end of the day for almost every market, we have two times 10 megahertz of LTE. This is giving us a clear path until 2017, 2018, whatever projection you might take with regards to data consumption on a standalone basis. There is no need for us to enter into any kind of deal at that point in time. We have a cash flow which we generate, we are investing $4 billion on top of the $2.5 billion, which we normally have in the U.S. business into the U.S. And with this, we have a clear path towards LTE.

We will implement or we have started implementing a challenger strategy on pricing, because we are the small player here. So we have to be aggressive and value for money. And therefore, you have seen our recent prepaid offerings here in the market, quite aggressive, and we have gained a lot of momentum on prepaid already. We are still suffering in this market on the contract side, but even here, we see improvements on the churn rates, which were the big problem for us in the past and still is a problem even in the first quarter where we have seen 500,000 negative net assets.

But overtime, the Android market is growing nicely here in the U.S. as well. We could tap this potential. We have an empty network. We have fiber links in the backhaul. So therefore, we could really play with this capacity. And we know how huge this uptick, this growth of data is in the U.S. market. So therefore we have a clear challenger strategy as we call it here for the U.S. market. We will rebrand in the U.S. in a more aggressive way of how we present the brand. We will approach the market with new propositions especially even for the semi-markets or for the small enterprises because we think there is a sweet spot which we haven't tapped yet. And what we do at the same time, we will finance this on a self-funding way in the U.S. by cutting out $900 million of costs here in the U.S. which we then could partially reinvest into the business. So that's the way going forward for the U.S. market. And I think there is a clear organic path, and we had a good trend in the first four months this year. And we hope that we could even improve on the branded contractor.

Hannes C. Wittig

Analyst, JPMorgan Securities Ltd.

Fantastic. So I'll take question from the audience now. So anyone who ask a question should ideally use that microphone. If that's all right maybe I saw it over here.

QUESTION AND ANSWER SECTION

Q

So a couple of questions. First is, just on a secular basis, the European service provider CapEx, do we just have a constant headwind because of the regulatory structure? Can you talk about whether it makes sense for large carriers, small carriers to invest CapEx when they have to open up their networks to someone else? And what does that mean in terms of how spending unfolds over the next few years?

Second question is although I'm not sure it's a – how high percentages of your spend, but some of your suppliers like Alcatel-Lucent or Nokia Siemens Network, obviously not making money. And in some way, it's nice to squeeze these guys as much as possible. On the other hand, you want them around so you can have competition on pricing. Can you talk about that dynamic as well?

Timotheus Höttges
Chief Financial Officer, Deutsche Telekom AG

A

Okay. I think it is – regulation is always painful for an industry, but especially in the fixed line industry. In the mobile industry, I think the ecosystem in most of the markets developed quite nicely. And if I look to the return on capital employed, on the mobile side, on my assets, this business model has and is working okay. We have to adapt our cost structure. We have to adapt the propositions in our subsidies to the APRU, which we could gain in the market. And if MTRs and interconnection prices get reduced, it will have an impact on the profitability on the price per minute. But in the past, in the mobile side, we were able to match this and not losing profitability big time on this one.

With regards to the spectrum policy, honestly, I believe that most of the European markets they are following a very decent and clear path. They are open up a lot of opportunities for us. The biggest market Germany, the 800, 1,800, 2.1, 2.5 gig spectrum was already entirely auctioned into the market. So, therefore, we have not at all a capacity constraint. I think regulation was quite positive on that one. And there are certain areas where I think on the mobile side where the regulator's right. It cannot be that you get charged by traveling in Europe, big time on high roaming fees. The consequence is that that people are not using their phone anymore and that is to opposite of what we want.

So therefore, we understand that and by the way Deutsche Telekom would benefit big time if we were to see roaming regulation being even more tough because we are net buyer. People are traveling from Germany to the south and using the network there and that's the opposite, so we are net buyer for roaming minute. So therefore that would be beneficial for us. So, overall I would say, yes, it's sometimes painful the MTR cuts us overall. On the mobile side, the regulators are falling in a post regulation, which is decent.

On the fixed line, and I cannot talk about every market because every market has its own flavor. Let's talk about the big levers for Deutsche Telekom stock, which is Germany. I think we need a new regulatory regime. In some markets, we are – by the way, some metrics regulated in Germany, so we are the only one being paralyzed. All the others have the advantage over us, even the cable operators. And it cannot be that we are number three in certain local markets and not having the ability to pricely react on that one. This is unfair competition.

And therefore the classical mechanism of European consolidation has to change. And that only could encourage all owners of this company to be vocal about that one, because if only the consumer is in the mind of the regulator, you will see a decline on revenues. And even if you invest at a high level, you will see less investment into modern infrastructure. And that is exactly what is happening in the field of fiber.

In the U.S. you have a much better regulatory regime. A couple of us regulated, five of us opened up from a regulation prospective and an explosion on investment took place. This is not taking place in Europe, and we need a new regime, which is more open up either a fair symmetric regulation or stopping regulation in certain areas, so that the industry is freeing up resources for bandwidth.

And today Deutsche Telekom is not willing to commit big portions of CapEx into an environment where we do not know how much we earn on this infrastructure the next day. Capital intensive industries, they have huge upfront investments so fixed cost and high underutilization than for a long time. And this cost of underutilization, they are negative in competition because our carriers or the ULL providers or the wholesale partners, they're buying that at variable prices. So we compete in a fixed model with variable prices. You cannot succeed that. And therefore, we are not willing to go this path. And therefore I think the political will has to change towards regulation in Europe before really huge investments are taking place.

Hannes C. Wittig Q
Analyst, JPMorgan Securities Ltd.

Maybe we...

Q

[Inaudible] (28:39)

Timotheus Höttges A
Chief Financial Officer, Deutsche Telekom AG

Sorry.

Hannes C. Wittig Q
Analyst, JPMorgan Securities Ltd.

Yeah. But we only have six minutes left.

Timotheus Höttges A
Chief Financial Officer, Deutsche Telekom AG

Maybe one question on that one. In a market which is [ph] commercializing, (28:45) in a market where the scale matters, you have to do everything to squeeze down your cost and we did big time. We have reduced Deutsche Telekom's cost by €8.3 billion since 2007. And the supplies they have to pay that price on that one. There is no question about it. They are indirectly influenced by the supply and one of the reason that we even want to improve our lever on the suppliers is that we build the biggest joint venture, procurement joint venture in Europe where we bundle all our activities as France Télécom, the separate company now buying technology and handsets in a combined fashion. So that is keeping in a global competition where we are local operators keeping our heads up, that is, let's say, the strategy. So this will impact even our suppliers in a world which is more and more commercializing.

Hannes C. Wittig Q
Analyst, JPMorgan Securities Ltd.

Thanks, Tim. Maybe take a question over here. Excuse me, if you could maybe make the quick walk over there just because it won't be heard otherwise.

Q

Feel like I'm in a spelling bee here. Can you spell the word Deutsche? Sorry. Can you just elaborate on what you were saying about the spectrum now that you consolidated from AT&T, how that enables you to get the iPhone without a special chip? And if an iPhone were ready, say, a new iPhone, an LTE iPhone were ready in, say, October, would you guys be able to take an iPhone that soon? It sounds like what you're describing in the U.S. market gives you the ability to be fairly disruptive right now relative to kind of what we're hearing out of the other carriers. Thanks.

Timotheus Höttges
Chief Financial Officer, Deutsche Telekom AG

A

Okay. I think – we could not talk about [indiscernible] (30:49) in that subject because it could go in every specific market. But on AWS, HSPA+ and the PCS spectrum, which we use for voice, we had 54 megahertz of spectrum here available and we have now 60 megahertz of spot, of which is still at least more than half of that is for LTE and for the HSPA+ capacity. So that was adjacent. We bundled it with even some exchange of spectrum with local partners here. So that we free up the spectrum, which we use for 2G services today. And we found that for the LTE bands.

Then we are working in an LTE band, which is adjacent to the LTE band which is AT&T is working on to make it very simple here for non-technicians. And then having this offer in the market with our spectrum, people who want to buy then our plans could use old iPhones and work then on our infrastructure. That is the so-called refurb market. In 2013, we're going to start then with LTE. This LTE band doesn't require an additional chipset as the old one did, so that we could take this standard product Apple is producing and deploy it on our network. So we hope that we then would get in that great partnership we have Apple in Europe that we good get then a decent portion without you know being forced into huge volume commitment, because that is something we cannot afford, and therefore we hope that we could help Apple grow their business in U.S. then on the standard chipset without additional cost. But for all of the top 100 markets we target about 200 markets but we have up to 2.10 megahertz in most of these markets which is significant from a capacity prospective, at least until 2017, 2018.

Hannes C. Wittig
Analyst, JPMorgan Securities Ltd.

Q

Maybe question over here? A gentleman.

Q

I got a very general question, if you look at what consumers pay in the developing markets and the margin step leaders make in developing markets, both of them are significantly less than the developed world. So why wouldn't the margins and prices consumers pay for a mobile services, not gravitate towards the developing market levels? So if you look at India or any other market and see how much consumers pay for the same data, same voice and the margins these payers make, they're much less. So why shouldn't it gravitate those levels not now but [indiscernible] (33:48) So why should the regulators regulate you more and make pricing come down more, I mean what's stopping that?

Timotheus Höttges
Chief Financial Officer, Deutsche Telekom AG
A

Look, that point, if all the costs for network, for construction, for rent, for the maintenance people, for the engineers deploying, even the retail the distribution which is a big portion of our cost structure, if all these cost put be at Indian level, I would definitely reduce minute prices significantly. We have a margin of something the vicinity of 35% of today in our businesses, including oil cost. By the way, we have already squeezed out big time cost in our ecosystem and we will move on that one, that is no doubt and probably you would even see further minutes pricing declining that is what we expect.

But any business model, a sustainable business model has always to reflect a decent business case from an amortization perspective, from a net present value perspective, or return on capital employed perspective. And therefore, you have to consider even the environment in which you're operating. And by the way, in Romania we have a significant lower minutes price, but the same margin, as in Germany where we have a higher price. So we adapt our minutes prices to the local situation and by the way, through the GDP of the health of the people in this respective area.

Hannes C. Wittig
Analyst, JPMorgan Securities Ltd.
Q

Okay. I think...

Timotheus Höttges
Chief Financial Officer, Deutsche Telekom AG
A

They will further shrink.

Hannes C. Wittig
Analyst, JPMorgan Securities Ltd.

I think we have run out of time. So not sure if we have – I think we are sort of at the end of it. I would like to thank Tim for coming here and giving us his views and maybe I invite the people who haven't had a chance to ask a question just to come here and have a chat. Thank you.