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Deutsche Telekom AG (DTE.DE)

Q4 2013 Earnings Call
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MANAGEMENT DISCUSSION SECTION

Timotheus Höttges  
Chief Executive Officer, Deutsche Telekom AG

OPENING COMMENTS

- It’s my first time to do this call as Group CEO, quite proud about it and therefore, quite excited about this discussion here today
- As we have worked intensively over the last weeks on a couple of strategic issues, I would also like to use the opportunity to give you in the second part of today’s call a bit of an update on our group strategy and its recent evolution as well on what I, as Group CEO, and our management team stand for
  - However, we are at the beginning of this process and this is meant as an update and teaser with some more details to be presented at our next Capital Markets Day
- I’m also very happy to have, for the first time, our new Group CFO, Thomas Dannenfeldt, here at my side for today’s call
  - So, Thomas, welcome as well

2013 BUSINESS REVIEW

- But let’s start today with a review on what we have achieved as a group in 2013
- In essence, I think we and you, as our shareholders, we can be satisfied with the 2013 results and Deutsche Telekom undoubtedly created value for its shareholders
Europe

- In Germany, we further improved our revenue trends and outperformed our competition significantly especially on the mobile side where we, as the only player, were able to show underlying stable service revenues for the year as we have promised
  - At the same time, we delivered on our EBITDA margin target of around 40% and started the rollout of our integrated network strategy
- In Europe, we saw particular in H2 an organic improvement in the revenue trends
- At the same time, our revenue and cost transformation execution is progressing well

US

- In the U.S., we accomplished the merger with MetroPCS successfully and showed an extraordinary turnaround in the market with more than 4.4mm new subscribers being one throughout the year
  - This is the outcome of the bold Un-carrier strategy and its rigid execution in the market by a fantastic TMUS management team
    - This was also reflected in a 53% uptake on the enterprise value of T-Mobile US since the company started trading early in May until year 2013
  - We will continue to extend our network aggressively also in 2014 with an increase of our LTE coverage to 250mm POPs with our continued rollout up to 20x20 megahertz LTE and the first deployment of 700 megahertz starting in 2014
  - We have earmarked US$4.2B to US$4.6B CapEx for the U.S. in 2014
    - However, the strategic target for the U.S. remain unchanged, self-funding and de-risking and we continue to believe that the U.S. wireless market longer-term needs further consolidation and that we are well-positioned to play an active role in this process

EPS an ROCE

- On the group level, we pursued our efficiency part quite well, especially Telekom IT delivered a strong €350mm reduction in IT spend for the Deutsche Telekom Group
  - But indirect cost cuts were also strong in other areas and countries like T-Mobile US or in Europe, here particular in Greece
    - As a result, we saw an improvement y-over-y in our EPS and our group return on capital employed

Balance Sheet Management

- At the same time, we invested almost €1B organically more into our business compared to the year before and achieved our FCF guidance targets
  - And equally important, we kept a healthy balance sheet, a stable rating, and executed on our promised dividend policy

Portfolio Management

- In terms of portfolio management, let me give you an example how we created value here as well
  - In late November, within one week, we sold the non-core asset of Scout for over 20 times enterprise value to EBITDA and strengthened ourselves strategically via the acquisition of GTS in Eastern Europe for a 4.5 times multiple
    - Both assets have roughly the same annual EBITDA so that the result was:
Strengthening our Eastern European portfolio, particularly in Poland and the Czech Republic
Strengthening our B2B offer, including MMCs and wholesale
And enjoying at the same time a €1B reduction of our group net debt

Q4 RESULTS

Market Growth

- Now, let’s come to Q4 specifically and Thomas will lead you through the details of our segment in a second
- Therefore, just let me quickly summarize how we see the world
- This quarter continued the very positive momentum we already were seeing in our key markets, Germany and the U.S. and also showed signs of improvement in Europe

Customer Win

- And we are satisfied with our operational performance and customer numbers in that specific quarter
- Overall, we won over 1.6mm new postpaid customers
  - 163,000 new TV customers
  - And 42,000 broadband net adds in the group

Group Revenue, EBITDA and FCF

- Our group revenue grew organically by 2.8%, a further acceleration vs. the previous quarter
- In Q4, adjusted EBITDA is in line with – and group FCF well ahead of capital market expectation
- For both KPIs, EBITDA and FCF, we have delivered or even succeeded our original guidance

Financial Accomplishments

- A few brief remarks on our headline financials
- Revenues and adjusted net profit grew for the full year 2013 with the revenue growth again accelerating in Q4
- Adjusted group EBITDA grew in Q4 by 1.3% y-over-y, driven by the U.S. and Europe
  - For the full year 2013 and excluding the impact of foreign exchange and consolidation and deconsolidation, we executed upon our guidance of around €17.5B adjusted EBITDA
- FCF for the quarter was slightly down y-over-y driven predominantly by higher seasonal CapEx spending
  - For the full year 2013, we slightly over delivered on our guidance of around €4.5B of FCF
- And as flagged, our net debt clearly was reduced to below €40B indicated already at our half year results

Summary

- So, overall, I would say a great quarter not only in one specific market, we saw improvements in the U.S., we saw improvements in Europe
  - And we have a very stable German business on our hand

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG
OPERATIONAL REVIEW

Germany

REVENUES

- Let’s start with Germany
- We are pleased with the operational and financial performance in Germany in Q4
- Let’s start with the financials
- As Tim said, revenues declined by 1.7% year-on-year
- Main positive driver were core fixed line revenues, which declined at 2.6%, continuing the positive trend from Q3
- Mobile service revenues showed the anticipated improvement in Q4, being down underlying by only 0.4%, thereby, again, significantly outperforming the overall market
  - As a result, we delivered on the promising underlying flagged development for all our mobile service revenues for the full year 2013
- Our wholesale revenues showed a strong improvement vs. previous quarters and increased on a reported basis by 0.5% year-on-year
- Adjusting for seasonal effects, the underlying performance of minus 1.3% year-on-year still showed a strong sequential improvement

EBITDA AND OPEX

- The adjusted EBITDA declined by 2.3% year-on-year resulting in a roughly flattish margin year-on-year, whereas adjusted OpEx continued to decrease year-on-year by 2.8%
  - Our other operating income and expenses line deteriorated a little bit year-on-year

NEW CUSTOMER ADDITIONS

- In German fixed, we saw, all in all, another satisfying quarter in line with previous quarters
- I would like to highlight the following
- Another 12% year-on-year reduction line losses despite 20,000 DT/LTE wireless broadband customers added in Q4
- Overall, we lost less than 1mm lines in the full year of 2013
- The continued strong growth of new fiber customers with 133,000 net new additions of which 52,000 came from wholesale driven by our contingent model
- Broadband net adds improved in Q4 as promised but was still slightly negative at minus 22,000
  - This is clearly not yet satisfying and we have to continue to work hard on the measures we named at our Q3 results to improve that

TV AND MOBILE BUSINESS

- On the TV side, our measures to increase the momentum in Entertain showed some first results in Q4 with 56,000 new customers being added
- Our average revenue per access continues to grow on a year-on-year basis with a growth of €0.4 in Q4
- This shows the continued execution on our up-selling strategy
- Turning to mobile, the German mobile market service revenues decreased by 5% year-on-year in Q4, an acceleration vs. the previous quarter
• As anticipated and flagged, we saw a sequential improvement in our mobile service revenues in Q4 with an underlying drop of only 0.4% year-on-year
• Main drivers here were the continued negative voice revenue trend in line with Q3; a continued revenue decline in SMS revenue as well of minus 30.5%, again, in line with the trend in Q3; a very strong mobile data growth of 30% also in line with what we saw in Q3

OPERATIONAL ACHIEVEMENTS

• Operationally, we continued our strong performance in the quarter
• We had 638,000 mobile contract net adds of which 280,000 were own branded and almost 200,000 T-branded net adds
  o This is the strongest quarterly performance in our own T-brand in many years
• We showed a continued smartphone momentum with almost 1.2mm sales including strong sales of Android and iOS devices
• By year-end 2013, we already had 2.8mm LTE customers on our network in Germany
• And we continue to have the best-in-class contract churn at 1.0%, down 10BPS year-on-year

US Business

• Let me be a bit brief on the U.S. as all relevant numbers were already reported by our team U.S. colleagues last week
• But we are clearly very satisfied and proud with respect to the outstanding operational performance in the U.S. and the continued success of our Un-carrier strategy
• For Q3 in a row, we added significantly more than 1mm of new customers with both prepay and wholesale net adds contributing positively to this number
  o At the same time, we saw the strongest year-on-year reduction on our branded postpaid churn with 80BPS down to 1.7 percentage points in Q4

ADJUSTED EBITDA

• The organic adjusted EBITDA decreased by 7.9% year-on-year due to the record subscriber growth
• Please note that due to the different EIP and JUMP! accounting under IFRS and U.S. GAAP, there are significant differences in the reported EBITDA figures for T-Mobile US
• We are also seeing good traction on volume in the Un-carrier four initiatives, which will be visible in Q1
• TMUS EBITDA guidance for the full year and their comments for Q1 are of course reflecting that

Europe

• Revenues in our European segment declined 3.3% on a reported basis
• Organically, the revenues decreased by 0.4% year-on-year in the quarter, driven by a smaller decline in the traditional telco revenues mainly driven by higher device revenues as a result of the introduction of split contract in some of our countries especially in the Netherlands
• Anticipated growth on our strategic growth areas like mobile data, TV and B2B and ICT business, example given in the Netherlands, Greece or Slovakia

ADJUSTED EBITDA

• On a reported basis, the adjusted EBITDA in the segment declined by 3.7% organically
The adjusted EBITDA even grew in line with the revenues by 0.4%
Main drivers for this sequential improvement were almost €80mm less SACs and SRCs especially in the Netherlands and Poland, mostly as a result of the introduction or higher share of split contract, and sequentially higher indirect cost savings in some markets particularly in Greece resulting from last year's headcount reduction program.

**TV AND MOBILE BUSINESS**
- We continue to demonstrate good momentum in our growth areas in Europe.
- We showed again good growth in TV, 107,000 net adds, now reaching almost 3.6mm TV customers.
- We delivered 64,000 broadband net adds in the quarter and as well mobile contract net adds were 132,000.
- Mobile data organic revenue growth accelerated again to 18% thereby compensating for the decline in the SMS revenues.

**REVENUE CONTRIBUTORS**
- 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 the quarter.
- We made again progress on the revenue transformation:
  - The share of total revenues from our growth areas increased by 4 percentage points year-on-year to 25%.
    - The share of the fixed revenues from connected home grew by 1.4 percentage points year-on-year to almost 22%, driven by TV revenue growth.
    - The share of mobile data revenues of overall mobile revenues grew by 3 percentage points to 18%.
    - And the share of B2B/ICT revenues as a total revenues increased by 1.4 percentage points to 4.5%.

**TECHNOLOGY AND COST TRANSFORMATION**
- Progress on the cost and the efficiency side included the All-IP share of all fixed network access lines grew by 9 percentage points to 28%, mainly driven by Croatia, Slovakia, Hungary and Romania.
- In Macedonia, we have already completed our All-IP migration.
- LTE sites in service quadrupled year-on-year to 4,800.
- We have LTE networks in commercial use in 10 out of all 12 countries already.
- Homes connected with fiber-to-the-home grew by 33% year-on-year to around 170,000.
- The number of full-time employees was reduced by over 8% year-on-year to 53,000 which included the deconsolidation of the Bulgarian business with 1,900 employees.
  - We are especially pleased with the successful completion of the second voluntary exit scheme in Greece.
- More than 1,800 employees left the company in a socially responsible way.
- The OT management estimates the annual savings at €94mm.

**Systems Solutions**
- Turning to Systems Solutions, Q4 results showed a mixed picture.
- The reported revenue decrease of 7.6% was mainly driven by Tel IT, forex effects, and deconsolidation of business sold.
- The organic revenue decline of the Market Unit of 4.6% is a deterioration vs. the previous quarters, but was still outperforming the difficult market.
o Order entry down by a third year-on-year, which, however, is driven by the huge Shell contract we’ve seen in Q4 2012

- Systems adjusted EBITDA and EBIT declined in the quarter as a result of a revenue decline, higher provisions for de-risks and seasonality and higher depreciation at Telekom IT
- Importantly, the EBIT margin of the Market Unit improved to 4.1% in the quarter and 2.8% for the full year

Telekom IT

- As planned and communicated, Telekom IT delivers on reducing the IT costs
- For the full year 2013, Tel IT delivered IT spend reductions of €350mm, of which €80mm were realized in the last quarter

GROUP FINANCIAL RESULTS

FCF

- Let’s move now to our group financials and turning to the FCF first
- Group FCF is down 6.6% in Q4 and 26% for the full year 2013
- Main drivers in the full year were cash generated from operations declining stronger than the EBITDA due to the working capital impact on the Value plans in the U.S. and the cash CapEx increase of €840mm driven by the LTE network rollout in the U.S

Net Income

- The adjusted net income increased by almost 78% year-on-year in the quarter and almost 9% for the full year 2013 with the main drivers for the full year being the decline in adjusted EBITDA, the anticipated decline in D&A, the reduction in our financial results by over €200mm mainly driven by a lower interest income due to a higher net debt as a result of the MetroPCS consolidation, and the externalization of TMUS debt by DT, placing TMUS bonds in the market as a part of the de-risking strategy

ROCE and EPS

- Compared to the negative ROCE in 2012 as a result of the impairment at T-Mobile US, we saw an improvement for the group ROCE to 3.8% for the full year 2013, driven by a significant improvement of the NOPAT year-on-year after the impairment last year and the decrease of the net operating assets on average by €2.7B
- EPS improved by almost 7% to €0.63 with the main driver being the well-flagged lower depreciation and amortization

Net Debt

- As flagged and expected, full year 2013 net debt came down in below €40B
- Main drivers for the year-on-year increase of €2.1 of the net debt were the consolidation of €3.4B net debt of MetroPCS
  o A €2.2B expenditures for spectrum in 2013, and that’s it
Balance Sheet

- Turning to our balance sheet ratios, net debt to adjusted EBITDA decreased again slightly to 2.2 times as a result of the sequential reduction of the net debt
- The equity ratio decreased slightly to 27.1% due to the slightly higher asset base and increased shareholders’ equity
- With regards to all 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

Timotheus Höttges
Chief Executive Officer, Deutsche Telekom AG

STRATEGIC BUSINESS UPDATE

- So, guys, I would love to give you all the details of what we have worked out over the last months here in my new job and even with the new team coming together
- But I have to just give you a teaser
- I know it's a very busy day for all of you guys, so therefore, this is just an appetizer
- I think we have much more to say about how we want to move forward and after the CeBIT fair, I will start road showing with Stephan and then we have, hopefully, more time going into the specific details on the strategy update
- So we will continue to work on all these aspects which I lay out and we will be able to provide you with the full picture including another three-year outlook at our next Capital Markets Day later this or early next year

Vision

- But here’s, let’s say, the most important summary of our strategy
- At DT, we have a very clear vision on what it takes to be a successful telco operator in 2020
- We think a successful telco operator in the future will have to:
  - First, migrate its production platform to All-IP completely
  - Second, to be an integrated player, especially here in Europe with true converged offerings
  - And thirdly, has a very strong market position in the consumer and as well as in the business customer segment
- Only with this superior business model, superior margin and returns and thereby value for all of stakeholders can be sustainably achieved

Leading European Telecommunication Provider

- Along these lines of the target picture for a successful telco operator in the future, our target is clearly to be the leading European telco provider
- Deutsche Telekom is by far the most European operator
- We have 75% of our enterprise value already in the European entities and most of them, by the way, with fixed and mobile assets
  - Therefore, I think we have a very good starting position to be the leading European telecommunication provider
But what does it mean to be leading?
To lead the way with a thorough and fast migration towards integrated IP networks across our European footprint with the target of a Pan-European network and production model to provide our customers with the best customer experience, with the best network, innovative and integrated products, as well the best customer service across all channels

Innovative Applications and Services

And last but not least, winning with partners some innovations in our networks, IT or on the access level, we will continue to develop ourselves but we want to be open to modern and innovative applications and services coming from third parties
We’re working with some but here are Spotify, Evernote and Snapchat, these partners we want to connect via a standardized and secure platform as we want to lead in business
The business segment for secure and reliable telecommunication, ICT solutions is still a growing market
In this market, we focus on scalable and standardized ICT products and we will be much more active and aggressive in the SME market than we have been before
Part of this element of our strategy is also the so-called T-Systems 2015 program where we will refocus and reshape T-Systems according to the new strategy and the necessities of recent market developments
I am a firm believer in network invest and network differentiation, both on the production and the access side
Therefore, the network strategy of moving towards our target picture of integrated Pan-European IP networks is the cornerstone of our strategy
It has three core components:
  o First, IP transformation
  o Second, Pan-European network architecture
  o And thirdly, integrated network services

OpEx Savings

On the production side of our network, we are building a modern future proof and simplified IP platform
  o This means for the consumer, superior product and customer service, dramatically reduced product and service introduction time and on a much faster network we will have significantly less latencies
For Deutsche Telekom, this means a significantly reduced production cost
In our first fully IP migrated country, Macedonia, we realized OpEx savings of €10 per customer and it will help us to simplify our maintenance and installation for products and services because most of the network have been optimized
In Germany, more than 2mm customers were migrated to All-IP already in 2013
In our segment Europe, we already have more than 2.7mm IP accesses
The overall picture for this program is to finish the total IP migration in Germany and all our European countries by 2018

Pan-European Network

Let’s move to the Pan-European network
With our idea of a Pan-European cross-country network in our footprint, we are thought leaders in this industry
• We want to combine the IP network across our footprint and get to a common European production model
• Basis for this is the complete migration to IP, complemented by a virtualization of single network components
  o Thereby, we will deliver products and services even faster to our customers and bring down production costs via cross-country synergies and network build-out
• Yes, you heard it correctly
• With this Pan-European network across our footprint, we will, for the first time in the industry, demonstrate that cross-country synergies, other than procurement, are achievable
• Our target here is to present in 2014 a fully-fledged concept to the market for the implementation of this Pan-European infrastructure and to begin with the implementation in 2015

Mobile Business Target

• The third pillar of our network strategy is – or it has been already announced at our Capital Markets Day in 2012
• We will, on the access side, pursue integrated networks, a combination of fiber to the curb and LTE networks
• On the mobile side, our targets are to cover 85% of the population with LTE by 2016 to introduce LTE in all our European countries and to cover between 50% and 85% of the population in the individual countries by 2017

Fixed Broadband

• On the fixed broadband side, we will build out a combination of fiber to the curb and vectoring
• Our target here to cover more than 24mm households with fiber to the curb, vectoring in Germany by 2016 and to cover more than 9mm households in our European segment with the fiber component

Network Differentiation and Investments

• As you know, DT is a firm believer in network differentiation and network investments
• For the over-broadband rollout in Europe, fixed and mobile, we will invest €6.5B between 2014 and 2017 in this differentiation
• On the basis of this infrastructure, customers should not care about fixed/mobile anymore
• Wherever they are, they should have the fastest access to their data
  o Now, if you want to deploy and utilize this infrastructure, what you need is a high utilization, yield management
• If you want to drive yield management, what you need on top of this is you cannot just focus on specific market segments, nor on the lower segment or on wholesale or on the top market segment
• You have to be inclusive to all customer segments
• If you want to pursue this kind of strategy to really generate utilization yield, you have to offer specific service to every customer segment
• The loyalty and enthusiasm of our customer is the foundation for this success
  o Therefore, we want to delight our customers with the best network, the best integrated products and the best customer service
• We are offering the best networks
• I think I made that clear already
• With LTE, we can already offer speed up to 250 megabit per second
• With LTE Advanced, we will get close to 300 megabit per second
• And in our fixed/mobile broadband – fixed broadband network, we are building out of the combination of a fiber to the curb and vectoring a much higher bandwidth capability

Hybrid Network

• And with our hybrid network, the combination of vectoring with our LTE infrastructure, we will be able to offer download speeds of up to 250 megabit per second and upload speeds of up to 90 megabit per second, which, by the way, is a key differentiator vs. any cable operators or mobile-only player
• Our clear target is to offer our customer the best network with the best coverage and the best bandwidth speed reliable and stable
• We will offer our customers integrated products for fixed and mobile communications from one source
• Last week, we presented our hybrid routing at the Mobile World Congress in Barcelona which we will start marketing in H2 this year already
• And we will start offering real bundled and converged products family plans in order to increase our customer loyalty and defend our broadband market share already in 2014 in Germany

Customer Service Improvement

• The third pillar for best customer experience is the service part
• We have done a lot of these things in the past in order to improve our customer service and have already achieved number one position, for instance, in Germany
  o But I want more
• I do not only want to have satisfied customer, I want customers promoting us and our product and service actively
• By the way, in the mobile field, in Germany, this is already taking place
• And here, our target is clearly defined
• In each of our markets, we want to be either number one or number two in the customer perception with regards to the Net Promoter Score
  o Now, to achieve this, we must simplify and speed up our customer service and offer our customer a consistent experience, no matter which channel we serve them
• We must strengthen our online channels with our Telekom help service, we already channel via Twitter and Facebook and we have to enable our customers to execute simple and small service processes automatically themselves, if they want and when they want
• This saves time and money for both sides

Winning with Partners

• The third pillar of our strategies, winning with partners
• We need innovative and convincing products to win new customers and to infuse our existing ones
• For our own in-house innovation, we will concentrate in the future on the areas where we are really good at, and where we have a technology edge
• These are networks, IT, platforms and access businesses
• For some of the fast and innovative online service, we want to partner with the right partners rather than to try to do everything on our own
Steckerleiste

- Let’s talk a while about the Steckerleiste
- With this approach, we want to build a partner system for innovative product and services to which partners can easily plug themselves in, thereby we would be able to offer our customers direct access to attractive products and services as we’re already doing with Spotify and Evernote, and we will enhance the value of our access business
- We will also offer our partners to market their products in all countries at the same time
  - And we will support them with marketing and distribution so that they can benefit from our international presence and scale on the ground
- Standardized gateways will allow our partners to concentrate themselves fully on the deployment and the development of their products while we manage all necessary processes
- These are technical components which we have to enable the Steckerleiste, like authentication, billing capabilities, quality of services, authentication or other security items
- This should convert us into the leading and preferred telcos for new over-the-top partners
- Our target is to simplify the integration and to speed up our process that we could enable and execute new partners within three months across our European footprint

TV Business

- Our TV business is successful and an integrated part of our core business and of our up-selling strategy
  - Therefore, we will continue to develop our TV platform in Germany and Europe
- We will continue to broadcast live TV and multi-cast via IP and DVB in HD quality, but enriched now with on-demand offerings of over-the-top partners and across all screens
- Simultaneously, we will increase our social media services around our TV offerings along the logic of the second screen
  - So therefore, we have to develop our TV platform beyond what we have today
- Our clear target is to have more than 10mm TV customers in Germany and Europe by the end of 2017

Market Positioning

- And last but not least, we positioned ourselves as platform provider and enabler for third-party partners, services where we have no direct contact or relationship with the customers
- One example is our cooperation with QIVICON with respect to the integration and steering of house automation like heating, energy, security
- Another example is the cooperation with the German book trade in developing and marketing the e-book reader, Tolino, a true alternative to Amazon Kindle here in Germany with almost 35% market share
- Or new intelligent networks in the area of connected car, e-health and energy are falling under this category

Business Leadership

- Let’s move to the fourth pillar, which is leading in business
• Our unique competence in telecommunication IT provides us with a great opportunity in the business customer segment which we want to take advantage of by:
  o First, reposition T-Systems with our project T-Systems 2015
  o Our push in the business customer segment in Europe
  o And a new initiative in the German SME segment which we call Mittelstandsoffensive
• By the way, we will announce all the new products which are already at the CeBIT fair on Sunday at our press conference

T-SYSTEMS 2015

• Let’s go to T-Systems 2015
• We will restructure and reposition our T-Systems business with a clear focus on scalable and platform based IT products and we’ll offer a standardized IT to our customers
• So in the past, we did a lot of off-shoring deals
• Now, we focus the business more from individualized services to more standardized IT services especially in the area where we have a lot of confidence which is cloud
  o This should lead to cost and efficiency benefits for our customers and for us and at the same time, we will concentrate ourselves on the decisive digital innovation areas promising the biggest sales growth in the coming years which is cloud computing, cyber security, big data and machine-to-machine
• One side comment here from my side, in today’s press conference, I laid out that we have analyzed 150 trends in the Internet and the telecommunication sector, from infrastructure trends even to market trends
• We do not have the time today to go for this package with you in detail and why we have selected the most relevance for us in our strategy
  o But Stephan and his team, they are willing to give you more details on how we came to the conclusion what the biggest bets are in the upcoming discussions
• Our target in winning in business area is to create from 2017 onwards around 50% of our T-Systems revenues in the market unit with products, which we call standardized IT products
• As T-Systems is one of our business segments, I will come back to the T-Systems 2015 project in some more details in a second

B2B OFFERING

• Strengthening B2B in Europe, as already communicated at our Capital Markets Day, B2B is part of our core strategy in Europe
• We want to use our international presence to improve market position in B2B
• We supplement our mobile-only countries with additional fixed line products, and good examples are the acquisition of GTS and the integration of T-Systems into T-Mobile in the Czech market with the GTS transaction still pending on European clearance
• Our target is to scale our B2B offering in the markets we are operating in and to grow our ICT revenues in Europe by a CAGR of around 20% between 2012 and 2015

MITTELSTAND INITIATIVE

• Now, coming to the German SME initiative, the Mittelstand Initiative
• The German SME market is a growing market for IT solutions
• We want to leverage on our very strong position in telecommunication solutions and the trust we have built about data privacy for SMEs in Germany in order to increase our IT market share
• We will do this by enhancing our product portfolio, by the way, even here with a lot of partners by products and services which are most relevant for these SME players
• Deutsche Mittelstand today is not heavy into cloud services, not heavy into security solutions, not heavy into converged products
  o And they do not use solutions for a virtual cooperation and we know this is a mega trend which is coming
• So we will be getting closer to these customers by installing a central order center
• So we will have one point of contact for all these SME partners
  o And on top of that, we will use their system houses, their system integrators to partner with so that we have already, let's say, salespeople working with us with these SME customers
• Our target is quite ambitious
• We want to create more than €600mm additional IT revenues in the SME segment in Germany only until 2018
• And please, have a look to the announcement which we’re going to make on Sunday during our press conference at CeBIT

T-Systems Restructuring and Repositioning

• Let me come back to T-Systems and its restructuring and repositioning in some more detail on the next two slides
• Because this is important especially as we had presented the T-Systems strategy to you only 14 months ago at our Capital Markets Day
• So why then the new strategy?
• What has changed?
• Actually, quite a lot has changed since then in the environment of T-System, which is why we have to transform our business model in this area
• First, due to the increasing competition and massive price pressures especially in the classical ICT services, parts of our established IT and telecommunication business do not generate adequate margins
  o So we need to stop offerings which become more and more unprofitable
• You know this from the history, a kind of Save for Growth story
• We will discontinue our hardware reselling business
• We will ramp down our non-standard portfolio
• We will fix the worst bottom line contributors and global business units by 2014
  o And we will even divest assets which are not in line with our future strategic scope
• More and more standardized or even productized solutions and services make their way from the consumer market or the mid-market into the enterprise business, which is why we have to transform the way we are operating
• We will accelerate our personnel restructuring at T-Systems, we will make a larger shift from make to buy in the classical ICT solutions and we will establish clear deal criteria in terms of gross profit margin requirements

Business Model Development

• In addition, the digital revolution opens up the new opportunities for our customers to get closer to the needs of their consumers
  o So we are increasingly asked to support our customers on their way into the digital economy
• As we are currently not benefiting sufficiently from the related market growth, we need to expand and develop our business model towards digital economy
• This is why we will: first, concentrate on dedicated growth areas based on competence with our proven track records like cloud, ICT security, machine-to-machine, big data and the expansion of our intelligent network, connected car, energy and health
• We will invest mainly in developing scalable platforms and ICT products and we will focus on our core strengths and establish new collaboration models with partners in our growth areas, especially in the cloud arena
• A lot of American companies are approaching us because they want to have access to our Deutschland cloud, which is perceived as the most secure

Long Term Outlook

• Overall, T-System aims at growing revenues while focusing on generating a healthier company by increasing profit to a competitive level
  o Hence, we expect to increase our EBIT margin to the peer level by 2017
  o This also means that we need to stop value-diminishing activities leading to a temporary decline in revenues by roughly €600mm in 2014
• Until 2017, however, we expect an increase of revenue from our growth area so that we will be able to achieve an overall revenue for the T-Systems Market Unit of roughly €7.7B in 2017
• Along this refocusing exercise, our revenue mix will change significantly by 2017 with the revenue share of growth areas growing from currently 34% to 46% and the share of the classical ICT business shrinking from currently 44% to 37% in 2017
• Of course, our old strategy has to be embedded in a solid finance strategy, which you find on the next slide
• Of course, we want to remain a reliable partner for our shareholders and create value of the owners of our company

Dividend Policy

• And therefore, we confirm clearly our dividend policy of €0.50 for the years 2013 and 2014 payable in 2014 and 2015
• And as promised, we will revisit our dividend policy in 2015 if our FCF profile allows us to do so
• We also will offer the dividend in kind option as last year to our long-term oriented shareholders, who want to participate in the share price upside and value generation of the company

Debt Capital Markets

• On the debt capital markets side, we continue to secure an undisputed access to debt capital markets at all times and to stick to the KPIs and guardrails communicated at the Capital Markets Day in December 2012
• And within the company, we clearly want to create value with our strategy with a target to earn our cost of capital
• Key ingredients for this are our continued efficiency and cost management
• We will introduce the concept of target costing known from other industries and hope to provide more details on this at our next Capital Markets Day

Portfolio Management

• Portfolio management, I'll come to this in more detail on my next slide
Risk management, our target clearly is to maintain a low risk country profile – country portfolio and fast transformation

We have to support the important big transformation projects like the All-IP migration and the broadband rollout as major value drivers for the business

  - This, by the way, means also investments into the All-IP migration, which we could state it later in the Q&A

As promised, some extra words on our portfolio transformation approach

Our core philosophy is to strengthen the strength by creating, protecting and investing into economic fixed mobile converged fortresses and to continue to invest into our networks

We also stick to our de-risking philosophy for T-Mobile US

And please let me state at that point in time, yesterday, there were some rumors on Bloomberg that I have made a statement towards a possible transaction in the U.S

I had no contact to the press yesterday nor I made any kind of a statement like it was quoted at Bloomberg in the board meeting yesterday

And we want to continue to show rigid portfolio discipline

Acquisitions shall be funded by cleaning weak spots in the portfolio, and we shall not exclude an asset as last option where we are structurally challenged or where we have no part to earn our cost of capital

  - And we have to create strategic flexibility and monetizing non-core assets in order to protect our balance sheet

The recent sale of Scout is a great example on portfolio shift

  - So you see, even in my new role as the CEO, I am not losing my roots which I have built as a CFO

GUIDANCE

Let me now come to what you have been waiting for anyway, our guidance

Basis for our 2014 guidance are the pro forma numbers for the group for 2013

This means the reported numbers adjusted for changes in scope of consolidation

These figures you'll find in the 2013 results both on the left hand side alongside the reported number

Financial Goals

For 2014, our group guidance is for a slight increase in the group revenues, which, by the way, is a great achievement for a European telco

  - A flattish EBITDA of around €17.6B, in line with current consensus estimates
  - And a FCF of around €4.2B

The main driver for the FCF in 2014 coming in below that of 2013 and maybe some capital markets expectation is our entrepreneurial decision to invest slightly more cash CapEx at T-Mobile US compared with 2013 as a result of the continued subscriber growth and initial investments into the build-out of the A-Block spectrum just recently acquired from Verizon Wireless

Investments

And second, to invest as planned and communicated more into the integrated network rollout here in Germany and significantly higher interest payments as a result of the higher net debt via the MetroPCS consolidation and due to the external financing of US$5.6B bonds last year

  - This increased spending pattern for T-Mobile US differs from our initial assumptions at our Capital Markets Day in December 2012 of a reduction of the TMUS CapEx when the increase of the CapEx in Germany kicks in
This is the right decision for the business in order to accommodate our further subscriber growth and to strengthen our network also on the low-band spectrum side.

As a result of this stride and value-generation investments into the future of T-Mobile US, the increased restructuring cash out for T-Systems and significantly higher interest payments, we also slightly alter our 2015 ambitions given at our Capital Markets Day in December 2012.

**EBITDA and FCF**

- We continue to expect growing revenues and EBITDAs
- FCF, however, is expected to grow slightly from the 2014 numbers

**Dividend Commitment**

- Our dividend commitment for €0.50 dividend payments both for 2013 and 2014 remains fully unchanged
- We will also revisit our dividend policy in 2015 as planned

**2015 Goals**

- In this context, let me give you a quick update on where we are with respect to our group mid-term ambitions for 2015 from today's point of view
- As said, with the guidance, we are on track with our Capital Markets Day target of growing our revenues from 2014
- With our guide towards a flat EBITDA for 2014, which is a deliberate decision to invest into the further growth in the U.S., let me also remind you of the fact that for example, in Germany, we could show a better near-term EBITDA profile if we would not invest significantly into All-IP migration
- We are on track for our EPS and return on capital employed targets for 2015, as communicated
- And as said with our guidance, the only deviation is the FCF ambition for 2015 mainly due to the right entrepreneurial decision at T-Mobile US and T-Systems

**SUMMARY COMMENTS**

- Let me finish with a quick summary on our key messages for the owners of this company
- We are thought leaders and frontrunners in the migration to All-IP networks and the creation of a Pan-European network across our footprint
- The fast execution of the All-IP migration across all countries by 2018 will give us a leading edge in terms of market agility, efficiency and costs
- We will strive for best customer experience based upon the best network, a truly integrated product portfolio and the best customer service
  - And we will concentrate our in-house innovation on areas of strength and do the rest with partners via our Steckerleiste and our partner platforms
- We will lead in business by:
  - Restructuring and refocusing T-Systems
  - The further strengthening of our B2B business in Europe
  - And a new initiative for the German SME market
- This superior business model and fast execution on key transformation projects will lead to superior margins and returns and as a result, to value generation for our stakeholders
- By operating with one single business model across our European footprint, we become faster and we become much more efficient than we were in the past
QUESTION AND ANSWER SECTION

Mathieu Robilliard
Analyzer, Exane Ltd.

Actually, I have two questions. First, in terms of the FCF generation, I think that at the end of last year, you said that 2013 would be impacted by the change of the business model in the U.S. in terms of the working capital consumption. And in fact, working capital consumption was high in 2013, but there was an expectation that, that could revert in 2014, and it does not seem from your guidance that, that's the case. So maybe if you can clarify what is the impact of the U.S. in terms of the working capital in 2014?

And looking at 2015, correct me if I am wrong, but what I did understand was that it's not growing that much in 2015 despite improving trends in revenues because you are reinvesting more for the IP migration. But still, I mean, with an EBITDA growing, I would have expected the FCF growth to be a bit stronger than what you're guiding for. So maybe you can also give some of the moving parts there. Is there more restructuring costs or things like that?

And finally, in terms of Germany, clearly good revenues in the fixed business, but the broadband net adds remain weak and you highlight that. And it's a bit surprising given all the efforts you have been doing both in terms of product, distribution, network. And so I wonder is it a pricing problem that you still have in Germany in broadband? Or is it just a question of being a bit more patient? Thank you very much.

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

Yeah. This is Thomas speaking. I'll start with the last element with the broadband net adds. I think we always said there are elements in terms of tactical elements, marketing and distribution. But also the most important element is the rollout of our new infrastructure. As you know, we started that in late Q3. So the uptake is coming in now step-by-step. And I think, yes, it's a matter of patience. We are not satisfied with the minus 22mm you see here in the quarter and — but we're expecting that to improve along the line of the rollout of the network in Germany.

On the FCF, the working capital question, basically I think what happened in 2013 is that there was a huge impact by the transfer in the customer base in the U.S. from the old plans into the new ones. And I think we're 70% roughly done. So there is still some way to go, some 15%, 20% maybe next year. But obviously, that impact coming from base customers migrating into the new Un-carrier logic, that has put the burden on 2013 in the working capital element and that will change in 2014. On the other hand, we guided some more new net adds. And also we will see some jump from impact to working capital kicking in. And more or less, we expect overall that those three elements, so less from the base migration, more from JUMP! and a little bit more from the net adds that this will be a wash more or less vs. the 2013 figures on working capital. And I think your — I'm not sure whether I got all the questions.

The third one was on 2015 on the question why we are guiding a slight growth in FCF, yes, we will see a growth on the EBITDA side. On the other hand, Tim mentioned that this — beforehand, we are restructuring on T-Systems in a significant way and there will be, just by the cash restructuring elements coming from T-Systems, some elements reducing that EBITDA towards the FCF.
Can you maybe give us a little bit of color on the restructuring charges in 2014 and 2015 that you’re expecting at this stage?

Timotheus Höttges  
Chief Executive Officer, Deutsche Telekom AG

Yeah. Overall, Mathieu, we had overall cash restructuring charges of €2B in 2013. That will come down to roughly €1.6B in 2014 with the mix obviously going down in Germany due to the rollout of the integrated network strategy going up at T-Systems. That’s the early part of the restructuring and then slightly growing restructuring charges for 2015, again driven by T-Systems.

Mathieu Robilliard  
Analyst, Exane Ltd.

Great. Thank you very much.

Thomas Dannenfeldt  
Chief Financial Officer, Deutsche Telekom AG

Let me spend the last sentence on the fixed line side in Germany. I think you’re right. On the connected home, as we call it, we should do better and we have already, let’s say, initiatives working in the marketplace on that one. But I even want to highlight what we have achieved already during the course of last year even in Q4. Line losses significantly down, even below €1mm here.

Second, VDSL, where we have rolled out VDSL, what we see, the huge uptake of customers buying this new product. So alone in Q4, more than 80,000 customer which is 17% q-over-q uptake in this regard. And we even saw an improvement of the TV net adds in Germany as well in Q4. So you see that we are already intensively working on this item.

Dominik Klarmann  
Analyst, HSBC Trinkaus & Burkhardt AG (Broker)

Yeah. Thank you. My first is a follow-up on German fixed, just wondering if you still think you can stabilize revenues in 2015 vs. the 2.5% decline or so currently and how much that target is dependent on significant acceleration of fiber uptake during 2014?

Secondly, on regulation, not in Brussels but in Germany, I’m wondering if you see any sense in the change in direction with the new grand coalition now in place.

And then, thirdly, on spectrum in Germany, how urgently do you feel you need 700 megahertz and when do you think at this stage it can realistically be cleaned up and made available for mobile usage? Thank you.

Stephan Eger  
Head of Investor Relations, Deutsche Telekom AG

Well, Dominik, maybe I start off and then Thomas and Tim will be kicking in. First, correction, we did actually assume back at the Capital Markets Day that we will stabilize revenues in 2014, not 2015 in Germany. And the main drivers obviously being mobile on the one hand side. We expected at the time between 2012 and 2015, 2% to 3% service revenue growth. And you know how we’re performing in the market. We are significantly outperforming the market. However, you see that the market has significantly deteriorated. Market was down by 5% in Q4. So I think we’re doing the utmost and we’ll be outperforming still, but it’s questionable whether in very near term, we’ll go back to the 2% to 3% service revenue growth.
Secondly, on the fixed line fiber, what Tim was saying, we’re currently not on track with respect to the 2% connected home revenue growth. We know that. We are working on that a couple of initiatives which we also mentioned at Q3 results and we are very upbeat that we’re going back on track especially in H2 with the rollout of vectoring DSL and the hybrid offering. But currently, we’re lagging maybe two or three quarters behind.

Dominik Klarmann
Analyst, HSBC Trinkaus & Burkhardt AG (Broker)

So basically you expect to compensate revenue decline also in 2014 on the fixed side with mobile growth, is that the right way to read this?

Stephan Eger
Head of Investor Relations, Deutsche Telekom AG

Yeah, I think that’s a fair summary and I do think we expect some similar trends with respect to revenues that we have seen in 2013.

Dominik Klarmann
Analyst, HSBC Trinkaus & Burkhardt AG (Broker)

Okay.

Timotheus Höttges
Chief Executive Officer, Deutsche Telekom AG

So coming back to the question with regard to the regulation in Germany and with regard to the spectrum, you know that since weeks, I’m running around of every conference and addressing the topic of we have too much competition in Europe, we have too much of local regulation which is not consistent with the European regulation. We have no incentives for investment as an industry and we do not have a level playing field with the Internet players. And so I always use the Austrian example as the worst case when it comes to spectrum. And they always compare, let’s say, the four-player market in the U.S. or the four-player market in China with the 200-player market here in Europe. There is a huge presentation for the ones who are interested. We could support you with this analysis which we have done over the last year. Now that said, wherever I meet politician and leaders, they are nodding with their head and saying we have to do something about, let’s say, the European footprint. There is a new statement, by the way, from the CEOs in Europe coming out soon talking about, let’s say, what we need that the environment improves.

And to give you the headlines, what we need is, first, a single market approach for Europe, which is even enabling for less antitrust regulation in smaller markets. We have a discussion about Ireland, not Deutsche Telekom but in Europe, for 4mm customers, but nobody cares about the 10mm customers in Sicilia. So therefore, I think it has to be a single market regulation which has to be imposed. Second, with this, we need a new redefinition for the antitrust rules here in Europe so that consolidation would be possible within this footprint and not that we enforce MVNOs and other things immediately after intra-market consolidation attempts.

Second, we need a new spectrum for growth initiative that spectrum is used for the build-out and not used for the reduction of indebtedness of local governance. Honestly speaking, what I have heard from Minister Dobrindt here in Germany with regards to his call in Netzallianz is that he wants to use the proceeds from the next spectrum allocation for a build-out in the underdeveloped areas. This makes a lot of sense if it’s going to take place. And even some other richer counties here in Germany already are supporting the build-out, like Bavaria, with additional money where Deutsche Telekom is actively working with. We have already 5,000 corporations now
over the last year’s build where we get support, financial support from local municipalities or others and then we build out in the rural areas.

And last but not least, I think even the regulatory environment is – I cannot say it’s getting worse. I cannot say – I can say it’s not getting worse. I can say it’s at least stabilizing. And there a lot of signals that there is – that people understand that we needed a better environment for investment. So that is what we hear. But you know that the political process needs its time and therefore, it’s not getting worse. There are a lot of debates going on at that point in time.

Dominik Klarmann
Analyst, HSBC Trinkaus & Burkhardt AG (Broker)

So the new government is at least as supportive as the old one, is that fair to conclude?

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

Maybe I can add the last point in terms of – if there is an urgency need for additional low band spectrum so far, I think at least from our point of view, for the next two or three years, that’s what we said on the Capital Markets Day as well. By the end of 2016, our goal was to have 85% of the country built off of LTEs, so mainly 800 low band and also 1,800. That’s what we’re going to do. I think we were a little bit quicker than this. So for the, let’s say, next two years, obviously, there isn't on the mid and long-term perspective, low-band spectrum is important clearly, yes.

Hannes C. Wittig
Analyst, JPMorgan Securities Plc

Just wanted to maybe explore a little bit potential implications of the All-IP strategy in Europe and you said you will demonstrate this year a capability of achieving cross-country synergies. So I was maybe interested in your thoughts about future M&A within Europe. Would you consider, for instance, expanding through acquisition of other European incumbents. Of course, Deutsche Telekom has a lot of experience in that area in especially in Eastern Europe but would that go back on to the agenda?

And secondly, you have said that convergence is an important or integrated operations are important for you. Of course, T-Mobile US doesn’t have fixed line. Do you see that as a significant handicap in the particular context of the United States? Thank you.

Timotheus Höttges
Chief Executive Officer, Deutsche Telekom AG

Hey, Hannes. I think the first thing, I’m and – the team is fully aware, fully aware that any kind of, let’s say, acquisition steps and M&A activities outside of our current footprint would be highly questioned from the capital markets because, so far, nobody has proven any kind of cross-country synergies except from the procurement, which you could even realize without M&A. Now, therefore, our activities towards the All-IP network and the Pan-European network is we concentrate because we have a very adjacent rim in the Eastern part of Europe, we want to now prove that with the virtualization of our infrastructure and with the IP migration that there are much more synergies which could be realized, even if you virtualize the ceiling of infrastructure. So therefore, the focus of our activities is going to be within our footprint than outside of our footprint.

Now, smaller things like GTS, which would make our strategy more vivid, more agile, more – much stronger makes always sense. But this is – I think this wasn’t your question. Towards the proof of the concept of the Pan-
European network strategy, I think we would totally kill the time in this call here today if we would go into the discussion. You're invited, all of you are invited to have this discussion during the course of the year and learn more how we want to structure this virtualization.

The second question is towards the U.S. There are a couple of fundamental difference between the U.S. and the European market. There is no fixed network operators whose footprint would match its mobile footprint in the U.S. environment. The U.S. market is in its lifecycle not where the European market is currently, there is still mobile and fixed, are rather separate worlds, by the way, just simply by size of these entities. And longer term, we might as well see a shift towards more integration. However, given our market position and market share in the U.S., we are a challenger and we have a very, let's say, compared to the big guys, small market share and therefore I think, for us, as the maverick in this environment, there is always enough, sufficient ground as a mobile-only play. So therefore, I do not see as a necessity for our U.S. operation.

In Europe, you know my opinion. Especially with Deutsche Telekom having 75% of its market already in fixed mobile businesses, we should really leverage every asset to its maximum, one, backhaul services, integration of mobile and fixed line at the home place with the hybrid routing, combining the different access opportunities and having something pure mobile or pure cable operators can't offer, this is a different territory towards customers and gives more bandwidth. And this is definitely something where we see a big business opportunity. So therefore, in Europe, this is our clear market approach.

Hannes C. Wittig
Analyst, JPMorgan Securities Plc

Very clear. Thank you.

Operator: The next question comes from Simon Weeden from Citigroup. Your line is open.

Simon H. Weeden
Analyst, Citigroup Global Markets Ltd.

Thank you. Good afternoon. A couple of questions really. One is just coming back to the question of the cash restructuring costs because we do see some elements of these recurring, whereas some are probably one-offs. In terms of addressing the restructuring at T-Systems, do you expect to see a kind of a continuation of cash restructuring charges going beyond 2015, for example, to pay people who have retired early or something like that?

Timotheus Höttges
Chief Executive Officer, Deutsche Telekom AG

Yes. I think the... okay, go ahead.

Stephan Eger
Head of Investor Relations, Deutsche Telekom AG

The answer is very clearly in that specific program where we said we will restructure T-Systems and T-Systems 2015+, which is the name of the project. That is embedded in what we are now guiding towards FCF in 2015, which is roughly half of €1B of extra restructuring costs – that is not going beyond 2015. What we always have is the normal annual restructuring costs of the normal annual headcount reduction and restructuring in all our entities especially Europe, partially in T-Systems. But the program is executed and being done when it comes to restructuring costs in 2014 and more so in 2015.
Timotheus Höttges  
Chief Executive Officer, Deutsche Telekom AG

Let me add one topic here to the restructuring questions and the cost element. In our strategy, we are focusing on customers, we're focusing on the differentiator towards our customer and we are focusing on the innovation. By the way, innovation is not only over-the-top services, innovation is for us, even innovation in the processes, innovation in the way how we produce connectivity in the future. Now this is, let's say, the four elements. But to be very clear, we have identified €2B of cost gap and addressed that in our Capital Markets Day. On the indirect cost side, this program is well on its way.

There is a gap which we've identified towards the benchmark on A.T. Kearney, which is around the €4B area, which is very much in our focus. And we have in Europe, in every single entity, we have additional cost programs up and running. The same is true. By the way, you have seen that in T-Systems where we have a big program up and running with additional special effects. And in Germany, there are areas where we are going to reduce our costs like overhead and other things. But we have this All-IP migration where we need additional people to make the All-IP migration happen. But I just want to reiterate that cost measures are very much in the focus even of our new strategy because we have to produce cheaper in the future. This is another differentiator when it comes to the upcoming years.

Simon H. Weeden  
Analyst, Citigroup Global Markets Ltd.

Okay. Thank you. I did have a second, if that's okay. Just on the scrip, the decision to offer scrip again. You're giving some pretty decent looking leverage metrics. You brought in another €1B net from the sale of Scout. Why do you feel it's necessary or sensible to be offering scrip with the potential of, obviously, issuing shares in replacement of dividends that you’d be paying otherwise in cash?

Thomas Dannenfeldt  
Chief Financial Officer, Deutsche Telekom AG

Well, I think basically what we've seen is, with the 38% of acceptance rate that there are at least some long-term investors who really do like it. And especially talking to our larger investors, we got some of the feedbacks honestly speaking, saying, no, we don't like it, others, they do like it and what we decided to do is, again, offer not like the Telefónica guys. By the way, we offer it as a matter of choice. You can do the cash or the scrip dividend like you've seen it last year.

Simon H. Weeden  
Analyst, Citigroup Global Markets Ltd.

And the default is obviously the cash.

Timotheus Höttges  
Chief Executive Officer, Deutsche Telekom AG

Yes.
Yeah.

Yeah. Hi. Thanks. I just have two questions. The first question is I just want to clarify your latest thoughts on potential M&A at T-Mobile US, so if you can’t do something with Sprint near term, does it make something – make sense to do something with Dish? And the second question is on German mobile, can you give us some color in terms of what kind of uplift are you seeing with ARPUs as people migrate to LTE, and what kind of changes are you seeing in terms of DT switchbacks?

Look, I think the first thing is, in the U.S., this team is doing a great job. And even if you look to the profitability of new customers which we are gaining, they’re absolutely comparable with the profitability of customers we are gaining, for instance, in Germany. On top of that, we have now built a network, 220mm going to 250mm LTE coverage in the U.S. We have sufficient capacity and, at that point in time, we have even sufficient spectrum. Now therefore, there is no urge, no hurry, no – any kind of desperate, a must M&A activity from our side. But we always have said three pillars of our strategy: self-funding, de-risking and kingmaker asset. And if you see AT&T, Verizon, what we have to match in Europe is regulation and over-boarding implication from political leaders here, that is something we do not have sufficient in the U.S. You have two big players with more than 100% of the FCF and with huge yield advantage, scale advantages in their business model.

So if there would be a value-enhancing story to create a kind of super maverick, a really big player who would be much better positioned against AT&T or Verizon, then we always said and we’re not changing that, then we are open to consider a consolidation in the U.S. market. Are there other optionalities? Look, I am not commenting to any kind of M&A speculations here in this call. This is, trust us, that over the last year, we have built a lot of, let’s say, respect in the M&A field. And there is no urgency to rush into anything. And let’s see which kind of options might arise on the horizon, we move ahead. It’s going to be interesting how the FCC is going to design the upcoming incentive auction because we have learned that they have the intention to keep a four-player market. But if they want to do that, they even have to do something which is supporting the companies with significantly less yields, less scale. And that could take place in the FCC auction design, which is going to be announced in Q2 this year.

And on German mobile and the relevance of LTE in the ARPU development and migration of customers, I think it’s important to understand, we use LTE as one element of differentiation versus, let’s say, especially the discounters vs. players like ePlus as well. So the tariff plan basically we have in place in the German operations supporting LTE, that’s the one who’s chosen most by the customers. So the most popular tariff plan around €50 MRC, that’s the one which is mostly chosen by the customer which is dominating, so to say, the choice of the customer. And so LTE is really used to drive the customers’ MRCs upwards and differentiate vs. competitors with coverage or less throughput in the network. And as I’ve said, we’re looking at the distribution of the tariff plans and the customer choice that works out well.
Ulrich W. Rathe  
Analyst, Jefferies International Ltd.

Thanks so much. I have three questions, please. The first one is on the German broadband again. Amongst the answers, what you haven’t commented on is the possibility that the trends at Deutsche Telekom or the losses that Deutsche Telekom is currently seeing might be due to the strengthening of the copper-based old nets, Vodafone, United Internet or Telefónica and so on who has strengthened the contingent VDSL resale. Could you just comment on the risk of cannibalization of your own retail base through that wholesale opportunity that the competitors now have? That will be my first question.

The second one is, Thomas, you mentioned the difference in EBITDA between U.S. GAAP and IFRS, which are growing and very large now. Given we have guidance from T-Mobile US, could you just comment on how you see those differences pan out in 2014 and maybe if you can give us your T-Mobile US assumptions under IFRS just as a translation to what we heard from T-Mobile directly?

And my last question is on the 2013 revenue trends in Germany – sorry, let me regroup. It’s actually on the T-Systems revenue trends. You’re talking about a very significant revenue loss of €600mm as part of restructuring that business portfolio. But I note also on the slide that you’re talking about a flat margin year-on-year 3% of the Market Unit. Why does the margin not go up if already €600mm of revenues that you don’t want to pursue any longer already dropping out in 2014? Why isn’t the margin actually going up in 2014? Thank you.

Thomas Dannenfeldt  
Chief Financial Officer, Deutsche Telekom AG

So I’m going to start with the first question on the German broadband. I think – and Tim mentioned that, I think he’s absolutely right. If you build new networks, you need to make sure that it’s not only about consumers, it’s also about the business segment and the wholesale segment. What we need to make sure is that we utilize the network at best from all segments, obviously, especially on wholesale and making sure that we don’t have cannibalization there but a good support in terms of margin. We think we have that in place, the price pressure in the broadband sector is, from our point of view, not coming from, let’s say, players like United Internet. That is not an issue.

The price pressure is coming from the cable networks and some very aggressive in the last weeks or months, very aggressive offers from Vodafone. I think that’s related to their spring program where they put also some money in the marketplace and then the SACs in place. But I think we are fine with a parallel way of ramping up wholesale and retail. As we do know, there is more than network differentiation. It’s also about customer service. Tim mentioned that in the strategy part. And we are still confident that the complete package with the service differentiation we do have in place, et cetera, et cetera, is giving us enough room for differentiation here and the risk of cannibalization can be controlled. I think that’s on the broadband.

Stephan Eger  
Head of Investor Relations, Deutsche Telekom AG

Ulrich, then on the question with respect to the differences between IFRS and U.S. GAAP, that was $86mm for the quarter and it was about $260mm for the full year, but we have differences in EBITDA in 2013. You know that the differences mainly come from, a, we are deferring equipment revenues under GAAP which we are not deferring under IFRS. And for the equipment installment plan under GAAP, we are inputting interest income on the customer receivables and recording it below EBITDA. Under IFRS, on the other hand, the revenue from the receivables is recognized in EBITDA. So these are the two major contributing factors. And as we don’t know yet fully how these play out in 2014, I cannot give you an accurate estimate how it will be planning out in 2014, but it should be somewhat in the vicinity probably that we’ve seen in 2013.
Deutsche Telekom AG (DTE.DE)
Q4 2013 Earnings Call

Timotheus Höttges
Chief Executive Officer, Deutsche Telekom AG

Let me answer the question on the T-Systems’ restructuring. First, by the way, I like the program because it's a quite complex one. It has the three pillars and we must stop doing things, transform certain business and grow in new areas. These are the topics. And you are now questioning especially about the area of what are we stopping and why – how is it impacting the margin. The first one is on the contract side. We have some value-destroying contracts and we want to improve these contracts. We renegotiate these contracts or we stop these contracts, very clear message and we have already started with 14 customers to discuss this kind of contract.

Second, portfolio. We have in the portfolio elements with very low margins. Examples for me like standalone hardware, reselling of hardware, all non-standard solutions are quite costly especially when it comes to the competition with the offshore areas, this is going to be very tough. In this area, we’re trying to sell the contracts to parties who might have a bigger offshore ratio or to other suppliers, by the way, in this regard, not only the contract, even in all the people being employed in this regard.

And the third one, some countries where we have business units which are not profitable for quite some time, I’d like to mention the restructuring in Iberia, so in Spain, the sale of T-Systems Italia or the system integration business in France. So this kind of business we are now restructuring, we stop it, just to give you a few examples.

Now, this is affecting revenues? Yes. Is this affecting now EBITDA and margin now? The margin question is, I think, fair. Now, knowing that most of these deals will be accomplished in the third or in Q4 this year, this will not have a significant impact on the margin already this year. It might then impact the quarter result, but not the average of the total year. So this is the reason. In principle, we have a clear ambition that we say, today, we have an EBIT margin of around 4-ish and we want to go beyond 6-ish. That is definitely what we have in mind and which program is showing.

Frederic E. Boulan
Analyst, Nomura International Plc

Firstly, if I could come back on domestic outlook. So we’re starting to see a wrap-up in media sales spend. I just want to get your thoughts on when you expect this to start to translate into much more stable, firstly, I guess, KPIs line loss and also better broadband subs, but then subsequently, better revenue and when you think the fixed business can get back to growth in Germany?

And secondly, on the U.S. point, if we look at financials for T-Mobile US, I think we’re still an asset, which has not found a financial equilibrium. Can you talk a little bit about the long-term plan here? Are you happy to run it with similar very growth-oriented strategy, but with a negative FCF, or this is a temporary strategy for 2014? And secondly, in a two-year to three-year view, can you share your thoughts on how you see this asset developing and, in particular, your thoughts post-lockup at the end of the year? And then I’ll get a final one on the convergence strategy. And if you could share some thoughts on some of the assets that don’t really seem to be ticking the box, in particular, Holland, Austria and the UK and what the plan is here in the medium term? Thank you very much.

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

And I’m going to start with the question about German broadband. I think and that was our expectation. We announced that – and in terms of looking at the subscriber growth, our expectation was to come back to a zero or a slight positive element in Q4. Already, we haven’t seen that. We have improved from Q3 minus 47mm to minus 22mm in Q4. But as we said, not satisfied with that. So on subscriber growth, my expectation is that for the additional network we put in place the last quarter, et cetera, and all the activities we have put in place, that we’re
now really back to a positive figure – zero positive figure in Q1. So on the subscriber side, I think we're pretty confident that we can turn it around and that we will also see – you remember on the Capital Markets Day, we said two percentage points of growth in connected home revenues that we will see again the slight growth there in the revenues.

On your question on line losses, I think we're not – never said that we will see a complete stop of line losses. We said it's about significantly improving them. We are now below 1mm knowing that there is a 100,000 in there which is sort of a shift from fixed line to mobile. So it is not about showing zero online losses, it's really about significant reduction year-on-year. And I think there's a good track record now and good development there as well. I think, Tim...

So going to your question on U.S., by the way, I think I laid out how we see the world in the U.S. at that point in time. We have a clear growth path going forward. But let me spend a sentence on the network build-out and the money which we additionally spend compared to what we had in mind in 2013 or what we have laid out earlier. We have gained the – acquired this A-Block spectrum. And our original thought was that the earliest time for building it out would be 2015. Now, that was due to technical features, chipset availabilities and other things and we have now learned that there is opportunity that we will have this ecosystem together already in 2014.

Now, we're sitting there and saying, should we now invest already in 2014, or should we do it exactly as we already meant in 2015? Now, knowing that we could reduce the build-out of our network with the low-band spectrum that we could reach customers which we cannot reach today and that we have new customers now commuting between the cities and, let's say, the more rural areas and we want to keep them or even attract them from a network capability. We – as the team in the U.S., we came to the conclusion from the value-creation story, it makes a lot of sense from churn and even from new growth opportunities, let's say, to accelerate the build-out of this A-Block and already starting in 2014.

So this is a very deliberate and a very clear entrepreneurial decision which was taken by the U.S. management, me as the chairman in the U.S. and with the biggest shareholder of the T-Mobile US Deutsche Telekom. And I think it's absolutely right to do that. So therefore, we accelerate the program and started already a little bit earlier here.

Now, coming to the assets you mentioned, look, I think if we have, let's say, a good wholesale agreement with BT on selling fixed broadband and we even have, let's say, some fixed line experience here as well with around 700,000 customers in the U.K. in this area. So we have even, you know, some thoughts towards more integrated products here, nevertheless, this is a decision which we have to take jointly in this financial – more financial asset with our joint shareholder for Telekom.

With regard to Austria and Netherlands, let me spend a sentence on Austria. I think what the government in Austria made with the auction process is a disaster. It is the worst example which could happen. I think it is – for me, the best example that there is a systematic and European regulation that comes to spectrum. You acquired spectrum and the next day you have an impairment on your assets. If you would not have acquired the spectrum, the impairment would be even higher. This is nothing, which is fostering investment build-out in a country which is fostering digitalization of society. And therefore, I think this is a disaster. The consequence of that is that everybody, including us, we have to try to increase the prices to amortize the huge investments which we have done on the spectrum side. We're trying to do that, we're trying to create value on the Austrian. Now questioning now a sale of Austria at that point in time would be probably from an M&A perspective, on a technical perspective, the worst point in time.
So therefore, we are now trying to do everything to enhance value in Austria to – trying to manage with this disastrous auction which was created by the regulator and creating value over time and trying to meet the requirements. It is not a big issue for Deutsche Telekom because it’s less than 1 percentage point of our enterprise value, but it’s definitely something which could be a good example for regulators to do it or not to do it.

On the Netherlands, the situation is different. I think we have a good position there from a spectrum position. I think we have a more, let’s say, challenger position in this market. I think I do not have a final answer on hand at that point in time. I think strategy is not something which has been realized already. Strategy is something of what has to be executed over the next years. So you could challenge me on that question later on again, how we approach that fixed/mobile converged issue here, but let us work on that one in the upcoming months.

Paul A. Marsch  
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)  
Q  
I've got a couple of questions. Thanks for taking the question, sorry. So I just wanted to inquire a little bit more about split contract because we saw the benefits of going to split contract in the Netherlands in the quarter. I just wondered maybe can you give us what percentages of the base across the European footprint at the moment is on those kind of contracts at the moment, split contract, where you’re basically recovering the handset cost upfront as opposed to amortizing it through the ARPU over the period of the contract?

And then maybe in the Netherlands, what percentage of gross adds actually took split contract offers in the quarter and maybe what was the handset selling price in the Netherlands for those customers?

And then on the whole converged services strategy, I’m just thinking back to the 2012 Capital Markets Day where management sounded quite reluctant to move down the convergence routes or the quad-play routes stating, I think, at the time that it was seen as being price deflationary. So what’s your view of the convergence proposition here? I mean are you looking at markets like Spain with Telefónica and what they’ve done with Fusion, where they’ve heavily discounted their offers in order to try and regain market share and offset the impact of the price discounts by reducing churn to extend the lifetime customer value or are you looking at it in a different way? Is it more about just fulfilling another customer need?

Thomas Dannenfeldt  
Chief Financial Officer, Deutsche Telekom AG  
A  
So I’m going to start with the split contract shares. Netherlands is roughly 50% of the device transactions; on Poland, we are on 43%; Austria, a small number, 5%; Slovakia, a third; and Romania, roughly 50%. So they are the numbers for Q4 for split contract.

Paul A. Marsch  
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)  
Q  
That’s great. Thanks.

Timotheus Höttges  
Chief Executive Officer, Deutsche Telekom AG  
A  
Now going to the converged story, I cannot recall that we were reluctant and we are reluctant when it comes to price deflationary. So that’s definitely the case. Now, we have analyzed the converged markets or the converged offerings. And in most of the market the reaction was, you are either under pressure from a mobile perspective or you were under pressure from a churn perspective on the fixed line side. So in these markets, the competition had to react and, therefore, they put the two things together and make a discount on that one.
Now, our strategy is exactly not in this direction. What we are trying to do is we want to create an added value. And what we have laid out in our strategy, I hope I could have brought that across is that we want to differentiate for the customers that our network is better than what others have. It has more bandwidth. It has a better access at home. It has better access on the move. And that we combine the two so that you could offer something nobody else can. And by doing this, there's no need that we start giving rebates or whatever in this regard. I think it has even a value for customer if you get a turnkey out of one hand. And this is, let's say, what we see. And we see this as perspective for Germany and wait for the offers which we bring out during the course of this year to prove this out.