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Deutsche Telekom AG (DTE.DE)

Q1 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

[o6GXVH-E Tim Höttges]

BUSINESS HIGHLIGHTS

Implementation of Strategy

- Let's start today's call with a brief summary of what we have achieved strategically, operationally, and financially in this quarter
- I think we made good progress in the implementation of our strategy during this quarter
- To give you a few examples, first, in our all-IP migration program, we finished, as forecasted, the migration in our first European country, Macedonia, and migrated almost 500,000 customers to all-IP in Germany – by the way, a run rate of almost 50,000 customers a week
- Both our LTE and fiber rollout, particularly in Germany, are full-steam underway
- In the Czech Republic, we bought out the minority shareholders, thereby paving the way for the integration of the GTS fixed assets after the closing of the deal, which during the quarter was approved, by the way, without any remedies

T-SYSTEMS 2015 RESTRUCTURING PROGRAM

- And the T-Systems 2015 restructuring program started in the quarter, with the sale of IDS [Individual Desktop Solutions] and a significant reduction of our hardware wholesale activities, as well as first cancellation of unprofitable contracts
- There was even an agreement reached with the unions on how we structure the restructuring
- Operationally as well as financially, we can be satisfied with Q1 and are on a good path to execute on our full-year targets

ORGANIC REVENUE GROWTH AND ADJUSTED EBITDA

- I think we delivered an organic revenue growth of 4.2% for the group, something pretty unique in the European telco sector, and above consensus expectation
- And by the way, reading the results from a lot of European competitors already today, this is quite unique what we are showing
- Q1 adjusted EBITDA was roughly in line with consensus expectations, and driven primarily by the record customer growth in the U.S

FCF AND CAPEX

- On the FCF level, we delivered €1B in the quarter, well ahead of consensus expectations and on good track for our full-year 2014 target of around €4.2B
- And please consider you might have seen that we have significantly higher CapEx already spent during Q1
 - As a result of that, we fully confirm our full-year 2014 group guidance

Q1 RESULTS

Revenues, Adjusted EBITDA and Net Income

- Let me quickly summarize our first quarter headline financials
- Revenues for the group grew by 8% y-over-y on a reported and 4.5% year-on-year on an organic basis, with the main growth drivers being the U.S. business
- The adjusted EBITDA decline of 3.9% was mainly driven by the exceptionally strong U.S. subscriber growth and the somewhat weaker T-Systems contribution in the quarter
- The adjusted net income in the quarter was mainly a result of the EBITDA development, whereas the reported net income was supported by the financial gain from the sale of the Scout stake

FCF, CapEx, Net Debt and Dividend

- The FCF, as said, was nearly stable y-over-y at €1B, driven by a roughly stable year-on-year cash CapEx and a slightly lower operational FCF, compensated by a slightly higher dividend from our UK business EE
- And, as flagged, our net debt clearly was reduced to around €38B, driven by the FCF and the proceeds of sale of the 70% stake in Scout, which were somewhat compensated by the minority buyout in the Czech Republic and some other effects
- The net debt, however, will clearly be higher in Q2 as a result of the annual dividend payment as well as the cash-out for the A-Block acquired from Verizon, which is expected in Q2
- [0B7 R4C-E Thomas Dannenfeldt]

FINANCIAL HIGHLIGHTS

Germany

- Let's move now to the operational and financial details of the quarter, and let's, like always, start with Germany
- We're pleased with our performance in Germany in the quarter

REVENUES

- German revenues declined by 1.5% year-on-year, a slight improvement vs Q4
- Main driver this quarter were the mobile service revenues, which again showed a continuous improvement, and returned to a slight 0.2 percentage points positive growth, with almost no MTR impact in the quarter
- Core fixed-line revenues declined by 3%, in line with the trend of previous quarters, and I'll come back to this for a deep dive perspective in a second
- Our wholesale revenues continued to show a positive trend improvement, declining by one percentage point year-on-year, driven by our contingent model

ADJUSTED EBITDA AND OPEX

- The adjusted EBITDA declined by 1.1% year-on-year, resulting in a strong and year-on-year improved EBITDA margin of 40.7%
- The adjusted OpEx in Germany decreased by 1% year-on-year, driven by lower-revenue related costs, like interconnection, and a slightly lower market in the West, which was somewhat counterbalanced by costs related to our IP transformation and our integrated network rollout
- In the German fixed, we saw, all in all, another satisfying quarter, in line with previous quarters

Wireless Broadband

- I would like to highlight the following: a 21% year-on-year reduction in line losses to 214,000, despite 70,000 DT/LTE wireless broadband customers added in the quarter
 - An accelerated growth of new fiber customers, with 220,000 net new additions, of which 129,000 came from our own retail business, the strongest quarter since we started marketing of the product
- In total, we already have 1.74mm fiber customers on our German network now
- Broadband net adds continued to improve, to minus 7,000 in the quarter, though we are not yet where we want to be

TV

- On the TV side, our measures to increase the momentum in Entertain showed again results in Q1, with 78,000 new customers being added
- Importantly, more than 60,000 of these new Entertain customers booked their Entertain package with a fiber access

REVENUES

- As promised, let me do a little bit of a deep dive into our revenues on the fixed-line side

- The overall fixed network revenues – core fixed-line and wholesale – in Q1 declined by 2.5%, with the fixed revenues – fixed line as per backup definition – declined by 3%
 - Within these fixed revenues, we saw a further slight improvement in voice revenues as in previous quarters, with revenues being down by 7.4% in Q1
 - However, we are not satisfied with the development of our connected home revenues, which declined by 1.2% in the quarter
 - This is not in line with what we set as target of 2% growth
- Within the connected home revenues, we saw a continued decline of our broadband revenues, with minus 3%, and further slowing momentum of our TV revenues, with growth of 7.7%
 - This means that we will have to work hard with our integrated network rollout and our up-selling efforts in order to turn this around

OTHER FIXED NETWORK REVENUES

- In the other fixed network revenues, we saw the following major trends
- The decline of 11.1% year-on-year in our variable revenues was in line with the trend of the previous quarters, and is mainly driven by price as well as volume decreases attributable to flat-rate components
- Fixed-line add-on options decreased by minus 7% year-on-year, showing a downward trend since quarters due to the increase of bundle revenues
- And our increase in other revenues, fixed, by plus 4.7% year-on-year is mainly driven by sale of terminal equipment in the leasing model
- In our wireline wholesale revenues, we see a continuous improvement since quarters driven by the strong uptake of the contingent model

Mobile

REVENUES

- Let's now turn to mobile
- The German mobile market service revenues decreased by two percentage points year-on-year in Q1, according to our estimates, a clear improvement vs. previous quarters
- As anticipated, we saw a sequential improvement in our mobile service revenues in Q1, and returned to a slight positive growth of 0.2 percentage points year-on-year, thereby again outperforming the market
- Main drivers here were the continued negative but sequentially improved vs Q3 and Q4 voice revenue trend, further slightly accelerated revenue decline in SMS revenues of minus 35%, and again, a very strong mobile data growth of 28.8%
- Operationally, we continued our strong performance in the quarter

NET ADDS

- We had 551,000 mobile contract net adds, of which 204,000 were own branded net adds
- We showed a continued strong smartphone momentum, with 953,000 sales, including strong sales of Android and iOS devices
- At the end of Q1, we already had 3.5 mm LTE customers on our network in Germany, and we continue to have the best class contract churn at 1.1%

Strategy Execution

- Let me also give you an update on our progress in terms of strategy execution regarding our integrated network rollout and all-IP transformation in Germany on the following slide
- By the end of Q1, we are at 38% fiber and a 74% LTE POP coverage
- We have already migrated 2.6mm customers to all-IP in Germany, which translates into over 21% of all of our broadbands and almost 13% of all our fixed lines being migrated to all-IP already
 - Currently, we are migrating at a speed of roughly 45,000 to 50,000 customers per week in Germany

U.S. Business

CUSTOMER GROWTH

- Let me simply summarize the highlights of the quarter, and all relevant numbers were already reported and discussed by our TMUS colleagues for the U.S. business last week
- In Q1, the U.S. business showed their best customer growth ever, with 2.4mm new net customers in total, of which 1.32mm were branded postpaid net adds, leading to an upward revision of the full-year branded postpaid net adds target to 2.8mm to 3.3mm
 - At the same time, we saw a strong year-on-year reduction of 40BPS in our branded postpaid churn, down to 1.5%, and a continued improvement in our customer quality

EQUIPMENT INSTALLMENT PLAN RECEIVABLES

- Fifty-three percent of our equipment installment plan receivables are regarded as prime, up from 44% in Q1 2013
- Service bad debt expenses decreased 3% year-on-year and 13% quarter-on-quarter in Q1 2014
- Most importantly, TMUS returned to a 4.5% service revenue growth in the quarter on a pro forma combined basis

POSTPAID SERVICE REVENUES

- Postpaid service revenues grew even at 5.6%
- As a result of the stellar subscriber growth in the quarter, the pro forma combined adjusted EBITDA decreased by 25.9% year-on-year
- And also as a result of the higher-than-expected subscriber growth for the year, T-Mobile US revised their full-year EBITDA guidance slightly down to \$5.6B to \$5.8B under U.S. GAAP for the full year

Europe

REVENUES

- Now let's turn to Europe
- Revenues in our European segment declined 6.5% year-on-year on a reported basis and 2.6% organically in the quarter, driven by the following effects: broadly stable operational trends in our traditional telco revenues quarter-on-quarter, but weaker ICT, energy, and handset wholesale trends compared to Q4
- It is worth mentioning that from €83mm organic revenue decline in this quarter, €61mm are coming from the mobile regulation

ADJUSTED EBITDA

- On a reported basis, the adjusted EBITDA in the segment declined by 6.4% and organically by 2.3%, resulting in a slightly year-on-year improved EBITDA margin of 32.9% for the segment
- Main drivers were here:
 - Lower direct costs, driven by, among others, lower market invest as the share was split
 - Contract transaction in some of the countries was higher
 - And also good indirect cost savings in some markets, particularly in Greece, resulting from last year's headcount reduction program, offsetting higher share of lower margin revenue businesses
- We continued to show good momentum in some of our growth areas in Europe

NET ADDS

- We showed satisfying growth in TV, with 55,000 net adds, now reaching almost 3.6mm TV customers in Europe
- Importantly, we also increased the number of our triple-play customers in the region to 1.7 mm, up from 1.4mm a year ago
- We delivered 58,000 broadband net adds in the quarter
- And on mobile contracts, however, we were not satisfying at 12,000 new adds
- Here we clearly lost momentum in the countries like Poland, the Netherlands, and Romania
- Mobile data organic revenue growth remained strong at 17%, thereby continuing to compensate the decline in the SMS revenues

Technology and Cost Transformation

REVENUE SHARE

- Let me give you a quick update on the progress being made on the revenue as well as on the technology and cost transformation in segment Europe in the quarter
- The share of total revenues from our growth areas increased by three percentage points year-on-year from 25%
- The share of the fixed revenues from connected home grew by two percentage points year-on-year, to 23%, driven by TV revenue growth, especially in Croatia, Greece, and due to our acquisition of DIGI in Slovakia
- The share of mobile data revenues of overall mobile revenues grew by three percentage points, to 19%
- We're especially pleased here with the growth rates in the Netherlands, the Czech Republic, and also in Croatia
- And the share of B2B ICT revenues as of total revenues increased by 0.9 percentage points, to 3.8%, driven mainly by our Slovakian and Romanian operations

PARTNERING EFFORTS

- We also continued to make good progress with our partnering efforts
- For example, our partnership with Evernote now is launched in all 12 countries, along with Deezer on the music downloads in six and Spotify in another two
- The IP share of all fixed networks access lines grew by 10 percentage points, to 29%, mainly driven by:
 - Slovakia
 - Croatia

- Hungary
- And Romania
- LTE sites in service almost increased by six times year-on-year, to 6,700
- We have LTE networks in commercial use now in 10 out of 12 countries already
- Homes connected with fiber-to-the-home grew by 43% year-on-year, to around 200,000, and households passed with VDSL/FTTH technology increased to over 5mm

T-Systems

REVENUES

- Let's now turn over to T-Systems
- Q1 clearly already was impacted by the restructuring at the market unit
- The reported revenues decrease of 7.8% was driven by Tel IT but also by mark-to-market unit
- Tel IT revenues declined by 12.7% year-on-year, reflecting a lower demand/cost base
- The market unit reported a revenue decline of 6.7% year-on-year
- Adjusting for deconsolidation and FX, the organic revenue declined by 4.1%
 - This was clearly impacted by the first steps towards the 2015+ restructuring plan, and for example, a significant first reduction in hardware reselling and first cancellation of an unprofitable customer contract
 - And the decline is in line with the projected revenue decline for the full-year 2014 as a result of the restructuring and the announced repositioning of T-Systems

ADJUSTED EBITDA AND EBIT

- T-Systems adjusted EBITDA and EBIT declined significantly in the quarter as a result of revenue decline and seasonal cost deviation, which is expected to reverse in the upcoming quarters

FCF, CapEx and Net Debt

- Let's move now to our group financials for the quarter, turning to FCF first
- Group FCF is down 5.3% in Q1, at almost €1B, significantly ahead of market expectation and on track for our full-year guidance of around €4.2B.
- Main drivers were the roughly stable year-on-year operational cash flow and the roughly stable year-on-year cash CapEx
- Group net debt was reduced, as anticipated, by over €1B to €38B at the end of Q1, with the biggest moving parts being the €1.6B cash contribution from the sale of the 70% Scout stake, the €0.8B payout of the buyer of the minorities in the Czech Republic, and clearly the €1B FCF

Adjusted Net Income and EBITDA

- The adjusted net income decreased by 23.5% year-on-year in the quarter, driven by:
 - a) the decline in adjusted EBITDA
 - b) the increase in D&A, driven by the U.S., and here predominantly due to the MetroPCS consolidation
 - And c) a decrease in P&L taxes in the quarter, in line with the decline of the adjusted EBITDA
- The group ROCE benefited strongly from the book gain on the sale of Scout stake, and stood at 9.3% at the end of Q1

- Please bear in mind that mathematically, throughout the year, the impact of that Scout book gain will be diluted, so that the 9% first quarter ROCE is definitely not an indication for the full year of 2014

BALANCE SHEET

- Turning to our balance sheet ratios, net debt to adjusted EBITDA remained stable vs. year-end 2014 (sic) [2013] (19:42), at 2.2 times, as a result of the sequential reduction of the net debt
- The equity ratio increased slightly, to 27.9%, due to the slightly higher asset base and the increased shareholder equity
- With regard to our comfort zone ratios, we are in green with regard to all ratios. And our ratings remain 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
- [o6GXVH-E Tim Höttges]

Q1 HIGHLIGHTS

Strategic Priorities

- So, on the strategic side, I think we have to execute upon our strategy and what we have updated you upon, and it is along the line of the four principles:
 - First, integrated IP networks
 - Second, best customer experience
 - Thirdly, win with partners
 - And fourthly, lead in business

Germany

ALL-IP MIGRATION

- We have a lot of things on the plate, and we are very active on pushing things forward, and I want to give you a little bit insight on the priorities we are working on
- I think in Germany we have to execute on our all-IP migration, with the target of migrating around 3mm customers this year
- And keep in mind we have to [ph] attend (21:08) every single customer in a dialogue and even physically on his infrastructure at home

INTEGRATED IP NETWORKS

- Secondly, we have to drive our integrated network rollout at full speed
- Thirdly, we are driving integrated products, so the fixed mobile converge products are coming during the course of this year

BROADBAND MARKET

- Fourthly, improving our performance in the broadband market from a net adds perspective; and last but not least, we have to execute on our new small and medium enterprise initiative which we have laid out in our last meeting
- In the U.S., we want to execute upon our LTE rollout target of 250mm POP coverage now

- This gives us new market opportunities as well as for our MetroPCS, but as well even for the T-Mobile brand
- We have to deliver upon our new higher branded postpaid net add target which we have laid out in the quarter result of 2.8mm to 3.3mm new customers
- And we want to deliver upon the EBITDA target of \$5.6B under U.S. GAAP

European Priorities

IP MIGRATION

- In our European priorities, the priorities are as follows
- First, we have to drive our IP migration with full speed, within Slovakia, being completed by year -end
- We have to continue to grow in our defined growth areas: mobile broadband, TV, and B2B ICT business
- And we are going to start the integration of our GTS business we have recently acquired

PAN-EUROPEAN NETWORK CONCEPT AND RESTRUCTURING PROGRAM

- And last but not least, we have to design our pan-European network concept, which is a very innovative and new instrument in our industry
- At T-Systems, I think the path is clearly defined
- We have to implement the restructuring program, which we call T-Systems 2015
- We have to increase our EBITDA and EBIT run rate throughout the year – by the way, improving in H2 – and continue to deliver upon our spend reduction target of \$1B until 2015 at telecom IT, where we have made great progress over the last three quarters
- [oC3HZB-E Stephan Eger]

GUIDANCE.....

- Just a very quick remark, the U.S. guidance, obviously as given by the U.S. colleagues, is \$5.6B to \$5.8B under U.S. GAAP

QUESTION AND ANSWER SECTION

Frederic E. Boulan

Analyst, Nomura International Plc

Q

Firstly, a question on your assets in Europe, Tim, I think you mentioned this morning unsatisfactory progress in a couple of assets, Poland, Holland. Can you discuss your options here, and also about EE, how do you think about this asset, considering the absence of fixed there and the entry of BT in the consumer market later in the year?

And, secondly, on the U.S. consolidation, John Legere was on the tape last week saying consolidation was a matter of when and not if. So if you seek out meaningful synergies in a combination with another asset, would you be ready to share the antitrust risk by not requiring significant [indiscernible] (25:18)? And also if you can walk us through your thoughts on monetization of your stake going into lock-up expiry at the end of this year vs. other options, and in particular, how you think about the AWS three auctions in that context? Thank you very much.

Timotheus Höttges

Chief Executive Officer, Deutsche Telekom AG

A

Thank you, Fred. So let me start with the assets in Europe. Look, I think Thomas' and my ambition is always to be very clear and not always making a dog and pony show on quarter results, but even vocal about, let's say, challenges which we are facing. That was the reason that we were addressing this issue on the Netherlands and as well in Poland. By the way, I think the net add numbers on the mobile side weren't as high as we expected. We want to see more share on the marketplace; especially in Poland against the Orange we were facing quad-play offers in that market.

We even had a little bit less momentum on tests and on other things because we took some promotions out of the business to improve the profitability. And in the Netherlands I think we have changed a little bit the logic of this contract support here. So, with this, I think the market ambition should be a little bit higher for our teams in this region. That has nothing to do that we are now questioning the portfolio position of these two assets. It's an operational topic which we're going to address throughout the year.

With regards to the U.S. consolidation, when, not if, and ready to share the risks and how could we monetize our stake here with the expiry of the lock-up, and what are our thoughts on the upcoming spectrum auction – that is how I understood your question, Fred – I think the first thing is we are very happy how our U.S. business is developing. We said last time, first what you have to do to turn around the business is infrastructure. We built this infrastructure of 200mm POPs, which we now increased to 250mm. With the LTE proposition, we said we have something to sell in the marketplace.

Now, we gained, over the last four quarters, big-time customers. Now the big-time customers, as a first step, is creating revenues, and for the first time this quarter we are able to show you the increase on an organic level that we have increased 4.5%. Now, the logical consequence is that now FCF and EBITDA is the consequence of this customer growth, which will help us to self-fund further growth in the U.S. business. So this is becoming a self-funding platform, which is creating more momentum in the marketplace.

So far, we are very proud of what we're doing. Especially if you look to the design of some of the EE shops or if you look to the branding of Sprint, they are copy-pasting what we are doing and trying to do that, so I think the momentum of our proposition is unbroken, and therefore whatever we do, we do it for creating additional value in

the U.S. market. There is no pressure. There is no hurry for selling a business at that point in time. We have a self-funding platform which is nicely developing.

That said, correct, we will have an expiry of the lock-up by the end of the year, so that we are open to sell some of the stock here; and, right, there's even a lot of speculation with regard to spend. I do not want to put oil into the fire on that one in this conference call, but I reiterate what I've said always. We are open to create the super maverick. I think to really create value in the market at a higher speed with a better network, with even more spectrum, a combination, for instance, with one of the players, would make a lot of sense to create a super maverick against AT&T, against this bifurcated market in the U.S.

So, therefore, if there would be an opportunity, it would be [indiscernible] (29:56). But you even know that the FCC and the DoJ make their statements. They want to keep this environment open for four players. I could always say, look, you could say, if you want that, what are, let's say, then the prerequisites from a spectrum policy, from reserved spectrum, and from advantages to compete with these two big players.

This is something which we're going to see next week because the FCC is set to propose pro-competitive spectrum auction rules for the next year's 600 megahertz incentive auctions. I even have heard that there might be a spectrum reservation for smaller carriers. Let's see what we will hear at the 15th of May on that subject. So, therefore, it is too early to say something on how it's developing, but we have a very good momentum at that point in time. With regard to the spectrum auction, we are waiting for the design which is coming, and we plan to participate in the auction next year.

Frederic E. Boulan

Analyst, Nomura International Plc

Tim, thank you very much.

Q

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

The third question, I think, was on EE and the perspectives on BT entering the market here on the mobile side. I think, first of all, what Tim mentioned on the U.S. is true for the EE as well. It's about value creation. Last year we came to the conclusion it's better to stick with the asset, stay with the asset like it is, and we think we can create more value by doing that. Why is that the case? A, we are happy with the operational development and the performance of the EE team. They're doing extremely well, I think, compared to the other players in the market, especially in terms of differentiating with the network, which is part of our strategy as well. So that's what they're doing very well.

On service, I think they started activities and initiatives to improve here as well to differentiate even further in the marketplace. So, operationally, I think they're doing good, strong team, number one. Number two, we think here the UK market will see the FMC trend as well as all the other European markets, but our assessment is that will be a little bit delayed, later than we will see it or we see it in the European markets. So there's still enough time to grow on mobile-only businesses, that's number two. Number three is we also, you might know or not, offer with EE, broadband product, and they are doing well. So they're improving here in terms of number of customers we're gaining and margin as well.

And number four, as BT is a new wholesale in the market based on our wholesale contract, we had a deep assessment and thought whether it is wise and good to keep them – or to take them on our networks. We think it is, that it's value-creating for BT and will be value-creating for EE as well. So our assessment is, with the good

operational performance, with the right steps from EE into the broadband market, and with its wholesale deal on BT, we're doing the right way to create even more value.

Ulrich W. Rathe

Analyst, Jefferies International Ltd.

Q

My first question is on Vivento. I noticed that it's the record high, historical record high, transfer of employees into Vivento this quarter. And it seems to be coming from within GHS, if I'm not mistaken. So I'm just wondering what is going on there, is this a sign of significant further cost-cutting, or how do we interpret this move at this point. And then my second question is on the German broadband and fiber situation, in particular on the retail side. Could you just shed a bit of light on where these net customer losses actually happened? Is this in the VDSL build-out regions, or is it in the non-VDSL but cable regions, or is it outside of those regions? And could you then also maybe comment a bit more on the strategies that you intend to deploy to actually stop and turn around that customer loss, as you've indicated as some of your focus point for the German business in 2014? Thank you.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

Yeah, I'm going to start with the second question on the German broadband side. First of all, the way we're doing the rollout is by competitive pressure and situation, so to say. So we analyze where the competitive pressure is high, where churn probabilities are high, and that's where we roll out first in the areas where we don't have a fiber infrastructure so far. So that is exactly the way we tackle the rollout. It is important to understand that the churn in the areas where we don't have VDSL infrastructure is a little bit higher, but not significantly higher, than in the other areas, but is exactly the way we're tackling the rollout, starting with the higher churn probabilities and going there.

Timotheus Höttges

Chief Executive Officer, Deutsche Telekom AG

A

I'd like to add something, Thomas, here on that subject. First, what we see in the areas where we've built fiber, we have a huge uptake from our customer base. We have record sales on fiber, more than 220,000 only in this quarter, on our fiber proposition, so that is a great outcome. Second, what we even see is that the trend on the broadband on the retail side is improving. We had in Q4 minus 47%, we had in Q4 minus 22%, and we have minus 7% in Q1. So we see that our activities are improving.

And to be very detailed here, we have even new tariffs in place on the marketplace, so that new propositions are made, like the Call & Surf by the LTE is supporting us in areas where we cannot sufficiently promote fiber, and we have even promotional activities going on on the broadband side here in Germany to be more competitiveness, even on the price side. I think it is very important that we accelerate or even execute along the lines of our CapEx rollout because the fiber is the answer on what we are doing, and we are quite confident that we're going to see a positive development throughout the year.

On top of that, the revenue stabilization, which is helping us as well on EBITDA and FCF, is coming from fixing the wholesale business. Remember, just a few quarters ago we had a minus 7%, minus 8% of this number. We are now almost stable on the wholesale side. And the contingent model is creating added value for us, and we are not losing this service revenue to the cable operators, so we're keeping some of the momentum. And the contingent model for the wholesalers is a good proposition, is working nicely, and helping us to utilize the infrastructure. So I think, overall, I think you're absolutely right. Stressing the negative number, we are not happy with that one, but we have a lot of activities, both on broadband, but as well our LTE substitution, and as well by build-out up and running.

Stephan Eger

Head of Investor Relations, Deutsche Telekom AG

A

And, Ulrich, just on what happened at GHS with the personnel here, we have in total a reduction of 1,118 people in GHS y-over-y. There are a couple of inorganic effects, so for example, we moved the procurement out of Germany and out of T-Systems into GHS to bundle that in one central function. That's about 291. Then we had consolidation of smaller companies like explosion interactive, 37 FTEs, ClickandBuy service in India, 19 FTEs. And obviously, we have a deconsolidation of Scout of 1,211 FTEs.

Underlying the reduction is 254 staff y-over-y, which is the reduction of 1.2%. And obviously that's the headcount reduction in some of the steering function and shared services. Shared services started with a shared headquarter a little bit later than the rest of the headquarter, and that is basically, as I said, 250 FTEs, and I guess some of them actually showed, then, up at Vivento. And with respect to the details in Vivento, [ph] Andreas (39:00) will come back to you right after the call.

Paul A. Marsch

Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

So I have two questions. I just noticed on the line loss that the consumer line loss trend continued to be relatively weak, I think slightly worse in the quarter, whereas the business line trend actually went positive in the quarter, with about 15,000 net additions. I'm guessing that that business trend is seasonal in Q1. But I just wonder, in consumer, if you have a view on how much of that might be being driven by mobile cannibalization and when that line loss on consumer might eventually stabilize or show some kind of inflection.

And then on VDSL, just a question on the margin, I'm not sure if it's right to look at it in this way, but are you able to give us any insight on the EBITDA difference for a Deutsche Telekom ADSL customer who migrates to a retail VDSL offer with Deutsche Telekom, how that compares with a customer who migrates to a wholesale VDSL offer, so is that customer who migrates to a wholesale VDSL offer materially EBITDA-dilutive?

Stephan Eger

Head of Investor Relations, Deutsche Telekom AG

A

Well, let me start, and I think Tim will also join upon that. Now, first of all, in the line losses, I don't think that we see too much of a mobile cannibalization issue. Look at our own mobile cannibalization by our LTE product; that is actually down sequentially. We're now at 17,000 customers being on there, and that has been much stronger in the quarters before. So I don't see that. On the contrary, we also would not see the business trend necessarily as being a seasonal impact in Q1. I think it has also something to do with the rollout of VDSL and FTTC over four quarters.

Paul A. Marsch

Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Right, okay.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

But, Paul, let me add one element where it's a kind of regular activity we're having here is, once a year, in the beginning of the year, we do a kind of adaptation between the business and the consumer segments, looking what kind of customers we have in the consumer segment especially, being business is smaller, very small business customers, and then what we're going to do is take them and put them into the business segment. So it's just every Q1 the year, we have that kind of activity to look into the consumer segment, take the small business customers in

there and shift them into the business segment, so in a Q1 there's always that kind of effect you will see also just beforehand.

Paul A. Marsch

Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Yeah, okay.

Timotheus Höttges

Chief Executive Officer, Deutsche Telekom AG

A

And one last answer, maybe on the business customer side, absolutely right. We are growing our business, so just off of my mind is something in the vicinity of 4% growth in this area from a revenue perspective. And the reason is simply the proposition which we have in the market, being it the cloud services, being it the security features, being it the integrated telco services which we are delivering, integrated in our service proposition, we have laid 19 new products out at CeBIT fair, this is helping us big-time here on the customer side. So, therefore, on the B2B side, we are very strong from a propositional side, and we do not see, let's say, a view to take from our competitors in this area.

Stephan Eger

Head of Investor Relations, Deutsche Telekom AG

A

And, Paul, just for clarification, the second question was is there any EBITDA difference – i.e., dilution – if a DSL retail customer in Germany migrates to a VDSL offer from ourselves, right?

Paul A. Marsch

Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Yeah, sure, because obviously you lose some costs in supporting that customer, but you're still making a decent ARPU from the wholesale revenue. Right?

Stephan Eger

Head of Investor Relations, Deutsche Telekom AG

A

Okay, but then – yes, the answer is yes, but then it was about retail moving to wholesale, the question.

Paul A. Marsch

Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Yeah. So if we're going to see a big take-up from the contingent model continuing through the year, for customers who might be leaving Deutsche Telekom retail and taking up a service from whether it's O2, Vodafone, United Internet, are those customers EBITDA-dilutive to you, and so are you making less EBITDA from those customers than you would if they migrated to your VDSL service?

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

There is...

Paul A. Marsch

Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Maybe it's just too complicated to answer in this forum, so.

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

A

No, I think now we get the question.

Timotheus Höttges
Chief Executive Officer, Deutsche Telekom AG

A

First of all, we got the question, thank you. I think there are two answers to this. First of all, strategically, our aim is to strength wholesale and retail vs. cable, not to fight retail vs. wholesale and let the cable guys go. So, the way we think that is we need to be stronger than cable and stronger than the wholesale guys in the marketplace, but also make sure that wholesale can get a decent share out of the market and not only seeing cable growing. So that's first of all the understanding, the thinking, looking at the whole game. So that's number one.

Number two, there is a slight difference in terms of the margin from retail to wholesale, but due to the contingent model, it's not as big anymore. As you know from the ULL pricing to the contingent model pricing, there's uplift in there. So there is difference, it's not so big anymore, and I think, again, the perspective is fight cable, not wholesale.

Polo Tang
Analyst, UBS Ltd. (Broker)

Q

Just have a few different questions. Just on German mobile, you've had very strong postpaid net adds in Germany for the past seven, eight quarters. So my question is, is when is this going to feed through into improving mobile service revenue growth. And related to German mobile, can you just talk through LTE in Germany, so what are you seeing in terms of the uplift to data usage and the uplift to ARPU? And just, finally, if something does happen with T-Mobile US, can you just talk us through future uses of cash? Could we expect this to be returned back to shareholders, or would it be a case of reinvesting proceeds to strengthen your European footprint? Thanks.

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

A

So, first of all, I think, on the German mobile side, we are very positive about the development because we see absolute revenue growth on service revenues, not having seen that too often during the course of the last years, to be honest. And I think that the main reason for seeing that positive trend vs. market – as I mentioned, we still expect the market to decline around 2%, maybe 3% vicinity – is about the differentiation in the network. So our view is what we've seen in the net adds, what we've seen, by the way, also in the way we differentiate in the marketplace in terms of network quality, is already reflected in our performance on the service revenues, and we expect that to go on further.

Timotheus Höttges
Chief Executive Officer, Deutsche Telekom AG

A

Look, another famous idiom from me here: you have to kill the bear first before you tailor the skin. So, therefore, Polo, your question with regard to the use of cash of a potential sale of the U.S. business, this is something which is totally theoretically and nothing which we really could seriously discuss. But maybe let me share a little bit of my thinking. At the AT&T times, we were very balanced in the approach towards debt holders, equity holders, and towards our balance sheet here, and this should always lead us on this kind of consideration. I'm a big shareholder of Deutsche Telekom, and therefore I'm even interested to see the appreciation from this kind of potential deal.

Paul A. Marsch

Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

And just to follow up on the question about LTE, what kind of uplift are you seeing in terms of DT switch in ARPU?

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

The uplift in LTE is linked – or let’s say the other way around – the most supporting element of LTE is to drive MRCs upwards, so the MRCs being sold to make sure that those MRCs are driven upwards, knowing that there’s a lot of noise in the marketplace pushing prices downwards. To give you even clearer answer on that one, the tariff plan we sold most is the one where LTE is incorporated, even if it is \$50 or \$45 tariff plan a month, compared to €20 to €30. Entry points in the marketplace the most sold one is the one with LTE. So it’s not LTE per se is; it’s driving up the MRC with the LTE element, and the LTE service improvement we do have.

Paul A. Marsch

Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Thank you.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

There’s no direct measurable ARPU in euros I can recall here on that one.

Justin B. Funnell

Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Obviously, the all-IP migration is gaining momentum, and by the looks of your line loss, going very well indeed. I was just wondering when you’d be able to start really showing cost-cutting benefits from that. Is that a 2015 story, for example? Secondly, is this move towards a integrated European platform, again, as you go all-IP in Eastern Europe, what are the potential savings there, and again, are they coming through next year or does it take a bit longer?

Secondly, I was just wondering how you feel about the potential remedies on the German consolidation deals. Do you see those remedies as something that might actually disrupt the market and make the market worse, or is this still too early to know? And then, finally, do you feel you need to react to Vodafone’s recent move to push fixed-mobile bundles more aggressively. Do you need to start going quad-play in Germany? Thank you.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

I’m going to start with the first part of the question of all-IP. I think it’s kind of typical for Deutsche Telekom that we are able to create big machines running big volumes in a very appropriate and proper way. So what you see right now is in the all-IP migration, as mentioned, 45,000, 50,000 customers being transferred to all-IP, changing their CPEs within their home, doing the switching, all that kind of stuff, and without any relevant and significant impact on service quality and customer reaction and customer feedback. So I think that’s where we are today. And I think the good message is that machine is up and running and we will accelerate that number further on.

The other part of the story is there are some millions of customers to be transferred to make a clean all-IP network happen, so that will take some years to make it happen, talking about 2.5mm, 3mm of IP migrations this year. It

doesn't mean there are still some millions left. So you asked when will we see effects of cost-cutting in 2015. No, 2015 not, because 2015 will be somehow the peak of the transactional volume we will see, but 2016 onwards, you can expect to see the first savings kicking in here.

Justin B. Funnell

Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Thanks.

Stephan Eger

Head of Investor Relations, Deutsche Telekom AG

A

But in Germany, and now in Eastern Europe, Justin, very quickly, where are we, in terms of IP migration, we're at about 70% in Slovakia in Q1, around about 50% in Croatia, 34% in Montenegro, 36% in Hungary. So, on average, in Europe, including Germany, we're at about 23%, with the laggard so far being Greece and Romania, but that has always been planned that they are kicking in later.

Now, with respect to this cost savings there, we always said Macedonia is the first showcase, with €10 per access line per year to be saved, and we always also promise you that we're coming up with a clear savings number with our Capital Markets Day later in the year, because obviously it depends on country by country where the savings are coming from. For example, in Croatia, the biggest chunk of the savings will be from energy, whereas it was completely different in Macedonia.

Timotheus Höttges

Chief Executive Officer, Deutsche Telekom AG

A

With regards to – maybe I like to add one sentence on this Pan-European network question here and the integrated European platform. Look, this was laid out as a strategy, and I have to be very honest, we are working intensively on that subject to understand what the opportunities are, where the big cost levers are coming from, what it would mean from governance perspective and other things, and we need some more time to really go through that. So it's a strategy, it was laid out, but you cannot expect immediate answers and the benefits coming soon. So we have to work that through diligently.

Now, the next question was with regard to the remedies on the German market competition. You know that shareholders on both sides approved the deal, and EU regulatory approval process is still ongoing. I think O2 made a remedy proposal to the EU Commission, and all market participants received this proposal and had the opportunity to comment upon. The EU Commission will decide on that paper at the 23rd of June – at least that is our knowledge here at Deutsche Telekom. And it is very difficult to discuss now the remedy proposal here because we are all lying under an NDA in this regard.

All I can say, from our painful experience, and one of my biggest management mistakes I personally did was the Tele.ring acquisition in Austria eight years ago. Intra-market competition, in general, has to be possible in Europe. We need that in order to set the economic framework for the necessary infrastructure investments into the mobile infrastructure. And scale matters in our industry. I think that is clear to everybody. But the remedies imposed on any deal should not kill the economic logic and the synergies of such a deal. Otherwise, it would be better to walk away from such a deal. And we should have done that in Austria in the past, but we were so much committed as managers to get things executed, and I hope that the Telefónica management is seriously considering the price and the benefits of this kind of remedy, and therefore, let's wait what is coming out of their proposal at the 23rd of June.

Going to Germany, react to push bundles more aggressively – quad-play, yes. And this comes from my heart. We were the first company here in Germany bringing the fixed and mobile business together a few years ago. This company is doing a good job on the sales perspective, doing a great job on the network differentiation side, doing a great job on investing into quality. This is the basis of bringing these two networks together, and you could be assured that, independent from the tariffs which we have recently launched on integrated things, we are even working on the customer experience side here. So I promise you here in that call, during the course of this year, you will see quad-play and other things around that during the course of 2014.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

I would like to add a few words on that one as well, because I think it's important to understand how we look at quad-play. Quad-play, in some countries in Europe, is a discounting game; in some countries, it's an up-selling game. And we believe, and we have seen the last years already in cross-selling activity that on quad-play, there is up-selling opportunities and there is opportunities to even see a better ARPU with the customer, and not discounting it because of having churn issues. We don't have churn issues here in the marketplace. Fixed-line churn is in the proper shape; it's around 6.5% to 7% in broadband. Mobile is in the proper shape. So it's not a defensive game. There's no reason to react on Vodafone or somebody else's activities bringing fixed-line into their shops. It's about creating value on the quad-play game.

Justin B. Funnell

Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Okay, thank you.

Stephan Eger

Head of Investor Relations, Deutsche Telekom AG

A

Well, thanks, Thomas. And before moving on to Ottavio Adorisio from SocGen, let me quickly come back to one other question from Ulrich beforehand, that was what's happened within Vivento, and now, stay tuned, guys. Within Germany, so actually there was nothing on the outside world changed, but we changed people within GHS from group business security into Vivento. Actually, these are the guys at the doors of all our operational businesses throughout Germany. So, Ulrich, you definitely win the question on the most creative question from the backup. I don't think that anybody will buy our shares on the backup ad, but now I think the question is at least tackled.

Ottavio D. Adorisio

Analyst, Société Générale SA (Broker)

Q

Couple of questions on my side, the first is just related to guidance. Thomas clearly explained that TMUS had to soften the guidance by around €100mm to invest in customer growth, but you kept the guidance at the group level. So I was just wondering where the savings will come from to compensate for that. And the second is, specifically going back to the U.S., and I will try to understand, and I appreciate that's difficult to comment on what's going on, but without throwing any oil in the fire, Thomas stated what really they are doing is, on one side, they've got the DoJ and the FCC that would like to maintain four infrastructure players. On your side, you basically said that you do need to basically gain scale, both you and Sprint. Therefore, my question to you is, what sort of remedies and concession would be prepared to make in the U.S. to facilitate a potential for entrance, and therefore to appease any sort of antitrust hurdle that looks to be at the moment on the horizon? Thanks.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

Yeah, I'm going to start on the question on the compensation. It's quite simple. It is additional cost-saving efforts and activities we agreed upon in the group outside the U.S. to compensate on that one to keep the guidance stable. And I think that's the simple answer on the first question.

Ottavio D. Adorisio

Analyst, Société Générale SA (Broker)

Q

Could you just clarify a bit more where – in Germany, in Europe, in T-System – where those savings are coming from?

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

Across the whole board, so that everybody is participating and supporting that one.

Ottavio D. Adorisio

Analyst, Société Générale SA (Broker)

Q

Okay.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

You can assume a kind of fair-share support of everyone in the group in that one.

Stephan Eger

Head of Investor Relations, Deutsche Telekom AG

A

Remember, the guidance revision, T-Mobile US, at the midpoint is \$1.50, so we're speaking about €100mm here.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

Yeah, and fair-share distribution.

Stephan Eger

Head of Investor Relations, Deutsche Telekom AG

A

Yeah, and the fair-share distribution, as Thomas said.

Timotheus Höttges

Chief Executive Officer, Deutsche Telekom AG

A

Ottavio, I think with regard to the U.S., first you need a deal. And then I think your question is smart, but you could imagine whatever happens, to discuss remedies and concessions in a call, that wouldn't make sense at all, because this is bilateral negotiation process and with the authorities, and even if we would have a deal on the table, I would not disclose that in a quarter result. You wouldn't do that either. So therefore I'm sorry for being that straight.

Hannes C. Wittig

Analyst, JPMorgan Securities Plc

Q

I just wondered how you're looking at incumbent consolidation as a subject, what priority for you. There was another comment today from the German Chancellor, in fact, related to the fragmentation of the Pan-European

industry. Is that a priority? Are you still seeing yourself as an important player in this, and do you think we will see some relevant action in the next 6 to 12 months to drive Pan-European consolidation?

Timotheus Höttges

Chief Executive Officer, Deutsche Telekom AG

A

Hey, Hannes. So the first thing is I appreciate that our Chancellor is pretty aware about what's going on here in Europe. We have 28 markets. We do not have a single market package. The single market package gets reduced to the sour path, and then rather giving some sweet path to our industry, we have a ridiculous discussion on net neutrality these days. Looking to the U.S., we could learn in Europe how a market should be structured. And on top of that, we have a competitiveness which is very high, and you know all the incentives from regulators falls on price regulations than rather on infrastructure investments. So, therefore, the good thing is that something is changing. And if you read the German press on a daily basis, at Frankfurt or on other newspapers, there's a continuous flow of a discussion about what Europe needs from a digitalization perspective. Therefore, I appreciate that.

But, look, before you go into consolidation in Europe, you need another framework. The first one you need is single market package which is supporting interaction, and consistent to that one, even the antitrust perspective has to change. If the antitrust perspective is only related to the local countries, then even the single market will never take place. So therefore I think these are the two prerequisites before really a consolidation should take place. I'm a fan of European consolidation. At one point in time it has to take place, because scale matters in our industry, and the synergies could be realized, but at that point it would be much early to speculate on this kind of Euro-wide and cross-country regulation because the framework isn't given at that point in time. So, in the next month, to drive something and to see something, I would say no.

[oC3HZB-E Stephan Eger]

CLOSING REMARKS

- We're ending the call right now
- I know that there is a couple of more people in the waiting chain
- We obviously will call all of you from the IR team in the next 20 to 25 minutes
 - So thanks for that
- And for the rest, especially on the buy side, I think we'll see many of you in the next weeks
- We are on the road on conferences and in London and other areas, Boston and New York, with Tim and Thomas, more than happy to see and discuss the trends with you personally.

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