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Deutsche Telekom AG (DTE.DE)
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CORPORATE PARTICIPANTS

Timotheus Höttges  
Chairman-Management Board & CEO, Deutsche Telekom AG

Stephan Eger  
Senior Vice President & Head-Investor Relations, Deutsche Telekom AG

Thomas Dannenfeldt  
Chief Financial Officer, Deutsche Telekom AG

OTHER PARTICIPANTS

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

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

Simon H. Weeden  
Analyst, Citigroup Global Markets Ltd.

Ottavio D. Adorisio  
Analyst, Société Générale SA (Broker)

Peter-Kurt Nielsen  
Analyst, Kepler Capital Markets SA (UK)

Steve P. Malcolm  
Analyst, Arete Research Services LLP

Ulrich W. Rathe  
Analyst, Jefferies International Ltd.

Guy R. Peddy  
Analyst, Macquarie Capital (Europe) Ltd.

MANAGEMENT DISCUSSION SECTION

Timotheus Höttges  
Chairman-Management Board & CEO, Deutsche Telekom AG

Q2 REVIEW

Q2 Highlights

- Let’s start today’s call on another solid quarter for DT with a brief summary of what we have achieved and about, let’s say, the details, even talking about the U.S.
- We made good progress throughout the quarter on our 2014 key priorities as we have presented them in Q1
- In Germany, we are consequently executing on the integrated network strategy
- We have increased our LTE coverage to 77% of POPs
- We have increased our fiber coverage to 39% of all households; by the way, to the end of the year 45%
  o Good results because we see a very positive take-up rate in these new build-out areas, and we might have to talk about that later on

IP Migration

- We continue to invest heavily into our networks and in spectrum, and are investing more in our home market than any other European incumbent
I think that is a very important strategic imperative of our strategy and the consequent is, hopefully, that we see even more customers on broadband

- We accelerated our IP migration to 527,000 customers in Q2 with another significant ramp-up expected in H2 this year
  - And we improved, as promised, our run rate in broadband net adds, turning into positive territory, again, and expect positive net adds for H2 as well
- In the Mobile business, we continue to increase our service revenue market share and overall the market is declining
- Q-over-q we saw a deteriorating market of 2%, and with the minus 0.3% we have gained market share

Network Quality

- We continue to differentiate on that basis and the basis is our network quality
  - It is the premium services which we offer
- By the way, it’s even a high cost discipline, and it’s transparent and fair tariffs for good quality at the same time
- Maybe some right side remarks here, at that point in time there is a big play here in Germany with quoting the same, but it’s not behaving the same
- He’s accelerating the price competition
- I don’t understand why he’s behaving that way, talking about Vodafone

LTE Rollout in the U.S.

- In the U.S., we continued our LTE rollout, now covering 233mm POPs in 325 metropolitan areas, and we have announced a nationwide VoLTE coverage as well
- With 1.5mm net adds, we showed the fifth consecutive quarter with more than 1mm net adds and again raise the full year guidance for branded postpaid net adds now to 3mm to 3.5mm
  - And we significantly ramped up our service revenue growth and delivered on our EBITDA target with a y-over-y 22% EBITDA increase under IFRS accounting

TMUS Business

- Now to the recent news flow around the inorganic moves at TMUS, and I know that this is a big interest for all of you
- First, even if I would love to do it, I cannot comment on every specific rumor or deal or, let’s say, transaction which is discussed at Wall Street or in the respective journals
- We are very pleased with the hard work and the results that John Legere and his management team have delivered at TMUS recently and over the last 18 months
- Just yesterday, TMUS has announced that it has overtaken Sprint as the number one U.S. wireless carrier in the mobile prepaid marketplace, and targets to overtake Sprint in terms of total customers in 2014
- Current TMUS business momentum puts the company in a strong position from which to consider any future M&A opportunities or proposal, which obviously would have to add more value to TMUS shareholders than a standalone case
- At this point in time, we are not aware of any actionable proposal that offers such superior value
- In the long run, increasing the scale of T-Mobile is an important factor in bringing sustained competition to the U.S. wireless industry, as we have always said
The political and regulatory environment in the U.S. has to be open to considering further consolidation and to looking at the overall market evolution, not just on an isolated mobile market definition.

- If U.S. politics and regulation are of the opinion that the four player market in the U.S. is necessary, then they will have to take care of the ability of the smaller players to fulfill their role as a maverick and to be able to compete successfully.
  - This applies, amongst others, to the auction design for the 600 MHz spectrum auction which is coming in 2015, as an example.

Europe

- Now, let me come to Europe.
- In our IP migration process we already achieved an overall 32% IP share of fixed line access.
- And in Poland, we just launched our LTE network commercially and have now LTE networks in 11 out of our 12 countries.
- We continued to grow in our defined growth areas and started the GTS integration after the deal closed in May.
  - And importantly, we almost tripled our run rate in indirect cost savings q-over-q resulting in an organic EBITDA growth in the segment in that quarter.
- We are on a good track to reach the full year ambition level in this area.

T-SYSTEMS

- At T-Systems, we implemented our T-Systems 2015 program, called Master Plan, and are now in execution modus with a clear improvement at the market unit, in the EBIT margin and to be expected for H2.
- Financially, we delivered a strong set of results and are on track to reach our full year guidance, which we hereby confirm again.
- We delivered on organic revenue growth of 0.6% for the group in the quarter, in line with consensus expectation.

Q2 Adjusted EBITDA and FCF

- Q2 adjusted EBITDA was slightly ahead of consensus expectation and driven by all segments.
  - On the FCF level we delivered €1B in the quarter, slightly ahead of consensus expectation and on good track for our full year 2014 target of around €4.2B.

Q2 Headline Financials

- Let me quickly summarize our Q2 headline financials.
- Revenues for the group fell 0.3% y-over-y on the reported basis but grew 0.6% organically with the main growth driver coming from the U.S.
- The adjusted EBITDA increase of 0.3% was driven by U.S., but also by the significant cost reductions in Germany and in Europe.
- We are very pleased that the reported net income in Q2 showed a growth of 34% driven by the EBITDA growth, but also by a book gain related to the spectrum swap with Verizon.
- The decline in the adjusted net income is primarily a result of a higher y-over-y depreciation driven by one month more inclusion of MetroPCS and the increased investment level in the U.S.
The FCF at €1B was mainly driven by an increase in cash CapEx, slightly higher operational FCF and higher y-over-y interest payments; and, as indicated, our net debt increased q-over-q to around €41B driven by the annual dividend payment as well as the cash out for the A-Block acquired from Verizon.

However, year-on-year the net debt remained flat.

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

GERMANY OPERATIONS

Revenues

- Let’s move to the operational and financial details of the quarter, and let’s start with Germany
- We’re again pleased with our performance in Germany in the quarter
- German revenues declined by 1.8% year-on-year, a continuation of the trend of the previous quarters
- Mobile service revenues declined by 0.3% year-on-year, a slight deterioration vs. the previous quarter but still outperforming the market and taking market share
- Core fixed line revenues declined by 2.3%, a clear improvement vs. previous quarters – and I’ll come to this in a second on a deep dive
- Our wholesale revenues grew by 2.4% year-on-year, though adjusted seasonality and a negative one-time effect in Q2 last year we saw an underlying small deterioration vs. the last quarter
- The adjusted EBITDA declined by 1% year-on-year and, though, resulting in the strong and year-on-year improved EBITDA margin of 41.3%

Adjusted OpEx

- The adjusted OpEx in Germany decreased by 3.4% year-on-year driven by lower revenue-related costs, like interconnection [ph] lower market invest (11:33), which was somewhat counterbalanced by costs related to our IP transformation and, also, our integrated network rollout

Fixed Line

- In German fixed, we saw a good quarter with some improving trends vs. the previous quarters
- I would like to highlight the following:
  - An almost 30% year-on-year reduction in line losses to 168,000, despite 14,000 DT LTE wireless broadband customers added in the quarter
  - This is the lowest quarterly level of line losses since 10 years
- A further accelerated growth of new fiber customers with 227,000 net new additions of which 119,000 came from our own retail business
  - In total, we have already almost 2mm fiber customers on our German network

BROADBAND NET ADDS

- Broadband net adds continued to improve, too, and were positive at 7,000 in the quarter
- We expect positive broadband net adds in H2 as well, but bear in mind the usual Q3 seasonal effect from the old [ph] MaxWave (12:42) will kick in
- On the TV side, our measures to increase the momentum in Entertain showed again results in Q2 with 63,000 new customers being added
Importantly, 53,000 of these new Entertain customers booked their Entertain package with a fiber access.

The overall fixed network revenues, so core fixed line and wholesale, in Q2 declined by 1.2% year-on-year, while the fixed revenues, fixed line, is per our backup definition, declining by 2.9% year-on-year.

Within these revenues we saw the following trends: a stable year-on-year trend in voice revenues, down 7.6%; a slight year-on-year improvement in our Connected Home revenues, which declined by 0.9%.

This is clearly yet not satisfying and not in line with our target we set of 2% of growth.

**CONNECTED HOME REVENUES**

- Within the Connected Home revenues, we saw continued decline of our broadband revenues, with minus 3.1% year-on-year, and an improving momentum of our TV revenues, with a growth of 8.4%.
- We will continue with our integrated network rollout and our upselling efforts in order to turn this number into positive territory again.
- In the other fixed network revenues, we saw the following major trends:
  - The decline of 10.6% year-on-year in our variable revenues was in line with the trends 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 increased by 5.1% year-on-year, showing a positive momentum due to a strong increase of almost 17% in TV-centric options due to the positive take rates for Sky and our Entertain to go product.
  - Our increase in other revenues fixed of plus 7.6% year-on-year is mainly driven by sale of terminal equipment.
  - In our wire line wholesale revenues we see a 2.4% reported growth in Q2, again driven by the continued positive take up of our contingent model.
    - However, adjusting for the negative ULL effect in Q2 last year of €47mm and seasonality, the underlying revenue declined by 3.1%, slight deterioration vs. Q1.

**German Mobile Market**

- Let's turn to mobile.
- The German mobile market service revenues decreased by 2.4% year-on-year in Q2, a deterioration vs. Q1.
- Despite outperforming the overall market and further taking market share, our service revenues deteriorated slightly to minus 0.3% year-on-year, an absolute decline of €5mm.
- Main driver here was a €13mm decline in the mobile wholesale revenues driven by a large service provider.
  - This means that our own branded service revenues were growing this quarter by €8mm.
- All other factors, including mobile data revenues, SMS revenues and voice revenues, showed trends in line with Q1.

**MOBILE CONTRACT NET ADDS**

- Operational – we continued our strong performance in the quarter.
- We had 275,000 mobile contract net adds of which 198,000 were own branded, a flat development quarter-on-quarter.
- The overall decline in the contract net adds is a result of the de-recognition of inactive wholesale customers by one of our wholesale partners leading to an overall 78,000 net add figures in wholesale this quarter vs. 347,000 in Q1.
As a result of this de-recognition of inactive wholesale customers, our reported contract churn rate increased slightly to 1.4%

The underlying own branded contract churn, however, remained at a very low level of 0.9%

SMARTPHONE PENETRATION

- The smartphone penetration our own branded retail customer base continued to grow to now 70%; although, the smartphone sales momentum slowed down to 881,000 in Q2
  - This is an 11% reduction year-on-year
- This is mainly driven by an increasing average contract duration
- Positively, the number of LTE customers on our network in Germany again grew strongly to almost 4.3mm at the end of Q2

Integrated Network Rollout

- Let me give you an update, also, on our progress in terms of strategy execution regarding our integrated network rollout and our IP transformation in Germany on the following slide 10
- By the end of Q2, we achieved a 39% fiber household and a 77% LTE POP coverage
- For the fiber coverage, we expect a significant acceleration from H2 onwards as much of the groundwork now has been done already
- So I think we will see something like 45% by the end of the year
- And we have already migrated 3.2mm retail customers to All IP in Germany, which translates into almost 26% of all our broadband and 15% of all our fixed lines being migrated to All IP, already
  - This is a clear acceleration vs. Q1 and in H2 – in H2 we will foresee another acceleration, also driven by our integrated network rollout

U.S. OPERATIONS

- Let me quickly summarize the highlights of the U.S. – of the quarter regarding T-Mobile US, as all relevant numbers were already reported and discussed by our TMUS colleagues last week
- In Q2, T-Mobile US showed another strong quarter with 1.5mm net new customers in total, very importantly, of which 908,000 were branded postpaid net adds, leading to another upward revision of the full year branded postpaid net adds targets of 3mm to 3.5mm
- At the same time, we retained our branded postpaid churn at a very low level of 1.5% and saw a continued improvement in our customer quality. 53% of our equipment installment plan receivables are regarded as prime, up one percentage point against year-on-year
- The mix of prime customers within the branded postpaid gross adds rose by nine percentage points year-on-year
- As anticipated, service revenue growth in the quarter accelerated to 15.3% under the IFRS accounting
  - And, also as anticipated and flagged, the EBITDA showed clear improvement vs Q1, growing by 22.1% under IFRS accounting year-on-year and resulting in an EBITDA margin of 25%

EUROPE

Revenues

- Let’s have a look at Europe, now
• Revenues in our European segment declined 7.9% year-on-year on a reported basis and 5.3% organically in the quarter
• The deterioration vs. Q1 run rate of €93mm was mainly driven by a higher negative mobile regulation impact of €20mm; a €55mm higher decline in traditional Telco revenues, mainly driven by voice revenues; and, €18mm lower growth in our defined growth areas vs. Q1
• On a country basis, we saw the biggest contribution of the revenue decline coming from Greece and Poland; whereas in Greece, we continued to take service revenue market share in an overall very competitive and declining market, in Poland, clearly, we are not satisfied with our overall operational performance
• On a reported basis, the adjusted EBITDA in the segment declined by 1.7%
• Organically, the adjusted EBITDA grew by 1.7%, resulting in a strongly year-on-year improved EBITDA margin of 34.7% for the second
• Main drivers were an almost tripled run rate of indirect cost savings to €92mm in the quarter
  o This is mainly driven by Greece and the Netherlands and Austria, and the lower market invest year-on-year, especially in the Netherlands and Austria

Net Growth

• We had a strong market push in Q2 last year
• We continued to show good momentum in some of our growth areas in Europe as well
• We showed satisfying growth in TV, 61,000 net adds; now reaching over 3.6mm TV customers
• Importantly, we also increased the number of our Triple Play customers in the region to 1.7mm, up from 1.5mm a year ago
• We delivered 54,000 broadband net adds in the quarter
• Mobile contract net adds improved quarter-on-quarter, but still were not satisfying at 38,000, mainly driven by 60,000 contract net losses in Poland
  o Mobile data organic revenue growth remained solid at 13%, thereby continuing to compensate the decline in SMS revenues

Technology and Cost Transformation

• Let me now give you a quick update on the progress being made on the revenue as well as on 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 3 percentage points year-on-year to 25%, though the quarter – the growth rate declined somewhat quarter-on-quarter
• The share of the fixed revenues from Connected Home grew by 2 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 3 percentage points to 19% and the share of B2B/ICT revenues as of total revenues increased by 0.6 percentage points to 3.8%

Cost and Efficiency

• Progress on the cost and efficiency side included the IP share of all six networks access lines grew by 11 percentage points to 32%, mainly driven by Croatia, Slovakia, Hungary and Romania
• LTE sites in service increased by over six times year-on-year to 10,000
• We have LTE networks now in commercial use in 11 out of our 12 countries, already
Homes connected with fiber to the home grew by 41% year-on-year to around 210,000 and households [ph past (24:05) FTTH and VDSL technology increased to approximately 6mm

T-SYSTEMS

- Turning to T-Systems systems solutions, Q2 clearly, again, was impacted by the restructuring at the market unit, but also by the impact of a milestone completion of an internal IT project delivered by Telekom-IT
- The reported revenue increase of 0.8% was driven by Telekom-IT where this internal IT project – by the way it’s One.ERP – milestone completion led to a 32% year-on-year revenue increase
- These revenues are, of course, not showing up in the group revenues due to the revenue reconsolidation
- The same holds true for the EBITDA effect
- The market unit reported a revenue decline of 6% year-on-year
- Adjusting for deconsolidation and forex effects, the organic revenue decline was 4.5%, in line with the trend in Q1 and clearly a result of the 2015+ restructuring plan
- This decline is in line with the projected revenue decline for the full year 2014 as a result of the restructuring and repositioning of T-Systems
  - T-Systems’ adjusted EBIT declined significantly in the quarter as a result of the revenue decline and the seasonal cost deviation, which is expected to reverse in H2

Q2 FINANCIALS

FCF

- Let’s now move to our group financial for the quarter, turning to FCF first
- Group FCF is down 5.4% in Q2 to €1.05B, slightly ahead of market expectations and on track for our full year guidance of around €4.2B
- Main drivers were the €167mm increase in cash generated from operations and a €129mm year-on-year higher cash CapEx, mainly driven by the German integrated network strategy; and, a €98mm higher other effects, mainly higher interest payments
- The group net debt increased, as anticipated, to over €41B at the end of Q2, with the biggest moving parts being the €1.3B cash dividend payment, the €1.7B spectrum cost for the A-Block in the U.S., and the €500mm payment for GTS and the €1B FCF, obviously
- The adjusted net income decreased by 21.5% year-on-year in the quarter, and that is driven by the increase in D&A in the U.S., and here predominantly due to the MetroPCS consolidation and the entrepreneurial decision to keep the investment level in the U.S. high, and an increase in [ph] P&R (27:00) taxes year-on-year as last year’s second quarter included a release of a tax provision
  - The group ROCI benefited, as in Q1, from the book gain on the sale of the Scout stake and stood at 7.4% at the end of Q2

Balance Sheet Ratios

- Turning to our balance sheet ratios, net debt to adjusted EBITDA increased to 2.4 times as a result of the sequential increase in net debt
- This clearly marks the net debt peak for this year and we expect the net debt to EBITDA ratio to be at a normal level of 2.2, 2.3 by the end of the year, again
- The equity ratio decreased slightly to 27.5% due to the slight higher asset base
• With regard to our Comfort zone ratios, we are green with regard to all the ratios and our rating remains stable at BBB+ level with the major agencies and stable outlooks
  o As a result, we continue to get excellent funding conditions in debt capital markets

QUESTION AND ANSWER SECTION

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

Thank you for taking my question. The first one on the E-Plus/O2 merger in the German mobile market, I mean, I hear your frustration with Vodafone’s recent price moves, but more broadly what’s your view on Telefónica’s remedy package? Do you think there is now scope for the overall market to return to growth or does the Drillisch deal take away all the upside? Or would you even consider Vodafone the biggest risk factor at this stage? And then secondly, on regulation and the new incoming Commission in Brussels, I suspect Jean-Claude Juncker’s appointment as President is good news for the sector in general, but maybe you can share your priority list in terms of further necessary regulatory reforms for any new Commissioner succeeding Neelie Kroes.

Timotheus Höttges
Chairman-Management Board & CEO, Deutsche Telekom AG

Thank you, Dominik, for your questions. I’d like to start with the German environment and what you have seen just at a glance. We have a revenue market – the revenues of minus 0.3%. We have seen even on the fixed line with minus 2.3% less negative development than in previous years, and overall, let’s say, our revenue – I would not say it’s stable already, but it’s coming closer to be stable with the line losses. The background for that one is definitely the infrastructure and the service on our infrastructure. We see that on the LTE side with 77% POP coverage already, 4.2mm customers with tariffs and LTE devices, and we see it even with VDSL. Thomas was very clear on that one by saying where we build VDSL we see a higher uptake of customers. And by the way, interesting wise, these customers are not buying only Internet access. They’re even buying more Entertain than we originally expected. So this is, I think, absolutely the support for our strategy for the huge investment which we’re doing in the infrastructure. I believe infrastructure competition at reasonable prices should be the way forward in Germany. And looking on the E-Plus and O2 merger, I think one of the intention is to really build a good LTE infrastructure in Germany, then they will compete in the same matter and logic as our business is doing today. I thought the same was true for Vodafone with their Spring program, but to be very honest on that one, I do not say that these guys are behaving that way, especially on the business customer side. They are reducing their prices and you see the impact on the revenue lines. We are trying to stabilize our revenue, even increases in the respective areas. Now going to the deal, I think overall we supported the deal on E-Plus and Telefónica here in Germany. There are two things I’m concerned about. The first one is the allocation of spectrum. This is something which is going on. There is a renewal of the 1800 MHz spectrum coming soon, so it should not be disproportionate among the players. That is, I think, decision the regulators is considering and he behaved quite reasonable in this regard over the last years. And the second topic is this so-called MVNO deal enabling Drillisch for access. Here my concern is that LTE is coming at the same price as all mobile services. And I would say LTE is coming with huge investments and, therefore, it should be able even to price on LTE. This is something. I do not know the exact details of this MVNO structure, but what I heard so far from other service providers in Germany is that their conditions which they currently have are absolutely competitive and, therefore, they are not seeing any kind of another competitive round which is taking place by the enforced MVNO. But I do not know the exact details of that, so therefore please ask E-Plus/O2 on this regard. With regard to regulations in Brussels, I think in July Jean-Claude Juncker has been confirmed as the future President of the EU Commission. Currently, the member states are nominating the candidates for Juncker’s college, whereas the new President still has to assign the
portfolios. I think it’s not clear which politician will become the next commissioner being in charge of the Telco sector and replace Neelie Kroes. First remarks and press reports by Juncker indicate that the new Commissioner President could engage in a policy shift for the ICT sector with positive effects for the digital economy. He announced that the digital economy will become his first priority. I think, by the way, this is absolutely right. You know I’m always talking about Europe is falling behind in this regard, so therefore we highly support this agenda here. And the concrete steps and implications of these messages remain to be seen, but clearly I think the entire industry inequities speak even for other big CEOs. Here in Europe we expect a quick decision on the single market package from the EU, which is needed to really, let’s say, create growth in this industry after years of decline.

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

Thank you. That’s very clear. Maybe I can sneak in just one other question on the fixed line side and the new vectoring offer, just to clarify if the wholesale price point for that product is the same as 50-megabit standard video sale, or is there a premium within the contingent model?

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

Yeah. This is Thomas. Thanks, Dominik, for the question. I think you all got the message it is important for us that we – with that new infrastructure, that we grow our retail as well as our wholesale revenues. That’s our perspective, so we are taking care of both. Price differential here is – on retail it’s a €5 surcharge the customer has to pay from 50 megabit to 100 megabit. On wholesale, on a per-line basis it’s €4.20, and if you look at the contingent model it’s a €3 surcharge. So clearly a premium on the way from 50 megabit to 100 megabit.

Simon H. Weeden
Analyst, Citigroup Global Markets Ltd.

Yes, I’ve got a couple of questions, if I may. One is just thinking about the situation in the U.S., and you know where I’m going with it, but I did wonder if you felt it was the partial offer nature of the offer that we know has been put down from one player that makes this particularly unacceptable, or if it’s the price point or if it’s a combination of the two? And then, the second question was regarding the German market and following on from the previous line of questions on MVNOs and possible capacity MVNOs and so on, do you think that third-party distribution of mobile in Germany could take a hit as we’ve seen in France if there’s a sharp increase in the aggressiveness of the pricing of online offers? Might that change the cost economics for distribution on the retail side for third parties and for your own retail shop? And how do you think about how far Germany has moved down the line of online distribution vs. where it could get to if somebody deploys a model like we’ve seen in France there? Thanks.

Timotheus Höttges
Chairman-Management Board & CEO, Deutsche Telekom AG

Hey, Simon, I think the first question with regard to the U.S. is, I think, a question a lot of guests in our call today are questioning. And, therefore, let me make that very clear. I cannot and I will not refer to any kind of specific rumors, nor any kind of opportunities or transactional moves which are happening in that market. To be clear on that one, at this point in time we are not aware of any actionable proposal that offers a superior value to our standalone option. This business is on a good track moving forward. Our service revenue is just in the quarter increased by 15%. We have increased our expectation to our branded postpaid and we have even delivered in a margin which has been decreased by 23% to 22% points. So I think what we clearly see, and that was a big question mark on investors in the past, after five consecutive quarters of more than 1mm new customers we even see now that the revenue is coming. With the revenue the FCF is coming, and with the FCF we’re even able to
finance the investments which are needed, let’s say, for our build out strategy. So therefore, we stick to our strategy, de-risking, self-funding and kingmaker asset, and whatever we do in the U.S., on the market side or on the consolidation side, there is no answer without T-Mobile.

**Thomas Dannenfeldt**
*Chief Financial Officer, Deutsche Telekom AG*

And, Simon, I take the question around Germany. I think first of all we need to recognize that aggressive online offers are in place since several quarters. If you look – always taking that examples to current price level – entry price level on an E-Plus network in Germany for data flat, single data flat, is €6, €6 to €7. The current price level for all net flat, so data flat, SMS flat, text flat and voice flat, is €15 in the marketplace, and that’s all driven by that aggressively priced online offers. So I think that’s what happened already and what’s kind of normal situation in the marketplace since several quarters already. And third-party distribution in terms of, let’s say, shop-based distribution, yes, they have – they had their hit already some quarters ago; so, to be honest, from my point of view nothing new in the first instance. How far are we progressed in terms of online distribution? I think what was did is several years ago, remember, we set up our second brand, called congstar. That was purely online distribution. Congstar is now heading towards the 3mm customer base, and we have also several partners, and also our – with the first brand online offer. So we’re making sure that we’re getting the fair share out of that one; obviously, not playing the price aggressive game, but we quality game. But we need to have the fair share here as well, so that’s how we set up ourselves. And I think we are doing well here.

**Peter-Kurt Nielsen**
*Analyst, Kepler Capital Markets SA (UK)*

Two questions, please; one on Germany, one on the U.S. Thomas, you talk about the Connected Home revenues, which are disappointing and weaker than expected again this quarter. Why is that? Is it the price points which are lower or is it simply the net adds on the broadband side? I mean, the overall KPIs are quite positive, so why is that and what can you do to improve that momentum going forward? And secondly, for Tim, please. Tim, you talked about the strong performance in the U.S. and being under no pressure to enter into M&A. You also mentioned the upcoming auctions, and I guess there will be some rollout post auctions and significant CapEx spend here. What are your thoughts on the funding of these investments? Thank you.

Thomas Dannenfeldt*
*Chief Financial Officer, Deutsche Telekom AG*

I’ll take the first question, again, on Germany Connected Home revenues. You know, the disappointing element is very easy. We clearly said end of 2012 we want to see a 2% revenue growth in Connected Home revenues. And the first element being a big player is make sure that you have within your base good price stability, and then get your fair share out of the growth there. So that’s the name of the game. I think basically the best way to describe it is we’re moving, now, forward and progressing in terms of Triple Play revenues. You’ve seen there is a 8.5%, 8.4% growth on the TV revenues, but still we have a decline by roughly 3% on the Double Play revenues; and that’s something we need to change. With the rollout of the networks, we’re not only getting the customers on television, obviously, but also upgrading them on Double Play. So a customer using 16 megabits a day now, in the future using 50 megabit. So upsell them. And that’s the way how we want to improve that revenue development. Net adds is one element of the game, but price discipline is the most relevant element in there if you’re the biggest player. So it’s not just go for net adds with aggressive pricing, but make sure that television upselling works, Double Play upselling works, and that we get a better share out of our [ph] growth assets and things (42:23) that working well right now with the rollout. So we should improve in the future again – in the next quarters again.
Okay. Let me answer your questions with regard to the fundings of potential network rollout and spectrum. First thing, maybe to make that clear, we anticipated the auctions and that was one of the reasons that we acquired the A-Block from Verizon. Now, we have even clearly stated that we want to participate in the AWS band auction and in the 600 MHz auction which is taking place by the end of next year. So therefore, spectrum is a prerequisite for mobile operators and we have to be competitive in this regard. Now, do we know what kind of spectrum we get? Do we know at what price point we get it at that point in time? No. But be aware, in our organic plan we have made our assumptions and there are two components which are allowing us financing. The first one is we expect an increase on our FCF and EBITDA by next year, and that was laid out in the capital market story; so, partially financed, therefore. And the second one is what Braxton even stated in his call; it is based on debt on the U.S. front, which is then doing the refinancing on that one. Maybe a last statement with regard to FCC and the regulation here, honestly, I hear that the FCC always states that they have to support that a competitive situation should be existing in the U.S. with four players. Now, the action from yesterday shows me as well that what is happening at that point in time, only supporting AT&T and Verizon at that point in time. And trying to keep four players in the market had a negative impact on the share price of T-Mobile US, minus 7%, and even on Sprint, minus 18%. So honestly, I haven’t got clear signals from the FCC how they are supporting the smaller carriers to play their role in a very competitive environment in the auction process in the U.S.

Ulrich W. Rathe
Analyst, Jefferies International Ltd.

Thank you very much. I have two questions; one is in Europe. The top line trends seem to be stuck at weakish levels. Are there any efforts in that part of the portfolio that require strategic solutions? That’s my question. And also, maybe, would DT be willing to commit incremental capital to Europe for such strategic solutions? My second question is on Germany. Obviously, the VDSL intake is rather encouraging. I was wondering how much of that is from the current footprint expansion? How much is really from ramping up penetration in existing areas? Is there really a case where the existing geographies have a continuous VDSL intake or are we simply seeing the boost from expanding the coverage and sweeping up the pent-up demand in those areas that didn’t have access to this sort of product before? Thank you.

Timotheus Höttges
Chairman-Management Board & CEO, Deutsche Telekom AG

First question with regards to Europe and the efforts needing strategic solutions, honestly, we need strategic solutions for every single of our businesses and we always have to adapt our strategic environment to, let’s say, the needs of the customers. And you see this tendency toward fixed-mobile convergence in the market here in Europe. You see the tendency towards superior broadband coverage in the countries. So therefore, we have to question that on every single day what are the strategic answers, and they might change over time. If you ask whether we are in the selling mode on assets, no, we are not. But if you look to the different business I would even say, yes, there is still a deterioration of revenues in our markets, but, by the way, if you look deeper into that one you will find different answers to the respective countries. Starting with the bad one, I’m not happy with Poland. Honestly, I think we have to do some homework here. This is simple manageable issues of Deutsche Telekom and of our team. We saw five consecutive quarters losing on a net add basis against Orange here and, therefore, I think we have to do something about it. On top of that, we look into the GTS integration here and how we could improve our positioning on fixed-mobile convergence services, especially for the B2B side. Second is for me Greece. In Greece, yes, we saw deterioration of revenue and in a macroeconomic environment which is still difficult, but what we even see here is that we are gaining market share in this environment. And I think this is something where we are not blaming ourselves, we are trying to do the best even to differentiate here from a network quality. We are trying to be quite disciplined in the way how we do the pricing. And what we’re consequently doing, and that was
the uptick of 4.7% on EBITDA, is that we are cutting out our costs. So, therefore, I think these are the two biggest markets in Europe where we are working on. We do that case by case. We still have an impact from the regulation side here as well, so this is a difficult year for us in 2014. And I think that even here, the regulators are understanding that more relaxation has to take place over the upcoming future to keep the capability for investments.

**Thomas Dannenfeldt**
Chief Financial Officer, Deutsche Telekom AG

And on Germany and the VDSL intake, first of all I have to say that we are very pleased with the acceptance rate and the uptake of customers choosing the products whenever we have rolled it out. There is a very good rate of utilization in a very early phase of the network and that’s very positive for the expanded coverage. It is not as easy to say and to split up the expanded coverage vs. the, so-to-say, old one, and I’ll give you an example just to make you understand what happens there. Give an example with the City of Hamburg; huge city and it is partly built out with old VDSL, so to say. And now what we’re doing is, for instance, we’re completing, more or less, the VDSL coverage there. So part of the city is old, part of the city is new, but the advertising campaigns, the marketing, all that kind of stuff, obviously, takes place along the old and the new footprint. And so, I would say there is some good synergies between that one. So it’s very different to distinguish that one. Just to give you, again, an idea about what does it mean in terms of base customers and new customers, roughly, with the example of Hamburg for instance, 50% in that case was customers already in the base using VDSL upgrading with IP migration in there and 50% of new customers are customers coming from voice single play. So roughly 50% new and upgraded customers and 50% migrated ones. I think that is the picture we can give you.

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

One more point to Thomas’ statement, maybe more in general. We as a team, we are committed network investors and you see that. In Q2, we saw an uptick in Germany by 58%; in the half year of 39%. In 3G, we have high coverage of more than 90% with 90,000 sites. In 4G, we have improved our coverage by another 5,000 sites, now 77% POP coverage indoor. In VDSL, we have now 39% coverage which is high bandwidth, and now vectoring is coming in H2. Hybrid routing is coming in H2; and only to give you in two years 50,000 construction areas here in Germany. By the end we will have 45% of all customers being on this high bandwidth here in Germany. We have IPTV for 65mn homes passed already, more than 90% with our Sat offering; so, full coverage here. And on the IP migration, which will enable all these modern services, we are migrating more than 50,000 households a week. A week. And therefore, please, always bring this huge transformation and huge CapEx into our balance with the FCF – the good FCF result and even the good margins which we are delivering at the same time.

**Paul A. Marsch**
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

I have two questions, actually. Firstly, on the U.S. situation with Sprint, I just wondered if you’re able to elaborate on the reasons why it’s not possible to proceed with the deal with Sprint. What were the main regulatory objections? Was it simply about four to three? Was there any movement at all from the regulatory side and was there any reception for the argument of a super maverick being created here? And, specifically, as well, was there any difference between the views of the DOJ and the FCC? And then, my second question is really about the reseller migration which – not just your sales. I think Vodafone has mentioned this in previous quarters as well. I’m just wondering what the story is behind resellers and MVNOs in a particular quarter deciding that they’re going to move business to another network operator. Is that when contracts come up for renegotiation? Are they doing it in the middle of an agreed contract? Is it about price? Is it about the discussion about the pathway to 4G for MVNOs? Maybe just some additional detail would help us to understand what’s going on there. Thanks.
Timotheus Höttges  
Chairman-Management Board & CEO, Deutsche Telekom AG  

Look. The first thing, I’m not commenting on any specifics on talks or potential talks or whatsoever on Sprint and T-Mobile. But I’d like to comment a little bit on the statements which were given by the U.S. politics and by the FCC, in specific. And it was clear that they were stating that they want to have a four-player market in the U.S. full stop. It was even clear that they said a BidCo is nothing in the interest for the low band spectrum auction, which was even stated very clearly. So therefore, I think there is a lot of, let’s say, messages coming from that angle. I – honestly, I question that, because this market in the U.S. is changing rapidly and you have seen the movement on the cable side. You have even seen the merger activities on the content side. So therefore, there is a lot of, let’s say, integration going on in the space of fixed line and mobile. This market is changing and just to look only on the mobile – the four mobile players, I think this is very shortsighted. And secondly, maybe to reiterate what I said earlier, the reaction of the marketplace on – that the super maverick might not taking place in the upcoming future, this reaction was very negative from a capital market perspective for the single operators because we have a bifurcated market where AT&T and Verizon having a privilege in the market. And if you want to compete from a return on capital employed, even from an investment perspective, it would have made and it makes a lot of sense. It makes a lot of sense to have a consolidation in this market in the upcoming future.

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

Thanks.

Thomas Dannenfeldt  
Chief Financial Officer, Deutsche Telekom AG  

And Paul, on the reseller migration, try to answer your question. First of all, I think we need to understand that there is a difference in terms of the model behind resellers and MVNOs in the marketplace. Resellers are service providers from starting in the 1990s. They very often – they all have contracts with every network operator, having customer base with every network operator, whereas MVNOs very often – not always, but very often have more exclusive type of contracts and are being used to address certain specific segments. So give you an example, one of our MVNOs for instance, Lebara, we’re addressing a specific ethnic group segment there we can’t address with our own brand. So that’s the logic, more or less, on MVNOs. So on MVNOs, it’s not so much moving from quarter-to-quarter revenues or volumes. That’s normally not the case. On the service providers and resellers there is obviously the opportunity, as they have contracts with each and every one, to move from one to the other operator; not at a dramatic, but at a certain level they can do it. And it’s either a matter of whether you have, for instance, competitive advantage by network, et cetera, or simply, also, how you incentivize them. If you bring enough money you can buy certain extent of market share as well.

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

And can I maybe just ask a follow-up? Do any of your MVNOs actually currently have in their agreements a pathway to 4G?

Thomas Dannenfeldt  
Chief Financial Officer, Deutsche Telekom AG  

No. You know, what we want to make sure is, as Tim said and I would like to reiterate, we are network investors. That doesn’t mean we are convinced that by different shading of network quality and different shading by quality over all, also service quality, we can get more money out of it. To giving it away for free, just investing into that 4G network and then giving it for free, is not the right way. The way to make sure that the premium is still existing,
that we still be able to get the money back and have the proper return is important. So it’s nothing we have in our MVNO contracts.

Ottavio D. Adorisio
Analyst, Société Générale SA (Broker)

Just to allow other people to ask question I can just one question, and this one is on the wholesale segment. I’ve seen that there have been significant improvements in access revenues from two, where revenues leaped from €273mm to €312mm. That was a 14.3% increase vs. decline reported in previous quarters. And it’s also relevant because contributed to almost 100BPS of growth in the fixed overall. Now, it looks like the increase was not due to volumes, because the rate of decrease in [indiscernible] (58:28) actually increased to 250,000, so my question is relatively simple. Have you been recording some one-off in wholesale revenues or was pricing the main driver with wholesale customers moving to fiber? And if this was the case, we should expect similar trends in the future. Thanks.

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

So basically the reason for that – for that numbers and development is that in the last year we had a special impact in our [indiscernible] (59:01) revenues driven by, I think, a legal case from 20 – I don’t know, 2003, 2004, 1990-something, early start of that decade or the last decade. Basically, I think it was [indiscernible] (59:15) 1999 to 2005, and there was one special effect which has taken place last year reducing that revenue line last year by €47mm, I think; yeah, €47mm is right. So that is where the effect is coming from, not an operational reason.

Steve P. Malcolm
Analyst, Arete Research Services LLP

I’ll go for two, if that’s okay. I just boringly want to come back to the U.S. and your comments on sort of FCC’s position, and then your position going forward. I guess one of the problems that – and I sympathize with your view that AT&T and Verizon have a huge scale advantage, but surely one of the big disadvantages you have is your balance sheet in the U.S.; and so does Sprint. So as you look at spectrum, does it not make more sense to put more equity in to take advantage of the momentum that T-Mobile has, which clearly is very strong at the moment, rather than load it up with more debt, which just sort of propones the disadvantage that it has against better capitalized bigger competitors? So that’s the first question. And then secondly, on Germany, when you look at the fixed line business it seems like the cable guys have a sort of big advantage at the low end of their product bases in the sort of 50 meg products, but that disadvantage disappears higher up. How do you close that gap at the low end? How do you make your 16 meg products more competitive with their 50 meg products, because it seems like you’re already there at the high end, but the low end is more of a problem? Thank you.

Timotheus Höttges
Chairman-Management Board & CEO, Deutsche Telekom AG

Hey, Steven, thank you for the question. I think what you have seen us over the last quarters, being quite consequent in identifying and using the opportunities of the growth in the U.S. So we have invested up front into the infrastructure, and now we are utilizing our infrastructure with the prepaid MetroPCS; but especially with our intense goals on the U.S. Un-carrier proposition, and this is something where we’re trying to take every opportunity which makes commercially sense. And that it should be even, let’s say, the path going forward, there’s nothing now [indiscernible] (1:01:33) to discuss that we are slowing down. This market stays intense. We remain elevated and we are committed even to grow beyond what we have said. The new targets were laid out by John and his team last week, just to take the new promotion for $100 for four lines, as one example, and even, let’s say, new Un-carrier propositions to come. Now, the question is now how to finance that growth. And for Deutsche
Telekom, as it’s been shared that we said a kingmaker assets, self-funding and de-risking. And this is, this was, and this is going to be the strategy going forward. Now, the self-funding opportunities now for this growth, they could come from both angles: from debt and from equity. So this is something John and Braxton and the team has to decide according to, let’s say, the market and the capability, what to digest and the access to the debt markets. But so far I think you see how they handled it, and they did that pretty well; and that is, let’s say, even the way going forward.

Steve P. Malcolm  
*Analyst, Arete Research Services LLP*

*Q*

Is it the sort of FCC’s position that makes you more reluctant to – I know you don’t want to commit to this, but to put equity in it? If there was a clearer position with spectrum and everything else, would you be more comfortable putting equity in it or is it just that lack of clarity from a regulatory perspective?

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

*A*

Look, I will not speculate on that one. There is nothing at that point to decide on, and that even depends on what are we talking about. So I cannot answer that question now here in a very specific, precise manner.

Steve P. Malcolm  
*Analyst, Arete Research Services LLP*

*Q*

Okay.

Thomas Dannenfeldt  
*Chief Financial Officer, Deutsche Telekom AG*

*A*

And I think on Germany – as always, I take the German question here. The answer – the simple answer is our integrated network strategy. We said we’d double the footprint in FTTC from 12mm to 24mm households. We double the speed in there from 50mm to 100mm. We go with IT as fast as we can and with the hybrid router deliver it by the end of this year in mass market bases. We will add up the speed in fixed line and mobile and make it useable for the customer at home. So basically, I think that’s the answer, still the same and I think we’re on a good path to execute on them all.

Steve P. Malcolm  
*Analyst, Arete Research Services LLP*

*Q*

Okay.

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

*A*

And even I’d like to invite all of you at least to have a look into our presentations at EFA. This is a very important fair here in Germany taking place and we will show something new around the new propositions coming in the mobile and the fixed line space very soon. So that is going to be even something where we’re trying to differentiate as the leader here in the German environment.

Stephan Eger  
*Senior Vice President & Head-Investor Relations, Deutsche Telekom AG*

*A*

Well, thank you, Tim and Thomas. And now let’s go to the last question of the day, which comes from Guy Peddy from Macquarie. Guy, please?
Guy R. Peddy  
Analyst, Macquarie Capital (Europe) Ltd.

Yeah. Good morning – well, good afternoon, Tim. Just a real question, Tim, just wanted to understand your strategy in the U.S. I’m trying to understand, the bifurcation of the market in the U.S. has probably been to your advantage in the last two years, given your operating performance and improved operating trend in T-Mobile U.S.A. So why is there this constant talk of consolidation, because surely the status quo is a very good environment for you? And I’m trying to understand, what is the headwind going forward that puts restrictions on your business development given the current market structure? Thank you.

Timotheus Höttges  
Chairman-Management Board & CEO, Deutsche Telekom AG

Look, I think – thank you for cleaning that uncertainty. The first thing is, yes, you’re absolutely right. The Un-carrier is the challenger for the establishment. The Un-carrier is growing and utilizing its infrastructure much better than it did in the past. Yes, we are growing and even we are creating a lot of value by the revenue and the performance the U.S. business is showing at that point in time. But what we always have said is for a business with 12% to 14% market share to earn a superior or an adequate return on capital employed of this infrastructure, for a small carrier to operate in a very competitive auction against, let’s say, AT&T and Verizon with its deep pockets, for a small player to utilize a country-wide infrastructure, this is much more difficult than for the big players. Therefore, we have said, look, if there would be a possibility to create super maverick in the U.S. market, this would definitely, let’s say, improve the economics and that would even give the opportunity to earn superior value for our shareholders in this environment. So I think this is, let’s say, what we are talking about. Short term, I think, we are a winner of the situation, but mid- to long-term we have to be very modest and always to face the reality of huge network investments and even spectrum acquisitions.