

## Deutsche Telekom. Combined management report of the Deutsche Telekom Group and Deutsche Telekom AG for the 2004 financial year.

- Net revenue increased by 3.7 percent to EUR 57.9 billion; adjusted to exclude exchange rate effects and changes in the composition of the Group, the increase was 5.8 percent
- Operating results increased by over 80 percent to EUR 9.9 billion
- Net income increased to EUR 4.6 billion
- Further sharp rise in net cash provided by operating activities to EUR 16.3 billion, free cash flow increased to EUR 10.2 billion
- Net debt reduced by EUR 11.4 billion to EUR 35.2 billion
- Broadband initiative leading to strong new customer growth at T-Com and T-Online
- Number of mobile communications customers served by the Group increased to 77.4 million
- T-Systems increased order book by 6.3 percent to EUR 13.4 billion
- Strategic realignment of the Group on three key growth sectors as of 2005
- Dividend of EUR 0.62 proposed for 2004

**Growth path continues in 2004; profitability up significantly.** The 2004 financial year was extremely successful for Deutsche Telekom. The Group achieved its goal of continuing profitable growth. In addition to the divisions' positive development, the successful implementation of the centrally managed, cross-divisional "Agenda 2004" program played a key role in this. The focus was on intensified cooperation between the T-Com and T-Online divisions on the Group's broadband initiative, and between T-Systems and T-Com on the business customer initiative. The divisions and the Group's headquarters also cooperated closely to implement the goals of Deutsche Telekom's efficiency, innovation, human resources, and quality initiatives.

The Group's continued growth path is reflected in the 3.7 percent increase in net revenue to EUR 57.9 billion. Revenue was negatively impacted in the year under review by exchange rate effects amounting to EUR 0.8 billion, in particular relating to the translation of U.S. dollars, and by changes in the composition of the Group amounting to EUR 0.3 billion. Adjusted for these effects, revenue growth amounted to 5.8 percent. The main contribution to this increase was made by its mobile communications and broadband business.

Operating results rose by more than 80 percent year-on-year to EUR 9.9 billion. This was mainly due to revenue growth and efficiency improvements as well as a write-up of U.S. mobile communications licenses.

The Group clearly achieved its goal of increasing net income in 2004, generating EUR 4.6 billion compared with EUR 1.3 billion in 2003. Besides the particularly positive development of the operating results, this was also driven by a EUR 0.7 billion improvement in net financial expense, mainly as a result of the continued debt reduction and the corresponding improvement in net interest expense. This was offset by an increase of EUR 1.8 billion in income taxes, particularly as a result of the high level of income before taxes and the restriction on the use of loss carry-forwards introduced in 2004.

As a result of this encouraging performance in the 2004 financial year, the Board of Management and the Supervisory Board of Deutsche Telekom will propose to the shareholders' meeting to pay a dividend of EUR 0.62 per share carrying dividend rights, which brings the dividend back to the level of 1997 to 2000.

Net cash provided by operating activities increased by EUR 2.0 billion year-on-year to EUR 16.3 billion. This sharp rise relates mainly to the substantial improvement in operational business and working capital. After deduction of cash outflows for investments in intangible assets (excluding goodwill), and property, plant, and equipment, free cash flow amounted to EUR 10.2 billion.

Net debt was again reduced significantly by EUR 11.4 billion year-on-year to EUR 35.2 billion, primarily using free cash flow.

**T-Com develops key growth potential with T-DSL.** In 2004, the T-Com division provided major impetus for increased use of high-speed Internet communication via T-DSL by continuing to differentiate its range of mass market broadband services and through concerted market development, in particular with T-Online as part of its broadband initiative. In Germany alone, the number of DSL lines used by T-Com customers for high-speed Internet communication rose from around 4 million to 5.8 million during the 2004 financial year. This also includes 246,000 DSL lines that T-Com sold to competitors under resale agreements. Deutsche Telekom's subsidiaries in Hungary, Croatia, and Slovakia that are managed by T-Com also increased their number of DSL lines by 140 percent year-on-year to 265,000. In total, T-Com increased the number of DSL subscribers it serves with broadband lines in Germany and abroad by 2.0 million to 6.1 million. Another key element of T-Com's broadband strategy is Wireless Local Area Network (WLAN) – the most important wireless technology for broadband Internet access via T-DSL. This provides customers with wireless online access using WLANs both from home and via public WLANs (HotSpots). T-Com sold 658,000 WLAN terminal devices in 2004 and concluded over 4,000 agreements to establish its own HotSpots in Germany.

The number of narrowband lines (including ISDN channels and lines for internal use) in Germany and abroad fell by 1.4 percent to 54.7 million channels. The number of ISDN channels increased by 0.8 percent over the course of the year to 21.7 million. In Germany, substitution effects by mobile communications and customer churn led to a drop in the number of narrowband lines by 1.6 percent compared with the prior year.

Key financial figures for the Deutsche Telekom Group

(billions of €)	2004	2003	2002	2001	2000
Net revenue	57.9	55.8	53.7	48.3	40.9
of which: international revenue	22.7	21.1	18.4	13.2	7.8
Operating results	9.9	5.4	(21.1)	2.8	7.6
Net income (loss)	4.6	1.3	(24.6)	(3.5)	5.9
Net cash provided by operating activities	16.3	14.3	12.5	11.9	10.0
Cash outflows for investments in intangible assets (excluding goodwill) and property, plant, and equipment	(6.1)	(6.0)	(7.6)	(10.9)	(23.5)
Free cash flow (before dividend payments)	10.2	8.3	4.8	1.1	(13.5)
Number of employees at year-end	244,645	248,519	255,969	257,058	227,015

#### Continued high growth in mobile communications.

T-Mobile substantially increased revenue and its subscriber base. T-Mobile USA was again the most successful T-Mobile company with almost 4.2 million new customers, 3.6 million of whom are fixed-term contract subscribers. The U.S. subsidiary had a total of 17.3 million customers at the end of 2004. T-Mobile Deutschland acquired 1.1 million new customers in the 2004 financial year, bringing the total number of customers to 27.5 million. The main growth here was in terms of quality, with over 80 percent of new customers being fixed-term contract subscribers. The company's focused subscriber acquisition strategy – for example the marketing of calling plans with packages of inclusive minutes and no monthly charge (Relax rates) – played a key role in this success. In Great Britain, T-Mobile UK (including Virgin Mobile) recorded around 2.1 million new customers, up 75 percent year-on-year. Subscriber numbers at T-Mobile Czech Republic and T-Mobile Netherlands developed particularly encouragingly in 2004, while in Austria they remained stable despite intense competition. Together with the Eastern European mobile communications companies that were still assigned to T-Com in 2004, the total number of mobile communications customers served by the Group amounted to 77.4 million.

An important milestone in 2004 was the conclusion of the agreement for T-Mobile USA to acquire the GSM mobile communications network from Cingular Wireless in California/Nevada. Previously, this network had been managed together with Cingular as a joint venture. Another significant event in 2004 was the launch of the UMTS mobile communications networks in Germany and the United Kingdom.

**Industry-specific marketing helps T-Systems make its mark in competition.** The systematic implementation of the Focus & Execution strategy helped T-Systems to increase new orders in 2004 by a total of 6.7 percent year-on-year. At the end of 2004, order levels, having increased by 6.3 percent, amounted to EUR 13.4 billion. T-Systems improved its performance once again despite the continued pressure on margins and the dynamic structural changes in its market environment. It achieved this primarily through continued improvements in efficiency and active cost management. The division increased its revenue from external customers as a result of industry-specific marketing. Overall, the positive development of T-Systems' revenue was driven by significant growth in revenue from the Information Technology unit. Business from telecommunications services continued to fall due to the strong price and competitive pressure in many areas of the market – especially in international carrier services.

**T-Online again increases subscriber numbers.** T-Online successfully maintained its healthy market position primarily thanks to the broadband initiative implemented together with T-Com. Subscriber growth was also driven by a new, attractive rate system and the expansion of the division's range of online content. T-Online recorded around 1.2 million new DSL subscribers in 2004, i.e., around 0.6 million more new additions than in the previous year.

**The strategic realignment allows us to continue tackling the challenges of a new era in 2005.** In 2005, we want to continue to build on the Group's successes in the 2004 financial year with a clear focus on sustained profitable growth. For this reason, the Group will concentrate on its three key growth markets: broadband/fixed network, mobile communications, and business customers, and will focus squarely on customer needs. The Group is therefore replacing its existing four-pillar structure with three strategic business areas: Broadband/Fixed Network covered by the T-Com and T-Online business units; Mobile Communications by T-Mobile; and Business Customers by T-Systems Enterprise Services for multinational business customers and T-Systems Business Services for medium-sized and large business customers. Walter Raizner, who was appointed to the Group Board of Management as of November 1, 2004, is responsible for the newly created board of management department Broadband/Fixed Network.

A core element of our strategic realignment is the process launched in 2004 of merging T-Online International AG ("T-Online") into Deutsche Telekom AG ("Deutsche Telekom"). When the merger takes effect, the (outstanding) shareholders of T-Online will become Deutsche Telekom shareholders. In view of the fact that some T-Online shareholders may prefer to sell their shares for a known cash purchase price well before the merger becomes effective, Deutsche Telekom announced on October 9, 2004 its decision to make a voluntary tender offer to purchase all shares in T-Online. The purchase price offered corresponded to the closing price of the T-Online share in Xetra trading on October 8, 2004 (EUR 8.99), the last day before publication of the decision to make the offer. T-Online shareholders had the opportunity to accept this offer from publication of the offer documentation on November 26, 2004 until midnight on February 4, 2005. As a result of this offer, Deutsche Telekom acquired a further 172,440,023 shares in T-Online, thus increasing its total shareholding to 88.02 percent of the capital stock and voting rights.

To successfully transform the Group's structures so that they are integrated in the eyes of our customers, and to secure sustained profitable growth, we have launched a so-called Excellence Program that will run for three years. This program covers three business area-specific growth programs actively supported by centrally managed, Group-wide projects.