30-Apr-2018

Deutsche Telekom AG (DTE.DE)

T-Mobile US Inc and Sprint Corp Merger Call

CORPORATE PARTICIPANTS

Hannes C. Wittig
Head-Investor Relations, Deutsche Telekom AG

Timotheus Höttges
Chief Executive Officer, Deutsche Telekom AG

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

OTHER PARTICIPANTS

Andrew Lee
Analyst, Goldman Sachs International

Akhil Dattani
Analyst, JPMorgan Securities Plc

Polo Tang
Analyst, UBS Ltd.

Dhananjay Mirchandani
Analyst, Sanford C. Bernstein Ltd.

Mathieu Robilliard
Analyst, Barclays Capital Securities Ltd.

Jonathan Dann
Analyst, RBC Europe Ltd.

Ottavio Adorisio
Analyst, Société Générale SA (UK)

Robert Grindle
Analyst, Deutsche Bank AG

Sam McHugh
Analyst, Exane BNP Paribas

Frederic Boulan
Analyst, Bank of America Merrill Lynch

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

Ulrich Rathe
Analyst, Jefferies International Ltd.

Mandeep Singh
Partner, Redburn (Europe) Ltd.

MANAGEMENT DISCUSSION SECTION

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

Good morning, everyone, and welcome to our Conference Call Regarding the Combination of T-Mobile with Sprint. With me are our CEO, Tim Höttges; and our CFO, Thomas Dannenfeldt, who will provide a detailed perspective on this transaction. Before I hand over to Tim, please pay attention to our usual disclaimer which you will find in the presentation.

And now, it's my pleasure to hand over to Tim.

Timotheus Höttges

Chief Executive Officer, Deutsche Telekom AG

Yeah. Thank you, Hannes. Good morning, everybody. Thank you for dialing on this short notice and this is really a special day for Deutsche Telekom, and even special for Thomas and myself having worked on this transaction for almost seven years now. This is even emotional, a very important moment in life.

So, we have decided yesterday and our supervisory board, and before that, in all the other boards, together with SoftBank, to combine our U.S. operations, mobile operations, T-Mobile US and Sprint, to create an even more powerful competitor in the most attractive wireless market in the world. We have created a lot of value in the U.S. in recent years, and now, we have a chance to supercharge this setup. We believe this is a huge value creation opportunity for the two companies' shareholders as T-Mobile takes over Sprint, and so, it is for Deutsche Telekom shareholders as well.

Some of you will have participated in yesterday's conference call hosted by John Legere and Marcelo Claure when they explained the transaction terms and the main financial implications. But this morning, I wanted to share the DT perspective and be available for your questions.

If you look into the slides, on page 3, you can see the highlights of this transaction. Through this transaction, we can create synergies with a net present value of $43 billion. This is after $15 billion integration costs. Because of these synergies, SoftBank and Deutsche Telekom decided to resume talks, and you can see what we have agreed. In some, we believe this is a very attractive transaction for Deutsche Telekom shareholders. And what is structured as a stock-for-stock merger, each Sprint shareholder will receive 0.10256 TMUS shares corresponding to a 9.75 exchange ratio.

Deutsche Telekom shareholders will participate in the U.S. synergies through their 42% stake in the new entity. So if you do the math, a fair share of DT shareholders in the synergies is €15 billion. Deutsche Telekom will also benefit from a perpetual voting proxy over the SoftBank shares, giving it at the outset 69% of the voting rights and Deutsche Telekom will continue to consolidate T-Mobile US. We have been able to agree on a very clear and decisive governance framework. The Un-carrier team is clearly in charge. This is very important to achieve a rapid execution post-merger and achieve the benefits for shareholders and U.S. consumers that we want to deliver with this transaction.

You will ask, especially given the European experience, why should U.S. authorities approve these mergers. John and Marcelo gave a lot of detail on this yesterday and I will talk about this a bit more in a moment. The bottom line is that the merged company will leverage its unique spectrum resources to deliver the fastest path towards the most powerful 5G platform. We will create U.S. jobs and we will give U.S. consumers much more value for money.

Importantly, the transaction does not require fresh capital, investments from us in the United States and is built on a sound financial framework, including the principle of strict standalone funding of the combined U.S. company. While the integration costs will take us out of our comfort zone at the group level, we expect to return inside the zone within three years after closing. We also expect the transaction to be accretive to adjust earnings per share after three years.

So importantly, our investments and growth plans for our operations outside of the U.S. are not affected by this merger. Of course, we will give you a lot more details about these plans at this year's Capital Markets Day in just over three weeks' time. Also, our stated dividend policy remains in place, specifically, we will pay the promised €0.65 for 2017 in 2018, and our dividend for 2018 and 2019 will reflect our cash flow growth this year. We also reiterate all of our stated guidance today.

On slide 4, you can see the group's unique portfolio position. In Europe, we lead in convergence, and in the U.S., we lead in wireless growth and customer experience. The transaction further strengthens this unique position. Deutsche Telekom will own 42% of the combined company and through the perpetual voting proxy control, 67% of votes. Deutsche Telekom will continue to consolidate T-Mobile US in its account.

Both Deutsche Telekom and SoftBank will be subject to a four-year lockup. I will be Chairman of the board, John Legere will be CEO of the combined company and Mike Sievert will be President and COO. Deutsche Telekom will nominate 9 out of 14 directors, of which, 2 are independents. We have agreed no breakup fees. There is a compensation mechanism of certain transaction-related financing costs that Sprint could incur. We also agreed a four-year roaming deal with Sprint which is limited in scope and on fair commercial terms.

Slide 6 shows you the spectrum ownership which is indefinite and the regulatory regime is investment-friendly. The U.S. telco industry profit pool is very large and we see a lot of upside for T-Mobile, standalone or combined.

On the next two slides, we present our case why we think this transaction is very much in the interest of the U.S. consumers. The merged company will bring 5G to U.S. consumers much better and much faster than anyone else, and also, better and faster than would be possible without the combination. This is mainly due to highly complementary spectrum portfolios owned by the two merging companies. On the one hand, T-Mobile's excellent position in unencumbered low-band spectrum and Sprint's unique position in the 2.5 gigahertz mid-band spectrum range. Also, T-Mobile's strong tower and backhaul infrastructure will allow the spectrum to be deployed much faster than could be achieved on a standalone basis.

Directly through its network expansion and investments and indirectly through its contribution to a more rapid 5G rollout, the combined company will create consumer benefits and jobs that could not be achieved otherwise. The business case is built on greater value at lower prices and this is enabled by hard cost synergies. So, we look at this as a real win-win.

Slide 9 details the cost synergies that we expect to achieve within a three- to four-year timeframe. In sum, we target more than $6 billion run rate annual cost synergies, driving the said $43 billion of synergies. This is net of an expected $15 billion integration costs. It also excludes any revenue synergies from new business streams, which we surely expect but which we have not quantified here. Please also be aware that our business case and the synergies we have outlined are based on lower prices and higher value for consumers.

On page 10, you can see the post-merger integration which is clearly a big effort, but we have high visibility and confidence that it can be done by our fantastic local team. Slide 10 refers to the positive experience of the MetroPCS integration which was faster and smoother than expected.

By the way, Thomas and myself, we have a lot of experience with post-merger integration of mobile operations. Just think about EE or think about Netherlands, think about Austria in all of the cases, we were able to realize the synergies faster than expected.

On page 11, you can see our governance setup which is designed for the most effective execution on slide 11. The Un-carrier team is clearly in charge.

Let me now hand over to Thomas who will explain how we are funding this transaction and what implication it will have for our group leverage and for our ratings.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

Yeah. Thanks, Tim, and good morning from my side as well, to all of you on the call. So on slide 12, you can see our funding plan. We expect T-Mobile's net to debt to peak at 2.9 times EBITDA in 2019, and then, de-lever to below 2 times within three to four years, which is an amazing speed of de-leverage you will see there.

We target a balanced debt structure and an investment grade rating post-integration. The initial funding plan is fully committed and de-risked. Importantly from group's perspective, we anticipate to return to strict standalone funding. On closing, $8 billion of group funding will be returned and the remaining $6.6 billion will not be renewed upon their maturity.

On the next page, on page 13, you can see that we expect to step out of our net debt-to-EBITDA temporarily while we will, based on the rating agencies' opinions we have received, you see them on the left-hand side, remain with our ratings' comfort zone throughout. So, we're being in line with what we always told you about all the comfort zones on the rating side, A- to BBB, and we always had BBB is an option for us if there's a relevant strategic transformation going on, and we believe that's the case here.

So, I'll hand over or give back to Tim to talk a bit again about DT portfolio implications.

Timotheus Höttges

Chief Executive Officer, Deutsche Telekom AG

A

Yeah. So, what this deal means for the group? We believe this deal is a great opportunity to further strengthen our position in the U.S., but also, to thanks on our unique Transatlantic portfolio which we show again on page 14.

As you can see on the next two pages, this portfolio has worked very well for Deutsche Telekom and its shareholder during the last three years, and today's announcement is another compelling step in this existing story.

On page 17, we show some of the benefits of our Transatlantic position. Some of it's in place, much of it is still opportunity, for instance, in the areas of IoT, B2B, 5G, and especially even fixed-mobile convergence. We also look forward to our new joint parentage of T-Mobile US with SoftBank.

On page 19, you can see the cash flow trajectory T-Mobile has owned that yesterday. Most of the integration will be achieved within the first three years and the synergy run rate is expected to exceed €6 billion. We expect the transaction to be free cash flow and adjusted earnings per share accretive after three years. And as already mentioned, our investment and growth plans for our German and European operations are unaffected.

On page 20, we show the expected timeline and the various approvals that we will now be working on. We expect closing in the first half of 2019.

So to wrap it up, first, we are very excited. T-Mobile US has a strong standalone case, has delivered amazing growth, has great momentum and fantastic growth trajectories ahead. But the transaction we announced yesterday can supercharge this and create even more value for shareholders and consumers. So, we have worked on this opportunity and I think we have agreed on a compelling transaction.

To summarize the main points, first, it's a unique value creation opportunity for DT shareholders. Second, we have achieved attractive transaction terms. Thirdly, the merger benefits U.S. consumers, investments and job creation. We have agreed a governance that is designed for a very efficient integration and our Un-carrier team is in charge, and we have designed a robust capital structure to make it happen.

We are now ready to open the lines for Q&A.

QUESTION AND ANSWER SECTION

Hannes C. Wittig
Head-Investor Relations, Deutsche Telekom AG

A

So thank you very much, Tim, and we can start with the Q&A. [Operator Instructions] Thank you. So with that, operator, can we please have your question, and I think we start with Andrew Lee from Goldman Sachs.

Andrew Lee
Analyst, Goldman Sachs International

Q

Good morning, everyone. Thanks for taking my question. The question is kind of on a strategic angle. You've now build yourself greater scale. Does this change your ambitions on the fixed line element of your U.S. operations? You highlighted that you are a convergence leader in Europe, a wireless leader in the U.S. Is that enough on a kind of 5 to 10-year time horizon or does this put you in a better position to see fixed line ambitions? Thank you.

Timotheus Höttges
Chief Executive Officer, Deutsche Telekom AG

A

Look, the first thing is that it is definitely to changing our ambitions in the U.S. with regards to the opportunities we have. We have, in the combination, a much better fit of a company with great spectrum, and on the other side, a company with a great network. To combine this would give us a lot of new strength in new areas. We will want to build the first 5G network in the U.S. and we not only want to build it in the cities, we want it even built to rural America, which is giving us additional growth opportunities in areas where we haven't been present before.

Second, our growth ambitions on IoT, our growth ambitions around B2B services, but especially on fixed-mobile substitution, so FWA and other technologies is something which we drive. This market is going more into a converged world, as you have seen from the announcement of the cable cos, and we will tackle this environment with our fixed wireless access services which we're going to deploy.

More to come on this subject but there's one thing absolutely clear. In the combination, we will be on eye level with the big carriers. We are more focused than these guys because we do not mess around with content and other stuff. We are very focused on services, on telecommunications side. Second, we have a management team which is executing along that line. Our spectrum position is much stronger than it is today, and therefore, the opportunities and our growth ambitions going forward are very ambitious.

Hannes C. Wittig
Head-Investor Relations, Deutsche Telekom AG

A

Thank you, Tim. And we go on to Akhil from JPMorgan.

Akhil Dattani
Analyst, JPMorgan Securities Plc

Q

Yeah. Hi, good morning. Thanks for taking the question. I've got two please. Firstly, Tim, you just talked about slide 17 where you talk about the importance of your global revenue scale. I just want you to comment exactly how you think about that and why it's so important to you. So, I guess is it that you feel it offers your advantages over some of the smaller European players? Is it about revenue scale? Is it about costs? What exactly drives the benefits that you're talking about there?

And then, secondly, I wanted to ask a question around consolidation rights. The way this deal has been structured, you get proxy voting rights over SoftBank shares. I just want to understand, is that a prerequisite to you being able to consolidate this business? And if we think four years forward when there would be the right for them to sell down their shares, would this theoretically be a requirement for you to buy those shares to be able to continue to consolidate the business? Thanks a lot.

Timotheus Höttges
Chief Executive Officer, Deutsche Telekom AG

A

Look, I was – I will ask you a question on the global relevance as well, and I know that Andrew was even – question is how is Deutsche Telekom Group as a whole. The first thing what I like to mention is we have a great portfolio. 90% of our businesses are now in AAA markets. So, this is unique. Think about other telcos who have this – sometimes even stranded investments or even very complex investments, South America or in Africa and other areas, we have a portfolio which is in AAA markets, Transatlantic.

The second thing is we have a portfolio which is unique and which is scaling up, which will give us benefits definitely on procurement side and even global reach for customers. So, there will be benefits synergies as well, nothing of this one is calculate that business case, but we have it in mind.

The third thing what is coming from me is our friendship and our good relationship with SoftBank. There will be a tighter collaboration with regards to global presence and global services. I will do everything that – coming closer to SoftBank's innovation piece and even coming closer to the global presence of telecommunication services with the SoftBank Group. Nothing of this one is planned yet, nothing of that one to announce already today, but this will definitely be something which is unique and this will help us.

Second, with regards to IoT services, with regards to global B2B things, there's a lot to learn. I know that we have huge things to export to the U.S., in this regard from a software perspective, but even here from Sprint side, SoftBank side, a lot of interesting activities taking place. So we will now be able to use these opportunities within the group and exchange best practices among ourselves.

And last but not least, 5G leadership, you know our engineering background here in Germany, you know the ambitions of the U.S. team. So therefore, we will see how we – how fast and good we are able to execute. But I'm very confident that this network leadership will be something with this in the DNA of both companies this side of the Atlantic and on the other side of the Atlantic.

So the inner strength, the intramarket concentration benefits from spectrum, from economies of scales, from building rural area – rural America, coverage, all of this is for the – strengthen the position inside the market and the rest of the portfolio diversification, the partnership with SoftBank, global connectivity will strengthen us.

So we really become a relevant player in the global field here. And this is helping in this scale market going forward.

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

A

And this is Thomas on the second question. Akhil, good morning. First of all, that was the question about what happens if Masa sells down after four years. And the question basically I understood was would we buy the shares and be able to continue the consolidation. So first of all let me state the following.

A, I think four years from now it's 2022 that's the first year where we would see an amazing amount of free cash flow kicking in by the delivery of that company. So, I'm really looking forward to that year because obviously 2019 and 2020 because of the integration efforts Tim mentioned will be somewhat burdened, but the fun starts then. So, that's first of all one observation.

The second one is, look, a good effective governance is super important if you have fast moving companies and environments. So, from our end it's – but it's by far too early to speculate about this what exactly happens right now then. There are many, many possible scenarios and ways to deal with it. But as I said in any case, let me be absolutely clear, we care about value creation, good effective governance, and avoid any ambiguity here to make sure that you get the value creation done. And consolidation, in that sense is then a byproduct of good governance and not the end in itself.

Hannes C. Wittig
Head-Investor Relations, Deutsche Telekom AG

A

Thank you, Thomas. Thank you, Tim. And move on to Polo from UBS.

Polo Tang
Analyst, UBS Ltd.

Q

Yeah, hi thanks. I just have two questions. Can you give some color in terms of how we should think about the profile of equity free cash flow from T-Mo US. going forward for 2019 and beyond specifically, I can see that T-Mo US. indicated $1 billion to $2 billion of equity free cash flow for 2019 compared to the current consensus which is about $4.5 billion. So you obviously have upfront restructuring impacting equity free cash flow. But I'm just trying to understand how the equity free cash flow for T-Mo US. will evolve post 2019. And the second question which is related is really about the dividend policy. So you mentioned that you'll be above 2.5 times leverage in 2019, should the deal go through. But how should we think about the dividend for DTE going forward, is there a risk that it's trimmed temporarily or are you confident that you can maintain at least a stable dividend at DT even with U.S. M&A? Thanks.

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

A

Yeah. Polo I'll take the second question on the divi. I think first of all let me be – let me clarify, we have our stated divi policy and that remains in place and that is incorporating 2018 divi to be paid in 2019. So on the years afterwards, so the 2019 onward divi to be paid in 2020 onwards, we would give you an update on the Capital Market Days in three weeks from now, for both elements or for both directions meaning with a deal or without a deal. I think on the free cash flow profile the U.S. guys yesterday mentioned that in 2019 they expect some free cash flow in the vicinity of $1 billion to $2 billion. And then after three to four years, as I mentioned, seeing an amazing acceleration of growth. The region they mentioned is $10 billion to $11 billion. And then on the longer term to reach even above $15 billion like $16 billion to $18 billion level. And I think that's given you – and you know that the original guidance Braxton gave for 2019 some one and a half years ago or two years ago on 2019 was $4.5 billion so I think that's easy then to make the math.

Hannes C. Wittig
Head-Investor Relations, Deutsche Telekom AG

A

Thanks, Thomas. And next we move on to Dhananjay from Bernstein, please.

Dhananjay Mirchandani
Analyst, Sanford C. Bernstein Ltd.

Q

Yes. Hi. Good morning, and thanks for hosting the call. I have two questions, one related to your decision making process in the run up to this deal and the other to the cost of synergy realization. So firstly, when you stepped away from the transaction with SoftBank in 2017, you laid out four criteria for your decisions. The standalone prospect of TMUS, the synergy potential, the risk of [ph] remedies (00:25:57), and the governance surrounding the merged entity. What across each of these dimensions has changed since then for you to convince yourself and your shareholders that this is in the interest of Deutsche Telekom?

The second question is on the cost of synergy realization, which is a staggering €15 billion. How precise is this estimate at this point in time, and what if any details can you share on the key elements of the one-off cost components in phasing? Thank you.

Timotheus Höttges
Chief Executive Officer, Deutsche Telekom AG

A

Look, you're totally right with regards to the changes in October-November when we failed being able to do the deal. Every deal has its momentum and every deal has this kind of magic moment where things look easier and things are working. I think the first thing is that in November, we were much more talking about merger of equals and about complex chairmanships and alike and I wasn't confident at that point in time that for this kind of complex transaction, the clear control and the execution mechanisms would be established in a proper way. So that has been definitely changed. And with regards to setup, we have John Legere being let's say the CEO and Mike Sievert, the President; and myself being the Chairman of this entity.

The second thing is how is the board composition. We have now nine out of 14 seats in this equation, and we have the nomination right for the CEO. So this is giving us a clear capability of steering the company in a very focused and clear way. Since that, even you know I think the share prices has changed and the exchange ratios have changed. There was so much I think unclearness in the share prices on both angles. How much is, let's say, fundamental, how much is already merger speculation on it that on this basis was very difficult to negotiate the real value, what the business are in a standalone position. This has been changed after the clear announcement that we're moving on on a standalone basis and on this basis it was much easier coming to a joint understanding about what a fair exchange ratio would be.

Since then the synergies got even higher, because of the tax reform which was brought forward. So it got even more [ph] sweetie sugared here (00:28:52) for us and for shareholders on both sides to move forward. So everything was better. And I think if you work so long on this kind of transaction, if you have so many exchanges in between, at one point in time, it makes click or it never make clicks. And I would say it made click in New York a few weeks ago when we restarted the dialogue and the result you can see of today and I think it's very encouraging.

Thomas Dannenfeldt A

Chief Financial Officer, Deutsche Telekom AG

And then a few words on the synergy side, first of all what I like to do is draw your attention again to page, I think it's page [ph] 17, (00:29:40) right, where we see that the overview on the synergies and the costs to achieve related to that. On the network, – it's page 9 sorry. On the cost to achieve first of all, basically you see that $10 billion of the $15 billion we're assuming here is related to network and then there's $4 billion on the back office and $1 billion in sales and service and marketing. And as you see also on the page, you see the integration years. I think it's important to reiterate again that this does not include any revenue or tax or other financial synergies that would be incremental, number one.

Number two, I think what we've seen in the MetroPCS integration is that the integration years we gave there in terms of target timeline have been easily overachieved, so we've been faster there. And I think it is a very realistic case, as Tim already mentioned, based on a lot of experience in those kind of merger situations, but especially with MetroPCS. The vast majority of the cost and CapEx synergies is really network and there is a super proven playbook and a team knowing how to do it. It's important to stress the NPV or the $6 billion annual run rate, more than $6 billion is based on the hard synergies and this is why we feel so confident on the case. It's more than 90% OpEx in there as an upside. And as I said, it does not include the revenue synergies.

And in terms of the magnitude and the size of the transformation on the network side and the customer side needs to be done from our point of view, it is very similar case to MetroPCS just lot more markets. On the MetroPCS case, we transitioned also big markets such as New York or LA, where there's many MetroPCS customers in those markets as Sprint has today in key markets. So in terms of the magnitude, it's the same playbook, it's the same size, it's the same team. It's just as I said a lot more markets, and this is how we feel about the synergy case.

Hannes C. Wittig A

Head-Investor Relations, Deutsche Telekom AG

Okay, thank you. Next, we have Mathieu from Barclays please.

Mathieu Robilliard Q

Analyst, Barclays Capital Securities Ltd.

Yes. Good morning and congratulations on the deal and the terms of the deal. I had two questions please. First, in terms of U.S. versus Europe, clearly you are increasing your exposure to the U.S. and you want to lead on 5G and that's key to the deal. How do you expect or how do you hope the European regulatory authorities or the

European Commission to look at that and to look at how the situation is in Europe where it seems suddenly we're lagging a bit behind in terms of 5G rollout? So that's the first question.

The second question has to do with your long-term EBITDA margin target for T-Mobile that appears on the slide of T-Mobile. If I remember correctly, you're expecting margins to be way above 50% in the long-term. And I was curious to understand exactly how this kind of profitability could be reached in a wireless operator. Thank you.

Timotheus Höttges
Chief Executive Officer, Deutsche Telekom AG

A

So, thank you, Mathieu, for the congrats here. Yesterday for the first time in my life and I'm 13 years in the Supervisory Board our – we got applause in the boardroom, so this was something unique. So you'll find us still very excited, so about that one. The second thing is look the issue here on this transaction here is I was always a fan of the U.S. and you know that. And when I became CEO, there were a lot of people in my Supervisory Board, there were a lot of shareholders around me saying the first thing you have to do as a CEO was sell the U.S. Sell it. And you know, I was convinced that this U.S. market is worth fighting for. We invested up to $40 billion into infrastructure into the 3G and 4G network coverage. We invested into spectrum big time to catch up especially on the 800 megahertz.

We expanded our footprint across the country. We merged into a public listed company, MetroPCS in the U.S. to scale up the business. And from by small steps, we scaled up and we're tripling now the value in the last four years in this environment. And now we have the next step of this phase going forward, because the U.S. market is very, very attractive. And from all the parameters on what you see. The first thing is it is from its demographic more attractive than the European market.

It is growing and the GDP is around 4% and even the growth of people in the U.S. is in the magnitude of 4%. This is the biggest telecom market in the world with a magnitude of $510 billion and a market cap of $757-or-whatever-billion and with an EBITDA $160 billion. So it is the biggest and most profitable, our telecommunication market in the world. And last [ph] but not least (00:35:22), it is the breeding house for all internet services in the world. It's the GAFAs. So the Googles, Amazons and Facebooks, it is the artificial intelligent environment. It is the Internet of Things, which is even growing rapidly in the U.S. market, so it is for digitization, the most attractive market in the world. And to be part of the system, where digitization networks are needed, we know there is a demand. It is 100% sure that there will be demand for the 4G and the 5G data services we are providing.

On top of that, the U.S. market from a regulatory side, is steered in a better way than the European market. Take an example, in the U.S., you are able to buy spectrum, in Europe you rent your spectrum. I can tell you if you rent assets, you always treat them worse than having owning them. So you can trade with them, you can exchange it with your partners and you can better utilize it because you have a longer planning horizon. This is one of the example.

The second one, even the way how the level environment is treating competition is much better than trying to anticipate every single behavior of a telco operator already in advance. It's a philosophical issue, the Homo Ludens against the Homo homini lupus est, so this is maybe my philosophical approach here on this subject. But nevertheless I think the European regulators, I think the local regulators, the politicians can learn a lot of things about how you drive innovation and growth in a market from the U.S. and therefore, it is absolutely worth to invest into this environment and to be present in this environment.

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

A

And then I'm going to talk a bit about the margins, although I have to say Tim, I had Latin at school, but I missed the boat.

Timotheus Höttges
Chief Executive Officer, Deutsche Telekom AG

A

Thomas, [ph] please (00:37:27).

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

A

So tell me afterwards what you were talking about. So on the margin, I think basically if you compare ourselves to the big guys carrying those kind of margins in the U.S. markets, what's the difference? Basically, one element obviously is synergies we're talking about and utilization in the network infrastructure. And related to that utilization, obviously, the scale. And I think the scale, if you look at scale disadvantages we're having today in the single operations of Sprint and as well as on T-Mobile, you see it's A, B2B obviously, where we are seeing now at T-Mobile fantastic growth dynamics; and B, it is obviously the rural areas and I think that will be one focus area for us in investments, in infrastructure investments in the shops and so on, to catch up there and to significantly scale up. And I think if you do your homework in terms of the synergies and the scale, you see what the other guys can achieve in the market and that should be our aim.

Hannes C. Wittig
Head-Investor Relations, Deutsche Telekom AG

A

Excellent. Thanks for the Latin wisdom and your words. So, move on to Jon from RBC please.

Jonathan Dann
Analyst, RBC Europe Ltd.

Q

Oh, hi there. One question and then a clarification. Could you just explain the rationale of the $8 billion repatriation from the U.S.? And then second when T-Mobile guides to $1 billion to $2 billion of cash flow, is that cash flow cash flow or is that before other cash items?

Timotheus Höttges
Chief Executive Officer, Deutsche Telekom AG

A

Look this question is from a portfolio [ph] reference (00:39:11) quite relevant and I like to define a little bit the strategic framework and then Thomas is going into the details of that one. Remember there was a time when we said, look, we want to have a self-funding of the U.S.

We want to have a derisking of the U.S. activities, and we want to build a kingmaker asset. This was the kind of three pillars of our strategy at the beginning. And we said if you want to invest into the infrastructure, you have to do it on your own. There will be no fresh money [ph] in (00:39:43) our covenants are from Deutsche Telekom into the U.S.

The improvements of the business gave us the opportunity even to lent money into the U.S. and that took place over the last years. Now in this case here, our idea is that we are not sacrificing any power in our European entities. We will not change the investment profile, nor it will have any negative implications to our plans going forward. We have this clear fixed mobile converged playbook here. We have a clear investment plan to improve especially our fiber infrastructure but as well our 5G mobile networks and this is not affected.

So what we said is we are building a deal without putting fresh equity into the U.S. At the same time, we are saying we derisk Deutsche Telekom by taking $8 billion off the table. So all the company's business has to be self-funded in the U.S. by the U.S. operation itself because we want to see that the entrepreneurship is feeling the pain from both angles of the market, equity and debt side. And second, our business here in Europe should not be affected by that one. Therefore, we take some money back into [ph] the room (00:41:19), which is by the way part of the backstop and the financing bridge which we have laid out. So we're going on in the next chapter of self-funding, derisking and kingmaker asset.

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

A

And I think Jonathan to add on – Tim has mentioned it all except one single element which is, we're clearly allowing the new company to go for the secured market on their self-funding way. That's important, I think, but the rest I think was spot on. On the question on cash flow, is cash flow. There is no change in the definition, as you know in the U.S., it's cash generated from operations minus CapEx and this always excludes the spectrum. So there is no basically no change to the definition we used so far.

Hannes C. Wittig
Head-Investor Relations, Deutsche Telekom AG

A

Okay. So the next question is from Ottavio at SocGen.

Ottavio Adorisio
Analyst, Société Générale SA (UK)

Q

Hi. Good morning. A couple of question on my side. First one is on the [ph] vote (00:42:22) in the release. You basically – you're relatively vague in terms of the termination event for the voting proxy and the exceptions for the four year lockup. You basically mentioned certain termination events and certain exception. So if you can basically clarify what certain events are and the exceptions? The second one is for Thomas. You didn't want to comment on the dividend. But on the other side, you have a target for the gearing. Therefore, the question is that [ph] would that (00:42:57) target to basically go down 2.5 in debt to EBITDA by 2021, imply in terms of dividends and asset disposal? And the third one is on the roaming agreements that has been agreed between TMUS and Sprint, if you can tell us what the costs will be to Sprint and the revenue to TMUS? Thank you.

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

A

I think, I'm going to start on the question for the leverage basically and the policy on the debt side. What we said is our comfort zone in terms of rating is A- to a BBB and we are willing to accept a BBB if there is a major transformation in the group going on. And that's what we consider is exactly what we're talking here right now. And that the comfort zone of 2 to 2.5 leverage in our definition is what we are aiming for. And as I said, we believe we can get back after the 2019 and 2020 impact on the integration costs to that level from 2021 onwards. On the divi policy, I said already for 2018 paid in 2019 no changes, update will come in three weeks' period of time. And I think that's it basically perspective on the divi and the leverage.

Timotheus Höttges
Chief Executive Officer, Deutsche Telekom AG

A

So with regard to the voting proxies, there are not so many exceptions from the rule by the way. In this, in the next four years there is – there are sales allowed for our partner in the magnitude of 18%. There is a schedule behind it which I do not want to release. But he can sell 18%, that means that the 51% ownership of Deutsche Telekom is guaranteed throughout this period. And afterwards, on the change of consolidation is something we will discuss when this question is becoming relevant and please you have to question Masa Son and SoftBank on this one because it's their shareholding and not ours, but I'm quite relaxed. As Thomas already laid it out, these are the period when things let's say becoming juicy. These are the time – and there might be even other partners jumping in and aligning their proxies with us again. There might be other opportunities which we consider as steps going forward. But any speculation on that one doesn't matter for you, nor it doesn't matter for us at that point in time. We will answer that question in due course. Now it's time to get the approvals. Now it's time to get – and show the synergies of that one and then we will see what's happening to consolidation in shareholdings.

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG A

And I'm going to answer the third one on the roaming agreement again. Basically, on the roaming agreement T-Mobile will provide Sprint with a roaming agreement for four years. By the way that agreement will survive in the event of termination of the transaction. The agreement is limited in scope and it's based on fair commercial terms. I think that's all to say on that.

Hannes C. Wittig
Head-Investor Relations, Deutsche Telekom AG A

Thank you, Tim and Thomas. And just be aware that the combination agreement will be filed publicly today, so you can look up further details. With that, I move on to Robert at Deutsche Bank. Rob?

Robert Grindle
Analyst, Deutsche Bank AG Q

Yeah. Good morning. My question actually is a follow-up on the MVNO agreement. Will the agreement happen before the deal takes place or would it only happen with the deal? And yeah, I know that it goes forward regardless. And then maybe you could make a comment with regard to the lack of a break fee on the transaction and I suppose that's a related point to the MVNO agreement. Thank you.

Hannes C. Wittig
Head-Investor Relations, Deutsche Telekom AG A

Hey Robert, let me answer this. So it's not an MVNO agreement. It is a limited scope roaming deal that will be starting today and will be in place for four years. And there is no financial breakup fee and the terms are good and there's no financial breakup fee in the transaction.

Next, we have a question from Sam at Exane please.

Sam McHugh
Analyst, Exane BNP Paribas Q

Yeah. Morning, everyone. And congrats on the deal. Two questions. First, when you talked about peak leverage of I think 2.9 times at TMUS, I just wanted to check if that included handset leasing or not. And then at a group level, when you take into account the leasing on handsets and tower obligations and all the other impact of IFRS 16, what will be the leverage of DT Group? And then secondly, I think TMUS talked about $40 billion of capital investment over the next three years. Does that include some of those $15 billion of cost to achieve the synergies? Thank you.

Timotheus Höttges
Chief Executive Officer, Deutsche Telekom AG A

No, and yes.

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

A

Tim is shouting from the back. So first answer to the second question is, yes, it does include and then on the leverage that is all prior to IFRS 16 effects. So we need to all do that kind of translation towards IFRS 16 and handset leases are included.

Hannes C. Wittig
Head-Investor Relations, Deutsche Telekom AG

A

Yes. And all the, of course, the rating opinions that we have received and disclosed are based on full transparency here. Next, we have a question from Fred and I think that's the second to last question. So Fred at Bank of America Merrill Lynch, please.

Frederic Boulan
Analyst, Bank of America Merrill Lynch

Q

Hi. Good morning. Congratulations on my side as well. Three questions please. First of all, just to follow-up on the previous question on leverage and the free cash flows. So if you could comment on where we could see group free cash flow in 2018 and beyond excluding the U.S. if you could provide any color on that. And on the net debt side, where do you see the net debt increasing in 2019, assuming the deal is approved? And I didn't really get your answer around the leasing. So if you can share the same metrics using TMUS and Sprint cash EBITDA if we strip out the leased devices I think north of $3 billion impact overall?

Secondly, around the approval process, there were a lot of questions on the call yesterday, if you could share with us if you had any positive signals from the administration on whether they would be okay to move away from their traditional [ph] concentration (00:49:49) measures and listen to your rationale around the need for scale to invest?

And then maybe a third more philosophical one around technology, I think John yesterday talked about 450 megabit per second average speed on mobile networks. Do you share that vision? And if so, how does that fit with your strategy in Europe? Thank you.

Timotheus Höttges
Chief Executive Officer, Deutsche Telekom AG

A

Look, let me start with the administration, and it is now much too early to make any kind of speculations to push anyone into any corner. This is a process and everybody has to look to the facts and understand them in a proper manner and then coming to a conclusion. But that said, our assessment from the management teams from the owner side is that the window hasn't been better as it is today. And there are a lot of reasons which we see for that one.

I think this deal is great for consumers, and having John at the top of that company really supercharging the Un-carrier. We have a DNA of that company and you cannot just go from an Un-carrier from a [ph] maverick (00:51:15) into an incumbent, that's not our DNA nor it's our attitude. And the opportunity of land grabbing in the U.S. is big and therefore we see this opportunity in the new setup.

The second thing is, it's very important that challenges that [ph] mavericks (00:51:32), that players in this U.S. environment have the capability of creating economies of scale. If you have to build a network in the 5G environment, you need the economies of scale. With this combination, our situation is much better than it ever has been. The economics are much better from the infrastructure side, and this will give something back to the consumers because our capability of building a countrywide network, including the rural Americas, it's much better than it has been before.

The third dimension of why we believe the setup is better is that the big players are distracted and in big combinations at that point in time. You know about the DoJ conflicts between Time Warner and AT&T and other things. So I think now this market is totally in M&A and this market is totally on fixed mobile convergence in the way of how it is driven. And therefore pitching as a mobile player with 5G into the opportunity of building a fixed wireless access of substituting fixed line services with our technology is definitely a new market definition as it has been before. This market is going into convergence more and more. All cable operators have announced big mobile numbers as well. So this is, let's say, a new setup for our company because the market definition has already changed out.

Now, what are the steps going forward? There are five elements of the approval process. The one is the DoJ and the way going forward. And the second one is the FCC. We have close relationships with the FCC over years now. I think it is very important that, for the FCC, we are able to show coverage for rural Americas even 5G commitments and investments. Then we have the state attorneys, which are always showing up in some of the states in the U.S. And then we have the authorities, the security authorities, CFIUS and alike, we have to convince that we are a good committed citizens in the U.S. environment. And last but not least, very important as well, The White House.

So I think these are the some elements of understanding how this process is being seen. We have an experienced team doing that on the ground, mainly driven by our U.S. operations. This is a U.S. deal, so it will be driven by Marcelo and by John Legere in the upcoming months and [ph] I've now – (00:54:41) as I said, are working on this deal since seven years and the regulatory approval process was always something which concerned us, but we were never that optimistic as we are today.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

And a few words on your question on the group free cash flow ex-U.S. beyond 2018. Obviously, Fred, I'm not willing to answer your question because if I do so, you don't come to our Capital Market Days anymore, and you would get the full monty of how it looks like and why we are convinced about it. But as you know, we haven't given guidance on that one beyond 2018. But as you know from a principle profile that we are bullish about seeing EBITDA growth in DTE ex-U.S. and cash contribution growth and the details, as I've said, in three weeks' time on the Capital Market Days.

I think on the leverage discussion, first of all, on the whole discussion about leasing, be assured that Braxton on his side when he had the rating advisory discussions, as well as we on our side discussed in full detail what the rating agency is about, what leasing impact on core EBITDA looks like, but obviously, we will not give any details around that on a yearly basis, it doesn't make sense.

From our point of view and on the leverage that will be in 2019 for the group level significantly above 2.5 as the simple math is given that a 2.9 times leverage on the U.S. will drive the group out of the comfort zone. From the dynamics, it will start to rebound already in 2020, assuming that we get an early approval obviously depends on the timing of the approval, but there will be a fast rebound towards 2.5 and then, as we said, from year three onwards, we expect to be back [ph] on this, so... (00:56:35)

Hannes C. Wittig
Head-Investor Relations, Deutsche Telekom AG

A

Thank you, Thomas. Now next, we have Usman from Berenberg, please.

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

Q

Hello, gentlemen, thank you for taking the question and congratulations on the deal. My first question was just on the margins for NewCo that have been highlighted. What was interesting was that the CapEx to sales that's being guided for NewCo at 13% to 15% long term is much lower than AT&T and Verizon. If I look at consensus there, midterm consensus is that [ph] 16% (00:57:13) to 18% of sales. So, is there anything that being an analyst I'm not understanding in this 5G environment about CapEx intensity? So that would be the first question.

The second question was on the – on this figure that's been highlighted of $40 billion higher investment, you've indicated that includes the integration costs. If I was a skeptic, I would be saying that, look, consensus CapEx estimates for Sprint and TMUS on a standalone basis already at around $32 billion over the next three years. If I add the integration CapEx on top, that gets me to the $40 billion plus. So, therefore, in the near term, excluding the integration CapEx, there's not really much of an increase in spending, and that integration CapEx in the long term is leading to lower CapEx intensity for the NewCo versus on a standalone basis. So just if you could address that, that would be great. Thanks.

Timotheus Höttges
Chief Executive Officer, Deutsche Telekom AG

A

Usman, so let me let me start with – I'm trying to answer both questions here. The first one is that I have to make clear that this business case which we are laying out is very robust and in a lot of areas very conservative, because we wanted to make sure and secure that the implementation and the accomplishment is convincing, let's say, you could say that reachable, achievable, and that is, let's say, the basis of that one. We have not included any kind of revenue synergies because of that. We have not inherited the fixed wireless excess upside into that one. So, a lot of things, the assumptions are conservative with what regard to that one.

Now, looking hindsight, we want to keep flexibility as well on the prices and as well on the way how we are growing the business, we are – we want to stay with our aggressiveness in the way going forward. This is the assumption, and doing this, we will be able to generate growth. The CapEx is something you take your assumption, I think we will see going forward how much of implementation CapEx and how much of growth CapEx we are requiring for this entity. This is something we will learn as well on the move. I understand your logic, but sometimes it's very even – it's difficult to understand what is in the revenue line of AT&T and Verizon, whether this is really comparable in the way how you're looking at it.

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

A

Maybe to complement a few additional elements, I think that – and we can judge that very well I think from a AT&T or Verizon's point of view in some of our European markets, so to say, that obviously team U.S. being a late story in LTE back in 2012 had the advantage of, A, the network grid being based on mid-band, which is in – if you start, it's a disadvantage, once you go, it's an advantage because it's more dense. The spectrum does perfectly fit especially in the combination of Sprint and T-Mobile US to that grid.

So you have to deal with less legacy and you have better fit how to utilize the spectrum position. And maybe one more element in terms of the dynamics [ph] when we headed – (01:01:16) I can tell you especially as the CEO of

DTE, obviously, during the course of the last years, we had various discussions about what's the right level of CapEx. But I can tell you this time there was no push back or whatever in terms of the right level of CapEx, it was simply the U.S. team laying out their thoughts and their plan and their robust plan, as Tim said, and we accepted and went for that. So [ph] we all alliance, synced (01:01:42) and on the same page and I think we have some upsides as I mentioned from grid and from a mid-band grid and spectrum which is reflected in those numbers.

Hannes C. Wittig
Head-Investor Relations, Deutsche Telekom AG

A

Yeah. So we will have – just to summarize and make very clear, we have the best grid, we have the best spectrum and we have the best backhaul and – or fiber backhaul everywhere. And we will roll out the best most modern equipment. So if you add all of this together, this is a very compelling package and very sustainable.

So next question from Ulrich at Jefferies, please.

Ulrich Rathe
Analyst, Jefferies International Ltd.

Q

Yeah, thank you very much. I have two, one is a follow-up. Maybe ask the sort of new one first, we've seen S&P put through a CreditWatch. I'm just wondering, what would your exposure be it for temporary downgrade of the credit rating by one notch? Obviously, you're aiming to get back [ph] sort of within three years. (01:02:44) But is there any material refinancings that would incur higher interest costs and would you have a sense of how much we're talking about there?

And the second question is a bit of a follow-up on this question of the terms and conditions of SoftBank's handing over the voting rights. I'm not entirely sure I understand what happened after these after these four years if SoftBank decide not to change anything, let's say, SoftBank is entirely happy with everything that happens, four year passes, they don't do anything. Do the share – the voting rights then continue to reside with Deutsche Telekom or is there anything that sort has to happen at that point? Thank you very much.

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

A

I'm going to start on the interest costs related to the temporary downgrade. Our assumption is that we will have on a yearly basis a double-digit number like a mid-double-digit number on a yearly basis to accept in terms of the interest – higher interest costs so there is what we're calculating with for that certain period of time.

Timotheus Höttges
Chief Executive Officer, Deutsche Telekom AG

A

Look, I think, the question is quite simple. If SoftBank stays in the group, these voting rights and this proxy prevail forever. So this is, let's say, the agreement, there is no limitation to this one in the contract. And then we have a lot of fun together, we enjoy life, we enjoy our partnership, we enjoy the ideas of let's say what we can do together. This is opening up for us a totally new door, it's an access for both areas to think about new opportunities in the way how we cooperate going forward. And we have not even started to think about that one. The only thing what I can tell you there is already a deep builded trust between the parties, which I really enjoy. And therefore, let's have fun and let's go longer. I would highly appreciate that and having no time limit to this one at that point in time.

Hannes C. Wittig
Head-Investor Relations, Deutsche Telekom AG

A

Unfortunately, we – I don't have much time anymore. But I just want to have a final question from Mandeep and then we will have to give further question at the IR level at our Q1 call or other occasions when we meet soon. So, Mandeep, can we please have your questions?

Mandeep Singh
Partner, Redburn (Europe) Ltd.

Q

Thank you very much for taking the final questions. Two quick ones hopefully. In the overachievement of the MetroPCS synergies which you're using as a valuable test case for having confidence this time around. How much of the synergies, how many – what was the sort of combined company head count sort of reduction? So I wanted to get a sense of how you can employ more people in this new deal yet achieve quite a big synergy number which is sort of above consensus expectations. So did you – were there head count reductions in that deal will be first question.

And my second question is, obviously, you tried these talks a few – last year then you both went your separate ways you couldn't agree. Are you able to sort of confirm whether the terms of this particular transaction are superior for you than they were a year ago? Thank you.

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

A

So I'm going to start with the first piece on the head count reduction because it's a super easy one. I think, as John laid out yesterday, we're going to create jobs from day one on. That's the clear message. And the key areas where I think we will be active in terms of creating new infrastructure, shops, et cetera, et cetera, is obviously the rural areas.

Timotheus Höttges
Chief Executive Officer, Deutsche Telekom AG

A

Coming back to that one, look, we are a job machine in the U.S. I just want to reiterate what Thomas just said. Look at many jobs we have created by building a shop across the entire country having this great service. And this service is something where we're going to invest. In our synergy plan, there's not so much negative – positive net present value from this angle, we are even investing additional money into leading service quality because we believe that what T-Mobile has achieved with a good network and a great service is better. So we will create jobs especially around this topic.

Now, going forward, the last six months showed us that we have better synergies, with the tax reforms even an improved situation, we were able to realize a better price, the exchange ratio is exactly where we thought it should be and the governance has improved significantly. There is no breakup fee of that deal going forward. And we are – we have a joint approach towards the customers in the way how we're running it, but – and a proven management team is able to do it the second time. So, therefore, I think everything from the setup was giving us confidence that it's the right timing and the right thing to do it now, and that is why we are sitting here.

Hannes C. Wittig
Head-Investor Relations, Deutsche Telekom AG

Okay. Thank you, Tim. And so, just to conclude today's Q&A, we believe this is a great transaction for Deutsche Telekom and to further strengthen our excellent position that we have created in the U.S.

And with that, we now look forward to talk to you on our first quarter conference call next Wednesday and then hopefully to see you all at our Capital Markets Day on the 24th and 25th of May in Bonn. And if you have any more questions – yeah, U.S. team will be there as well as Tim just point out to me and we will circulate the agenda this week.

If you have further questions, please contact us at the Investor Relations department. And with that, I give back to the operator. Thanks all.