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PRESENTATION

Operator

Good afternoon, and welcome to Deutsche Telekom's conference call. At our customers' request, this conference will be recorded and uploaded to the Internet.

May I now hand you over to Mr. Hannes Wittig.

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

Good afternoon, everyone, and welcome to our live Q1 2022 webcast and conference call. As you can see with me today are our CFO, Christian Illek; and Srini Gopalan, who heads our German business. Christian will first go through a few highlights. Srini will update you on the German business and talk about the German segment performance. Afterwards, Christian will talk about the other segments and our group financials and outlook, and then we have time for Q&A.

Before I hand over to Christian, please, as always, pay attention to our disclaimer, which you'll find in the presentation. And now I hand over to Christian.

Christian P. Illek - *Deutsche Telekom AG - CFO & Member of Management Board*

Thank you, Hannes, and welcome to Q1 '22 results call. Look, we had strong results on both sides of the Atlantic, and we continue to make progress against our strategic priorities.

Let me just start off with the U.S. who has reported 2 weeks ago. I think all up, very strong growth on all key financials, very strong customer growth. And that led obviously to the guidance increase which the U.S. team has already announced. Outside the U.S., we delivered a very strong EBITDA growth of 6%. Overall, we generated more than EUR 2 billion of free cash flow, and we confirm our guidance.

On top, and that is more related to the strategic direction of Deutsche Telekom, we closed the deal in The Netherlands. We created the joint venture in Germany with IFM, GlasfaserPlus. We set up a joint venture together with Vodafone in the Czech Republic. And we invested part of the sales proceeds of the Dutch business, meaning EUR 2.4 billion, into acquiring further shares in the U.S., which now puts us at a 48.4% shareholding. So on a group level, if you add everything up, very strong growth on the financial metrics, including the adjusted EPS, which we're going to see later on; a sequential decline in financial debt. And we incorporate the U.S. guidance increase obviously into our group guidance.

So let's move on to financials on Page #5, and let's start with a reported view. So revenue is up by almost -- by a little bit more than 6%. Adjusted EBITDA was growing by 7%. Adjusted EPS grew in that given quarter by 80% to EUR 0.45 per share, and our free cash flow enjoyed a nice EUR 1.2 billion increase to EUR 3.8 billion, which is 46% relative to last year. Our financial debt before leases is on a year-by-year basis pretty much stable; if you include the leases, has increased by 5%.

Page #6, let's move on to the organic perspective. And you see how we grew. T-Mobile US obviously grew with 0.3% on adjusted EBITDA. This effect is coming from the unwinding of the handset lease business which we inherited from Sprint. If you basically take a look at the core EBITDA figure, it grew by more than 10%.

Germany maintained its constant momentum and grew by another 3.6% in the previous quarter. The European segment grew by 6.9%. I think that's stunning, and it's really impressive how they turned around the business. Group Development grew by 19%. And if you exclude the held-for-sale effect of the Dutch business, it would have been 11.4%. And even T-Systems had a very, very good growth in EBITDA. It grew by 18%.

So all up, the ex-U.S. business grew by 6.1% this given quarter. Germany is now 22 quarters in a row with consecutive EBITDA growth. Europe is chasing Germany with 17 quarters. And my ask to the 2 segments, meaning Srini and Dominique, please repeat. So for the group, our organic revenue after leases grew by 2.4%. So I talked about the core EBITDA performance of the U.S. with 10.5%. If you apply that metric on a group perspective, growth would have been 8.5%.

So if we take a look at the organic service revenue growth, it grew by 4.7%, which is EUR 1 billion in that given year. And that's an acceleration compared to the previous year and the fourth quarter. And the organic service revenue ex U.S. grew by 1.6% in the Q1 results.

Moving to Page #7. You see how the cash flow developed. So driven by growth from cash from operations, which was almost EUR 1.1 billion, our free cash flow grew up by EUR 1.2 billion. And we were able to compensate higher CapEx spendings of almost EUR 400 million by having less lease payments, and that mainly reflects a prepayment, which took place in the U.S. in Q3 of the last year.

If we're moving to the adjusted net profit. It grew by EUR 1 billion to more than EUR 2.2 billion. And that is very much driven by the adjusted EBITDA growth. It's also driven by a better financial result, which is the options and the forward which appreciated on a year-by-year basis. And the lower depreciation is basically coming from the transition to -- from the handset leasing business towards the EIP business in the U.S.

So all up, very, very good results. Obviously, if our results is getting better, we have to pay more taxes. And since there is a big growth coming from the U.S., we also have to pay the minorities, and that basically explains the EUR 2.2 billion on adjusted net profit.

So let's move on to the next page, and that is financial debt. And you could see that the -- you can see that the financial debt has decreased by EUR 2.5 billion to EUR 98 billion, and that is very much driven by the free cash flow which we generated in Q1. It's also driven by the sales proceeds, meaning the Dutch business and GlasfaserPlus.

And then there is obviously increases coming from the U.S. One is the payment for the spectrum of the Auction 110. Obviously, the dollar has appreciated relative to Q4 by $0.02. That basically increases our U.S.-based debt by EUR 1.3 billion. And we have an increase of financial liabilities due to the extension of the Crown Castle deals coming from the U.S.

If you include leases, all up, you see that our leverage ratio has increased to 3.1, but it's very much driven by the 12-year deal arrangement which T-Mobile US created with Crown Castle. And excluding leases, we're getting closer to, I would say, the ratio -- the upper end of the ratio with 2.6 because the upper end of the ratio is 2.5.

So let me move on to an overview of networks and take a look at the -- on the overall performance and start with the usual networks slide. You see that we have now almost 11 million European homes, so that comprises Germany and the European segment, with FTTH infrastructure. In Germany, we are going towards 4 million. The Ultra Capacity network in the U.S. is now passing 225 million homes, and you know the target by the end of the year is 260 million. And in Germany, we are leading way ahead of competition when it comes to 5G coverage. On customers, you see that we have seen momentum on both sides of the Atlantic, and we recorded strong growth. And that holds true for mobile, it also holds true for broadband and TV. So all up, I think very good results.

And now I would like to hand it over to Srini to give you a little bit more deep dive on the German operations. Srini, please.

Srinivasan Gopalan - *Deutsche Telekom AG - Management Board Member - Germany & MD of Telekom Deutschland GmbH*

Thank you, Christian. Having done this presentation in German in the morning, I can only say I'm delighted to be doing it in English now.

So let me start talking about Germany. So this quarter has been impacted by quite a few specific factors. And when you're looking at a business as large as Germany and you have all of these one-offs, it's really important to look through these one-offs and to look at what's happening to the underlying business. And I'm pleased to report that when you look at the underlying business, there is really no change to our momentum. And a lot of the one-offs, as they wash themselves through, you will see a reversion to a lot of the trends as we go through the next few months.

When you look at our revenues as a whole, revenues grew by 0.9% this quarter, which was driven -- which is lower than recent growth rates and driven by a few specific factors. The vast majority of these we had flagged earlier. The first one of these is the nonrecurring public sector revenues, and we talked a lot about this through last year. That created a drag of about 50 basis points this quarter.

The second one of these then is the absence of the elevated lockdown-related call revenues that we've seen in Q1 2021. And that created another 40 basis points headwind this quarter. So just between those 2, that's about 90 basis points headwind. We saw a third factor play through this quarter, which is delays in some of our IT service revenues due to chipset availability, and this resulted in some delays in our B2B projects with our customers.

So these headwinds resulted in an overall lower than the past few quarters organic revenue growth. But I think it's really important to understand that a lot of these, especially the public sector projects and the larger projects with our B2B customers that were impacted by chipset shortage, come at the margin -- significantly lower levels of margin than our overall connectivity business, which is why you see that our EBITDA growth has continued to stay really strong at 3.6%. Because in many ways, the core driver to our EBITDA growth tends to be much more our broadband, our wholesale and our mobile service revenue growth, which are the significantly higher margin contributors.

So moving on to the next slide and looking at where we are on service revenue. Organic service revenues were up 0.6%, which is lower than recent quarters. But the underlying growth rate was very similar when you add back the public sector onetimer of 0.6% and the lockdown boost of 0.5%.

Mobile was strong at 2.5%, with the headwind from termination rate cuts largely being offset from a partial recovery of visitor and roaming revenues. We haven't as yet seen the impact of the Lebara MVNO loss. That will really fully materialize in Q3 this year. But really strong mobile performance there.

Let me now dive a bit more into fixed. So what we're seeing in fixed apart from the onetime effects that we talked about on the revenue side, on the net add side is the impact of the new customer protection law. I think both 1&1 and O2 referred to it in their calls as well. This is the TKG law. So just for context, and as I'm sure most of you are aware, this law has removed the automatic extension of customer contracts, which used to be an automatic extension of 1 year, in favor of a 1-month cancellation period.

So this results in a couple of things: one, a pull forward -- a onetime pull forward of churn that you would have otherwise seen a year later, and that churn gets pulled forward now. And the second is the removal of overlapping contracts, which is, in the past, some customers have already signed up for a new contract while they were on their previous extension. So the new law removes the need for this and therefore, results in a base adjustment for us as an industry, which is why you can't kind of add up all of the net adds lost in one place and assume that it will pop up back again in another place, right?

Now the good news is beyond this base effect, we've actually seen no real change in the underlying gross add or churn momentum. And so this is something I obsess about on a weekly basis. When you look at kind of what is our gross adds and what is our weekly churn request, there is no real material change in that trend. And we estimate, as you can see on this slide, that the headwind from the law change is somewhere between 25,000 and 30,000 broadband lines this quarter. And as we go through the year, we expect this completely to wash out. Especially in half 2, you will see a significantly lower impact of this.

I move on to the next slide, which talks about retail fixed. Again, our retail fixed revenue performance impacted by the one-offs I talked about earlier. Wholesale is pretty much exactly following out the trajectory that we laid out last year, which is returning to growth as the new commitment model kicks in. So we're seeing, this quarter, a decline of 2.1%. Next quarter, it will be back to growth. So pretty much the trend that we laid out to you when we talked 12 months ago.

If I move on to the next piece and talk about where we are on mobile. So you can see here that in mobile, we saw an increase in churn, thanks to the TKG implication. Just to be clear, when we say 0.8% to 1.2%, that's specifically on our Magenta-branded consumer. When I look at it on the business as a whole, the increase in churn is more like 0.8% to 1% because the TKG has less of an influence on B2B and also has less of an influence on our more discounted brand, Congstar. It has its biggest influence on the Magenta brand, which has the oldest customers as well.

And our estimate is that this quarter, we lost about 30,000 to 40,000 consumer net adds in mobile as a result of the implementation of the law. But our contract net adds seemed -- came across really strong because of a very good performance from our B2B segment. And again, when we look at the underlying momentum of this business, so when I look at again churn requests and gross adds per week, you're not really seeing any shift in the underlying momentum other than the pull forward of churn or the cancellation of dual contracts.

So if I then pull together to talk about where we are on our overall capital markets commitments, if we go to the next slide. And I think it's really important to have this conversation because when we step back from the quarterly volatility that's bound to be there in a business of this size, I think it's fair to summarize this as we're on track to not just meet but be at the higher end or exceed the vast majority of our capital markets commitments.

So we had said we would build 10 million homes on fiber. We're well on track to build 2 million homes this year, and we're well on track for over 10 million in 2024, especially now that our GlasfaserPlus joint venture has been approved. We're also building multiple new partnerships in Hamburg, for example, giving us access. We've also doubled down on our fiber target for Berlin. So I'm feeling pretty good about where we will get to, upwards of 10 million homes on FTTH.

Broadband revenues, we had guided more than 4%. We are at 5% this quarter. And I fully expect when we look at '20 to '24, we will be above 4%. One piece that we spent a lot of time at the Capital Markets Day talking about was our belief in upsell as a key driver to our growth. And if you remember, at that point in time, we had said 25% of our customers have greater than 100 Mbps. That number is already at 35% on more than 100 Mbps. So kind of the track to creating value through upsell on higher speeds and broadband remains well on track. And as I said, excluding the one-off effects of TKG, demand for this market continues to remain fairly strong.

On mobile service revenue, we have undisputed leadership on the network side. As you've seen, we've had 2.5% growth. We see a balanced growth across B2C and B2B, and we fully expect to be in line or at the top end of our Capital Markets Day communication on mobile.

Last but not least, EBITDA AL, where we've consistently, I think, in the last year grown at above 3.5%. That performance continues through to quarter 1. That's driven in equal parts by net margin growth, as I said. Ultimately, the key determinants of net margin growth tend to be broadband growth, wholesale performance and mobile service revenue. You've seen those trends remain materially in track -- on track.

And we've built a really strong record on indirect cost reduction. And in many ways, that indirect cost reduction is driven by strong service performance, where the lower the complaints we have, the lower the fault repairs we have, the less volume we need in service, but as well as digitization. Just one example of it is what we've seen in app penetration going up to 57%.

So in summary, Germany remains strong and well on track to be at the higher end of our Capital Markets Day commitments. And as I've said, this quarter, we've seen a few headwinds, but we are confident that the vast majority of them will start reverting from next quarter onward.

With that, let me hand back to Christian.

Christian P. Illek - *Deutsche Telekom AG - CFO & Member of Management Board*

Thank you, Srini. So let's move over to T-Mobile US. And Page 20 shows you the strong momentum reported by T-Mobile U.S. with a 6.6% service revenue growth but also with a 10.2% core EBITDA growth. And both are marking a sequential acceleration. The adjusted EBITDA according to IFRS was only stable year-over-year, and this is because we have reduced the handset leasing business by USD 600 million.

So if we're taking a look at the customer performance, strong customer growth continues. We added 300,000 accounts in the U.S. The ARPU was up year-over-year by 2.3%. That led to a guidance increase on ARPU by 1% for the full year. The total postpaid additions were 1.3 million, of which roughly 600 million coming from phone and the other from mobile internet. And within that, there were 340,000 net additions on fixed wireless access.

So in total, we're enjoying now more than 1 million customers in our customer base, and this is just 1 year after launch. Also, you can see as -- and people were concerned about the churn in the U.S., especially given the Sprint migration. It has improved from 1.1% to 0.9%. And so very, very strong numbers for the quarter.

Let's move over to Europe on Page 22. Organic revenues grew by 4.2% this quarter. Mobile service revenues grew by 2.2% this quarter. And the European segment benefited from better visitor and roaming revenues, especially in Austria, given the skiing season. But on the other hand, it was offset by some termination rate cuts, especially in Poland. But all up, good performance.

Organic EBITDA growth, as I said earlier on, was almost 7%. And now Europe is enjoying the 17th quarter of consecutive EBITDA growth. We're clearly seeing some cost pressures due to inflation. We'll get into this later on, on overall DTAG level. But we're also confident that in many markets in Europe, we will be able to leverage pricing to offset this kind of effects. So what you can see on the commercial performance on the next page, strong across the board, holds for all the different categories.

And that gets me to the next page, which is Group Development. On Group Development, strong organic revenue and EBITDA growth, both driven by T-Mobile Netherlands and GD Towers. As I said earlier on, if you exclude the held-for-sale accounting, that would still have been a growth of 11.4%. Obviously, with the closing of the sale of T-Mobile Netherlands, that's going to be the last quarter where we're going to report on T-Mobile Netherlands and then it's going to be deconsolidated.

On towers, very promising results. So in total, we added 1,000 towers in Germany. That's a net number. We built basically 1,300 new sites, but we also decommissioned 300 sites, gets you to the 1,000. The recurring revenues grew by 7%. Organic EBITDA grew even by 10.2%. This is due to lower cost per site. So very promising and satisfying results.

Finally, Systems Solution. We're making progress on systems. The order entry was going down slightly. Same holds true for the revenues. On the other hand, we've seen a very nice EBITDA increase. And again, I would say we're pretty much on track with the transformation. And -- but there is the structural challenge of the classical IT business, which has to be compensated by growth business, and we're in the middle of that.

So before I get to the group guidance, let me just spend a couple of minutes on inflation and take a look to what extent we are exposed. I think that's Page 28 exactly. And we've done pretty much the same thing what we have done throughout the COVID crisis. We did an analysis of what we expect is going to happen going forward.

So let me start with energy costs. Total energy costs add up to EUR 1.5 billion in the total group, of which 50% is being carried by the U.S. In the U.S., 2/3 of the energy prices are hedged with long-term hedges based on PPAs. The other 50% are coming from the T-Mobile ex U.S. business and the vast majority, roughly EUR 0.5 billion, is coming from Germany.

And we've told you this before, Germany is protected with multiyear hedges, and we have further extended those hedges. And from this perspective, I think we only have to face part of the price increase because the other prices are already locked in. On top, we're benefiting from the retirement of the renewable energy surcharge.

So we don't expect a lot of headwinds in the upcoming years in the German business, but we're seeing risk in the European segment. In the European segment, in many countries, you are not allowed to go for multiyear hedging. So therefore, we have to basically take shorter-term activities, and we're getting into, let's say, intense discussion on how PPAs may resolve that issue for us going forward.

The second big issue is obviously wage cost. And let me just elaborate a little bit on the wage agreement which we have achieved yesterday here in Germany. It covers 55,000 employees and it covers 2 years. And it basically entails 2 increases and 2 one-offs. So the way how it's been structured is the increase is supposed to start in August this year, and it ranges from 2.7% to 3.1%. And obviously, the higher increase is coming with the lower salaries. There is a second increase happening in June 2023, which is 2.1%.

On top, we have 2 one-offs, which we're going to pay to the lower-income employees. And if you basically add everything up, also the visibility over 2 years, then we're absolutely satisfied with the result. I think it's acceptable for both sides. It's acceptable for the tariff party, the unions, but it's also acceptable to us.

Can I have the next slide, please? So when it comes to leases, you know that the leases still belong in the European business to us as operators. And in the U.S., we have multiyear agreements with ATC, 15 years; and Crown Castle, 12 years. And these price increases are not based on the CPI or on the inflation. They are basically negotiated within that contract. So there is no additional risk to be faced. And when it comes to our big investment buckets, meaning fiber in Germany and also mobile equipment in the U.S., those costs are secured by long-term contracts.

So finally, let me just take a look at the interest payments. All up within the group, we're paying EUR 3.9 billion, of which 85% of the interest costs have to be carried by the U.S. operation. You know that the U.S. operation is doing their financing only on fixed terms, and the maturity -- the average maturity on the U.S. financing is 10 years. Outside the U.S., it's different. We're pretty much having 50% fixed, 50% variable. But we don't expect a lot of impact for the remainder of this year. That may be a low double-digit number but not more than that.

So if you summarize the inflation impacts, first of all, there are challenges which need to be managed. In many cases, we have hedging and long-term contracts protecting us. We're most exposed in the European segment. But in the European segment, we have the biggest opportunity to also pass on some price increases to consumers. So all up, I would say, we can manage those challenges.

So that -- and as Srini was confirming the CMD targets, obviously, I'm confirming the CMD targets for the overall group. And that brings me to our -- to this year's guidance. And you've seen on the preceding charts that we have our business performing pretty well. And this is why we're basically increasing our group guidance today. What we're essentially doing is we're keeping the ex-U.S. guidance stable and passing on the guidance increase of T-Mobile U.S.

That brings us to a guidance increase on the adjusted EBITDA from EUR 36.5 million to 36 -- greater than EUR 36.6 million and for the free cash flow from around EUR 10 billion to larger than EUR 10 billion. And the EPS, we expect to come in higher than EUR 1.25 per share. And please be aware, our guidance was excluding the Dutch business. So that has to be taken out. And our guidance was based on an average ForEx exchange rate of $1.18, and everyone knows where the dollar is right now.

So it gets me to my summary on the final page. So what I would say is, first of all, you see the T-Mobile US business is performing strong when it comes to customer growth, merger integration, speed and results and also when it comes to the financial results. Outside the U.S., we have a strong EBITDA momentum, and we're tracking well ahead of the Capital Market Day commitments. The dip in fixed line, as Srini explained, will be largely reversed in Q2 but at latest, in the second half of 2022.

We dealt with the challenges coming from inflation, especially when it comes to energy. I think we're well protected in Germany and the U.S., and we raised the guidance for the group. So we're confident for the short term and the midterm future.

And with that, we can open it up for questions. Thank you.

QUESTIONS AND ANSWERS

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

Thank you, Christian and Srini. And now we can start with the Q&A part. (Operator Instructions) So we start with Josh at Exane, please.

Joshua Andrew Mills - *BNP Paribas Exane, Research Division - Research Analyst*

So 2 questions for me. The first one is on the fixed line trends in Germany. And thanks for the explanation, Srini, on the headwinds and also some of the revenue restatements. But if we step back and look at your results, T-Deutschland, United and then what we think will happen with Vodafone next week, it does seem like there's been quite a big slowdown in the German broadband market. And so my question is how do you see things at the moment? Has there been an unwind of the demand we saw during COVID? And when you talk about returning to normalized levels of growth, do you think that 80,000 to 90,000 broadband net adds a quarter is a realistic run rate for the rest of this year and into next? Or should we anticipate that, that actually starts to come down a bit?

And I think the second question, somewhat related to this, is if we look at some of the recent price moves from Vodafone in particular but also United and Telefonica Deutschland on the new cable offering, EUR 30 for gigabit speeds, it does feel like there's a bit more competition in this market as people scrabble around for growth. So how is that impacting your business? And when you talk about the ability to pass through higher prices as an offset for inflation, is that something you still think you can do in Germany fixed? Or is it coming from other areas?

Srinivasan Gopalan - *Deutsche Telekom AG - Management Board Member - Germany & MD of Telekom Deutschland GmbH*

Right. Thanks, Joshua. That's about 4 questions that I can see nested into that. So let me first begin by separating 2 things, fixed line revenue and broadband net adds or broadband volume, right?

So the key to understanding fixed line revenue for me is to disaggregate it between broadband, wholesale and the rest, right? And it's in the rest category that you've seen a lot of the noise. And the reason I don't particularly worry about that or it doesn't cost me any sleep is most of the rest category is -- a reasonable part of it is projects and fundamentally lower-margin stuff. In terms of the sustainability of the revenue on broadband and wholesale, I feel pretty good about that. But we can come back and see if there's any further questions on that bit itself.

When you talk about the broadband market as a whole, I think when you look at this over a 3-, 5-year period, you will see the source of growth changing from volume and penetration to value and ARPU as the market structurally moves towards higher speeds. That's bound to happen, right?

Because broadband penetration is in the early 80s, it will start heading towards the mid-80s, early 90s. At which point, most of the growth in this market, like we've shown -- and seeing the kind of step up from 25% of our population -- of our base to 35% of our base being greater than 100 Mbps, structurally, over the next 3 to 5 years, you will see that balance switch from pure volume growth to more ARPU growth. And that's bound to play through.

Specifically, are we seeing some evidence of an unwind of the COVID trends, et cetera? Not really because the COVID bump-up in the fixed line market growth in Germany was significantly smaller than it was anywhere -- than in a lot of other places in Europe, right? So what we're seeing is -- what we're expecting is as we go through this year, towards the second half of this year, you will start seeing more normalization on the broadband market as the TKG effects flow through.

Now what that specifically means is I would expect the revenue trends, because of the washout of the one-offs, to start normalizing more in quarter 2, whereas I would expect the volume trends to be more half 2. Now if you take a 5-year view of this market, yes, there will be a shift in balance towards ARPU rather than volume just because of the penetration dynamics, right? So that's the way I see this playing out.

On the price moves, honestly, the whole promotional pricing has been something that's been around for a long period of time. And Vodafone has, for various stints, done 6-month promotions, et cetera, et cetera. I think the real issue with the cable network has been the ability to compete on quality rather than price, right?

And so yes, this is by nature a promotional market. In fact, to your question on inflation, I think the key to managing inflation in the German market is more about taking out promotional pricing than anything else because the natural trend that we see towards upgrading of price plans itself causes a nice 2% to 3% increase in ARPU without driving prices, right -- without driving prices up.

The biggest lever we have, and we've been consciously driving down this, is to take out more of the promotional pricing because that causes much more of a drag to overall ARPUs than anything else. And one of the dangers in trying to simply pass on higher prices to the base is the fact that you create a disparity between the front book and back book, which ultimately comes to bite you in terms of churn. So our preference is higher prices through growth in ARPU and pull back on promotional pricing. I think that pretty much covered off all of the elements of that question.

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

Very good. Thank you, Srini. And then we move on to Jakob at Crédit Suisse, please.

Jakob Bluestone - *Crédit Suisse AG, Research Division - Research Analyst*

I guess you sort of set it up for a towers question. I guess 2 questions, please. One, just on towers, I appreciate there's probably a little bit what you can say. Maybe you can just give us an update on the process. And specifically, is there anything you can comment on around timing on when we may know more?

And then just secondly, just a question on free cash flow in the ex-U.S. business, which is quite strong this quarter. Could you maybe just help us understand how much of the sort of strong free cash flow was phasing related, so will revert later in the year, versus some of the more permanent effects? So for example, strong EBITDA and I think there were some reimbursements on tax as well.

Christian P. Illek - *Deutsche Telekom AG - CFO & Member of Management Board*

Okay. So let me -- Jakob, let me start with the towers question on process. We see a lot of interest of the parties which we're dealing with. But we don't have a distinct time line yet on which signing can happen or not, and therefore, it's hard to predict how it plays out. So therefore, I would give you the abstract number Thorsten has given last year. He was saying '22 time frame.

The second piece is what we're seeing is everyone is really appreciating the attractiveness of the German market. It's been the largest market with the highest growth proceeds. Obviously, there is competition getting into the market with 1&1, and that drives the attention towards this whole process. Unfortunately can't be more specific on that one.

And I think on the free cash flow actually, as we -- I think we have in the presentation a backup, if I'm not mistaken. If you take a look at -- I think it was an EUR 800 million increase on the ex-U.S. business. EUR 400 million was coming from working capital measures. Obviously, there is some phasing in there. The other one was coming from stronger EBITDA and less CapEx.

On CapEx, I wouldn't be too optimistic that this year-on-year decrease will stay there. We expect higher CapEx in the European business along the guidance which we have given but more than what we have seen in Q1. So you see 2 phasing areas, and we're betting on EBITDA.

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

But I think it's good to have the money at this stage, and we reiterate our guidance for the year with great confidence. And with that, we move on to Mandeep at Redburn, please.

Mandeep Singh - *Redburn (Europe) Limited, Research Division - TMT Specialist Sales*

Can you hear me?

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

Yes, we can hear you.

Mandeep Singh - *Redburn (Europe) Limited, Research Division - TMT Specialist Sales*

Okay. Look, I am going to come back to towers again. I appreciate you can't name names and you can't give us a timing update that is be too specific. But previously, the management has kind of given some flavor of the type of partner, entrepreneurial, independent, that kind of update. I mean can you just give us a little bit more on just the flavor of the type of transaction you're seeking. Is it you want to have a listing? Is price maximization the kind of most important factor? What are the most important criteria for you right now?

Christian P. Illek - *Deutsche Telekom AG - CFO & Member of Management Board*

Hang on a second. So as you're indicating, Mandeep, we're interacting with different types of interested parties. And you heard Tim saying this, I think, in the last call, he wants to go for value maximization. And that is definitely something which intrigues us most.

The second one is -- and that was the second effect, is if we can create an industry solution which gives us a premium, obviously, we would be interested in that. But I can't be more specific than that one. But if you have a forced ranking on the most important criteria, I would say value maximization is #1.

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

Thanks, Christian. And next, we have Robert at Deutsche Bank, please.

Robert James Grindle - *Deutsche Bank AG, Research Division - Research Analyst*

Yes. It Was good to see the sensible wage agreement with the unions. I thought that protections against redundancies are extended but not for DTAG. What does that mean, Christian? Are you in any worse place on redundancies than before? Is it normal for that unit to be treated separately?

And the second question, you're much closer to the leverage target range ex leases than you are including leases. Are you pleased with the former or makes no difference as it's the latter target that's relevant to your view on like some stuff like buybacks, dividends, M&A and things like that?

Christian P. Illek - *Deutsche Telekom AG - CFO & Member of Management Board*

Okay. So on the wage agreement, I think we were hopeful in the previous calls to say we're hopeful for a sensible agreement, and we expect that this is in the same vicinity like the previous arrangements are. And I think all up -- and it's contingent upon the approval of the (foreign language). Sorry for the German word. I think this is an acceptable agreement which we're having.

With regard to the severance -- (foreign language), severance protection, I think this is structurally exactly the same what we have had in the past years. So look, we don't do termination based on business reasons and then we close down operations. We haven't done this in the past. So it usually comes with the severance payments, whether it's going to be (foreign language) or severance payments in general and I think very much in line with what you have seen in the years before. On the other hand, don't expect that special factors from the personnel side will significantly come down as we're moving throughout the transformation. So I think very, very comparable relative to previous years even if we have some areas where we don't have these kind of protections.

And the second one with the leverage target, you're absolutely right. The leasing increase is higher than originally anticipated. But look, I want to see the leases coming down -- the net debt, including leases, coming down. And then we can have a discussion out of a position of strength. Right now, we said it's -- the target range, 2.25 to 2.75, and all the capital markets commissions are bound to this target. And I think we're making some progress in that direction, but I don't want to withdraw from the articulated and communicated target range.

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

I think it's fair though to highlight that our competition is using the AL metric usually. And so when you compare us to our peers, keep that in mind. And with that, we move on to -- Christian?

Christian P. Illek - *Deutsche Telekom AG - CFO & Member of Management Board*

Let me drill on one point because I wasn't sure whether I bring it in the presentation or not. Take a look how the perception of the rating agencies is. Last year, Moody's basically removed the negative outlook, and we are on BBB+ if we're talking on Standard & Poor's terms. On Fitch, we're on BBB+. And end of April this year, Standard & Poor's gave us a positive outlook because they're believing that we will receive BBB+ in the upcoming 24 months. So from this perspective, I think even the rating agencies have a way more positive look on us as an operation when it comes to leverage.

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

But we still got some work to do. And so with that, on to George at Citi, please.

Georgios Ierodiaconou - *Citigroup Inc., Research Division - Director*

Yes. Actually, both of them are follow-ups on some of the topics that were raised earlier. Firstly, on Germany, I know there was a question earlier about cable offers. I just wanted to also -- perhaps if you could comment a bit on the recent decision by the Bundesnetzagentur around zero rating. And I know there should be, at some point, some update. But I'm curious how you're thinking of going about replacing StreamOn, whether that can be accretive or not and whether it's contemplated in your plans perhaps given that you offered it to the customers because you thought it added value.

And the second question is going back to the towers. And I just wanted to ask a very specific one. In the past, I think, Christian, you described a structure where you had a preference in not consolidating the asset in order to give it the best chance to perhaps engage in other activities. Is that still the case? Or could conditions on that side have changed? Or is the preference still to be a minority owner of the asset?

Srinivasan Gopalan - *Deutsche Telekom AG - Management Board Member - Germany & MD of Telekom Deutschland GmbH*

Maybe I'll pick up -- thanks for that question. Let me pick up the one on StreamOn and then hand back to Christian on towers. Look, fortunately, the BNetzA has largely banned the zero rating offers in Germany. Now what are the time lines on this? The marketing for new customers has to be stopped from the 1st of July, and existing customers can still use the product until the -- until March 2023.

Now that's something we're working on right now. We're reviewing our tariff portfolio. We saw Vodafone, for example, add on 20% to its allowances on its front book as its first step to dealing with the removal of pass. We're pretty confident that we have something which actually makes this accretive. But obviously, our plans from a tariff portfolio perspective are quite confidential. So we're expecting to you -- we're expecting to surprise you with something pretty soon, which we are confident of in terms of accretion.

Christian P. Illek - *Deutsche Telekom AG - CFO & Member of Management Board*

So on the second question on towers, George, look, the biggest opportunity or the biggest advantage is obviously you can lever up the company much more if you are the minority shareholder. And if you want to play on eye level against the specialized tower companies, obviously, we have to create a structure which puts us in this position. So let me put it a little bit vague. I would say this is more likely than not.

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

Okay. Thanks, guys. And next is David at Bank of America, please.

David Antony Wright - *BofA Securities, Research Division - Head of Developed EMEA European Telecoms Equity Research and Director*

Best regards, of course, to Andreas and the team on his birthday. But my question is lease and towers, there you go, to touch on both delights.

In your considerations of a towers deal, have you spoken with the agencies at all on what kind of multiple they might want you to add back for a lease? So from an EBITDA perspective, et cetera, what would they like you to capitalize? Have you had those discussions? Or do you have an idea of how we might expect the lease accounting and the lease you guys show in net debt to change if there was a towers monetization, deconsolidation event?

Christian P. Illek - *Deutsche Telekom AG - CFO & Member of Management Board*

David, yes, we have, but I cannot be transparent about it. But that is obviously one of the critical discussions which we had. We also involved auditors on the construct. But wait until we have a deal, if we have a deal and then we can basically provide you with the transparency.

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

So with that -- sorry, that was not exactly giving you the level of precision you were hoping for, but I think that would be not appropriate at this point in time because it will depend on the agreement, of course. We go on to Andrew at Goldman, please.

Andrew J. Lee - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Mine was another follow-up on Robert's question. At the end of his question, he's asking around your capital deployment thinking. And as we come up to a point where free cash flow starts to come in thick and fast for DT, obviously, it's becoming very salient. I wonder if you could just talk about your thoughts on M&A.

So what we're seeing is lots of companies across the sector selling assets and being incentivized for simplicity. And on the flip side, we're seeing private investors take advantage of that and in their view, pick up assets across Europe on the cheap. So I wonder if you could just talk about what your discussions are with Group Development, et cetera, about the acquisition opportunities in Europe and whether you think the backdrop has changed, whereby cross-border synergies especially in fixed lines as we get closer to all-IP and fiber has made acquisition more enticing than maybe the public equity markets see at the moment and your peers are acting on.

Christian P. Illek - *Deutsche Telekom AG - CFO & Member of Management Board*

Okay. Thanks, Andrew. And Robert, sorry for missing out on answering your question on capital deployment. Look, we have a triangle which we need to manage, right, when it comes to financials. It's the EPS, it's the free cash flow. And we said, on top, we want to achieve the 50.1% in the U.S. We want to build out fiber. And I want to get back into my rating and leverage corridor. And once we have achieved all these targets, I think then we can -- we are open up for a completely new debate.

And that ranges around higher dividends. That ranges around -- and buybacks on the DTAG side. Don't forget about this one. We always said this as we did the capital increase. But we're not there yet. And therefore, I'd like to achieve my targets first. And I'm happy to engage in any kind of discussions on what we're going to do with the extra profits and free cash flow.

The second piece on M&A, again, I'm a little bit tight-lipped on that one. Look, the biggest return on M&A right now is increasing the stake in the U.S Given their free cash flow expectations and EPS expectations coming from the U.S. and we are not above the 50.1%, so that's a very attractive M&A target for me.

And the second one is I think we have been transparent about the Romanian business. As Srini was running the segment, we were keen on selling the whole business. That didn't work out. We still have a mobile asset in Romania. And obviously, we're willing to give it to somebody who is interested in that asset. But anything beyond that hasn't been a big discussion in the boardroom at all.

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

And for those who have followed, our stakes in our Eastern European subsidiaries have been increasing over the last few years because they are not doing big buybacks but small buybacks. And so our percentage ownership stakes are actually moving up in those assets. And with that, we move on to Usman at Berenberg, please.

Usman Ghazi - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

I just had 2 questions, please, both on the German business. Just starting based on mobile first. It's obviously very clear that you have the coverage and the capacity to kind of lead in the mobile segment in Germany. But I mean your service revenue trends are basically tracking the market, right? The market is growing at 2%, you're growing at around 2%. You've got other players in the market like TEF DE for example. Granted they've got some wholesale support, but still, they're still tracking above the market. So I mean how -- is this an acceptable situation for you, having invested so much in spectrum and sites and everything and then just to track in line with the market? That was my first question.

And then my second question was just sort of going to the TV segment -- the IPTV segment. Again, this is an area where Deutsche Telekom, surprisingly to me, has continued to underperform much smaller players like Freenet, waipu. And I was just wondering what you could do to accelerate take-up here. Yes, those are my questions.

Srinivasan Gopalan - *Deutsche Telekom AG - Management Board Member - Germany & MD of Telekom Deutschland GmbH*

I could pick that up. So firstly, on mobile, you're absolutely right, we do lead on capacity and coverage. And from our perspective, the way we think about mobile is, I guess, 2 pieces. One, the market equilibrium is important in mobile. And when you're looking at our job as responsible market leaders, it's a 3-way market.

Yes, TEF is more dependent on wholesale than the rest, right? The primary driver to making -- to ensuring that we get return on our capital employed is actually market growth. And so we're much more in favor of driving something which is sustainable for market growth. And to be honest, I don't know of many markets that are tracking at above 2% on mobile service revenue. And I would argue that's a result of our responsible behavior as a market leader rather than look at us in context of the market, right?

Now there are places where we would like to perform better, specifically on the Magenta consumer brand. And we've talked about that, and you will see us move in that direction. But on the whole, look, a mobile market growing at 2%, 2.5% is healthy in the context of the vast majority of markets. And market growth is truly important for us from the perspective of ensuring we get return on capital employed. When you have 3 players with 30% to 35% share, market growth plays a much, much bigger role in return on capital employed than 1/4 of 4% growth.

On TV, look, there's 2 different pieces. One, in quarter 1, we added 17,000 new TV customers, but that's -- a large part of that is the result of the TKG. If you look at it more historically, in quarter 4, for example, Vodafone lost nearly 75,000 customers and we had strong growth in our TV customer base. So I'm actually quite happy on where we are on TV.

There's one point I'd like to make though. In TV, our strategy in the last year has moved from pure volume to being able to monetize. So if you look at our TV ARPUs, we've seen a sharp increase in TV ARPUs. We moved our introductory price point from EUR 5 to EUR 10. That's helped massively in terms of monetizing a lot of our content.

So 3 comments, I guess. One, the recent volume impact you're seeing on TV is mostly TKG novela. Second, more broadly over a 3-year time frame, I would expect TV volume growth to be more moderate. Third, I'm seeing really strong TV value growth because of the direction we took on pricing. And we think that direction on pricing goes hand-in-hand with a drive towards bringing more content in, whether that's Disney+, whether that's Netflix or RTL Plus. We are moving beyond simply being your replacement for your cable -- live TV effectively. So I'm actually quite happy with where we are on TV as a whole.

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

And for the record, we have not lost service revenue market share in last 12 months. And actually, we are still bigger in service revenue terms than O2 by a reasonable amount. And let's move on to Akhil at JPMorgan, please.

Akhil Dattani - *JPMorgan Chase & Co, Research Division - MD and European Telecoms Analyst*

Can I ask 2 as well, please? The first if I can go back to some of the comments you made on inflation and pricing. And I guess very high level, I'm just trying to understand. If we look at the midterm targets you've provided at the Capital Markets Day, you've given very clear revenue and EBITDA targets. But obviously, with inflation running higher than you would have envisaged back then, is it fair to assume revenue growth has to be higher? Or do you think it's more about cutting costs? So I guess I'm just trying exactly get what you're talking to.

And you obviously mentioned pricing in Europe. Obviously, Srini, you mentioned discounting in Germany. But I mean, I guess it all comes down to the same thing. Ultimately, is this a function of believing you can pass on inflation and growing maybe a bit better than otherwise you might have thought? So comments there would be great.

And then the second thing was on T-Mobile U.S. And referencing back to some of the points, Christian, you've made on balance sheet priorities. T-Mobile US has been hinting again recently that they could announce a buyback decision this year rather than next year. Now obviously, I don't want to preempt exactly what you may or may not do, but if you could give us some high-level comments on how you think about that potential volume of proceeds.

And it was quite interesting, your comments earlier to Andrew's point about M&A, that you said one of the most interesting options would be T-Mobile US given the cash flow generation. I guess in that context, how do you feel about that? I mean does it really make sense to settle on the buyback? Or could it make sense just to accrete instead?

Christian P. Illek - *Deutsche Telekom AG - CFO & Member of Management Board*

Akhil, good question on inflation because I would say different courses for different horses. So what I said -- and let's slice the elephant. Inflation in Germany, energy cost exposure is limited because we have a relief. We can't do anything for it or against it, which is the retirement of the renewable energy surcharge, and that will largely compensate for any kind of price increases which we are facing in Germany. And again, in 2024, our coverage on energy consumption is already locked in for 80% of the total volume. So that gives you kind of an answer to what extent this is critical. Secondly, we have just struck a deal on the wages. So that also carries through 2 years, so that gives you visibility for the next 2 years as well.

Europe is different. Europe is more exposed to energy cost increases, but Europe has a big -- they will also face some salary challenges. So -- but Europe has the opportunity to pass on prices in the given market. So what we're going to basically see in the European segment is a higher momentum on net margin increase. At the same time, you will see some gaps on the indirect costs. Ideally, you cover them with incremental measures, but I think it's going to be a combination of incremental cost measures in the European segment but also increased net margin.

And in the U.S., look, the U.S. team has given a guidance on this one -- on energy. I gave you some transparency on this one. So I think it's different answers on the same topic.

So the second one, T-Mobile US on share buybacks. Look, I stick to the official statement, which is up to $60 billion in between '23,'26. My general thinking on share buybacks is if you don't find better means for the money, obviously, then you should consider those share buybacks.

But we are still in the process of finalizing the integration. So from this perspective, I would say, in the U.S., I expect them to deliver on the synergy results on the time line what the integration is, and then we see how it plays out. But this is obviously something which needs to be discussed on the T-Mobile US Board first before we can give you some transparency on this one. And that means timing and that means the size of a potential share buyback.

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

I think Akhil also asked about what we as Deutsche Telekom will do with the proceeds. And Do you want to maybe comment on that?

Christian P. Illek - *Deutsche Telekom AG - CFO & Member of Management Board*

I'm a practical guy, right? You can distribute the skin of a bear once the bear is dead, and therefore, let's see once there's free cash flow coming our way. I said we have to fulfill our 3 capital markets -- financial targets on capital markets, which we have given in line with the strategic targets. And once we are there, I think we can have a discussion on what we're going to do with the proceeds.

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

And the good news, we have all this free cash flow and these buybacks coming our way and all this goodness, as they would call it in the United States, that we then can talk about. So with that, move on to Ulrich at Jefferies, please.

Ulrich Rathe - *Jefferies LLC, Research Division - Senior European Telecommunications Analyst*

So one -- my first question is more of a clarification on this telecom law impact. I don't want to get too nitty-gritty about it, but you seem to be saying that the volume impact is really something for normalization in the second half. And on one of the final slides in the presentation, you talked about it will largely revert in the second quarter. The impact is visible, so I would just be interested in a bit more color on how this fits together. I mean 1&1 seemed to say that they had only about half of the full year budget for what they think might happen in the year coming through in the first quarter. Is that a similar picture for you?

And then my second question is Vodafone is changing management. That often comes with an adjustment of strategy. Potentially -- there's a possibility, I think at least, that they might get an investment budget. How would you view the world tomorrow if there were an announcement of an incremental budget for new management in Vodafone? Where would you be most concerned? Or how would you think about that?

Srinivasan Gopalan - *Deutsche Telekom AG - Management Board Member - Germany & MD of Telekom Deutschland GmbH*

Great. Thanks. So let me pick up both those. So let's talk about the TKG impact. There's actually 3 pieces to this conversation, right? One is a statement of our fixed line KPIs will revert in Q2. The second is the conversation around the timing of the TKG effect. And a bit linked to that, I want to go back to some of the earlier conversations on what does this mean in terms of broadband market, right? Let's just deal with the first one first.

When we say vast majority of KPIs will revert in the second quarter, that largely refers to the revenue side of the picture, where a lot of the noise that we saw in the first quarter in our KPIs will be dampened in the second quarter. That's piece 1, right? And that's the piece in some sense that to me has the least impact on EBITDA because a lot of the noise that you saw in the first quarter is about the lower-margin project revenue, but that noise will dampen down as we go into the second quarter.

The second piece, which is the TKG and the impact of it. Now the TKG is a one-off pull forward of churn. It kind of -- the effect diminishes over the year and the vast majority of the impact will be in the first 2 quarters. There will still be some impact in the third quarter. By the time you get to the fourth quarter, it's washed its way through the system.

And I think you're referring to 1&1 who talked about 200,000 with 90,000 in the first quarter. When you look at the broad phasing of impacts, you're right in thinking about Q1 being the highest, going down in Q2, going down further in Q3 and washing itself out of the system by the time you get to Q4. So that's kind of the second piece on TKG.

I just want to tie this back to a point that was made earlier on what do we see as -- what do we see driving broadband growth and specifically 80,000, 90,000 net adds, et cetera, et cetera. Let's just put this in context, right? When you disaggregate our broadband growth, last year, about 2.8% of our growth, almost 3% of our growth came through volume and an equal amount through ARPU roughly, when you look at pure broadband. As we play forward over the next 3 to 4 years, right, we don't expect that mix to remain the same. We expect the volume proportion of that to head downwards towards, let's call it, a 2%, whereas the ARPU effect of that to be above 2%, which is why we combined guide for more than 4%.

Now what does that translate into exactly? Does that mean exactly 80,000, 90,000 net adds in Q4? I don't have a crystal ball, and it would be spuriously accurate to forecast exactly how many net adds. The picture I would paint is a Q1, Q2 slowing down of this market because of the TKG effect; as we get into Q3 and Q4, a recovery of this market; but over a 3- to 4-year period, a return to a slower market growth rate with more contribution coming from ARPU versus pure volume. I think that's the rational way to think about this as you're thinking about modeling this.

Vodafone changing management and what does that mean in terms of strategy and investment budget? What does this mean for you? Look, we tend to be very focused on our own strategy. What we are seeing is that -- and you know our preference. We like competing in a market which is driven by quality rather than price. We believe that Vodafone will inevitably invest in densifying its coax network. There's a lot of debate on FTTH versus coax. But look, a coax network, especially when it's densified, can function quite well. And we would actually like a world where we're competing on quality versus purely pricing. So we'll see what the investment budget lands up meaning. But in general, structurally, I have a preference to compete on quality versus price.

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

Thanks, Srini. And we move on to Polo at UBS next. Thank you. If not, maybe we can -- we take James first and then move on back to Polo later, James from New Street.

James Edmund Ratzer - *New Street Research LLP - Europe Team Head of Communications Services & Analyst*

Yes. So 2 questions, please. The first one, just love an update in your thoughts around FTTH expansion. I mean obviously, you've got your CMD target of EUR 10 million by 2024 plus potential for additional joint ventures beyond that. And I was really interested in whether you are thinking about signing more additional joint ventures. You obviously signed quite a big one with IFM. Do you think you could see more coming? And do you see the pressure from any of the altnets that might need that you accelerate that build-out further?

And secondly, just love an update on your thinking about the BT state at this stage. I know kind of last year, you talked about potentially being the kingmaker there, and things seem to have gone a bit quiet. So any update on the situation with British Telecom piece would be great.

Srinivasan Gopalan - *Deutsche Telekom AG - Management Board Member - Germany & MD of Telekom Deutschland GmbH*

I'll take the one on fiber, and Christian can have the pleasure of dealing with the BT stake question. So on fiber, look, where are we right now? Our expansion is going to plan. I think the altnet play in Germany, most honest, is proving more fragmented than we would have thought a couple of years ago, and it's a bit hard to call where that environment is going right now.

I think suffice to say, a lot of them are finding it easier to raise money than build fiber, right? I think there is more money coming in. Or I think the easiest bit is to do the PR about the money. The next easy bit is to raise the money. The toughest bit is to actually build fiber. So I think it's fair to say it's a lot more fragmented than we would have thought it to be. And so from a pressure from altnets to accelerate, I'd say that's reasonably limited and well within the scope of our current thinking on plans.

But that said, let me give you my take on the JVs, which is we don't see this being a patchwork of JVs, right? The way I think about this is how do we make sure that we get owner economics from the vast majority of our footprint, right? Now in terms of JVs, we are open to a few JV conversations, but I would paint a picture of 3 to 4 JVs which supplement our own build.

And we've already got 2 with Glasfaser Nordwest and GlasfaserPlus. Where -- what those JVs do is give us close to owner economics in places where we don't own the network completely. So there may be 1 or 2 more places where we look at that, and that could help accelerate some of our build. But this is not going to be a patchwork of 15 JVs because our focus is to try and make sure, when the fiber end game plays out, we have as much owner economics-based fiber as possible.

Christian P. Illek - *Deutsche Telekom AG - CFO & Member of Management Board*

So unfortunately, on BT, not a lot of new news. Look, my current assessment of the BT stake is I'm happy along 2 vectors. One, obviously, I'm expecting a dividend this year to come. And the second one is also the share price increase, which we have seen over the past months that helps me to cover my pension obligations.

All what I can say is whenever you put money into a pension fund, there is ways in order to get it out. So if there is a necessity or whether there is a willingness to use the BT stake in a different direction, we have established a way on how we do this. But as I said earlier on, there's no news on BT.

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

Okay. With that, we move on to Ottavio, and we have one more question after that. So Ottavio at Soc Gen, please.

Ottavio Adorisio - *Societe Generale Cross Asset Research - Equity analyst*

I have a couple of questions. The first on fixed and a quick one on free cash flow. The one in fixed is basically related to the profitability. You mentioned earlier that the momentum of the one-offs in fixed didn't fit into EBITDA because what effectively you lost were revenues with low marginality. Now a significant portion of the one-off was this -- in the public sector. So my question is that -- would it imply that public sector profitability is relatively low or this specific contract was not very profitable?

And still remaining on profitability. I also noticed that this quarter, you have reclassified construction revenues from wholesale outside of wholesale but within fixed. Now I believe this construction revenue piece was to recharge the JVs. Now the revenue still remained within the fixed. And I was wondering, these construction revenues, you built at the cost of the JV or you do make a markup?

Moving on to free cash flow. This is to Christian, to an answer you gave earlier. Among all the moving parts this quarter, there has been a tangible decrease on the cash leases, I guess, because of a prepayment you made in Q1 2021. Now considering free cash flow this year, it's relatively going pretty well so far. Could there be any plans to reinvest back on any prepayment of the leases or you're happy how the leases are at the moment?

Srinivasan Gopalan - *Deutsche Telekom AG - Management Board Member - Germany & MD of Telekom Deutschland GmbH*

Okay. So I'll pick up the first one. It is -- so I think there's 2 elements to the answer. I think firstly, public sector in general is actually very strong margins when you look at our public sector business. The specific issue tends to be with project revenue, where project revenues are one part of a broader relationship. They're a really important part of the relationship, but they're much weaker revenues. And that's quite often true of whether it's public sector or large private sector. And so the point I was making earlier, it was actually specific to this project and typical of the project type revenue that we bring in. So I hope that clarifies that, right? It is -- our public sector actually, from a pure margin perspective, is really strong.

The reason we removed construction revenues is purely because they're nonrecurring by nature, right? The fact that they're nonrecurring then kind of distorts the underlying trend.

Christian P. Illek - *Deutsche Telekom AG - CFO & Member of Management Board*

So Ottavio, on the free cash flow, first of all, I'm not sure whether it was Q1. I think it was in Q3 where the U.S. prepaid roughly USD 1 billion to ATC, which obviously has now a positive impact on the cash leases in the first quarter.

The second one is, am I happy with the cash leases or not? Look, first of all, the last majority -- the vast majority of cash leases are sitting in the U.S. I'm just looking at my numbers here. It's north of 30 billion, whereas in the rest of the business, we have -- we're below 5 billion. And as you recall, the recent deals they have constructed -- or transacted on, they're all long term, ATC is 15 years, Crown Castle is 12 years, because the terms and conditions just give you a benefit from the leasing costs you have on a monthly basis.

So it's not a question whether I'm happy or not. It's more a question of what is the most attractive deal construct. And I'm willing to accept longer terms if we get something in -- which is a big return to us from an operational cost perspective. So it depends on a deal-by-deal basis. But what I also heard from the U.S. team is with ATC and Crown Castle, they do not expect a lot of very large leasing deals in the future. I think there's always leasing deals to be renewed, but I think not in the same vicinity as we have seen over the past 1.5 years.

And with regard to free cash flow, look, I'm not sure whether you asked the question or not. That greater than EUR 10 billion, let me kind of quote myself, which I said in -- I think it was in Q3 last year, it's prudent.

Srinivasan Gopalan - *Deutsche Telekom AG - Management Board Member - Germany & MD of Telekom Deutschland GmbH*

Sorry, the one question I don't think I answered was whether there was a margin on construction revenues. There's a small, almost irrelevant margin on the construction revenues.

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

Thanks for the clarification. And if your concern is that we only achieved our free cash flow target this year because of prepayments, no. And move on to Emmet -- last year's prepayments, I should say. We might do other prepayments. Let's see what -- how the year pans out.

With that, we move on to Emmet at Morgan Stanley. And that's the last question for today.

Emmet Bryan Kelly - *Morgan Stanley, Research Division - Head of European Telecoms Research*

I've got 2 questions as well, please. Just my first question is kind of big picture. You covered the cost inflation side, which was clearly very helpful. And I guess the related theme to inflation is how this is squeezing consumers with rising fuel prices, rising food prices, rents going up. How do you believe your business is positioned in the event of the consumer being squeezed quite badly in Europe and also potentially in the states in terms of your value proposition, maybe price elasticity, demand? Or is there a risk of losing share to kind of cheaper challengers? I know Tim has said in the past that he's been quite reluctant to raise prices in Germany.

And then my second question, please, is on the old subject of net neutrality. I saw a nice quote from for Ms. Vestager about 10 days ago talking about tech players who generate a lot of traffic that enables their business to function, that they've not been contributing to enabling that traffic. So if you have any updated thoughts on where you stand on net neutrality and whether tech companies should be paying for access to your telco pipes, please.

Christian P. Illek - *Deutsche Telekom AG - CFO & Member of Management Board*

So let me start with the consumer behavior and then I'd hand it over to Srini to give you more details in Germany. So that was a big question throughout the COVID crisis as well. And what we've seen is that customers weren't optimizing themselves because I think from a desirability, a mobile contract is so high in the [forethinking] that you -- at least we haven't seen that, that you won't move from one operator to the next and then endanger quality of services, something like this.

And I think you also see it in the numbers. You see that the U.S. has increased its ARPU guidance despite the fact that we have a significant inflation in the U.S., which by the way is slightly higher than it is in Europe. I talked about the price increases which we are conducting in the European market. So the teams are fairly comfortable that they can basically pass on these inflation factors, and they wouldn't be if they would expect that consumer behavior is changing.

And on Germany, I think I have a more prudent guy sitting here telling you what he expects in Germany.

Srinivasan Gopalan - *Deutsche Telekom AG - Management Board Member - Germany & MD of Telekom Deutschland GmbH*

So a couple of things, Emmet. So I think one of the reasons we've been reluctant to put up prices in Germany and thought of this more as the natural effect of More for More, especially on the fixed line side, is we don't want to get to a place where we land up forcing customers to make a trade between price and quality, especially on the fixed line side. And I'll come back to mobile and your other question on net neutrality.

Look, I think today, in fixed, given how big a part of a consumer's life, especially post COVID, fixed has become, I think the thing we're seeing is that price sensitivity on fixed, if anything, has marginally gone down. Now that doesn't mean we can take this for granted forever. And we're conscious, in a rising inflationary environment, what we've got to do is give people more value, which is why we think of the speed upgrade strategy as the heart of how we deal with this rather than pricing. Now the good thing is we've still got 2/3 of our base below 100 Mbps, which keeps us fairly well protected in terms of the ability to do that, right?

Now on mobile, I think we have thought about this for a while from a portfolio perspective, where, again, we have with some of our second brands the access to some of the more discounted elements of this segment. And what we found in B2B is even as inflation goes up, the sensitivity to switching mobile provider on the B2B side is significantly higher because it's more than a mobile connection, it's what keeps them connected to the business. So I think summary of that is we've got buckets where the sensitivity to the general squeeze is lower. And we will stay cautious about our pricing there so that we don't get forced into making a volume versus value trade. And we've got brands in our portfolio that do help us flank.

On net neutrality, I think the short answer to should they pay for access is, we believe, yes, right? So that's a fairly uncontroversial answer. But look, we think we do strongly believe -- and you've seen some of the recent papers that we've worked on which talk about the fact that we believe there is a large load that comes from the tech players and that they don't contribute to enabling that traffic or continuing to make sure this is an industry where it's viable to keep investing. So we do believe they should be paying their fair share. It's a good way to finish on a Friday afternoon.

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

OTT. Okay. Christian, I think we are wrapping up now. And thanks for everyone's time on a Friday afternoon after a very busy week. So appreciate the attention and your questions. And if you have any further questions, of course, please call the IR department. Contact us, please, and we are sure to help.

And with that, I give back to the operator. Thank you very much.

Operator

We'd like to thank you for participating at this conference. We are looking forward to hear from you again. Goodbye.
