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# Deutsche Telekom AG *(DTE.DE)*

Q1 2013 Earnings Call

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# MANAGEMENT DISCUSSION SECTION

**Operator**: Good afternoon and welcome to Deutsche Telekom's Conference Call. On our customer's request, this conference will be recorded.

## Unverified Participant

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**Operator**: Now please listen to the statements of René Obermann and Tim Höttges. Afterwards you are welcome to ask your questions. May I now hand you over to Mr. Stephan Eger.

## Stephan Eger
*Head of Investor Relations, Senior Executive Vice President, Deutsche Telekom*

Hey, good afternoon and good morning to our listeners in the U.S., and welcome to the first quarter conference call of Deutsche Telekom. As always, with me René Obermann, our CEO; and Tim Höttges, our CFO. We'll be starting very quickly now with the presentation of Tim and René followed by a Q&A session, and we'll be ending on time at 2:00 P.M. given that today is a very busy results day. Thank you.

## René Obermann
*CEO & Chairman-Management Board, Deutsche Telekom AG*

Yes. Good afternoon. Thank you, Stephan. Let me quickly talk about the achievements in the first couple of months.

A few key things have been accomplished. First, the positive regulatory decisions and proposals in Germany on the unbundled local loop side and the vectoring support for our plans for significant investments into the next-generation infrastructure. Second point, as you know we have successfully completed the merger with MetroPCS and consolidated the new T-Mobile USA as of May 1. Third, at the same time, OTE successfully accomplished its restructuring and its refinancing after the sale of Globul and HellasSat. We'll have a deep dive into this later on.

Let me come to the Q1 results and start on the group level. First of all, we are very satisfied with our operational performance and customer numbers in the first quarter. We have seen strong mobile net adds in Germany and the U.S. and good TV and fiber net adds in Germany and Europe. The revenue decline of 4.5% year-on-year reflects the ongoing regulatory and economic pressure in Europe, as well as the impact of subscriber losses and the move to value plans in the U.S. This basically also feeds through to EBITDA. Bear in mind that the seasonal EBITDA pattern is different from Q1 last year. A real positive is the 31% increase in net income, mainly driven by €0.3 billion lower depreciation compared to last year. And our full-year outlook is confirmed.

For Germany, operationally we kept good traction in fixed with winning more than 100,000 fiber customers in retail, 45,000 via the so-called contingent model in wholesale and again 441,000 contract customers in mobile, of which 144,000 were own branded.

Financially, we've seen a good quarter with a solid revenue trend and an EBITDA margin north of 40%. Importantly and as projected, we have significantly improved our underlying service revenue trend and we're basically stable year-on-year, excluding the regulatory impact. Our goal remains to return to positive underlying service revenue growth in Germany for the full-year 2013.

For the U.S., operationally some progress in Q1 with 579,000 mobile net adds. The significant reduction in branded contract losses and branded contract churn were clearly the highlights. Financials, the lower customer base as well as the transition to value plans still weighs on revenues, but good cost-cutting secured a 25% EBITDA margin. And we have seen a very successful launch of our so-called 'uncarrier' strategy and the iPhone in the U.S. since April.

Europe, in a tough economic environment, we again delivered good customer numbers for our main growth areas. 72,000 net adds for both mobile contract customers and TV and 59,000 net adds in broadband. The financials for the quarter were heavily impacted by 2.5 times higher regulatory effects than in Q1 2012, a tough economic and competitive environment and special taxes. Please bear in mind that the new utility tax in Hungary was fully booked in Q1 with an amount of €23 million for the full year, thereby impacting our Q1 EBITDA negatively. And we continued to deliver on our technology strategy in Europe with growing all our – with growing our all-IP accesses by more than 50% and increasing the number of FTTC/FTTH homes passed.

In the Systems Solutions business, operationally the order entry was very strong with a growth of more than 33% to close to €2.1 billion. The market units in the quarter grew revenues slightly by 0.2%, whereas Telekom IT, due to project seasonality and cost-reduction efforts, showed a significant revenue decline. At the same time, EBITDA and EBIT margins improved significantly.

Let me make a few brief remarks on our headline financials. Net profit, both adjusted and reported, grew again in the first quarter. Main reason for the strong growth in adjusted net income is the lower depreciation driven by a lower asset base in the U.S. and, as projected, a decrease in depreciation in Germany. Remember that we – that the reported net income in Q1 last year included the book gain of the disposal of the OTE stake in Telekom Serbia.

Free cash flow is being down 7.5% year-on-year in Q1, and that bodes well for our full-year target of around €5 billion. And our net debt was basically stable in Q1, despite almost €1 billion in spectrum spend in Q1.

As you know, we gave full-year 2013 guidance under the theoretical assumption of including MetroPCS for the full-year 2013. This guidance is confirmed and is unchanged. Now as the deal has closed as of May 1, give us a bit of time to deep dive into the numbers and plans for customer migration and integration costs. We'll update you on the full-year 2013 group guidance including PCS for eight months with our Q2 results early August.

With this, let me hand over to Tim for more details on the first quarter. Thank you.

## Timotheus Höttges

*Chief Financial Officer, Deutsche Telekom AG*

Yeah. Thank you, René, and good afternoon, everybody. Let's start with Germany.

We are pleased with our operation and financial performance here in Germany in the first quarter.

Revenue declined by just 1.6% year-on-year, very similar to the previous quarters. Mobile revenues grew up by 0.5%, driven by terminal equipment revenues and the stabilization of our underlying service revenues. Core fixed line revenues declined by 2.9%, in line with the development in the last quarters.

Wholesale revenues at minus 6% worsened versus Q4, mainly due to higher negative regulatory effect from interconnection, but also lower voice service revenue trends. The adjusted EBITDA declined by 3.8% year-over-year, resulting in a strong margin of 40.5%, mainly driven by an OpEx reduction of 2.3% percent year-over-year. Major drivers for the reduction of indirect cost were savings in call centers, technical services and the reduction in temporary employment.

In German fixed, we saw a satisfying quarter in line with previous quarters. I would like to highlight some points here. A rather stable trend in line losses, adjusting for the 30,000 LTE wireless broadband customers added in Q1. Bear in mind that we have reduced our line losses since the 2008 peak by almost 60%. Continued growth in the average revenue per access, driven by the continued migration to double-play and triple-play. And a very strong growth in fiber retail customers of over 50% year-over-year to more than 1.1 million as well as a strong take up in fiber wholesale customers driven by our contingent model with partners.

Turning to mobile; the German mobile market service revenues decreased by 2.7% in Q1 according to our estimates. As promised and projected, we already saw a stabilization in our underlying service revenue, excluding the MTR effect driven by: first, an ongoing negative, but quarter-over-quarter slightly improved trend in voice revenues; an accelerating decline in SMS revenues driven by volumes; IP substitution and increased bundlings; good mobile data growth of 17%; and the non-recurrence of negative effect from 2012; for example, the loss of one of our service providers.

And importantly, we again showed a strong commercial performance with 441,000 mobile contract net adds, of which 144,000 were own branded net adds. Continued smartphone momentum with more than 1 million sales, including strong sales of Android and iOS devices, and strong growth in double-play customers now accounting for 62% of branded contract customers, up from 50% a year ago. Best-in-class contract churn at 1.1%, down 60 basis points year-over-year.

Coming to the U.S., these are the last stand-alone T-Mobile US results. In Q2 T-Mobile US will start reporting integrated results for the new company that combines T-Mobile US and Metro.

Turning to the standalone results, we already reported our much improved customer development in Q1. Most noticeably, we reduced branded postpaid losses to 199,000 customers, a 61% improvement compared to Q1 2012. This was driven by a 60 basis point reduction in branded postpaid churn.

In terms of our financial service revenues, declined at about the same rate as in the previous quarter, driven by customer losses in the past year and the continuing migration to Value and Simple Choice plans, which now constitute 36% of the branded postpaid base.

As in previous quarters, total revenues declined less than service revenues due to growth in equipment revenues, also driven by the Value plan migration. Despite the service revenue decline, T-Mobile generated an almost stable adjusted EBITDA margin of 25%. This was due in part to lower advertising expenses than in Q4 and continuing progress on the cost front.

In terms of ARPU, prior trends also continued with a decreasing branded postpaid ARPU, driven by the Value plan migration, and strong growth in branded prepaid ARPU, driven by the success of our monthly prepaid plans, by the way, a growth of 11%.

Let me also provide you with a brief strategy update on the U.S. On April 30, we successfully closed our combination with MetroPCS. As you know, T-Mobile US had quite a debut on the New York Stock Exchange on May 1, and now has an equity market cap of approximately $13 billion. The benefits of the combination are our superior spectrum position, especially on a megahertz per customer basis, the significant and very concrete synergies and the attractive growth profile.

With regard to the 'uncarrier' promise, we launched our radically simplified Simple Choice plan on March 26. The iPhone launch mid-April has been very successful and significantly exceeded even our own internal expectations with approximately 500,000 iPhone 5 sold until to-date.

We are also making very good progress on the network front, with already 7 4G LTE markets launched. We are confident that we can reach our 100 million mid-year POPs target and our 200 million year-end POP coverage target. With regards to HSPA+ on 1900 megahertz spectrum, we have already exceeded our mid-year target of 170 million POPs.

As shown in our first slide, our European segment faced a tough quarter with 2.5 times higher negative regulatory effects versus a year ago and an ongoing difficult economic and competitive environment, which is reflected in the revenue and adjusted EBITDA development in that quarter.

Revenues declined by 6.9% in Q1, the underlying decline, x-regulatory effects, foreign exchange and one-timer was 3.9%. Please remember that due to the accelerated Q1 program in Q1 2012, the base comparison was more difficult in the first quarter.

Main positive contributor to the segment revenues was Hungary, where the energy retail business and an increased smartphone share, and an increased prices were the main drivers. The biggest negative impact came from Greece, with declines in the fixed classical voice business, price pressures in the mobile contract base and lower usage in prepaid.

In terms of adjusted EBITDA with our strict efficiency and cost discipline, we managed to partially overcompensate a lower contribution margin, and for the new Hungarian utility tax booked in Q1 for the full year, which had a negative impact of €23 million. The underlying EBITDA declined by 4.7%. The biggest negative impact for the contribution margin again came from Greece, due to negative revenue impact. At the same time, Greece is also the biggest contributor to indirect cost savings. The main positive contribution to underlying EBITDA came from Poland due to rationalized market invest and a move to split contracts.

From the commercial perspective, we continue to demonstrate good momentum, particular in our growth areas. First, we showed again good growth in TV, 72,000 net adds, now reaching over 3 million TV customers. Second, broadband net adds of 59,000. Thirdly, contract net adds of 72,000 and mobile data growth of 13%, excluding currency effects. And last but not least, the smartphone share of dispatch devices of 68%, up from 57% a year ago.

Let me give you a quick update on the progress made on the strategy for the segment Europe and Technology, presented at our Capital Markets Day in December. As a quick reminder, the four strategic objectives of our revenue and cost transformation program are: all-IP migration; B2B Big Bang; mobile Internet push and innovation excellence; and cost reduction and operational excellence.

Progress on the revenue side; the share of total revenues from our growth areas just mentioned increased by 4 percentage points year-over-year to 22%. The share of the fixed revenues from connected home grew by 2 percentage points year-over-year to 21%. The share of mobile data revenues of overall mobile revenues grew by 3 percentage points to 16%.

Progress on the cost and efficiency side; the all-IP share of all fixed network access lines grew by 8 percentage points to 21% of the base. The first PSTN exchange are being shut down in Macedonia and Croatia. And cost savings, driven by measures which were implemented within the last 12 months, with personnel reductions mainly in Greece, Slovakia, Croatia and Hungary.

As one deep dive, I would like to elaborate a bit on the OTE group as a good example on our portfolio philosophy, as well as an excellent management and operational performance in one of the most difficult market environments.

At OTE, the management team took the necessary restructuring measures in the last three years, including a significant employee reduction in order to even increase the pro forma EBITDA margin. At the same time, the team grew the TV customers, the fixed broadband customers and the mobile contract customer base, across the entire OTE footprint. We haven't lost momentum in the marketplace.

With the help of a significant reduction in cash-outs, for instance via dividends and CapEx as well, and asset disposal, the last being the Globul disposal announced two weeks ago, the management will be able to reduce the OTE net debt by around €2.4 billion since year-end 2010, thereby fully securing its refinancing for the next years.

Having accomplished this difficult mission, the OTE management team will now be able to fully concentrate on the challenging Greek, Romanian and Albanian markets and to find the right answer with respect to investment levels for the future.

Turning to Systems Solutions, Q1 results were good. The revenue decline of 5.6% was mainly driven by a 24.9% revenue decrease at Telekom IT, mostly related to seasonal effects, whereas the Market Unit continued to grow. It's good if the revenue of our internal Telekom supplier is reducing, because this is driving our internal costs down at the same time.

At Telekom IT, we expect a slight uptick in revenues again in the coming quarters. Order entry in Q1 was particularly strong and up by 33% year-over-year with deals like EADS and SBB contributing. [Foreign Language] (24:31).

Adjusted EBITDA and adjusted EBIT showed a significant improvement with the EBIT margin increasing to 0.3% in the quarter. Main drivers were efficiency measures as well as the conclusion of the cost-intense transition and transformation phase for some of our big deals.

Going back to group level, starting with our financials and turning to free cash flow first, the actual free cash flow at €1 billion is roughly stable compared to last year's first quarter and an excellent starting point to meet our guidance of €5 billion. Cash generated from operations was basically stable. CapEx excluding spectrum investments decreased slightly to €2.1 billion in Q1, while we saw an increase of CapEx in the U.S., plus €281 million. Germany was considerably lower, minus €300 million, due to the long winter, which we had to face in the first quarter. You will remember that we guided for an increase for the full year, so expect that CapEx will increase in the upcoming quarters.

The adjusted net income increased by 31% year-over-year, despite the lower EBITDA and higher P&L taxes, predominantly driven by lower depreciation, this is coming from lower asset base in the U.S., and the anticipated depreciation expiration of older parts of our infrastructure in Germany and a better financial results driven by an improvement in interest and gains from currency translation.

Our net debt also remained almost stable compared to 2012 at €37.1 billion in the quarter, with the major drivers being a €900 million investment into spectrum, predominantly in the Netherlands, and a smaller negative currency effect. Due to the closing of the PCS transaction, as of May 1, we will take on the PCS net debt of $3.4 billion on to our balance sheet, which will together with the annual dividend payment in Q2, result in an increase on our net debt in Q2, but despite of that we will even see higher revenues, higher EBITDA and free cash flow getting consolidated at the same time.

Turning to our balance sheet ratios, net debt to adjusted EBITDA remained stable year-on-year at 2.1 times. The equity ratio at 28.5% improved slightly from Q4. The year-on-year decrease was caused by the reduction in shareholders' equity due to the U.S. impairment, in particular, by the way which we facilitated in the third quarter last year.

With regard to our comfort zone ratios, we are in the green with regard to all ratios and our ratings remain stable at BBB+ level with the major agency and stable outlooks. As a result, we continue to get excellent funding conditions in the debt capital market.

With this, René and I are now ready for your questions.

## Stephan Eger

*Head of Investor Relations, Senior Executive Vice President, Deutsche Telekom*

All right. I think we can start now with the Q&A session. We've got about roughly 30 minutes time, so please restrict yourself to one or two questions each. And I think we can get started. Who's the first in the line?

# QUESTION AND ANSWER SECTION

## Stephan Eger

*Head of Investor Relations, Senior Executive Vice President, Deutsche Telekom*

A

I think it is Ottavio Adorisio from Société Générale. Ottavio, your questions please?

## Ottavio D. Adorisio

*Analyst, Société Générale SA (Broker)*

Q

Hi. Good afternoon, gentlemen. I have a couple of questions; one, German mobile, the other one U.S. Mobile. Starting from German mobile, you did report receiving growth in service revenues when compared to previous quarter and competitors. Some of your competitors report a significant spike in cannibalization of legacy revenues from over-the-top, with a significant fall in SMS. On this issue, could you please let us know what was the year-on-year growth in SMS traffic for T-Mobile, and how you contained impact of OTT cannibalization?

And furthermore, the business segment was one of the few weak spots in domestic mobile, due to an 11.7% fall in MOU and 11.5% in ARPU. So, what were the drivers there, and what do you expect trends in voice traffic to improve in future quarters?

For U.S. mobile, it's a pretty straightforward question. You had very good encouraging trends in customer metrics and churn, but you also had a very cautious note on margins for second quarter, due to your planned increase in expenses related to the iPhone launch. So, what should we expect in terms of margin dilution for the second quarter in the U.S.? Thanks.

## René Obermann

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

A

Let me try and answer the first part of the question. Quantity decline is about 18% year-on-year. So, over-the-top substitution for traditional SMS is quite heavy on the quantity end. On the revenue side as well, it's about 21% or almost 22%. So, there was quite a hefty decrease on the SMS revenue side. On the other side, there is a strong increase on the mobile data revenue side as well. So, what we lose on the SMS side, we gain on the mobile data side, and that trend continues. And we've addressed that trend very early.

## Stephan Eger

*Head of Investor Relations, Senior Executive Vice President, Deutsche Telekom*

A

And I think when it comes to what do we do against that, I think that is what we've reported in previous quarters. I think we do pack more and more of SMS flats into our bundles, so that we have a lesser and lesser dependency on variable SMS revenues in the base. Ottavio, one question with respect to your question on voice traffic, I don't think that we fully understand where you're driving towards?

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

I was looking at the back half data where you actually showed consumer KPI business, customer KPI, consumer KPI a bit resilient, but when I look at the ARPU on the business side, I see an 11.5% decline, and most of the decline is due to voice traffic. So, I was just wondering, if there was any specific drivers on the business side?

**Stephan Eger**
*Head of Investor Relations, Senior Executive Vice President, Deutsche Telekom*
A

One of the specific drivers was the Easter weekend, which unlike last year actually this year fell into the first quarter. And that is especially impacting the business customers' voice traffic, because it's not only one or two days, it's basically a couple of days which we are then losing, especially in the voice traffic for business customers, Ottavio.

**Timotheus Höttges**
*Chief Financial Officer, Deutsche Telekom AG*
A

Let me try to answer the question on the margin dilution in the U.S. and the – our forecast with regard to the upcoming quarter, mainly the second quarter. My first statement is going to be that we are very happy with what's going on in the U.S., not that we were able to accomplish this very difficult deal, but independent from that one, we see a very good uptake of our new propositions the uncarrier strategy in the U.S. market. And we are very glad about let's say, the 500,000 iPhones we have sold since our launch at the 12, of April. So, just imagine how short this new proposition, this new idea of selling into the market, how short this period is.

With regard to the full year, look, last week, we closed the deal. We are now consolidating all let's say, assets. We are even in the phase of making a new forecast towards the end of the year. We will come with the second quarter with new guidance for Deutsche Telekom. Don't forget that our original assumption was a full consolidation for 12 months of MetroPCS. We now have to consider 8 months of MetroPCS in the group. This is now taking place, and we will give you an update on these new numbers with the Q2 numbers, but we are very optimistic and very encouraged by what we have seen, and therefore, we do not see any kind of reason to dilute or to expect lower margins throughout the year at that point in time.

**Stephan Eger**
*Head of Investor Relations, Senior Executive Vice President, Deutsche Telekom*
A

Thanks, Tim. And we continue with Simon Weeden from Citigroup. Simon, please go ahead.

**Simon H. Weeden**
*Analyst, Citigroup Global Markets Ltd.*
Q

Thank you very much. Just one question, really, and it's not unrelated. Just looking at the 9%-or-so-fall in service revenue growth in the U.S., and keeping in mind that the customer count numbers turned earlier perhaps than the revenue growth did in Germany, I just wondered if we look ahead at the next nine months and think about T-Mobile US just on its own for a moment, what sort of – do you expect to see that profile improving rapidly from here? Should this be the worst quarter for service revenue growth in the U.S.? Or do we still have a fair bit of the base that needs to move over on to the value plans, creating a bit of a drag on ARPU, while it does it?

**Stephan Eger**
*Head of Investor Relations, Senior Executive Vice President, Deutsche Telekom*
A

Well, Simon, you know the impact on service revenue declines, especially in the last two quarters, had two major reasons. Reason number one is, we have round about 2 million less contract subscribers than we had a year ago.

So, that is still filtering through the service revenues. Secondly, there's still a transition towards the value plans in the U.S. But as Tim has just now pointed out, I think we're just about to turn more positive into subscriber numbers in the U.S., and we're more encouraged by what we've seen lately and this obviously will also, over time, filter through to service revenues. We're not going to give you an update on the service revenue guidance for the full-year. That has been done by the colleagues at the Capital Markets Day and also the T-Mobile US colleagues, John Legere and Braxton will give you an update on that in the second quarter.

**Timotheus Höttges**
*Chief Financial Officer, Deutsche Telekom AG*
A

But maybe – giving some indications where we stand with regard to our service expectation in the U.S., we have already launched 7 LTE metros areas in the U.S. The 100 million LTE POPs, we have covered so far, we are on good track with this.

We have seen that our new plans, the Simple Choice plans, are working pretty nicely, which will help us especially in combination with our Value plan, and we have even a good traction on the bring-your-own-device issues. We had more than 100,000 iPhones per month as a run rate, which is helping us because this is coming without any kind of subsidies for us. We have a focus on this branded issues, on the post-date areas, so we have seen a lower churn. Traditionally, this business always comes with better margins and a better revenue profiles.

And on top of that, even the MVNO track record, so far is doing pretty nicely. So that is another contribution too urgent for us here, so therefore, I would not be too much worried about just singly – single-looking on the ARPU level, I think we should keep the service revenues and even the margin on the service revenues in our focus.

**Stephan Eger**
*Head of Investor Relations, Senior Executive Vice President, Deutsche Telekom*
A

Thanks, Tim. And then let's continue with Hannes from JPMorgan. Hannes, please.

**Hannes C. Wittig**
*Analyst, JPMorgan Securities Plc*
Q

Yes. Good afternoon. Thank you for having the questions. First, I wondered what you – strategically what your thoughts are related to sharing your German LTE network or your 800 frequencies with competition. That seems to be a discussion that some of your competitors would like to have, and I wondered if you were prepared to have full active network sharing even in Germany. Secondly, on cost-cutting, last year was a strong year for cost-cutting. Are we currently enjoying a strong rollover effect, call it, a still strong base effect from the cost-cutting. And then as we proceed during the year that will soften somewhat, or do you think cost-cutting will continue at the exact same pace as the year progresses?

**René Obermann**
*CEO & Chairman-Management Board, Deutsche Telekom AG*
A

Yeah. On the network sharing, in principle, in LTE, I think the – this is always a weighing the benefits and the disadvantages. And I would say, we'd in principle be open, but this is a tough decision, because we also need to develop strategic and competitive edges, and it's not easy to give them up. But there may be, under certain circumstances, it may be economically and strategically viable to do so, but that's normally not an easy decision. And therefore, that's as much as I can say to this. I would not confirm that we would do it. I would not deny we would do it. We have to leave our cards open here, LTE network share in Germany. Tim, just looked at me.

So Tim, would you want to talk about cost-cutting?

**Timotheus Höttges**
*Chief Financial Officer, Deutsche Telekom AG*

A

Yeah. Very quickly, I think we have laid out additional cost program in our Investors Days in December. And we have said we are committed to reduce our indirect costs by €2 billion. So this kind of programs are up and running, and therefore, you know just expect – or give us some benefit of the doubt that we are going to execute along this line. I do not see that we are slowing down, because you know as long as our revenue is under that much pressure, we have to improve our productivity, and we even know that towards our benchmarking they still get too close.

Even this, we know that Germany is always the main focus with regards to cost-cutting. I'm quite impressed about some countries outside of Germany, with regard to cost-cutting. Look to Greece. For the first time in history, they have significantly accelerated to improve their productivity, have even increased their margin by cost-cuttings. Look to the U.S. Independent from this huge new customer uptake, which we are facing and the renovation of a lot of, let's say, things at the same time, the management is very disciplined on getting costs out of the system, which they then could partially reinvest into the direct areas.

And now coming to Germany, Hannes, I cannot go into, let's say, all the measures which we have on, but I want to highlight, let's say, two of them. There is one big program, which was very active in the first quarter, which we call [ph] lean admin. Lean admin (40:18) is a severance, or our pre-retirement program, for all the German entities in the Telekom Deutschland segment, so not the T-Systems, not the GHS, and the target is a very confident cost reduction only in non-operational areas.

So that we become more competitive and even leaner and, with automatic with this, having bigger empowerment within the management teams within this organization. This program has been closed at least because there was a high uptake in the first week, so there's huge head count reduction, which was enabled by this program.

Another one is the Save for Service initiative in Germany, and here, we have to always consider that all-IP migration is the biggest driver for cost reduction, but this is coming with some investment at the beginning, because of the IT in transformation which is taking place, so that is, let's say, something we are working on, but you could not expect that you will have short-term impact from that one. But we are committed to get momentum on the cost side.

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**Stephan Eger**
*Head of Investor Relations, Senior Executive Vice President, Deutsche Telekom*

A

Thank you, Tim. And we continue with Sanford Bernstein, so it should be either Robin or Sam.

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**Sam McHugh**
*Analyst, Sanford C. Bernstein Ltd.*

Q

Hi there, yeah, it's Sam here. Thanks for taking my questions. I've got two. So, the first one is, I was just wondering if you can give me some color on the mix of gross adds in German broadband in terms of retail and unbundled and how you're seeing the evolution between DSL net adds – I mean, gross adds and copper gross adds and just whether there is still demand for copper broadband?

And the second one is, at your Capital Market Day, you talked about some unconventional CapEx-light moves in some markets and particularly the Netherlands. I'm just wondering if there's anything you could – you can tell us more on that and whether you were considering doing anything interesting perhaps with a partner, perhaps Tele2, or something like that? Brilliant, thanks very much.

**Stephan Eger**
*Head of Investor Relations, Senior Executive Vice President, Deutsche Telekom*
A

Well, Sam, first of all, 16,000 net adds for our broadband in Germany, which is DSL. Then we had about 46,000 net adds in wholesale, of which 45,000, basically, are from the new contingent model. So that is driving pretty heavily. Not quite sure whether that fully answers your question.

**Sam McHugh**
*Analyst, Sanford C. Bernstein Ltd.*
Q

And it's 16,000 on DSL, but then you've added 116,000 VDSL retail customers, so I guess, is the gross adds much higher on the copper side? Are you still seeing people coming onto copper? Or were most of your activations on VDSL?

**Stephan Eger**
*Head of Investor Relations, Senior Executive Vice President, Deutsche Telekom*
A

I think the big focus is currently on VDSL, to be honest. Now that's also where the marketing focus basically lies. With respect to the DC – DSL broadband offerings and marketing, we are very much in line with what we have done in recent quarters, i.e. – which is called value-based steering. And current marketing focus is clearly on VDSL and IP net adds.

**Timotheus Höttges**
*Chief Financial Officer, Deutsche Telekom AG*
A

And then, let me add that from a fiber net add perspective, last year, we had 66,000 net adds. This quarter, we have more than 100 – we have now 109,000 in the first quarter, so there's an uptick of 65% year-over-year. And it is even a quarter-over-quarter increase of 11.2%. So therefore, we see that customers are more interested in double-play offers with higher bandwidth. That is based on what we're seeing and that is where we have our promotions.

**René Obermann**
*CEO & Chairman-Management Board, Deutsche Telekom AG*
A

And the second question with respect to Tele2, I think, we wouldn't comment upon that currently.

**Stephan Eger**
*Head of Investor Relations, Senior Executive Vice President, Deutsche Telekom*
A

Next one is Jonathan Dann from Barclays. Jon, go ahead.

**Jonathan R. Dann**
*Analyst, Barclays Capital Securities Ltd.*
Q

Hi, there. With German mobile, could you just sort of provide some color on sort of where competition is moving, sort of where you're seeing positive traction, et cetera?

And then secondly, I guess a general capital allocation question. Broadband in Germany is going well, as is German mobile. Do you see sort of reallocating capital from sort of non-Germany back into Germany at perhaps a faster rate?

**Timotheus Höttges**
*Chief Financial Officer, Deutsche Telekom AG*
A

Look, I – that is not a discussion we're considering or we're discussing at that point in time. I'm talking about, let's say, the CapEx or the capital allocation. And so far, in the first quarter, we were not able to invest at the run rate we originally expected. Digging was quite difficult, because we had a very long winter here across entire Germany. So therefore, we are now accelerating.

The good thing, by the way, and I remember our last call where we said what could be an inflection point, and an inflection point could be that we get a signal for a stable ULL prices and that we would even get a positive signal towards the vectoring decision. Both took place in the first quarter. I think these are very good signals for that one.

And then we – therefore, we gave green light on getting prepared for a quicker and fast VDSL rollout across the country. It means some preparation, but we are starting with this, and so things are moving on. But don't forget, there is still the consultation phase, which is taking place, and it will need another 6 to 8 weeks, before we get all, let's say, the formalities in place for the – for vectoring, for instance. But in principle, green light, but no need because we have sufficient CapEx considered for Germany at that point in time.

And by the way, same is true for the marketplace. In our Investors Days, we said we're going to increase in Germany, just from my mind, our €250 million more SACs and CRCs compared to 2012 into the market investments, mainly into mobile data growth and smartphones. And compare our gross add numbers with the ones the quarter before or even the third quarter, we have a great run rate. And I think our offers are well-perceived from a customer angle here. 441,000 in net adds only in this quarter shows, for the – for a first quarter in Germany, very good track record. So therefore, there is no additional money needed at that point in time. And so therefore, I think allocation is not needed.

With regard to the first part of the question, where is the competition moving? I think – I'm not sure whether you are asking towards tariffs. From a tariff perspective, I would say it is moving into double-play offers, including, let's say, more and more data propositions. That is, let's say, the thing we are observing. On top of that, with different quality of services, all carriers offering different speeds in – within the tariff structures. And we even see good uptick of LTE here in Germany, almost 1 million handsets using the LTE infrastructure in Germany already up today.

So that is, let's say, [ph] our vision (48:07). With this, we hope that we're going to see a positive traction on the ARPU. We don't see that yet, because there was a price round, which was going down. We saw that our ARPU for contract customers went down as well year-over-year. And therefore, this is contributing to the high competitiveness in our market at that point in time. And, let's say, the base, which is even using this more attractive tariff as well.

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**Stephan Eger** A
*Head of Investor Relations, Senior Executive Vice President, Deutsche Telekom*

Thanks, Tim. Let's move on with Jacques de Greling from Natixis. Jacques, please.

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**Jacques de Greling** Q
*Analyst, Natixis SA (Broker)*

Thank you. First question. Following KPN's debut in its domestic mobile market and the recent decline in mobile profitability for the German businesses E-Plus and O2, don't you think it would be fair in this race for DTE investors to have mobile EBITDA?

Second question, could you help us to understand or to quantify the depreciation expenses we should expect for the full year 2013 in the U.S., including the PPA effect of MetroPCS? Thank you.

**Timotheus Höttges**
*Chief Financial Officer, Deutsche Telekom AG*
A

Jacques, now just very quickly on this, there is no EBITDA which we calculate for the mobile division anymore. Everything, the technology, the backbone network, everything is integrated and the net – the cares – the customer care services, our shop organization. Everything is an integrated business today. So therefore, we do not have – we do not steer towards a mobile EBIT.

**Stephan Eger**
*Head of Investor Relations, Senior Executive Vice President, Deutsche Telekom*
A

That would basically mean that we would have fully artificially, to cluster and to have – to artificially provide you with an EBITDA margin or the EBITDA on the mobile business, which absolutely makes no sense.

With respect to the second question, bear in mind what René has said at the beginning, we'll give you an update on anything with respect to – including MetroPCS, for the 8 months with our Q2 results, Jacques.

Let's move on with Fred Boulan from Nomura. Fred?

**Frederic Boulan**
*Analyst, Nomura International Plc*
Q

Hey. Good afternoon, gentlemen. Just – sorry to come back to the U.S., but if you could comment on – I mean, back on the phasing question. So, your guidance for the year, [ph] €16.4 billion to €16.6 billion (50:44) of service revenue, does imply a very sharp improvement from Q1 levels. Obviously, we should see better net adds, but you seem pretty confident about this phasing, but can you elaborate on how you can drive that considering the year-on-year base, which still be quite de-favorable?

And then secondly, if you could comment on the positive contribution on your EBITDA from the transition to the value plan, so you have a – we see different accounting. So, if you could help us understand the underlying performance here before this change in accounting; that would be very useful? Thank you.

**Timotheus Höttges**
*Chief Financial Officer, Deutsche Telekom AG*
A

So, Fred – and look, with regards to the guidance for the full year for our U.S. operations, I think that doesn't make sense. We are working now on the forecast for the integrated company. And we will give you a full update – the management will give you a full update from our U.S. operations very soon, with the Q2 results. And then, let's say, we – you will get the full view with regards to, let's say, where we stand with regard to the revenue, the EBITDA and even the free cash flow expectations here. So, that's to the first point. The second point, Stephan?

**Stephan Eger**
*Head of Investor Relations, Senior Executive Vice President, Deutsche Telekom*
A

Yeah. The second point, Fred, I would like to refer you to pages 4 and 5 of our T-Mobile US investor quarterly where we actually show you how the operating expenses at T-Mobile US have moved year-over-year, but also sequentially quarter-over-quarter and where you also see the impact, then, from basically losses from equipment sales going down quarter-over-quarter and sequentially. That is probably the biggest contribution from what – from the value plans.

But we would not – also again, we would not artificially now exclude the impact of the value plans as – in order to get to something which you might call an underlying performance because, in the end of the day, moving to all value is part of our strategy.

And I think we strip out all the operating expenses from the loss of equipment sales on page 4, then you've got the network expenses, the customer expenses and the G&A expenses, and I think that gives you quite a good impression how the bits and pieces with respect to the cost base have moved.

Let's move on with Nick Delfas from Morgan Stanley. Nick?

### Nick Delfas
*Analyst, Morgan Stanley & Co. International Plc*

Q

Yeah. Thanks so much, Stephan. So two questions, I mean I just want to follow-up on Jon's question on how the pricing environment is changing in Germany. What changes through the quarter have you seen? And how much additional pressure could we expect in some of the pricing categories for German mobile? I'm thinking of pricing changes from O2 and from E-Plus. And then secondly, I think you had a restructuring charge of about €200 million in Q1. What should we expect for the year as a whole? Thanks very much.

### René Obermann
*CEO & Chairman-Management Board, Deutsche Telekom AG*

A

Well, René speaking. I think, no surprise. Competition is still along traditional lines, for instance, with us or Vodafone pushing handset subsidies because still the purchase decision by customers is largely influenced by the handset and the package price.

O2, BASE, pushing a bit more SIM-only. There's still relevance – it's still relevant of allnet flats, voice and SMS, that is increasing. So, it's no real surprise in where the competition develops. Nobody has changed the name of the game yet, in a way. We are trying to increase the importance and the relevance of innovative services or bundles, i.e., the bundling with Evernote or with Spotify, offering cloud services or increasing storage like 25 gigabyte for a T-Online account and bundle those services. But no, the fundamental name of the game hasn't changed.

I hope it will because quality of service, networks, service differentiation, all those things become a relevant factor more and more, particularly with the explosion of mobile data traffic. And therefore, I think we're well positioned with a network and quality leadership, and we can defend prices at a decent level and not have to play only the 'lower, lower, lower price' game, number one.

And number two; I hope that customers will more and more appreciate the bundling of access packages and tariffs with new services such as Spotify and others. So it's – it kind of takes time to change the name of the game in competition. But I do think positioning ourselves as the quality leader in service and network continues to make sense and gives us the chance to have better margins and new decent prices.

### Timotheus Höttges
*Chief Financial Officer, Deutsche Telekom AG*

A

The – Nick, the question with regards to the restructuring expenses, we had €215 million in the first quarter, by the way, mainly driven by Germany. Here, the program I mentioned, the so-called lean admin program. For this year, we overall expect expenses of approximately €1.1 billion. And that is, let's say, in the vicinity of the number we have seen in 2012.

**Stephan Eger**
*Head of Investor Relations, Senior Executive Vice President, Deutsche Telekom*
A

Thanks, Tim. I think we've got time for two more questions. And I would ask Justin Funnell of Credit Suisse, first, and then Dominik Klarmann of HSBC. All the rest, rest assured, we'll call you from the IR team in the next 1 or 2 hours. All the names have been registered. And let's move on now with Justin.

**Justin B. Funnell**
*Analyst, Credit Suisse Securities (Europe) Ltd.*
Q

Thanks. A couple of quick questions; I think you introduced new caps on DSL in Germany to do with amount of usage. I think they would have come later in the quarter. Did that have any effect on trading in the quarter or into Q2? So, should we expect a bit more line loss in Q2, perhaps in German fixed line?

Secondly, the churn rates of 1.9% in the U.S. is obviously a great figure. I was just talking to your existing T-Mo US pre the PCS merger. Do you think that 1.9% figure is sustainable? Is that the new normal for your business?

And then finally, you obviously laid out your strategy several years ago that you wanted to improve ROCE on assets and if you couldn't you would sell them. The U.S. obviously had a great offer two years ago from AT&T. If one of SoftBank or DISH didn't get Sprint and made a great offer for your U.S. business now, would you be seriously consider it, please?

**René Obermann**
*CEO & Chairman-Management Board, Deutsche Telekom AG*
A

Justin, first of all, to the facts. The differentiation of prices between low packages for normal or low users and flat rates in fixed line, that differentiation is announced to happen not before 2016. And we've several times asked to-date for clarification in the media, because we several times said we need to announce it in order to make sure that the terms and conditions of existing contracts get changed over the next two to three years, so we can introduce that price differentiation. It is to the benefit of all customers, because only a few percent would be affected.

We have constantly and very loud and clearly repeated that message to the market, and we're gradually getting through with the facts, because it's a highly emotional debate in the network – in the Internet community. There are a few hundred thousand people who are communicating intensely about this and who are, of course, against any price increase.

However, if you look to the current market situation, you have in the market flat rates starting from €20 to whatever, €25, €30 or, in our case, €30-plus, €30-some plus VAT.

Given the traffic increase and all the needs for investing, this is an unsustainable situation. And therefore, we've been clear and loud and said, between €10 and €20 for a really big flat rate versus a smaller package, that would be the differentiation from today's point of view.

Again, we will receive criticism, but if you look into the media, there's quite a differentiated report on it. Some people say, it's honest and it's clear and they have to do it. Some others say, 'hey, it's critical.' Initially, in the first couple of days, we had an increase in call center volumes, so people called to get information and call centers and sales were very busy to explain. That ebbed away – that lowered soon thereafter. And the peak of this debate seems at the moment to calm – have calmed down. But I stand behind the long-term need for differentiating flat rate prices from smaller packages, and I think it is to the benefit, to the long-term benefit, of the company and our ability to make the investments because, at €30, you cannot have a terabyte of usage and all the benefits of having a built-out network.

So, we are working as much as we can in order to convince the market that we still are very customer-focused, that we still will pursue market-driven and competitive tariffs. And it is a difficult communication, but we are standing firm in our position there. And we are working on the explanation, because I think we have to do more work on the explanation.

That was a long answer to a short question, but the honest answer is – initially, it led to a higher degree of inquiries in our call center. We have not seen any massive churn impact yet. I cannot exclude, it will lead to some additional churn initially; but at this point in time, I have no indication that it's a massive churn rate, which we are facing here. It doesn't seem to be the case.

So, I don't want to underplay it, but I also don't want to overplay it. I think we should remain calm here. I hope that answers your question. Long answer. Tim?

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**Timotheus Höttges**
*Chief Financial Officer, Deutsche Telekom AG*
A

Okay. With regard to the stated strategy and our improvement on ROCE on assets or sale, I think your question was more going towards what's our plan towards within the U.S.

And the first thing is that we've seen over the last quarters here, especially in the first quarter, an improvement of ROCE, mainly driven by more efficient CapEx over the last years and the high depreciations we – the lower depreciations we've faced from German infrastructure and from the U.S. asset impairment, which we took last year. So this is helping us, because the total asset employed is lower now. But that is not your question. I think, in principle, what we have stated -strategy stays a strategy.

And with regard to the U.S. in specific, our answer is, we have now all the ingredients to restart the engine and even become more successful in the U.S. We have the synergies, which we have to realize. We have the new markets where we introduced the Metro brand. We have the LTE infrastructure, a lot of it already invested and built. And we have this new proposition.

So therefore, now it's time to create value, and that is following the same logic, as we have done that over the last year in the UK, where we had a very difficult position a few years ago, now it's a market leader. And it is still a way to go for the EE business, especially when it comes to the margin side; but from a revenue perspective and even from an LTE, for instance, a differentiation perspective, this business is on a good track.

And therefore, now it's time for improving the value, getting money out of the story, which we have created. We always said that, long term, there might be a consultation needed in the U.S. And there are a lot of rumors around that, but I will not speculate around any kind of the marketplace in this regard. Let's see. We're now focused on execution in U.S.

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**Stephan Eger**
*Head of Investor Relations, Senior Executive Vice President, Deutsche Telekom*
A

Thanks, Tim. Last question, by Dominik Klarmann. Dominik?

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

Yeah. Thank you. Well, actually, two questions on German fixed. Firstly, just to check if, by now, you find a deal with Vodafone on the contingent model or if you are still in talks?

And then a follow-up question on the data caps in German fixed, and I understand it's a sensitive topic and long term in nature. But just to confirm that those data caps will be the same for your retail as well as your wholesale products. I guess that's what the requirement is from the NCA regulation, anyway, but I would also think it should also steer the Altnets in the same direction that you are heading. So just to confirm that's the right understanding. Thank you.

### René Obermann
*CEO & Chairman-Management Board, Deutsche Telekom AG*

A

Yeah, let me. On the second point, first of all, let me repeat it. We will continue to offer flat rates, today, tomorrow and in 2016. From today's point of view, in 2016, we will differentiate the prices for flat rates by probably €10 to €20. At least, that's what we consider today as a possibility. It depends on the market and the competitive situation.

As a result of that, the – if we do it on the retail sides, we can, I think, also justify some increases on the wholesale side for flats rate. It's the same thing. For the data volume, also the prices have to increase then. We can only do that if we also behave on the retail side in a similar way. Otherwise, we would discriminate our competitors, and that we can't do. So, we will continue to treat our competitors non-discriminatory, of course. But if we have the achievement on the retail side and can position flat rate prices a bit higher, it also may have consequences for the wholesale side. So, I hope that answers your question.

### Timotheus Höttges
*Chief Financial Officer, Deutsche Telekom AG*

A

Let me answer the question on the German fixed line situation. And the question whether Vodafone has signed or entered into a contingent model with us, not yet. We are closely working with these guys, and we are open, as you know, to accomplish on that one as well.

But let me briefly give you, let's say, an insight into, let's say, our infrastructure deal with Telefónica, because this is another example where one of the partners, our – sorry, one of these competitors is partnering with us, because they could enable broadband services for their customers in a competitive VDSL infrastructure, while we are sharing risks of our investments, which is helping them on the return on capital employed and amortization logic. And that makes a lot of sense for these heavy investments in front of us. We're open to that one. And then we are quite happy that we found this agreement with Telefónica.

## Stephan Eger
*Head of Investor Relations, Senior Executive Vice President, Deutsche Telekom*

Thanks, Tim. I think we're done for today. Thank you very much. As I said before, we will ring all the investors and analysts who have not had the chance to post a question in this call.

And with that, we'll be hearing each other again on August 8 or 9 for the second quarter results. Thank you. Bye-bye.

**Operator**: We'd like to thank you for participating at this conference. The recording of this conference will be available for the next 7 days by dialing Germany 49-1805-2043-089 by a reference number 443254 and the pound sign. I repeat, Germany 49-1805-2043-089 by a reference number 443254 and the pound sign.

We are looking forward to hear from you again. Thank you and good-bye.