

02-Mar-2017

Deutsche Telekom AG (DTE.DE)

Q4 2016 Earnings Call

CORPORATE PARTICIPANTS

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

Timotheus Höttges

Chairman-Management Board & CEO, Deutsche Telekom AG

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

OTHER PARTICIPANTS

Sam McHugh

Analyst, Exane Ltd.

Stéphane Beyazian

Analyst, Raymond James Financial International Ltd.

Akhil Dattani

Analyst, JPMorgan Securities Plc

Emmet B. Kelly

Analyst, Morgan Stanley & Co. International Plc

Ottavio Adorisio

Analyst, Société Générale SA

Simon H. Weeden

Analyst, Citigroup Global Markets Ltd.

Dominik Klammann

Analyst, HSBC Trinkaus & Burkhardt AG (Broker)

Guy Peddy

Analyst, Macquarie Capital (Europe) Ltd.

Spyros Nicholas Delfas

Analyst, Redburn (Europe) Ltd.

Ulrich Rathe

Analyst, Jefferies International Ltd.

Frederic Boulan

Analyst, Bank of America Merrill Lynch

Mathieu Robilliard

Analyst, Barclays Capital Securities Ltd.

Andrew Lee

Analyst, Goldman Sachs International

Justin Funnell

Analyst, Credit Suisse Securities (Europe) Ltd.

MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, and welcome to Deutsche Telekom's Conference Call. At our customer's request, this conference will be recorded and uploaded to the Internet.

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

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

Yes. Good afternoon, everyone. Welcome to our Q4 and Full Year 2016 Conference Call. With me are our CEO, Tim Hötting; and our CFO, Thomas Dannenfeldt. As usual, Tim will first provide his highlights for the year before Thomas will dig deeper into our Q4 performance. Finally, Tim will provide his closing comments and then we will have Q&A. You will find our usual disclaimer in the presentation.

With this, let me give the word to Tim for his highlights.

Timotheus Hötting

Chairman-Management Board & CEO, Deutsche Telekom AG

Yeah. Hello, everybody. Warm welcome here also from my side, and just quickly go in to the matter here. 2016 was a good year for Deutsche Telekom for our customers and for our shareholders, benefiting from our ongoing high investments in Europe, and in the U.S. We achieved strong growth with customers with earnings and with our dividend. We delivered our guidance from 2016. Today, we also present our guidance for 2017, where we target another year of strong investments combined with double-digit free cash flow growth. We are delivering against the group target we presented at our Capital Markets Day two years ago, and we confirm these targets today.

As always, I will start with a short overview before Thomas will provide you with some more detail on our most recent quarter results. The first slide is our usual quick reminder of our main strategic building blocks. The good news is that a strategy stays a strategy stays a strategy and that these remains as valid as on the first day. And we are focusing on execution. We like to be consistent and we like to be predictable.

Slide five shows key financials over time. It shows that we promised at the beginning of 2015 and what we have since delivered. Some businesses are outperforming, some exceptionally strong. Other business delivered as expected, while others still have to work to do. I think you know who I'm talking about. But the simple message is that, when you add it all up, we are delivering on our growth promises.

Our revenue have grown over €10 billion in the last two years. Our EBITDA, excluding the U.S. leasing effect, grew by almost €3 billion, which is over 15% during this period, well ahead of our guidance.

Despite our high investments, our free cash flow grew by almost 10% and with the €0.60, we are proposing today our dividend will grow by €0.10 between 2014 and 2016. Going forward, we expect our strong growth to continue and you can see the main element of our guidance on this slide.

We expect our revenues to keep growing and our EBITDA to grow by 4% to €22 billion in 2017. As you know, we guide using last year's average exchange rate. If you were to take the exchange rate of our most recent

consensus instead, our EBITDA guidance would be around €4.4 billion higher. And despite of further increase in investments to €12 billion, we expect our free cash flow to grow by more than 10% to €5.5 billion [indiscernible] (12:32) €22.2 billion and 5.5%.

On the next slide, you can see some of the 2016 highlights. We continue to strengthen our position in Europe and in the U.S. We invested more than €11 billion in 2016, and on top of that, we spent €3 billion on spectrum, mainly in the U.S. Unlike some of our peers, we are not taking a break from investing the contrary. And we are seeing the results, our strong growth continues. Our revenues grew by almost 6% last year, our EBITDA by over 7%. Despite our high investments, our free cash flow grew by 9% to €4.9 billion last year. And we are therefore happy to propose a dividend of €0.60 per share for 2016, up from €0.55 the year before.

Our customer growth remains strong. Again, the demand for our German fiber product stands out. We now connect almost 7 million German homes and businesses with fiber. We added a new record of 2.4 million fiber customers in the last 12 months alone. Clearly, our German customers are very happy with this product and we remain focused on rolling out our super-dense fiber network as quickly as possible.

In the U.S., we gained more than 8 million subscribers last year, well ahead of our initial guidance. And the guidance provided by our U.S. team shows that we will not stop.

The next page shows some examples for the strong momentum we are seeing with our customers. We continue to see good momentum with our MagentaEINS convergence products. We now have 4.4 million converged subscriptions in Europe, up from 3.9 million at the end of the third quarter.

Germany delivered 3 million MagentaEINS customer, promised at our 2015 Capital Markets Day, two years ahead of time. I already mentioned our success with fiber in Germany, where we added a record of 2.4 million homes in the last 12 months. 33% of our retail broadband homes are now on fiber, up from 23% one year ago.

Our U.S. performance continues to speak for itself. We now have almost 72 million subscribers. Just to put it in perspective, Sprint has 59 million. In the cloud, we grew 12% last year and we now have €1.6 billion of sales in this strategic growth market. When it comes to innovation, I don't want to bore you with the repetition of what I told you in recent quarterly presentation. So let me stick to a few highlights.

2016 was a year of many exciting product launches, such as our Open Telekom Cloud, new security solutions or our new EntertainTV platform. Our networks in Europe and in the U.S. won many surveys. In Germany, our continued network leadership was recently confirmed by all the major network tests. In the Netherlands, we just announced a highly innovative network partnership with Huawei, which will give us an edge for years to come.

Our highly innovative hybrid router now has almost 300,000 customers. Our German more-for-more tariff were well received and our German customers almost doubled their data usage last year. We added mobile video to our MagentaEINS portfolio and this was very well received with over 100,000 new subscriptions in Q4 alone.

At last week's Mobile World Congress, we focused on 5G, where we see ourselves well positioned and clear as an innovation leader. Let me highlight just two innovations in particular.

Together with SK Telecom, our partner, we demonstrated the world's first cross-country network slicing. Network slicing is a key feature for 5G. It allows to differentiate the network experience for different users. We demonstrated that this can be done across country borders, which is a key, for instance, for global [ph] cars (17:03) or for global vertical solutions.

We followed up the world's first one millisecond latency over a mobile network, which we delivered at last year's Congress, with a pioneering network innovation, which guarantees latency for individual 5G applications. This guaranteed latency addresses the requirement that we have frequently presented as a request from our customers.

We made great progress with our Smart Home platform as well, where we added 100,000 German customers last year, and which we successfully sub-license to other European operators. We have 40 partners for this platform alone, so this is also a great example for successful partnering.

We are also seeing the first tangible benefits of our network transformation. In Germany, for instance, where we have rolled out our All-IP aggregation platform, customers find it easier to connect, and our incoming call center traffic is lower by around a quarter.

Innovation also means service innovation. In Germany, we now have more than 600,000 customers to our IT support service and we saw almost 0.5 million transactions on our Magenta service app. In Austria, through our digital assistant, Tinka, we are successfully using artificial intelligence in our customer service since 2014 and we are very close to launch commercially an artificial bot.

Slide nine compares our 2016 performance with the guidance at the beginning of the year and summarize the outlook for 2017. As mentioned, our main group financial metrics are well on track for what we committed at last year's Capital Markets Day and we reiterate these targets today.

With this, I hand over to Thomas, who will discuss our fourth quarter in greater detail.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

Yeah. Thanks, Tim. And very warm welcome from my side as well. As always, my first slide shows the financial highlights for the group as a whole. Our financial momentum remained strong in the fourth quarter despite some legacy issues in our T-Systems unit and increased customer investments in the European operations.

Our revenue growth reaccelerated to 9% this quarter, largely driven by double-digit service revenue growth in the U.S. For the year as a whole, our revenues grew by over 5%. Adjusted EBITDA grew 2.4% in the quarter. For the year as a whole, our reported adjusted EBITDA grew 8%, equivalent to 4.1% on a comparable basis.

This growth was achieved despite a temporary slowdown in the run rate of our indirect cost savings, due to a further step-up in network migration costs and additional commercial investments in Europe. Our adjusted earnings were broadly stable year-over-year. Our reported fourth quarter net profit was hit by the BT write-down. Looking at it from a full-year perspective, this write-down largely reversed our earlier book gain we had in the first quarter of the year.

After a very strong third quarter, our fourth quarter underlying free cash flow was slightly down year-on-year, but this basically reflected phasing and, as you can see, we comfortably delivered our promised €4.9 billion for the year as a whole. Our net debt was impacted by U.S. dollar strength and spectrum purchases, but we nevertheless managed to reduce our headline leverage ratio to 2.3 times EBITDA.

Moving on to slide 12. In Germany, our sales were down by 0.5% this quarter. We adjust for the drag from roaming and termination rate cuts, our German revenues were slightly up year-on-year. Our EBITDA grew in the

fourth quarter, taking us to the promised €8.8 billion full-year EBITDA we had initially guided for. Going into 2017, our German business no longer includes the tower operations, which we now report under Group Development and we've provided a pro forma restatement with today's earnings release.

For 2017, we expect the positive EBITDA momentum of the last quarter to continue benefiting from almost stable revenues, the more advanced IP migration, and the efficiency measures we took in 2016.

On slide 13, we present our German service revenue trends. In the appendix, we provide additional detail on the component part. And as you can see, our reported service revenues are again almost stable this quarter. When you adjust for roaming and termination rate cuts, our German service revenue would have grown slightly in the quarter, or would have been flat year-on-year.

Our reported mobile service revenue were again almost stable this quarter and again, as you can see in the appendix, adjusted for the close to 2% regulatory drag and a further close to 1% convergence accounting drag, our underlying mobile service revenue momentum remains firmly in the positive territory.

As before, small quarterly trend variations should not be overrated. We do not see major underlying trend changes and remain on track for our Capital Markets guidance of 1% service revenue CAGR before roaming.

Our fixed line service revenue momentum improved strongly this quarter, but remember that Q2 and Q3 trends have been impacted by one-offs in our wholesale division. So the underlying picture remains one of slow, but steady trend improvements. You can find more detail on the various drivers again in the appendix.

On the next two slides, we dive a bit deeper into our German mobile performance. Our commercial momentum performance remain very steady. We gained 514,000 contract customers in the fourth quarter, but this was again impacted by seasonal volatility in lower value service provider cards.

More importantly, our own branded customer base grew by 180,000, broadly in line with the trends in the previous quarters. We now have over 11 million LTE customers, up more than 3 million in the last 12 months.

The next slide shows the progress we are making from our convergence propositions and data monetization. Only two years after launch, MagentaEINS already accounts for one-third percent of the relevant mobile customer base and we achieved this milestone while keeping our underlying consumer mobile service revenue stable, which shows our successful up-selling. Benefiting from our more-for-more tariffs and other innovative propositions, our consumer mobile data usage growth further accelerated this quarter and almost doubled year-on-year.

So moving on to fixed line on slide 16, the clear highlight is the 674,000 new fiber customers we achieved last quarter, which is a new record. While our resellers keep doing well, most of the new customers were in our retail platform. We think this clearly demonstrates the benefits of our strategy to bring our super dense fiber network to as many homes as quickly as possible.

Our broadband growth accelerated to 87,000 broadband customers, benefiting from our outstanding fiber momentum, our Test the Best promotions and our new TV platform. You remember, we said 80 to 90 will be the number and, I guess, we're spot on here.

TV net additions improved to 61,000, which is good to see, but we think there is still a way to go on the TV side. Benefiting from our broadband momentum, line losses further improved. For 2017, we target at least the same broadband net adds as we delivered last year.

So driven by growth in broadband and a better performance in our other revenue, our retail revenue momentum improved by 1 percentage point to minus 1.1 this quarter. Our broadband revenues grew 1.6% this quarter as in previous quarter in close side of the 2% CAGR we promised at the Capital Market Days. And again, also here you can find more detail on our fixed line revenue performance in the appendix.

On slide 18, you can see that we added a further 2 million German households to our fiber footprint in the fourth quarter, bringing the full year total to 4 million and now covers 64% as promised two years ago in the Capital Market Days.

53% of access lines already in our IP platform, so we are more than half way there, and we continue to work towards migrating our mass market access business to All-IP by the end of 2018.

So now moving to the U.S., to our usual two slides we have on T-Mobile U.S. who already presented there very strong numbers two weeks ago. Our momentum remains very strong. We won 1.2 million branded postpaid customers in the fourth quarter, and we also added more than 0.5 million prepaid customers. Strong subscriber growth and slight ARPU growth combined to 10.6% mobile service revenue growth, and we saw another quarter of very strong EBITDA growth.

With this result, T-Mobile U.S. provided guidance for the U.S. GAAP EBITDA of \$10.4 billion to \$10.8 billion in 2017, and also guided for 45% to 48% free cash flow CAGR from 2016 to 2019.

When re-consigning our T-Mobile U.S. with our EBITDA guidance for 2017, please take into account around €0.4 billion of U.S. GAAP IFRS versus IFRS adjustments, and compared to consensus, also around €0.4 billion of currency effect as already mentioned by Tim. T-Mobile also provided a strong customer growth outlook of 2.4 million to 3.4 million branded postpaid net additions.

On the next slide, we show some selected performance metrics for our U.S. subsidiary. Our branded postpaid phone churn improved year-on-year again, as did our bad debt expense ratio, as did our cost of service. To sum it up, another fantastic quarter for T-Mobile U.S.

So back in Europe, on the next slide, it was a very strong quarter for customer growth in our European segment. Continuing the Q3 performance, 381,000 contract net adds marked a substantial improvement compared to the prior year.

In the Netherlands, we have now grown contract net adds for six quarters in a row, 71,000 this quarter. The convergence momentum continues to accelerate with 180,000 new additions. And meanwhile, our TV and broadband momentum remains strong and steady.

Adjusted for roaming, our organic revenue momentum was stable this quarter. However, organic EBITDA was down almost 10% this quarter. This reflects revenue mix effects, the impact of European roaming, some comp issues, but mainly it reflects increased market invests as we can see in the improved customer momentum.

Going forward, we will continue to focus more on customer momentum. Our performance will also be impacted by some roaming, investments in convergence, our Pan-Net project in the European Aviation Network, but we nevertheless anticipate only a slight further EBITDA decline in 2017.

As chart 23 shows, in Europe, we now have migrated almost 60% of our homes to IP, and our LTE coverage now stands at 84% and our fiber coverage at 26%.

The performance of T-Systems this quarter was negatively impacted by write-downs related to two large legacy contracts, which we had already flagged to you in our call in Q3. The unit's EBITDA performance was being impacted by All-IP transformation costs as the business customer migration is stepping up a gear.

Revenues were down 7.4% year-on-year and our Q4 EBITDA was only €60 million. Many of you will ask if this reflects increased pressure in the public sector in global accounts or more generally in the overall B2B business. Why we are clearly not satisfied by our financial performance of T-Systems this year, the picture is more differentiated. We're doing well in the public sector and more generally in our European B2B businesses.

You can see this, for instance, in the positive 2016 B2B revenue momentum shown by our German unit. Our overall order book was stronger than in the previous years. In our case, the challenges are well known and in principle unchanged. We still have some exposure to standard IT business. And like most of us, we are subscale in the global connectivity game.

As you know, we began to tackle these issues a few years ago through refocusing of activities towards a more network centric services such as public cloud and security product, and through a major efficiency program.

Last year, we also presented ngena, an innovative platform for global peer-to-peer connectivity to overcome our scale limitations. And we are now in good discussions with BT regarding further cooperation. Yesterday, we've announced – was it yesterday or the day before, we announced the cooperation regarding the international network collaboration.

We're seeing mostly good progress with our strategic initiatives. Unfortunately, progress is sometimes slower than we would like and occasionally there are some legacy issues, but we think the direction of travel is right. For 2017, we project at least stable EBITDA for the division.

So on the financials, Q4 free cash flow was down year-on-year, but as mentioned earlier, this was mainly due to phasing. Just to remind everyone, we've been – after Q3, we've delivered much more than 80% of the total year's guidance. So that was clear, our net debt was impacted by the strength of the U.S. dollar, by spectrum payments due to this quarter, and by a number of other miscellaneous items, including revaluation of the T-Mobile mandatory convertible.

The next slide shows our financial metrics. At 2.3 times, our net debt remains well within our comfort zone of 2 times to 2.5 times adjusted EBITDA. At the end of last year, we extended our existing funding agreement with T-Mobile by agreements related to a further \$3.2 billion. We continue to see this as a win-win for both parties because of the meaningful cash cost savings. Year-to-date, we have already raised €6.8 billion of debt under favorable conditions all in general by the way covering our maturities in 2017 and to finance and advance our latest funding agreements with T-Mobile.

My final slide, as always, summarizes the strategy we've presented to you at the Capital Market Days 2015 and as Tim said, a strategy is a strategy is a strategy. So, we continue to execute well against those targets, and we remain confident that we will keep delivering them going forward.

And I guess, with this, I hand over back to Tim with some of his closing remarks. No?

Timotheus Höttges

Chairman-Management Board & CEO, Deutsche Telekom AG

No. We'll go into the question and answer right away.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

Okay. So...

QUESTION AND ANSWER SECTION

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

A

Okay. Thank you, Tim and Thomas. It's now time for the Q&A. [Operator Instructions] And we would be grateful if you could in general restrict yourselves to two questions at a time. Thank you. So the first question we have is from Sam McHugh at Exane. Sam?

Sam McHugh

Analyst, Exane Ltd.

Q

Yeah, good afternoon, guys. Two questions then please. First on the All-IP migration. Can you just remind me how much you're spending on that, OpEx and CapEx annually? And when we should expect those costs to subside? And then secondly, just on the potential for the tower business. How much scope is there to increase tenancy rates? And you talked about creating value in it; can you just kind of outline the other kind of ways you could create value? Thank you very much.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

So I'm going to start with the All-IP part, and then I go to the tower business, potentially Hannes will answer that one. We are spending roughly €1 billion this year in total spend across Germany and T-Systems and the European segment CapEx and OpEx altogether. And there is no change on the mid-term outlook we've given in terms of the related upside to that. Just to remind everyone, we said it will be €1.2 billion net OpEx reductions by all the topics we are driving here on the superior production model materializing themselves completely in the early 20s.

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

A

Yeah. And on the towers, I think the – you've seen that we have moved it out of the German segment and into our new segment, Group Development, and the main point here is that we think it gives us greater opportunities to develop the business. So this is not primarily financially motivated. Financial transactions could be part of the development path going forward, but it's not a necessity, you know and you have seen, we are well within our rating corridors and debt reduction, therefore, is again not a primary driver.

So what is – the main focus is to develop the business operationally and strategically as we move towards 5G and I think you can see that to some extent in the appointment of Bruno Jacobfeuerborn as a CEO of our tower business. He is a highly recognized leader in 5G across the world and is also our group CTO and I think that

speaks in itself for some of the opportunities we see towards 5G, Internet of Things and et cetera. So yes, that could also lead to more third-party business over time, but I think it's too soon to be too specific here.

So the next question, we can take from Stéphane Beyazian at Raymond James. Stéphane?

Stéphane Beyazian

Analyst, Raymond James Financial International Ltd.

Q

Yes. Thank you. I just would like to come back on T-Systems and perhaps BT. The new agreement with BT Global Services is about network and expanding your footprint. But I'm wondering looking at both issues, BT and yourself in a global market, if you don't have here a case for more concerted commercial strategy on geographies to take some market pressure off or simply a tie up outside your whole market? And probably, following up on the BT question, you expressed concerns last year on critical issues at BT such as Brexit, pensions and network. Is there any change in your investment approach now that BT shares are, let's say, cheaper than last year? Thank you.

Timotheus Höttges

Chairman-Management Board & CEO, Deutsche Telekom AG

A

So the first thing is with regards to the Brexit and the question about BT. It does not change the way how we think about our financial investments in BT. Although we are quite concerned about this regulatory debate in the UK, which is not coming to an end. So this is definitely I think, for me, the biggest obstacle in my observation as a 12% shareholder here.

In principle, BT is a great company. It executes well and it will definitely benefit from the EE integration going forward. It has strong market positions in the consumer market, in the B2B market in their home country, and it is well positioned as well on the content side, it's a fixed mobile converged player. And this is a business we understand and which we heavily promote. Our intention is to promote BT wherever we can and it is up to BT how much they take advantage of it and how fast they're doing it. In any case, we will do everything to make this business as successful as possible, and we are not considering any change in our shareholding or perspective as of today. We are anyhow subjected to a standstill and a lockup agreement until mid of the year. So, that is, let's say, the current positioning.

Independent from that one, we made some progress in the way while we're cooperating with BT, and we are hosting their customers on our SAP, on our server architecture, and we are doing a direct interconnect with their infrastructures on the fixed line customers, and this is helping both companies to better utilize the infrastructure. So, has it changed? No. The intention is there. And is it an easy phase for BT? No, definitely not, but we are a side of the team and trying to support wherever we can.

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

A

Okay. Thank you, Tim. So, next question we have from Akhil at JPMorgan.

Akhil Dattani

Analyst, JPMorgan Securities Plc

Q

Yeah, hi. Good afternoon. I have two questions please if I may. Firstly on the German mobile market, last year, we saw Deutsche Telekom announce more-for-more price increases back in February. Since then, we've seen pretty much the entire market follow suit. So just keen to understand how you feel the benefits of those changes have impacted Deutsche Tel and whether we should read anything or not into the decision as yet, not to have

replicate to that again as we've gone into this year. And linked to that we've seen a number of markets across Europe starting to push through much larger data allowances in attempt to really present the gap between the MVNOs, who find it very hard to replicate these sorts of offers. So, just keen to understand do you think there is merits to simile putting too much larger data increases going forward as you try and increase the gap between the [indiscernible] (40:21).

And then secondly, I guess a very open ended question around the U.S. We've seen the new Head of the FCC make a number of comments around consolidation and his thoughts around that. SoftBank has been quite public in some of their commentary, so just wanted a simile you might be willing to share any thoughts around U.S. consolidation going forward and your start on that. Thanks a lot.

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

A

So, Akhil, there was three questions, but we will try our best.

Timotheus Höttges

Chairman-Management Board & CEO, Deutsche Telekom AG

A

So, Akhil, let me, let's say, give a kind of statement with regard to our German market and I think 2016, and especially the fourth quarter, was a very encouraging quarter for the German business. We have very strong broadband net adds, the best numbers we have seen and we are very close heading to the 40%. So, significant improvements and as well in the way how we are competing with the cable operators at this one.

We have seen an increase on TV adds. That's definitely the case where we want to see more progress to be made with our new TV platform. So, that's something to come. Record improvement on fiber net adds, 394,000 net adds in that quarter on the fiber side. This is more than 120,000 more than the average of the last quarters. So you see wherever we are now opening up and as well as what I had mentioned last time, where we open up new bandwidth and new infrastructure, the customers are very happy to take our brand.

We have increased the Magenta ONE footprint from 3 million beyond and every MagentaEINS customers coming with €8.70 additional ARPU, which is helping us on the revenue side. And on overall, we have seen that on the mobile side, our brand and our network perception is even stronger. We are very much supported from the B2B side in this regard, a lot of customers, independent from the situation that we do not have to reduce prices in the competition. It is the quality issue, which is driving customers into our arms, is paying-off. So, we're quite encouraged and that gives us the foundation for the encouraging forecast with regard to growth in the German entity for 2017.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

And maybe to add on this one, and then we come to the question on the U.S. First of all, more-for-more, just if you look at the numbers, we've seen, in 2016, we've seen headwinds regulatory, headwinds by roaming and by MTR cuts of €88 million, in the total year, €77 million roaming, €11 million was MTR, but our decline was €43 million, or in other words, the underlying growth was around €40 million, so we could turn the underlying non-regulatory elements of the business into the positive territory again. And I think that gives you an indication that more-for-more was the right move and it worked, especially as it was addressing a customer pain-point having too less of data volume available for their usage and their demand.

By the way, this was also the reason why we added or doubled the volumes in the base, not only for the new customers, and this is one of the reasons why we introduced, for instance, the mobile TV element on the mobile side for our converged customers as a free component to encourage the customers to use even more the mobile network we have here in Germany. So, driving consumption is the way forward for us, incentivizing the customer to use more and enjoy the fantastic experience is the way forward. Is there – and you're thinking about having the next €5 up on that one? No. Is there, obviously the – whether driving the consumption, the underlying thinking is to drive the mix of the tariff plans and the price plans up? Yes.

Timotheus Höttges

Chairman-Management Board & CEO, Deutsche Telekom AG

A

Your question with regard to the U.S. The first thing is, you know that nobody is able to answer this question because any kind of transaction has to be diligently being analyzed, worked through and then be decided from the authorities in the U.S. The total climate I think from the Republicans in the U.S. is more open and a less regulative as in the former regime that is that we all expect, so that's, let's say an over – let's say observation.

The second thing is, we are in the so-called allocation phase of the 600 megahertz spectrum. And I hope that we would see the encouraging results coming out very soon. We know the total amount, which has been spent and that it's €0.90 per megahertz POP spectrum overall, which has been paid. So we are waiting now for this final allocation. And until then, I will not even speculate, not even think about, let's say, any kind of consolidation of this environment not to risk, let's say, the outcome of this undertaking.

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

A

Thank you, Tim. So the next question is from Emmet at Morgan Stanley. Emmet?

Emmet B. Kelly

Analyst, Morgan Stanley & Co. International Plc

Q

Yes. Thanks very much, Hannes. I have just two questions, please. The first question is one I've asked before, which is on your German TV business. So I think, in 2016, you launched the new Entertain platform on the set-top box. I guess the upside is your ARPUs in German TV are still very high, at €37. I guess the downside is, net adds have been stable and haven't really accelerated throughout the year.

Can you maybe talk a little bit about the TV strategy in 2017 and what steps do you think you can take over the next couple of years to make your business more mass market and maybe get TV penetration up to where Orange or Telefónica is?

And then the second question is something I may have missed, so forgive me if I did. On T-Systems, I know EBITDA is very lumpy in this business, but I estimate EBITDA was maybe €175 million per quarter since the beginning of 2015, it stepped down to €60 million in Q4. Can you maybe say how much of the step-down is from the write-down you mentioned and how much is organic or performance related, please? Thank you.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

Hi, Emmet, this is Thomas. To your second question, it's quite easy. I think, you're right, with the levels you've given like €160 million, €175 million, that kind of level is correct, down to €60 million and the difference is exactly what is related to those specific deals. And the first question was on – what Hannes?

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

A

TV guidance.

Timotheus Höttges

Chairman-Management Board & CEO, Deutsche Telekom AG

A

So Emmet, look, promise and deliver. We are increasing our targets for TV customers in Germany. We have done that. Internally there is a higher commitment on that one, and you have seen from our broadband net adds and the market share that this is something which we always have in mind by changing the speed in certain areas. Now, do we want to have more TV customers? Definitely, this is the case. Now, how can we make that more mass market product without violating the total amount of ARPU?

We do not want to give it for free as a service into the community, we'll only create money out of it. We have now continuously developed new features such as restart and/or replay, as well as this interactivity. We have improved on our content portfolio. We have acquired smaller long-tail content like the Ice Hockey League or like the ladies football or like the third league.

And this kind of stuff we have new channels; HBO, Fox and TV Now from RTL Online. We have created new special offers since September which is €120 credit voucher for content. We have continuous rise of high-speed VDSL, the ability which enlarges the market for us where we could sell the product. This was a limitation in some of the areas so far. And we hopefully benefit from the ongoing DVB-T migration, which is taking place in Germany. We have incentivized our sales forces in the shops to openly address this DVB-T migration. We are approaching customers directly in this regard.

On top of that, we are considering more and more a kind of TV-only product over the top and by our app so that we could bring, let's say, this TV services into the [indiscernible] (49:47) TV mobile, for instance, cost €6.95 per month, and it is coming, but no zero rating. So including the data consumption, which has been offered, so even here we have things to do.

Are we now going into exclusive content, big things, which you might have in mind with your questions to create a kind of exclusivity on the content? No. Our answer is clearly the aggregator strategy. We want to aggregate as much of content in an easy usability in our TV Entertain services, mobile and fixed.

And there will be more to come from functionalities. To stop that discussion here, I think the service is very well perceived, the platform is absolutely stable and in a good performance. So, I think we have the ingredients. We need more focus and we have to scale it up knowing that the German TV market is slightly different than in other markets.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

And, Emmet, back again Thomas here, because I've given you the answer on your question, but I missed to give you the outlook. And I think that's important to add that as well. For 2017, we guided the EBITDA of the – for the Market Unit on the level of €0.5 billion, which would amount to a stable performance or maybe it's a slight up, let's see. So we don't anticipate or expect further write-downs related to the management issues, so just to be clear about the past and what you should expect looking forward.

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

A

Thank you, Thomas. So, next I go to Simon from Citi. Simon? Simon, can we have your question? Okay. With that, I'll first go to Ottavio from SocGen. And then, we come back to Simon.

Ottavio Adorisio

Analyst, Société Générale SA

Q

Hi. Good afternoon, gentlemen, and thanks for taking the questions. A couple of questions. The first is another follow-up on the T-Systems. Going through the accounts, you basically attribute the negative performance in the top line on the Market Unit to, first, downward price trend in the ICT business, and also to exchange rate effect. It's possible to breakdown the business into two. Then also you mentioned about the outlook. Now, in the outlook, I can see that you're looking for flattening performance next year and actually an improvement in 2018. So, we would like to – possible to know what is going to drive that particular performance on the top line and on EBITDA?

And the second one is on the European business. The trends were not good on EBITDA, but you attribute that to the significant investment in customer. And one can see that Austria and Netherlands had a pretty good performance on net adds. However, Poland was relatively weak this year, and customer net adds were also very weak. So, I was wondering what's going on, on the Polish business? I can see that the fourth quarter was better than the rest, but if you can give an outlook going forward, and as you believe that the business as it is or as it stands is basically a deal or you probably need to do more in terms of M&A to stabilize the business?

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

So I'm going to start with T-Systems. First of all, as I answered Emmet's question, the impact on the EBITDA we've seen on T-Systems Q3 and Q4, there was not price trends, there is as a principle, obviously by All-IP migration and by some price pressure we have in those markets, they're always existing. But the main element of the negative impact we've seen in Q3 and then more in Q4 have been those two big contracts and so they are not related to the [ph] FX and ITC (54:23) that's a general situation in the market.

As a kind of headwind, continuous headwind but we have also tailwinds. Remember, we've changed the strategy some years ago and move in more and more from a IT outsourcing big deal type of business into a platform-based scalable IT business, for instance, like cloud business, like security businesses. So those business, by the way, which inherited not the same risk you have in big IT outsourcing deals, but those business where you one set of a platform and then you scale them and use them, so you de-risk also by moving from IT outsourcing big deals into platform business. And that's why we are still confident and clear in terms of the two years perspective of that business. The only thing I guess we have underestimated is how long it will take to get completely the garage cleaned so to say, so get the legacy big deal contract and control. So, I think that's the difference just, but the rest is top line growth and EBITDA improvement by scalable cloud and security businesses.

Timotheus Höttges

Chairman-Management Board & CEO, Deutsche Telekom AG

A

Ottavio, with regard to the European situation, the first thing. If you would have taken the Netherlands, which was always you know flagged here is the challenging environment, take it out of the European P&L, you would see that the business was on an operating business flat, and the – for the EBITDA development in 2016. So as a total, our European footprint, we have a lot of good things in it.

If you take the Greek performance, just as an example, if you see, Croatia, Hungary, and as well Slovakia, so that's focused on the bad things in this portfolio, and you pointed out. We had a challenging environment in the Netherlands. In the Netherlands, I can tell you, we have taken really decisive action; a new management, unlimited tariff, Huawei deal on the network, investments into the LTE infrastructure leading the market test, cost cutting and reducing the head count, buying Vodafone's fixed-line business. So just to highlight six things, and that all in just less than three months. So, you see that we are serious at the moment when we're taking over and when we are changing the speed on businesses.

Now, in Poland, and – sorry, and Europe, last highlight, a low-light situation here. In the fourth quarter, we had a customer growth of 380,000 new contract customers. This alone shows, let's say, that there's a great momentum being created, the quarter before was less than half. So, and the second thing is, if you look to the LTE coverage, we have now 84% LTE coverage, and we have a fiber coverage at least 100 megabit per second of more than 26% of the population and our All-IP migration is beyond 60%. So I think this is let's say showing you how serious we are working on the European portfolio and that we see some encouraging developments there as well.

With regard to Poland, the Polish market wasn't that easy and we have to improve the situation as well. You're totally right and it always starts with new customers, with new contract customers and if you take the numbers, they were negative in the first and second quarter, they were positive in the third quarter and they were tripling already in the fourth quarter. So we are on good track with the contract adds.

Second, we won the P4 network test in January. So it was proven that our network is doing better and the same is true for the profitability where we now have reduced costs in a decent way. The next is, we are opening new doors in Poland. We identified the strategic negative from our business that we were not present in retail sufficiently. This is ongoing and it's in our planning and we make good progress here as well. So are we fast enough? You could always question that, but at least we took even here decisive actions.

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

A

Thank you, Tim. With that, I'll make another try, attempt to get Simon on the call. Simon, can you ask your question, please?

Simon H. Weeden

Analyst, Citigroup Global Markets Ltd.

Q

Yeah. Can you hear me, Hannes? Can you hear me, Hannes?

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

A

Yes.

Simon H. Weeden

Analyst, Citigroup Global Markets Ltd.

Q

Great. Okay. We'll go with the handset. Well, I just had two operational questions really. One was, if you could just comment a little bit more about the state of competition at the lower end of the mobile market in Germany and if you're able to go further from here in diversifying away from the use of service providers. And the second thing is on the Dutch fixed business you've acquired from Vodafone. I know you touched on it just now in some of the other changes you've made in the Netherlands. But I wondered if you could elaborate on how you can use that to reposition your sales in the Netherlands, specifically? Thanks.

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

A

Let me start with the competition. I think we can all see what's happening in terms of the pricing, that's quite public. And I think we have seen fairly constructive moves. But, it's always a bit risky to extrapolate short-term movements.

I think there may be some structural drivers for a bit more constructive pricing from the German MVNOs. But let's wait and see if the current, let's say, environment can be sustained. At this point, it looks cautiously encouraging, but we have had our ups and downs in the past. So let's see how this will develop.

And I think, at the same time, we can say, we have very steady momentum and we are doing well in terms of positive service revenue growth adjusted for headwinds that Thomas mentioned earlier. I think we have a clear plan in terms of boosting data usage through the items that Thomas has already mentioned. And those are truly, also the right things to do whatever happens in the lower end of the market.

Our quality differentiation surely holds up very well. And, if anything, I think that has become more relevant as the data usage has gone up. And also you can see that some of the German low-end competition has access only to fairly low data speeds. And so that it helps us to maintain a premium. In terms of the Dutch fixed line network, I pass on to Tim.

Timotheus Höttges

Chairman-Management Board & CEO, Deutsche Telekom AG

A

Thank you, Hannes. Hannes wants to answer all the questions. He knows everything about the business. So therefore, next time, Thomas and myself will not show up anymore. Yeah. We make holidays. Good idea. Good job, Hannes. So let's talk about the Netherlands.

I think it's important to know what we're doing there. I was there in the last, two months, I was twice there in the Netherlands with the team and with the people there. The first thing is this, the fixed line part, as you know for me not the most important issue, it is a different situation to counter the fixed mobile converged offerings from [indiscernible] (01:02:08) and Vodafone and KPN. But independent from that one, we are in discussions how we could improve the wholesale prices, especially on fiber with KPN.

So we use that, but we will, even trying to find new ways of [ph] killing (01:02:25) commercially with KPN, I had a discussion with [indiscernible] (01:02:27) on that one in the mobile fair, but I don't want to go into more detail on that one.

The second thing is, our business there is much focused on the mobile. We believe there is in every market, a place for a good mobile player that is why we launched the unlimited plan. The unlimited plan has been perceived from the market very strongly. So I think the first step was made. And in this mobile world, it's not the consumer side alone, we have gained some really big customers on the business side, and I think we are regaining momentum here as well. So [indiscernible] (01:03:06) is very much focusing on this new contract net adds in the business side as well.

We have recruited a very strong new management team with Søren, an external CEO from Telia, who has joined us and a good mix of people, very diverse people there. And Vodafone broadband gives us just additional firepower on the office which we [ph] haven't timed (01:03:33). So let's see how this is developing, but I think the

total mix and the experiment as well taking that out of the European NetCos into this corporate development portfolio is hopefully creating even more agility as we have seen already.

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

Thank you, Tim. And next I would like to have Dominik, your questions please.

A

Dominik Klarmann

Analyst, HSBC Trinkaus & Burkhardt AG (Broker)

Yeah, hi it's Dominik, HSBC. So one big picture and I understand you can't be specific on U.S. M&A, but maybe you can share your current thinking on pros and cons of allocating capital in Europe versus the U.S. And then secondly on 2018 and your free cash flow target of roughly €6 billion, if I deduct the low end of the T-Mobile free cash flow guidance and use your, I would say, conservative FX assumptions, would imply that the European free cash flow declines by about €400 million in 2018 versus the 2016 base.

Q

At the same time, if I look at your 2018 Annual Report outlook, you're seeing European EBITDA grow, CapEx fall. So why would European free cash flow fall that much? Is that target by now just very conservative or are there rising cash outflows below operating cash flow that we should be aware of? Thank you.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

I'm going to start with the question on a big picture in allocating capital in EU versus Europe. I think basically we have given the conceptual answer three years ago, when Tim was very much around talking about Europe is falling behind in infrastructure, because we are fragmenting, we, meaning Europe is fragmenting itself, it's splitting up into little pieces instead of scaling up.

A

So the U.S. market per se has scale advantages, that's something which is not new, and that's an important driver in terms of capital efficiency you have. So, that's one element of the answer.

The second element is, I guess that, we maneuvered ourselves into a situation last three years, four years that we are capable to go for a standalone perspective on a longer period of time, a successful one.

And Europe in terms of [ph] pass (01:06:12) of regulation and in terms of scaling, it's still a mixed bag. We've – I think we are in Germany and our whole market in a situation, which is okay, so this is why we're investing there. But if you look at the European level of regulation, that's a mixed bag still. And so there are very many good reasons to keep going in the U.S.

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

Okay. And on your second question, you are surely referring to the two sets of free cash flow guidance that are out there, so we have the cash flow guidance for four years, CAGR of 10%, and that will get us to a number in 2018 that we have not yet disclosed. Today, we have just guided for the 2017 number, and we have guided towards growth of 12% to €5.5 billion.

A

And separately the T-Mobile US, of course, their earnings call have guided for a three-year CAGR of 45% to 48% over a three-year period, which takes them into 2019. But they have not been specific in terms of the trajectory how to get there. So, I think we cannot really make calculations for 2018, out of just two sets of outlooks.

But I think, it's fair to say that, when we talk about 2017, we see a significant ramp-up in investment, which is more relevant for our German business, in particular. I think we are all completely aware of what drives it.

And so in those terms, yes, there is a different free cash flow trajectory in 2017, in Europe and in the U.S. But I think we cannot read anything in it for 2018. And it's nice to see that the medium-term outlook for Deutsche Telekom is well supported by what T-Mobile US has guided for.

Timotheus Höttges

Chairman-Management Board & CEO, Deutsche Telekom AG

A

Dominik, I like your question, it's very controlling like, but let me make a clear statement here. Look guys, you know, we have [ph] many (01:08:26) Capital Markets Days, and we were very clear about 1% to 2% on growth, on revenue, 2.4% on EBITDA and CAGR of 10%. Since that in the third year in a row, we're over-delivering on that one by double amounts.

So, I do not want to be semantic, but you know, we have promised and we have over-delivered on all these numbers. And if we're giving you a guidance with another 12% growth on our free cash flow for this year, we don't do that just hazardously, we do that by intention, we are very clear on that one.

So we are, let's say, very committed that even in the next year, we are able to deliver on this guidance, independent from all these mathematics, which is maybe playing to this group.

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

A

Okay. So our next question we have is from Guy Peddy at Macquarie. Guy, can we have your question please? Guy?

Operator: Okay. I think, Guy, you are muted by yourself. Could you unmute your phone?

Guy Peddy

Analyst, Macquarie Capital (Europe) Ltd.

Q

No – sorry. I'm not sure what's going on there. Hello, team. Probably another question for Hannes, I suppose. If you could just talk a little bit about domestic CapEx, on what pressures or if there are any pressures you're getting to deepen your fiber build, especially to residential homes. This is obviously clearly a big issue that is impacting in the UK, and obviously very relevant for BT?

And then, on a secondary point, more for probably Tim. You've mentioned that BT remains a good investment. But during the course of the past year, you must have been shocked by the fact that, there's been accounting scandals, management have slightly misread Ofcom, management has slightly misread a restructuring of their assets, and therefore they've suffered a big slowdown in some of their sort of corporate enterprise and public sector customers. I'm just wondering, why you think owning BT at these levels is still a good investment given the past year's performance? Thank you.

Timotheus Höttges

Chairman-Management Board & CEO, Deutsche Telekom AG

A

Hey, Guy. It's Tim. So, the first thing with regards to the domestic CapEx pressures. Look, I think there is always a discussion going on that, is our infrastructure well fit-in for the future needs? Are we are sufficiently covering the

population of Germany? What is the right technology? And as you could imagine, there is some pressure as well from [ph] Bleco (01:11:03) and some association as well from my dear competitors, the red ones especially, who are just always trying to tell me that our infrastructure is not good enough compared to theirs, which honestly I might understand from an advertising perspective.

Now, the reality is different. The reality is that, we have constantly increased our net debt numbers in the German environment. Whenever we are opening up, let's say the good vectoring or super vectoring services, the moment the customers really like it and they buy into that one and you have seen the great numbers in the fourth quarter, which is heading that we are doing pretty well in the competition against the cable operators at that point of time.

The second, there is no political pressure. The political pressure is on was that in the coalition agreement, 50 megabit for the entire society was [ph] at request (01:11:59). And Germany with let's say with vectoring and with exclusivity of vectoring in the neutral areas, we are able to support this political aim with the technology we are deploying and that is appreciated, because you know, in the areas where we are building this, we are the only one who is really let's say servicing good quality. And then there is this area, where subsidies are paid for building out the very rural areas, so from 80% to 100% coverage.

And in these areas, the technologies mainly are based on vectoring technologies and in this areas the percentage of Deutsche Telekom is significantly above 50%. So even in this areas, people like to see us competing and [indiscernible] (01:12:53) pitching for this money, otherwise they would not, let's say contributed into our direction. So the intention to cover with our bandwidth service as much of the German market and that our telecom signal is available for all of the customers in Germany is working out.

On top of that, in the last quarter, we have hired a guy from the competition Pruchnow, you might have known from his Versatel or his Telefónica times. He has one task, he is, let's say, the guy for the corporations. So whenever there is a corporation model in a rural area, where we could jointly build out or where we could jointly use an existing fiber infrastructure, we are willing to consider that.

There are already two deals, which I'd like to mention to the community here. The first one is innogy, who has made a corporation with us, where we are using their fiber infrastructure, and the second dealers NetCologne, where we are cooperating. So, there is more to come with regard to the build out of fiber in Germany as well for this corporation model, which is more efficiently.

I think, the discussion or the tone which we have is something, which might sometimes be irritating for you guys, but there is no pressure on us to further invest. We are the top investor with €5 billion in the German infrastructure and we get a lot of appreciation as well for the efforts we are taking here.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

Just to clarify, the €5 billion referred to the geography in Germany and that relates to the year 2016, so there is no confusion, especially now we have changed the segmentation, you have a pretty clear CapEx outlook for the various units in our Annual Report. And let me also maybe add one word before we get onto BT, we have not guided for CapEx beyond 2018 as you know, we have said – we have guided now for 2017, otherwise we provide free cash flow guidance going through 2018 in the way that we talked about earlier.

But what is clear is that, at some point our FTTC deployment comes to an end, and then there's some funds available, and I think it's directionally clear that our networks will get denser and denser, and we'll keep investing fiber, as we do now, we spend a lot of money on fiber every year, more than a €1 billion, as you know and this is

a part of money that can be used in different ways going forward. But we have not really guided beyond 2018, so it's too early to talk about that.

And on BT, Tim?

Timotheus Höttges

Chairman-Management Board & CEO, Deutsche Telekom AG

A

Look, of course, we were surprised and disappointed by the BT's management, recent profit warning and the underlying developments, but we continue to believe that BT has a lot of good fundamental substance. I mentioned their positions in the British market earlier and we continue to think that there is a lot of potential for collaborations between our two companies.

So there is anyhow a period where we have a standstill here, and I hope that especially the DCR situation is going to be soft soon. And then, we will see a value enhancing that is let's say our prognosis here and we believe BT is a good asset from our perspective.

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

A

Thank you, Tim. And next, I would like to have your question, Nick from Redburn.

Spyros Nicholas Delfas

Analyst, Redburn (Europe) Ltd.

Q

Yeah. Thanks so much. Nick Delfas here. So, just two please. On the scrip dividends, could you talk a little bit about why you continue without, I guess, shareholders, you take the full divi being diluted by about 8% since 2012, and there is also a discrimination against non-German domicile shareholders. So why continue with that policy rather than just pay the full dividend in cash?

And the second question is about restructuring charges. I know it's almost in the past we've talked about when the restructuring charges might reduce, they are obviously still quite high in 2016. It looks like you need to transition the product set in T-Systems and there are 44,000 employees there. So, really it's a question about duration of restructuring charges, and also how the cost per employee might evolve? Thanks very much.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

Yeah. Nick, on your first question on the scrip divi, it's quite simple. First of all, let's just remind ourselves that both have developed well, the stock price and dividend development, that's number one.

Number two is, we still see 50% roughly acceptance rate last year again on the scrip divi. So, there is obviously a share of the people who like it. And thirdly, it's voluntary, it's not like we're forcing someone onto this stuff. So, that's on scrip divi. And so as you know, it's an year-by-year opportunistic perspective we're taking here, it's not part of my planning, but as long as we feel, there is a good development of stock price and divi and a high acceptance rate might go with it again.

On the restructuring charges, you are spot on. I've spoken about it in the Capital Markets Day two years ago, with the expectation that it will go down and decline. 2016 was not exactly what I would call still high, it was kind of record high, and there was a very specific reason, the government decided to end the – what was that [indiscernible] (01:19:01) voluntary early retirement schemes and stop that scheme and not to prolong it anymore.

So, it was a kind of last exit situation for those people who can apply for. And we decided then to use that specific situation and max out the volumes here. So, that is why you've seen that that peak in 2016, it was not related to systems or any specific other business, it was simply driven by that decision by the government.

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

A

Thank you, Thomas. So the next question I would like to take from the webcast and it's from Steve Malcolm at Arete. The question is, would you be prepared to take your net debt over EBITDA to around three times, if the right deal emerged in the U.S.? I guess, question for Thomas.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

Yeah. First of all, the guidance we give on our rating and our leverage is based not on speculations on M&A, but on our plan and the structure we have right now, whenever we assess opportunities we take that into account. So that's an element of the equation if you assess a deal and nothing else.

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

A

Yes. We of course remain – I mean our language has always been that we remain committed to our ratings corridors, but we could temporarily depart from them, if there is a strong strategic boutique and that's how we still think about it.

So next question is from Ulrich at Jefferies.

Ulrich Rathe

Analyst, Jefferies International Ltd.

Q

Thanks very much. I have two questions please. The first one is coming back on that free cash flow outlook. At the given FX assumption, you're essentially guiding free cash flow up €600 million year-on-year. But if I look at the combination of EBITDA and CapEx, that's essentially guided down year-on-year by €200 million. So, clearly there is something in between. And I understand, you expect good working capital to do much of the difference. So, I just wondering, could you comment on what's going on in the working capital if this carryover from things you did in 2016, are these new initiatives, what are the sources for this? That will be my first question.

And the second question is on the broadband share in Germany. Mr. Höttges explained that in the fourth quarter, you saw roughly 30% of market growth. You believe that 87,000 was maybe 30% of market growth, which sort of implies with your 40% share of the base, but you still lost share even with that 87,000 intake. I was just wondering when you guide for 2017 to essentially sort of produce similar intake as 2016, that effectively means I think that you're guiding for further share loss and I was just wondering how you think about share loss? Does it simply not matter, because you're doing so well on the fiber upgrades or how do you think about broadband share in total? Thank you.

Timotheus Höttges

Chairman-Management Board & CEO, Deutsche Telekom AG

A

Okay. Let me start with the first one, Thomas?

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

A

No, go ahead.

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

Okay. So on the first one, I think when you look at our free cash flow equation going forward, I think you could also just look at the EBITDA and see that the EBITDA is going up and the free cash flow is going up by similar amount, of course, otherwise there are a lot of moving parts, so yes, we are investing more.

And when you then look at working capital, it's important to appreciate that while we expect improvement in working capital next year, we still expect a working capital drag next year. We expect a continued working capital drag, although we think it will be lower than in 2016. 2016, it was particularly strong due to a very strong growth in the United States plus the shift in the commercial model towards leasing, which has also been somewhat a factor here. But the big picture is we grow free cash flow, because we grow EBITDA. And I think that's how what's the fairest way is of looking at it. At the same time, we are very happy that we can grow free cash flow while we invest more, and that will help us in the future.

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

A

And on the broadband share in Germany, first of all, last year was a kind of two very different half of years we had, first half was mobile dominated and fixed line wasn't very strong, whereas we improved significantly dynamics in the second half of the year, and we'll keep going. The guidance we have given in total numbers, meaning the similar amounts like we've seen this year, is obviously dependent on what the total market size will be.

So the clear message is, we'll go for 40%, and if the market – whatever the market size is, so now we can think about what the market size is, but the clear message is, we're going to go for our fair share, we're going to use the momentum. We have right now customer loves our product, and we go for it. And if that means, there needs to be a higher number in 2017, because the market is a little bit larger, we go for a higher number.

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

A

Thank you, Thomas. And next, I would like to have a question from Fred at the Bank of America Merrill Lynch.

Frederic Boulan
Analyst, Bank of America Merrill Lynch

Q

Hi, good afternoon. Thanks for taking the question. I'm going to try a follow-up on the U.S. before moving on. So firstly, you've moved away from your self-funding strategy last year, just trying to understand whether you'd consider going a bit beyond that and increase your commitment to the U.S.?

And then secondly, you talked a lot about 5G in Barcelona, if you could share a little bit with us your thoughts on the impact on your network, what kind of CapEx can we think about, and whether you think BT will be better positioned versus mobile only provider or incumbents in general versus mobile, whether you will also access to

third-parties and therefore as you suggested a bit before, which will limit your ability to differentiate? Thank you very much.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

So, first of all, I'm going to start on the U.S., Fred, this is Thomas. I guess, yes moving away from self-funding last year was a clear commitment and an increase of commitment to the U.S. for good reasons. When we started the journey, it was highly cash flow negative, and after we've seen that, the business has developed well and it was in a good territory. We decided to move away from the self-funding.

As you know that, it does not mean that we completely it by 100%, but by a larger extent are willing to support the U.S. We're doing that always at arm's length perspective to ensure that the minority rights are covered well, but yes, for sure it means an increased commitment to the U.S. what we've seen and shown last year. And as I said, we like the development of the business. We see there is a standalone path and that's fantastic.

Timotheus Höttges

Chairman-Management Board & CEO, Deutsche Telekom AG

A

It's good doing it this way for the group and for the U.S. Now, that said on 5G, Fred, it was quite impressive to see that a lot of, let's say, practical things happening in this new technology. And Deutsche Telekom has been always part of the leading telcos in the world on developing technologies. For instance, Bruno Jacobfeuerborn was heading the 5G-PPP Standardization Committee for that one.

Last year, we have announced the strategic partnership with SK Telecom, and the intention behind was that we are strengthening the skills on 5G deployment, because SK is definitely one of the first in the world going to be launching 5G, because 2018 for the Olympic Games, they want to have a showcase for the worldwide community.

We have been quite proud of showing a lot of [ph] loud (01:27:02) around slicing and around guaranteed latencies and guaranteed quality classes in the network, and we have been able to launch worldwide NarrowBand IoT service at the booth in Barcelona.

That said, you see that Deutsche Telekom and its communities working on a lot of things. The big drive tests in Germany at the autobahns in Bavaria is empowered by Deutsche Telekom. So, I can tell you, if it comes to the perception, I would say we are definitely leading the game here in our markets where we're operating, and I see that as a differentiator definitely [indiscernible] (01:27:49).

We will not release any numbers at that point in time. It's too early to say how this rollout is playing into the CapEx envelope, which we foresee. So it is part of the current planning of what we have, so nothing to worry that we are coming up with suddenly an increase or whatsoever. We have our envelope, we are investing more than our competition is doing, thank you for supporting all of us for the strategy, I think it paid out in the U.S. where we've invested more than €20 billion into the LTE infrastructure over the years, now we have a high level pilot work with Verizon dream and the second is true for Germany where we have invested heavily, now we're gaining the customers on the fiber side and we are leading in eight out of our markets on the [indiscernible] (01:28:39) drive tests in the Eastern European rim as well. So I think that's the right thing going on and give us some trust and some confidence that we are doing this as well in the 5G environment.

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

A

Maybe I'll add a few words also on the backhauling side, if your question was related to backhauling. What we're doing already in 4G is, we're offering backhauling services for our competitors, this is not about monopoly situation, this is quite simple, as long as we have good commercial conditions in pricing, and not regulation telling us how we have to price our products, it's quite easy. There is nothing wrong with partly sharing your infrastructure with competition and gaining advantages from it.

The other way around, it creates additional margins. And you always need to be careful, that's what we're doing, and it's to be one or two steps ahead of competition, but there is nothing wrong with also partly sharing the infrastructure. As we do it in 4G for fiber base backhauling with the competition as well.

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

A

Thank you, Thomas. So next, I would like Mathieu from Barclays to ask his question. Mathieu?

Mathieu Robilliard
Analyst, Barclays Capital Securities Ltd.

Q

Yes. Good afternoon. Thank you. First, in terms of German EBITDA, so you're guiding for growth. Could you maybe give us a little bit of granularity into the pluses and minuses driving that growth? How much could it be for revenues or is it almost nothing? What is related to employees or structural costs, et cetera, et cetera? So that's the first one.

And the second one, quickly on FCF, lots of questions. In the past you have given some granularity in terms of what are the elements that drive the FCF. So maybe if you could share that with us for 2017 in terms of, for example, restructuring cost that you anticipate at this time, and maybe some of the other items? Thanks.

Thomas Dannenfeldt
Chief Financial Officer, Deutsche Telekom AG

A

This is Thomas, Mathieu. First of all, on the German EBITDA, there is, basically, it [ph] varies (01:30:39) bits and pieces. One is, on the revenue side, you've seen we guided our CAGR we've given for [ph] four (01:30:45) years was slightly above 0 plus 0.3%. We are at minus 0.3%, so there will be a little bit of contribution from revenue side.

But, don't forget, I mentioned that a minute ago we had a peak in our personnel restructuring costs in 2016, that is obviously also driving the OpEx downwards and then giving us room to maneuver on the OpEx side. So there is a contribution by less personnel costs driven by restructuring we've done last year, and those components add up altogether to the growth we guided in the German EBITDA side.

And the second question was? On the free cash flow – restructuring costs. First of all, on the restructuring costs, we will see because in talking to about the free cash flow, there is always a difference between restructuring EBITDA and cash. On the cash side, we will see a decline of €200 million to €300 million in this year versus last year on the cash related restructuring costs. And then more granularity maybe the tax, the interest and – what I have forgotten tax interest.

Mathieu Robilliard

Analyst, Barclays Capital Securities Ltd.

Q

Receivables.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

No [indiscernible] (01:32:07) working capitals. Yeah, that is, so if you go interest tax and the [indiscernible] (01:32:12) wash, so the main driver here is the plus €800 million we have on the EBITDA. And Tim, do you want to tell me something? It's the €800 million on the EBITDA and the lower restructuring costs.

Timotheus Höttges

Chairman-Management Board & CEO, Deutsche Telekom AG

A

Look, Thomas, it's so great, as a former CFO to help you out here in these numbers for the first time in this time. €22.2 billion is the adjusted EBITDA, minus €12 billion is the CapEx, minus interest taxes and received dividends are of minus €2.7 billion. Then we have working capital of minus €0.4 billion and then we have special factors on cash, which is minus €1.6 billion makes the number of €5.5 billion.

Mathieu Robilliard

Analyst, Barclays Capital Securities Ltd.

Q

Unbelievable.

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

A

Okay. It's good to have two highly competent leaders for this business and now we have two more questions and the first one is from Andrew at Goldman.

Andrew Lee

Analyst, Goldman Sachs International

Q

Yeah. Thanks for taking my questions and sorry if this is flogging a dead horse on U.S. So I just wanted to ask a strategic question in terms of the challenges that you might face in this market. I mean, let's say the M&A has been announced over the past few months were to be approved. It's a clear shift towards convergence and with 5G seemingly coming quicker according to the Mobile World Congress feedback. How does that impact your view on your position as a kingmaker asset, the important of being convergence to you and the timeline in which you have to make a decision on what you do there?

And then just secondly on the B2B side again, it's been asked a lot, but I just wanted to ask a kind of fundamental question on T-Systems or BTs, B2B operations, or just fundamentally these assets, very difficult for us to analyze?

And in the past, it looks like there have been low barriers to entry, low marginal cost to entry from your competitors and therefore lot of pricing pressure. As we move into this new cloud on ICT platform base world as you mentioned, it looks a little bit like, the software-as-a-service and platform-as-a-service revenues can be done by many other players. So, why isn't that a more difficult setup for growth and hence as much if not more pressure on the top line that means, you're just going to have to slash cost to stand still. Any help in how you think about this structure it will be really useful? Thank you.

Timotheus Höttges

Chairman-Management Board & CEO, Deutsche Telekom AG

A

Look, first it would be an understatement to say that we are delighted with the T-Mobile U.S. standalone performance and the execution which is taking place with all the money which we've invested there. We have created here just over the last few years a unique position, and it's not so easy to just copy that as you have seen out of the developments. Along the way, there were many decisions for us to take, and I think we were always so far right, what we did and what we didn't consider. There were offers in the market from some French guys and alike, remember, where we did the right thing of just ignoring it.

Now, there is something in your question which I cannot at least confirm that there is a clear tendency towards convergence. Look, I'm the biggest fan of convergence, and we are driving convergence very, very intensively, but I do not see that in the U.S. market yet. So, maybe I'm missing something, but so far it has been consideration of cable operators. To cable, it has been cable to content, or mobile-to-mobile, but I haven't seen, let's say, a fixed mobile converged [ph] tendencies here (01:36:12).

Now, that said, if this tendency is there, might be good for consideration. Look, we have created a business which has a lot of organic and unorganic opportunity in this environment. We have created huge opportunities. And for us, there's no rush, there's no need to rush into anything to do something. We will evaluate any opportunity now from a position of strength, and our primary goal is to create even more value of our shareholders. The value we have created since 2013 is just \$25 billion, only to give you the magnitude of this 400% increase, and I hope we have even some trust to do and consider the right things here.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

Yeah. And a few words on the B2B side question on our thinking. I guess, first of all, I think, we need to be careful in terms of comparing T-Systems and BT Global Service in terms of – this is the same box. We're talking about it's not. Where we basically struggle was in terms of profitability is the IT outsourcing business to a huge extent, and especially if you look at the Q4 impact you've seen and the lack of scale in the telco side and that's exactly not where BT Global Services lacks. They – I guess, they – and you've seen that by the deal which was or the cooperation which was announced yesterday that they are looking for our – the value we can add in that partnership on SAP cloud services, meaning IT. They don't have that in that extent and we are using more there better available worldwide telco infrastructure.

So it is not like the same issues here, it's different. But in principle what I can tell you is, moving away from IT outsourcing basically means you take over a complex legacy IT infrastructure of a big company and you restructure it. And obviously, whenever you do that, you have a big risk because it's a big – very specific legacy based deal you have and that's different to a cloud service you build up in a very lean way, the way we build it up is very much along with partners and partnerships we're doing and what we basically do in here is, we use the best partners we can get in there and combine that with all of the strengths.

So talking about a German cloud doesn't mean there is a specific level of trust we have for the business customers, not only here in Germany, but in a wider scale here, creating that perfect set-up of the ingredients we can bring in and partners can bring in without creating huge risk profiles in that business and without creating another type of legacy. That is what we are aiming for. And what is working already well, Tim mentioned that that, for instance, mark to book bill is one example of that German cloud-based thing, we're expanding it because there is demand and so we're going to go there.

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

A

Excellent. So the last question for today is from Justin at Credit Suisse.

Justin Funnell

Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Thanks, Hannes. Yeah, I mean, it's another sort of way of trying to get a bit more color on your thinking in the U.S. So just thinking about the 2.5 gigahertz band that Sprint has. Obviously, they've got a very wide band there with some technologies being announced that was in theory made that band more valuable. But it creates not a band that's been used very much in Europe, even though most operators have already got it. Is there any thinking you can share about how you think about that spectrum band, how vulnerable is it?

And then secondly, you show the uptake of MagentaEINS on your customer base. You've got pretty reasonable uptake on your contract, mobile contract base, but only 15% on your broadband business. I just – I mean, it looks like you're sort of selling it to your existing mobile base rather than using it as an acquisition tool. Is that right? And could you actually get to a point we start to use it as an acquisition tool at some point in the mobile market? Thank you.

Timotheus Höttes

Chairman-Management Board & CEO, Deutsche Telekom AG

A

Look, Sprint is clearly making its own strategic and technology choices, and is working to make its network more competitive. So some of these bets may work out, others maybe not. So that's definitely something else than what the industry does and what we are doing. And then when it comes to us, we think we will materially benefit from the investments in spectrum in a network that we have consistently made over the last years.

Just think of our low band spectrum, 5x4MIMO, think about VoLTE, SingleRAN, we are a global industry leader and we have always been able to drive the tangible network improvements which we developed across the globe as well in the U.S. So, look, if you would ask me, this is helping maybe Sprint to become a denser network, fine for them. But we have already built this dense network and these guys are investing, I think, something like €2.5 billion while we are investing significantly more and not only in one year. So it's two time higher and therefore our network is definitely not only better, it is even more common. So, let's see how that is common to their strategy, it's not our strategy and I should not comment on that.

Thomas Dannenfeldt

Chief Financial Officer, Deutsche Telekom AG

A

Yeah. And Justin, on your question on MagentaEINS, I think what we've seen there and what we see there is basically what we have expected meaning that the mobile contract customer share in MagentaEINS bundles is higher than the fixed line side for various reasons. Number one, please – what I'd like to do is, remind ourselves that in 2010, when we merged the fixed line in the mobile side in Germany, we started with cross-selling, which is kind of pre-phase of MagentaEINS product and we've seen exactly the same dynamics. Obviously, mobile is ramping up much faster and is growing faster in terms of the adoption rate for various reasons. Number one is, you have various SIM cards in a household, but you have one access on a fixed line side normally. Some people have two, but normally have one. That's not true for the mobile side. And then switching on mobile is, so to say, the exit-oriented barrier is lower. So there is a fast adoption rate in there. So what we've seen from 2010 to 2015 when we did cross selling, but no converged products was exactly that kind of dynamics. I think it's natural that fixed line is somehow lagging behind. But on the other hand, you're right, it's an opportunity looking forward.

Hannes C. Wittig

Head-Investor Relations, Deutsche Telekom AG

Thank you, Thomas. I think that was the last question for today and the conference call is now about to end. So, we had long Q&A today. So, we will not continue to elaborate. And should you still have further questions, then we would like you to contact us at the Investor Relations Department. And with that, I give it back to the operator.

Operator: Thank you. We like to thank you for participating at this conference. The recording of this conference will be available for the next seven days by dialing +49-1-805-2047-088 via a reference number 500972#. We are looking forward to hear from you again. Good-bye.

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