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DTE.DE - Q2 2019 Deutsche Telekom AG Earnings Call

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Co. reported 2Q19 YoverY reported revenue growth of 7.1%.



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PRESENTATION

Operator

Good afternoon, and welcome to Deutsche Telekom's conference call. At our customers' request, this conference will be recorded and uploaded to the Internet. May I now hand over to Hannes Wittig.

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

Yes. Good afternoon, everyone, and welcome to our second quarter 2019 conference call. With me today are our CEO, Tim Höttges; and our CFO, Christian Illek. As always, Tim will go first -- first go through his highlights for the year-to-date, and then Christian will talk about the quarter in more detail, and then we have time for Q&A.

Before I hand over to Tim, please pay attention to our usual disclaimer, which you will find in the presentation.

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

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

Welcome, everybody, here also from my side. Thank you, Hannes, for introducing. And let's wrap up where we stand.

Look, from a summary perspective, I can tell you first half year, all hands on deck Telekom. And just as a preliminary, I can't remember quarter during my 20 years at Deutsche Telekom which has shown numbers like this. We had 7% growth on our revenues, 8% growth on EBITDA, 24% growth on the earnings. We had a lot of willingness to transform within the company. We have announced changes in our shop footprint. We have announced changes within the systems portfolio. And even on the unorganic side, we made a lot of progress with the integration of Tele2 and



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(inaudible). And on top of that, we had this good step forward in our proven process within the U.S. So I think a lot of things are heading towards the right direction, and I'm very happy about where we stand after half year.

All our operating segments are growing on both sides of the Atlantic. Our EBITDA after leases is up almost 8% year-to-date. Organic sales are up by 3%. Organic EBITDA after leases grew by 3.7%, and our ex-U. S. EBITDA grew by 1.8% in the first half. Our free cash flow is up by 9% like-for-like, and adjusted earnings grew by 3.9%. So the things are moving.

CapEx in the U.S. was front-loaded as per guidance, while ex-U. S., CapEx was broadly stable as we promised.

We are well on track for our 2019 guidance in every key metric and for every [end]. And we are well on track for the long-term growth guidance we gave at last year's Capital Market Day.

Moving on to Slide 5, the foundation of our strong growth remains our good investments in networks. In Germany, we already passed over 22 million homes with super vectoring, speeds up to 250 megabits per second. And we are on track for our 28 million customers or households being approached by year-end.

This year, as outlined at the Capital Markets Day, we are completing our German FTTC footprint, and we are beginning to ramp up FTTH deployments. Initial focus here is on the subsidized build-out in white spots in the business parts and on collaborations.

We made further progress with our IP migration, reaching 93% of German lines, so up from 90% last quarter. So we are well on track to finish the German B2C migration this year and the B2B migration next year.

German LTE coverage, close to 98% full year target. Our telco added another 1,400 new sites in the last 12 months. This is on track with our ambitious plans to increase our site footprint by 1/3 by 2021.

This quarter was, of course, big for spectrum auctions, not just in Germany. While we could all watch the daily drama on the Bundesnetzagentur website, in Germany we acquired 130 megahertz of additional spectrum at a cost of EUR 2.2 billion. 110 of the spectrum are additional to our current footprint. 80% of our base stations are already ready for 5G. We have all the [ingredient] for leading the market in 5G, and this is clearly our goal.

In the U.S., we successfully participated in the 2-millimeter wave spectrum auction. We were able to boost our nationwide average holdings to almost 500 megahertz at a cost of only \$840 million.

While we are busy building our low-band 5G network, at the end of June, we also launched our first 5G offerings based on millimeter waves in 6 American cities.

Moving on to Slide 7. And our momentum with customers remains very strong. More than 13 million German homes already subscribe to our fiber products, 2.4 million more than 1 year ago.

In Germany and in our European markets, we added 2 million converged customers in the last 12 months. We added 3.1 million mobile contract customers, of which 1.7 million organically. And T-Mobile continues to grow strongly, you know the numbers, and raised its guidance for 2019 branded postpaid net adds again towards a new range of 3.5 million to 4 million. This compares to an initial guidance of 2.6 million to 3.6 million.

T-Mobile also raised its 2019 EBITDA guidance to \$12.9 billion to \$13.3 billion, up from an initial \$12.7 billion to \$13.2 billion. T-Mobile also said they expect CapEx at the top end of their previous range.

At the same time, we are happy to confirm our [\$13.4 billion] 2019 EBITDA after lease target for our U.S. operation -- ex-U. S. operations here. So the European footprint.

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However, we only confirm but don't raise our group guidance at this stage. The reason for this is the higher-than-expected U.S. GAAP IFRS translation mainly related to the so-called power purchase agreements. These are essentially forward swaps related to our complete shift towards renewable energy. Because of these swaps, we now expect the U.S. GAAP IFRS translation at around \$0.7 billion this year, instead of an initial \$0.6 billion. This pretty much offsets the T-Mobile's EBITDA guidance hike at the group level.

In the appendix to this presentation, you can also find the guidance for each segment, which we again confirm this quarter.

While we are delivering on the financials, we remain busy working on the portfolio. This remains a key focus. Let me start with the big news we had 2 weeks ago when T-Mobile entered a consent decree with the U.S. Department of Justice.

We also announced several agreements with DISH. These agreements mark further important steps towards final approval of this transaction. We continue to see this as a major win-win for U.S. consumers and our investors. You can find the details in the various filings. We reiterate our [\$43 billion] synergy target, but we are particularly pleased that the agreements protect our plans to supercharge the Un-carrier as we intended it.

We will spend an unprecedented \$15 billion to aggressively leverage a unique combination of frequencies, a market-leading 300 megahertz in total. We will create a totally transformative and superior 5G network, so we are ready to successfully compete. And U.S. customers tend to benefit whichever way you look at it.

We have now gained many important approvals, and we remain confident and optimistic about the remaining regulatory steps in the U.S.

Back in Europe, we have fundamentally strengthened our operations in Austria and The Netherlands while we have exited Albania. We have carved out our Dutch towers and are working on our Austrian towers. And by the way, our German tower co-op has been legally separated since 2002. I was surprised about the excitement that Vodafone announced separating their tower business in Europe. But anyway.

As the next step in our T-Systems transformation, we have announced to transfer our telecommunications and classifieds ICT portfolio unit from T-Systems into the German segment by mid-2020. We might discuss this in more detail later on. But this is an important step to focus the business more towards the customers in the respective area of telecommunication. This will create a more efficient and customer-friendly setup. And we have decided to carve out the T-Systems security and IoT portfolio units to make them more agile and competitive towards the different customer groups which we are aiming.

With this, you see that Deutsche Telekom is working hard on all fronts within the competitive landscape we are facing.

I will hand over to Christian, who will give you more details on the financials of the second quarter.

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

So thank you. Welcome from my side. So let me start with the Q2 financials displayed on Page #10.

Reported revenues this quarter were up by 7.1%. Organic growth was 2.9%, very similar to the last quarter. Reported EBITDA after leases grew by 7.1%, and that would've been 3.5% organically.

So how do we grow outside the U.S.? EBITDA growth DT ex-U. S. was up 2.9% this quarter and (inaudible) 1.5% growth on an organic basis, which is a little bit below the guided run rate, but it's very much due to phasing in the GHS, and we're comfortable to meet our full year guidance.

Free cash flow was up by 5.4% this quarter, a bit below the full year run rate. But you know that our cash flow was quite volatile, and you can see this if you make a comparison on the first half year results where free cash flow grew at 11.4%.

Adjusted net profit grew by 7.4%, roughly EUR 100 million, and the strong increase in the reported net profit obviously is related to the Toll Collect settlement which we faced in the second quarter of last year.

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Let me move to the operational performance by segment, and let's start, as usual, with Germany. Total revenue [grew] by 1.2%, very much driven by toll service revenue growth but also our increased handset revenue growth. EBITDA after leases grew at 2.4% this quarter, same number as you have seen in Q1, and it is very consistent with the full year guidance.

As we're moving to the service revenue, you'll see that the service revenue overall grew at 0.6% this quarter, and that was very much driven by the performance in mobile service revenues but also wholesale.

Headwinds, obviously, we're facing also due to the IP migration in the fixed retail revenue side. Fixed retail revenues declined by 1.4%, which is a bit worse compared to the last quarter.

Wholesale grew at 2.1%. And on the mobile side, we had a service revenue growth of 2.4%, and that includes a negative impact of 0.6% coming from regulation.

Don't be too optimistic for the next quarter. Next quarter, we are facing 2 negative effects on the mobile service revenue. Obviously, we're going to see the full quarter impact on the international calling regulation which we haven't seen in the second quarter, and this will coincide with a tougher comp effect next quarter, mainly related to the visitor revenue phasing from last year. So that will probably weigh a bit on next quarter's service revenue results. But overall, we're absolutely confident to meet our 2% CAGR guidance which we have given to you at the Capital Markets Day.

So if we move into the next page, the steady performance on the mobile side. We had another 150 -- 140,000 net adds, which was fueled both from B2B and B2C.

On Page #14, you can see that the mobile data usage continues to grow. And last quarter, it was 3.2 gigabytes, up from 2.8 gigabytes in the previous quarter. And also we see a steady growth in the convergent offerings now and the last quarter. 54% of all Magenta-branded mobile contracts are part of convergent relationship. That's an increase of 8 points compared to the 46% from last year. And 23% of the broadband households are now in a converged contract. That's another increase of 3 points compared to the 20% last year.

Moving over to the German fixed performance. As you can see, we had quite a bit of a soft increase on the mobile broadband net adds. This is driven by a couple of factors. One is, overall, we're seeing a slower market increase overall in the German broadband market, while at the same time, the IP migration impact continues to be fairly stable. If you exclude the IP migration, we would've been well above 30% in net add growth. But to be honest, we're not satisfied with that result. And all operational teams are now -- we have all hands on deck and actually, to basically increase that momentum going forward.

We had the 15th consecutive quarter where we have more than 0.5 million fiber net adds. This is a very strong performance, as you can see. We have seen softer performance on the wholesale side in the recent quarter, but that remains a steady growth engine to us.

Finally, we added 58,000 TV customers, consistent with the better growth which we have seen in the recent quarters.

Taking a look at the revenue trends on the fixed line. As I said earlier on, our retail revenues fell by 1.4%, very much driven by a weaker single play and other revenue (inaudible). On the other hand, the broadband revenue growth remains to be fairly stable with 2% -- 2.3% growth, also in line with what we have seen in the last quarter.

Let's move on to our usual slides from T-Mobile U.S. who have already presented their great results, including another guidance 2 weeks ago. We won 1.8 million new customers. This is now the 25th consecutive quarter with more than 1 million net adds. Our [EBITDA after lease] growth under IFRS was 6%, slightly below the 7% reported by T-Mobile on the U.S. GAAP, and Tim explained it. This is very much driven by a negative impact on IFRS, driven by the power purchase agreements.

Taking a look at the performance metrics for T-Mobile. A stunning postpaid churn rate with 0.78% compare this relative to the recent year in 2018 or even 2017. I think the commercial results, as we have seen that also in the previous quarters, underpinned by a very strong network performance.



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And the cost of service were slightly higher compared on a year-by-year basis because we received some hurricane-related reimbursements back in the second quarter of last year.

Moving on to Europe, Page #19. 300,000 additional mobile contract net adds, 330,000 new converged customers, that brings us to a household penetration in Europe to 45%. This is an increase year-over-year of 11% points. Steady broadband performance with 63,000 net adds and a slight increase on the TV side. But we have some pretty hefty competition in Romania here.

So this strong commercial performance obviously continues to fuel the financial growth, which you can see on Page #20. Reported revenues were up by 2.8%. EBITDA, on a reported basis, was up by 5.9%. If you basically make a comparison on an organic basis, which means take UPC out of the equation, revenues were up by 0.4% and EBITDA by -- was up by 2%, which is slightly better than the last quarter. This is why we remain absolutely on track with our full year guidance and also with our Capital Market Day targets which we have given to you.

Next slide, Page 21, is T-Systems. On T-Systems, I think we're making good progress on a very ambitious transformation plan. But let me clearly state, there's still a way to go. Our order book continues to develop positively. You see that we have a 15% increase year-over-year. Revenues are fairly stable.

On an EBITDA side, let me draw a conclusion -- comparison on the half year performance. On a half year comparison basis, EBITDA has increased by 19%. And that also keeps us very confident that we're going to reach our full year guidance of EUR 0.5 billion EBITDA and also will be committed to our Capital Market Day targets.

Next segment, Group Development. Obviously, the results here are impacted by the consolidation of Tele2 Netherlands, and we had an intra segment transfer of Dutch towers from T-Mobile into GD Towers as of January.

The organic sales grew by 2.1%, and EBITDA grew by 6.3%. The underlying Dutch mobile service revenue growth accelerated to 3.3% based on steady commercials. And as Tim already said, during the last 12 months, we have added 1,400 physical sites here in Germany. So we are well on track with our footprint expansion of 9,000 sites in between 2018 and end of 2021.

On the tower side. The recurring rental revenues grew by 3.4%, while EBITDA after leases grew at 2.9%. Everything is on an organic basis.

Let's get to the last 2 financial charts, one is dealing with free cash flow and net debt and net income, and then we get to the balance sheet ratios.

As I said early on, the free cash flow grew at 5.4%. This was mainly driven by higher operating cash flow while -- which was overcompensating the frontloading of the CapEx spend in the U.S. From a guidance perspective, we're fully on track with the guidance which we have given.

The net debt has increased by EUR 3.8 billion Q-over-Q. This is very much driven by 3 factors: one is a payout for the group dividend; the second one is additional tower leases, which we contracted in the U.S.; and the third one is driven by payouts, especially for the millimeter wave auction in the U.S. And that drove net debt to a EUR 3.8 billion higher level compared to Q1.

Net income, as I said early on, roughly EUR 100 million. That was very much driven by a stronger EBITDA performance despite the fact that we had to face higher depreciations and also higher payouts to minorities.

If we move into the final chart, which is basically showing the balance sheet ratios, you see that all of our ratios, whether it being rating or whether it being the leverage, are still green. However, one has to mention that we're really at the upper upper end of the corridor when it comes to leverage. We have given ourselves a target of 2.25 to 2.75, and now our leverage ratio is at 2.74. But we expect a slight improvement towards the end of the year.

So if I sum it up, I would say it was another good to very good quarter in Q2. We're delivering against our 2019 guidance. We're in line with what we have set at the Capital Markets Day. And with that, Tim and I are ready for questions. Thank you.

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Hannes Wittig - Deutsche Telekom AG - Head of IR

Great. Thank you, Christian. Thank you, Tim. And now we can start with the Q&A. (Operator Instructions)

QUESTIONS AND ANSWERS

Hannes Wittig - Deutsche Telekom AG - Head of IR

So let's start with the first question, which is from Polo at UBS.

Polo Tang - UBS Investment Bank, Research Division - MD & Head of Telecom Research

Yes. Just a few questions. Just in terms of German mobile, now that the German spectrum auction is over, what are your thoughts about the prospect of network sharing in Germany? And what are your latest thoughts about the risks from a fourth mobile network build?

And my second question is really just following up in terms of the German broadband market. The commentary that you obviously highlighted, that is the slowdown in terms of the broader market. We've also heard that from some of your competitors. But what is your perspective of why the market is slowing down for German broadband? And has this continued in terms of July and August?

Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board & CEO

Polo, this is Tim. So let me start with the network sharing agreement and the discussions which we're having. I think we have said publicly that we are open to collaborate in order to improve the capacity utilization of the existing sites. I think Vodafone also stated their willingness to collaborate. There is an obvious place for sharing which relates to some of the coverage obligations which we're having, especially from the 5G auction which has been defined, especially the white spots or the waterways where it would make total sense to collaborate.

Now that said, you should know that with our tower costs, which we have established 2002, we have already quite a few tower colocations. The ratio is, today, on our towers, is 2.3x. So then we have to find out where this kind of collaboration and tower-sharing is -- in addition, is possible.

We are exploring currently alternative sharing solutions from a technical and from an economic perspective. So it's too early to say where we are heading to. But in any case, let's share a little bit the principles how we're approaching these negotiations.

We are talking about reciprocity. So our Deutsche Telekom is coming with even more investments and amount of towers in the German landscape. And therefore, it's not that I give you 1 sly tower and you give us the access to the rest of the towers. That doesn't make sense. So they should be following the principle of reciprocity. So 10 from me, 10 from you, that makes total sense. Then we have a benefit out of this. This is the one idea.

The second one is we haven't decided on the way how we are sharing. There will be definitely sharing based on the passive side, that's the easy one. But whether we go into sharing and other sharing and capabilities, this is from a technical basis not so easy, and we have to really understand whether this is feasible.

One last sentence, tower white spots. There is an initiative from the government to build the sites in rural areas. I think the idea here is to build a passive infrastructure with connectivity which we can use then for our antennas. And we definitely support this idea because these are areas and -- very rural areas in the countryside, even in natural reserve areas where it is very difficult for us to get any air sites so that the government is then supporting us, and this makes total sense. This will help to reduce the build-out cost, and it will give then full coverage everywhere prospectively. And that is something which we are supporting as well, so we are in a good dialogue with the Ministry of Infrastructure on this subject as well.

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

Let me continue with the German broadband market. So what we're seeing right now, and if you compare the net adds of the other competitors in Germany, is that the overall market growth is slowing down. One of the arguments which we are getting is we had a, let's say, an artificial migration impact in Germany coming from people from the outside entering Germany which has slowed down significantly. This is one of the reasons.

At the same time, as the market slows down, our forced migration rates keep at the same level. So the impact of forced migration becomes higher. What we also see is that most of our competitors continue to offer longer promo periods compared to us. And therefore, obviously, we have to think thoroughly through on how we basically change that momentum in order to increase our net add share.

Do we see anything longer term, July and August? I think it's a bit too early to tell. I would say the only thing which we can influence is our place, so we have to optimize our go-to market. We cannot do anything on the market development, we'll see that. But expect us that we're working on our net adds here, and I think everyone is basically in sync here.

Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board & CEO

Polo, I think I missed one question, which was with regards to Eins&Eins and the mobile network build-out of the next operator which has been -- see -- and look, the first thing is we have now an incoming fourth network operator. But on the other side, 1&1 Drillisch is not a new player. It's already an established player in the market with over 9 million customers. And so therefore, he has already, let's say, a base which utilize a perspective infrastructure he's going to build.

As part of the merger remedies, Eins&Eins has national roaming bytes on the Telefónica Deutschland network. So he's even enabled during the phase of building his infrastructure to use existing capabilities of one of the operators. And therefore, we take that very serious. I think there is a decision for a new operator being made, and we will react (inaudible) here from our perspective without going into the details on this one. But we take him quite serious with his ambitions to build out an own infrastructure. Given his 25% build-out requirements by 2025 and the spectrum he has acquired, we expect that at the beginning, he will act regionally limited, so in specific areas. He will combine that then with the national roaming he has on the Telefónica network to offer country-wide service.

(technical difficulty)

I think all things considered, we will see some impact on the market from this player. It's good to have him because it will even help in the rural areas to have another kind of pillar for building sites and building infrastructure. So I hope that the government and the political leaders here made at the end of the day pays off.

Hannes Wittig - Deutsche Telekom AG - Head of IR

Okay. The next question is from Mathieu at Barclays.

Mathieu Robilliard - Barclays Bank PLC, Research Division - Research Analyst

First, coming back to tower and actually network strength. So do you see -- I think just the statement of objections to your planned network sharing agreement in the Czech Republic, I was wondering if you think this is a very special situation or a special case, or actually you think we should make some read-across for similar deals in other countries, and you had just mentioned in Germany. So I was wondering how you read that statement in the context of Germany.

And the second question, I'm sure there's a little bit of spectrum auction fatigue, but I guess that the outcome of the spectrum auction wasn't exactly what the regulator and the government expected. And I wanted to see if you thought they could be thinking differently for the future renewals, say, maybe 800 megahertz in a few years time in order to try to avoid the kind of outcome we got.



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

Okay. So let me start with the Czech situation. So first of all, let me note that the state of objection is not a final ruling. And obviously, we're strongly opposing the preliminary conclusions which have been drawn by the EC. We strongly believe that the network sharing has vast benefits when it comes to innovation, when it comes to better efficiency, by retrieving cost synergies and so forth and obviously providing better quality. To your question of whether we're seeing a read-across, no, we don't see a read-across. Across different countries, first, we have to see how the final ruling will look like in Czech. Secondly, we're taking things, also we had that discussion on M&A, for example, in The Netherlands on a country-by-country basis. The EC has been very clear about this that they're taking everything on a country-by-country and on a case-by-case basis. So we don't see a read-across on this one.

Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board & CEO

Yes. Look, I would not call it a spectrum fatigue which we're having here. I think this is another course of business here. And there are auctions going easier. Others are more difficult. I just want to draw your attention to what happened on the millimeter wave auction in the U.S. I think it's a fantastic outcome for the U.S. market and even for deploying high bandwidth in -- for the U.S. citizens. I think the German auction wasn't as easy, and I was clear what was coming out. I was announcing that even publicly. But at the end of the day, the auction was chosen or the methodology was chosen as we know it. I think the design has contributed to higher costs at the end of the day because a shortage was created on spectrum, and that was why it took longer.

Now on top of that, I think reducing the increment as they did it during the auction was even another failure of the Bundesnetzagentur in the way how they designed it, which ended then in a very long process of uncertainty. And on top of that, I think even taking 100 megahertz of spectrum out, where it's totally unclear how this is getting allocated to the industry and to the players and maybe being fully unused at the end of the day in most parts of the country, I think this is a design failure of this German auction.

Now without going too much detail, because I think it's not making a big difference for investors here at that point in time, I will -- we are working on a letter, on a suggestion, a constructive approach on Bundesnetzagentur, what in the future should we do differently in this auction and then the auction designs. And I think we are still contesting the auction in court in the way how it was designed in parallel because I think this was in -- a lot of areas was unfair how it was designed. So water under the bridge. Management always have to live with their interdependencies. So we take it as we -- as it is and we move forward, and we're designing our rollout plan according to this one. And there's nothing else to be said is that we are trying to avoid mistakes as happened in the upcoming auctions.

Hannes Wittig - Deutsche Telekom AG - Head of IR

Great. Thanks, Tim. Thanks, Christian. Next is George at Citi, please.

Georgios Ierodiaconou - Citigroup Inc, Research Division - Director

I have 2. The first one, around the U.S., please. And I know you can't comment about the details, but more about just thinking on how to approach the objections that some of the states have expressed. And what I wonder is whether you have any plans to engage in a dialogue with them, perhaps find a settlement for or whether using -- given what you have from the relevant authorities, it makes more sense to just wait it out and wait for a final court decision.

And my second question is around the network sharing option that you have. The 2 operators that share in Germany but maybe also in other countries, not just in Germany, have kind of left the door open in their conference calls for a single -- for some more collaboration in legacy technologies, perhaps even a single 2G network, where the other 2 or 3 operators can roam. In that way, you see a lot of spectrum, you get rid of a lot of cost and equipment and everything else. Is that something you are considering also? If that's the case, could you share with us which -- what's the framework which you think to maximize the synergies?



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Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board & CEO

George, let me start maybe a little bit broader with the view on the U.S. situation and where we are. Look, I think we stepped over a big hurdle recently with the DOJ approval. Now -- and for us, this is a major milestone which was achieved because we have now both from the FCC and from the DOJ, we got the federal support. And yes, the process was much longer and more complex than we all thought. And yes, there were remedies being opposed here on us. But what I can tell you is the deal mechanics and the deal logic is fully intact.

Our deal logic was always to build out a 5G network which is unique in the U.S. market. And part of the remedies is that we build 97% upon the next 3 years and 99% in 6 years on 5G services beyond 100 megabit per second. This is part of the package part of the remedies part of, let's say, our strategic plan.

The \$43 billion synergies are confirmed and not tackled. And the profitability and the long-term cash generation is supported or, let's say, confirmed from us as well.

So I think the deal logic is intact and having now both federal institutions supporting the deal. What we have had to accept was that there is another operator being created. And DISH, as the remedy taker, is taking the Boost, the Virgin Mobile and the Sprint prepaid business, which is almost 9 million customers. He's getting 800 megahertz of our spectrum. He is supported by a 7-year MVNO on this one. And on top of that, if we decommission shops and sales, he even can take this to build his own infrastructure. So if we see all of this packaged together, our logic is intact. But nevertheless, there is a significant opportunity for DISH to build a credible, disruptive fourth wireless carrier in the U.S. with a remedy.

So I think we found a very balanced approach on all the sites to support the customer interest, to support the competitive interest and as well to support the network build-out in this environment. So I think we are very, very convinced about this deal logic when we go now into the court and when we're trying to get the justification and the support for these.

Clearly, the states filed their lawsuit before our agreement with the DOJ. And therefore, we believe that a lot of, let's say, this remedies which I just described are addressing their concerns already. But nevertheless, we will be willing to engage with the state AGs, including those who are part of the lawsuit, to find kind of reasonable agreement. Today, we expect that we meet in court, which is now organized or, let's say, for the beginning of December. The 9th of December is the court where the lawsuit is taking place. And that is the time and the date we are working on those.

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

Okay. When it comes to the network sharing, especially in Germany, sorry to disappoint you, it's a little bit too early to basically comment on details because we haven't had detailed discussions yet. What we always said throughout the 5G auction -- after the 5G auction period to build out the rural areas, as we are being obliged to do so, it doesn't make sense for anybody to do it on themselves. So there is a rationale obviously to go for network-sharing option. This easiest way would obviously be passive network sharing. But I think that is contingent upon the discussions which we have to have. And you see that we have quite a variety of sharing agreements in our portfolio, just remembering you about the T-Mobile Czech and O2 question, which we just had.

I think when it comes to the German tower market, one thing is very clear. From a tower perspective, that's going to be a growth business, because we're going to see additional demands and build-out in the rural areas. We will have another player, who has to build out a network. So there is obviously a lot of towers to come to the German markets. From the tower perspective, it's really an attractive market.

Hannes Wittig - Deutsche Telekom AG - Head of IR

Great. Thanks. So next is Akhil at JPMorgan.



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Akhil Dattani - JP Morgan Chase & Co, Research Division - MD and European Telecoms Analyst

Can I just get a follow-up on the topic of towers? Obviously, you've talked about network sharing but, Tim, you mentioned at the beginning, early in the call, you're surprised at the share price reaction of Vodafone's comment. I guess I'm just keen to understand how you think about that. I guess network sharing and synergies have been talked about for a long time by yourselves and others. I guess the shift that people perceive from their end was an attempt to try and monetize the valuation arbitrage that is perceived between telco. So to what extent are those things you're talking about and in turn thinking about how do you think about the merit or not of actually financially spinning out towers? So I guess that will be my first question.

And then the second one is on the U.S. I guess it's a bigger picture question. I mean you've obviously talked about the deal logic remaining intact despite the remedies. How do you think about the operational performance in U.S.? I guess one of the things that stands out since the deal was announced is the extent that Sprint numbers have missed consensus numbers. We've seen if you look at Street numbers, double-digit cuts to EBITDA mid-term. I guess how do you think about the execution risk that, that entails? And I guess your confidence in actually delivering on the objective of that transaction financially?

Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board & CEO

Okay. Let me just go again into the tower question here regarding the monetization. Look, the first thing is that we talk about the towers already since 2002. And I mentioned that I was the one first Chairman, I signed even the first contracts of this company. And since then, we're operating independently. We have now a new team to that business, new management and significant cost savings in our EBITDA. Just to give you an example, after 6 months, \$274 million, I think that was the number which we have seen. So we improved the performance of this company by -- every day. Not just by the way, creating value.

Second, Christian said it. This business is heavily growing and today it is 100% owned by Deutsche Telekom shareholders. So the moment where we monetize that business, that moment, we might lose this opportunity. So therefore, we have to find the right timing to monetize this business.

I strongly believe that even our towers have a value of 20x on what we have seen in the market. And I saw some sell-side now even putting into some of the parts here, which I think I highly appreciate that because it is creating more transparency about the asset base of Deutsche Telekom.

Now guys, give us some credit. With our GD troops, Group Development with Thorsten Langheim and Christian on this, we have a track record on finding the right way of monetizing assets. Remember when we did the MetroPCS deal at 15 60, was a strike by us when we did the deal. Remember how we monetized Scout? How we monetized Strato at the right valuation? Nobody expected it.

Look, just on this small transaction of [Mishtolia] where we had lossmaking T online portfolio in a shrinking click rate business, which we exchanged into stock, which is now today more than 550 million worth of equity value. So I think we have some track record on how we monetize it.

And by the way, it is not the question of how, it is more the -- it's not the question of whether we do it, it's more the question how we do it. Are we considering on IPO at one point in time? Are we trying to merge with somebody on this one creating synergies beyond the portfolio which we have? Are we selling pieces of that one? Are we going out of the majority at that point? Are we developing that business for a while, knowing that this asset is growing?

So guys, please give us the credit for what we have done and the benefit of the doubt. Be aware that we are looking of every opportunity, which is rising in the marketplace. I'm very open on that one. That is why I pushed the business into Group Development where this is suited today. And let's comment when we realize value than rather announcing something and then running after our commitments.

So the second question, let me think, the U.S. bigger deal logic are intact. Operational performance in the U.S. Sprint, missing consensus. Look, I'm not commenting on any kind of internal discussions whether this business is intact, it's delivering on OpEx and CapEx synergies. And if you want to realize the value, you need the total business and not only half of it, you need it all. Look, customers in spectrum are at the smallest amount of what we have in mind. So I'm not commenting on any REIT rate here on the conference call. Please understand that.

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Hannes Wittig - Deutsche Telekom AG - Head of IR

Yes. I mean we have clearly confirmed the OpEx and CapEx synergies of the transaction. I think you also heard Braxton on the call that where we are in terms of our leverage assumptions and EBITDA business case.

So next question is from Ulrich at Jefferies, please.

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

My first question is about the remedy deal. I think in the past we've heard you discuss the risk that DISH has a bit of a litigious track record. What is it that protects you from this in the current deal? Is it the structure of the contract? Is it maybe that the industrial logic of this deal aligns you better? Or what gives you the confidence that this is a good deal from this particular angle?

And the second question is going back to the broadband slowdown. I was just wondering, is there element -- an element in the reasons also that you are now discounting in the Test the best way discounting the offers initially and that when customers sort of get back to paying full price that there is a bit of a bill shock there? Or is this simply not an issue when you look at the numbers of what's happening in your own customer base?

Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board & CEO

Yes. With regard to the first question, not easy to answer. First, you meet in these deals, always new partners and you never know how the future is looking at that point in time. And I know Charlie Ergen now already for years. We once had a discussion to merge our businesses. That's quite some time ago. I meet him on a regular basis. I think he's a great entrepreneur in how he has driven the business. But we know about his reputation and, therefore, the only thing what we can do is to protect ourselves by drafting and agreeing to contract, which is giving us and our shareholders appropriate protection in the deal.

Now you have seen the 8-K filings and have read them. So you know about what has been said about the protection rights. I do not want to disclose, I'm not allowed to disclose anything, which is going beyond that with regard to protections and trying the controls and other things. So therefore, please, just trust us on -- that we have an appropriate and diligent way of how we are drafting contracts here.

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

So when it comes to the broadband question. So specific answer to a specific question, no, we don't see a bill shock. So we don't see a significant increase in churn once the customer has to pay full price. What we're seeing is that competitors are still significantly more aggressive on Promos than we are. And I think we have to think through how we get to an operational full potential when it comes to go-to-market activities, whether it's going to be an up-sell, or whether it's going to be specific offers to specific reasons in order to bring up the net add ratio on the broadband side. But it's not like customers are leaving us once they're seeing the full price.

Hannes Wittig - Deutsche Telekom AG - Head of IR

Great. Thanks. Next is Mandeep from Redburn.

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

I just wanted a quick question on the dividend. Is it reasonable assumption, should our deal complete this year, that we should just assume the dividend for Deutsche Telekom will be \$0.50? Is that a reasonable or fair assumption to make? If you could maybe just help us with that.



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

Look, I can only come back to our dividend policy. And we said there is a floor, which is 50 cents. I've been asked the question, especially if the deal closes this year, what's going to be the full impact of the combined entity? We said it's EPS dilutive. But since we don't have full visibility in books, we can't tell you the exact number. So I cannot confirm the \$0.50. I cannot confirm anything else. I think we just have to simply take a look into the combined entity and then take a look how EPS is impacted.

Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board & CEO

Knowing how important that question is for our shareholders, Christian and myself, we have said that by the Q3 results, after discussing that with the Supervisory Board and giving a direction towards this, and knowing exactly where our business is heading to, which looks quite positive at that point in time, we will give you an indication by the next quarterly results on how we think about the dividend for 2019.

Hannes Wittig - Deutsche Telekom AG - Head of IR

Okay. And with that, we move on to Christian at HSBC, please.

Christian Fangmann - HSBC, Research Division - Analyst of Telecoms

Yes. A couple of questions. First one is on your earlier statement on the U.S. You said basically I think literally we don't raise our U.S. guidance yet. So I mean do you see that there is upside if they hit the higher end of their own guidance? Is that why you're a little bit cautious where they end up?

Secondly, there was a decision on StreamOn. And I think you are now basically allowing EU roaming so all the customers can use it outside of Germany. Can you quantify maybe the financial impact from that? I mean you already guided for a lower H2. Is that one of the reasons?

And then lastly, on T-Systems. Yes, there was some announcement that you're transferring the connectivity business over to the German unit. Can you maybe quantify the EBITA effect -- impact? I think the total business of T-Systems is around EUR 500 million or so this year, which would be transferred, just have a feel. And then is it fair to say generally that you're a bit behind maybe on your restructuring plan? I mean was that transfer always part of the plan? Or was it kind of a new development?

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

So let me start with the StreamOn question. Obviously, there were quite a bit of intensive discussions on whether we would allow roaming, yes or no, on the EU on the StreamOn proposition. We finally came to the conclusion that we will include this because we're forced to. But we don't make a statement on the financial impact of that, I would say, proposition expansion.

Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board & CEO

Let me give you a little bit of (inaudible) what we're doing at T-systems and what's happening there. And by the way, we are -- we announced to our employees that we are working on this one. The work is not being finally negotiated with the unions and we will need as well the support of our Supervisory Board, which is meeting beginning of September. So we are working on this project. And I think it's worth doing this.

What are we doing here? And look, there were the dark times of Deutsche Telekom where battles took place and where the question was, which kind of business belongs to A? And which kind of business belongs to B? And there were some artificial borders being built in the company. And one of the leading ones is the telecommunication service business because, just to give you an example, if we are negotiating governmental



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contracts, these governmental contracts are discussed with T-Systems. But the execution with the municipalities or even with the states is taking place in the Deutschland business. And this is creating interfaces.

Another example, and I remember that battle when Rene sent me in that battle 2006 when he said we will never give up our T-Mobile business, we will never be negotiated by T-Systems. And I was successfully negotiating that at that point in time. So the entire sales organization and even the pricing for every big customers on mobile is in the German business and not at T-Systems. The T-Systems business only handles the margin when they are selling to the big corporate customers mobile services.

On top of that, we have product houses who are developing the latest products, like the MPLS substitution products, the SD-WAN services, when it comes to connectivity services in free move and other areas. So we do that twice. We do that either on one side and on the other side in the organization.

And so you could question and you could criticize me for why, Tim, have you waited so long on bringing this business together? Honestly, we had so many other big things to get resolved over the past that it wasn't -- it was always on my list but never on the priority list.

Now cleaning up all the garage here, we are now even in that corner, and there's another element. We even wanted to make sure that the classified business, or the business we share related to secure service for governmental issues, that they are very close to the core network and how we're operating.

So therefore, we decided, and we are aiming for bringing this 2 business together to be more efficient, to be more custom-oriented, to make it out of one hand with one leadership and with an even stronger attempt to grow the business.

I think pro forma financials will be provided with the 2020 numbers coming out. I think there is no change in the financial guidance on a pro forma basis here. And I think we are talking about 1/3 of the revenues of T-Systems, which are affected by this reorganization within the organization.

On top of that, the TC business, the telecommunications service business, is very close to 2 other business. One is the security business, because network should be always secure. And the second one is very close to the IoT business, because a lot of, let's say, business applications are in the IoT running all this infrastructure.

Now we don't want to create another now silo organization here. And therefore, we take this companies independent. We build own companies around T sec and known company about the IoT. So that this company has 3 kind of areas which they're selling to. The first one is Germany. The second one is T-Systems. And the third one is to markets outside of this footprint. So we put a P&L behind that. You know that I'm a big fan of this individual entrepreneurial ownerships of businesses. And just pointing on The Netherlands, looking to other areas where we have done that, we see that there's a correlation even with the success we're having. So therefore, this is our second attempt to grow significantly these 2 areas in our B2B portfolio. So this is the reason behind T-Systems and what we're doing there. And we will report in the next quarters about the success and the process we made.

Coming to your third question and coming to the U.S. and coming to the guidance. Look, (inaudible) is this guidance by USD 150 million, in the midpoint. However, we now expect that the bridge between the IFRS and the U.S. GAAP results will be around USD 0.7. In our old plan, it was just USD 0.6 billion. And I laid out where it's coming from, mainly from this bonds for renewable energy. And you know that we have a total new [powers] the sustainability in that group. We want to be based on renewable energies by '21 already for all fuel

emission within the group. And our ambition is by 2030, to reduce our energy consumption by 90%. This was one pillar of our big sustainability program, which we have laid out here. Maybe it's worth that we put that into one of the next capital -- next quarter results to show you what we are aiming for. And therefore, we have an additional cost, which is showing up in the IFRS numbers, but not in the U.S. GAAP numbers. This is the reason that we haven't increased our guidance. If this would not have been the case, I probably would have done that. But that is the reason that we are -- that this guidance is intact.



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Let me say now the sentence on where we stand then. You have seen the numbers. Honestly, we worked hard into the year. We have a new management team here, we have a new CFO, we have a lot of new managers in the business. And we had to sort out who is doing what and to gain our traction. If I'm now looking after the second quarter on the business, I think we have tractions on all angles of the business. An organic integration of acquisitions doing very well. The track which we have on cost side, you have seen in Germany, the costs is -- the indirect cost, improving. Towers to targets we have laid out. Even the operational business, doing very nice. Eight consecutive quarters now in a row for our German and Europe business where we are growing revenues now. So this is not only just a 1 quarter event, this is already sustainable. So I see that this company is forward -- and working forward. So therefore, if we're moving at the likelihood that we see exceeding is higher than failing. That is clearly my assessment for 2019.

Hannes Wittig - Deutsche Telekom AG - Head of IR

Okay. Thank you, Tim. Next is Fred, Bank of America, please.

Frederic Emile Alfred Boulan - BofA Merrill Lynch, Research Division - Senior Analyst

So a couple of questions. Firstly, on the U.S. if you could share with us expectations from them on timing, if you could give us a date of the (inaudible) once this is past this, what's your date of view on timing?

And just in comments on your commentary on Q3 dividend. So will you be in a position by that time to have had that look into the numbers and refresh your math? And leverage dividend outlook are you looking at one year or more kind of a multiyear dividend?

The second point on broadband, just more general strategic view. As a market leader, your method used to be focused more on the selling. I mean shouldn't the focus be on share revenue instead of net adds more specifically? Or you think you have to concede to around that [40%] target share of that as an important number?

And then very quickly, whether you had any thoughts into 5G pricing? Vodafone has lodged 5G price premium on all the price points in Germany. You have that EUR 85 price point. But if you could tell us a bit more about your pricing strategy in Germany on 5G.

Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board & CEO

Okay, Fred. Let me start. First, U.S. expectation timing. The first thing is there has been a delay. You know that now for the federal -- sorry, for the (foreign language) for the trial, the 9th of December is now the time which has been defined. That said, this is, let's say, what we are working on, how -- what the implications on the closing is going to be, that is too speculative at this point in time. So we are focusing now on the 9th of December with regard to the next milestone and almost the last milestone in these long procedures here.

It's not good that we have so long time period of uncertainty. But if you look to our operational performance, if you look to the T-Mobile business, I'm not so worried. I'm not worried too much because we are working on a very strong operational track here and I do not see why this should break within the next 4 or 5 months.

Second question. What I've said on the dividend, we have a dividend policy. We have a Capital Markets Day and we have clearly said that our dividend is following the earnings per share growth for the next years and this is intact. What we haven't foreseen is that because we were expecting the closing in 2019, what is happening if the closing of this year is not taking place. What is then the dividend? What is the logic behind that? And we know that there is some uncertainty in the market at that point in time. Look, we had so many things to do in parallel. You cannot define a dividend if you do not know what you earn at the end of the year.

So therefore, I think with the diligent approach and with some patience and I know guys, I know you're all not patient, but this is, let's say, what I can only tell you at that point in time. We will have now in the next 8 weeks an intense discussion with our board, looking to the numbers where we foresee how the performance of this year is going to look like and expecting that maybe the closing is not going to take place during the course



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of this year, what would be an appropriate dividend to be paid off to our investors. This is the path which I described. And to give you an indication because it's anyhow subject to the board approvals and to the annual meeting, giving you an indication, as we always did it in the past, in the third quarter is something which Christian and myself are aiming for.

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

So let me take on that broadband question, Fred. And I think it's not an either or, it's a both. We always had an ambition to have a 40% net add share and we always said that we want to have our organization to focus on more upselling given our great opportunity which we have on super vectoring. So I think they have to basically handle both vectors, volume and up selling. And I think what you've seen in the recent quarters and years is we have always shown a steady hand when it comes to pricing. So there is a difference between promotional activities and structural pricing activities. So don't expect any surprises on this one.

On the strategy on 5G pricing. I think it is way too early to discuss price points. And if we discuss price points, we discuss price points with everyone. But I think we have a strategy, which is More For More. And I think we should apply that strategy which has been proven successful also for the 5G environment. And since this has given superior experiences, I would expect a continuation with the More For More strategy when it comes to 5G pricing.

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

Excellent. Thank you, Christian and Tim. And we take 2 more questions. I think the next one is from Andrew at Goldman Sachs.

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

I have a question again back on towers and on the efficiencies. But one of the perennial problems is operators retaining efficiencies [received]. What gives you the confidence you can retain tower efficiency benefits, especially when the typical response we see when operators in the market each make savings is that they end up giving these benefits to the customer in the form of lower prices?

And then a second question just on tower densification, you've highlighted -- I think you're highlighting more towers to customers approach and you obviously highlighted some more deployed sites in Germany. What do you think is the increase in densification of towers you need in Germany in the long term for 5G? And how does that -- or does that differ across markets?

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

Okay, Andrew. So I think whatever we will do with the towers will always be to protecting our network leadership. I think we have clear leadership in Germany. We intend to protect and extend this leadership. 5G is a great opportunity for this. I think at this point in time, you referred to our 9,000 site expansion plan, which we first laid out at the full year results 2017, so in February 2018. And that plan is intact. But frankly, it mainly relates to coverage rather than densification. Of course, there is always a bit of densification going on. But the plan of the 9,000 sites plan is mainly related to motorway coverage, where we raise white spots to the extent that they're economical for us together with other carriers. And that's why they're usually actually also sites rather than rooftops going forward. And the first year is more focused on rooftops. Going forward it's more macro sites. That's all in the guidance at the Capital Markets Day. And I think we will then of course also consider the build-out application related to the 5G auction. I emphasize that this 9,000 plan preceded the auction and the coverage obligation. Those will add to the build-out plan that we have. But again they are more related to coverage rather than densification. And so I think the focus will -- for the next few years, will be -- they'll be on coverage rather than densification.

I think with that, I just move on to Wolfgang Specht, who is at Bankhaus Lampe, who wants to ask the next question.

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Wolfgang Specht - *Bankhaus Lampe KG, Research Division - Analyst*

Two questions from my side and on Systems Solutions. Can you give us an idea how your plan for the classical IT part of T-Systems are? We learned that you put sale of the mainframe business to IBM. But this is still an idea of kind of bigger deal for the complete classical IT?

And the second one, on the German fixed business. You indicated ongoing problems going into Q3. Are you, however, confident that subsegment can grow into the second half? So do you expect some kind of Christmas business here?

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

First question with regards to the System Solutions, so if we're moving with the TEC part and with 5 business, so the governmental security service and we will have then a kind of IT service company, which is the T-Systems part of it. In this area, we have a lot of business where we have applied kind of portfolio strategy approach. This portfolio approach means a very focused approach towards the markets which we have behind that and it means as well the cash accretive business. This business have these portfolio elements have to develop over time. As we have said, we're not tolerating any kind of losses anymore in the T-Systems business. And if the business is coming in the right angle, we even consider portfolio measures to move forward.

Now the sale of the mainframe business deployment obviously we always see the antitrust side on this one, because we thought it's in better hands if IBM would run it. We will now find a solution. We're working on a solution. It's too early for me to disclose that, but I think we are very close to solving that issue.

And for the other classical IT areas, we have our turnaround plan, which is intact. Adel is doing a great job. You have seen the numbers. Order entry is growing. We have seen profitability rising. We have planned 10,000 layoff in these areas. We have a very clear strategy talent offshore and facilities. And on top of that, improving quality. All parameters are in the right direction and green. And we will move on, on delivering on the commitments which we have given you.

So I was then sliced on the 1 set and the telecommunication service on 1 hand on the other side. This is, let's say, the way how we are moving forward. And if the business is not performing as cash losses are existing, we take decisive actions, not excluding even a sale of parts of the business.

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

On the German fixed performance. Let me elaborate a bit on Q2 and then give kind of a direction towards Q3. In Q2, we had quite a bit of a weak IT business and we expect this to increase in the current quarter. As I said earlier on, we're working on plans in order to increase the net adds as well as the up selling. I don't have any specific indications right now on the Christmas business. So we haven't discussed that in detail -- in great detail yet. But let me leapfrog from the fourth quarter to the first quarter and as we said the B2C IP migration is going to be finalized at the end of the year. Obviously the forced churn effect from the consumers will disappear in the first quarter of 2020.

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

Okay, something to look forward to. And a few things, I hope. And with that, we come to the end of the conference today -- conference call. If you have further questions, please contact us at the Investor Relations department as always. And with that, I think Tim and Christian and I hand back to the operator.

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

Bye guys.



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Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board & CEO

Thanks. Bye.

Operator

We'd like to thank you for participating at this conference. The recording of the conference will be available for the next 7 days by dialing +49-1-805-204-7088. Reference number 524203#. We are looking to hear from you again. Goodbye.

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