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# Deutsche Telekom AG (DTE.DE)

Q3 2014 Earnings Call

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# MANAGEMENT DISCUSSION SECTION

Timotheus Höttges
*Chairman-Management Board & CEO*

## BUSINESS PERFORMANCE REVIEW

### Growth Drivers

- And let's start today's call on a very solid quarter here from Deutsche Telekom and give you a brief summary at the beginning what we've achieved in that respective quarter
- What superficially appears to be, apart from the stellar continued growth at T-Mobile US which was reported already last week, an unexciting quarter is, if you dig a bit deeper, for us a rather eventful quarter where a lot of the transformational changes are happening
  - Be it our IP transformation process in Germany and Europe, where we are leading, let's say, all telcos here in Europe
  - Be it the integrated network rollout in Germany
  - Another increase on our CapEx side
  - And the continued progress on our LTE network in the U.S
  - Or the further acceleration market share wins which we have gained in the U.S. operation

### Portfolio Improvement

- Second, to balance this out on the financial side with results which either meet or slightly exceed market expectation, makes me personally quite happy about, let's say, the ongoing improvement which we have seen throughout the year here in our Deutsche Telekom's portfolio

## GLOBAL MARKET PERFORMANCE

### Germany

- Now let's go into the markets
- In Germany, we are executing on our integrated network strategy and we have increased our LTE coverage to 79% of POPs and our fiber coverage to 40% of all households, with continued good take-up rates in the new buildout areas
- To give you a little bit more flavor, we have now significantly overtaken even Vodafone
- They've just announced 70% coverage; and 79% coverage is not even country-wise, it's even the near window coverage
  - So we are leading the pack again with regard to quality on LTE
- We further accelerated our IP migrations to 576,000 customers in Q3, which is now reaching 3.7 million IP customers by the end of September

#### MOBILE

- In mobile, we continue to outperform the market in an overall still declining, but quarter-over-quarter slightly improving mobile market with flat service revenues at Deutsche Telekom

- I think even a very good achievement and coming to that later, record sales of the iPhone 6, the strongest quarter we have seen for a long time on this product
    - So even encouraging

BROADBAND

- In broadband, we saw the expected annual Q3 impact on the net adds resulting from the expiration of the huge volumes of the broadband contract stemming from the marketing waves in 2006 and 2007
- I was witnessing this growth at that time
    - So due to the launch of our MagentaEINS coverage tariff portfolio and over 1.3 million vectoring households now being ready for marketing, we see this trend to reverse in Q4 and expect flat broadband net adds at least for the full year
- Fiber net adds of 225,000 in the quarter continued the strong trend on previous quarters, almost doubling of the run rate of last year

US

- In the U.S. we saw improvement as well
- We delivered the strongest ever quarter with over 2.3 million net adds in total, of which 1.4 million were branded postpaid; exceeding market expectations by far
    - And as a result, the T-Mobile US management again raised the guidance for branded postpaid net adds for the full year now to 4.3 million to 4.7 million
- Equally important, we again significantly ramped up our service revenue growth to 10.2% year-over-year under our IFRS accounting, which is even exceeding our analyst expectation significantly
- Obviously, the market and our T-M US management team expect a stellar subscriber growth, which is now translating into industry-leading service revenue growth; also to be translated into strong profitability growth going forward and will give their full-year 2015 guidance with the fourth quarter results in February

Europe

- In Europe, we even saw improvements
- Due to our IP migration efforts, we have already achieved an overall 35% IP share of fixed line accesses
- On the mobile network side, we have added 1,900 LTE sites just in the third quarter
    - Overall, by the way, 4 times more sites than one year ago; 12,000 sites being added to the LTE coverage in the European entities
- On the financial side, we saw a slightly improved revenue trend in the quarter and continued excellent work on indirect costs, resulting in a very strong EBITDA margin of 35.7% in this respective quarter

## OTHER HIGHLIGHTS

Group Business

- On the group level, we delivered a good set of results, in line or slightly above consensus expectation; and they're on track to reach our full year guidance, which we hereby confirm again
- We delivered an organic revenue growth of 1.4% for the group in the quarter, slightly ahead of consensus expectations

  - And Q3 adjusted EBITDA was slightly below of consensus expectation, entirely driven by the stronger than expected customer growth in the U.S
- And on the free cash flow level, we delivered €1.1 billion in the quarter; on good track for our full-year 2014 target of around €4.2 billion

Financial Summary

- So let me summarize our Q3 headline financials
- Revenues for the group grew 0.8% year-over-year
- On the reported side, and if you look on the organic basis, we have seen an improvement of 1.4%
- This is very, very encouraging and the main driver in this regard was our U.S. operation
- The adjusted reported EBITDA decline of 1.8% was also driven by the U.S
- The organic decline was 0.9%
  - The decline in the adjusted net income is primarily a result of the EBITDA reduction
- And the free cash flow of €1.1 billion was mainly driven by the expected and well-flagged increase in cash CapEx, a slightly higher operational free cash flow and higher year-over-year interest payments
- The biggest driver for the increase in our net debt to €41.8 billion at the end of the third quarter was the big swing in the U.S. dollar-euro exchange rate in this respective quarter, which only accounts for €1.1 billion of the increase

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## Thomas Dannenfeldt
*Chief Financial Officer*

### OPERATIONAL AND FINANCIAL REVIEW

Germany

- So let's move to the operational and financial details of the quarter
- Let's start with Germany
- In Germany, we continued to show a good performance in the quarter

REVENUES

- The German revenues declined by 1.5% year-on-year, which is an improvement versus the second quarter
- Service revenues were basically flat, a slight improvement versus the previous quarter and, again, outperforming the market and taking additional market share
- Core fixed line revenues declined by 2.4%, in line with the second quarter
- I'll come up to this in sort of a deep dive in a second
- And our wholesale revenues shrank by 2.7% year-on-year, basically in line with the underlying performance of the last quarter
  - Main drivers were a continued positive growth trend from excess IP data and a continued negative trend in voice
- And our others revenue rose by 0.4% year-on-year due to a strong order volume at our field and desktop service business for small and medium enterprises; a smaller company called RSF

ADJUSTED EBITDA AND OPEX

- The adjusted EBITDA declined by 2.1% year-on-year, a decline with the consensus expectations and resulting in a strong EBITDA margin of 41.6%
- The adjusted OpEx in Germany decreased by 0.9% year-on-year, driven by lower revenue related costs like interconnection and also lower IT costs year-to-date
    - Partially counterbalanced by significantly higher market invest due to the iPhone 6 launch, and higher technical service costs due to the IP transformation in Germany

FIXED BUSINESS

- In German fixed, we saw a solid quarter with the expected seasonal Q3 impact we always have on broadband net adds and line losses, due to the termination of contracts from the huge 2006-2007 broadband marketing campaigns
- Tim mentioned that already
- I would like to highlight the following
- An almost 25% year-on-year reduction in line losses to 193,000, despite 12,000 DTE/LTE wireless broadband customers added in the quarter and the described Q3 impact
    - This continues our strong year-on-year reduction trend of the last quarters; a continued strong growth of new fiber customers, with 225,000 net new additions, of which 114,000 came from our own retail business
- In total, we already have almost 2.2 million fiber customers now in our German network
- Broadband net adds were impacted by the Q3 impact, and was slightly negative
- As Tim pointed out, the early success in our new VDSL rollout areas and the new Magenta FMC proposition, as well as the 1.3 million new vectoring households being up and ready for us to market, leave us confident to get to positive broadband net adds in Q4 and a flat number for full-year 2014

TV BUSINESS

- On the TV side, we had 59,000 new customer additions in the quarter
- With the launch of our new Magenta-Zuhause-Tarife portfolio, including some new promos, we expect some further push here in the fourth quarter as well
- Coming now to the promised deep dive into our core fixed revenues, which declined by 2.4% year-on-year in the quarter, in line with the trend with the second quarter
- Within those, the fixed revenue fixed line, as per our backup definition, declined by 2.5% year-on-year; an improvement versus the second quarter
    - Within these fixed lines revenues, we saw an improving trend in voice revenues, down 6.8% year-on-year; a slight sequential improvement in our Connected Home revenues, which declined by 0.7% year-on-year
    - This is clearly not yet satisfying and not in line with our set target of 2% growth
- Within the Connected Home revenues, we saw a continued decline of our broadband revenues with 2.9% year-on-year; and a slightly improving momentum in our TV revenues with growth of 9.1%

OTHER CORE FIXED NETWORK

- In the other core fixed network revenues, we saw the following major trends: the decline of 10.1% year-on-year in our variable revenues was in line with the trend of previous quarters, and is mainly driven by price, as well as volume decreases attributable to flat rate components; the decline of 7.3% in our add-on option revenues, especially driven by less booking of voice-centric options; and an increase in the other revenues of 5.5%, mainly driven by higher sales volumes of terminal equipment, especially media receivers

MOBILE

- So turning to mobile
- The German mobile market service revenues decreased by 1% year-on-year in Q3 according to our estimates, an improvement versus the trend in the second quarter and contrary to market expectations
  - Within this market framework, we continued to outperform the overall market and took further market share with our basically flat service revenue year-on-year
- Main drivers over here, an improving trend in our voice revenues, declining by 4.3% year-on-year, mainly driven by the fact that prior-year comparison are no longer impacted by the lower voice share as a result of the launch of the new [ph] term 2013 (14:32) tariff grid in May last year
- The slight improvement in the SMS revenue declined to now 26.4% year-on-year, and a reduction in the mobile data revenue growth to 11.7% year-on-year
  - Mainly driven by the fact that prior-year comparisons are no longer impacted by the higher data share as a result of the launch of the new [ph] term 2013 (14:56) tariff grid last year in May

MOBILE CONTRACT NET ADDS

- Operationally, we continued our strong performance in the quarter despite the fact that we derecognized 564,000 inactive wholesale cards from one of our service providers
- This, by the way, artificially increases the contract churn
  - Adjusting for this, our own branded contract churn remains at a record low of 1% level
- By the way, we will continue this policy of derecognition of inactive wholesale cards going forward and expect to peak almost 2 million in Q4 this year
- Overall, we had 432,000 mobile contract net adds in the quarter, of which 235,000 were own branded; an improvement over the second quarter and also over the quarter three last year
- The smartphone penetration in our own branded retail customer base continued to grow to now 74%, driven by a strong quarter of smartphone sales, with almost 1.4 million in the quarter; clearly, also driven by the iPhone 6 launch
- Positively, the number of LTE customers in our network in Germany again grew strongly to almost 4.7 million at the end of the third quarter

INTEGRATED NETWORK ROLLOUT

- Let me now give you an update on our progress in terms of strategy execution regarding our integrated network rollout and also our IP transformation in Germany on the following slide 10
  - By the end of the third quarter, we achieved a 40% fiber household coverage and a 79% LTE POP coverage
- We've already migrated 3.7 million retail customers to all-IP in Germany, which translates into almost 30% of all our broadband and 18% of all our fixed lines being migrated to all-IP already

US Market

- Let's now move to the U.S. and let me quickly summarize the highlights of the quarter, as all relevant numbers were already reported and discussed by our T-M US colleagues last week

- In Q3, T-M US showed its strongest ever growth quarter, with 2.3 million net new customers in total, of which 1.4 million were branded postpaid net adds; leading to another upward revision of the full-year branded postpaid net adds target now to 4.3 million to 4.7 million
    - At the same time, we retained our branded postpaid phone churn at a very low level of 1.6% and saw a continued improvement in our customer quality. 53% of our equipment installment plans receivables are regarded as prime to flat year-on-year
- The total bad debt expenses at $85 million were strongly down year-on-year and slightly down sequentially
- As anticipated, service revenue growth in the quarter remain the strongest in the industry at 10.2% under IFRS accounting, slightly ahead of consensus expectations
- Importantly, we saw a first sequential slight growth of 1% in our postpaid phone ARPU of $49.84 and a flat quarter-on-quarter ex-Q2 non-recurring factor
    - As a result of the much stronger than anticipated custom growth in the quarter, the IFRS EBITDA declined 6.1% year-on-year in the quarter
- T-M US management expects to come in at very low end of the EBITDA guidance for this year

## Europe

### REVENUES

- Now moving to Europe
- Revenues in our European segment declined by 3.6% year-on-year on a reported basis and also organically, ahead of consensus expectations
- This absolute decline of €123 million year-on-year was mainly driven by:
    - A negative mobile regulation impact of €114 million
    - A partly seasonally driven lower decline in core tech revenues
    - And higher revenue contribution from our growth areas
- And on a country basis, we saw the biggest contribution to the revenue decline coming from:
    - Greece
    - The Czech Republic
    - And the Netherlands

### ADJUSTED EBITDA

- On a reported basis, the adjusted EBITDA in the segment grew by 1.3% year-on-year
- The organic growth was at 1.8%, resulting in a strongly year-on-year improved EBITDA margin of 35.7% for the segment, significantly ahead of market expectations
- Main driver for this very strong EBITDA performance were: the continued good execution in indirect cost savings, mainly in Greece, the Netherlands and Hungary
    - And the year-on-year reduced market invest in markets like the Netherlands or Austria where we spend significantly a year-ago in the marketing push effort
- Business growth drivers
- We continued to show good momentum in some of our growth areas in Europe

### BROADBAND NET ADDS

- We showed satisfying growth in TV with 51,000 net adds; now reaching 3.7 million TV customers
- We delivered 38,000 broadband net adds in the quarter

- Mobile contract net adds, adjusted for the bankruptcy of one service provider in Austria, improved sequentially to 55,000

POLAND

- In Poland, we again lost contract customers as T-Mobile tried to end the price war and heal the certain market mobile price level, but its efforts were sabotaged by the Polish incumbent and its aggressive campaigns
- Mobile data organic revenue growth remained solid at 14%, thereby continuing to compensate the decline in SMS revenues
- And our Connected Home revenues accelerated to an organic growth of 8%, especially driven by TV

MARKET SHARE ANALYSIS

- Let me give you a quick update on the progress being made on the revenue, as well as the technology and the cost transformation in the segment Europe in this quarter as well
- We made again progress on the revenue transformation with a sequential acceleration in some of our growth areas
- The share of total revenues from our growth areas increased by 4 percentage points year-on-year to 26%
- The share of fixed revenues from Connected Home grew by 1 percentage point year-on-year to 22%, driven by TV revenue growth
    - Especially in Croatia, Greece; and also due to our acquisition of DIGI in Slovakia
- The share of mobile data revenues of overall mobile revenues grew by 3 percentage points to 20%
- And the share of B2B and ICT revenues, as total revenues, increased by 0.9 percentage points to 4%

COST AND EFFICIENCY

- And progress on the cost and efficiency side included the IP share of all six networks
- Access lines grew by 11 percentage points to 35%, mainly driven by Croatia, Slovakia and Hungary
- LTE sites in service increased by almost 4 times year-on-year to almost 12,000
- We have LTE networks in commercial use in 11 of our 12 countries already
- Homes connected with fiber to the home grew by 43% year-on-year to around 230,000
- And households passed with VDSL and FTTH technology reached to approximately 6 million

System Solution

- Turning to System Solution
- The third quarter clearly shows signs of the expected cost reduction measures and bearing first fruit
- Order entry in the quarter was strongly up by almost 40% year-on-year, mainly driven by a major deal in Belgium
- The reported revenue decrease of 4.9% was driven by telecom IT and the Market Unit, which reported a revenue decline of 4.7% year-on-year, in line with the trend in the first two quarters and the projected revenue decline for the full-year 2014 as a result of the restructuring and repositioning of their systems
    - Drivers are, for example, a significant reduction in hardware reselling and cancellation of unprofitable contracts
- The adjusted EBITDA for T-Systems was flat year-on-year, resulting in a slight increased EBITDA margin of 9.5%

- Main drivers were continued efficiency improvement at Tel IT, but also first positive contributions from staff reduction and cost optimization at the Market Unit
  - As a result, the adjusted EBIT rose strongly by 12% year-on-year, resulting now in a margin improvement to 2.7%
- Also at the Market Unit, the EBIT margin improved strongly quarter-on-quarter to 3.3%

## GROUP FINANCIAL RESULTS

### Cash Flow

- So let's now move to our group financials for the quarter, turning to the free cash flow first
- Group free cash flow is down 21.2% year-on-year in Q3 to €1.125 billion, fully on track for our full-year guidance of around €4.2 billion
- Main drivers were: a €188 million increase in cash generated from the operations; a €233 million year-on-year higher cash CapEx
  - Driven by the German integrated network rollout in the U.S.; and a €257 million higher other effects, mainly higher interest payment
- Group net debt increased, against our expectation and entirely driven by the significant devaluation of the euro throughout the quarter, to €41.8 billion at the end of the third quarter
- As you can see from the chart, this currency effect accounts for €1.1 billion increase in the net debt in the quarter and completely wiped out the positive free cash flow contribution
- The adjusted net income decreased by 2.8% year-on-year in the quarter
  - Mainly driven by the decline in adjusted EBITDA; the increase in D&A in the U.S. and here predominantly due to the entrepreneurial decision to keep the investment level in the U.S. high; and the accelerated depreciation of the Metro network
- The ROCI benefited as in previous quarters from the book gain on the sale of the Scout24 stake, and stood at 6.3% at the end of the third quarter

### Balance Sheet

- Turning to our balance sheet ratios
- Net debt-to-adjusted EBITDA remained flat at 2.4 times as a result of the small sequential increase in net debt
- Assuming no further dramatic currency movements for the remainder of the year, we expect the net debt to decrease again in the fourth quarter
  - However, we have to be aware of the potential impact of the AWS auction in the U.S
- The equity ratio decreased slightly to 27.2% due to the slightly higher asset base
- With regard to our comfort zone ratios, we are in the green with regard to all ratios; and our rating remains stable at BBB+ level with major agencies and stable outlooks
  - As a result, we continue to get excellent funding conditions in the debt capital markets

**Timotheus Höttges**
*Chairman-Management Board & CEO*

## CLOSING REMARKS

- Now, gents, first, thank you for your patience

- And I'm sorry again for the cut-down in the meantime
- I will now make an operating, controlling session at Cisco and with the internal IT team
- Be assured on that one, because I stand with my team for execution and delivery and not for underperformance
  - So sorry for that one
- Second, you see even a little bit, hopefully, of our service mentality here within the IR team
- We have now extended our session by 45 minutes, and I hope that we have covered your questions in the same way as we always did

Upcoming Events

- So we are now going on a road show to Paris, Zurich, London and so forth
- We will meet a lot of you guys in Barcelona, where we will present with a big team
- This quarter was encouraging for us because it shows in every segments improvements, not only from a market side, but even from an EBITDA perspective
- We are already in preparation for our Capital Markets Day where we're going to present you the whole story and, let's say, the execution according to our strategy
  - And it will be an intensive debate about network buildout, intensive discussion about customer growth, and an extensive discussion even about the planned IP and the IP migration, which we are driving within the infrastructure
- And there will definitely be even, as always, a new attempt towards the cost efficiency within our organization
- I'm looking forward to meeting you all physically in short notice

# QUESTION AND ANSWER SECTION

Polo Tang
*UBS Ltd. (Broker)* Q

I actually have two questions. The first one is could you talk a bit more about the take-up of your MagentaEINS bundles? So is it getting a lot of traction? And if so, why is it getting traction? Is it because of the bundle discount or is it because of the faster mobile speeds?

And my second question is really just about pricing in the German mobile market. What have you been seeing recently? And is there any impact from Drillisch and their recent LTE promotional offers? And do you see Drillisch as a risk to the market? Thank you.

Timotheus Höttges
*Chairman-Management Board & CEO* A

Hey, Polo. This is Tim. So the first thing, the MagentaEINS is a big opportunity for us. It's not just a new product or a new kind of pricing which we put into the market, it is the combination which we always have to see with the buildout of our mobile infrastructure and the VDSL and vectoring technology.

So this is at one point in time coming together, because what we have with the huge buildout which we are taking – with the huge CapEx which we are putting into the market, especially here in Germany, in the U.S., but even in

Europe, we are creating new opportunities for upselling. And one of the upselling opportunities for us is Magenta One.

So we could tap on the cable side new customers, which do not have a mobile offer. We could even tap on the base where we have our customers only using DSL and upselling TV, or we could even approach both angles and offer them higher downloads and bandwidth speed within the infrastructure. So the network buildout in MagentaEINS, it is something which we have to manage.

Now looking forward, honestly, I do not want to release the numbers today, because at one point in time we want to talk about big numbers. So we're just after launch. The message I like to convey is that we are very encouraged about the feedback of our customers so far, and that there is a pull from the customer side with regard to MagentaEINS.

We were really leapfrogging the German market as the first player. The campaign resonated very well with our consumer base; and even MagentaEINS is simply understandable from a customer perspective, but that even this brand seems to work very nicely. But give us a little more time to really talk about severe developments.

Now going to the mobile side, on the mobile side, look, the thing which is important for me to say is that the discount Drillisch is granting is not as big as the company news flow might suggest. At least, I do not see them at that point in time. Yes, their tariffs might be €5 to €10 below an equivalent SIM offer from other MVNOs and they even include 4G, but the positioning of Drillisch and the way how they are selling its products and the way how the brand is positioned, tell us the big brands here in the German market is something where it's a long way to go to really, let's say, challenge our very good price for quality or quality for price proposition which we have developed over the last year.

So, therefore, let's see how this is going to evolve. Overall, I think we do not share the view that the price competition is going to heat up significantly.

Mathieu Robilliard
*Exane Ltd.*

Q

Two questions please. First, with regards to the U.S., growth numbers obviously in terms of net adds and company maintained the EBITDA guidance. My question there is how do you balance growth versus free cash flow generation? I think you're suggesting that in Q4 you probably will have less net adds. Is that a voluntary decision because you want to remain within the EBITDA guidance, or is it because you think the market is maybe less attractive in Q4? If you could give us a little bit of color on how you think and how you manage that balance that would be very useful?

And second, with regard to cost cutting in Germany, very strong cost cutting. I mean, this year has been clearly showing a lot of progress. Is there much left for 2015? Thank you.

Timotheus Höttges
*Chairman-Management Board & CEO*

A

So let me start with our U.S. operation and with our business success here. First, look, it's a great thing what we're experiencing here, and it's for me, at least looking at what John Legere, Mike Sievert and the team is doing, one of the most impressing marketing stories I've ever seen, at least witnessed in the telecommunication market. So I'm very lucky that I'm part of the success here.

And if you talk about marketing stories, marketing stories are never about price only. And if you look to the uncarrier story, and we have now seen the...

[audio gap] (32:37 – 32:52).

Timotheus Höttges
*Chairman-Management Board & CEO*

A

So, sorry. We are back. So this was a live IP migration at Deutsche Telekom. I feel very sorry for this interruption, but we were cancelled here from the Deutsche Telekom network to the conference here. So I hope everybody is back. So, sorry for that.

Now going back to the question with regards to the U.S. Again, the situation is that it was our seventh uncarrier move and we have been so far very disciplined in the way how to balance revenues on the one side and growth on the other side. The intention was always to create customers, to create revenues, to create EBITDA, free cash flow, which is then enabling us on a self-funding basis to invest into the infrastructure. This was and this is our clear intention towards the U.S. entity.

Now, this now seen, with regards to the competition here, we were very successful in the second quarter. We had this promotion on our [ph] 4,400 (39:17) initiative. We had our initiatives on the – which was, by the way, finalized by the end of this month; and we have had a lot of, let's say, additional bargains from a cost reduction perspective. Braxton stated that, I think, in the U.S. earnings call that the team is as well working on a number of top line and cost initiatives that would help them to fulfill the full-year EBITDA line.

There is a big benefit, which is coming from the close-down of the MetroPCS CDMA network in two respective cities, Boston and Las Vegas. They were shut down in July and they are helping us on the cost side. So their synergy is something which is reducing overall the cost perspective. And there have been, as well, the initiatives from the market side, which were helping us on top of that. So we are quite confident that we are able to reach our EBITDA line, which we have laid out for the end of year. The expectation is to come in at the very low range of the guidance, which we have laid out.

Thomas Dannenfeldt
*Chief Financial Officer*

A

This is Thomas. On the cost cutting in Germany, I think there are a lot of elements we've seen performing well this year. Telecom IT, we said we would use the total spend by €1 billion between 2011 and 2015. We are well on track here. Same holds true now for the Market Unit where the cost reduction is kicking in. And also on the German business you've seen the OpEx reduction working well in Q2. It seems like in Q3 it's slowing down, and the reason for that is higher SSC [ph] CRC (41:20). And to be honest, I think that's a good message. It's a good message because it's reflecting a very rich mix of MRC we're selling in the marketplace that is driving the SSCs and [ph] CRCs (41:33), but obviously as this is coming with good profitability, I'm completely fine with that.

And your question was basically, is there much scope left for 2015. I can tell you in our industry there's continuous and always room left for reducing the cost. That holds true for each and every segment of that group here. And I think we will give you detailed update on the Capital Markets Day by the end of February about the figures.

Stephan Eger
*Senior Vice President & Head-Investor Relations*

A

Thanks, Thomas. Matthew, I hope you got all the two questions, answers on your questions. If not, we'll obviously call you even then thereafter. Next one on the line is Fred Boulan from Merrill Lynch. Fred, please go ahead.

 

Frederic E. Boulan
*Bank of America Merrill Lynch*

Q

Hey. Thank you very much for the question, a couple of points. Firstly, on the cash flow, if you could just discuss your expectations for working cap, receivable factoring and restructuring costs for this year, and any views at this stage about 2015 CapEx?

And secondly, I just want to come back to the U.S. and your strategy here for the Iliad episode. So in particular, views on network and financial strategy in your coming spectrum auctions. Is the message still that TMUS will have to re-lever to pay for the [ph] TWS 3 (42:48) spectrum or you could help them to go through that short-term cash call? Thank you very much.

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Thomas Dannenfeldt
*Chief Financial Officer*

A

Fred, I'll take the first question on the cash flow, free cash flow bridge for 2014. As you know, we guided the EBITDA around €17.6 billion. You should expect the CapEx, excluding the spectrum on €9.3 billion and interest level of roughly €2.5 billion. The cash tax is around €0.6 billion and you know we have regular asset sales every year that's around €0.3 billion level. The dividends we're going to receive is also €0.3 billion level, and then others and that is including the working capital and the restructuring payments, about minus €1.6 billion which then totally sums up to the around €4.2 billion for the free cash flow as the guidance. Now I hand over to Tim for the U.S. question.

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Timotheus Höttges
*Chairman-Management Board & CEO*

A

Look, with regards to the question on the U.S. spectrum auction, the first one is to be very precise here, we are not able to take any answers or any questions regarding the spectrum or our spectrum strategy due to the anti-collusion period in connection with the pending AWS re-auction. So please understand that, that this is impossible for us now to go down to that one.

With regard to our overall strategy for the U.S. situation, look, this is a business which is creating value. And we have just since the beginning of our journey with MetroPCS and on the New York Stock Exchange; we have improved our customer base by 55%. We have gained 19 million new customers and we have created a customer base of 53 million consumers in the U.S. Now do I expect revenue improvements? Yes. Do I expect EBITDA improvement? Yes. Do I expect free cash flow improvement? Yes. So there's a very clear expectation that this customer growth is creating even financial benefits throughout the year.

Now looking with regards to investments, on the network side we have stemmed a big portion of it already, 250 million pots. So there's huge opportunities to harvest. And with regard to spectrum in general, I could tell you spectrum is normally an asset, which is not losing its value. So even from that one I'm not concerned at.

With regard to the balance sheet, it's a self-funding initiative where we are confident that this is going to be or able to handle this within the U.S. portfolio and the U.S. asset side. So I do not see that with our good starting position and with the good position which we have achieved, that there is any hurry at that time [indiscernible] (46:03) portfolio. Now with regards to the market environment and you've just seen the numbers of Sprint recently, I think this bifurcation of Verizon and AT&T on the long-term isn't healthy.

So therefore either the regulators should do something about it, which I do not expect, or maybe mid-term we always have said that consolidation would improve the competitiveness towards AT&T and Verizon. So therefore our strategy towards kingmaker asset is not changing.

### Justin B. Funnell
*Credit Suisse Securities (Europe) Ltd.*

Q

Yeah, thank you. A couple of detailed questions, please. On your German mobile markets estimates you I think have it at minus 1% in Q3 from roughly minus 2% in the first half. Just wondering what you thought was driving that? It's obviously not a huge change, but is that a 4G effect or something else coming through?

Secondly, line loss for the unbundlers, a rather new and positive trend. The unbundled lines were down €150,000 in Q3. Just wondering what you're seeing going on amongst your friends in the unbundler community. How much are they losing momentum as demand shifts to fiber? And could you make any predictions about where unbundled lines are going to go over the next year or two?

Finally, the turnaround in Europe. Obviously very welcome after several years of weak trends there. Are there some rather one-off effects in Q3, or is there something we can look forward to for future courses as well? Thank you.

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### Timotheus Höttges
*Chairman-Management Board & CEO*

A

I'd like to start with the first part of your question with regard to Europe and the positive development we have seen there. And honestly, yes, I found this quarter result quite encouraging. The reason why I find that encouraging is, first, we have seen price stabilization. In some of the markets we were even able to upsell, so increased, improve our revenues per customers in this market, so there's more discipline coming to that market.

Second, I'm positive due to the fact that the cost discipline and the way how we reduced our cost in the European footprint is stunning, because, to just give you a number, we have seen in Europe a decline on the cost by 6%, almost 6%. So this shows that on the indirect cost side there's a new attempt, a new approach from Claudia Nemat and his team to improve the productivity and the efficiency within the organization.

Thirdly, we are following the same strategy as we are doing it in our German entity, a fixed mobile converged approach and upselling on our new products like TV. And in TV, we are in most of the markets already a market leader. So all of this together is giving me much more confidence. Do I see overall an improvement on the macroeconomics? We've seen slightly an improvement, yes, but I think it is too early to say it is a turnaround in the Eastern European markets, but at least it is even not worsening from our perspective here.

So therefore our overall, yes, we were positively encouraged by the development in Europe. Now maybe one last sentence on Europe. If you look into the mobile environments, you would find that we have gained slightly market shares in eight out of the 11 markets. So even here you see it is not coming at the expense of our consumers or growth on the market share side. So therefore let's see how this develops. A swallow doesn't make a spring, but we are much more positive with regard to the disciplined execution in Europe. Now with regards to the German mobile market, I like to hand over to Thomas.

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### Thomas Dannenfeldt
*Chief Financial Officer*

A

Yeah. Thanks, Tim. I think on the improvement on the overall mobile market. It's not like something big happened. I think it's a little bit more focused on richer MRCs by getting more quality focus in the market. E-Plus is improving a little bit. Vodafone is, as known, bringing more CapEx into the market. So those are very different elements of that kind of improvement, not a substantial single change. That's at least our assessment, knowing that there are only two having reported, us and E-Plus so far; and Vodafone and O2 we still don't know, but not a big element, but a combination of smaller activities.

On the line losses for unbundlers, basically the intention of the contingent model we have out there is to move our wholesale partners to bring the customers being on ULL into the contingent model and using the new network. We have an SSC on the fiber customers. The wholesale numbers are improving there. There's a strong growth element in there. And obviously that's then, as a consequence, also reducing the ULL numbers. So that's something we intend with that model. And the faster it goes, the better the utilization on our new network is. So basically we are looking at that positively. As long as, as I said, the fiber customer numbers on wholesale are improving that way.

### Stephan Eger
*Senior Vice President & Head-Investor Relations*

A

Thank you very much. And let's continue with Jonathan Dann from Royal Bank of Canada. Jon, please go ahead.

### Jonathan R. Dann
*RBC Europe Ltd. (Broker)*

Q

Hi there. It was just a question on the balance sheet and dividends. I mean I appreciate there is I suppose an unknown relatively large U.S. spectrum auction. Do you think we're at the stage – I mean consensus assumes revenue EBITDA growth. Are we at the stage where we can start to think about dividends per share growing with the current balance sheet? Hello?

### Stephan Eger
*Senior Vice President & Head-Investor Relations*

A

Hello, guys. We're back. Apologies for the second cut off. Obviously we will be prolonging this conference call to get all of your questions addressed in the hope that we don't produce another, third cut down. Luckily, we are a telecom company. So if I may ask Jonathan to repeat his question, please.

### Jonathan R. Dann
*RBC Europe Ltd. (Broker)*

Q

[indiscernible] (57:14) ...the trends. Looking at the forecasts, revenues, EBITDA are growing; cash flow should grow. I guess are we moving into an environment where we can begin to think about dividends expanding again?

### Timotheus Höttges
*Chairman-Management Board & CEO*

A

I like this question. So look, let's have the update of this 2014 year. Let's have investor's conference at the beginning of the year. We have send out already the invitation. Let's have the discussion on all the topics on our planning and the prospects until then internally and then we have a full picture of the whole story at our Capital Markets Day. I urge us all to be patient and wait for the investor's day.

### Stephan Eger
*Senior Vice President & Head-Investor Relations*

A

Thanks, Tim. And apologies, Jon, again for the delay. We continue with Ulrich Rathe from Jefferies. Ulrich, please go ahead.

### Ulrich W. Rathe
*Jefferies International Ltd.*

Q

Thanks very much. I would like to come back to the very first question on MagentaEINS. You answered this very much with the upsell opportunity, and I understand that. But if I may sort of challenge this a bit, I mean the upsell opportunity was there before, the constituent products were there before. Now the bundled product is obviously discounted compared to the constituents. It may make it somewhat easier to sell it into an existing customer base, but of course there's very heavy marketing as we see it on national TV quite frequently now. And Mr. [indiscernible] (58:53) saying to the press that he's seeing good demand also from existing customers. I was just wondering how do you actually control the spin down risk, the cannibalization risk in that situation amongst your existing base? Thank you very much.

Timotheus Höttges
*Chairman-Management Board & CEO*

A

Thank you for that question, because it seems to me that I haven't been precise enough in my first answer. The clear intention is not that we make a rebate system; the clear intention is not that we only have an upselling opportunity. The clear intention is that we have a different [ph] shade on hand towards (59:28) cable-only assets, towards mobile-only assets, and even leveraging the network and the product quality that we have.

Now looking into the different categories, because there are different possibilities to realize the value out of that. From the base of 36.5 million households, which we have, there's only 4.8 million consumers just having a mobile and no fixed line contract. And there are 4.1 million integrated households that had a fixed line, but not a mobile contract at Deutsche Telekom. So let's say even in these days there's huge upselling potential either towards mobile or towards the fixed line side.

The second thing is, having these customers this is going to create loyalty, which is creating value as well. Thirdly, we have, with all, let's say, the optionalities for TV and entertain services, which we could then offer on the move. But even at home, we have the opportunity to upsell on TV, which we have done already in the past in our fixed line structure which we could even now do in the MagentaEINS services. And honestly, I even believe that we could gain some new customers on top of that.

Now MagentaEINS resonates with the consumers in Germany. That is at least what we have from our first experience here. We really, let's say, are on full marketing already? I would say no, because it's not just about tariff. It's even about the functionalities. It's even about how you use your services. It's even about the ID management for different services. You could access your cloud service from the mobile and from the fixed line, but you need an app for that one.

So I don't want to go into all the details because that is something which we release in our next wave of the service. We even haven't talked about the fixed mobile convergence in our business customer segment, which is another opportunity which we could have. But guys, this is a true differentiator which we have on hand, which should help us to grow revenue and it's not a kind of rebate model which we are imposing into the marketplace.

Stephan Eger
*Senior Vice President & Head-Investor Relations*

A

And by the way, Ulrich, we will be also doing a deep dive into our fixed model conversion strategy on the Capital Markets Day in February. So that is one of the big options we'll be addressing in much more detail then.

Thomas Dannenfeldt
*Chief Financial Officer*

A

Stephan, maybe I can add one more element on what kind of requirements are existing to book that kind of MagentaEINS product because it gives you an idea how also a little bit of steering of upselling takes place. There is a minimum MRC you need to have on mobile of €30, otherwise you can't have the product if you want to have it.

On the IP side, you need to move to all-IP. So we're combining the step of becoming a MagentaEINS customer. We also move the people into IP which is a kind of synergetic move. Also towards the IP migration, you need to have one household address. And I think we are pretty successful in the cases where the people really see a discount that they don't take the discount, but they reinvest it so to say and book other product, other additional elements. So they take the benefit they have to increase their usage instead of getting just the rebate. So I would say there are lot of important elements in place to make sure that it's not just a back booking effect you see finally.

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**Simon H. Weeden**
*Citigroup Global Markets Ltd.*

Q

Thanks very much for taking the questions. Just a couple of short ones and somewhat in follow-up on what you've been asked already. On the first one, we're getting a lot of feedback from a few probably more Northern European operators results season so far about the impact of 4G getting greater, increased volumes, customers bumping into their upper limits on their bundles and choosing to upgrade their plans to keep up with their usage, and people starting to see beneficial effects from ARPU on that. Could you give us a view on where you are with that in Germany and in any of the Eastern European markets where it's gone far to say?

And the second thing is just back to the pricing question in German mobile and whether you see changes that Telefónica has been making to its more aggressive E-Plus offices being constructive for the market or if that's not a particularly relevant point at the moment?

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**Timotheus Höttges**
*Chairman-Management Board & CEO*

A

So going to the euro operator and the 4G impact becoming greater, yes, definitely that is the case. And by the way, this is definitely one of the reasons that we are now even accelerating our buildout on LTE infrastructure in the Eastern markets and the relevant markets. Now with regards to the integration of services and the inclusion of services, and I think what we are trying to do in the big markets is that just price competition and just inclu ding every things into it, just bring 3G and 4G service into the same tariff plan. It's not our intention. Our intention is really to upsell the 4G services to the consumer base.

As we have done that in Germany quite successfully, that is exactly the same intention in the Eastern European market. And if I look to the speed on, and this is something where I would say we're quite successful in the Q3. We have 3.5 million of consumers which is a year-over-year up of 134%. The quarter before it was 2.5 million consumers. So as you see that we are able to bring the consumers on the new LTE propositions and to upsell the speed on option in the respective tariffs.

And I hope that this is an understanding of the whole industry. I do not see any negative developments so far and as I mentioned at the beginning, in eight out of 11 markets we were gaining service revenue market share than rather losing. With regard to Germany, Thomas?

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**Thomas Dannenfeldt**
*Chief Financial Officer*

A

Yeah. I think the low-end price points that they have not changed in the course of the last quarters or years. The entry price level on ID on a data flat was around €3, €4. That's the case in several quarters, with huge bundles around €10 to €15, and that has not changed. I think what basically has not happened so far is a reduction of brands in the German marketplace. They are still the same crowded situation we've been facing since two years with tons of MVNOs and brands. That has not changed at all. The price has not changed.

I think the only answer you can give in that environment is what we're doing successful since two years. You differentiate wire networks. There are cheap offers. But if you want to have a good offer, a good reliable offer, a high performing network, you go with us. So I think that's the right strategy, differentiation by network and customer service and not too much looking at price points in the marketplace.

Ottavio D. Adorisio
*Société Générale SA (Broker)*

Q

It's pretty straightforward. First of all, thanks for taking the question anyway. The question is on fiber and for the quad-play. Now on fiber penetration increased by 5% year-on-year. Now considering you have almost 25% left to achieve the target for year-end 2016, I was wondering if you can comment on the drivers slowing down the rollout at the moment and how you plan to speed it up going forward?

And for the quad-play, basically a follow-up from the previous one. I understand that it's very early stages in the moment. But compared to other quad-play offerings we've seen around Europe, one feature that looks missing in your bundle is an incentive for customers to take on additional mobile SIM cards in line with family plans in the U.S. Now you are one of the few incumbents in Europe that has first-hand experience of that U.S. market, and I was wondering if you can comment if the implementation of family plan to your bundle offering would be a physical strategy going forward? Thanks.

Thomas Dannenfeldt
*Chief Financial Officer*

A

I think we're going to start with the fiber penetration and the speed of the fiber penetration. I think I mentioned already in the last call, first of all, our speed – or the increase by quarter was around 1% on the coverage and we need to speed up to 2% to 3% per quarter. That's what is part of our plan. The way we're doing it is kind of block wise handling of the coverage, so we're building for a certain amount of households, the network. And then in a block, we give it into the marketing and sales organization.

So, for instance, that happens now between Q3 and Q4 or has happened already. There's an amount of 1.3 million coverage we build out. Technically, it was not given into marketing so as to market the product. That is exactly what happens right now. So we're doing it block-wise. So it's not a continuous process. It's number one, number two. Yes, you're right. We need to speed up from 1% increase per quarter to 3% per quarter, which is part of our planning and part of the acceleration we're doing here. So we're pretty confident that we can keep our 2016 target and promise in terms of the complete 65% coverage.

Timotheus Höttges
*Chairman-Management Board & CEO*

A

Going to the second part of the question with regard to the quad-play, and the short answer is simply yes. It is clear our intention that we incentivize the customers in a way that they take on additional SIM cards. Now how could I prove that to you? If you would live in Germany, you would even not raise the question because if you see the advertising spots which we have, we are communicating a family. It's a little bit of a soap opera advertising campaign. Every three weeks a new kind of story of this family, how they use their services simultaneously in different infrastructures: being on vacation, using the cloud service, being at home, having the entertain on the go.

So it is a funny story about, let's say, the integrated services in one MagentaEINS networks; and on top of that, we're approaching families with our MagentaEINS offering. It's including additional SIMs for the kids and for other members of the family living at the same place. So it is our clear intention. Do I have, let's say, proof of the concept yet and what is the impact of it? I think it's too early to say, but we were even motivated or, let's say, inspired by the U.S. market and their office. So definitely, we have considered your idea.

### Peter Kurt Nielsen
*Kepler Cheuvreux*

Q

Thank you very much. Just two questions, please. Firstly, Thomas, you made some comments related to the IP migration. There is, if I understand correctly, some costs associated with that. Are you seeing the underlying cost reductions coming through as you migrate the lines to IP in line with your plans?

And just secondly on a more broader note, you obviously have a target of stabilizing revenues in Germany in the coming years and I'm sure you will update us on that on the Capital Markets Day. We are seeing lately that forecast for Germany and indeed the European Union, I GDP forecasts are being and have been reduced. Is that something which alters your thinking in this regard or in regard to some of your other targets and ambitions you have for the German market? Thank you.

### Timotheus Höttges
*Chairman-Management Board & CEO*

A

Maybe before Thomas is going into the detail, let me state again what I said at the beginning. It looks like a quite conservative quarter, but at the back there's a huge dynamic with regard to the transformation. And to just give you what our services is working on just while we are talking, we have one of the highest success of the iPhone 6. We have, from the contingent model, significantly more demand from Vodafone and Telefónica with regard to the wholesale product.

We are stemming 60,000 IP migrations in our base at the same time, and we have 50,000 construction areas across Germany for building the fiber on the VDSL side. The vectoring has now been opened for consumers; and on top of that, the buildout of fiber on a lot of countryside. And even we're not mentioning the LTE network buildout, which has now overtaken all the competition here. So this company is under fire. That is what I could tell you.

And is that always easy? No. And the ones on the call who might work in Germany, they know that there might be even some issues on consumers when it comes to the IP migration, and we are handling each of that. But this service organization is really very stretched at that point in time. So, therefore, I think we are well on target to achieve the mentioned 3.7 million IP consumers which we had, had by the end of September and that we have, let's say, the numbers which we had laid out by the end of the year. But, Thomas, the question was going even more towards the underlying costs which are included in our OpEx line of today.

### Thomas Dannenfeldt
*Chief Financial Officer*

A

That's absolutely correct. And so it is, I think, very fair to say that knowing that OpEx and the costs are already included in the actual and current numbers. We're talking about several hundred-million-digit number. Right now for the time being, and I think that's true for 2014 and also for 2015 and 2016, reducing our EBITDA. As you see it right now, or the other way around, slowing down speed of that transformation would bring up the EBITDA. That's not what we're intending, because we need to do it as fast as we can. So I think on the IP migration, very simple message. It's baked in the numbers you see. It's baked in the planning you will see in the Capital Markets Day, but it's a significant OpEx number we're spending here to make that migration happen.

On the stabilization of revenues in Germany, I think obviously that we need to achieve that. Back in 2012 in the Capital Markets Day, we said there are two big drivers to achieve it. One was to outperform the mobile market by 2% to 3% in service revenues. And by the way, we did. The issue I think we have here is we assume that the mobile market will stay stable and we grow by 2% to 3%. What happened is, mobile market was like minus 2% and we were flattish. So, yes, we outperformed the market, but it's a matter of whether the market really sees an improvement and shows really absolute growth. Obviously, with some consolidation taking place now there are opportunities looking forward.

The second element is, or was and is still, is broadband revenue growth. We are at minus 0.7% in this quarter on broadband revenues. That is obviously something we need to change into the area of plus 2%. That was our expectation back in 2012. With the rollout we're seeing right now with Magenta One and the upselling opportunities Tim mentioned, with all those ingredients I think we are bullish to achieve that growth again. And having here also the supporting element looking towards the stabilization of the revenues.

The GDP is – and we see that in Europe as well – is not that big impact, it had not that big impact on our business. Looking at the European business, for instance, you can say for 2013 and 2014 the biggest impact is regulation. That's the number one impact. The number two impact is price pressure by lack of consolidation in the markets. And the number three element, then, is GDP. That's what we see in our European markets. And what we've seen I think during the course of the last years in the German environment especially is that there is not a too strong correlation between the GDP development and our business, which can be positive in crucial times as well.

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

Yeah, thank you. What's your take on cable raising their access prices, but also their speeds? Is that a healthy dynamic in your view? And linked to that, are you still planning to launch the hybrid router this year, or is there any delay on that?

And then on my favorite topic, regulation, new commissioner, Oettinger, seems to have a very clear pro-industry agenda. He openly speaks about the need to enable companies to become more profitable. Now in Germany we have rising ULL rates and pricing flexibility on wholesale fiber already and we also have seen consolidation in mobile being approved. What else, what other reforms are needed to get the industry back to growth in your view? What's your sort of wish list for Oettinger? Thanks.

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**Timotheus Höttges** — A
*Chairman-Management Board & CEO*

So let me start with the ULL regulation. And first, I have to express that there's a deep frustration about the non-existing progress on the single market package and that the old commission within two years did not manage to pass it. So that's where we are. Now talking about Germany, talking about Europe, the political leaders are talking very much about digitalization and very much about the need for infrastructure.

I have never experienced in my 14 years at Deutsche Telekom a more positive sentiment from Germany politician leaders, but even from the European statements which I heard from President Juncker and even from Mr. Oettinger. So, therefore, this announcement having been made is quite positive.

Second, what I've never seen before is that in the past the enemy of the carrier was always the other carrier. It seems to me that this mindset is changing. There is a lot of common in the telco industries between cable operators, between the telcos on the mobile and on the fixed line side because we all, let's say, are faced by the same impact from over the top players and the asymmetric regulation towards these models and even the common mind which we have on the data protection laws and others. And there is a kind of common understanding, so that we are more and more speaking with one voice, even in Brazil.

By the way, this helps a lot because in the past everybody was advocating its interest and I faced, and there's even some evidence on that one that this industry starts really talking with one voice towards a change on the landscapes. I think there are three important things which we are driving forward. The first one is a kind of deregulation, a deregulation which is supporting infrastructure investments because that is what Germany and Europe needs urgently, more investments into infrastructure.

Second, a clear data protection law, which is bringing the American system into balance with the European system that we are allowed to do the same business models or at least these guys are forced into the same model as we are; and that there is a level-playing field towards the over the top layers and the telcos on interconnection and other things.

And the third one is the issue on net neutrality and that this industrial Internet is requiring quality classes is something where at least my talks I'm having every day and that there's a lot of, let's say, understanding. I'm not a supporter for net neutrality, don't take me wrong. Every content has to be delivered, but the question is do we need quality classes in the infrastructure? And if you follow [indiscernible] (01:22:13) even here that there is more understanding in Europe and there is a clear positive sign, at least from the German political leaders towards quality classes in this infrastructure, which will allow us to monetize the different service in the future in a better manner.

So, therefore, I'm encouraged by the statement which has been given, but at the end of the day only the result counts. I hope that with amendments to this single market package, there will be decision taken soon and not another two years or three years to wait for. But this is something the new commission now has to address. But overall and I said that even in the last call and I could reiterate that what I hear, and the statements from political leaders are very much in favor that we are able to amortize the huge investments which we're putting into the infrastructure.

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**Thomas Dannenfeldt**
*Chief Financial Officer* **A**

Dominik, on the first part of the question, the take on the cable, rising access prices and also speed. First of all, I need to say that I think that's partly right and partly wrong. It's partly right because what we see is the two players in cable, not all three. So KDG is not raising prices, access prices, as far as I see. But the others are doing it partly, and partly meaning they're doing it more or less in the TV area and space and not so much in the broadband area and space.

So, yeah, there are some movements. And I think in principle, yes, it's a healthy dynamic, because nothing else – the strategy we have also is the upselling element. You find in here higher speed, more volumes you got in there and higher price; and that's what we're trying to achieve as well, with migrating the customers from a pure DSL line into entertain and to fiber where we see the nice growth rates we're having here. So, yes, in principle, healthy dynamics and very much fitting to our strategy of upselling.

With the rollout of FTTC, you see we are enhancing the area where we can do that upselling. You've seen that 12% growth in entertain, 58% in fiber. We will launch the hybrid router in Q4 this year, yes, and go with the strategy we have announced in putting LTE and fixed line speed together.

And I think what is also positive for us is that in the areas where we have cable coverage and now we're rolling out the FTTC network, we see a very high and good acceptance rate, but still low churn rates. So people don't move to

 

– they want to stick with Deutsche Telekom. They appreciate a better offer, they appreciate more speed, but they're not going just for speed to competition. The churn rate is still low in that area as well. So that is a very healthy development for us I think.

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**Stéphane Beyazian**
*Raymond James Financial International Ltd.*

Q

Yes, thank you. Two questions, if I may. The first one is, just to come back on German wholesale just by the contingent model. Wholesale revenue trends have deteriorated in the past two quarters. So my question is, at what point, if any, do you expect to stabilize German wholesale thanks to fiber?

And my second question is, as you warned CapEx is – you're pricing ahead and that's a high level and record high actually for this quarter. When shall we expect CapEx to peak? Thank you.

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**Timotheus Höttges**
*Chairman-Management Board & CEO*

A

Let me just remind you that it is not that we love to build, let's say, or sell our fixed line infrastructure investments into wholesale. It is a requirement from the regulator that our infrastructure is accessible for everybody else. Now over the last two years we found a very intelligent and smarter way that at the same time as improving our bandwidth with vectoring, we are able not just selling the ULL, we are selling a bitstream access and even we got a contribution for the investment from the wholesale customers here and with regards to the unbundlers.

So, therefore, I think this is much better than the old model. And if you look to the revenue contribution, this is very encouraging because we're almost stable. And remember, we just had quarters where we were shrinking on the wholesale. And it is even better for us to have a contingent model in place with wholesale partners than losing the entire value to cable operators. So that is the same assessment on that one.

The impact on the prices, on the consumer prices, by the way, it is not just coming from the wholesale carriers. If you look to [ph] Eins & Eins (01:27:37) United Internet, I saw them being very, very disciplined in their price points. They are still keeping a point of €30 in the marketplace. I was more irritated about Vodafone and their latest offers and how aggressively they're trying to differentiate on that one, which I couldn't understand from all the investments they are doing on the infrastructure side. But it wasn't, let's say, United Internet in first instance driving the prices down.

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**Thomas Dannenfeldt**
*Chief Financial Officer*

A

Okay. And I think the figures, maybe they look a little bit curious because in Q2 we had a special effect in the wholesale revenues. Basically, the trend was minus 5%, minus 5.5% I think last year, and this year it's minus 2%, minus 3%. And if you exclude the special factors effect we had in the Q2, Q2 was minus on 3%, now we are minus 2.7%. So we're improving step by step as we said from the minus 5% last year now to 2.7% this quarter and we expect here to improve, especially as Tim mentioned, because the wholesale partners are as well using the new infrastructure and enjoying that opportunity as well. So we are confident that we move forward here and improve towards the stabilization as well on the wholesale side.

I think on the CapEx, as we said in 2012 at the Capital Markets Day we'll stay roughly on the level we have here. And by the way, as long as I have a good return, a proper return on the investment, as long as I can keep my free cash flow going, I'm absolutely fine with having those kinds of levels of CapEx.

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Paul A. Marsch
*Joh. Berenberg, Gossler & Co. KG (United Kingdom)* Q

Yeah, thank you. So you don't publish the data ARPU for German mobile customers, but it is possible to work it out from the service revenues and the customer data that you give. And if you work it out, it does look as if there's been some stagnation of the sequential data ARPU trend from Q1, Q2 and Q3 at just over €6 per customer. I'm just wondering if you can maybe elaborate on what's going on there in a little bit more detail, and how confident you are on the outlook for mobile data ARPU trends to re-accelerate as we head into next year?

Stephan Eger
*Senior Vice President & Head-Investor Relations* A

The issues we're following, Paul – it's Stephan here. And with the introduction of these flat rates, the differentiation between data and voice is basically artificial, and it depends on how you then define what then counts into the data camp and what counts into the voice camp. And with every new tariff that we launched, that definition is basically changed. And the last time that was changed back in 2013 when we introduced that new mobile tariff which was called 2013. Yes. And there we saw in the last four quarters basically a data revenue increase of somewhere between 25% and 30%, and we also saw a voice revenue decline somewhere in the mid-teens.

And you're right. If you now look at what happened this quarter when there is basically the first quarter where that trend has grown out, because it's always four quarters ago when that new tariff grid was introduced. We do see actually a reversal of that strength. So we see a significant improvement of the voice revenue. I don't think this is underlying the case. It is because of what I just told you. And we see the reversal in the trend of the data ARPU, which is now only up plus 11%.

So I would not really – I think what is really of importance to us is that we're striving and working towards a service revenue stabilization overall and an ARPU stabilization, and hopefully also increasing that. And we see first positive signs in really selling a significant higher ARPUs and MRCs into the market, especially in the last months and weeks. And I would not really now artificially, because it is artificial, distinguished too much between voice ARPU and data ARPU because it's a question of definition, as I said.

Nick Delfas
*Redburn (Europe) Ltd.* Q

Thanks so much. So two questions. The first one's on fiber expansion in Germany. I think there are various political proposals to help you rollout in less economically advantageous areas and more rural areas. Could you update us on what's going on with that and will you be getting a big subsidy like BT's, which I guess is getting £1 billion, £1.5 billion to roll out in rural areas?

And then secondly, I just want to follow up on what Tim said on fixed line regulation and wanting to get the benefit of investments. Looking backwards though, is there any plan to ask for the ability to shut down central offices over time as you simplify your network and you move beyond the ADSL product? Thanks.

Timotheus Höttges
*Chairman-Management Board & CEO* A

Look, Nick, this is absolutely correct. Under the new Minister Dobrindt, who is in charge of the Ministry for Infrastructure, there was a joint attempt from his ministry together with the industry how to deliver on the digital agenda which has been laid out by the government for 2018 with 50-megabit coverage. Now the decision on, let's say, what has been announced so far is that for next year there will be a total CapEx expected for the industry of

 

€8 billion, which was undefined by the competitors of Deutsche Telekom. We have committed a €4 billion number already for the buildout, because it is a calling to our track and what we have said already.

Now we've said 65% of the population could be covered by our fiber buildout in Germany from 65% to 90%. The buildout only could be financed by additional subsidy and between 19% and 100%. And we as industry, we jointly believe that this is only able with LTE and mobile services. So a fixed line buildout would cost too much. Now this is more or less common sense within the great coalition and within the industry. Now I'm not worried about the 65%, not at all, because we are exactly delivering what we have said already.

Are we improving the efficiency of our infrastructure? We are well on track with regards to the execution of this buildout, as I mentioned before, 50,000 construction areas. And even, let's say, on the vectoring side, we – sorry, yeah, on the vectoring side we see improvements here and within. Now the second piece is where do we see subsidies coming from. The first thing is the subsidy policy is working nicely in the southern areas in Germany, because these areas are rich. And in the eastern and northern areas it is not as easy.

Now, for instance, in Bavaria there is huge programs running. And most of the programs, by the way, they decide to do it with us, with Deutsche Telekom. Talking for Bavaria, a significant portion of the subsidies which were given were built with Deutsche Telekom. Now this is encouraging. I hope this is moving on. Now is there additional money coming? Yes. Because even a decision taken by the government that the proceeds from the 700 megahertz option given back to the different counties for the build-out of exactly these rural areas.

Now for the last 10%, you know the buildout scenarios on our LTE site. We are all building it. Deutsche Telekom is ahead of it. We are trying to help in every region where it's necessary to get full coverage. This is our promise here in the market. So, therefore, this is a mobile connectivity. So, overall, it seems to be that there is a common ground how this buildout is taking place, and there are additional subsidies coming.

And maybe one last comment. There's even a lot of subsidies being available already, so cash is there, but some of this money for vectoring buildout in the rural areas is blocked by the European Commission. So even here I think a change in the regulatory environment would help us immediately to improve the coverage here. Deutsche Telekom is I think the one in this rural area who is the builder of this infrastructure. We always combine our investment possibilities with ones of the subsidies, and therefore everybody feels quite optimistic that we get this 50-megabit target achieved in the planned time scheme.

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**Thomas Dannenfeldt**
*Chief Financial Officer* A

And on your question on the benefit, especially I think on the IP migration. That's what the question's about. It is not so much about rental fees reduction. It's also getting rid of the [indiscernible] (01:37:58). That's an element in the case, that's a minor element in the business case. The main element in the business case is switching costs, reduction of switching costs. It is energy reduction. It's customer service reduction. So that is not the main thought, that rental fee reduction of the business case.

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**Stephan Eger**
*Senior Vice President & Head-Investor Relations* A

Thanks, Thomas. And the last question on the call goes to Tim Boddy from Goldman Sachs. Tim, please? Tim, are you around? If that's not the case, then I would suggest we move on to Jacque de Greling. Jacque?

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

Okay. Could you elaborate a little bit about what could be the outcome for Germany next year? Thank you.

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**Stephan Eger**
*Senior Vice President & Head-Investor Relations*

A

Jacque, you were a bit cut off. Can you repeat the question again, please?

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**Jacques de Greling**
*Natixis SA (Broker)*

Q

Okay. Thank you. If you cannot comment on the U.S. auctions, could you elaborate a little bit on what could we expect for Germany coming next year? Thank you.

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**Timotheus Höttges**
*Chairman-Management Board & CEO*

A

Look, first, what we have seen here in Germany is a very pragmatic approach from the German regulator what we have seen so far. There is a non-discriminatory mechanism, so there is no spectrum reservation for new entrants. The auction design what we have seen so far is the same as it was in 2010. So it's a SMRA auction which is called the simultaneous multiple round auction, which is absolutely reasonable compared to the combinatory clock auction design which we have seen in the Netherlands and Austria. The plans to include the 700-megahertz spectrum are getting more and more tangible or feasible.

And there is a big agreement at least from the [indiscernible] (01:40:08) within the rate coalition. I think there's still some discussion with the Minister and President here in Germany – 900-megahertz, 1,800-megahertz and 1.5-gigahertz will be part of this auction design. The requirements or remedies of these auctions are fair from our point of view. And so, therefore, we're looking forward. There is a frequency gap of 2 times 15-megahertz instead of a frequency reserve. And so both mechanisms ensure that all operators receive 900-megahertz spectrum. So this even makes a lot of sense from a fair policy perspective.

So, therefore, I cannot speculate on pricing because then I would signal something, and you'll understand that. That is something I am not allowed to. But in principle, I could tell you it makes sense. And in the consultation, we even supported the approach of the local regulator.