

## Half-Year Report Six months ending June 30, 1996

### Introduction

Deutsche Telekom's restructuring process has been recognized in its financial statements during the first half of 1996, in time for its initial public offering.

Already in 1990 it was established in Postreform I that Deutsche Telekom would be fully subject to taxes beginning January 1, 1996. This includes corporate income tax, trade income tax and other taxes as well as value added tax (VAT) on monopoly services.

Deutsche Telekom reacted to the introduction of VAT with a reduction of 13 per cent from its monopoly prices effective January 1, 1996.

This reduction, together with other price reductions introduced during 1995 and as of July 1, 1996, dramatically lowered the price structure to a level comparable to that of international competitors. Since volume growth remained consistent with the prior year, despite a weaker economic situation in Germany, Deutsche Telekom's long announced price policy led to the expected decrease in revenues from monopoly services of 13 per cent and a related reduction in net income.

To strengthen Deutsche Telekom's competitive position, the remaining net income was fully utilized to offset the remaining financial impact of the publicly announced strategic personnel reduction of 60,000 employees as well as other one-time restructuring costs.

"Global One", the international alliance with France Telecom and the US Network Operator Sprint Corporation, established its operations during the first quarter of 1996. The alliance has been approved by the EC Commission. Deutsche Telekom successfully continued its globalization strategy with the acquisition of 10 per cent shareholding in Sprint Corporation and the expansion of the investment in Matáv, the Hungarian telecommunications company.

### Summary of first half-year results

Deutsche Telekom applies US "Generally Accepted Accounting Principles" (US GAAP) for accounting and valuation purposes to the extent permissible under the German Commercial Code. This is done to minimize the number of items for a US GAAP reconciliation of net income and equity, which is required for the admission of its shares at the New York Stock Exchange (NYSE). The consolidated group has changed, particularly through the first-time consolidation of the Hungarian telecommunications company Matáv.

Consolidated Balance Sheets				
	30.06.1996	30.06.1995	Change	31.12.1995
	(DM million)	(DM million)	in %	(DM million)
<b>Assets</b>				
Fixed assets	143.015	138.654	3,1	139.215
Other assets	20.542	30.682	-33,0	21.032
<b>Total</b>	<b>163.557</b>	<b>169.336</b>	<b>-3,4</b>	<b>160.247</b>
<b>Liabilities and equity</b>				
Equity	26.068	22.854	14,1	24.732
<b>Liabilities</b>	<b>137.489</b>	<b>146.482</b>	<b>-6,1</b>	<b>135.515</b>
<b>Total</b>	<b>163.557</b>	<b>169.336</b>	<b>-3,4</b>	<b>160.247</b>
Other assets include prepaid expenses and deferred charges. Liabilities include deferred income DM 159,249 million excluding Matáv				

Consolidated Statements of Income				
	1.Hj. '96	1.Hj. '95	Change	1995

	(DM million)	(DM million)	in %	(DM million)
<b>Net revenue</b>	<b>30.637</b>	<b>32.557</b>	<b>-5,9</b>	<b>66.135</b>
Increase in inventories and other own capitalized costs>	1.496	1.393	7,4	3.320
<b>Total performance</b>	<b>32.133</b>	<b>33.950</b>	<b>-5,4</b>	<b>69.455</b>
Other operating income	2.134	561	280,4	2.138
Goods and services purchased	(4.823)	(4.365)	10,5	(9.506)
Personnel costs	(9.422)	(9.495)	-0,8	(18.502)
Depreciation and amortization	(8.649)	(7.257)	19,2	(15.377)
Other operating expenses	(4.766)	(3.779)	26,1	(9.685)
Financial expense	(3.892)	(4.178)	-6,8	(8.211)
<b>Results from ordinary business activities</b>	<b>2.715</b>	<b>5.437</b>	<b>-50,1</b>	<b>10.312</b>
Extraordinary losses	(1.841)	(285)	546,0	(1.264)
Levy to the Federal Republic of Germany and taxes	(670)	(1.640)	-59,1	(3.778)
<b>Income after taxes</b>	<b>204</b>	<b>3.512</b>	<b>-94,2</b>	<b>5.270</b>
(Income) loss applicable to minority shareholder	(75)	1	-	2
<b>(Income) loss applicable to minority shareholder</b>	<b>129</b>	<b>3.513</b>	<b>-96,3</b>	<b>5.272</b>
Undistributed income, beginning of period	1.291	-	-	-
Transfer to retained earnings	-	-	-	(3.981)
<b>Undistributed income, end of period</b>	<b>1.420</b>	<b>3.513</b>	<b>-59,6</b>	<b>1.291</b>

	1.Hj. '96	1.Hj. '95	Change	1995
	(DM million)	(DM million)	in %	(DM million)
Cash provided by operating activities	12.381	12.575	-1,5	23.687
Cash used in investing activities	(6.497)	(12.934)	-49,8	(13.321)
Cash used in financing activities	(4.440)	(4.127)	7,6	(15.234)
Effects of foreign currency translation on cash and	-	(71)	-	(89)
<b>Net change in cash and cash equivalents</b>	<b>1.444</b>	<b>(4.415)</b>	<b>-</b>	<b>(4.957)</b>

Despite the decline in net income, cash provided by operating activities of nearly DM 12.5 billion were consistent with prior year.

### Investments

Deutsche Telekom (excluding Matáv) increased its investments in intangible and tangible assets during the first six months of the financial year by approximately DM 0.3 billion to DM 6.6 billion, mainly due to the acceleration of the digitalization program which will be finalized by the turn of the year 1997/1998. Investments in financial assets of approximately DM 3.9 billion were mainly focused on Sprint Corporation, Atlas/Global One and a mobile telecommunications operator in the Czech Republic.

Fixed assets			
	1.Hj. '96	1.Hj. '95	Change
	(DM million)	(DM million)	in %
Intangible assets	154	113	36,3
Tangible assets	6.941	6245	11,1
Financial assets	3.886	1.079	260,1
<b>Total fixed assets</b>	<b>10.981</b>	<b>7.437</b>	<b>47,7</b>

### Financial Obligations

Deutsche Telekom reduced its financial obligations in accordance with its plan. At the end of June 1996, debt amounted to approximately DM 105.5 billion. Debt is already DM 20 billion less than the amount at the time of incorporation at the beginning of 1995. Net financial obligations are DM 98 billion, excluding DM 1.3 billion for Matáv. The future reduction of financial obligations will continue as planned.

### Revenue

The introduction of a new tariff structure evoked discussion in the media and led to a temporary downturn in the use of telephone services by customers during the first months of the year, resulting in a decrease in the volume and length of calls.

Revenues for the first half of the year reached DM 30.6 billion, including revenues at Matáv, which was fully consolidated for the first time.

Revenue				
	1.Hj. '96	1.Hj. '95	Change	1995
	(DM million)	(DM million)	in %	(DM million)
Telephone services	22.455	25.456	-11,8	51.748
Supply and service of telecommunications equipment	1.941	1.976	-1,8	4.007
Mobile telecommunications services	1.731	1.478	17,1	3.115
Cable television transmission and broadcasting services	1.621	2.017	-19,6	3.631
Text and data services	1.414	1.277	10,7	2.807
Telephone directories and publishing	263	248	6,6	500
Other services	280	105	165,8	327
International investments (Matáv)	932	-	-	-
<b>Total</b>	<b>30.637</b>	<b>32.557</b>	<b>-5,9</b>	<b>66.135</b>

Excluding the effect of VAT, total revenues (excluding Matáv) rose by 1.3 per cent in comparison to the prior year.

Revenue from telephone services, which were affected by the 13 per cent price reduction, decreased by 11.8 per cent. Revenues from cable television transmission and broadcasting services, which were also affected by the price reduction, declined by 19.6 per cent.

Revenues from mobile telecommunication services, which were not affected by price reductions resulting from the implementation of VAT, rose by 17.1 per cent and revenues from text and data services increased by 10.7 per cent. The positive development in the first half of 1996 compared to 1995 was further bolstered by an increase in the number of connections and customers:

	<b>30.06.96</b>	30.06.95	<b>Change</b>	<b>Change</b>
	<b>(millions)</b>	(millions)	<b>(millions)</b>	<b>in %</b>
Number of connections including ISDN channels	<b>42,9</b>	40,8	<b>2,1</b>	5,1
of which ISDN channels	<b>3,8</b>	2,1	<b>1,7</b>	81,0
Cable customers	<b>16,2</b>	15,3	<b>0,9</b>	5,9
T-Online customers	<b>1,1</b>	0,8	<b>0,3</b>	37,5
Mobile phone customers	<b>2,4</b>	1,8	<b>0,6</b>	33,3
Paging customers	<b>1,0</b>	0,7	<b>0,3</b>	42,9

#### Personnel

Average number of employees					
	<b>1.Hj. '96</b>	1.Hj. 95	<b>Change in number</b>	<b>Change</b>	1995
	<b>1996</b>	1995	<b>of employees</b>	<b>in %</b>	
Civil servants	<b>112.417</b>	118.839	<b>-6.422</b>	<b>-5,4</b>	117.138
Salaried employees	<b>44.358</b>	46.285	<b>-1.927</b>	<b>-4,2</b>	45.246
Wage earners	<b>53.921</b>	59.752	<b>-5.831</b>	<b>-9,8</b>	57.368
<b>Deutsche Telekom</b>					
(excluding Matáv)	<b>210.696</b>	224.876	<b>-14.180</b>	<b>-6,3</b>	219.752
Matáv	<b>20.635</b>	-	<b>20.635</b>	-	-
<b>Trainees and interns</b>					
Deutsche Telekom					
(excluding Matáv)	<b>9.213</b>	12.452	<b>-3.239</b>	<b>-26,0</b>	11.968
Matáv	<b>715</b>	-	<b>715</b>	-	-
<b>Deutsche Telekom</b>					
<b>Total</b>	<b>241.259</b>	237.328	<b>3.931</b>	<b>1,7</b>	231.720

The average number of employees decreased during the first six months of 1996 by approximately 14,000 as compared to the same period in 1995. At June 30, 1996, approximately 207,000 people were employed by Deutsche Telekom; in addition, approximately 20,500 were employed by Matáv. Thus, approximately 23,000 jobs have already been eliminated in a socially acceptable manner since January 1, 1995. A total of 60,000 jobs are planned to be eliminated through the year 2000.

	<b>1.Hj. '96</b>	1.Hj. '95	<b>Change</b>	1995

	1.Hj. '96	1.Hj. '95	Change	1995
	(DM million)	(DM million)	in %	(DM million)
Wages and salaries	6.570	6.664	-1,4	13.197
Social security and pension costs	2.682	2.831	-5,3	5.305
of which for pension costs	1.725	1.864	-7,5	3.509
<b>Deutsche Telekom</b>				
(excluding Matáv)	9.252	9.495	-2,6	18.502
Matáv	170	-	-	-
Total	9.422	9.495	-0,8	18.502

An increase in wages and salaries by 3.2 per cent as of May 1, 1995 as well as further tariff related charges offset the reduction in personnel costs related to the decreased number of employees.

#### Depreciation and Amortization

	1.Hj. '96	1.Hj. '95	Change	1995
	(DM million)	(DM million)	in %	(DM million)
Amortization of intangible assets	239	139	71,9	349
Depreciation of tangible assets	8.410	7.118	18,2	15.028
Total	8.649	7.257	19,2	15.377

The increase in depreciation is primarily attributable to the scheduled depreciation of capitalized VAT at Deutsche Telekom AG. This depreciation is offset by VAT reimbursements according to §15a UStG (German tax law concerning VAT). The reimbursements are recognized as other income. Depreciation at Matáv, which is fully consolidated for the first time, amounted to DM 184 million.

#### Net income

The following other developments affecting net income occurred (excluding Matáv):

- Personnel costs decreased by close to 3 percent
- Interest expense decreased by approximately 10 percent
- Costs for goods and services purchased and other expenses rose as expected, in particular for restructuring projects, disposition of assets and valuation allowances. Additionally, DM 800 million were spent with an emphasis on ISDN marketing.

The extraordinary loss includes personnel restructuring charges of approximately DM 1.75 billion and DM 0.1 billion for costs in connection with Deutsche Telekom AG's upcoming initial public offering. Thus, results are as follows:

#### HGB

	DM million	of which Matáv
Results from ordinary business activities	2.715	118
Income after taxes	204	74
Income applicable to minority shareholders	-75	-75
Consolidated net income	129	-1

in accordance with US-GAAP

Consolidated net income determined in accordance with US GAAP amounts to DM 521 million. Differences compared to net income determined in accordance with German Commercial Code are primarily due to lower personnel restructuring accruals and a different method used to calculate deferred taxes under US GAAP.

#### **Consolidated Shareholders' Equity**

Consolidated shareholders' equity at June 30, 1996, determined in accordance with German Commercial Code, is approximately DM 26.1 billion and, determined in accordance with US GAAP, approximately DM 30.9 billion. The difference results principally from differences in recognition of personnel restructuring accruals, deferred taxes and a different treatment of minority interests, accumulated since the initial consolidation.

#### **Outlook**

Similar to previous years, an increase in revenues is expected for the second half of 1996 in comparison to the first half of the year. The initiatives to reduce costs will be continued consistently. Additional restructuring programs - as for example ISDN - are materially complete. Costs associated with the initial public offering will have a one-time burden on net income. Dividends to the previously sole shareholder and the new shareholders will be secured by the results for the second half of 1996. An increase in net income is expected for 1997, as the extraordinary charges will no longer apply and the prospects for growth in the telecommunications market are positive.

**Bonn, September 17, 1996**  
**Deutsche Telekom AG**  
**The Board of Management**  
**Half-Year Report Six months ending June 30, 1996**