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Start statement René Obermann

– The spoken word shall prevail –

Conference Call
Deutsche Telekom AG, First quarter report of 2011
May 6, 2011

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Thank you, René Obermann!

Starting with Germany, I am pleased overall with the development, especially in terms of profitability. While revenues decreased by 3.2 percent, this was driven partially by the mobile termination rate cut and the discontinued mobile prepaid cards business. We discontinued the trade with mobile prepaid cards due to our focus on higher-margin businesses. This business had a very low margin.

Excluding these two effects and adjusting for the first-time consolidation of Click and Buy, revenues would have declined by 2.0 percent, an improvement over the minus 2.2 percent decline seen in Q1 last year.

Encouragingly, adjusted EBITDA increased by 3.7 percent to EUR 2.4 billion, driven by strong adjusted opex reductions of 7 percent. The margin improved to 39.7 percent, up 2.6 percentage points from last year.

As you know we changed our reporting for the Germany division as of Q1. In particular, we now report the revenues and customer figures for private and business customers. We no longer report separate EBITDA's for mobile and fixed as an artificial allotment pro rata towards fixed and mobile would be more and more meaningless in an ever more integrated operation!

Let's have a look at the key drivers of the Germany segment:

Fixed-network revenues were down 5.1 percent year-on-year, mainly driven by the 1.6 million line losses over the last twelve months and the related decrease in single play revenues and a decrease in wholesale revenues. Revenues in the first quarter were impacted by two one-timers: the discontinuation of the mobile prepaid cards business and a negative revenue credit in connection with a court decision. Without the one-timers the underlying revenue decline was 4.3 percent, compared to a decrease of 3.7 percent on a like-for-like basis in 2010 (excluding Strato). The main operational effect in Q1 was the decline in wholesale revenues by 6.6 percent (or by 5.7 percent without the negative revenue credit) due to lower usage (Interconnection, call-by-call) and lower intercompany-related revenue.

Connected Home revenues, that is double play and triple play revenues, increased by 3.5 percent, supported by stable double play and still small but strongly growing triple play revenues. The latter grew by 43 percent year-on-year and now represent an annual revenue stream of more than EUR 600 million.

In mobile, service revenues grew by 2 percent, adjusted for the reduction in mobile termination rates. The continued growth was driven by strong growth in data revenues, which now account for almost 23 percent of service revenues (not including SMS!), up almost 6 percentage points year-on-year.

Let’s turn to the market share developments. We have a unique market position to target the data market segment in Germany.

In fixed broadband we maintained a 46 percent market share with a net adds share of 34 percent in Q1. We purposely did not participate in some of the value-destructive pricing competition seen in the German market lately. We significantly increased the number of retail fiber customers (VDSL) by more than 100 percent to over 400,000 and thereby strongly improved the quality of our fixed-network customer base. This was driven in particular by solid IPTV growth of 40 percent year-on-year to now 1.3 million customers connected. Triple play customers now account for more than 10 percent of our broadband customer base and remain a key focus for future growth.

On the mobile side, we estimate a relatively steady service revenue market share sequentially, although only one competitor has reported so far. Our market share was supported by the strong ramp up in data revenues, which grew by almost one third year-on-year, even faster than the growth rate in Q4. This reflects the successful launch of our new tiered product portfolio: Approximately 1.5 million customers signed a new contract, with a “double play” share of more than 60 percent. Smartphones accounted for close to 60 percent of handsets sold in Q1, up by an impressive 22 percentage points year-on-year. We sold close to 300,000 iPhones in Q1.

Let’s turn to the Europe segment now.

KPI trends remained solid despite the challenging economic environment in a number of markets. In particular, TV customers grew by 20 percent with the number of IPTV customers going up by 50 percent. IPTV is also a key growth driver for the number of broadband customers in general, which increased by 11 percent year-on-year to 4.7 million.

Supported by the increasing availability of cheaper smartphones, in particular Android, we have seen a virtual explosion in the smartphone share which has increased rapidly to 43 percent of dispatched devices as of Q1. The smart-phone uptake is also supporting the continuous growth in contract subscribers that we have seen over the past quarters.

With regard to our integrated operations in Europe, there is good news and bad news. First the bad news: In these markets we are still facing a very difficult economic and regulatory environment, especially in Greece and Romania. Additionally, the austerity measures adopted by several countries, especially the special tax in Hungary, are clearly burdening our results. The good news: We managed to maintain good margins in all markets despite the revenue trends.

Let me make a few comments specific to the different markets:

In the OTE Group we continue to face challenging fixed-line regulation in Greece. Nevertheless, we had slightly positive broadband net adds in Greece and managed to exceed 1 million TV customers within the OTE Group, while maintaining an almost stable margin.

Croatia remains our best IPTV market with almost half of our total IPTV cus-tomers in the Europe division, increasing by close to a quarter year-on-year. The slight decline in EBITDA margin reflects strong market invest in mobile which resulted in iPhone sales more than doubling.

The underlying performance of the Magyar Telekom Group, if you take out the EUR 20 million special tax in Q1, was actually quite impressive with 4 percent adjusted EBITDA growth despite the topline pressure. Accordingly, the underlying margin improved from 41 to 45 percent. In particular, strong growth in TV customers continued, which grew by 14 percent year-on-year to more than 800,000.

We also saw strong TV growth in Slovakia, with the number of TV customers almost doubling since Q1 last year. The decrease in margin was mainly due to fixed, reflecting lower basic subscription fees for IP/Internet and the integration of the IT provider Posam, with mobile strong and stable at a high 48 percent margin.

When it comes to our mobile-centric operations, we deliberately increased smart market investment to counteract revenue pressures from regulation in key markets like the Netherlands or Poland. This resulted in strong KPIs, which will support future revenue and EBITDA development in these markets.

In Poland, we achieved stable revenues despite regulation. We attacked via smart investment in high-value customers, resulting in a smartphone share of phones sold of close to 40 percent, tripled year-on-year, and data growth of 26 percent.

Dutch mobile revenues were severely impacted by the MTR cut of approximately 50 percent as of January 1. Without the impact from regulation (MTR + EU roaming), service revenue growth would have been positive at 2.7 percent (and total revenues at 2.5 percent), much better, by the way, than the incumbent. Differently from the incumbent, we did not see any significant cannibalization of the SMS revenues. To the contrary: They are still growing at a high single-digit percentage rate. We chose to offset the regulatory impact with smart value-centric market invest, which resulted in continued strong mobile data revenue growth of 37 percent. iPhone sales were even stronger in Q1 than in Q4 (75,000 vs. 62,000) despite the loss of exclusivity. The improving quality of our customer base is reflected in a low stable contract churn of 1.3 percent and an increasing contract base, up 13 percent year-on-year.

In the Czech Republic, we managed to further improve our already high margin and maintain a very low contract churn of just 0.5 percent due to strong customer retention in the quarter.

In Austria, strong market invest resulted in higher net adds and a contract churn at an impressive 0.9 percent. The margin was weaker this quarter, but please recall that the margin benefitted from an extraordinary reduction in cluster costs in Q1 last year.

In Systems Solutions the good revenue momentum seen in previous quarters improved further to 6.1 percent growth in Q1 with external revenues growing by 5.5 percent. This is a reflection of T-Systems' success in winning deals as well as the economic recovery on the corporate side. And the deal flow remains very strong, with order entry up more than 20 percent year-on-year. Recent big deals include Everything Everywhere, Fraport, and Voltaris, our first significant smart metering deal.

Adjusted EBITDA remained almost stable at EUR 189 million with a margin of 8.4 percent, despite higher transformation costs for new contracts and to safeguard quality in deals. On the other hand, the relatively high cash capex in 2010 – due to investments in multiple new contracts and customers and the extension of Dynamic Computing platforms – resulted in higher depreciation and amortization charges which impacted adjusted EBIT. The adjusted EBIT margin decreased to 1.3 percent from 2.2 percent the year before. Profitability was supported by the continued execution of our Save for Service program with a EUR 0.1 billion contribution in Q1.

The first quarter was certainly a tough quarter for us. The competitive environment was very intense and took its toll on our results. Let me just mention the iPhone and first LTE handset launches by Verizon as an example. Nevertheless, we continued to stabilize our service revenues, which were up 0.4 percent year-on-year, driven by strong data revenue trends and the insourcing of the handset insurance business, which was already included in our Q4 numbers.

In terms of net adds, we saw an increasing bifurcation between negative contract net adds and growing prepaid net adds. Contract customer losses increased further due to the competitive impacts already mentioned, which is clearly dissatisfying! Main reasons for this were lower gross adds and still high contract churn. In addition, we increased our credit standards in Q4, as you already know. This has had a negative impact on contract gross adds in the short term but should be beneficial over time with regard to contract churn.

We are encouraged by the strong prepaid customer growth, which demonstrates the success of our multi-brand strategy, including Simple Mobile and Walmart, to mention just two examples.

The EBITDA margin was impacted by high upfront market investments, which were also driven by the competitive environment. In particular, we saw significant increases year-on-year and sequentially in retention, advertising, and network expenses. The latter increased in connection with the continued buildout of our 4G network in the US. During the transition period to fiber backhaul, we are paying for both copper and fiber backhaul for the same cell sites in some instances.

Smartphone uptake was very strong with an increase of nearly one million in 3G and 4G smartphone customers on our network. This resulted in strong data ARPU growth, which increased by more than 20 percent year-on-year. Blended ARPU remained stable despite the mix shift toward prepaid and contract ARPU actually increased by USD 1 year-on-year to USD 53.

Following this overview on the divisions, let’s take a closer look at free cash flow. Excluding the EUR 400 million paid for the PTC settlement, cash flow generated from operations was stable at around EUR 3.9 billion. The reduction in free cash flow, therefore, resulted only from a different seasonality of interest payments and cash capex. In Q1 we had almost EUR 0.2 billion more capex versus Q1 last year due to unfortunate weather conditions and high uncertainty around the economic recovery last year. This different seasonality of interest payments and cash capex will be balanced out in future quarters. Accordingly, we confirm our guidance of a stable to slightly growing free cash flow versus the 2010 level of EUR 6.5 billion.

In terms of our cost cutting program “Save for Service” we achieved additional savings of EUR 334 million in the first quarter with the biggest contributions from Germany and Systems Solutions. This resulted in a net reduction of the Deutsche Telekom cost base by almost 7 percent at the corporate level with significant net opex savings in Germany and Europe. Overall, we have now achieved a total run-rate of cost savings amounting to EUR 2.7 billion, almost two thirds of the target EUR 4.2 billion for the entire 2010 to 2012 program.

Finally, our balance sheet ratios remained solid and well within the respective comfort zones. The ratios will further improve following the completion of the sale of T-Mobile USA to AT&T next year. In recognition of the impact of this deal, both Fitch and Standard & Poor’s recently changed the outlook for their long-term ratings on Deutsche Telekom to “positive” from “stable” and Moody’s has put us on their watch list with “positive” implications as well.

With this René Obermann and I are now ready for your questions!