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# Deutsche Telekom AG *(DTE.DE)*

Q4 2012 Earnings Call

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# MANAGEMENT DISCUSSION SECTION

**Operator**: Good afternoon and welcome to Deutsche Telekom's conference call. On our customer's request, this conference will be recorded.

Disclaimer: This presentation contains forward-looking statements that reflect the current views of Deutsche Telekom management with respect to future events. These forward-looking statements include statements with regard to the expected development of revenue, earnings, profits from operations, depreciation and amortization, cash flows, and personnel-related measures. You should consider them with caution.

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In addition to figures prepared in accordance with IFRS, Deutsche Telekom also presents non-GAAP financial performance measures, including, among others, EBITDA, EBITDA margin, adjusted EBITDA, adjusted EBITDA margin, adjusted EBIT, adjusted net income, free cash flow, gross debt, and net debt. These non-GAAP measures should be considered in addition to, but not as a substitute for, the information prepared in accordance with IFRS. Non-GAAP financial performance measures are not subject to IFRS or any other generally accepted accounting principles. Other companies may define these terms in different ways.

**Operator**: Now, please listen to the statements of René Obermann and Timotheus Höttges. Afterwards, you are welcome to ask your questions. May I now hand you over to Mr. Marcos Gudetz (04:00).

## Unverified Participant

Good afternoon, everyone. Good morning to all of you from the United States and welcome to our Q4 conference call. Unfortunately, Stephan Eger is down with the flu since today and asked me to send greetings to all of you. I think we can directly start with the presentation followed by the Q&A session afterwards. We have roughly one hour and need to finish in time at approximately 2 p.m. German time. Having said that, I would like to hand over to our CEO.

## René Obermann

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

Thanks, [ph] Marcos (04:28). Let's start by reviewing the key achievements in 2012. An adjusted EBITDA of €18 billion and a free cash flow of €6.2 billion with that we achieved the objectives for the group and I think it's fair to say against the industry trend.

In terms of dividend policy, we delivered on our three-year dividend guidance with a proposal of €0.70 dividend for the full year 2012 and we will propose that to the AGM. We have also introduced a prudent and a sustainable dividend policy for the years 2013/2014 with a dividend of €0.50 per share each.

In Germany, the revenue trend improved further to minus 2% after minus 4% in 2011. The adjusted EBITDA margin remained at 40%. We had a strong market result with 1.3 million mobile contract net adds. That's significantly better than in previous periods; 2 million Entertain customers by year-end 2012 and almost 300,000 new fiber customers. As outlined at our Capital Markets Day, we implemented the Future Integrated Network Strategy and we also introduced a new fiber wholesale model.

In the Europe division, we managed to slow down the historical revenue decline, adjusted for forex to minus 4% from minus 5.5% in 2011, while keeping the underlying adjusted EBITDA margin roughly stable at 34%. Over the past 12 months, Europe increased its mobile contract customer base by almost 1 million, gained almost 300,000 new TV customers, and 200,000 additional broadband customers. Importantly, OTE was able to safeguard its refinancing well beyond 2014 now. LTE networks are up and running in four countries.

In the U.S., key financial trends remained challenging with a revenue decline of 4.1% and a decline in adjusted EBITDA of 7.5%. Operationally, T-Mobile U.S. was able to return to customer growth of more than 200,000 in 2012 following a loss of 550,000 in 2011. However, we still lost more than 2 million branded contract customers, representing a 6% improvement over 2011, but it's still a painful loss. Encouragingly, branded contract churn was reduced by 30 basis points to 2.4% and we did lay the groundwork for improved future performance with the agreement with Apple, the proposed merger with MetroPCS and the sale of our tower assets.

Systems Solutions had a satisfactory result with a small growth of 0.6% and a growth in adjusted EBITDA of over 11%. Order entry was strong, with a growth of more than 18% to close to €9 billion, mainly driven by a new contract with Shell, but also with other significant companies. We established Telekom IT to support group IT cost savings.

Looking at the key figures for 2012, let me just make a few remarks. Revenue was almost stable with a decline of 0.8%. This is quite different from most peers in Europe. In terms of adjusted EBITDA, we delivered on our €18 billion guidance. However, EBITDA was impacted by higher market invest in Germany and the U.S., especially in Q4 and I will get back to this in a minute.

Net profit, both adjusted and reported, turned positive again in Q4. For the full year, reported net income was impacted by the impairment in the U.S., while adjusted net income was at €2.5 billion. The highlight clearly was the free cash flow of €6.2 billion, better than the €6 billion guidance and down just slightly from the prior year. This is even more impressive considering that we maintained stable cash CapEx of €8.4 billion. In terms of net debts, we achieved a solid reduction of €3.3 billion to below €37 billion despite a €3.4 billion dividend payout, including minority dividends.

In this context, let me briefly review how we did against our targets for the last three years, which we set ourselves in 2010. We delivered on the following: group wide fixed broadband retail customers, mobile Internet revenues, Save for Service, free cash flow, and importantly, our dividend commitment. On the other hand, we missed the mark with regards to stabilize the German revenues totally, that's not yet done, return on capital employed and partially on our share buyback commitment. I think it's fair to say that our performance and delivery on commitment overall compares favorably to most of our European peers.

So, let's take a closer look at the EBITDA development in Q4. As we had flagged earlier, the EBITDA in Germany and the U.S. was impacted by higher market invest. In Germany, with the market invest, we achieved a solid revenue trend, down just around 0.4%, record smartphone sales of 1.5 million devices and high branded contract customer net additions of 226,000 in Q4, up more than 50% year on year. In the U.S., we said all along that we would increase market invest, especially advertising in the second half of the year and especially Q4. This development was incorporated into our $4.9 billion EBITDA guidance for the year, on which we delivered. In turn, we achieved positive net adds in Q4 and reduction in branded contract customer churn by 50 basis points and strong smartphone sales of 2.8 million devices.

Based on our Q4 results, we reiterate our 2013 guidance and also our mid-term ambition presented at the Capital Markets Day. For 2013, we are guiding an adjusted EBITDA of €18.4 billion including MetroPCS and a free cash flow of approximately €5 billion. In terms of shareholder remuneration, we intend to pay a dividend of €0.50 per share for both 2013 and 2014.

Our mid-term ambition including MetroPCS includes a return to growth in revenues and adjusted EBITDA by 2014, a free cash flow of approximately €6 billion in 2015, an improvement in the earnings per share to approximately €0.08 in 2015 and an improvement in the group ROCE to 5.5% in 2015. We will review our 2015 dividend later in light of developments up to then.

Let me turn it over to Tim, who will take you through the divisions and much more detail to financials. Thank you.

## Timotheus Höttges

*Chief Financial Officer, Deutsche Telekom AG*

Thank you, René. Good morning. Good afternoon, everybody. I'd like to start with Germany.

In Germany, the revenues declined by just 1.4% year-on-year; very similar to the development we have seen in the third quarter. The mobile revenues grew by 3.2%, driven by very strong term in equipment revenues. Core fixed line revenues declined by 2.9%, very much in line with the developments in the third quarter. Wholesale revenues at minus 4.6% were somewhat weaker than in Q3 due in particular to some provisioning in Q4. Adjusted EBITDA is already highlighted, declined by close to 10% mainly due to higher market invest in mobile.

In Germany, we've – the fixed-line business we saw a number of encouraging developments. In particular, I would like to highlight the following topics. First, we had a further reduction on our line losses by 20% year-on-year to just 236,000. We saw a continued growth in the average revenues per access driven by the continued migration to double-play and triple-play. And we saw a very strong growth in fiber retail customers now by close to 50% increase to more than 900,000 customers of this double-play VDSL offerings.

It is worthwhile mentioning that also VDSL wholesale finally is gaining traction. The customer base grew by 47,000 in Q4. On the other hand, we generated just 3,000 broadband net adds given the slow overall growth of the German broadband market, this still implied a broadband market share of close to 45%. The broadband net adds and comparative strong growth by our cable competition underlined once again the importance of our Future Integrated Network Strategy for Germany.

Turning to mobile, German mobile market service revenues decreased by 0.4% in Q4. Similar to other carriers, we also saw a slowdown in service revenue trends. Excluding the MTR effect of €10 million, our mobile service revenues decreased by 2.2%. Specifically, this was driven by the following developments. A worsening trend in voice revenues, an accelerating decline in SMS revenues, driven by volumes and IP substitution, a weaker revenue development in business, driven by a continued tough competitive and pricing environment and a weaker revenue trend in consumer still impacted by the loss of Drillisch and the voice and SMS trends adjustment.

On the other hand, we saw strong commercial results with 437,000 mobile contract net adds. Record smartphone sales of 1.5 million including strong sales of Android and iOS devices and strong growth in double-play customers, now accounting for 60% of branded contract customers, up from 42% a year ago.

Let me highlight that the fourth quarter especially here in the German environment was driven by strong market investments. We were able to put more market in – money into the market due to, let's say, the good EBITDA performance we have seen over the first third quarters.

While the service revenue developed in Q4 was frankly disappointing to us, we intend to return to underlying service revenue growth in 2013. Our confidence to return on the mobile business to growth is based on the following developments: growing ARPU of new branded contract customers; our strong smartphone sales and strong increase in the contract customer base; our best network positioning in the market resulting on the highest customer satisfaction in German mobile and the best mobile data proposition; and the fact that certain effects in 2012, in particular the loss of Drillisch won't recur in 2013.

On the other end, we will have the continuing impact of the MTR cut and roaming regulation and the still decreasing ARPU in the existing customer base due to tariff optimization. I think it is worthwhile to mention that it is good to keep the customers with Deutsche Telekom here in Germany and giving them a better and – better-fitting tariffs, which we did as well in the fourth quarter. But our ambitious is, I repeat, to return to underlying service revenue growth in 2013.

Let's move to the U.S. In the U.S., we saw essentially stable total revenues for the third quarter in a row. While the trend in service revenues weakened further slightly due to the continuing migration to Value plans, this was offset by higher equipment revenues, also driven by the Value plans. Accordingly, total revenues declined by 5.2%. This compares to a decline of 5.9% in the third quarter. The decline in service revenue, as well as higher advertising spend impacted adjusted EBITDA in Q4, as already highlighted by René. This was, however, in line with our full-year guidance of $4.9 billion on which we delivered.

In terms of customer results, we achieved a significant reduction in branded contract customer losses which improved by 27% year on year. Growth in branded no-contract customers continued, though at a slower pace than in Q3, primarily due to higher churn. On the other end, the growth in wholesale customers was very strong driven by strong MVNO net adds in particular.

Turning to ARPU, the trends already seen in previous quarter continued. Namely, a continued reduction in branded-contract ARPU driven by the customer migration to Value plans and the continued growth in branded no-contract ARPU driven by the continued success of our monthly 4G rate plans. Data ARPU remained robust, exceeding $20 for branded contract customers for the first time.

In this context, let me briefly update you on the MetroPCS merger approval process, our Un-carrier strategy, and the progress achieved with the network modernization. I would also like to reiterate the tremendous benefits of the combination with MetroPCS.

First, I'm pleased to say that the definitive proxy was filed on February 25 and the MetroPCS shareholder meeting has been scheduled for March 28. All other regulatory approval processes are also on track, so that we currently anticipate closing in early April. The combination with MetroPCS has tremendous benefits. It significantly extends our spectrum position in key markets [ph] for example by (18:46) more than 20% in the top 25 markets on average. The combination has very significant cost synergies, with an NPV of $6 billion to $7 billion and NewCo is projected to have a very attractive growth profile, as we have highlighted before.

With regard to our Un-carrier strategy, you know about our Apple partnership and our plan to transition to 100% Value plans. While I can't provide you with additional details today, expect to hear more on these topics in the near future.

We are making excellent progress with regards to our network modernization. Thanks to the pending merger with MetroPCS, we have a path to an at least, a two times 20 megahertz LTE network in 90% of the top 25 markets, starting in 2014. This year, 2013, we are on track to launch 4G LTE in 100 million POPs by mid-year and 200 million by year-end, mostly with two times 10 megahertz initially.

We are also making progress with regards to rolling our HSPA+ on 1900 megahertz spectrum with already 142 million POPs. This is key to enabling bring your own device, for which T-Mobile U.S. already has an excellent track record, gaining approximately 100,000 iPhone customers per month over the last few months.

Turning to Europe, our pockets of growth contributed to slowing down the historical revenue decline. Revenues declined in Q4. This quarter was marked by the highest negative regulatory impact in 2012. Across the year in 2012, out of 13 countries, MTRs were cut at least once. In Greece and Romania, MTR even were cut twice. The one-off at T-Mobile Netherlands, which benefited Q4 2011, negatively impacted the year-over-year comparison. Our growth areas, we managed to partially compensate the environment driven decline of traditional telco revenues. We slightly improved the underlying revenue developments versus Q3.

In terms of adjusted EBITDA besides negative effects from a lower contribution margin, we were impacted by the new usage-based tax in Hungary, which is the second special tax in the country, impacting us in second half of the year 2012. Due to our indirect cost savings, we were able to partially compensate for the above effects.

From a commercial perspective, our connected home revenues were supported by growth of broadband base now exceeding 5 million access and growth for our TV base now approaching 3 million customers. Our mobile contract customer base grew by almost 1 million year on year and exceeded 28 million subscribers. The mobile data growth was supported by growth of the smartphone share that exceeded 60% of dispatched devices in the fourth quarter.

Comparing our revenue performance with our main peers, we improved our performance significantly year-on-year. While in Q4 2011 we have outperformed four out of nine main national competitors, in Q4 2012 we outperformed seven of nine. We improved our total mobile revenue performance versus Orange in Poland and Slovakia significantly.

In addition, let me highlight some other key developments concerning the Europe division. Post various refinancing measures in Q4, such as syndicated loan at the level of OTEs Bulgarian subsidiary Globul, and in Q1 when OTE raised €700 million on the debt market, OTEs cash position together with anticipated free cash flow is expected to be fully sufficient to cover all repayments in 2013. Together with the intended disposal of HellasSat, Globul and Germanos Bulgaria liabilities becoming due in 2014 and beyond are also deemed covered, given no major unforeseeable disruptions, for instance on microeconomic or political scale.

The rating agency Standards & Poor's has reacted and has increased the rating of OTE by two notches to B plus. I think it's very important to let you know that OTE is fully refinanced without any support of Deutsche Telekom's money. OTE has a very attractive deal on selling the HellasSat at a multiple of seven times. They have improved their LTE coverage significantly in the country and they have not lost market share at the same point in time. And for the first time in history, the company was able to improve its cost position by laying off more than 1,000 people year-over-year in this area. So, this company has improved significantly and this is even, by the way, reflected on the share price.

We pride ourselves on our technology leadership with LTE rollouts in Greece, Hungary, Croatia and Austria. In the first three mentioned countries, iPhone 5 customers can now, as in Germany, use our superior 4G LTE network. We are pioneering the All-IP migration in Croatia and Macedonia, we launched a TeraStream pilot in Croatia and we have already 128,000 homes connected with FTTH driven by Slovakia and Hungary.

Turning to Systems Solutions, Q4 results were quite strong. Revenues grew by 5% driven by 2.1% growth at the market unit and the expected recovery in Telecom IT revenues, which were up by 15%. Order entry in Q4 was strong with deals like Presbyterian Healthcare in the U.S., and the State of Lower Saxony. The increase of almost 90% was mainly driven by the prolongation of the big Shell deal. Importantly, external revenues increased by 2.6%. Adjusted EBITDA and adjusted EBIT also grew nicely by 9% and 24%, respectively. The underlying EBIT margin at the market unit improved to 3.1%, up 50 basis points from Q4.

Turning to the financial KPIs, the free cash flow we have over-delivered on our guidance and over-delivered by €200 million of the €6 billion target. Actual free cash flow at €6.2 billion was only slightly lower than on a – than last year. Fourth quarter free cash flow came in line with expectation. The reduction versus Q4 2011 was driven by higher CapEx and the reduction in EBITDA due to higher market invests.

Adjusted net income for the full year amounted to €2.5 billion. The reduction versus 2011 was driven by the decline in EBIT to some extent offset by lower finance costs. Reported net income was dominated by the U.S. impairment that impacted our Q3 results in connection with the combination with MetroPCS. I already explained that effect in detail last quarter, but it was driven essentially by accounting rules, which mandated the impairment based on the market price of MetroPCS at the time of the announcement of the combination. In reality we strongly believe that the combination with MetroPCS will actually increase the value of our [ph] weighted assets (27:33) due to much stronger spectrum position in particular.

In addition to the impairment, reported net income was also impacted by a positive impact from asset sales and a negative impact from restructuring. These two effects essentially offset each other.

Based on the strong free cash flow we achieved a significant reduction in net debt by €3.3 billion, or we reduced our net debt base by 8.1% to now €37 billion, and this despite a dividend paid out in 2012 of €3.4 billion, €0.8 billion in pension funding and €0.4 billion in spectrum purchases. The sale of our U.S. towers, which closed in Q4, reduced our net debt base by €1.9 billion.

Turning to our balance sheet ratios, net debt to adjusted EBITDA, our leverage KPI remained stable year-on-year at 2.1 times. The equity ratio at 28.3% improved slightly from Q3. The year-on-year decrease was caused by the reduction in shareholders equity due to the U.S. impairment in particular.

With regard to our comfort zone ratios, we are in the green with regard to our ratios. And our ratings remain stable at BBB plus ratings, with the major agencies and stable outlooks from all of them. As a result, we continue to get excellent funding conditions in the debt capital markets.

With this, René and I are now ready for your questions.

## René Obermann

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

Thank you very much, Tim. Now we can start with the Q&A part. [Operator Instructions] As we have left approximately 30 minutes under 2 o'clock German time. Please limit yourself to one, up to two questions. And now we can start with the first one. Thank you.

# QUESTION AND ANSWER SECTION

**Operator**: Mr. Tim Boddy from Goldman Sachs. May we have your question, please?

## Tim D. Boddy

*Analyst, Goldman Sachs International*

Q

Yes. Thanks. I just wanted to ask about some of the competitive intensity that we see or competitive dynamics we see changing in the German mobile markets and your conviction about the return to underlying growth. Could you just talk a bit about your outlook for your tariff plans? Whether you think it's right to respond to some of your competitors' latest changes and just give us more color about your ambition there? Thanks very much.

## René Obermann

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

A

I think the situation in Germany structurally is somewhat better than in most other European markets, not only because the economic environment is healthy, but because there is also quite a bit of upside on upgrade selling from single to double play and to higher tariff plans and buckets.

On the other side there is of course some price pressure, continued price pressure on voice and on text messaging, but there is a nice and healthy growth in the opportunity for wireless data packages and wireless data services. So I think we're – it's not too optimistic to say we can go back to growth in Germany. Despite the pressure on text and on voice, there is more opportunities in wireless data. We're only scratching the surface of this. Data traffic is growing so fast and that will offer opportunities also to design new tariffs and also QoS differentiation, service-based tariff differentiation as an opportunity.

**Operator**: Mr. Dominik Klarmann from HSBC. May we have your question, please?

## Dominik Klarmann

*Analyst, HSBC Trinkaus & Burkhardt KGaA (Broker)*

Q

Yes. Thank you. On the theme of creating a strong European Telecom sector, just interested in your takeaway from Barcelona in terms of getting political support for broader consolidation? I'd say surely Neelie Kroes is a big supporter, but how do you view DT competition's position, [ph] on Nunez (32:01) position? And then linked to that, in the light of that improving climate towards consolidation, at what stage would you consider reviewing your M&A policy?

René Obermann
*CEO & Chairman-Management Board, Deutsche Telekom AG*

A

Look, we will not comment on M&A speculation, Dominik. But I think the first part of the question is very valid. I come back from Barcelona with a strong reiteration of Neelie Kroes' position. I mean she even said it publicly that she is willing to take – to do what it takes to stimulate the investments and the frame conditions for the wireless sector. She has articulated her agenda in July, and she is now pushing for this to be implemented with the means she has, which of course means every country by country it will have to be implemented in the national regulation. Here in Germany, we had a hearing at the end of January on the new topic, new network proposals we've made, including vectoring. Then couple of other weeks were given to, I don't know, hundreds small and mid-sized and bigger parties to comment.

So I expect that the Bundesnetzagentur, the national regulator will take a decision fairly soon and probably this decision will – I guess the decision should be positive, but including an obligation to re-sell what we call bitstream excess on the basis of non-discriminatory terms and conditions. So I think that's – and maybe the obligation to – for all those street cabinets where competitors had invested into already, I think we're talking about a few percent only, not to touch them, but to leave them to the competition. So bottom line, Dominik, I do expect the framework from Neelie to be implemented into the European markets and Germany being hopefully one of the first markets. The discussion is ongoing. My view is that the Netzagentur, the regulator has an open mind because they consider this would be a good solution and it would lead to a more equal playing field between telcos and the cable guys.

**Operator**: Mr. Simon Weeden from Citigroup. May we have your question please?

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

Q

Yes, thank you very much. Couple of questions, second one very quick I think. Just on broadband performance in Germany, could you elaborate a little bit on where the pressure is coming from and whether or not you think that that your sort of market share of net additions is going to remain under pressure during 2013? We're particularly keen to hear the extent to which...

René Obermann
*CEO & Chairman-Management Board, Deutsche Telekom AG*

A

Simon, Simon. You also realize that the market growth as such as slowed and that within the players, three years ago, four years ago, what we talked about were dozens of players who were all picking from our bones, flesh from our bones. And as far as I can tell, it is pretty much bifurcating now to the cable guys and ourselves, everybody else doesn't seem to pick much of the share. And if you look at the overall picture, we kept our number fairly stable. We even grew it a little bit.

We are not in a position to – I don't think it would be smart for us to push on the price side even more aggressively. So, we're not trying to position us here as the price leader in order to pick a few thousand more net adds, but instead try and defend our share as much as we can by holding a reasonable price policy and not kill too much value for us and for the rest of the market. But clearly, the cable guys come from a lower base and they seem to grow as the number suggest. But look at our numbers, they're not so bad. We're defending our position currently very well without screwing up the margins totally.

**Operator**: Mr. Matthew Bloxham from Deutsche Bank. May we have your question, please?

**Matthew C. Bloxham**
*Analyst, Deutsche Bank AG (Prime Brokerage)*

Q

Yeah, hi. I just kind of wondering if you could clarify a bit more the comments made about Everything Everywhere? I think there's some comments that you said this morning that seems to suggest really the focus is on an IPO and it might be at the backend of this year, I'm just kind of wondering if you're exclusively looking at that, or other options are on the table? Thanks.

**Timotheus Höttges**
*Chief Financial Officer, Deutsche Telekom AG*

A

Matthew, by the way first let me start, the developments which we – what we have seen even in the fourth quarter and even you know in the first quarter tells us Everything Everywhere are quite encouraging. I'd like to mention three points. First, our LTE network is coming on air quite faster than where we had expected. We have more POPs covered than anybody else as you know. So we're making good progress here.

Second, in the fourth quarter we only had, let's say, customer in five or six weeks for the LTE deployment – for the LTE sales into the market. Now with the developments – the current developments we see that the uptick is very high. One out of four customers are taking an LTE options. So it seems to be that this high bandwidth is well accepted from the customers.

Thirdly, we are very happy with the outcome of the auction, not from a price perspective, but from a spectrum perspective, because we have clearly defended our leadership on the spectrum position in this environment by getting 2 times on the 800 spectrum and you know 35 megahertz on the 2.6 spectrum base here. So therefore, the thing is moving in the right direction.

Now, with regards to the potential IPO, yes. We always said that our preferred solution as you know an IPO. The earliest timing, and that is what I said earlier today, could be let's say the fourth quarter, because we need a lot of preparation for this kind of work, together with our partners France Telecom, and we even want to show the market that not only our LTE proposition is selling well, but even the brand is getting more accepted and even our margin is going to improve. So therefore this is the earliest. You know that we do not have any kind of time pressure on that one. We want to take some value off the table. We still both want to hold let's say control of this entity, but you know, talking about let's say the best timing is always something to do with the market environment, and therefore let's see how this develops throughout the year, and then we will learn more. But you'll find us quite encouraged by the track we are taking here.

**Operator**: Mr. Hannes Wittig from JPMorgan. May we have your question, please?

**Hannes C. Wittig**
*Analyst, JPMorgan Securities Plc*

Q

Yes. Good afternoon. On the German mobile market stabilization, you did not mention LTE, which obviously now should create an addition boost from your ability to sell the iPhone LTE version in Germany exclusively. So I wondered if you could comment a little bit on LTE momentum, what percentage of your German mobile additions that generate right now? And whether that represents any change from the fourth quarter? And related to this, I wonder looking at the trends whether you are still confident that you can keep the margin at 40% in Germany, given the outlays you had in the fourth quarter to sustain your momentum? Thank you.

**Timotheus Höttges**
*Chief Financial Officer, Deutsche Telekom AG*

A

Sorry. Yes, Hannes. So, let me first [indiscernible] (39:59) our challenge on the service revenue, they're not coming from LTE, nor are they coming from a good positioning of our product at [ph] High Street (40:09). We had very strong growth in the fourth quarter, especially on smartphone sales. And we sold 1.5 million smartphones in Germany only in the fourth quarter. So this was let's say, a record number compared to the previous years. So the acceptance for data offerings, and even – automatic with this let's say the need for more bandwidth, is definitely a market we foresee.

We sold almost twice as many iPhones as in Q3, and therefore on the 1800 megahertz spectrum, our network perception is significantly better from anybody else, even our LTE speed options, and that is your question, they increased. In Q3 we had in the vicinity of 22,000 options. In the fourth quarter we had close to 100,000. So we have more than tripled our sales in this regard. So I would say we should – even strengthen our efforts towards sales on the LTE offerings, but this is taking time, and I think the focus from our sales force is on it.

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**Operator**: Mr. Frederic Boulan from Nomura. May we have your question please?

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**Frederic E. Boulan**
*Analyst, Nomura International Plc*

Q

Hi. Good afternoon. Two quick ones from my side. First of all, if you could come back on the economics of VDSL, you've embarked in a significant spending program in fixed so far and we're seeing pretty [ph] two digit (42:04) broadband additions, and still even if there was some progress in Q4, the very slow adoptions so far VDSL, so what can you change this time around to reduce time to money? Or make sure you don't rule out the demand even there? And second, if you could come back a bit on the reasons specifically, driving the slowdown we saw in mobile service revenue growth in Q4 versus Q3? I mean you talked about voice and SMS pressure, should we expect this to carry on or even accelerate in 2013? So if you could give us a bit more granularity on what happened precisely in the quarter? Thank you very much.

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**Timotheus Höttges**
*Chief Financial Officer, Deutsche Telekom AG*

A

Let me first answer the question, I missed one part of Hannes' question which was about, let's say, the confidence with regard to the margin in Germany. And the first, there's no need and even nothing we expect that we are going away from our guidance [indiscernible] (43:08) €18.4 billion including Metro, so therefore, that is let's say, the commitment we have given and you know that we always want to stick to our commitment. We – if there is more growth on LTE, and if we would see more investments into the market we have to substitute in our indirect cost base. And you maybe have seen that we have announced a new program which is called [ph] Lean Etman (43:37), so we are already in the execution of that program, reducing our overhead in the German organization big time. And this will give us more headroom for investments into the marketplace. So therefore, I do not have a worry that we're not able to keep the margin at this level around [indiscernible] (43:58) area.

With regard to the slowdown of revenue growth in the Q4, well they continue accelerate in 2013? I think we were quite clear on that one. No, we expect that on the mobile side, we're going to return to growth and we're doing a lot of, let's say, efforts and you've seen that in the high activity on the marketplace in the fourth quarter already we're doing everything, turning back to growth in this area. And with regard to the overall revenue commitment, I think we have said, we are returning back to growth in 2014 for the group and there's no new news since we have hold our Investor Day here that we are shying away from this commitment.

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**Operator**: Next question is from Mrs. Robin Bienenstock from Sanford Bernstein. May we have your question, please?

**Robin A. Bienenstock**
*Analyst, Sanford C. Bernstein Ltd.*

Q

Yeah. Thanks very much. I guess, I have a slightly different question about service revenue growth in Germany, which is if you think about declining handset innovation and some more aggressive wireless offers from cable, why should you focus on service revenue growth at all and not instead on EBITDA growth? And secondly, I'm just curious you've got a Huntington deal with O2 Deutschland and United Internet. I'm wondering whether you have one with Vodafone? And if not, whether that's something you're discussing with them? Thanks very much.

**René Obermann**
*CEO & Chairman-Management Board, Deutsche Telekom AG*

A

Vodafone, not...

**Timotheus Höttges**
*Chief Financial Officer, Deutsche Telekom AG*

A

No.

**René Obermann**
*CEO & Chairman-Management Board, Deutsche Telekom AG*

A

Let me just double check before I say something wrong, Robin. Don't think Vodafone is concluded yet, but we'll find out. There were a couple of other companies where it was concluded with, NetCologne for instance. I'll find out in a second.

The service revenue growth, look, the overall market may be stagnating, or it's hard to say whether it will be slightly growing or slightly segmenting or slightly lower. But I don't see any decline in innovation on the device side. I mean, if you saw Barcelona, I was actually stunned by the number of manufacturers who are now making another big attempt, and I saw devices which are all poised to take more data volume and more data services. I mean, the screens get bigger, the capabilities of these devices, multimedia capabilities grow, there are really good innovation stuff coming, from the audio side to how to deal with pictures and the small video clips and so forth, all kind of stuff designs to lead to consumer data growth. And also on the productivity side, on the business side as well, there are many innovations coming. And even the hybrid between tablet and smartphone, all of that to me indicates there's more momentum, cameras with a direct interface and so forth.

So maybe, I'm too optimistic, Robin, but I do think that the wireless data piece is still the biggest chance to grow, and the growth will not slow down. So I think we should really focus on grabbing our fair share in the wireless data space as opposed to being too conservative, because once the market is – the market shares, how you say, distributed and people have positioned themselves, it's more tough to gain it back. So therefore, I think it's now much smarter to keep a – also focus on growing the share in the wireless data piece and keeping the network leadership up and go for smartphones and data package plan – and data bundles.

Okay. What is the answer? We have NetCologne, we have United Internet, our good friends, and we have Telefónica signed up for the contingent model and that model seems to develop some good traction, Robin. Not Vodafone yet.

**Operator**: Mr. [indiscernible] (48:23). May we have your question please?

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

Q

Yeah, hi. It's Ulrich Rathe actually at Jefferies. Coming back to German mobile, at the Capital Markets Day, you said that you're planning €200 million of incremental investments in 2013 compared to the level of market investments in 2012 in Germany, and also said this would be mainly in the mobile market. I was wondering, with this significant step up of market investments we've seen in the fourth quarter, does that still apply? So, do you still sort of have this plan to actually step it up another €200 million on top of the 2012 sort of total now? And the other question I have is – I mean I understand a large part of this service revenue decline is actually the repricing of the back book. Now, this has been going on for quite some time now. Can you give us a sense of how far this has proceeded? And to what extent you really feel that the largest part of the back book is now on front book tariffs? Or is there really a lot more to work through, if there's any way you could quantify that, it would be helpful? Thank you.

### Timotheus Höttges
*Chief Financial Officer, Deutsche Telekom AG*

A

The €200 million marketing campaign and promotional money, Ulrich, is baked into our plan. You know our plans haven't changed since December and we will stick to our plans and we will deliver. So, I don't – I know – I don't know whether that answers your question, but €200 million – of the whole plan, you are familiar with €17.4 billion, excluding an €18.4 billion, including Metro, is what we want to accomplish and all of that is unchanged. And with back book and front book, I guess you mean the number of customers who have optimized their tariff plans I suppose, right? And how many are still to come?

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

Q

Yes.

### Timotheus Höttges
*Chief Financial Officer, Deutsche Telekom AG*

A

Is that what you mean, Ulrich?

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

Q

Yes, correct.

### René Obermann
*CEO & Chairman-Management Board, Deutsche Telekom AG*

A

Look I think the biggest part is finished, that is at least what we foresee. It's always depending on how fast the [ph] hardware (50:28) prices are going down, but what we see with the – on the current levels and with the old, let's say the first generation of iPhone users, the biggest part is finished. What we saw in the fourth quarter was, let's say, a downswing on the – which was higher than – a little bit higher than what we expected on the SMS side.

On the SMS cannibalization from over the top services and from applications, we are – you are aware that most of our tariffs are already, let's say, including big SMS bundles – so, there was, let's say, a bigger deviation than expected on the SMS side, but with regard to the main part of, let's say, back book is front book.

**Operator**: Mr. Peter Nielsen from Cheuvreux, may we have your question, please?

### Peter K. Nielsen
*Analyst, Crédit Agricole Cheuvreux International Ltd.*

Q

Yes, thank you. Sorry, my questions are along – bit along the same line as Ulrich's. There seems sort of have been incremental pressure on the business market in German mobile in this quarter, certainly also if you look at ARPU developments, may I ask where – has it accelerated in this quarter? Where is it coming from? Has there been a specifically high number of contracts renegotiated in the quarter? And is there more to come, so to speak? I mean will this continue to work through the numbers all through next year? Thank you.

### Timotheus Höttges
*Chief Financial Officer, Deutsche Telekom AG*

A

Yeah, Peter, of course, Q4 usually is an aggressive quarter with regards to everybody tries to capture a decent share of the Christmas sales. And in this quarter, we had the launch of iPhone 5. And we have overall – I mean, iPhone 5 stood for, I think, it's about a third or even more than a third of our total sales in smartphones. We had overall, we had...

### René Obermann
*CEO & Chairman-Management Board, Deutsche Telekom AG*

A

[indiscernible] (52:22).

### Timotheus Höttges
*Chief Financial Officer, Deutsche Telekom AG*

A

...600,000. So, it's even more than that. So, we had very strong smartphone sales. That wasn't intent, but then when you actually campaign set up in a quarter like that whether you sell 1.1 million or 1.4 million, it's kind of hard to see it. Because once the dynamic is there and customers want it, you cannot stop a campaign right in the midst of November or December because those campaigns tend to be planned and prepared over several months prior to the Christmas season beginning.

So, the Q4 is very aggressive anyway. This one was particularly capitalized by a very high smartphone acceptance in the market and the iPhone 5. And as I said and maybe you know it doesn't go down well with you, but I do believe that it's the right thing to do to be aggressive when there is so much room now to grab the data tariffs and the new customers or retain your existing customers and upgrade sell to them into data packages. And therefore, okay on the one side, it's sad to have some EBITDA sacrifice, on the other side it's good to have the customer growth. And we had unprecedented growth over the last – this last quarter. And that only happened some years ago into that extent. So, I see it to be honest with two sides, positive and difficult.

**Operator**: Mr. Justin Funnell from Credit Suisse, may we have your question, please?

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

Q

Yeah, a couple of questions, please. Just in terms of German fixed line this year, your line loss is coming down to have smaller numbers, and just sort of raising the questions as to whether you can start to think about putting fixed-line pricing up or at least cutting the size of discounts? I think your LOE rates also gets reviewed the middle of this year, and the Commission in Brussels have said that LOE rates could actually go up in nominal terms. I'm just wondering if we're going to start moving to a better phase for fixed line pricing into the second half of this year and beyond? Secondly on the U.S., just wondering if you can give an update as to how many of your churn in the quarter was in your view iPhone driven? I think in the past, you've given figures of [indiscernible] (54:44) quarter and a third of your churn being iPhone driven. Whether that's changing? Or that's a pretty steady number? Thank you.

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René Obermann
*CEO & Chairman-Management Board, Deutsche Telekom AG*

A

Before we go into that, Justin, a quick comeback to [ph] Peter Gord (54:56), because honestly I misunderstood the question. And I apologize, [ph] Peter Gord (55:00). Could you ask for pressure on mobile business segment and not on mobile business, and you meant the customer segment business. The decline was worse than previous quarter, almost 2.7% and there was a regulatory effect from MTR and roaming, then there was a large customer contract loss, which we lost quite a while ago, but which in comparison with year on year put pressure on the revenue side, and we had quite a number of higher discounts for customers to be retained, because we realized we were in some big customer accounts not competitive and we had to improve our conditions. And we did that in order to prevent those customers from churning, and that led to another 60 million. So the business segment, which you were asking for, overall turned in worse because of these particular reasons. I hope that answers your question.

And to Tim, I think he's answering to Justin's question.

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Timotheus Höttges
*Chief Financial Officer, Deutsche Telekom AG*

A

Yes. I think Justin had two questions. The first one is the line losses in Germany and what we're expecting for 2013 in this regard. I think the line losses are somewhere predicted around 2012 levels. We do not expect that the line loss to fall below the magic range of 1 million. But we believe that is going to happen then in 2014, so the low churn rate in this area and the good opportunities of up-selling to double and triple-play is giving us confidence that we are able to reduce it slightly further.

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**Operator**: Okay. Mr. Lawrence Sugarman from...

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Timotheus Höttges
*Chief Financial Officer, Deutsche Telekom AG*

A

So, U.S. was still not answered. I think you asked for the churn question, U.S. in Q4, how much iPhone driven, is it changing stable? So, we would expect the good churn trend to continue without taking...

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**Operator**: [indiscernible] (57:12).

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Timotheus Höttges
*Chief Financial Officer, Deutsche Telekom AG*

A

What's that?

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René Obermann
*CEO & Chairman-Management Board, Deutsche Telekom AG*

A

[Foreign Language] (57:17 – 57:18)

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Timotheus Höttges
*Chief Financial Officer, Deutsche Telekom AG*

A

Okay. We're taking actions to further improve the retention, such as targeted offers to existing customers and some of the high-churn groups within branded contracts, i.e., FlexPay Contract, Even More Plus, they are almost churned out. So in phase two of our churn program, we will continue the successful program which we started in phase one and also tackle some of the bigger issues, for instance, improving in-home coverage, addressing network-related churn with the network modernization program, aligning spectrum with the big players and so forth. So, yes, is the bottom line answer. We would expect on the churn side to see some further progress.

**Operator**: Sorry about that. Now, Mr. Lawrence Sugarman from Liberum Capital, may we have your question please?

### Lawrence J. Sugarman
*Analyst, Liberum Capital Ltd.*

Q

Yes. Good afternoon, everybody. Then, two questions please. Firstly, just on GHS set, EBITDA losses have increased sort of slightly ahead of the previous run rate. Could you give a little bit of color on that? And also talk going forward, if the run rate we've seen this year is something that is light – particularly in the light of what I believe has been a focus on controlling costs in the headquarters? And secondly, more of a hypothetical question, obviously there's been a lot of discussion around potential changes in the competitive dynamics in the German market and talk of potential major deals, could you give us an indication as to whether if the most likely deal is a merger revolving around Vodafone and DT was to happen, how that would impact on your thinking around the marketplace?

### Timotheus Höttges
*Chief Financial Officer, Deutsche Telekom AG*

A

Lawrence, first question with regard to GHS and the EBITDA development here. Let's remind ourselves in Q4 2011, we got a €97 million compensation payment from France Télécom related to the buy in the joint venture. So, that was a one-time gain, which we haven't had this year, so that is one of the reasons.

The second reason is for enabling our new digital growth initiatives, we have increased our cost at the DBU. So that is, let's say, coming with additional costs by the way in line with what we have seen already in Q4 – Q3 marketing's recruitment of specialists and other things, so there were additional costs coming from that one. With regard to let's say, shape headquarter initiatives, so let's say, the savings, we are very well on track. Only for the headquarter, we have reduced in 2012 our head count here at the headquarter by 540 people. And there is more gross reduction coming from people but as well from cuts, so therefore overall I think a very complex issue, but mainly coming from this one-timer in 2011.

### René Obermann
*CEO & Chairman-Management Board, Deutsche Telekom AG*

A

Germany – change in dynamics of the German market any deal. Look I, in general, I believe that in Europe including in Germany, market consolidation is needed. We still and make sense – we still have somewhere around 160 small, mid-size, and larger competitors on the service and infrastructure side. So, consolidation makes sense in general and a reduction in the number of players is useful for the market because the market is, need some – needs to be, continue to be very healthy and it's you know if everybody competes for the same customer, it's going to be very unhealthy. So, I would welcome a general consolidation, on this specific thing you're referring to, I don't know what to believe, I don't know what to think because rumors are coming in and out of the market.

Wherever they come from, I don't know and I do not participate in those kinds of speculations. I'm not scared. I think this would offer at least short to midterm opportunities for us if it was ever to happen, but I do not participate in the speculation.

## Unverified Participant

Ladies and gentlemen, the conference is about to end. Should you still have further questions, we kindly ask you to contact our Investor Relations Department. Thank you and good-bye.

**Operator**: We'd like to thank you for participating at this conference. The recording of this conference will be available for the next seven days by dialing Germany 49-1-805-2043-089 via reference number 442066#. I repeat Germany 49-1-805-2043-089 via reference number 442066#. Thank you. We are looking forward to hear from you again. Good bye.