

DEUTSCHE TELEKOM

IFRS 16 ACCOUNTING CHANGES

Webinar February 4, 2019



LIFE IS FOR SHARING.

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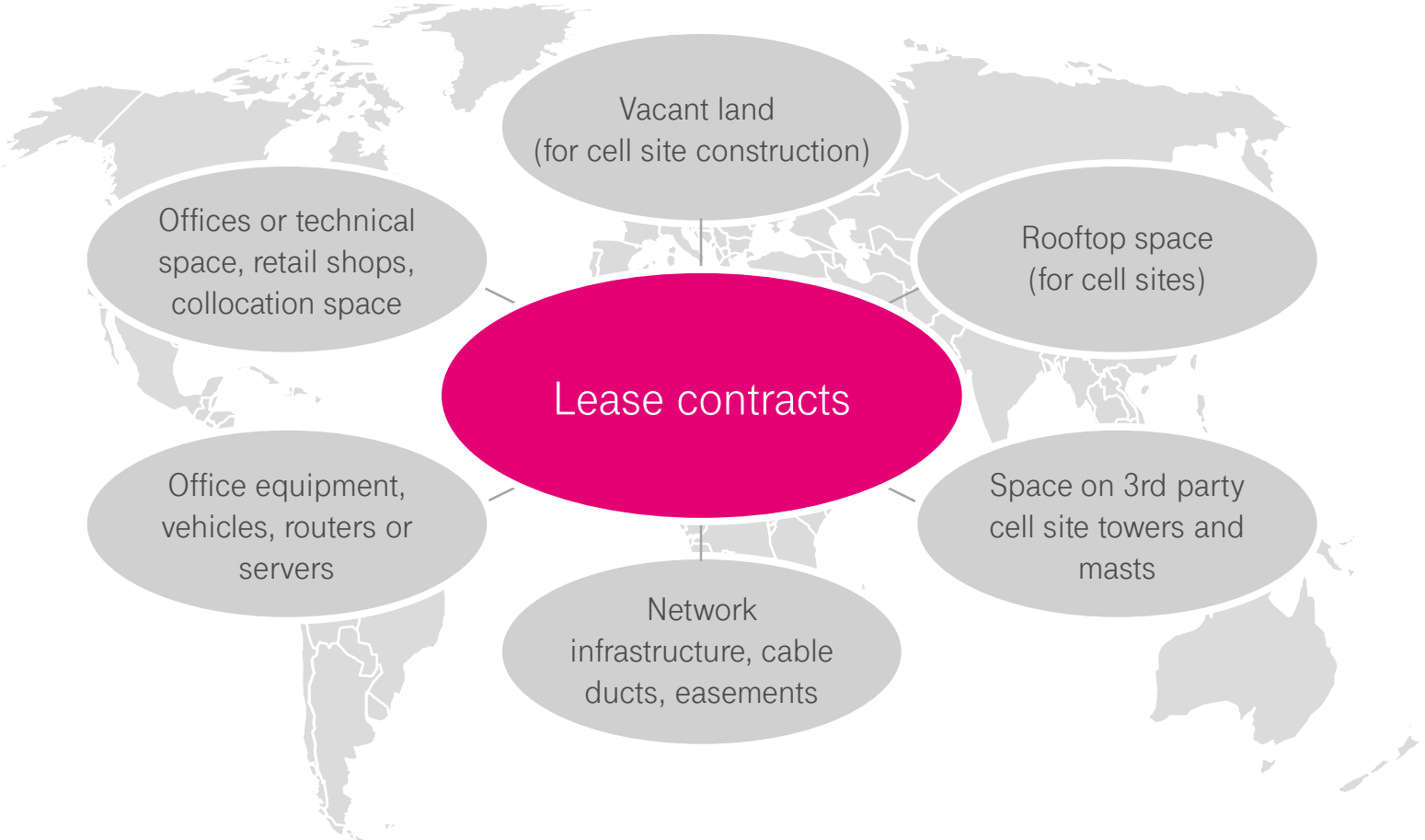
In addition to figures prepared in accordance with IFRS, Deutsche Telekom also presents alternative performance measures, including, among others, EBITDA, EBITDA margin, adjusted EBITDA, adjusted EBITDA after leases, adjusted EBITDA margin, adjusted EBIT, adjusted net income, free cash flow, free cash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



2019 ACCOUNTING CHANGES: INTRODUCTION

- Current accounting standards on leases will be replaced by **IFRS16**
- Standard will have **effects on P&L, CF statement (incl. FCF), balance sheet (incl. net debt)** on group and segment level
- **No restatement** for 2018 or earlier periods
- Introduction of the new KPIs **adj. EBITDA after leases (adj. EBITDA AL)** and **FCF after leases (FCF AL)** to ensure comparability of periods
- Approach is coordinated with our European peers
- First reporting date under new standards will be Q1/2019 results in May 2019
- Guidance for 2019 (given with FY results end of February) on group and segment level will be based on new KPIs **adj. EBITDA after leases** and **FCF after leases**

OVERVIEW LEASES: MAIN LEASE ACTIVITIES IN DT GROUP



FORMER LEASE ACCOUNTING RULES (IAS 17): FINANCE LEASES VS. OPERATING LEASES

Accounting of the underlying leasing object at the party which takes the majority of the risks and rewards. If lessee has majority of risks and rewards, it is a finance lease – otherwise it is classified as an operating lease.

Finance Leases

Lessee:

- Carries the majority of the risks and rewards in the underlying lease asset
- Is the economic owner but not the legal owner of the underlying leased asset
- Recognizes the underlying asset and the financial liability on the balance sheet

Lessor:

- Recognizes a lease receivable and derecognizes the underlying lease asset
- The difference between the lease receivable and the carrying value of the derecognized lease asset is a gain or loss from the transaction

Operating Leases

Lessee:

- Has an obligation to make ongoing lease payments

Lessor:

- Continues to have the majority of the risks and rewards in the underlying lease asset
- Recognizes the underlying lease asset and recognizes the monthly lease payments as lease revenue; as well as depreciation charges from the lease asset.



NEW LEASING RULES (IFRS 16): CHANGES FOR LESSEES (RECOGNITION AND MEASUREMENT)

Right-of-use model:

- Elimination of the risk and reward approach
- Lessor transfers a right-of-use of the underlying asset to the lessee
- Recognition of the right-of-use asset on the balance sheet of the lessee as well as recognition of a financial lease liability to make lease payments for the lessee

Subsequent measurement:

- Right-of-use asset will be depreciated regularly (typically on a straight-line basis)
- Depreciation over the shorter period of lease term or useful life
- Lease payments reduce the financial lease liability
- Interest on remaining balance of the lease liability increases the carrying amount of the financial lease liability (unwinding of discount)

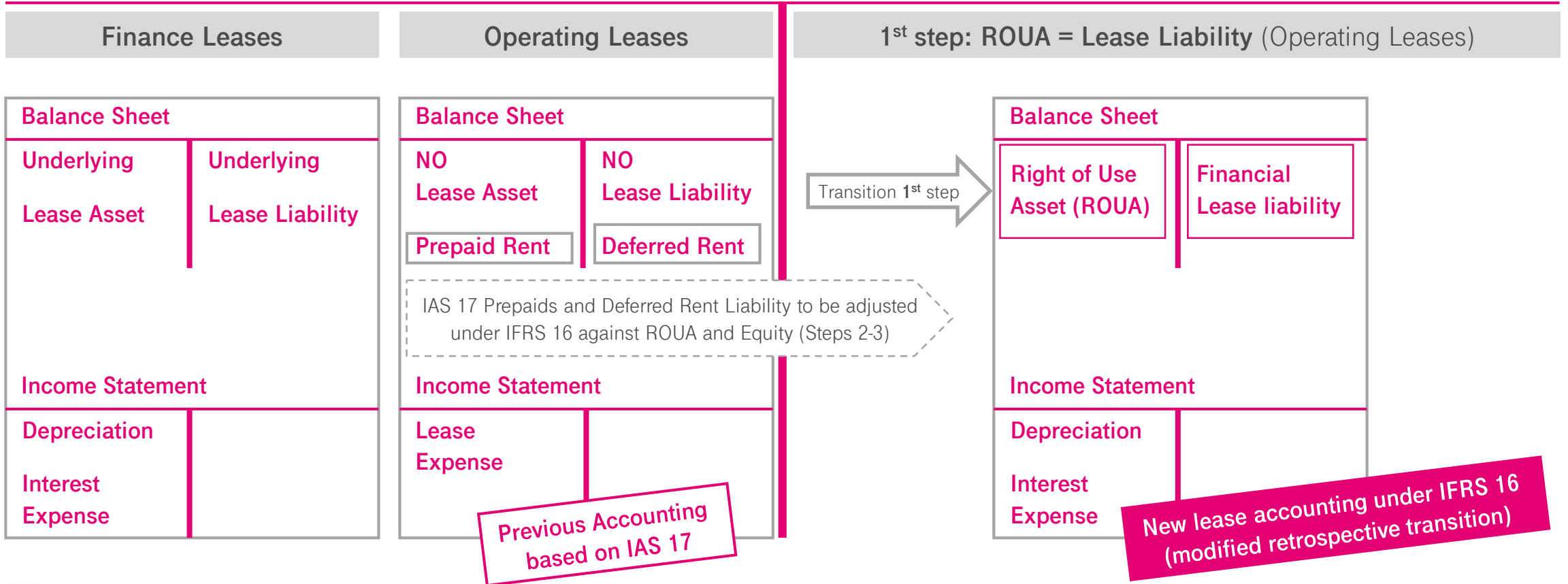
Increase in EBITDA: elimination of operating lease expense (OPEX) and increase in EBITDA due to depreciation and interest expense under IFRS 16.

Increase of total assets and financial liabilities (net debt) on the balance sheet.

Increase of FCF as former operating lease payments are replaced by repayments of financial liability.

NEW LEASING RULES (IFRS 16): SUMMARY FOR LESSEES – 1/2

Lessees



NEW LEASING RULES (IFRS 16): SUMMARY FOR LESSEES – 2/2

Lessees (IFRS 16)

2nd step: Recast existing IAS 17 deferred rent liability against equity

Balance Sheet	
	Equity
Right of Use Asset (ROUA)	Financial Lease liability
Income Statement	
Depreciation	
Interest Expense	

← 2nd step

3rd step: Reduce ROUA for existing IAS 17 prepaids + remaining accruals

Balance Sheet	
	Equity
Right of Use Asset (ROUA)	Financial Lease Liability
Income Statement	
Depreciation	
Interest Expense	

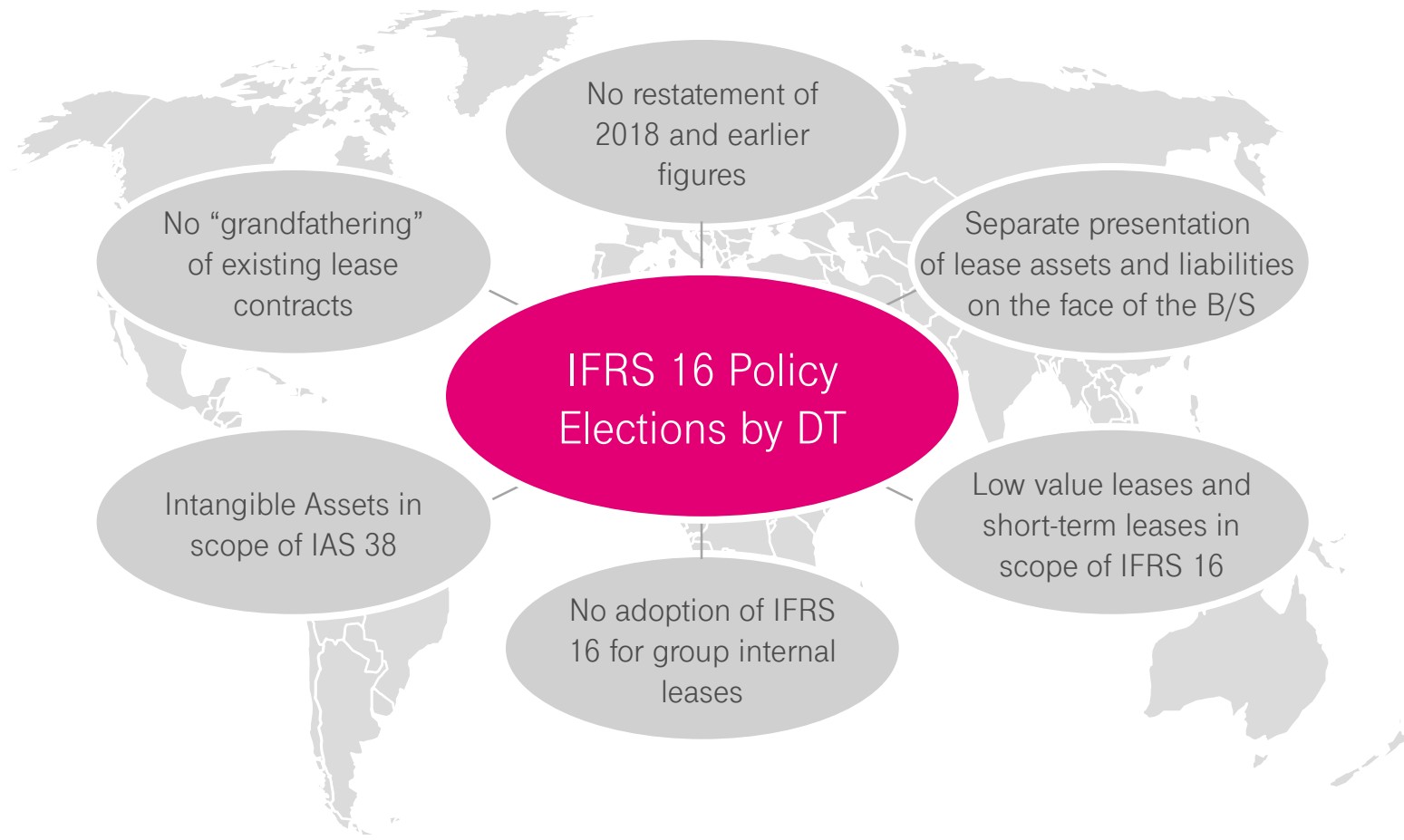
→ 3rd step

Total implementation effect:

Increase in equity and lower ROUA than lease liability



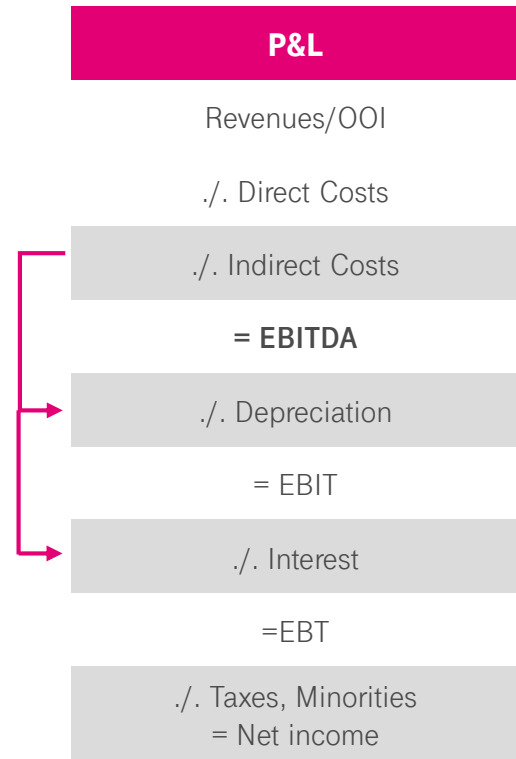
IFRS 16: SELECTED POLICY ELECTIONS AND DECISIONS BY DT



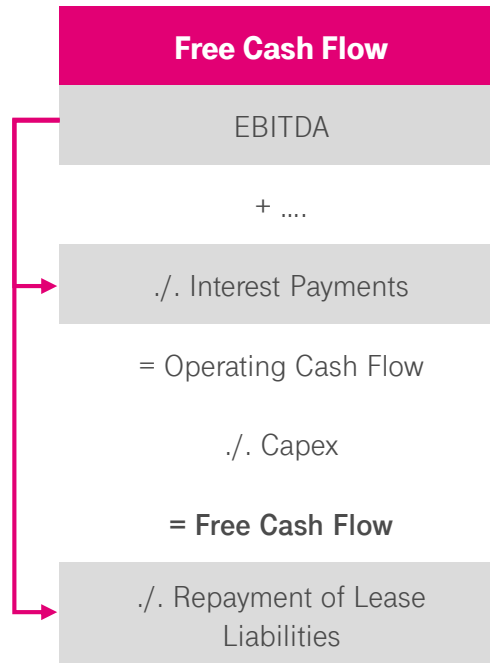
IFRS 16 – IMPLEMENTATION IMPACT ON 2019 IFRS FINANCIALS

	KPI	IFRS 16 impact
P & L	Unadjusted EBITDA	<ul style="list-style-type: none"> ↑ Depreciation charges and interest expense recorded instead of operating lease expense ▪ Depreciation and interest add back leads to significant improvement in unadjusted EBITDA
	Profit from operations (EBIT)	<ul style="list-style-type: none"> ↗ IAS 17 operating lease expense is replaced by depreciation and interest expense ▪ IFRS 16 interest expense portion is added back and will improve EBIT
	Interest Expense	<ul style="list-style-type: none"> ↗ Recognition of interest expense on the lease liability ▪ Interest used to be implicitly included in IAS 17 operating lease expense
Cash Flow Statement	Operating CF	<ul style="list-style-type: none"> ↗ All interest payments are recorded as a reduction in operating CF (general DT policy) ▪ Improvement not to same extent as EBITDA; only principal portion of lease payments improve oCF; no significant IFRS 16 impact resulting from interest portion of payments
	Financing CF	<ul style="list-style-type: none"> ↗ Principal portion of lease payments will increase net cash used in financing activities and no longer affect net cash from operating activities when making operating lease payments.
	Investing CF	<ul style="list-style-type: none"> → Not affected by IFRS 16 implementation
Balance Sheet	Financial Liabilities	<ul style="list-style-type: none"> ↑ Significant increase in financial liabilities due to recognition of lease liabilities ▪ Increase in lease liabilities will lead to a corresponding increase in net debt
	Total Assets	<ul style="list-style-type: none"> ↗ Significant increase in total assets due to the capitalization of right-of-use lease assets. ▪ Increase in ROU assets will be lower than lease liabilities because IFRS 16 requires adjustments for existing IAS 17 balance sheet positions (prepaids and accrued liabilities)
	Equity	<ul style="list-style-type: none"> ↗ IAS 17 deferred (straight line) rent balance at TMUS will be recast using IFRS 16 lease terms ▪ Instead of adjusting ROUA, recast portion of deferred rent balance is adjusted against equity

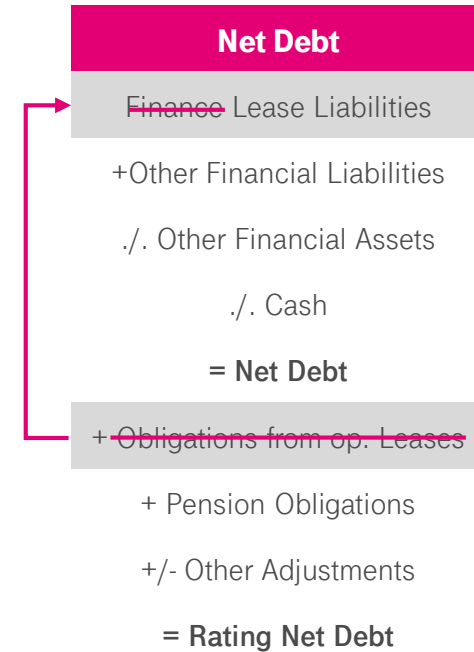
IFRS 16: IMPACTS ON DT GROUP IN DETAIL



- EBITDA-Increase caused by the shift from operating expenses to investing activity (depreciation/interest)
- Leasing impact below EBITDA; net income (and EPS) with slightly negative impact



- FCF-increase by shift from operating cash flow to cash flow from financial activities
- Leasing impact outside of investing activity and Free Cash Flow
- Cash Capex remains unchanged



- Increase Net Debt by shift from off balance sheet financing to debt financed invest activity
- Rating Net Debt remains almost unchanged

IFRS 16: NEW (MAJOR) STEERING KPI'S (1/2)

EBITDA After Leases

Indirect Costs After Leases

Adjustment for all lease transactions¹
 (“previous” finance leases and “new on balance”-operating leases)

P&L	
EBITDA	Indirect Costs
Lease Adjustments Indirect Costs	Lease Adjustments Indirect Costs
- Depreciation RoU	- Depreciation RoU
- Interest Expense Leases	- Interest Expense Leases
= EBITDA AL	= Indirect Costs AL

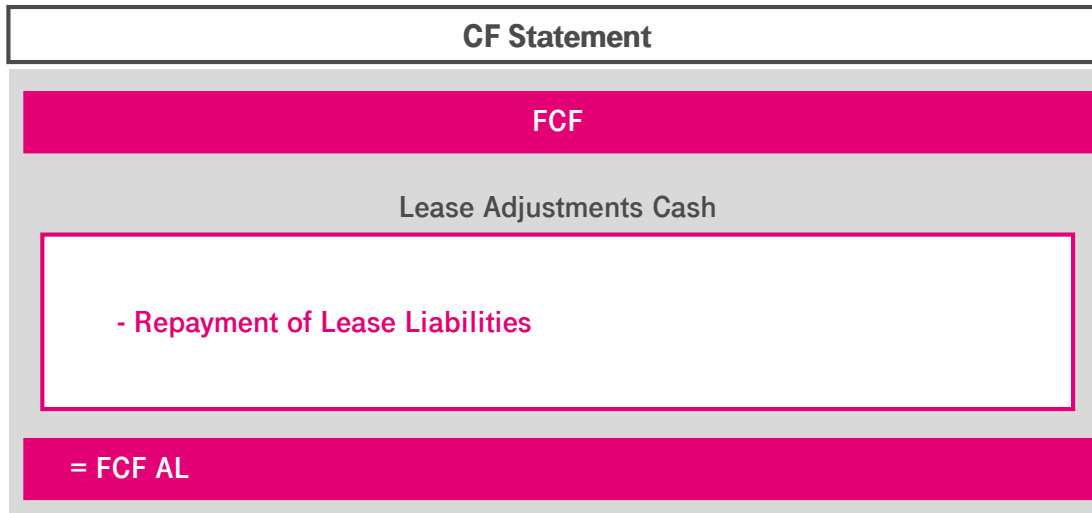
1) Except TM US Finance Lease Transactions

- Lack of consideration of leasing transactions in EBITDA, i.e. leasing transactions outside of steering focus
- **Main objective of KPI “EBITDA After Leases”:**
 - Focus on cash view
 - Comparability to Peers
- **Differences compared to prior accounting under IAS 17 can occur mainly by the following effects:**
 - Effects of interest accrual are higher in early periods than in later periods (Timing-Effect)
 - First time consideration of former finance leases (except TM US)

IFRS 16: NEW (MAJOR) STEERING KPI'S (2/2)

FCF After Leases

Adjustment for all lease transactions¹
(“previous” finance leases and “new on balance”-operating leases)



1) Except TM US Finance Lease Transactions

- **Main objective of KPI “FCF After Leases”:**
 - Comparability to Peers
 - Consideration of repayments of lease liabilities within FCF AL provides an even more cash oriented view
- Differences compared to prior accounting under IAS 17 can occur by the **first time consideration of “previous” finance leases** (except TM US)

FINANCIAL STATEMENT TREATMENT IFRS VS. US GAAP

IFRS 16

- All leasing contracts are **on balance** (asset and corresponding liability)
- All leases will be treated as **financial leases**
- Leasing expense from operating leases will be substituted by depreciation and interest, i.e. **EBITDA increases**
- Payback of leasing expense will be presented within Cashflow from financial activities, i.e. **Free Cash Flow increases**

US GAAP ASC 842

- All leasing contracts are **on balance** (asset and corresponding liability)
- Rights of use can be still distinguished between operating and finance leases
- No treatment change in terms of profit and loss, amortization of right of use asset and interest will be treated as Opex, i.e. **EBITDA remains unchanged**
- No treatment change in terms of Cash Flow; Leasing expense will be presented within Cash Flow from operating activities, i.e. **Free Cash Flow remains unchanged**

To ensure comparability of the new “After Leases” KPIs with EBITDA and Free Cash Flow of T-Mobile US according to US GAAP **expenses and payments for former finance leases of TM US will not be deducted** from Group EBITDA AL and Free Cash Flow AL



IFRS 16: 2018 AFTER LEASES PRO FORMAS

We expect no significant deviation from previously disclosed figures.

	<u>Guidance 2018</u>	<u>Estimated 2018 “AL” Figure</u>
Adj. Group EBITDA	around 23.6 bn €	around 23.3 bn €
<i>Adj. EBITDA excl. TM US</i>	<i>around 13.2 bn €</i>	<i>around 12.9 bn €</i>
<i>Adj. EBITDA TM US</i>	<i>around 11.7 bn US\$</i>	<i>around 11.7 bn US\$</i>
Group FCF	around 6.3 bn €	around 6.1 bn €

All figures based on current guidance and guidance f/x rate! Mind that the assessment of the accounting changes impact is still of preliminary nature and may be subject to change!



IFRS 16: 2018 AFTER LEASES PRO FORMA DETAILS

Also on segment level no significant deviation to previously communicated figures expected

	<u>Guidance 2018</u>	<u>Estimated 2018 “AL” Figure</u>
Adj. EBITDA Germany	8.6 bn €	8.5 bn €
Adj. EBITDA Europe	3.8 bn €	3.7 bn €
Adj. EBITDA Group Development	0.9 bn €	0.9 bn €
Adj. EBITDA T-Systems	0.4 bn €	0.4 bn €

All figures based on current guidance and guidance f/x rate! Mind that the assessment of the accounting changes impact is still of preliminary nature and may be subject to change!



ADDITIONAL REMARKS

- We will communicate net debt and the net debt/adj. EBITDA ratio based on the IFRS 16 results
 - Consequently we will also adjust our net debt/EBITDA ratio corridor to match the changes implied by the new accounting standard
 - As additional information we will also communicate a net debt figure without leases to ensure comparability
- Please keep in mind that in 2019 we will fully consolidate Tele2 in the Netherlands and UPC in Austria. UPC was in 2018 only included for 5 months. Tele 2 transaction closed on 2nd of January 2019

THANK YOU!