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Deutsche Telekom AG (DTE.DE)

Q3 2015 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Timotheus Höttges
Chairman-Management Board & CEO

Q3 REVIEW

- And welcome everybody to this conference call here today, and I like to start to my key messages on first slide
- In this quarter, like in the previous one, we made very good progress towards our guidance for this year and towards the strategic targets we communicated to you at this year's Capital Markets Day
- We are very happy to reiterate our guidance and these targets today

Revenue and EBITDA

- Our financials are growing strongly, most of them by the way double-digit
- Our revenue grew by 9% year-on-year
- Our adjusted EBITDA grew by almost 13%
- Our organic EBITDA growth was 8.1% and even faster than the 6.7% growth in the last quarter
- Our FCF was €1.3B, up 16% year-on-year

- It was another of better than expected performance in our core KPIs
- In the U.S., we simply won't stop
- We gained 2.3mm customers and extended our lead over Sprint
- We raised our 2015 subscriber guidance for the third time this year and again without changing our financial guidance

Germany

- In Germany, we made good progress
- Our line losses of 83,000 was the lowest in 11 years
 - And we added 235,000 broadband subscribers in the nine months, of which 78,000 came in Q3
- Remember, at the beginning of the year we promised that we come up with higher numbers than the quarters 2014
- Our strong KPIs are driven by our network investment, but also reflect the success of our Magenta1 bundle offers where we now have 1.6mm customers after one year
- This is, by the way, already half the way towards the 2018 target we shared at the Capital Markets Day
- The success of our conversion offers impact our headline service revenues, but our underlying trends remain healthy and our mobile service revenues are on track for our medium term guidance
- While we delivered strong financials, we added almost 3mm German lines to IP in the first nine months, on track for completion of this very ambitious project at the end of 2018

LTE AND FIBER NETWORKS

- As you know, we are not only investing in an industry-leading all-IP migration, we are also rapidly building out our LTE and fiber networks
- We now reach half of German homes with fiber, a coverage increase of 10 percentage points within one year
- In the last 12 months, more than 1.6mm new German homes choose our fiber network
- At the group level, we invested almost €8B in the first nine months, a double-digit increase on the prior year, 15.5% increase
- As I have mentioned, while we are tracking ahead on many core KPIs, we are happy to confirm our financial targets
 - This is due to our strict cost control

EBITDA

- In the U.S., despite the faster-than-expected subscriber growth, we continue to expect \$6.8B to \$7.2B of EBITDA this year
- In Germany, despite the faster than expected growth in fiber all-IP and Magenta1, we still expect €8.8B of EBITDA this year
- At the group level, we reiterate our guidance for €18.3B adjusted EBITDA and €4.3B FCF
- As you know, our guidance is based on last year's average exchange rates and excludes the €175mm one-timer, we reported in Q1
 - If we were to use the YTD average dollar exchange rate, our EBITDA guidance will translate into [ph] €19.3B (4:44)
- And we remain happy with the current consensus expectations of €4.4B FCF this year which compared to €4.1B in 2014

Transactions

- We also successfully concluded a number of small, but interesting transactions in recent months
- Our deal with t-online shows how we embrace the best ownership principle while we create strategic options
- The launch of our direct-air-to-ground project demonstrates our passion for seamless connectivity on the ground, on the move, and in the air
- And at the end of last quarter's call, I emphasized our commitments to cut costs and to monetize of our network, and I'm pleased that our cost discipline allows us to grow our cash flows while we are investing record amounts
 - But we will always try to do more
- And for the monetization of our network, clearly we are very pleased with our customer momentum
- But again, there is clearly more that could be done

MagentaEINS

- In this context, let me say a word on our MagentaEINS convergence propositions which are attracting a lot of attention
- MagentaEINS is tracking well ahead of our initial plans
- We have already more than half the customers after one year that we were hoping to have after four years
- Our revenues per MagentaEINS households are higher than before due to successful cross and up-selling
- When it comes to the discounts, you have to look at the total picture
- Rather than increasing our promotional spending MagentaEINS bundled benefits have replaced other previous discounts
- And because of the success of MagentaEINS, we have since been able to additionally remove various discounts this year
 - I'll give you an example
 - For instance, at the beginning of September we have halved our promotional period for our VDSL offers
- And since November, we have also discontinued our regional broadband promotions
- But precisely because of the success of our MagentaEINS propositions, we now have the ability and will continue to increasingly shift the focus on monetization going forward

FINANCIAL RESULTS

- Slide five summarizes our core financials
- As already mentioned, we achieved strong headline and organic sales growth
- Driven by our double-digit EBITDA growth, our earnings grew by 30%
- Despite our increased investments, our FCF grew by 16%
- The year-on-year increase in our net debt is mainly the result of spectrum investments and currency effects, but our debt declined sequentially and as promised, we are back within our target corridor
- In summary, we're very happy with our operational performance YTD
- We are able to accommodate major long-term investments while we achieved some very strong customer metrics and confirm our full-year financial guidance

TRANSACTIONS UPDATE

Approval of the BT-EE Merger

- The next slide provides a bit more detail on three interesting transactions in the quarter
- Before I touch on this, let me say that we are very happy with last week's decision by the UK antitrust authority, CMA to recommend the approval of the BT-EE merger without remedies
- We believe this merger is a great opportunity to create value for our shareholders and deliver an ever better customer experience
- In August, we gave our t-online general interest portal to Ströer, one of Germans – by the way, the German's leading outdoor advertising company, in exchange for 12% of the equity and [indiscernible] (9:08)
- We are very happy with this strong partner and see sustainable strategic benefits from future collaboration, for instance, the increased visibility of the T-brand in the out-of-home furniture of Ströer
- This transaction shows again how we are happy to exchange control for strategic upside where it makes sense
 - In a much smaller transaction, we also agreed an exit from our phonebook publishing business DT Media
- In 2013, we had sold 70% of Scout24
- We use the recent IPO to further monetize this asset and have now raised over €2.1B from this successful investment
- We are still participating in futures upside through our remaining 14% stake

Partnership with Inmarsat

- In September, we announced a highly innovative partnership with Inmarsat to provide hybrid LTE satellite connectivity to European Airlines, starting with our launch partner, Lufthansa, in 2017
- Across whole Europe, we will operate 300 new base stations to provide the customer experience similar to the comfort of high-speed broadband at home
 - Like our hybrid router, this project shows how we deliver on our passion for superior and seamless connectivity
- By the way, this air-to-ground service is coming with bandwidth of 4G speed in the vicinity of 75 megabit per second in a flying plane
- And there are 22,500 planes which are traveling across Europe every day

Concluding Comments

- And, finally, please let me use this opportunity to reiterate our stated European M&A policy
- We are not looking at major acquisitions outside of our footprint
- We believe our recent transactions provide compelling evidence that we are highly committed to pursue M&A only where there is a clear opportunity to create value for shareholders

Thomas Dannenfeldt

Chief Financial Officer

GERMANY HIGHLIGHTS

- And as always, I'm going to start with Germany
- Our sales in Germany were stable
- While growth in our handset revenues was lower than in previous quarters, obviously here due to less spot market sales, our total mobile fixed service revenue momentum improved sequentially
- The margin was 41% in the quarter with the year-on-year decline largely driven by growth in handset sales and transformational cost

Adjusted EBITDA

- Adjusted EBITDA declined by 2.4% year-on-year as a result of cost saving
 - But we firmly reiterate our target to achieve stable €8.8B EBITDA this year
- While our mobile service revenues declined slightly y-over-y, we believe, nevertheless, we outperformed our peers
- Our contract subscriber momentum was steady with close to 400,000 net adds

Mobile Service Revenues

- So now, let's have a look at the German mobile service revenues
- Year-on-year, our reported mobile service revenues declined marginally
- But we are not worried because this mainly reflects the success of our Magenta bundle offers and we're not seeing any major change in the market environment nor in our underlying trend
- As you know, we report our Magent1 bundle discounts in mobile revenues as well as the migration from LTE broadband to our new hybrid router, which are then booked in fixed
- The combined impact from these convergent propositions on our reported mobile service revenue growth further accelerated for 1 percentage point last quarter to 1.4 percentage points this quarter, largely explaining the sequential slowdown

Broadband Net Additions

- Now, let's turn to the fixed line
- We had another excellent quarter of broadband net additions
 - And remember, Q3 is normally our toughest quarter
- Last year, we lost broadband customers
 - This year, we added 78,000
- Tim has already mentioned our continued strong growth fiber momentum. 425,000 additional households opted for our network, bringing the YTD net additions to 1.3mm with a majority in our brand
- Helped by our strong broadband momentum, our line losses diminished further to only 83,000, our best performance in over a decade
- Positively, driven by our successful retail up-selling strategy, retail broadband revenue momentum has now turned firmly positive
- Benefitting from this, our core fixed revenue declined by 2% compared to minus 2.7% in the last quarter

German Service Revenues

- On the next slide, we want to provide some additional perspective on our German performance

- Last quarter we introduced the concept of total German service revenues, defined as all mobile service, wholesale and core fixed revenues excluding the devices
 - These were down only 0.6% this quarter, and that is an improvement compared to the last quarter benefitting from a better broadband and a better wholesale revenue momentum
- Bigger picture, we can see that as a result of steadily improving broadband revenue momentum we are tracking around a 1% decline this year, which is more than half of a percentage point better than last year
- Broadband revenues are well on track for our 2% annual growth guidance we provided at the Capital Markets Day and wholesale revenue are well on track for stability as promised
- So, while there are many forces at work here, we see our KPI trends going in the right direction
- And we remain confident with our guidance for total annual German revenue growth of 0.3% between 2014 and 2018 we gave in Feb

Investments in High-Speed Infrastructure

- As we discussed at our Capital Markets Day, we are accelerating our investments in high-speed infrastructure
- By the end of the quarter, we reached every second German fixed line household with fiber adding 10 percentage points of coverage in one year, where LTE coverage increased to 87%
- In the quarter, we added 0.9mm lines to our IP footprint, and we now already have 8.6mm homes on this platform in Germany, one-third of our total lines
 - With this, we are again well on track towards our 2018 target

US HIGHLIGHTS

- Now, turning to the U.S., let me quickly summarize the highlights of the quarter
- I think all relevant numbers were already reported and discussed by the U.S. team, but it's helpful I think to summarize the key messages
- T-Mobile U.S. added 2.3mm customers this quarter
 - Of these, 1.1mm were branded postpaid net adds
- Importantly, TMUS raised its 2015 branded postpaid subscriber growth guidance for the third time this year to between 3.8mm to 4.2mm
- This is up from 3.4mm to 3.9mm at the half-year stage and compared to 2.2mm to 3.2mm at the beginning of the year
- Again, while we raised our subscriber guidance, we did not change our EBITDA forecast

Revenue Growth

- Revenue growth slowed sequentially to 7% year-on-year, and this was mainly due to the recent introduction of JUMP! On Demand on our equipment sales
- Leasing revenues were below €50mm in the quarter
- Service revenue growth remained double digit at almost 12%
- And our branded postpaid phone ARPU was stable sequentially
- Despite the strong growth, U.S. EBITDA growth accelerated further to 41% from 23% last quarter
- Handset leasing contributed little to this improvement
- And let me again clarify here the treatment of handset leasing to avoid any misunderstanding
 - The impact from handset leasing will be excluded and is excluded from our restated guidance
- And as we have promised, we will be fully transparent on the accounting effects here

- On the next slide, we are showing how some of the key drivers of our U.S. businesses are developing
- We had another quarter of declining churn, with branded postpaid churn again down a record 18BPS y-over-y
- Porting ratios remain positive against all carriers

Bad Debt Expenses

- After meaningful decline last quarter, bad debt expenses ticked up this quarter, but they remain under control
- Our LTE network already now covers the 300mm POPs we targeted by the end of the year
- And our low band 700-megahertz frequencies covering 60% of the U.S. population has already been deployed for nearly 175mm people
 - They are beginning now to become commercially relevant
 - Positively, the new iPhone supports these frequencies
- Despite our network expansion, our cost of service declined more than 4 percentage points year-on-year, benefiting strongly from MetroPCS merger synergies
- So, back across the Atlantic to Europe

European Segment

- Our European segment reported a 3.6% revenue decline
- Compared to the previous quarters, GTS has now rolled over while the planned unwind of our discontinued business continues to be a headwind
- Organic revenues declined 3.7% year-on-year after 2.7% last quarter
- On a country basis, we remain particularly pleased by our performance in Hungary and Greece
- Meanwhile, our Dutch business continues to be impacted by intense competition and the rollover of the split contract launch
- We're responding to this through innovative product offers and through investment in what we believe is the leading LTE network in the country
- On a reported basis, adjusted EBITDA declined by 3% this quarter after 2.6% last quarter, mainly reflecting the rollover and the deemphasizing of split contract plans
- We continue to make good progress towards the targets we presented at our Capital Markets Day
 - 45% of lines are now on IP in terms of our technology leadership, up from 35% last year
- Our broadband customer base grew by 5%, our TV customer base by 4%
- Our LTE networks now cover 65% of the population, up from 42% one year ago, and we already cover 18% of homes with fiber

T-Systems

- Now, turning to T-Systems, our results reflect our ongoing restructuring at the market units, as well as continued cost savings delivered by Telekom IT
- Gross revenues grew by 2.3% after decline of 1% last quarter
 - This benefited from 5% year-on-year growth at our market unit
- We are especially pleased with our cloud services where [ph] DT grew (20:40) 30%, and achieved €1B of sales in the first nine months
- Revenue growth also benefited from the toll collection system in Belgium

- Systems Solution EBITDA declined year-on-year this quarter but this reflects mainly the phasing of launch costs
- When you look at the first nine months, the market unit has delivered 16% EBITDA growth

GROUP FINANCIALS

FCF and Net Debt

- Now, let's move on to our group financials for the quarter
- FCF grew 16% year-on-year and we remain comfortable with the current consensus expectation for this year
- As mentioned, we were able to deliver this increase despite a significant increase in our investments
- Our net debt diminished sequentially, mainly as a result of our positive FCF
- The adjusted net income grew by 30% to €1B, mainly as a result of our strong EBITDA growth

Balance Sheet Ratios

- Finally, a few words to our balance sheet ratios
- At the end of this quarter, we returned to €2.5B in net debt over adjusted EBITDA as we promised, down from €2.6B at the end of the last quarter
- Our ratings remained stable at BBB+ and are well within our comfort zone with ranges from, as you know, BBB to A-
- We believe our debt ratios should be seen in the context of a very strong EBITDA growth in the U.S. and the group level
- So, we believe this quarter shows that we are executing our strategy as we presented it to you at the recent Capital Markets Day and as it is laid out on this slide

QUESTION AND ANSWER SECTION

Dominik Klarmann

HSBC Trinkaus & Burkhardt AG (Broker)

Q

Firstly, just on MagentaEINS, what's the up-selling momentum at the moment? So, how much of the €10 discount are you able to offset vs. I think about €5 run rate in previous quarters? And why do you still feel you need that €10 euro headline discount? And then secondly, just on German fixed. Now that we have that rather positive decision by BSA on bitstream regulation last week, where do you want to price Layer 2 vs. Layer 3 bitstream? And what's your expectation on the still pending vectoring decision?

Thomas Dannenfeldt

Chief Financial Officer

A

I'll take the first question. First part of your question was up-selling momentum in MagentaEINS. We are now talking about €6 to €6.5 up-sell after transaction. So, if you take the revenue of a household before the transaction, you take it after the transaction, actually there is a plus €6.5. So, momentum is – so positively, so to say, accelerating vs. what you've seen in February and in the middle of the year. On the discount, Tim mentioned that several times, and the debate we have in here internally, obviously, is all around monetization. But the way we look at it is we look completely at every promotional element and discount we give. And Tim mentioned that we've taken out the 24 months promotional period in, I think, on September, moved it down to 12 months. We took out, Q2 already, the free routers. We're now removing the extra promotion in some regional areas. So, the way we look at it is not solely on that specific discount element, but the complete sum of all the parts. And we feel there is room to maneuver and that's why we've taken it off. So far, we keep that discount as it is because the transaction per se is very accretive, as I said, it's €6.5 after transaction plus.

Timotheus Höttges

Chairman-Management Board & CEO

A

Yeah, Dominik, first question on the bitstream access regulation here. The first thing, this is an ongoing process. It's a negotiating process. We made some documentations here and we're in a discussion here with the different parties. The Bundesnetzagentur decided on October 29 that fees for the Layer 2 and the Layer 3 bitstream access will be subjected to uniform regulation by the centers of – abuse of dominance. So, because of the future importance of Layer 2 bitstream, Telekom Deutsche must submit the Layer 2 bitstream charges always ahead to Bundesnetzagentur for approval. So, this is, I'd say, the formal wording on this one, and we're in the middle of this process. But my stomach tells me is the following. The market the politicians enjoy that it seemed at least Deutsche Telekom investing heavily to infrastructure. And this is a good momentum. Overall, we see more CapEx in the market due to the better regulatory framework, which we all enjoyed over the last two years. So, I do not see any kind of aggressive tendencies to negatively influence this track record. Now, going to the third question of vectoring, look, I made that clear in the German press. We have a debate on regulatory and politically industry policies here. And we simply forget one thing: the customer. There are areas in the vicinity from 65% to 80% of the POPs in Germany who are not able to enjoy high broadband connectivities. And Deutsche Telekom made clear, we see a way to invest almost €1B into these areas and to support broadband infrastructure up to 250 megabit, so this is vectoring and vectoring plus technologies in this areas, just from our house. And the only thing what we need is the allowance from the Bundesnetzagentur for this so called [indiscernible] (27:54). And now that said, I think there are no good arguments so far from our competition, because you know we simply need this investments. If they are able to do it, fine. We make it legally binding to the government that we are committed to this one that this is not just getting any kind of regulatory advantages here, that we are really committed to do so up to 2018. And now we will see how the decision is getting taken. We expect something coming faster than

waiting longer, but we have to admit that there is the Bundesnetzagentur and a separate decision body within this Bundesnetzagentur who is in charge of that and we should wait for the decisions from this [indiscernible] (28:53).

Q

could you please comment on the fall in German contract net adds and the increase in contract churn and whether there are any technical factors behind this?

Thomas Dannenfeldt

Chief Financial Officer

A

Yeah. Maybe I start with the contract churn side. Reported contract churn was 1.9%. I'm going to split it up for you, so it's easy to understand what's going on here on that level. The contract churn on B2C on our branded side last year was 1.0% and it's 1.0%, so there is no change on the B2C side basically on the contract churn. There are two elements which influenced that number and moved it up. The big one is MVNO element in churn. Here, a big chunk of that one. Then, there is a smaller one which is 20,000 of hybrid router LTE – LTE router to hybrid router. And then, there is a larger account we lost in Q3 which is roughly 25,000. And that is influencing the churn in Q3. So, there is no general negative trend behind, but as I said, MVNO element and that specific large customer. And that is also related then to the net adds. You've seen the net adds declining roughly year-on-year by 90,000. As I said, 20,000 is LTE router to hybrid router. 25,000 is the major account we've lost. And then, there is another 40,000 roughly on a promotional tariff plan from last year where we had very low level of ARPU behind which is booked also at other elements on the net adds.

Hannes C. Wittig

Head-Investor Relations

A

Okay. So I understand that we are back with the ability to take your questions in person. While you get ready for that, let me just read out a question from Jon Dann at RBC. Jon asks, first, do you expect the German broadband momentum to continue beyond the year 2015. And secondly, he would like to know whether our CapEx in Germany could possibly drop below €4B given our technology benefits that we have from vectoring. So Thomas, maybe you can help us with that.

Thomas Dannenfeldt

Chief Financial Officer

A

Yeah. First question, well, momentum in 2016 is yes. And second question, below €4B, is no. We clearly said on the Capital Markets Day is we're going to grow FCF while we grow the CapEx because the investment need for more bandwidth is there and we will go for that.

Ulrich W. Rathe

Jefferies International Ltd.

Q

Two questions, please. The first one is could you comment on the mix of the subscriber intake in mobile, in particular between the branded one between the sort of Magenta and the congstar one. I'd be interested to know, of course, where the mix currently is, but also where that has changed over recent times. My second question is with regards to the MagentaEINS discounts and the fact that you simply add them back in totality to sort of compare that to the midterm growth. I understand that the midterm growth is not a quarterly growth, but if one – I mean, the discounts are permanent, if one adds back some fair share to the mobile trends it still looks as if your mobile growth currently is running a bit below the midterm trend. So would you agree with that? And if yes, what would take the trend back up really towards that 1% even after the sort of the fair allocation of the MagentaEINS discounts also to the mobile business? Thank you.

Thomas Dannenfeldt

Chief Financial Officer

A

Yeah. Let me start with a question on Magenta vs. congstar on that [ph] 144 (36:46) net adds, it's [ph] 50% to 60% (36:50) is Magenta; and roughly, [ph] 90% (36:51) is congstar. That's in terms of net adds, as well in terms of value. Obviously, the value mix is different. It's much more towards Magenta. It was your first question I think. And the second question was, obviously, what will happen is I think it is towards the guidance we've given on the mobile service revenue is 1% guidance, we stick to that guidance. We think we will see that 1% growth next year. And then the midterm as we said, obviously, what will happen is that kicking in an acceleration that positive one of Magenta discounts will have a rollover effect after four quarters and then decline again on the comparison year-on-year.

Hannes C. Wittig

Head-Investor Relations

A

And maybe if I can add a word to this, I would highlight that, of course, our guidance was based on the assumption that we will have 3mm MagentaEINS subscribers, by the year-end 2018. There will be a – have 1.6mm at the end of Q3 2015. So, clearly, the drag is higher because our growth in Magenta is faster. But if you adjust for that, we are completely in line with our medium-term guidance. And if, of course, the Magenta1 growth were to slow down beyond the rollover effect, you would also get less of a drag from that. But, of course, we enjoy the growth in Magenta. So, that's something you should see in the total picture. So, I hope that answers your questions, Ulrich.

Ulrich W. Rathe

Jefferies International Ltd.

Q

Follow Up on the mix question. You answered it very clearly for the current mix. Has there been a material shift in the mix recently in Q3 sort of or this year between the first and second and third quarter?

Thomas Dannenfeldt

Chief Financial Officer

A

No. No. No. It's kind of stable trend during the course of last quarters.

Ulrich W. Rathe

Jefferies International Ltd.

Q

Yeah. Perfect. Thank you.

Hannes C. Wittig

Head-Investor Relations

A

Generally, I think what you should also appreciate when you look at the trend is that last year, in September, we decided to start the Magenta propositions only at €30, so we moved them up in the market. And of course, with the T-brand positioning, you get a bit of an extra momentum in congstar, but that's a very deliberate choice. So, in terms of the quality of the intake, there's no difference to what we have seen or are hoping to see.

Mathieu Robilliard

Barclays Capital Securities Ltd.

Q

First, in terms of the German cost cutting. As you highlighted cost cutting is a bit strong in Q3. You do expect to make that up in Q4. Can you give us a little bit of color as what happened in Q3 and how things can improve in Q4? And the second one has to do again with mobile service revenue trends and the activation of data. One of your

competitors has indicated that the proportion of customers that take more than 1 gigabyte is increasing nicely this quarter. Can you give us a little bit of color as to how these trends are? And also can you reassure us in terms of the competitive environment going to Q4? Thank you.

Thomas Dannenfeldt
Chief Financial Officer

A

Yes, sure Mathieu. So let me start with the EBITDA and I think it was very clear that we stick to our €8.8B stable EBITDA development for Germany which obviously does mean Q4 on a year-on-year basis needs to look much better in 2015 than in 2014. And we are very comfortable with that and confident that we will reach it, A, because basically last year's comparison was very low to be fair. Secondly, in Q3 we had a heavy load on the indirect costs very much related to IP transformation and rollout – the preparation of new infrastructure. We will roll out [ph] 2.0 (41:03), we will bring 2.4mm new households in place in Q4 which were prepared in Q3 already. That is the size of all households in Denmark, just to give you kind of color what that size means. So, that kind of preparation caused higher indirect costs in Q3; that's a simple question of phasing we have in here within the year. What we will not do is reach that €8.8B stable EBITDA by doing compromises on the commercial side. We will not compromise there. So, we will stay with our, I think, competitive setup of products and offers we have and we'll reach that €8.8B. And as I said, it's a matter of phasing of infrastructure build out in IP. That was number one question. Second question was on...

Timotheus Höttges
Chairman-Management Board & CEO

A

So, I'll help you out here, Thomas. The question was on the data usage in the marketplace, and what we see is the moment customers are using LTE, their data consumption is going up. By the way, what we've seen on the consumer side is that the – for the LTE devices, there's a 169% higher data usage than customer without an LTE device. So, what is the message for us on that one? The first one is data consumption is increasing. The second conclusion is there is Moore's Law in our market that the more consumption it is, you have to produce the gigabyte cheaper. And the third one is it has to get balanced in the way that you, over time, increase your ARPU, so overcompensating the volume effect by a price stability. That is, let's say, the intention which we have. And so, it might be that we increase the data volumes over time, but obviously, with the assumption that we could make money out of it.

Thomas Dannenfeldt
Chief Financial Officer

A

Thank you, Tim. And with regard to the competitive environment in Q4, I think we're seeing some promotions right now. But of course, fourth quarter is a quarter that usually has a fair promotional intensity. I think there's a time to sell iPhones, et cetera. But when you look back over the last six to eight quarters, there's no major shift in terms of the commercial propositions that we are seeing in the German market. And we are, of course, hopeful that this will remain the case.

Akhil Dattani
JPMorgan Securities Plc

Q

Two things, please. Firstly, just to follow up on the question on competition. You've talked about how you're unwinding some of your price promotions as an offset to MagentaEINS. And if we look for your result sheet, you've also seen quite a nice reduction in your SACs and SRC as well. So, can you just comment? Is that purely just a function of that or is that also reflective of kind of a more positive view in terms of competition? And I guess related to that, Telefónica Deutschland on their call earlier today seemed to suggest that some of the promotional activity, the low end of the market is eased off and some of these promotions haven't been repeated and

continued. So, just kind of any thoughts and updates around that would be useful. Secondly, just on MagentaEINS and the discount there. You've given us a helpful slide in terms of the overall drag and the way that that's been increasing on the mobile service revenue performance. Just wondered if you could help us understand the evolution of that. Obviously, the momentum is continuing, but next quarter starts to annualize that. So, should we think we're through the bulk of the dilution on service revenues and it's stable to improving? And then just a very last one on – a follow-up from the previous question on mobile data usage. If you have any stats in terms of the overall y-over-y growth in Germany, whether it's accelerating or slowing, that'd be helpful as well. Thanks.

Timotheus Höttges

Chairman-Management Board & CEO

A

Yes. First of all, on the SRCs, SAC, CRC development, I think one element is – in the comparison between last year and this year is for sure that the run rate and the take-up rate of iPhone 6 vs. iPhone 6s. So last year's vs. this year's in especially prolongation of contract is reflected in the CRC spend here. So a part of the reduction you see is related to lower run rates iPhone 6 vs. iPhone 6s and the same hold true by the way on the Samsung side. Another one is that churn is in a good shape that loyalty is increasing also especially by Magenta1, so there's also some positive upside element from Magenta1. As Hannes said on Magenta1 discount a minute ago, on the midterm perspective we've given that guidance of 1% service revenue growth on mobile and that implies that overtime we will see that negative impact becoming lower or diminishing. So we stick to that 1% midterm perspective on the mobile service revenues. And the third one on mobile data usage, Tim mentioned that the question was are what about the more than 1 gig usage in the marketplace. It is basically driven by the new equipments we have in the marketplace. In Samsung S is with 1.1 gig average use of our customer, iPhone is 1.2 gig, the iPhone 6s Plus is with 1.6 gig. So those handsets are by their capabilities consuming more bandwidth, and so it's moving up the consumption obviously.

Hannes C. Wittig

Head-Investor Relations

A

Yes. Just to add a bit of data to that. The usage has grown by about 100 megabytes a month since a year ago in the residential customer base and a bit faster in the business customer base. And the growth is pretty steady quarter-on-quarter.

Justin B. Funnell

Credit Suisse Securities (Europe) Ltd.

Q

A few just small ones, please. As you said on the call, you believe now you've got the best mobile network in the Netherlands and certainly some of the user test support that. What are you going to do with that? Are you going to push harder now at the market share or try and achieve the greatest value on the sale of the asset or perhaps both? Secondly, there's been a few stories in the last few weeks about looking at quality of service in light of net neutrality laws. Just wondering if you could give us big picture size of the opportunity there please. And finally, would you consider doing a tower spin-out given the recent valuations of these assets?

Timotheus Höttges

Chairman-Management Board & CEO

A

The first question is on the Netherlands. Look, it's a bit like déjà vu from the U.S. situation. Over the last one-and-a-half, two years we have built the network on LTE. We have now a great network. The network has now reached a 95% coverage by the end of October, latest LTE standards here. We have restructured the total, let's say, layout and the network is almost empty, so the bandwidth is very high and you saw that in the test. Now what we have to do now is to create the connectivity experience around that that we have restructured our tariff. We have encouraged more commercial momentum in the market. We have done some promotions to announce our

infrastructure and the capabilities which we have. We called it the transfer weeks, which brought us back into the net base growth. So we're doing something now to get a proposition around it. I think price is not the ultimate answer for us, especially if we have a leadership in some categories. And it's anyhow not the smartest answer if you have a fixed mobile convergence play against you. So it is about, let's say, the total proposition. It has a lot to do with the service. It has a lot to do with the branding. So if you would give me, let's say, a ranking, it would be value on services than rather going for the quick gross add numbers here. Now coming to the second question on net neutrality laws, funny thing, because I wrote a blog after the decision and there was some heavy reactions here in Germany from network activists on this kind of quality classes which are now allowed. The specialized services with improved quality in addition to the good Internet extra services is the compromise which was achieved in the discussion between the different [ph] Internet cost (50:48). I think this decision is representing or represent a very balanced compromise. So the optionalities are now given. It's much too early to talk about, let's say, a monetization on that one at that point in time. I think there are certain [ph] industry (51:12) who would have a need for this specialized service. I don't want to reiterate the health industry or the connected car industry, but it could be as well for some of the smaller companies starting up with specialized service who cannot afford having [indiscernible] (51:28) data centers like Google and co have today that this kind of companies are interested on improving their benefit and their quality here. So this is something we're going to offer. Honestly, it's too early to say because so far no service has been launched. But I think the first big step has been taken, promised and delivered from the commission and from the European parliament. And we could be sufficient and let's say satisfied with the outcome of it.

Thomas Dannenfeldt
Chief Financial Officer

A

And maybe to answer on the tower question from my side. There are two parts of the answer. One is obviously towers, we own the towers in Germany, a big tower company, and it's a part of the, what I call, lineup of deleveraging opportunities we're having. It's like the towers – it's like the remaining [indiscernible] (52:30) and so on and so on. So that's obviously one part of it. The other part of the answer is tower company, first of all, has a nice margin, per se. Number one. Number two, it will become more and more important towards 5G that you have control on your locations, on the antennas, on what you can put there, et cetera, et cetera. So it's not just like there are nice valuations right now, let's go for it. That's obviously an opportunity and we consider it, but there is another strategic element of the question, which is looking at 5G and locations. Is that the right way looking forward? So, as I've said, we consider it, but not more so far.

Tim D. Boddy
Goldman Sachs International

Q

I wanted to ask a bit about the impact of Super Vectoring and potentially over time G.fast and how you see that playing through. Obviously, it's very encouraging but you, hopefully, wouldn't have to do Fiber to the Home at huge costs in the near or even the medium term. So I guess the first question is, has this pushed out Fiber to the Home deployment by a decade or more? Secondly, do you think you have enough room in your CapEx envelope to fund Super Vectoring just when you're looking at late next year or into 2017 and then G.fast? Or could we see a near-term acceleration in CapEx to achieve that? And then finally, do you see that as an upselling opportunity for the market to sell higher speeds for higher prices or is it an opportunity to attack cable more vigorously and further accelerate your growth? My second question is around the move to all-IP. This is a cost you're bearing that, actually, all of your peers are not. I wondered if it's possible to talk about your EBITDA growth in Germany YTD if you stripped out that cost of the migration. I'd imagine you'd be growing low-single digits.

Timotheus Höttges
Chairman-Management Board & CEO

A

Let me take the first question, Tim. Look, we go our own way. And by the way, the idea was how could we cover Germany with 50-megabit per second by 2018. And what we see was all, let's say, the technical development space, going to VDSL, going to vectoring, going to vectoring plus, and now we are working on G.fast as well, we see that at a significant lower cost and in a much faster way, we could ramp up bandwidth up to 250 megabit per second in this piece of copper-based technology. This is by the way satisfying more customers immediately. If we talk, for instance, about the vectoring area, which is now under investigation from the Bundesnetzagentur, we're talking about 6.2mm households in Germany, which we could ramp up until 2018 with this technology. Now that said, the moment where we're ramping it up by the way this year, fiber based 3.8mm households in Germany only. So to see how many households we have already ramped up here and there's another 1mm plus households coming by the EOY gives us a huge opportunity and we see that that customers are willing to take that. They are interested in getting, let's say, the bandwidth. And the moment we do that we could even up-sell new services. The classical one is ENTERTAIN. We have seen 55,000 net adds in Germany on ENTERTAIN in the quarter, and if you would ask me now openly and honest, that's not enough. We should do better. We have to do better, because the functionalities of ENTERTAIN is great and on top of that the bandwidth is given, so that is definitely something where we internally discussing how to improve. Now, the answer is simply, yes, there's more to come. On top of that, we are looking very deep into technical development. G.fast is another opportunity, up to 500 megabit per second, which we could provide already today in the labs and if you go to bonding, you could double up that speed. So there are a lot of interesting technologies, which could help us to accelerate the build out without let's say going GPON Fiber to the Home. Second, there's 5G coming, and I think what we haven't discussed in the community yet is the question is how much of these fiber build-outs, especially in the rural areas, could be substituted by 5G technologies. With receivers on the houses and indoor coverage coming from the repeaters, you could go up to high bandwidth. I've seen a coverage of 3.8 gig already with 5G in the labs and this might be as well our technology. I think there is not a black and white. There is not a fiber or non-fiber world. I think there's going to be a hybrid world, and we have to be, let's say, smart on how to combine the right technologies for the right customers.

Thomas Dannenfeldt
Chief Financial Officer

A

Yes. And before I answer the question to all-IP, the remaining element of the question was upselling opportunity for the market [indiscernible] (58:01) cable. I think it's clear, it's an up-selling opportunity for the market. That is what you see already in the marketplace that people are willing to pay more if they get more and it's really a value for the customer. So, on all-IP, your assumption was right. It's a single-digit number up if you strip it out; correct for the quarter, correct for the year. You've seen the profile we've given in the Capital Market Days in 2015 and 2016 it will peak the effort in terms of all-IP. From 2016 to 2017 onwards, it will start to decline. Remember the curve we've given you, but your assumption here is correct.

Ottavio Adorisio
Société Générale SA (Broker)

Q

It's very simple questions regarding pricing. Looking through all the slides you have on pricing, I can see that you almost changed nothing from quarter-to-quarter but one price and that is MagentaEINS L you reduced by €5. When I look at the mobile components, MagentaMobil actually remained unchanged. So the €5 looks that they've been taken out for the fiber element. That is almost a 20% reduction. So my question is, first of all, how much of the fiber lines have been sold through MagentaEINS and if this has been changing over the last four quarters? And second, the rationale beyond the discount. It's basically an effort for upselling, to move the customers through the value chain or second better macroeconomics, considering out the coverage of fiber starts ramping up and therefore you can afford to be more aggressive on fiber without any impact on the bottom line. Thanks.

Thomas Dannenfeldt

Chief Financial Officer

A

Yes. I'm not sure whether I got it all right, but I'll try and you give me feedback whether it answers really your question. First of all, roughly, if you look at the numbers in terms of all broadband numbers, roughly 10% are supported by Magenta1. That's the share of Magenta1 in the uptake of the fiber broadband numbers. Number two or second part of the question was the reduction. Let me remind you that we're talking about the MagentaEINS L here. That is from €70 a month upwards, so we're talking high-end pricing here, not low-end pricing. Basically, I think what we have changed is the ENTERTAIN PREMIUM part which was €10 up into €5 up. So the component which was pricing-wise changed was the TV part to make that more attractive, because obviously Tim mentioned that we're doing okayish, I would say, on ENTERTAIN on TV. It's like 10% to 15% year-on-year growth every quarter, but we should do better. And obviously, if we're talking about €70 upwards, what you should also do is consider whether you create just by pricing barriers to entry. So our assessment here was we need to make television more attractive. We're talking about high pricing segments and we moved from €10 to €5 on the television side. I'm not sure, maybe you give me feedback whether that answers your question really.

Ottavio Adorisio

Société Générale SA (Broker)

Q

Yes. It does and I probably want to use my second questions here if I can. And it's basically, if the idea is to push TV, why you'll changed the price on the one package and not all the three MagentaEINS packages? And the second is going back to the first question, the fiber mix. You said that MagentaEINS, only 10% of the package is taken with fiber. Have you seen any sort of changes since you launched MagentaEINS or has it been around that particular share?

Thomas Dannenfeldt

Chief Financial Officer

A

Yes. First of all on television first, the logic of Magenta packaging is that TV starts with the M package. So we have S, M, L. And in S, it's excluded. So in S, it's just mobile and broadband. From M upwards you have television in there because, obviously, TV is a relevant element in our upselling scheme. So we don't we want to give it for free away, but it should upsell. But we also need to make sure that the upselling price component is not too high. So that's the reason why we changed there and not further on on the lower end. And second question was fiber mix with Magenta1. Hannes, you need to help out there. I don't have it at hand.

Hannes C. Wittig

Head-Investor Relations

A

Again, the EINS is – we have answered that question from my perspective. If that's not clear, Ottavio, please contact me and we will sort it out.

Thomas Dannenfeldt

Chief Financial Officer

A

Maybe the only one element I can tell you is that in the vectoring rollout areas, we have a higher share of Magenta1. That's the mechanic, but I'm not sure whether that ultimately answers your question. We will follow-up.

Hannes C. Wittig

Head-Investor Relations

A

Okay. So, we said – I previously had a question by e-mail kindly provided by Emmet from Morgan Stanley. And the question was maybe you ask it directly again. Now if you could have a question from Emmet Kelly at Morgan Stanley. Emmet, can we get you? I would in that case. Emmet has asked the closure of the BT-EE deal has been provisionally approved by the CMA. This will see Deutsche Telekom owning a 12% stake in British Telecom, pending final regulatory approval. Do you view this as a financial investment or is it a first step in the cross-border consolidation that you have mentioned in the past?

Timotheus Höttges

Chairman-Management Board & CEO

A

So, first, we are indeed very happy, let's say, with a future stake in BT, which has already gone up, by the way in the value since we acquired or agreed to acquire the 12% stock here. I think taking up the business to the next level by partnering, this does not mean for us to have the majority. More generally, I think we have communicated a clear and attractive plan for our existing portfolio at the Capital Markets Day. And yes, we are creating a pan-European network in the next few years, but primarily purpose of this is improving efficiency and our internal customer experience. And I think it is clear from our track record, please give us here some credit, with any transaction we would be committed to create value for our shareholders. And so, we have no decisions to stepping up on BT. We're just in the approval phase and we are building a more intense relationship after the merger approval. And I will go into the board of this company if I get voted here and as expected and then we will see, but nothing else planned. I think the opportunities we have created in other business with minority shareholders have created a lot of, let's say, shareholder value already.

Robert J. Grindle

Deutsche Bank AG (Broker UK)

Q

A couple of my questions were answered, but I was curious to see whether you felt and perhaps it's early at this stage, but whether you felt any impact from the two big sort of news events in Germany recently, i.e., Volkswagen, is that a big customer of yours and immigration is that [ph] certain (1:06:11) to have a material effect on your mobile business for example.

Timotheus Höttges

Chairman-Management Board & CEO

A

So, let me take the immigration issue first. I think it's a big challenge for everybody, for the municipalities here, for the government and it's law and Deutsche Telekom has taken very early, let's say, position here. We have started to build out wireless line hotspots in every refugee camp here. That is, by the way, a service which we provide for free because we think it is very important for the refugees to stay in contact with their families. This is something which we are driving. We have already, let's say, covered more than 50 of the refugee camps in Germany with wireless line. The second one, what we do is we have built a platform, an online platform where people could document their biographies which we could use then for recruiting purposes. The third one is we are discussing with the government that for the registration processes within the refugee camps, you need civil servants. And we have civil servants on board. So, we could maybe transfer civil servants from Deutsche Telekom into these refugee camps. And by the way, we're not talking small numbers here. They really have a need to accelerate the registration processes within these camps. And on top of that, we have hundred new credit – new apprentice jobs within Deutsche Telekom for people who get allowance to stay. So, that is, let's say, the situation. We are doing what we can we do from Deutsche Telekom's perspective here and this is highly appreciated from our stakeholders. The second question is with regards to Volkswagen. Look, I think what we see here is that the CEO Müller is taking a strong direction. He is working on cultural change. He is addressing the right topics. You know that we have made some [indiscernible] (01:08:50) experience in the early 2000s. And so, I think he's addressing this topic. It's not something where, I would say, this is a German issue or let's say relevant for all companies here in Germany. And with regards to the cost and to anything of our fleet, we are in discussion with

Volkswagen to understand, let's say, where the investigation stands and what that means for the fleet management of Deutsche Telekom.

Frederic Boulan

Bank of America Merrill Lynch

Q

Two. Firstly on mobile, in Germany. If you could discuss your network differentiation strategy. Is this something we can maintain in the medium term considering what [ph] Vod is doing with Spring (1:09:57) and the current merger of the – O2 and E-Plus mergers. And do you think you are in a position to extract premium pricing in the long run here? And secondly on your data – mobile data strategy. So you've increased its allowance by 30% in a couple of price plans in September, not to mention its pricing. Is this something which is necessary to stimulate the growth and eventually monetize data or are you not substantially postponing the data monetization process? And then, a different question around content. As a differentiating factor in mobile or fixed, what are your thoughts here in Germany but also in the U.S. where you're starting to see your competitors investing in dedicated mobile content?

Timotheus Höttges

Chairman-Management Board & CEO

A

Look, the entire purpose of Deutsche Telekom's strategy and this is now in place since two years, is that we do not want to compare on High Street prices. On stupid €9.95 or €15.95 that we want to have – we are selling connectivity, and people say, I trust into Deutsche Telekom, they have a better service, they have a better connectivity, it is easy to access the different networks and there are additional service which I only get with Deutsche Telekom. So, we really want to be different in the way how we're doing. The basis for that one is the network and what you see is – and by the way, I think you give us – give us some credit for that one. Nobody in this industry is investing at a speed as we are doing. 87% high LTE, already 7mm LTE customers on it. We have opened up 3.8mm new households with high bandwidth. We're going to vectoring and vectoring plus, up to 250-megabit per second very soon. We go into the rural areas where people really are in a more difficult situation than in the big cities. So, we have the connectivity and we build the connectivity. The hybrid router is an innovation which we brought forward, highly appreciated especially from customers who do not have the bandwidth today. And on top of that, we have launched new tariffs at the IFA, our Consumer Fair here in Germany, where we have now integrated family packages especially for the kids, so that the kids are always approachable, they do not have to pay for that one on voice side. And the data volume is growing with their age or by the decision of the parents how much they allocate to their kids. And on top of that, maybe you have not seen that product but I think there is a real innovation in our industry. We are trying to substitute the old decked or the old fixed line telephone by a tablet in the household. So, on this tablet, by the way, it cost only €49 for MagentaEINS customers. It is nicely selling around [ph] 15,000 (1:12:59). We are trying to sell a tablet and on this tablet, you'll find your bills, you'll find an immediate, let's say, SMS, e-mail, or a chat with our customer service desk. You could do all Internet services and you could use and all these applications are pre-installed you could use all, let's say, additional service on Deutsche Telekom, being at Smart Home, being at the entertain services or just being as HomeTalk or conference calling. So, all of this is pre-installed on this tablet and this is, let's say, kind of new digital cockpit for, let's say, families at home. So, this is the idea how we are trying to differentiate our services and upselling the new categories into the household. So, I think that gives you the idea. I think we're on a good way with regard to our differentiation strategy, and compared to the other players in the market, we earned already a premium in the market and our brand recognition, our customer satisfaction scores are significantly higher than the ones of our competition here in Germany.

Thomas Dannenfeldt

Chief Financial Officer

A

Fred, on your specific question on the allowance increased by 30%. That's basically I think the blueprint for monetization. Because what we've done is we kept the allowance of the S tariff plan, which is a half of a gig where it was and we increased it on the M, on the S tariff plan. So, the increase of the allowance was on the price plan if you buy it – this price plan you get with the Samsung handset or an iPhone, you pay €60 for that. And basically, what we're doing is by spreading between the low end and the mid and high end to make that mid and high end more attractive, buy that data allowance and moving the people up from that lower price plans like the S into M and L. That's the intention. And I can tell you with the current numbers we've seen, it works. So, it's the positive blueprint and not the postponement of monetization process here.

Timotheus Höttges

Chairman-Management Board & CEO

CLOSING COMMENTS

- So, I think we had plenty of time to discuss the current situation
- We are very happy with the development in the quarter, especially on the FCF side and the OpEx side
 - And I think the market is doing well
- We could do always better
- What is, let's say, last time I mentioned, what are the tasks which we are working on and you have seen that we have taken out discounts in order to improve the revenue and that we have improved our cost base here
- And let me stress a little bit, let's say, what is the direction for the team here for the upcoming weeks and months going forward

Monetization of Data Build-Out

- The most important thing for us is the monetization of our data build-out
- So, we are doing heavy investments and we want to earn the money back
- We could do that by good take-up rates and utilization of our infrastructure
- We could do that by up-selling in our tariff structure, and we could do that by differentiating by new services, just to give you three examples on that one
 - So, the monetization of the investments is our primary focus

Cost Efficiency

- Secondly, we are very intensively discussing efficiency steps within the organization on the cost side, but as well on the way how we digitalize our processes in the organization and how we could bring the e-company into the online service proposition in a much more broader way as we're doing that one
- On the strategy side, I think we are focusing on spectrum in the U.S.
- That's a very important thing for us, and we are focusing on CapEx because you have seen that the optionalities that the moment we build up networks, the moment we are able to monetize and to create a differentiated towards customers
 - So, this is something which we are discussing intensively

Partnerships

- And as well on the partnerships, we are doing a lot of efforts

- This quarter was very much about partnerships in B2B and I urge you to really look into our cloud service businesses, because apart from the Intercloud we have launched the OneTelecom cloud which is a model which is able to really compete with AWS
- And this is based on a German cloud, this is based on the German security and data centers, and this is based on an individualized sales force which we have here on the ground, I think this could be a very interesting, significant value driver going forward

Portfolio Side

- And on the portfolio side, I think there are three areas which we are looking into that one at this moment
 - The one is, as we've mentioned Netherlands
 - The second one is Romania
 - And the third one is our Poland activities where we are not happy with the performance currently
- I think this is an operational issue which we internally have to address, and this is our way going forward
- But we are very confident that we're going to achieve, let's say, our target for 2015 and confirm the capital market guidance going forward

Hannes C. Wittig

Head-Investor Relations

UPCOMING EVENT

- Just on the subject of cloud services, we are planning to do a webinar on cloud services sometime earlier in 2016, so please be aware of that

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