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Q3 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.

Unverified Participant

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Now please listen to the statement of René Obermann and Timotheus Höttges. Afterwards you are welcome to ask your questions. I now hand over to Mr. Stephan Eger.

Stephan Eger

Head-Investor Relations, Deutsche Telekom AG

Good afternoon and good morning to our listeners in the U.S. Welcome to the Q3 conference call. As always we've got René Obermann, our CEO; and Tim Höttges, our CFO onboard for the call. To start with a very formal topic before we start with the presentation, I'd like to make sure that you've taken note of the Safe Harbor Statement at the beginning of the slide deck. Reason is a slide regarding the business combination with MetroPCS and Tim will comment upon that later.

Thanks and that, let's hand over to René our CEO.

René Obermann

CEO & Chairman-Management Board, Deutsche Telekom AG

Thank you, Stephan. Good morning, good afternoon. First of all, let me emphasize that today we are presenting and will be discussing our third quarter results and all strategic and forward-looking topics like shareholder remuneration 2013 and beyond of the German broadband rollout plan in detail. We would like to discuss with you at our Capital Markets Day on December 6 and 7 in Bonn. Let me use this opportunity to personally invite all of you again to join us there. I would love to meet all of you personally. We'll put a lot of emphasis and preparation into this, so I hope this is going to be worthwhile.

Now to the third quarter results, we continue to deliver upon our full-year guidance. Supported by currency, group revenues were stable at €14.7 billion. Adjusted EBITDA at €4.8 billion was slightly below last year's level, 2.6%, driven by higher commercial expenses, particularly in Germany and the United States as indicated in Q2 already. After nine months we are well on track to reach our full year guidance for the free cash flow, with the accumulated nine months free cash flow being up 13% year-on-year and already beyond €5 billion. On this basis, we reiterate our full year guidance and also our dividend policy which is unchanged. This compares again very favorably to the results of other incumbent operators in Europe.

In Germany, we saw an improved trend in mobile service revenues and again encouraging fixed line results leading to an overall revenue decline of only 1.3%. Operationally, we saw again good net adds in Entertain and in VDSL and very low line losses at 284,000, 12% better than last year. If you think about where we're coming from, this is less than half of what it was a few years ago.

In mobile, service revenue trends improved to minus 0.5% in Q3 and we saw another good quarter of mobile contract net adds amounting to 555,000 of which 171,000 are our branded customers.

As indicated in Q2, we have started investing into measures to fight back on market share and increased our market invest by 30%, more importantly, we are getting all awards currently on network and service quality, that's the basis where we will get our market share up again. As a result, the adjusted EBITDA declined slightly year-on-year, but the margin still remains at a high level of almost 42%.

In the rest of Europe, we delivered solid financial and operational results in an overall difficult environment with unnecessary MTR cuts in nine out of 13 countries with new austerity taxes and an ongoing difficult economy. Reported revenues were down 5.7% due to these mentioned challenges. Adjusted for foreign exchange, organic revenues were down 5.2%. However, the year-to-date organic revenue development of minus 3.3% still showed a significant improvement compared to last year.

Due to a strong performance in OpEx reduction, the adjusted EBITDA margin of the segment improved to 36.3%. This, together with good CapEx discipline, led to a strong cash contribution of the segment. Despite the difficult environment, we continued to grow key KPIs – key KPIs [ph] thought logic – (08:50) like broadband and TV customers as well as mobile contract net adds.

In the United States, the situation remains challenging despite some encouraging trends in contract churn and no contract customer net adds. Total net adds in the quarter were positive with 160,000 net new customers predominantly driven by very strong branded no contract net adds. The branded contract customer churn improved as well from 2.6% to 2.3% in the yearly comparison and the branded contract growth adds improved by 17% sequentially. Revenues and service revenues however weakened sequentially primarily driven by contract customer losses and weaker ARPU trends, which has detailed reasons and we should talk about that later. EBITDA declined by 14% year-on-year driven by higher advertising spend as predicted in Q2.

And importantly, a month ago, we announced another important step to strengthen our U.S. operations, the proposed combination with MetroPCS, which will strengthen our business significantly with respect to the LTE spectrum and our position in the fast growing no contract service offerings and at the same time, will generate substantial cost synergies over the next years.

The highlight of the last quarter clearly was our strong cash generation with our free cash flow up by 37% year-on-year, well on track to reach our full year guidance of around €6 billion.

So let me quickly turn to the huge net profit impact this quarter. Adjusted net profit declined by 28%, due to a higher depreciation in the U.S. You will recall that last year, we stopped depreciating the U.S. following the announced sale of T-Mobile USA. This was reversed in the fourth quarter.

The reported net income was heavily impacted by the exceptional write-down in the U.S. as a result of the announced combination with MetroPCS. This write-down is forced by [ph] an enforced (11:13) impairment under IFRS rules purely based upon market pricing of MetroPCS and it does not take into account the huge discounted cash flow-based value generation as a result of the transaction. Tim will give you more technical details on this write-down and the resulting net profit of the quarter.

On slide seven, you can see that the organic decline in revenues was almost offset by currency gains, mainly from the strength of the U.S. dollar. The 2.6% decline in group EBITDA was, as said, mainly a result of higher commercial spending in Germany and the U.S., but also the difficult environment in Europe.

And with this, over to Tim who will update us with the details of the third quarter results.

Timotheus Höttges

Chief Financial Officer, Deutsche Telekom AG

Thank you, René. Hello, everybody. Let's go into the German business first. In Germany, we saw improved revenue trends and almost stable adjusted EBITDA margins, despite higher market investments of around €100 million, mainly by the way in the mobile area. Revenues declined by only 1.3%, essentially due to better revenue trends in mobile, wholesale and others. Mobile revenues increased by 3.2%, driven by strong smartphone sales but also an improved trend at the service revenue side.

Our fixed-line trends were stable at minus 2.7%, in line with the previous [ph] orders (12:51). Wholesale service revenues were down 2.8%, driven by improved trends in voice and network services and to less negative regulatory impact than in Q2. The revenues in others declined by 12%, driven by fixed-related and value-added revenues such as lower revenues from public telephones, directory assistance and the 0180 numbers, a slight sequential improvement.

As announced in Q2, we spent significantly more on market invest in order to turnaround the mobile service revenue trend and to catch up in terms of market share. Nonetheless, due to continued OpEx discipline, our adjusted EBITDA margin remained broadly stable year-over-year at almost 42%.

Mobile service revenues declined by 0.5%, an improvement over the 1.8% and 1% decline in Q1 and Q2 respectively. This was driven by the way by continued strong mobile data revenues, with a growth of 21%. Excluding the loss of one wholesale provider and the impact of roaming price cuts in July, service revenues would have grown heavily and healthy year-on-year. In this context, based on our recent data for retail own brand contract customers, 90% off all SMS and voice minutes are being built as part of [ph] flip rates (14:28) or other tariff bundles. Therefore, we are relatively immune to the over-the-top risk.

The KPIs were strong with mobile contract adds 555,000, of which of 171,000 were valuable own branded net additions. I think this is the best number in the industry in the third quarter here in Germany. We had very strong smartphone sales in the quarter with 322,000 iPhones and 561,000 Android phones being sold. We are partially (sic) [particularly] (15:06) pleased with the sales of iPhone 5 in Germany, of which we sold 100,000 just in the last two weeks of September.

We further expanded our LTE coverage and plan to cover 100 bigger cities by year end. Product-wise, we introduced the LTE speed option for our customers with speeds up to 100 megabit per second in September. On top of that, the German fixed line business developed nicely. Entertain and retail fiber customer net adds were particularly strong at 76,000 and 83,000 respectively. As a result of our successful up-sell strategy, the consumer average revenue per access line, or ARPA, improved again by €0.30 to €25.80 year-on-year. Access line losses were again significantly better than last year at 284,000. In broadband, market growth slowed down dramatically according to our estimates. Despite our lower 9,000 broadband net adds, our market share stayed broadly stable at 45%.

Going to the U.S., in the U.S. we saw positive overall net adds driven by strong branded no contract customer intake and a 17% sequential increase in branded contract [ph] prices (16:43). The 365,000 branded no contract customer net adds reflect the continued success of our monthly 4G plans. And in the second quarter we continued to see a slight year-on-year improvement in the branded contract churn from 2.6% to 2.3%.

Service revenues declined by 8.4%, mainly due to branded contract customer loss and weaker ARPU trends, resulting from the shift to value plans and change in the subscriber mix.

As indicated, we increased our advertising spend and customer acquisition costs in the third quarter significantly. As a result, adjusted EBITDA declined by 14% year-on-year. Nevertheless, EBITDA during the first nine months was essentially flat at \$3.9 billion despite the revenue decline.

The combination with Metro is a key strategic move for us in the U.S. First, it strengthens our strategic position in the attractive U.S. wireless market, specifically it strengthens our spectrum position to roll out 4G LTE, and we expect NewCo to have a very attractive growth profile with a five-year revenue CAGR of 3% to 5% and an EBITDA CAGR of 7% to 10%, that's a big commitment.

Second, the network migration is straightforward. We will be able to deliver synergies early to the – early migration to a single network. This will result in \$5 billion to \$6 billion net present value of network synergies out of \$6.7 billion of total synergies. MetroPCS will enable deeper LTE spectrum, at least 20 times 20 megahertz in top areas such as New York, Los Angeles and Dallas. In fact, in 90% of the top 25 markets. This still will be a key differentiator [ph] than with (18:52) major competitors.

Third, the combination represents a compelling value opportunity by the projected cost synergies. Additionally, it strongly enhances the asset value compared to some of the past valuation without deploying more capital.

Fourth, the combination provides us with increased financial flexibility. NewCo will be publicly listed on the New York Stock Exchange, equivalent to an accelerated IPO with synergies. And it creates a path toward a self-funding platform in the U.S., with direct access to the capital market.

Turning to Europe, trends were weaker in Q3 compared to the first half of 2012 both in revenue as well as in EBITDA terms. The main reasons for this were a still difficult economic environment in some of our markets, notably the Netherlands, Czech Republic, Hungary, and Greece.

A very negative impact from regulation in this quarter. In Q3 alone, we had MTR cuts in nine of 13 countries. The negative year-on-year revenue impact of regulation amounted to €82 million in the quarter. And as for taxes, the third quarter saw more special taxation in Hungary, Slovakia, and Montenegro and less in Croatia. Overall, special taxes had a negative EBITDA impact of €32 million in the quarter.

Despite this difficult environment, we performed again reasonably well operationally. We grew our broadband customer base in the region by almost 4% and our TV customers by 8%, and have 1 million more contract customers than the year ago by the end of September.

As we continue to perform well, [ph] that is (21:05) our main competitors. In the Netherlands, we outperformed KPN in terms of service revenues development. In Poland, Romania, and Slovakia, we outperformed Orange in the revenue development.

On slide 14 (sic) [slide 15] (21:25), you see an overview on the revenue and adjusted EBITDA, development in our European markets on a country per country basis. Let me do a quick deep dive into two of our countries. In

Greece, we have seen weaker financial trends in the third quarter with both reported revenues and EBITDA down by 11%. The revenue decline was due to a 27% MTR cut in August, the new EU roaming regulation and the most difficult comparison. Nevertheless, due to good cost cutting, the EBITDA margin was slightly improved. Operationally, we saw a continued good performance in mobile contract net adds, we turned positive again, and in fixed line we added 34,000 broadband net adds, 19,000 new sat TV customers and even had a positive IPTV [ph] net of (22:27) development. This is a huge improvement compared to the previous quarters.

In terms of refinancing, the OTE management is on a very good way to secure the refinancing on their own with the planned asset sale of Hellas Sat and Globul on top of the free cash flow generation they are generating.

In Hungary, we showed positive revenue growth driven by new revenue streams, especially energy resale, IPTV sales and the integrated fixed and mobile pilot (22:59) offer. Due to the lower margin of some of these businesses and the impact of the double special taxation, EBITDA declined by more than 6% year-on-year. Operationally, Magyar outperformed [indiscernible] (23:20) in terms of contract net adds and increased prices of mobile services in September and the prices of fixed line in October.

In this context, let me make a few remarks about our UK joint venture, Everything Everywhere and their Q3 results. We achieved a growth in service revenues of 3.1%, ex-MTR cuts, with 250,000 contract net adds, we showed a strong growth and had a good share of the market. Postpaid churn remained at a low 1.2%. And on October 30, we started our commercial LTE offering and will leverage on our head start in LTE in the UK as well as our strong iPhone 5 position in the next quarters. By the way, even here in this market and so far we have only seen the O2 numbers, we significantly outperformed O2 on the service revenue market share perspective.

As indicated and explained in the preparation package, we had a restatement in Q3 due to the bundling of the national internal IT business within Telecom IT under the roof of Systems Solutions. As a result of low project activity in Q3, in contrast to Q3 2011 and further efforts to bring down overall IT costs at Deutsche Telekom, the telecom IT revenues decreased by over 43% year-over-year. Due to seasonal normalization, we expect an uptick here in the fourth quarter. But revenue decline, internal revenue decline is a good message because it shows that we are able to manage down our costs. As a result of this, overall revenues at Systems Solutions declined by 10.7%, however, [ph] this is (25:24) for the future the main focus area, external revenues grew by 0.8% and international revenues grew by 9.5%.

Due to the zero margin [ph] logic (25:32) at Telekom IT, the overall EBIT margin at Systems Solutions is significantly below the margins reported previously. However, due to good gross cost savings of €203 million in Q3, 2012 both adjusted EBIT and EBITDA margins improved year-on-year.

In the third quarter, we saw a particularly strong free cash flow generation with a free cash flow of €2.3 billion, up 37%, 37% year-on-year. For the first nine months, free cash flow amounts to €5.1 billion, up 13% year-on-year. Therefore, we are very well, very well on track towards our full year free cash flow target. This was helped by significantly lower cash CapEx, which, however, is expected to increase in Q4 alongside our market invest in markets like Germany or in the U.S. Therefore, the guidance of around €6 billion for the year end remains unchanged.

The adjusted net profit in Q3 was, as in the second quarter by the way, impacted by an increase in depreciation, predominantly from the U.S. due to being fully consolidated again. This trend will reverse in Q4. The reported net income was heavily impacted by the exceptional write-down as a result of the announced transaction with MetroPCS. Let me clearly state that this write-down is the result of IFRS standard rules that forced us to do an impairment as the result of the agreement with MetroPCS. However due to the IFRS rules, we had to base this technical evaluation upon the MetroPCS share price before the announcement. I will leave it to your judgment,

whether this really makes sense. In our view, this approach does not at all reflect the value generation as the result of the announced transaction. Economically, we will generate significant value with the combination of the two entities via an enhanced growth profile and cost synergies with a net present value of US\$6 billion to US\$7 billion.

Turning to our balance sheet ratios, the net debt was reduced year-on-year by over €4 billion to €39 billion. With the proceeds of the tower deal in the U.S., we expect our year end 2012 net debt to be below €38 billion. As a result, the key ratio of net debt to adjusted EBITDA improved already in this quarter will further improve from 2.3 to 2.1 times year-on-year.

However, due to the write-down related to the U.S. transaction, the equity ratio was reduced and as a result the gearing temporarily exceeded our comfort zone ratio with 1.3. Due to our Q4 free cash flow generation and net debt reduction, we expect to return back to our comfort zone ratios of 0.8 to 1.2 times by year-end.

We continue to have a stable outlook from all rating agencies and maintain undisputed access to the debt capital markets at very favorable conditions.

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

Stephan Eger

Head-Investor Relations, Deutsche Telekom AG

Thanks, Tim. And before starting now with the Q&A part, I would like to ask you for a bit of patience with respect – as René has pointed out earlier with respect to shareholder remuneration 2013 beyond CapEx plans for Germany, et cetera. We will all discuss that in full detail at our Capital Markets Day in December. Today, we would like to discuss our third quarter results with you. And with that, let's hand over to the operator.

QUESTION AND ANSWER SECTION

Stephan Eger

Head-Investor Relations, Deutsche Telekom AG

If there is no operator around, not a problem at all. We'll start now with Q&A session. So I will remind you to limit yourself to one or two questions only. [Operator Instructions] And I think we'll start with Simon Weeden from Citigroup. Simon, go ahead.

Simon H. Weeden

Analyst, Citigroup Global Markets Ltd.

Thanks, Stephan, and thank you very much. I've got two questions. One is with respect to the U.S. Could you give us some idea as to how you, if you were to get the [ph] ISO (30:46) at some point in the U.S. and you've not been sure about it, suggesting you've been interested in looking at it from a retail point of view, how and indeed would you mitigate the impact of it on the EBITDA margin so that we can think about the scenario should that come to pass?

And the second question is; with respect to the balance sheet, noting the drift above the target of one of the metrics, I just wondered if there is, if you can give us a view of what the balance sheet would look like post the payment of the next dividend. And if you have any sense as to whether any of the rating agencies are getting tougher or thinking of moving your outlook downwards or your ratings downwards at all? Thank you.

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

A

Simon, it's René. Hi. We are working hard to upgrade our network and to do the spectrum reforming and indeed have already accomplished 95% of the 1900 GSM spectrum to be utilized now for HSP+ – HSPA+ and then free up AWS band in order to launch LTE on it next year, and the plan is by the end of next year to have 200 LTE on top. On that basis we really keep the strong interest of expanding our range of high-end smartphone devices. That's all I can say at this point in time, everything else is subject to speculation.

On the dividend thing, it's better if I hand this over to Tim on the balance sheet question.

Timotheus Höttges*Chief Financial Officer, Deutsche Telekom AG*

A

Hi, Simon. I think you're absolutely right, I've observed as well that the rating agencies are tucking their ratios with regards to the rating bands. The situation with Deutsche Telekom today, even including the announcement of the impairment, our refinancing capabilities at Deutsche Telekom are very favorable. We are quite lucky being based here in Germany, and therefore, the refinancing costs are at all-time low. To give you an example, we had a seven-year MTN issued recently at a coupon of below 2%, slightly below. So therefore that is quite comfortable and how we are looking at the situation today. Nevertheless, over the time they will tighten their bands.

I think for us the question is not the rating as an independent KPI. It should be always linked to the capability to get our maturities refinanced and this has a lot to do with the CapEx and the investment strategy we are planning. For us, at the Investor Day we'll give you heads up on how we look at these investments for the upcoming years. And it will be based into a kind of clear going forward strategy for the bond holders and it will be a clear strategy [ph] toward our (34:04) equity shareholders. And I think we cannot make this a topic for our Q3 results and presentation today, we need I think a comprehensive story along with that.

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

Q

That's fine. Thank you very much.

Stephan Eger*Head-Investor Relations, Deutsche Telekom AG*

A

Thanks, Tim. And we'll continue to Nick Delfas from Morgan Stanley. Nick Delfas?

Nick Delfas*Analyst, Morgan Stanley & Co. International Plc*

Q

Yeah, thanks very much. First of all, just a comment please to set the scene for Q4 a little bit on the U.S. if you can. I guess it will be useful to say something about how September and October fared with the iPhone 5 and should we would be expecting more like 700,000 to 900,000 branded contract losses in Q4?

And secondly, just a comment on U.S. pricing really, I mean it seems that the customer losses continue. Pricing overall is not that different of Verizon and AT&T. Do you think that's going to need to change in order to stabilize the customer base? Thanks.

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

A

Yeah, Nick, you would not expect me to make any precise forecast on Q4 now, would you? But in general, the 492,000 contract losses are actually an improvement over the second quarter, and we benefited from a sequential pick up in branded contract gross adds which were plus 17% with almost million new branded contract additions and we had a reduction in branded contract churn of 30 basis points year-on-year to 2.3%, so not insignificant. And clearly the network upgrade, network modernization, network quality helps. But you know, let's face reality, a lot of the high the value customers have left and there are still some to go if we can't offer the iPhone at some point in time and given the iPhone 5 launch in September, it's already showed some effects. But given the iPhone 5 launch, the outlook for Q4 remains somewhat uncertain. However, we should continue to benefit from a year-on-year reduction in branded contract churn. So with the numbers you had in mind, sounded overly pessimistic to me.

Nick Delfas

Analyst, Morgan Stanley & Co. International Plc

Q

And on pricing?

René Obermann

CEO & Chairman-Management Board, Deutsche Telekom AG

A

I think the – what you see partially, the ARPU impact, the slight ARPU decline in postpaid, and record ARPU increase in prepaid is nice, but in postpaid it's slightly going down, is somewhat impacted by the unlimited offers and the value offers we have in the market since quite some time where customers bring their own device and enter some very attractive price propositions. We have – you may have followed, we have unlimited 4G data, very attractive packages in the market and our competitors, the big ones had to change their pricing schemes and I think they have increased their data pricing and introduced tier pricing models and our offers are unlimited, much more convenient to the consumer. So I don't think – I think we're well positioned at this point in time, it really is about network quality, then the other initiatives such as B2B and also of course the smartphone device range.

Nick Delfas

Analyst, Morgan Stanley & Co. International Plc

Q

Great, very clear. Thanks very much.

Stephan Eger

Head-Investor Relations, Deutsche Telekom AG

A

Thanks, René. We'll move over to Justin Funnell from Credit Suisse. Justin, please?

Justin B. Funnell

Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Thank you. Just two questions, please. The – nice to see your VDSL net adds picking up very strongly, is there supply peripheral demand [ph] at all, (38:04) are you starting to see real demand for high speed broadband in Germany and if so, what's driving that?

And then secondly, on the U.S. business, any thoughts on whether Softbank is going to change the game at all, does that have any effect on your strategy in the U.S. business, perhaps more CapEx for example?

René Obermann

CEO & Chairman-Management Board, Deutsche Telekom AG

A

Justin, the VDSL uptake is a – I think is a combination of various factors. We did, as you saw from the OpEx side, we pushed a little more and because we need to be a bit more aggressive, particularly in Germany, my credo here

is to the team since quite a while, do defend the share, our paradigm is really compete, compete, compete, compete and fight for share and also in fixed line we have to defend ourselves. So there are some price promotions there is additional marketing activities and there are sales efforts and therefore it's a combination as usual of various marketing factors, not just one. However, I do think on mid to long-run speed matters and therefore we are lobbying heavily for our very, very good program which we will outline to you in December with vectoring and VDSL and vectoring to get customers up to 100 megabit. So there is a growing demand for speed. We are well prepared for that. We just need a few little bits and pieces on the regulatory side to make that happen, more details in December.

Justin B. Funnell

Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Thank you. And Softbank at all, any thoughts on that or just...?

René Obermann

CEO & Chairman-Management Board, Deutsche Telekom AG

A

Yeah. Let me just switch the topic. Quite frankly, we do not know yet what the Softbank ownership really will mean for us. There is an element of speculation in there. I mean, you know, I – frankly speaking, Masayoshi Son in many respects to me has always have been a role model and when I looked into the – into Japan what he did there with Softbank and how he built his portfolio of Internet companies and services and what he did with the J-Phone he bought from Vodafone, I really think he's a very courageous entrepreneur. So it has to be seen what he – how he can accomplish the similar thing in the U.S. We don't think his investment will immediately change the spectrum results of Sprint. That may take time because Sprint has relatively little LTE spectrum and reliance on high bands, not consolidated Clearwire. So it does not offer any significant synergies as well. So, contrary to our suggested deal between T-Mobile U.S. and MetroPCS.

At the same time, midterm you can expect him to be an aggressive player in the market. Let's face reality, but we also think we have means to compete, particularly when we are into LTE with two times 20 megahertz. Our net proposition is going to be very competitive and we have the spirit and the initiatives already in our [ph] challenger (41:10) strategy to fight back. So I'm not going to give up the territory even though I respect the man a lot.

Justin B. Funnell

Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Thank you very much...

Stephan Eger

Head-Investor Relations, Deutsche Telekom AG

A

Thanks René. Let's move to Robin Bienenstock from Bernstein. Robin?

Robin A. Bienenstock

Analyst, Sanford C. Bernstein Ltd.

Q

Yeah. Thanks very much. So your royalty network will clearly be better in the U.S. in the densely populated parts of the county, but it will still be thinner in terms of coverage in the less dense parts of the county. So I'm wondering to what extent you think that reduces the addressable market for you in the U.S.?

And then secondly, I just had a question about your working capital, which is going to a big negative number, it looks like this year, a lot bigger than last year, lots of restructuring charges in there and I'm wondering if you can

help me think about what that means if anything for margins next year and what I should think about in terms of potential cost there next year as well? Thanks.

René Obermann

CEO & Chairman-Management Board, Deutsche Telekom AG

A

All right. Robin, the LTE question, allow to me to answer that in telling the HSPA coverage as well, because after all for customers it does matter the network speed and throughput and capacity matters not so much whether you are on LTE or 3G and from my own and personally your own user experience, I suggest that you don't care whether you see the LTE signal or the 3G signal. In Germany, we launched LTE and it's still somewhat spotty. And for me as a user all that matters is high-speed coverage. And therefore our HSPA network is with 225 million PoPs coverage in [ph] spring (42:45) and successful spectrum migration onto the 1900 band is going to be an important component in the game.

And then next year, in the course of the year we'll cover up to 200 million PoPs and that in combination still having Edge as a world-class technology available to the customer and seamless upgradable to 3G and 4G proposition, and that combination I think will be more competitive and the network perception will improve. But also to be honest, it's grinding work, because we are coming from very low perception and we need to move up the ladder, and it's grinding work and it will take some time. But we are coming and we will have a good competitive environment – network, sorry, not environment that we have.

Timotheus Höttges

Chief Financial Officer, Deutsche Telekom AG

A

Robin, with regard to your working capital question, and by the way, impressively the good free cash flow performance is coming with an increase of our working capital of almost €400 million. And what you could see here is we had an increase in the trade receivables and we had an increase in the inventories here in this regard, almost €306 million. So this has to do with some payment terms of conditions with vendors and even seasonality here. So could have been even better if we would have tighter managed the payables situation. I think almost most important thing is that from a cash CapEx perspective, some of the payout coming in the fourth quarter, so we had higher book CapEx in this quarter. So there might be some higher payouts then in the fourth quarter to come.

And then I think as normal, we have carried impacts from the severance payments in our working capital. So this is an amount full-year year-to-date of up something around €800 million and then there were very small items which we carry in our working capital like change in provision, which is €34 million issue and some others. So, overall I would say, it's a measure of how we're managing receivables and inventories in the upcoming quarters and there was a slight deterioration on that number this quarter.

Robin A. Bienenstock

Analyst, Sanford C. Bernstein Ltd.

Q

Okay. Thanks.

Stephan Eger

Head-Investor Relations, Deutsche Telekom AG

A

Thanks, Tim and Robin. Let's move to Fred Boulan from Nomura. Fred, go ahead.

Frederic E. Boulan

Analyst, Nomura International Plc

Q

Hi. Thanks a lot. Two questions. Firstly on the U.S., if you could elaborate on your targets to stabilize the T-Mobile contract, side of the business in 2013 and then grow modestly thereafter which will change here and how much EBITDA investment you're willing to swallow there? And again, if you can explain how you plan to grow the combined business back to 3% to 5% growth when I think T-Mobile and Metro in Q3 declined about 7% together?

And secondly, on Mobile Germany, so you are definitely improving quarter-on-quarter. We're seeing significant slowdowns at both E-Plus and O2. So do you think T-Mobile can continue to improve ex-MTRs in the coming quarters and how do you see the balance between pricing power on LTE versus [ph] after (46:34) dilution from people on that pricing playing out in the coming quarters. Thank you very much.

Timotheus Höttges

Chief Financial Officer, Deutsche Telekom AG

A

Okay. Let me begin with the question of stabilizing the contract situation. As I said earlier to Robin and others, we will go full steam ahead with the modernization of our network with improved coverage, with improved capacity and we will introduce LTE in 2013 and we funded for that with \$4 billion on top investments, \$4 billion which is ongoing.

And the coverage will be improved by about 20% and we will have a differentiated, stronger LTE network than some of our competitors with two times 20 megahertz when we combine it with MetroPCS in largest geographies, which is very, very important. I cannot underestimate – or we should not underestimate how important the spectrum position here is. We will continue to differentiate the contract value propositions with unlimited simple worry-free offers. John, our new CEO in the U.S. who by the way is a very customer driven competitive person, talks about us becoming kind of the uncarrier trying to illustrate that we try to stop the – some of the bad practices in the industry and be really more customer friendly than the others, so simple worry-free offers.

Expanding the B2B presence, which is kind of a low hanging fruit at least just for some percentage point of the market in the small to very small enterprise segments beyond our current 5% share by investing in an expanded sales force and new IT capabilities – it's many of the small companies and very small companies they purchase like consumers, all they need is basic connectivity, good value plans and of course the device range and that is something we are interested in capturing that opportunity. And again offering the best value plans of any national carrier through the value plans and customers bring their own device. The bring your own device program is attractive and is working.

And then lastly, position – reposition the brand as one that delivers great coverage and network performance at a terrific price. The brand has not lost its momentum completely, it has lost some momentum, but many customers still – and I see that from feedback customers give us – hate to leave T-Mobile because of the iPhone and they are prepared to wait a little bit, but they are not prepared to wait forever. So the brand still is somewhat strong and we need to reposition it as an aggressive great coverage network performance at a terrific price.

Having said all of that, one last sentence, in the combination with PCS, our objective is to have basically flat growth in contract offers, stabilize the subscribers in 2013 and modestly grow the subscriber base in 2014. The revenue partly offset by changing mix to value plans but the no-contract offer stands for 80% or more of the growth. So this is something we like to push very hard and I wish I had a similar no-contract business in Germany or in Europe as we have in the U.S., us \$27 in ARPU, Metro in the vicinity of \$40. This is wonderful. And no-contract means another payment method. It's not different. These are not bad customers, they just pay differently and we should use that opportunity to the fullest. Thank you.

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

A

And with regard to the question on the ARPU, the first and almost most important ultimate goal what we have in our mind from the morning until the evening is, how to regain growth in our businesses and that is true for Germany as well and therefore we are trying to fetch not only let's say the high value contract customers, we are trying to get every customer who is willing to pay something for our services. And therefore, and you see that in our huge contract net add number, on above 500,000 net adds only this quarter, is a mix of let's say high value customers from iPhone 4 or iPhone 5 and the wholesale customers and even some new business which we have introduced which is Lebara and Turkcell service providers which are automatically coming with a lower value, but generating additional contributions.

And if you now look to the ARPU alone, this would give you the wrong indication. It's correct, the ARPU accelerated the decline to 8.4% but if you look to the mix and if you look to the specific segment, you will see that without Lebara and Turkcell, the ARPU is stable at something around €31 per month. So therefore you see that we fetch a big portion of the high-value market and on top of that we get service provider businesses on top of that.

Second, how to gain growth is the up-selling story. Going like we did in fixed line from single to double from double to triple play, and this is exactly what we are doing on the mobile side as well. We keep the high-value customer base and our churn is very low in Germany and it has improved by another 0.1 percentage point this quarter. And maybe a last comment with regard to the service revenue overall. You have seen maybe the plus numbers, they lost minus 2.5%. You have even maybe saw the trend of 2002, lost another minus 2.9%, while we gained 0.5 percentage points. So I think this shows that our overall trend to regain growth here in the German mobile [indiscernible] (52:50) environment is the right thing to do.

Frederic E. Boulan*Analyst, Nomura International Plc*

Q

Great. Okay, thank you.

Stephan Eger*Head-Investor Relations, Deutsche Telekom AG*

A

Move on with Peter Kurt Nielsen from Cheuvreux. Peter Kurt, please go ahead.

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

Q

Thank you very much, two quick questions please. Firstly, on the German DSL market. As you mentioned, intake is low in this quarter, significantly lower than previously, even adjusted for seasonality. Do you see this in any way related to the launch of LTE or as a more structural longer term significant slowdown in the market?

And secondly, as you mentioned earlier, you are well ahead on the free cash flow towards your guidance for €6 billion for this year. Tim did talk about a higher cash CapEx in Q4, but could you still elaborate a bit on how you expect to get to only – if I may say so, €0.9 billion free cash flow in Q4? Thank you.

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

A

LTE is positioned on the country side, mostly, Peter, to be a substitute for DSL. This is how Vodafone positions it. This is also how we position it. We also offer it in conjunction with DSL, so customers can have both of all – best of all worlds. But yes, to some extent the wireless substitution may pick up a little bit. I'm honest to you. I don't

have the full substitution detailed numbers at this point in time, but my suspicion is you are right. There may be an effect from LTE that the DSL overall is slowing down.

I think this trend gets reversed, Peter, or it will not be a strong trend if we are able to speed up our network and really offer a differentiated access speed and stability with DSL, sorry with VDSL and Vector VDSL. I think then the customers will see that video and all other applications in the household that there are still better off if they have both wireless and wire line, particularly when it comes out of one hand from their preferred service provider. So you may be right, there may be a small substitutional effect by LTE. Overall, the market growth is not that strong and all what you say I can endorse. And free cash flow is Tim's domain.

Timotheus Höttges

Chief Financial Officer, Deutsche Telekom AG

A

So René is smiling on me and I'm smiling back. There is kind of feeling [ph] kind of (55:20), let's say, the last quarter on our side, which is optimistic [ph] about us (55:28) achieving our targets, there is as well a consensus in the market and there is as well a forecast from our organization. And let me share with you the fact [ph] are not to stomach (55:41).

So the consensus in the market tells us that you are expecting €4.3 billion EBITDA for the fourth quarter. €4.3 billion minus €2.5 billion of net cash CapEx, which is absolutely in line with what we have forecasted, this is the €8 billion number and minus €0.5 billion interest payment, which is expected. We had €1.8 billion after nine months, so this is the normal run rate, minus €0.3 billion of working capital. This is especially restructuring expenses, which we forecast and then even some very small amount of taxes. This will equal with the €0.9 billion of free cash flow. So let's say that is how the forecast and let's say you could look at it from an overall perspective.

Peter K. Nielsen

Analyst, Crédit Agricole Cheuvreux International Ltd.

Q

That is very helpful. Thank you.

Stephan Eger

Head-Investor Relations, Deutsche Telekom AG

A

Thanks, Tim, and thanks, Peter Kurt. If I am well informed, we've got now Dan Jenkins from State of Wisconsin for the buy side. So, Dan, if you are ready please shoot with your question.

Daniel F. Jenkins

Analyst, State of Wisconsin Investment Board

Q

Yes, can you hear me? Can you hear me okay?

Stephan Eger

Head-Investor Relations, Deutsche Telekom AG

A

Yes, everything okay. Go ahead.

Daniel F. Jenkins

Analyst, State of Wisconsin Investment Board

Q

Okay. I had a question related to the combination with MetroPCS. You talked about increased financial flexibility in the path toward self-funding. Is that your intention you think to issue debt then out of the T-Mobile USA unit, and will you do that to finance the transaction close? Hello, can you hear me?

Timotheus Höttges*Chief Financial Officer, Deutsche Telekom AG*

A

Okay. Yeah, sorry. Look, there is no need for us to issue or to raise any kind of debt at that point in time. Everything is refinanced and even you know, the bonds which are related to the transaction are mainly money which was already funded within Deutsche Telekom in the past.

Look, the way how we constructed the deal is that we said, okay, at the beginning to go into the market and make a non-recourse self-funding for the U.S. entity would come at very high cost. And for the group, Deutsche Telekom, this would mean a cash out of an approximately €1.5 billion plus. Just you know that the expenses we would have for banks and for issuing all the bonds on a non-recourse basis. And everybody in the market would look at this and would say, look, this is an entity fully consolidated by Deutsche Telekom and at the end of the day, they will never risk the equity in this entity. So they will, even if these bonds would be non-recourse finance, they would look at us and would say, ha, these guys would be handling it as a lender of last resort because the investment and the equity value is so high.

With this in mind, we said okay, now we make proof of the concept first, and we bring the company together, we integrate the company and we make that a sound story, but we have flexibility in the way how we structured the bonds and therefore, we could over time start selling it into the marketplace and that is definitely something we might consider, but now as we did in Everything Everywhere, one step after another, now we bring – make the company up and running, we convinced the market that this is a good story to buy into that one and then at reasonable costs, we might start selling.

Daniel F. Jenkins*Analyst, State of Wisconsin Investment Board*

Q

Okay. Thank you.

Stephan Eger*Head-Investor Relations, Deutsche Telekom AG*

A

Thanks, Dan. Thanks, Tim. Let's move on, we've got time for two more and the rest will be called as always by the IR team, sorry for the inconvenience. And let's move over to Hannes Wittig from JPMorgan. Hannes?

Hannes C. Wittig*Analyst, JPMorgan Securities Plc*

Q

Yeah, good afternoon, I have two quick questions, one of your smaller competitors in Germany has said that it is open to mobile network sharing in Germany. Is this something you would consider or do you think you would lose a commercial advantage and therefore would not want to consider it?

And second question relates to the iPhone 5. Of course you already had very strong iPhone sales in September. If you are going to expect that iPhone sales will further accelerate given that you have the 1800 advantage and how should we think about it on a sort of on a 6 to 12 month view? Thank you.

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

A

Hannes, very quickly on the question first, you know, in the past Deutsche Telekom was always open to consider network sharing and for a long time we had network sharing with [indiscernible] (1:00:49) here in Germany and therefore, if there would be an opportunity, we would definitely have a look on to that one. So we have to always

consider using the spectrum from the other guys as well. So it's kind of the [ph] readjusting (1:01:07) capacity, but in principle to use the hardware and the network is definitely something we're willing to consider.

With regard to the iPhone sale, [ph] i5 (1:01:21) again, I think it was luck or it was the wisdom of our technology people, [indiscernible] (1:01:27) I'm not sure, to make a bet on the 1800 spectrum and we are the only ones in Germany being able to demonstrate the iPhone 5 in its full beauty, and I could tell you the LTE download is impressive on this phone.

So therefore people buy into that one and we even get the feedback via press and on the drive tests and all the benchmarks which are done recently. So therefore it's a good product and it's great that we have it. To compare it with the iPhone 4 launch, we have 100,000 handsets sold more than during the launch of the iPhone 4 at that same point in time. So it's very successful launch. Now if you would ask me is there a limitation for the fourth quarter, I would say the more we could get, the better it is. Today we have a backlog, so the more handsets Apple is willing to deliver, we're going to sell and we are quite optimistic towards the fourth quarter.

Stephan Eger

Head-Investor Relations, Deutsche Telekom AG

A

Let's move to the last for today it's Emmet Kelly from Merrill Lynch. Emmet, please?

Emmet B. Kelly

Analyst, Merrill Lynch International Ltd.

Q

Yes. Good afternoon, everyone, and thanks for taking the question. You talked a little bit about moving customers in Germany from single-play up to double-play and then on to triple-play and I'm just wondering could you say a few words about quad-play and the prospects for quad-play products in Germany? We are seeing quad-play gathering pretty good momentum in France with France Télécom and obviously Iliad have launched as well. And then Telefónica has launched quad-play over in Spain a few weeks ago, it's getting a lot of press at the moment. Could you just remind us what the backdrop is to quad-play in Germany, are there any regulatory restrictions on you launching this and how do you feel about the prospects for launching quad-play and basically taking advantage of your fixed line presence and the mobile combination? Thank you.

Timotheus Höttges

Chief Financial Officer, Deutsche Telekom AG

A

Look the first thing, yes, it's definitely an opportunity to the market, I think being focused in the way, how you're selling things is very important for the sales organization and you see that it took quite some time before we saw the uptake from double to triple play. We are very happy with the development on Entertain and let's say that it's now a more pull than a pure push market as it was in the past and same is true by the way on the mobile side from voice to data and from data to even more content here. So our clear focus today in Germany – in the German market is on the double and triple-play propositions. Yes, there is some quad-play here in Germany because we have a so-called telecom advantage or telecom [ph] software product and the month (1:04:26) you're buying both of it, you get a price discount but it's not our prime focus at that point in time here in Germany. Therefore our current market focus is behind the other product.

There is even some restriction to it. Yes, from a regulatory position that isn't that easy. So therefore that has to be proved and discussed with the regulator beforehand how we mix the prices, but in principle it's not a market issue at that point in time, it might give us up-selling opportunities later on [ph] and not affiliated (1:05:09) and not making so many big bets on that at that point in time.

Emmet B. Kelly

Analyst, Merrill Lynch International Ltd.

Q

Great. Cheers. Thanks, Tim.

Stephan Eger

Head-Investor Relations, Deutsche Telekom AG

Thanks, Tim. Thanks, Emmet. Unfortunately due to time restrictions we have to close as of today. I know there is 13 people in the queue with [ph] Mattieu (1:05:24), Ulrich and the like, we'll call you without any further adieu from the IR department. Thanks a lot and speak to you soon. Hopefully on December 6 in Bonn. Bye-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 438947 and the # sign. I repeat, Germany 49-1-805-2043-089 via reference number 438947 and the # sign. We are looking forward to hear from you again. Goodbye.

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