

# The 1998 financial year.

## 11

Deutsche Telekom has maintained its leading position extremely well in one of the world's most intensely competitive telecommunications markets. We recorded a 33 percent increase in net income over the previous year. Moreover, our customers were able to benefit from our consistent innovation strategy that allowed us to find solutions to complex communications problems. One of our major tasks in the future will be to further develop and focus our company's innovative strength.



# Management report of the Deutsche Telekom Group and Deutsche Telekom AG.

## Deutsche Telekom (Group)

DM (bn)	1998	1997	1996	1995
Net revenue <sup>1</sup>	69.9	67.6	63.1	59.6
Net income	4.4	3.3	1.8	5.3
Balance sheet total	155.1	162.8	174.3	160.2
Investments	14.7	15.5	22.6	17.7

## Employees

at year-end <sup>2</sup>	1998	1997	1996	1995
	195,876	209,295	220,667	213,467

<sup>1</sup> 1995 figure adjusted for value-added tax.

<sup>2</sup> Includes MATÁV employees from 1996; excludes trainees and student interns.

**Deutsche Telekom ended the 1998 financial year successfully and held its own in competition. Consolidated net income increased by 32.8 percent to DM 4.4 billion. A proposal will therefore be submitted to the shareholders' meeting for a dividend of DM 1.20 to be paid per share.**

The management report for Deutsche Telekom AG has been combined with the management report for the Deutsche Telekom Group.

## Overall economic development

### Improved economic situation

The economic situation in Germany continued to improve during the course of 1998. The upward trend that has been lasting over two years was thus unbroken. This development is reflected in the value of all products and services produced within the country, the gross domestic product (GDP). While the GDP increased by 2.2 percent in real terms in 1997, it enjoyed growth of 2.8 percent in real terms in 1998. Another sign of a favorable economic environment is that capital expenditure on plant and equipment grew by an impressive 8.6 percent in 1998. These developments are very important for Deutsche Telekom, since most of its business activities are concentrated in Germany.

The cost-of-living index for 1998 increased by an average of just 0.9 percent over the previous year, in spite of the value-added-tax increase in April 1998. At present, inflation poses no threat to the German economy.

### Difficult situation in Asia

International financial markets had calmed somewhat by the end of 1998. The stock markets have been recovering noticeably since October 1998. These trends have been supported by decreasing interest rates within the European economic and currency union and by continuing good economic performance in the United States. The crisis in Southeast Asia continued in 1998 and only in the second half of the year did the situation start to become more stable. Long-term recovery in Southeast Asia is not yet foreseeable. In 1997 and 1998, Deutsche Telekom therefore made extensive provisions for risks relating to its investments in Southeast Asia.

### Development of the telecommunications sector

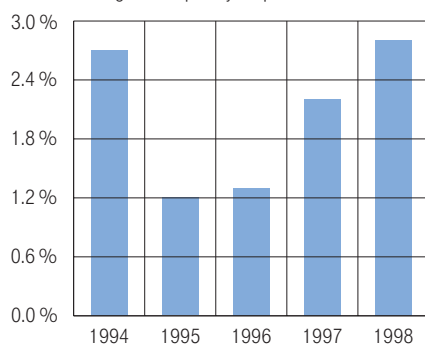
#### Growth and liberalization

Against this macro-economic background, the German telecommunications market in which Deutsche Telekom operates grew by around 8 percent in 1998 (approximately 9 percent in the previous year) to DM 86.5 billion (1997: DM 80.0 billion). The market volume grew significantly in 1998, by about 15 percent (1997: around 13 percent), but the average price reduction of ca. 7 percent (1997: ca. 4 percent) meant that the growth in value was not as marked.

In 1998, Deutsche Telekom's share of the 8 percent growth in the domestic telecommunications market it serves was a growth in revenue over the previous year of approximately 1 percent.

## 1998 GDP, real

Changes over prior-year period



1994:	2.7%
1995:	1.2%
1996:	1.3%
1997:	2.2%
1998:	2.8%



The last remaining restrictions are lifted at the beginning of the year. Germany's telecommunications market is now fully liberalized.



Unveiling on January 26: The new Team Telekom is ready for the 1998 season.



They enjoy having the spotlight on someone else for a change: Ron Sommer and Udo Reiber are obviously happy with the new cycling team.

With the liberalization of the market, Germany became one of the most open telecommunications markets with the fiercest competition in the world. By permitting interconnection, unbundled access to subscriber loops, telephone-number portability, preselection and call-by-call selection, Germany has taken a leading role in European telecommunications liberalization; intense competition has developed very quickly as a result. By the end of 1998, a total of 155 licenses for voice telephony services had been awarded to operators with their own networks; 167 licenses for transmission lines had been issued. These 322 licenses are held by a total of 164 different companies. Numerous additional license applications have been submitted to the Regulatory Authority for Telecommunications and Posts for approval. Since the beginning of 1998, the total number of companies providing telecommunications services in Germany has grown by some 35 percent, to nearly 1,500.

These new providers belong to various strategic categories, often with highly diversified products and services and market-segment focuses. International carriers and newcomers to the sector, such as power suppliers and municipal companies, have entered the German telecommunications market. Companies' market debuts have often been accompanied by major and costly advertising campaigns aimed at generating name recognition. Strong pushes by new competitors, especially in the area of long-distance telephony, have taken market share away from Deutsche Telekom.

Deutsche Telekom's revenue in 1998 – excluding international activities (in particular MATÁV) and the billing of revenue for competitors – amounted to approximately DM 66.2 billion. With a computed market share of ca. 76.5 percent in 1998 (1997: approximately 81.5 percent), Deutsche Telekom lost an average of approximately 5 percent of the domestic telecommunications market in which it operates, as expected.

The number of call minutes in Deutsche Telekom's telephone network increased by ca. 4 percent in 1998. Major tariff adjustments led to a fall in prices of approximately 10 percent in 1998. Despite the enormous pressure of competition, revenue from calls in Deutsche Telekom's telephone network – over DM 31 billion – was only approximately 6 percent lower than in the previous year. The main factor in this development was the drop in revenue from long-distance and international calls. Deutsche Telekom recorded large increases in revenue in the City zone, in fixed network to mobile communications and in the services area compared to the previous year.

The mobile communications segment also experienced strong growth in 1998. According to the Regulatory Authority's figures, by the end of the year the four digital mobile communications networks had achieved subscriber growth of 65.2 percent, to a total of over 13.5 million registered subscribers. Competition has also intensified in this segment and has pushed prices down considerably. Several tariff innovations were introduced by T-Mobil, Deutsche Telekom's mobile communications subsidiary, in particular. Of these innovations, the introduction of "Local" rates (local network rates) had the largest impact on the sector's overall development.

### Regulation of the telecommunications market

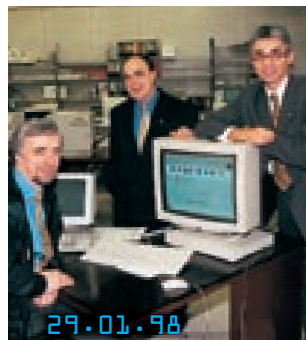
#### Complete liberalization

The Telecommunications Act provides the legal framework for telecommunications liberalization in Germany. This act demands sector-specific supervision of telecommunications competition. By completely liberalizing its telecommunications market, Germany has complied with a European Commission timetable calling for telecommunications liberalization in most EU Member States by January 1, 1998.

Deutsche Telekom's major tariff decisions, and certain services the company offers to competitors, are subject to approval under the existing regulatory framework. The Regulatory Authority for Telecommunications and Posts took numerous regulatory actions in its first year of operation. For example, the authority did not permit Deutsche Telekom to charge any fee for the telephone-number portability required by the Telecommunications Act. For preselection, the Regulatory Authority approved a rate much lower than that for which Deutsche Telekom had applied. Deutsche Telekom has acted to protect its interests by filing suits against these two decisions; these actions are still pending. In another important decision, the Regulatory Authority permitted Deutsche Telekom to raise its cable TV rates. The authority also approved Deutsche Telekom's application for rate decreases of up to 62 percent, for telephone calls in the fixed network, beginning on January 1, 1999.



The man the sports journalists have to see: Jan Ullrich, the big winner in the 1997 Tour de France.



Pilot test for Uni@home: Students at the University of Bochum can now access their campus network via ISDN and the Internet.

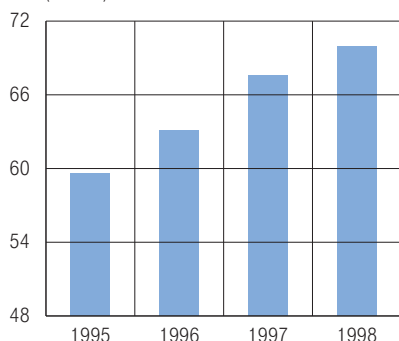
#### Deutsche Telekom (Group) revenue<sup>1</sup>

DM (bn)	1998	1997	Change <sup>2</sup>	1996
Telephone network communications	40.2	41.9	-4.2 %	39.9
Licensed service providers/ Carriers	3.2	2.4	31.2 %	2.2
Data communications/ Systems solutions	4.9	4.6	7.8 %	4.2
Mobile communications	6.0	5.0	18.9 %	4.2
Broadband cable/Broadcasting	3.5	3.1	13.0 %	3.0
Terminal equipment	2.9	3.2	-8.7 %	3.4
Special value-added services	4.0	3.9	2.5 %	3.3
Other services	2.5	1.1	141.0 %	0.9
International activities	2.7	2.4	15.8 %	2.0
<b>Total revenues</b>	<b>69.9</b>	<b>67.6</b>	<b>3.4 %</b>	<b>63.1</b>

<sup>1</sup> Revenue reporting is based on the Group business area structure in 1998. The previous year's figures are shown in accordance with the new structure.

<sup>2</sup> Based on the more precise million figures.

Development of revenues (DM bn)



1995: 59.6<sup>1</sup>  
 1996: 63.1  
 1997: 67.6  
 1998: 69.9<sup>2</sup>

<sup>1</sup> 1995 figure adjusted for value-added tax.

<sup>2</sup> 1998 figure includes DM 1 billion from the billing of services of other network operators.

The Regulatory Authority failed in 1998 to make a final decision on the central question of whether different network operators and telecommunications providers should be subject to different interconnection rates. While the Regulatory Authority supports such "carrier segmentation", in principle, the question of the specific structure for such segmentation remains to be decided.

#### Development of business in 1998

##### Increased revenue

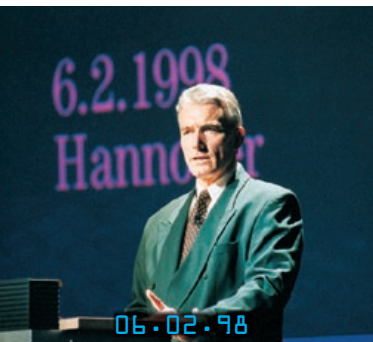
During the 1998 financial year, Deutsche Telekom generated consolidated net revenue totaling DM 69.9 billion. This represents an increase of 3.4 percent over the previous year.

Deutsche Telekom's largest revenue driver, telephone network communications, generated DM 40.2 billion, less than in the previous year. The main factors in this revenue development were price cuts and increasing competition in the course of the year, in particular in the areas of domestic long-distance and international calls. The continued increase in the number of ISDN lines by 37.5 percent to 10.1 million had a positive influence on the revenue generated by telephone network communications. Overall, however, revenue in the telephone network communications business area fell by 4.2 percent to DM 40.2 billion in 1998. A major increase in revenue was recorded in the area of interconnection services and in data communications and systems solutions in 1998. Nevertheless, this increase could not fully compensate for the reductions in revenue in telephone network communications.

In 1998, mobile communications recorded year-on-year revenue growth of 18.9 percent. The T-D1 service experienced a sharp rise in revenues as a result of the dynamic development in the number of customers, which grew 67.1 percent to reach 5.5 million at year-end. At the same time, the revenues reported for the analog T-C-Tel fell as the number of customers continued to drop.

Revenue in the broadband cable and broadcasting group business area improved by 13.0 percent to DM 3.5 billion due to the price adjustment on November 1, 1997. Revenue in the terminal equipment business area decreased as planned by 8.7 percent compared to the previous year to DM 2.9 billion as a result of the streamlining of our product portfolio. Revenue in the special value-added services group business area increased in 1998 by 2.5 percent to DM 4.0 billion, partly due to the tariff adjustment on November 1, 1997.

The success of T-Online as the largest online service provider on the German market is reflected in the pleasing increase in revenue in other services to DM 2.5 billion. The number of T-Online customers grew by 40.6 percent to 2.7 million at the end of the year. Furthermore, other services include revenues generated for the first time from the take-over and billing of services of other fixed-network operators, amounting to DM 1.0 billion. These revenues are offset by a corresponding increase in goods and services purchased.



Hagen Hultzsch, head of the company's Technology and Services Division, opens the Multimedia Symposium on February 6.



600 business customers and 300 journalists from around the world engaged in lively discussion on topics such as multimedia, e-commerce and the Internet.



An important focus of the Multimedia Symposium: tele-learning.

In the international activities group business area, revenue amounting to DM 2.7 billion was primarily generated by the Hungarian telecommunications operator MATÁV. This represents an increase of 15.8 percent in 1998. This can again be attributed to an increase in the number of lines operated by MATÁV in its fixed and mobile networks.

**Continued rise in net income**

During the year under review, Deutsche Telekom generated consolidated net income totaling DM 4.4 billion, which represents an increase of 32.8 percent over the previous year. Results from ordinary business activities amounted to DM 10 billion (1997: DM 7.2 billion).

The increase in net income can be attributed to the following factors, some of which have offsetting effects: The 3.4 percent increase in revenue to DM 69.9 billion, of which DM 1.0 billion is attributable to the billing of services of other fixed network operators, was offset by an increase of 9.5 percent in goods and services purchased to DM 13.3 billion (1997: DM 12.1 billion). This growth is, however, mainly attributable to expenses for the first time for goods and services purchased for the billing of services of other fixed network operators, amounting to DM 1.0 billion.

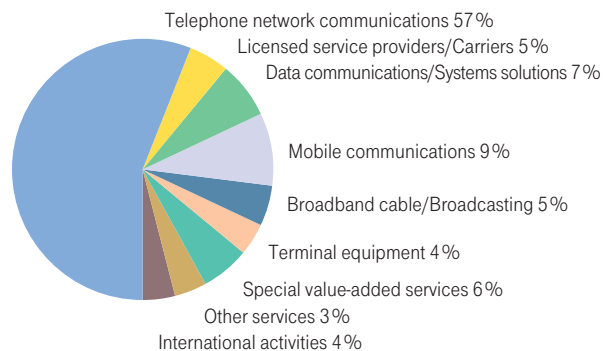
As the workforce reduction program was continued according to plan, personnel costs in the year under review fell by 2.2 percent to DM 17.9 billion (1997: DM 18.3 billion). Personnel costs per employee, however, increased by 3.9 percent. Besides the 1.5 percent increase in wages and salaries under collective bargaining agreements and a remuneration adjustment related to eastern German collective bargaining agreements, this growth was attributable to age-related salary increases, the review of salaries in some areas to bring them in line with market conditions and the payment of an annual fixed amount of DM 2.9 billion towards civil servant pensions.

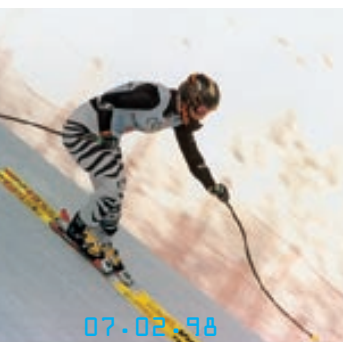
Depreciation of intangible assets and of property, plant and equipment fell by 5.0 percent as expected to DM 17.7 billion (1997: DM 18.6 billion) as a result of the considerable decrease in investment.

Other operating expenses increased by DM 0.3 billion to DM 10.5 billion.

Financial expense of DM 6.4 billion in 1998 represented an improvement of 17.8 percent compared to the previous year (1997: DM 7.8 billion). Net interest expense fell in line with expectations by DM 0.6 billion to DM 5.8 billion as a result of the scheduled reduction of debt. Furthermore, the loss related to subsidiaries, associated and related companies was cut by more than half to DM 0.5 billion (1997: DM 1.4 billion). The main factors in the loss related to subsidiaries, associated and related companies were further start-up losses at Atlas/Global One and negative influences resulting from Deutsche Telekom's investments in Southeast Asia. Besides the ongoing proportional losses (DM 0.1 billion) and scheduled amortization of goodwill (DM 0.1 billion),

Revenue by business area

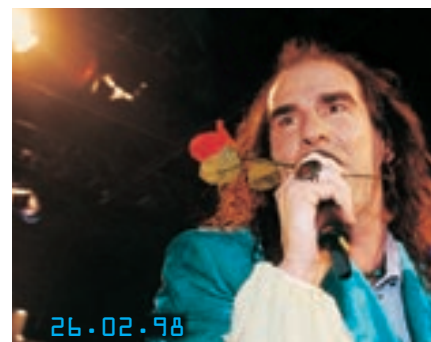




Katja Seizinger races to a gold medal at the Winter Olympics in Nagano, Japan.



Arno Inderwies monitors TV transmission in the Fuchsstadt earth station during the Games in Nagano.



The German qualification for the Grand Prix D'Eurovision: A total of 690,000 callers voted via T-VoteCall; 20 percent called in on cellular phones. The fans' run-away favorite: Guido Horn.

#### Group/DVFA earnings per share

DM (million)	1998	1997	1996
Consolidated net income	4,388	3,303	1,758
Amortization of goodwill	381	617	284
Other additions <sup>1</sup>	0	0	1,064
DVFA/SG earnings <sup>2</sup>	4,769	3,920	3,106

Number of common shares 2,743,240,100

DVFA/SG earnings per share 1.74 1.43 1.13

<sup>1</sup> Extraordinary losses for personnel restructuring measures and share offering costs, net of tax effects.

<sup>2</sup> DVFA/SG earnings calculated in accordance with currently applicable method.

#### Key figures for Group segments in 1998 in accordance with SFAS 131

	Net revenue	Income before taxes	Return on sales <sup>1</sup>	Capital expenditure on property, plant and equipment
<b>DM (bn)</b>				
Telephone network communications	40.2	9.4	23.4%	3.7
Mobile communications	6.0	1.3	22.0%	1.0
Broadband cable/Broadcasting	3.5	(0.6)	-18.0%	0.7
Terminal equipment	2.9	(0.2)	-7.6%	0.2
Special value-added services	4.0	(0.3)	-8.8%	0.1
International activities	2.6	0.5	20.2%	0.9
Other segments	10.6	(0.1)	-0.7%	1.7
Reconciliation <sup>2</sup>	0.1	0	-	0
<b>Total</b>	<b>69.9</b>	<b>10.0</b>	<b>14.3%</b>	<b>8.3</b>

<sup>1</sup> Based on more precise million figures.

<sup>2</sup> Net revenue from subsidiary companies shown under international activities in the consolidated financial statements.

a further provision for risks of DM 0.2 billion was necessary due to the critical developments in the region.

The DM 1.9 billion increase in corporate income tax is primarily attributable to the improved results before taxes compared to 1997. Moreover, this figure was influenced by accounting and valuation differences between balance sheets prepared for financial reporting and tax reporting purposes, in particular provisions and accruals. The increase in corporate income taxes is offset by a reduction in other taxes of DM 0.3 billion, which is primarily a result of the discontinuation of trade capital tax. Overall, tax expenses increased by DM 1.6 billion to DM 5.2 billion.

#### Results of the individual segments in accordance with SFAS 131

In 1998, the telephone network communications business area reported income before taxes of DM 9.4 billion. This result was influenced by the growth in the overall telecommunications market and by the intensification of competition in the course of the year. The price cuts on March 1, 1998 also reduced profitability in this area.

Income before taxes in the mobile communications business area amounted to DM 1.3 billion in 1998. This result was achieved despite continued price cuts in the course of the year and the increase in goods and services purchased due to the strong growth in the number of customers in the T-D1 network.

The effects of the price increase from November 1, 1997, in the broadband cable/broadcasting business area were felt in 1998. As a result, losses before taxes in this area were limited to DM 0.6 billion.

Losses before taxes from terminal equipment totaled DM 0.2 billion in 1998. In the year under review, Deutsche Telekom streamlined its portfolio of terminal equipment in order to minimize losses in this area.

Special value-added services generated losses of DM 0.3 billion in 1998. Price realignments and adjustments to the number and location of Deutsche Telekom's public telephones contributed to the improvement in these results in 1998.

International activities recorded income before taxes of DM 0.5 billion in 1998. This area consists principally of the Hungarian telecommunications provider MATÁV.



The grid, a futuristic symbol for Deutsche Telekom's network expertise, dominated the company's 10,000 m<sup>2</sup> stand at the CeBIT '98 exhibition. Under its motto "Our team. Your success.", the company showed its newest products and services.



Malaysia's Prime Minister Mahatir, shown here with Board of Management member Detlev Buchal, was one of the many VIP guests visiting the stand.

Other segments, which include licensed service providers and carriers, data communications, systems solutions and multimedia as well as T-Online, generated losses before taxes of DM 0.1 billion. The group business areas of licensed service providers/carriers, data communications and systems solutions contributed to this result. The total also includes losses attributable to associated companies, including Global One and Deutsche Telekom's investments in Southeast Asia.

### Annual financial statements of Deutsche Telekom AG

Corporate groups with international activities are increasingly focusing their reporting on the consolidated financial statements. However, in Germany the dividend paid to the shareholders is based on the net income generated by Deutsche Telekom AG. For this reason, the annual financial statements of Deutsche Telekom AG are presented in summarized form below.

The balance sheet total for Deutsche Telekom AG decreased by DM 7.7 billion to DM 150.3 billion. The equity ratio increased by 1.5 percent to 30.7 percent. Deutsche Telekom AG recorded a 1.7 percent increase in net revenue, bringing the total to DM 61.4 billion. With income before taxes totaling DM 8.5 billion, Deutsche Telekom AG surpassed the 1997 figure by 25 percent. Net income amounted to DM 3.3 billion after deduction of taxes totaling DM 5.2 billion. The proposal for the appropriation of net income calls for almost all of this amount to be distributed to the shareholders.

### DM 1.20 dividend per share

The Supervisory Board and the Board of Management propose, subject to approval at the shareholders' meeting, to use the unappropriated net income of DM 3.3 billion to pay a dividend of DM 1.20 per individual no par value share, on the dividend-bearing capital stock of DM 13.7 billion. In addition, shareholders who are fully subject to domestic taxes will receive a tax credit of DM 0.51 per individual no par value share.

### Summary of the financial statements of Deutsche Telekom AG

#### Statement of income

(DM bn)	1998	1997
Net revenue	61.4	60.4
Changes in inventories and other own capitalized costs	1.2	2.0
Other operating income	7.7	8.4
Goods and services purchased	(13.4)	(11.6)
Personnel costs	(15.3)	(15.9)
Depreciation and amortization	(15.0)	(16.9)
Other operating expenses	(12.9)	(13.2)
Financial income (expense), net	(5.2)	(6.4)
<b>Income before taxes</b>	<b>8.5</b>	<b>6.8</b>
Taxes	(5.2)	(3.5)
<b>Net income</b>	<b>3.3</b>	<b>3.3</b>

#### Balance sheet

(DM bn)	Dec. 31, 1998	Dec. 31, 1997
Property, plant and equipment, and intangible assets	99.7	118.0
Financial assets	28.5	16.6
<b>Noncurrent assets</b>	<b>128.2</b>	<b>134.6</b>
Inventories, materials and supplies	0.7	0.8
Receivables	7.7	8.2
Liquid assets	12.3	12.4
<b>Current assets</b>	<b>20.7</b>	<b>21.4</b>
Deferred taxation	0.5	0.8
Prepaid expenses	0.9	1.2
<b>Total assets</b>	<b>150.3</b>	<b>158.0</b>
Shareholders' equity	49.4	49.4
– of which: net income	3.3	3.3
Accruals	13.6	13.0
Liabilities	86.8	94.9
Deferred income	0.5	0.7
<b>Total shareholders' equity and liabilities</b>	<b>150.3</b>	<b>158.0</b>

The annual financial statements of Deutsche Telekom AG which have an unqualified audit opinion from C&L Deutsche Revision Aktiengesellschaft Wirtschaftsprüfungsgesellschaft are published in the Federal Gazette (Bundesanzeiger) and filed with the Commercial Registry of the Bonn District Court. The annual financial statements are available upon request from Deutsche Telekom, Investor Relations, Postfach 20 00, D-53105 Bonn, Germany, fax +49 228 181-84 05.



Gerhard Schröder, at the time still Minister President of Lower Saxony, conversing with Chairman Ron Sommer and Gerd Tenzer, head of the company's Networks, Purchasing, and Environmental Protection Division.



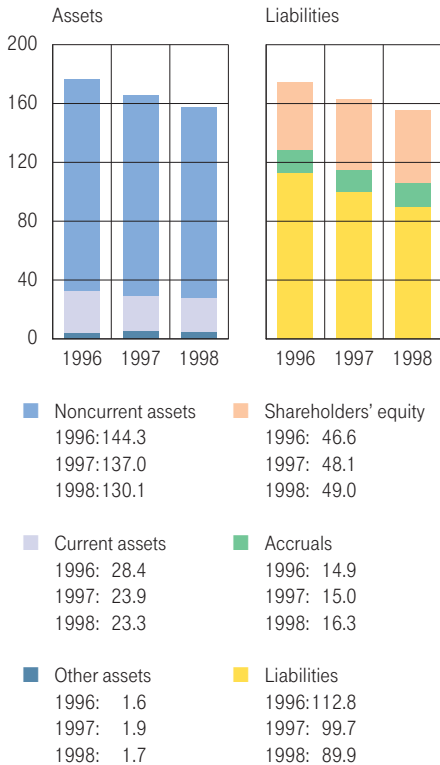
Deutsche Telekom was one of the exhibition's big attractions: Over half of the 670,000 CeBIT visitors stopped by Deutsche Telekom's stand in Hall 16.



Big surprise: Ron Sommer and Federal Chancellor Helmut Kohl himself congratulating the two-millionth T-Online customer.

**Balance sheet structure**

(DM bn)



**Balance sheet structure: equity ratio enhanced**

The balance sheet total of the Deutsche Telekom group declined by DM 7.7 billion to DM 155.1 billion in the 1998 financial year. On the assets side, the reduction can be attributed mainly to the decrease in noncurrent assets by DM 6.9 billion, with depreciation and disposals of property, plant and equipment being only partially offset by a lower level of capital investment. Current assets declined only slightly by DM 0.6 billion, mainly due to the sale of securities shown under current assets. Shareholders' equity rose primarily due to the increase in retained earnings from net income as at December 31, 1998 to DM 49.0 billion (1997: DM 48.1 billion). The equity ratio rose to 29.5 percent, compared with 27.5 percent at the prior balance sheet date, excluding proposed dividend payments.

**Further reduction in debt**

Deutsche Telekom has once again enhanced its financial structure by systematically reducing its debt by a further DM 9.8 billion (11.1 percent) in line with expectations to DM 78.1 billion. As a result, of the amount originally scheduled for repayment (approximately DM 60 billion in the old consolidated group), a total of DM 50 billion in debt has already been repaid since 1995; the reduction of debt to DM 65 billion by the year 2000 is a goal we will continue to pursue vigorously.

In order to broaden its sources of funding, Deutsche Telekom floated a bond issue with a volume of DM 2 billion in May 1998. This debut benchmark bond was issued by Deutsche Telekom's finance subsidiary Deutsche Telekom International Finance B.V. and is intended to improve Deutsche Telekom's maturities structure and to optimize interest expenses.

**Investments down**

During the 1998 financial year, Deutsche Telekom invested a total of DM 14.7 billion (1997: DM 15.5 billion), of which DM 9.3 billion (1997: DM 13.9 billion) was invested in property, plant and equipment, and intangible assets, and a further DM 5.4 billion (1997: 1.6 billion) in financial assets.





Deutsche Telekom's team at the company's CeBIT stand in their smart outfits.



The 1998 press conference on Deutsche Telekom's financial statements at the company's Bonn headquarters: Joachim Kröske, head of the company's Finance, Accounting and Controlling Division, discusses the annual financial statements.

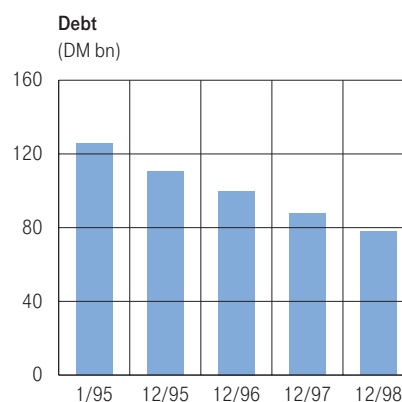
As expected, investments in property, plant and equipment decreased considerably to DM 8.3 billion (1997: DM 13.3 billion) after the completion of investment projects in 1997, the conversion from analog to digital transmission and switching equipment and the completion of the development program for eastern Germany. Investments in property, plant and equipment focused primarily on transmission and switching equipment and the telecommunications line network. A total of DM 1.1 billion was spent on other plant and office equipment. Investments in intangible assets in 1998 totaled DM 1.0 billion (1997: DM 0.6 billion). This was mainly spent on the acquisition and updating of software.

There are several reasons for the increase in investments in financial assets to DM 5.4 billion, compared with DM 1.6 billion in 1997. Deutsche Telekom invested a further DM 1.2 billion in fixed-income security issues (bond funds), mixed funds and equity funds launched by Deutsche Telekom. These funds are intended to optimize income from medium and long-term liquid reserves. A further DM 0.5 billion was invested in associated companies, in particular Atlas/Global One.

Other investments in related companies accounted for further investments of DM 3.2 billion. Of this total, DM 2.4 billion was accounted for by the acquisition of a 2 percent share in France Telecom as part of a cross shareholding. A further DM 0.3 billion was invested in the satellite company SES Société Européenne des Satellites S. A. and over DM 0.1 billion in the Italian joint venture Wind, established in November 1997, as well as DM 0.1 billion in the Israeli company VocalTec Communications Ltd. Deutsche Telekom also invested approximately DM 0.1 billion in capital measures at Sprint.

#### Cash generated from operations remains strong

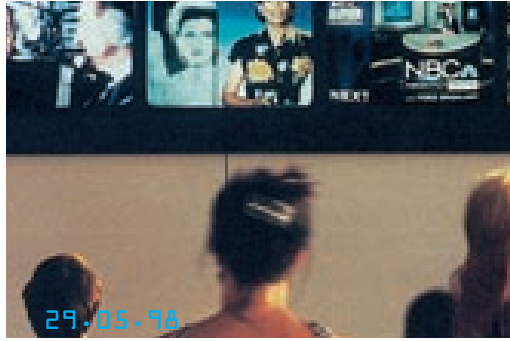
Net cash provided by operating activities rose by DM 3.8 billion to DM 26.4 billion, whilst net cash used for investing activities totaled DM 14.7 billion (1997: DM 10.5 billion). Whereas investments in intangible assets and property, plant and equipment was reduced, the amount invested in financial assets increased. Cash provided by financing activities totaled DM 13.3 billion. This represents a slight decrease compared with 1997.



Jan. 01, 1995: 125.5  
Dec. 31, 1995: 110.4  
Dec. 31, 1996: 99.9  
Dec. 31, 1997: 87.9  
Dec. 31, 1998: 78.1

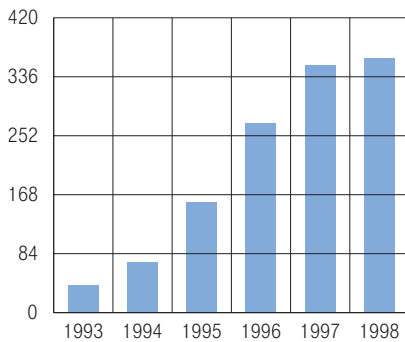
#### Statement of cash flows (summarized)

(DM bn)	1998	1997	1996
Net cash provided			
by operating activities	26.4	22.6	22.3
Net cash used for			
investing activities	(14.7)	(10.5)	(25.3)
Net cash provided by (used for)			
financing activities	(13.3)	(13.8)	6.8
<b>Net increase (decrease)</b>			
<b>in cash and cash</b>			
<b>equivalents (up to 3 months)</b>	<b>(1.6)</b>	<b>(1.7)</b>	<b>3.8</b>



In late May, the Board of Management decides to spin off the company's broadband cable business. The network will be regionalized.

Patent applications by Deutsche Telekom



1993:	39
1994:	72
1995:	158
1996:	270
1997:	353
1998:	363

## Purchasing

### Considerable reduction in purchasing volume

The Group's total expenditure for goods and services decreased by approximately DM 4 billion, to approximately DM 19 billion, compared to 1997. Major investments of recent years, creating one of the world's most modern telecommunications infrastructures, played a central role in making this decrease possible. Purchasing volume as a percentage of revenue decreased to 27 percent, a good level by international standards.

Other factors – in addition to completion of significant telecommunications-infrastructure investment projects – also contributed to the decrease: price reductions in important purchasing markets, internal cost cuts and major successes in purchasing. Once again in 1998, the main purchasing focus was on telecommunications equipment, IT hardware and software and related IT consulting services.

Purchasing was further internationalized through establishment of purchasing offices in the most important technology markets, i.e. in North America and Southeast Asia. Purchases from foreign companies and their subsidiaries accounted for approximately 20 percent of total purchasing volume in 1998. In addition to internationalization, purchasing policy emphasized continuing intensification of supplier relationships, along with reductions in the overall number of suppliers.

In 1999, purchasing will continue to focus strategically on long-term reductions of product-purchasing prices, especially with respect to overall life-cycle costs.

## Research and development

### Innovations assure our future

Deutsche Telekom's competitiveness depends on development of innovative products and services; innovative development helps strengthen our position in the international competition. Our innovation strategy is aimed at quickly translating technological progress into benefits for customers. The innovation spectrum is broad: In addition to carrying out research projects, we develop new products, services and applications for the Group and work constantly to improve the efficiency and quality of the network infrastructure.

Our research and development facilities – our Technology Center, T-Berkom, our five software development centers, Multimedia Software GmbH Dresden, and the development units of our mobile communications subsidiary T-Mobil GmbH – had about 4,400 employees in 1998. A total of some DM 1.3 billion was invested in research and development in 1998 (1997: DM 1.2 billion); about 40 percent of this went into software development. 363 new patent applications were submitted in 1998, once again exceeding the total for the previous year. Currently, Deutsche Telekom holds some 3,000 property rights worldwide.



Some 6,000 shareholders attending Deutsche Telekom's shareholders' meeting in Hanover on June 4.



The company's management taking shareholders' questions.



Ron Sommer, Chairman of the company's Board of Management, was enthusiastically welcomed. Many shareholders asked him to autograph their copies of the annual report.

### Transmitting large amounts of data with WDM technology

The Technology Center, with main offices in Darmstadt, is responsible for developing and optimizing the Group's network infrastructure. Its work emphasizes in 1998 included ATM, IN and IP platforms. The Technology Center also has activities in the area of transmission technology. Within the framework of ACTS (Advanced Communications Technologies and Services), an EU-supported research and development program, Deutsche Telekom is centrally involved in pilot systems for advancing Wavelength Division Multiplex (WDM) technology. In 1998, Deutsche Telekom became one of the first network operators in Europe to successfully test WDM technology and introduce it for special applications. The Wavelength Division Multiplex system makes it possible to transmit extremely large amounts of data over existing optical fiber networks. We plan to use this technology to meet rapidly growing bandwidth requirements for ATM and IP services.

### Innovative drive throughout the country

Our subsidiary T-Berkom, located in Berlin, develops customer-oriented applications, telematics services and terminal devices, working in close cooperation with national and international high-technology partners, universities and major research establishments. T-Berkom's developments include innovative Internet and Intranet services such as Music on Demand, games for networked players and Internet telephony with Surf&Call. Further examples are telecommerce and call center solutions with computer telephony integration and voice control, and new types of terminal devices such as the T-View 100PC. T-Berkom has a specially equipped laboratory that tests newly developed products and services for user-friendliness and convenience. A key criterion for the company's work is that its new products and services provide proven benefits for customers.

Deutsche Telekom's development centers in Berlin, Bremen, Essen, Darmstadt and Saarbrücken develop the entire range of software the company requires. The spectrum ranges from software for supporting internal business processes to software components for products and services. Major focuses of the centers' work in 1998 included additional changes in Deutsche Telekom's order management systems: complex legacy systems are being replaced by more flexible, newly developed systems.

In our development centers, we have expanded our IT competence in key areas such as network management systems and services components such as intelligent networks; this is giving us a competitive edge by enabling us to respond more quickly and directly to new types of requirements.



Mid-June: Gerd Tenzer, head of the company's Networks, Purchasing, and Environmental Protection Division, and Wolfgang Clement, Minister President of the state of North Rhine-Westphalia, launching a pilot project for introduction of ADSL.

Another Deutsche Telekom subsidiary, Multimedia Software GmbH Dresden, develops software for products and services that use multimedia, Internet and Intranet technologies. Projects completed in 1998 included a digital media library, for the Mercedes Benz Marketing Academy, that will support on-demand retrieval of training materials – including everything from text documents to training videos. In addition, Multimedia Software GmbH Dresden, helped design the Web presences of Deutsche Telekom AG, Team Deutsche Telekom, the cycling team, and KölnArena in Cologne.

#### **T-Venture**

In its first full year of business (the figures in brackets refer to the 1997 short financial year), T-Venture committed, and proportionally paid out, some DM 33 million (DM 8 million) for minority stakes in 9 (2) telematics-sector companies. Our first investment project from the previous year (December 1997), Intershop Communications AG, had a successful initial public offering in July 1998 on the Frankfurt stock exchange (New Market); this IPO venture was carried out in cooperation with Technologieholding, one of Germany's leading venture capital companies. Within the framework of its international fund strategy (indirect investments), T-Venture has committed to acquire stakes in funds in the U.S., the UK, the Netherlands and Israel, thereby starting to build an international network of professional venture capital partners. All of T-Venture's direct and indirect investments have already led to lively exchanges of information between all parties involved. The company has concluded sales and license agreements and opened a "window on technology".

#### **Cooperation with France Telecom**

Cooperation with France Telecom plays an important role in our research and development activities. We are cooperating in areas such as ATM technology, intelligent networks, IP services and standardization issues. In the year under review, Deutsche Telekom and France Telecom established the "ThinkOne" joint venture in Brisbane, California as a center for joint research and development projects. ThinkOne will focus primarily on Internet technologies, multimedia services, data communications and mobile communications services. The joint venture company integrates two existing organizations that concentrate on identifying and explor-

ing the potential applications of new information and communications technologies: Deutsche Telekom Advanced Solutions, established in 1996, and France Telecom Research & Development, which dates from 1997. The latter of these two companies is a laboratory of CNET, France Telecom's research center.

#### **R&D activities to be merged in 1999**

In 1999, Deutsche Telekom plans to establish a new subsidiary, T-Nova GmbH, that will bundle the Group's development of innovative products and solutions. Deutsche Telekom's Technology Center, its five software development centers and T-Berkom will all be transferred into this new subsidiary, which is scheduled to begin operations on July 1, 1999. T-Nova GmbH will be responsible for research and development for products, services, networks and network elements and process-supporting software for the Deutsche Telekom group. In addition, the company will provide support for market introduction and operation of its developments, and it will offer consulting and systems-integration services. We are expecting this concentration to contribute significantly to the Group's innovation power.



Full concentration: children showing their talent at the big party to finish the art contest for the new telephone book.



Deutsche Telekom makes it all possible: live broadcast of the Football World Cup, here on a big screen.

## Employees

Deutsche Telekom's employees are its greatest resource. In 1998, we reconfirmed our commitment to future-oriented personnel policies, with human resources management strongly emphasizing development of our employees' skills and qualifications. In addition, we continued our program of workforce reduction avoiding compulsory redundancies in 1998.

### Staff level down to 179,200

As at December 31, 1998, Deutsche Telekom employed 179,200 people – 46.8 percent of them civil servants and 53.2 percent non-civil servants (salaried employees and wage earners). These figures are based on the composition of the 1995 consolidated group. Including the changes in the composition of the Group (especially MATÁV), the number of employees was 195,900 at the end of 1998. The number of trainees and interns was 6,900 at December 31, 1998.

Approximately 34 percent of our employees are women. One of the Deutsche Telekom group's declared aims is to promote equal opportunities for men and women and to live by this policy in its everyday work. In 1998, for example, this policy prompted Deutsche Telekom to launch the "Mentoring program for women", a pilot project that is training women for management level positions.

### Staff downsizing and personnel redeployment

The company's workforce reduction program was continued in the 1998 financial year. In comparison with the workforce level at the end of 1997, the number of employees – based on the 1995 composition of the consolidated group – had decreased by some 12,000 by December 31, 1998. The workforce reductions, which are necessary to maintain the company's competitiveness, are taking place by means of normal attrition, severance packages, tide-over allowances, part-time work for older employees, financing assistance for civil servants giving up their status and leaving the company, and early retirement programs. A Group-wide redeployment strategy is ensuring that the personnel requirements of all regions and specialization areas can be met. Pursuant to a collective bargaining agreement, there will be no dismissals due to rationalization before the end of the year 2000.

The Group's medium-term goal of reducing its workforce (not including MATÁV personnel) to about 170,000 by the year 2000 without compulsory redundancies – a reduction of 60,000 from the 1994 level – will be fulfilled ahead of time.

### Workforce productivity considerably improved

The workforce reductions have cut Deutsche Telekom's personnel costs. In 1998, these costs amounted to DM 17.9 billion, representing a decrease of 2.2 percent compared to the 1997 financial year. Revenue per employee – based on the 1995 composition of the consolidated group – increased by 9.4 percent to DM 362,000 per employee in the year under review.

### Deutsche Telekom employees as at balance sheet date<sup>1</sup>

	Dec. 31, 98	Dec. 31, 97	Dec. 31, 96	Dec. 31, 95
Civil servants	83,848	91,542	105,419	114,430
Salaried employees	54,008	51,681	44,235	43,672
Wage earners	41,313	47,811	51,406	55,365

**Deutsche Telekom<sup>2</sup> 179,169 191,034 201,060 213,467**

#### Changes in the

composition of the Deutsche Telekom group in previous years (in particular MATÁV)	16,707	18,261	19,607	-

#### Total Deutsche Telekom

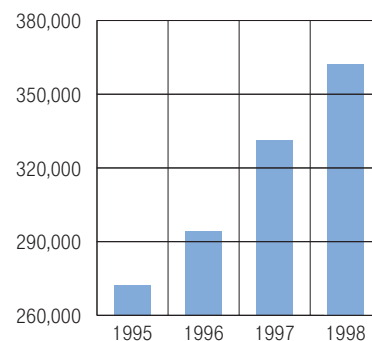
**group 195,876 209,295 220,667 213,467**

Trainees/students interns 6,932 6,711 8,923 11,718

<sup>1</sup> Adjusted to reflect full-time jobs.

<sup>2</sup> Before changes in the composition of the Deutsche Telekom group of previous years.

### Revenue per employee at Deutsche Telekom<sup>1</sup>



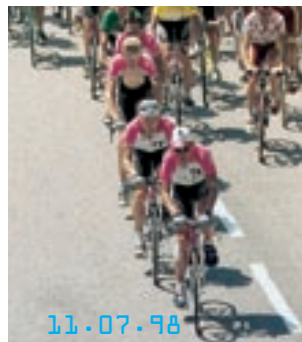
1995: 271,000<sup>2</sup>  
 1996: 294,000  
 1997: 331,000  
 1998: 362,000

<sup>1</sup> Revenues and number of employees prior to changes in the composition of the Deutsche Telekom group; annualized average number of employees excluding trainees.

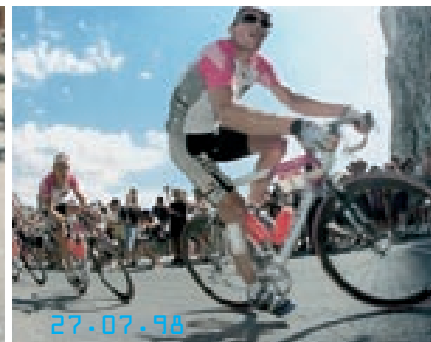
<sup>2</sup> Based on revenue figures adjusted for value-added tax.



The fans in good spirits.



Start of the 1998 Tour de France, running from July 11 to August 2.



Suffering through one of the Tour's brutal climbs: Udo Bölts and Jens Heppner.

### Performance-based salaries

In order to meet the challenges expected in the future and already imposed by the competitive environment, Deutsche Telekom is gradually phasing in a standardized remuneration system that is oriented to individual performance. On January 1, 1998, a new guideline took effect calling for variable pay elements for management positions; a managing employee's salary now depends on the company's achievement of established corporate aims, on the employee's attainment of individually agreed targets and on the employee's overall performance. After a new remuneration plan was negotiated for the Deutsche Telekom subsidiaries T-Mobil, DeTeCSM and DeTeSystem in 1997, a similar plan was introduced at DeTe Immobilien on January 1, 1999.

### Personnel development and innovative work arrangements

Deutsche Telekom considers efficient training and personnel development, by means of ongoing support and continuing education for employees, to be a key element in strengthening its leading market position further. In 1998, a total of DM 0.6 billion was invested in training and continuing education within the company.

In addition, the company concluded collective wage agreements on part-time work and – for the first time in Germany – a collective wage agreement on teleworking. These agreements are giving Deutsche Telekom greater flexibility in its procedures; they are enabling us to enhance efficiency, distribute work periods more effectively, save time and cut costs, and further increase productivity.

### New collective bargaining agreement on employee benefits

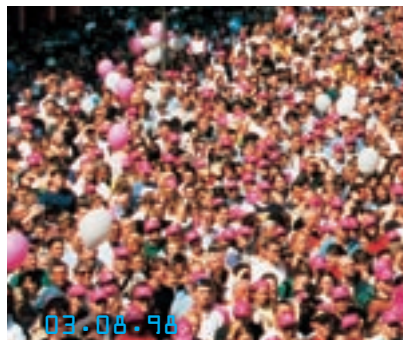
In the year under review, the company concluded a new collective bargaining agreement on employee benefits. The purposes of this agreement are to streamline the company's special benefits and institutions such as hostels for employees, social counseling services, the PTT recreation scheme, to align them with market standards and to reduce their costs. Deutsche Telekom views its social security benefits as another instrument for fostering and enhancing the performance and good morale of its employees.

### Personnel report

In 1998, Deutsche Telekom published a first personnel report. This report, which is now to appear on an annual basis, provides information about our innovative concepts and measures for developing and promoting our employees' full potential.



On tour with the Tour: Deutsche Telekom and the German TV channel ARD jointly operate this mobile broadcasting center.



A sea of magenta: Team Telekom is enthusiastically welcomed in Bonn.



One team, one goal, one spirit. Team Telekom's cyclists obviously enjoy basking in the crowd.

### Dependent company report

Due to the majority shareholding, Deutsche Telekom is a dependent company of the Federal Republic of Germany. No controlling agreement or profit-and-loss transfer agreement exists. Pursuant to § 312 of the German Stock Corporation Law (AktG), the Board of Management of Deutsche Telekom AG has therefore prepared a Dependent Company Report describing relations between the controlling body and affiliated companies. The Board of Management has included the following statement at the end of this report: "The Board of Management hereby states that, under the circumstances known to the Board of Management at the time of performing the business transactions, the Company received appropriate remuneration for such transactions. The Company did not perform or omit any actions on behalf of or on the instructions of the controlling company or any affiliated companies."

### Issues concerning the Group

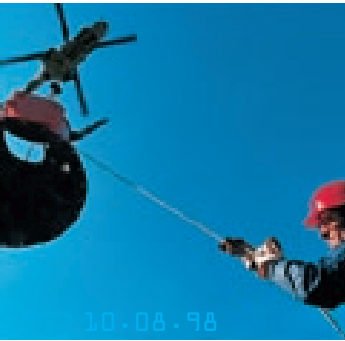
#### Risk management

Our economic environment is typified by the enormous speed at which competition is developing, by new technologies and the growing challenges of a global information society. It is our aim to tackle these challenges with a systematic risk management system.

Deutsche Telekom is, and always has been, subject to audit by external auditors in accordance with § 53 of the German Law on Budgetary Principles (Haushaltsgrundsätzegegesetz). This audit includes an audit of risks and measures taken. We have suitable internal auditing and controlling departments because we think the coordinated interaction between taking advantage of opportunities and the analysis and limitation of risks on strategic and operational levels is a precondition for our corporate success in the long run.

We have also developed our own risk management instruments to supplement existing processes. We attach great importance not only to risk analysis and procedures for overcoming risks, but also to the early identification of risks. Our risk management system is designed to give the company's management rapid and coordinated information on major individual risks, to evaluate these risks and to report on the current status of measures taken to limit and monitor risks.

The risk management systems of the various divisions are being combined and further developed as a Group-wide system. We are implementing processes for strategic planning, operational control and for monitoring corporate risks, designed to cover the particular requirements of the regulated telecommunications market. A defined risk management system ensures that risk analyses are taken adequately into account in all business processes.



A high-precision job: Installing a new transmitting antenna at the Habichtswald TV station near Kassel.



Interference-free, top-quality reception guaranteed: The new antenna is in operation.



Crash test dummies are breathing easier: Supercomputers and fast networks are making new, more effective crash-simulation methods possible.

Our actions are focused on the potential for increasing the company's shareholder value. As such, we are always looking to improve our risk management system. The main risks associated with our business activities are currently:

- the further development of Deutsche Telekom on the domestic telecommunications market as a result of marked price reductions and regulatory decisions;
- the development of conditions surrounding our options for refinancing;
- the continuation of our drive to cut costs;
- the development of our international investments and the associated country-specific risks;
- the further development of the German real estate market in light of our real estate portfolio, which has a remaining book value of approximately DM 35 billion.

#### Management of financial risks

Within our Group-wide risk management system, we attach particular importance to the management of risks related to our financial situation. All our treasury activities – in particular the use of derivative financial instruments – are subject to the primary principle of risk limitation.

Derivative financial instruments are used to limit the risks associated with currencies and changes in interest rates. As a matter of principle, these instruments are used not for speculative purposes but only for purposes of hedging. On December 31, 1998, the notional amount of transactions made totaled DM 15.1 billion for derivative interest instruments and DM 1.1 billion for foreign currency forward exchange contracts. Derivative finance contracts were concluded to safeguard against interest rate and currency risks and, to a lesser extent, to optimize interest income.

Transactions are recorded in a central treasury system immediately after their completion so that the economic effects of derivative financial instruments can be identified and controlled at all times. It is thus always possible to monitor current developments in this area. We have established a further important precondition for ensuring efficient risk management with the clear, functional separation of transactions and controls in our structural and operational organizations.

All financial transactions and risks are recorded in a central treasury system. The management is informed regularly of the level and market value of all financial transactions. In the 1999 financial year, we plan to improve our risk evaluation processes further. Deutsche Telekom will implement the value-at-risk processes established in the banking sector for the evaluation of financial risks in line with the recommendations of the Bank for International Settlements.

#### Preparing for the year 2000

Deutsche Telekom was very early in recognizing that the advent of the year 2000 could create major problems in IT and communications systems. In 1997, the Board of Management established a central project management team to oversee the Group's year 2000 conversion processes. This central team is coordinating and controlling the relevant activities of "sub-project" teams in the Group's various units. The sub-projects are basically proceeding along the following lines: inventory, analysis, conversion, test, overall integration test.

The overall integration tests focus on interactions between systems. Deutsche Telekom plans to complete all of these tests, and the resulting conversions and adjustments, by June 30, 1999. The company is also working closely in this area with its suppliers and international partners, and it is currently preparing contingency plans in cooperation with all its year 2000 conversion personnel.

Overall, expenditure for conversion and testing of systems is expected to amount to about DM 300 million. Year 2000 compliance problems could create additional financial burdens. Deutsche Telekom expects, however, to have all systems year 2000 compliant in time for the year 2000.





Josef Brauner, head of the company's Sales and Distribution division, in a "Music on Demand" sound check at the 1998 CeBIT Home exhibition.



Visitors to the ISDN dome enjoy a completely new look at the world of telecommunications.

### Introduction of the euro

The introduction of the euro on January 1, 1999 was an important event for Deutsche Telekom. We have been preparing for this complex task since 1997, when we established a central project team to develop, implement and control all required euro-conversion measures. All areas concerned then took first steps of identifying the conversion and conversion-related measures they considered necessary. The company's subsidiaries are carrying out their own euro conversions independently, within a central framework. The central project team is coordinating all conversion activities, thereby paving the way for integrated, timely and well-planned introduction of the euro throughout the Group.

Deutsche Telekom will start euro conversion at the beginning of the year 2000. Whereas from January 1, 2000, customer billing will normally be in euros, telephone bills are already listing totals in euros to help customers familiarize themselves with the new system. The company's internal and external accounting systems are scheduled for conversion at the beginning of the year 2001. Deutsche Telekom's financial statements and quarterly reports will be published in euros beginning with the company's report for the first quarter of 1999.

Deutsche Telekom expects expenditure for euro conversion to total approximately DM 280 million. The Deutsche Telekom Group's 1998 expenditure for euro conversion amounted to ca. DM 40 million. Expenditure of approximately DM 95 million is expected for 1999.

### Key events after December 31, 1998

Deutsche Telekom increased its debut benchmark bond issued in May 1998 with a volume of DM 2 billion and converted it at the same time to the euro. The bond was increased and converted from DM 2 billion to EUR 2 billion (DM 3.9 billion) on January 12, 1999.

In a decision announced on February 8, 1999, the Regulatory Authority for Telecommunications and Posts set the price for competitors' access to Deutsche Telekom's subscriber lines at DM 25.40 per month. This price regulation will remain in effect until March 31, 2001. Deutsche Telekom filed a complaint against this decision on March 8, 1999, as a precaution and in order to meet to the deadline for filing such complaints.

Deutsche Telekom submitted an application to the Regulatory Authority for Telecommunications and Posts on January 25, 1999, for approval of new price releases effective April 1, 1999. Had this application been approved in full, the price per minute for long-distance calls in the fixed network between 9.00 p.m. and 6.00 a.m. was to be reduced to 6 pfennigs, with fixed-network calls in the City zone costing 3 pfennigs per minute in the same period. The Regulatory Authority for Telecommunications and Posts announced its decision regarding this application on March 16, 1999. Whereas the price of 6 pfennigs per minute for long-distance calls was approved, approval was denied for the charge of 3 pfennigs in the City zone. Deutsche Telekom can therefore implement the planned price cuts only in the long-distance zone.

In February 1999, Deutsche Telekom increased the stake held by its mobile communications subsidiary T-Mobile in max.mobil. Telekommunikations Service GmbH, Vienna, from 25 percent to 71 percent. This increase is still subject to the approval of the EU Commission (merger department) and the Austrian regulator. Deutsche Telekom is seeking to acquire more shares.

In 1998, the decision was made to establish the broadband cable business area as a wholly-owned subsidiary. The core of the broadband cable area, along with its noncurrent assets, was transferred to Kabel Deutschland GmbH at the turn of the year. This new company has been charged with operating the cable business and with the task of establishing regional cable companies, together with investors, in Germany. In addition to Kabel Deutschland GmbH, Deutsche Telekom also established a separate service company on February 1, 1999 that is to provide services to the cable companies and to other cable-network operators and program providers as a wholly-owned subsidiary under the name of MediaServices GmbH. The service company's tasks include marketing, customer management and distribution of a package of digital channels offered by a number of providers.



Visitors to the ISDN dome are able to lean back and watch telecommunications in action in Germany.



France Telecom and Deutsche Telekom intensify their cooperation. On September 16, Michel Bon, Ron Sommer and Joachim Kröske sign a cooperation program and an agreement for a cross-shareholding.

On March 2, 1999, Sprint informed Atlas, the joint venture between Deutsche Telekom and France Telecom, that it did not intend to approve Global One's budget for 1999 in its current form. Sprint, France Telecom and Deutsche Telekom have since then been looking at how to progress. If the parties cannot agree, the relevant provisions of the joint venture agreement will apply.

### Outlook

#### Our expectations for the telecommunications market

We are expecting restrained economic growth in Germany in 1999. According to current forecasts, gross domestic product is likely to fall below the 1998 level. At present there is no identifiable danger of inflation for 1999.

We expect current market trends on the German telecommunications market described above to continue in 1999. This would mean that, while volume will continue to grow, prices will continue to fall, which will lead to a further slowdown in value growth in the domestic telecommunications market in which Deutsche Telekom operates.

#### Future investments

It is likely that further optimization of capacity utilization in the networks and successes in purchasing will lead to a continuous reduction in investments in property, plant and equipment in 1999 and in the medium term. Deutsche Telekom plans to invest approximately DM 3 billion in expanding the T-Net in 1999.

A considerable proportion of Deutsche Telekom's investments is to pave the way for future innovative products and services. We are therefore pushing ahead with the development

of broadband lines which, on the basis of T-DSL technology, allow high transmission rates via the copper wire pair. We are also concentrating on the expansion of the Intelligent Network, with which value-added telephone services can be realized, such as virtual private networks or T-VoteCall. On top of this, increasingly complex products and services are being developed in line with customer requirements, such as combined fixed-network/mobile communications products and multimedia services.

The main areas of investment in the expansion of the T-Net are the access network and Deutsche Telekom's domestic and international networks. More than DM 700 million are to be invested in the access network. This will be spent mainly on connecting newly built-up areas, for minor expansions to the existing network and for setting up new lines, made necessary by the heavy demand for ISDN accesses. Deutsche Telekom will invest over DM 1.2 billion in its domestic and international networks in order, for example, to realize new features in the telephone network service and to acquire worldwide submarine cable transmission rights, allowing transmission of the ever growing volume of Internet traffic. In the medium term, we will invest more than DM 800 million in the development of our Internet platform.

Investments totaling DM 1.5 billion are planned at Deutsche Telekom's mobile communications subsidiary T-Mobil in 1999, most of which is to be spent on the expansion of the T-D1 network. This includes increasing the number of base station areas from 14,000 to at least 20,000 in response to the growing volume of traffic.

Furthermore, Deutsche Telekom is making investments in line with regulatory requirements, to improve quality, to increase the level of network security and to optimize processes with the help of newly introduced IT systems.

#### Revenue trends in the future

On January 1, 1999, Deutsche Telekom launched large price reductions for long-distance calls. This was combined with a simplification of the tariff structure, with essentially only two tariff periods in future. The Regulatory Authority for Telecommunications and Posts has approved further price cuts for long-distance calls in the fixed network from April 1, 1999.

The purpose of this measure is to stabilize Deutsche Telekom's market share. We expect to be able to cushion the resulting large drop in revenue from long-distance calls with higher subscriber-line revenues. This is to be achieved through customer migration to higher-value access lines, such as ISDN, T-NetBox or T-Net 200, which enable customers to benefit from Deutsche Telekom's lowest call tariffs. Moreover, we also have the opportunity to regain some of the market share we have lost. The risk associated with our tariff measures is that they may not be as successful on the market as hoped.

The lower level of revenue from telephone network communications is to be compensated further by revenue growth in other business segments. T-Mobil's rapidly growing mobile communications business is particularly important in this respect. We also expect growth in systems solutions and data communications, already strong in 1998, to be well above average in 1999. Deutsche Telekom is developing more and more from a provider of pure transport services into a



Following his nomination by the Board of Management, Jeffrey A. Hedberg, a native American, was appointed by the company's Supervisory Board as the new head of the International Division.

telematics service provider and a partner for industry and public authorities for outsourcing the entire spectrum of telecommunications and EDP services.

Of the items listed under other services, T-Online has the best growth prospects. Europe's largest online service provider benefits both from the explosive growth of the Internet and the services offered with T-Online, and from planned internationalization.

Revenues from international activities over and above the Hungarian company MATÁV will grow considerably in the coming years. Having taken over the majority stake in the Austrian company max.mobil., with a market share of 37 percent the second-largest provider on what is currently the most dynamic mobile communications market in Europe, we will consolidate these revenues for the first time in 1999. We also plan to expand our activities in Austria to include online services and the fixed network. Austria can be taken as a prime example of Deutsche Telekom's planned expansion measures in Europe.

Looking at the revenue trends of the individual business areas overall and working on the assumption that our expectations are fulfilled, it appears now that revenue in 1999 should be around 1998 levels. We intend to compensate for drops in domestic revenue resulting from price cuts with growth and expansion in the business segments of the future and with international expansion.

### Future results

We will continue to pay close attention to our costs in order to ensure a satisfactory level of profitability for Deutsche Telekom with the revenue trends described.

Deutsche Telekom plans to reduce its debts consistently from the current level of ca. 50 percent of the balance sheet total to approximately 40 percent. According to Deutsche Telekom's debt repayment structure, a further DM 10.5 billion are to be repaid in 1999. The refinancing conditions that can be achieved will be of particular importance for the Group. In the coming years, up to DM 15 billion of DBP (Deutsche Bundespost) bonds and debentures from the early nineties are to be repaid annually. The level of the new interest rates depends on Deutsche Telekom's rating, among other things, and on the related balance sheet structure and prospects for the future.

In May 1998, we issued a debut benchmark bond to improve our financing costs. We increased the volume of the bond in January 1999. Both issues were very well received and highly rated on the capital markets. This is the first step in positioning Deutsche Telekom on the international bond market.

Overall, we are working on the assumption that interest expense will fall considerably in the coming years.

Depreciation of property, plant and equipment will also decrease further as a result of lower investments. Having invested in the past in digitization and the development program for eastern Germany, Deutsche Telekom now has one of the most modern telecommunications networks in the world. Invest-

ment activities will therefore continue to fall. Based on the present situation, the level of depreciation is therefore expected to come into line with the current level of investment in the long term.

As we intend to continue our workforce reduction program in the future, we expect personnel expenses to continue to fall. This decrease will be augmented from the year 2000 by the conversion of the system for contributions to the special civil servant pension fund and will reduce the financial burden on Deutsche Telekom further.

Other operating expenses are a particular focus of our attention. Every individual item is checked to evaluate its cost saving potential. We expect to make considerable savings in this area as well.



December 11: The Regulatory Authority approves the company's "1999 Price Campaign". This move paves the way for rate cuts of up to 62 percent.

In the coming years, we aim to keep the growth in the cost of goods and services purchased below the rate of revenue growth. It must be remembered at this point, however, that our development from a provider of pure transport services to a systems provider entails an increase in goods and services purchased – such as from information service providers and software companies. Competitors' interconnection services will have the same effect.

We aim to reach the break even point in 1999 in the area of investments. Losses at Global One are expected to fall and be compensated by earnings from other investments. The values of current Asian investments have almost all been adjusted and are therefore generally combined with opportunities. The risks related to the individual countries and the associated business development – as well as the future development of Global One – are of particular importance for the future of Deutsche Telekom's investments.

Following the considerable improvement recorded in the 1998 financial year, we expect to achieve a further reduction in the cumulative deficits from our loss-making business activities in 1999. Assuming the improvement measures we have initiated in the area of terminal equipment and special value-added services continue to be successful, we expect to stop making losses in these areas in the 2000 financial year.

Based on the current situation, we therefore plan to have the broadband cable/broadcasting segment as the only loss-making area in the year 2000. The broadband cable business was set up as a wholly-owned subsidiary at the turn of the year in order to establish the preconditions necessary for Deutsche Telekom to sell the business as planned. Based on the prices currently payable internationally for broadband cable networks, we expect this sale to make a corresponding contribution to our results in the future. Progress now depends on the concrete offers received.

#### Increasing equity capital

Deutsche Telekom is reaffirming its claim to leadership in Europe and its position on the rapidly changing global telecommunications market. To ensure we achieve the necessary growth, we are examining a combination of various steps. Existing international investments with the potential to grow in value are to be increased. Furthermore, we plan to expand our growth areas both on the domestic market and, in particular, internationally, and to make the purchases necessary for a provider of transport services to develop into an all-round telematics solutions provider.

Deutsche Telekom is therefore currently considering its future capital requirements and any resulting need for a secondary public offering.

Of its authorized capital stock, Deutsche Telekom still has a volume of up to 286.3 million shares which it has the option of selling by the end of the year. Under the terms of the second posts and telecommunications reform, the Federal Republic of Germany, as Deutsche Telekom's majority shareholder, has agreed not to sell its shares in Deutsche Telekom via the capital market before December 31, 1999. This condition also applies to the shares held by a federal corporation, the Kreditanstalt für Wiederaufbau.

# The Deutsche Telekom share.

## Strongest shareholder value growth in the DAX.

Overall, the German stock market recorded a 15 percent increase in prices over the previous year. The German stock index (DAX) reached record levels during 1998, which, however, could not be sustained to the end of the year. The share price of the Deutsche Telekom share (T-Aktie) increased by 60 percent during this period, for a growth rate that was significantly better than the market as a whole. As a result, Deutsche Telekom's market capitalization rose by more than DM 56 billion in 1998.

On the German stock market, the previous year's strong growth in share prices continued in the first seven months of 1998. Starting at a level of 4,364 points (Xetra close on January 2, 1998), the DAX climbed to 6,186 points by July 20. This value, the highest ever recorded for the DAX, was followed by considerable correction. On October 8, the market reached its nadir for the year, 3,862 points. This downward trend, which was paralleled by developments on all of the world's important stock exchanges, was triggered primarily by the continuation of crises in Southeast Asia, Russia and South America, as well as by the near-collapse of a hedge fund for institutional investors. The German stock market fluctuated widely, recovered in the fourth quarter of 1998 and closed out the year at a DAX level of 5,007 points (Xetra close on December 30, 1998). The Euro Stoxx 50 index recorded a closing level of 3,342 points, up from 2,532 points at the beginning of 1998.

### Development of the T-Aktie

The T-Aktie grew in value by about 60 percent in 1998, based on the closing prices in the Xetra trading system. With this result, the T-Aktie placed third among all shares that experienced growth. The share considerably outperformed the German stock market as a whole, measured in terms of the DAX, which grew by about 15 percent. In absolute terms, Deutsche Telekom's market capitalization enjoyed growth of over DM 56 billion in 1998.

From its Xetra closing price of DM 34.21 on the first day of trading in 1998, the T-Aktie participated in a brief slide by the German stock market as a whole and reached its low for the year on January 15: DM 31.19. Until the end of April, the T-Aktie moved with a strong

upward trend on the German stock market; in the months thereafter, it significantly outperformed the market. On July 13, it reached its first maximum of DM 55.61. At about the same time, the DAX reached its all-time high, a level from which it lost about 37.5 percent in the following months, reaching its low for the year. While the T-Aktie was unable to resist the market's downward pull, it did not lose ground as fast as the rest of the market and grew again considerably at year-end. The T-Aktie closed out the year with a Xetra closing price of DM 54.88 on December 30. Since January 4, 1999, German stocks have been listed in euros. The Xetra closing price on the first day of trading in 1999 was EUR 32.43, which corresponds to DM 63.43. Based on the closing price of EUR 38.85 on March 15, Deutsche Telekom achieved a market capitalization

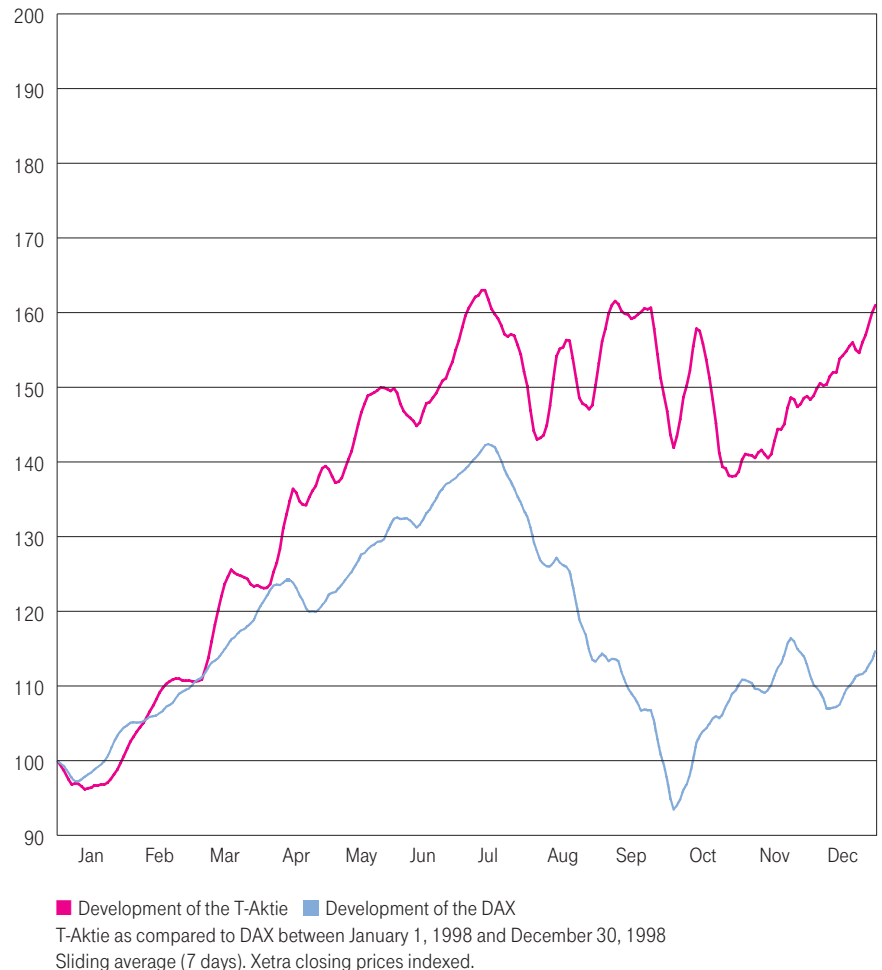
### Highest and lowest prices of T-Aktie in 1998

(Xetra closing prices)	High	Low
1st quarter 1998	41.65 DM	31.19 DM
2nd quarter 1998	50.14 DM	39.70 DM
3rd quarter 1998	55.61 DM	44.90 DM
4th quarter 1998	55.97 DM	43.40 DM

amounting to the equivalent of DM 208 billion.

The T-Aktie has also outperformed the DAX in the more than two years since Deutsche Telekom's initial public offering in November 1996. An investor who purchased DM 10,000 worth of Deutsche Telekom's shares at their initial offering price of DM 28.50 saw the value of his or her investment grow to about DM 19,980 by December 30, 1998 – based on the calculation method used for the DAX. If the initial DM 10,000

Development of the T-Aktie in 1998 as compared to the DAX



#### Index weightings – March 3, 1999

MSCI EMU	3.21 %
DAX 30	5.67 %
DJ Euro Stoxx 50	6.51 %

#### 1998 T-Aktie figures

Consolidated net income	DM 1.60 per share
Net cash provided by operating activities	DM 9.62 per share
DVFA/SG earnings	DM 1.74 per share
Earnings per share (U.S. GAAP)	DM 1.59 per share
Dividend proposal	DM 1.20 per share
Shareholders' equity	DM 17.87 per share

No. of T-Aktie shares issued (millions)	2,743
Market value (year-end)	DM 150.6 bn

#### 1999 financial dates

Press conference on the financial statements	April 15, 1999
Analysts' meeting (DVFA)	April 15, 1999
Shareholders' meeting	May 27, 1999
1999 Group half-year report	late August 1999

Press conference on the 1999 financial statements	April 2000
Shareholders' meeting	May 25, 2000

#### Stock exchange listings

Germany (all stock exchanges)
New York (NYSE)
Tokyo (TSE)

Deutsche Telekom AG is a member of the "Deutscher Investor Relations Kreis e.V." (DIRK).

investment had been placed in a DAX account instead, it would have grown to about DM 17,875 in the same period.

In 1998, a total of about DM 147 billion worth of Deutsche Telekom's shares was traded on all eight German stock exchanges, including electronic trading (Xetra). This figure puts the share in eleventh place in the trading statistics for German stocks. The trading volume at the New York Stock Exchange was about 1 billion US dollars; in Tokyo it was about 6 billion yen.

Deutsche Telekom has 2.7437 billion shares outstanding. On July 13, 1998, the T-Aktie was entered into the Commercial Registry as a no-par value share. This conversion of the T-Aktie, which previously had a nominal value of DM 5, was the result of a decision of the shareholders' meeting on June 4.

The T-Aktie has been traded on the stock market as a no-par value share since August 10. The change in the nominal value anticipated the introduction of the euro on January 1, 1999, when all German stock market listings were converted to euros. The share's value is not affected by the conversion.

Based on the share's year-end value for 1998, Deutsche Telekom's market capitalization is some DM 150 billion. This figure again places Deutsche Telekom among the largest companies in Germany and Europe by market value. Since the initial public offering in November 1996, some 26 percent of Deutsche Telekom's shares have been held by institutional investors and private investors. At the end of 1998, the German Federal Government owned nearly 50 percent of Deutsche Telekom's shares. Another 23 percent was held by a federal corporation, Kreditanstalt für Wiederaufbau (KfW), which assumed its shares from the Federal Government in two tranches, transferred in 1997 and 1998. Agreements between Deutsche Telekom and France Telecom, aimed at strengthening the cooperation between the two companies, were backed up last year by a cross-shareholding arrangement under which each company acquired 2 percent of the other's shares, purchasing the shares from the relevant other government. At the close of the 1998 financial year, the German Federal Government transferred an additional 1.2 percentage points of its Deutsche Telekom holdings to KfW. Pursuant to the Second Posts and Telecommunications Reform, Deutsche Telekom is entitled to increase its capital by issuing up to 286.3 million additional shares until the end of 1999.

The Deutsche Telekom share is included in the leading stock-exchange indices, such as the DAX, Euro Stoxx 50 and the MSCI Index.

The unappropriated net income per share increased last year from DM 1.20 to DM 1.60. A dividend of DM 1.20 per share for the 1998 financial year (the same dividend as in the previous year) will be proposed at the annual shareholders' meeting.

Earnings per share for 1998, calculated in accordance with the DVFA (Deutsche Vereinigung für Finanzanalyse und Anlageberatung) method, were DM 1.74. The DVFA figure differs from the net income per share mainly as a result of different treatment of goodwill amortization. To ensure reporting consistency with the first three quarters of 1998, the DVFA result was calculated using the calculation methods in effect to date. Deutsche Telekom plans to use the new DVFA calculation methods for its reporting in the 1999 financial year.

Earnings per share calculated in accordance with U.S. GAAP were DM 1.59. The method for calculating the U.S. GAAP result is described in the Notes to the consolidated financial statements.

Once again in 1998, Deutsche Telekom held two analysts' meetings in cooperation with the DVFA. In May 1998, Deutsche Telekom established an investor relations office in New York in response to rapidly growing interest of U.S. investors. At two roadshows, held in May and September, we informed our largest shareholders about the company's progress. Deutsche Telekom held company presentations in Bonn, in several European financial centers and in Canada.

According to a survey commissioned in the fall by the Handelsblatt business newspaper, Deutsche Telekom's investor relations activities were the best in Germany in 1998.

Deutsche Telekom has energetically continued its open information policies in both investor relations and in public relations. In 1998, the company published quarterly reports for the first time. On January 19, 1999, Deutsche Telekom published a first overview of its business development in the previous year, on the basis of preliminary calculations.