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NOVEMBER 09, 2017 / 1:00PM, DTE.DE - Q3 2017 Deutsche Telekom AG Earnings Call

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PRESENTATION

Operator

Good afternoon, and welcome to Deutsche Telekom's Conference Call. At our customer's request, this conference will be recorded and uploaded to the Internet.

May I now hand you over to Mr. Hannes Wittig.

Hannes Wittig - Deutsche Telekom AG - Head of IR

Yes. Good afternoon, everyone, and welcome to our Q3 2017 conference call. With me today are our CEO, Tim Höttges; and our CFO, Thomas Dannenfeldt. Tim, as always, will first go through a few highlights followed by Thomas, who will talk about the quarter's financials in more detail. And again, after this, we have time for Q&A.

Before I hand over to Tim, please pay attention to usual disclaimer, which you will find in the presentation.

And now it's my great pleasure to hand over to Tim.



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Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board and CEO

Yes, thank you, Hannes, and a warm welcome also from my side. I'm pleased to say that at the 9-month stage, we are well on track for our 2017 targets. Q3 was a strong quarter. All our major businesses are growing, growing customers and growing revenues. We have upgraded our EBITDA guidance again this morning due to T-Mobile US, and our free cash flow is on track for another year of double-digit growth.

So let me start on Page #4. You know our philosophy: strong investments drive customer growth and financial results. And because of this, we can keep growing investments to keep this virtuous circle going.

Let's look at investments a bit closer. Year-to-date, our investments are up 12.2%, in line with our full year guidance of around EUR 12 billion. Of this, we plan to spend a bit over EUR 5 billion in our various German operations, including over EUR 4 billion in our German unit. And as you know, a lot of this will be spent on fiber.

I know you are worried about German CapEx risks. I have seen the most recent CapEx consensus for Germany, which is now stable through 2021. As Thomas already said in the second quarter call, from today's perspective, that seems a reasonable assumption and provides a strong basis to deliver for German customers going forward in a number of possible scenarios.

Because it makes sense, we continue to focus our resources on bringing high-speed connectivity to as many customers as quickly as possible. Last week, we switched on 3.5 million vectoring homes, bringing the year-to-date installations to 7 million. By the year-end, we are aiming to raise this to 10 million.

Just consider that for a second. We have almost 40 million households in Germany. And only in 1 year, we are installing fiber to the cabinet installations for almost 10 million households. These homes will get 100 megabits per second now and up to 250 megabits per second from next summer.

We also started our fiber build-out to German business parks. You may have seen a number of announcements here in recent weeks, for instance, in Hamburg or in Düsseldorf or in rural Southwest Germany or in the files. And we just won a tender for fiber to the home subsidies in rural Eastern Germany.

Where others talk, we just do it. Because of our investments, we grew across all our geographies in the U.S., in Germany and in our other European operations. And the financial results reflect this.

Year-to-date, our revenues are up 4.2%. Our adjusted EBITDA is up 6.6% and our free cash flow is up 8.8%. And we delevered strongly this quarter, reducing our net debt-to-EBITDA ratio to 2.3x from 2.5x the quarter before. So we are well on track for investing in our future and generating double-digit free cash flow growth. We raised our EBITDA guidance again for 2017 and keep executing against the target from our Capital Markets Day in 2015.

Slide 5 shows some examples of our success within our quarter, especially focusing on customers. In the last 12 months, we added a further 1.6 million converged customers. The number of fiber customers in Germany grew by 2.8 million, and in the U.S., we won 5.9 million customers. In the cloud, our growth has reaccelerated to 14%.

Page 6, as usual, shows by means of a few examples how we drive customer experience through innovation. We doubled the customers in our smart home platform in the last 12 months. Over 350,000 customers take advantage of our hybrid, an increase of about 100,000 compared to last year. Downloads of our service app increased as did our levels of online IT support. We are using digitization to simplify our processes and the customer experience. And like our peers, this is, of course, an area of great focus.

Our StreamOn tariffs in Germany have proved increasingly popular. We already have over 400,000 subscribers in Germany, and we have recently launched it in Croatia, Poland and Greece. In the U.S., Netflix On Us is our latest Un-carrier proposition, and it is off to a very good start.



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Slide 7 compares our year-to-date performance with our guidance. It is fair to say that this year again, we are quite comfortably ahead of the group level guidance we issued at the 2015 Capital Markets Day. For 2017, we now incorporate the recent EBITDA guidance increased by T-Mobile US. Adjusted for currency and accounting, this translates into the EUR 150 million that you can see in our group guidance increase.

The outlook for the remainder of our businesses is unchanged. Mainly due to higher investments in the U.S. and Greece, we are keeping our free cash flow outlook for 2017 unchanged at around EUR 5.5 billion, up from EUR 4.9 billion last year.

Before I pass on to Thomas, let me comment on last weekend's news regarding T-Mobile and Sprint. You will remember our statements in our first and second quarter conference calls, that it is possible, if not likely, that there will be various discussions regarding various potential strategic combinations among industry participants, including our self. And we said, it was far from clear that any such discussions will lead to successful outcome, and this is where we are.

In the last few months, T-Mobile US and Sprint, together with their parent companies have explored ways to create a win-win for their shareholders and for U.S. consumers by scaling up and realizing substantial synergies. However, this weekend, we decided to terminate our discussions.

You remember our stated design criteria for a possible agreement. To be clearly superior to our excellent stand-alone prospects, any merger would have to stick up primarily on valuation, on effective governance, on regulatory concerns and have sound financial foundations. In the end, unfortunately, we could not make the equation work, and this is where we are. But what you can be absolutely sure of is that we did our very diligent homework on all of these criteria.

Where do we go from here? The answer is simple. We won't stop. With our support, T-Mobile US has invested over \$40 billion in the last 5 years. We are only starting to benefit from these investments. We are winning the network tests even before the new low-band spectrum has been deployed. You know our unique and massive regional expansion opportunity where we are just starting, and we are only just starting to leverage our B2B opportunity.

Our financial performance is excellent, allowing us to maintain a high investment profile and strong commercial momentum. In Q3, for instance, adjusted for the hurricane damage, our EBITDA was almost \$300 million, ahead of consensus expectations. T-Mobile is in great shape, and we won't stop or should I say we are just starting. But as ever, while we are excited by our standalone prospects, we will, of course, remain open-minded about other opportunities to create value for our shareholders.

Before I hand it over to Thomas, let me also express my sincere thanks to Niek Jan van Damme and Reinhard Clemens, who are leaving us at the end of this year. I'm very grateful for their contributions. You can see the strength of our German operations today.

Now let me turn it over to Thomas to review our excellent third quarter in Germany and elsewhere in greater detail.

Thomas Dannenfeldt - Deutsche Telekom AG - CFO and Member of Management Board

Yes. Thank you, Tim, and a warm welcome to everyone from me as well. So let's deep dive a little bit in the numbers.

Adjusted EBITDA grew 3.3% this quarter and by 6.6% at the 9-month stage. Our adjusted net income grew 19.6% this quarter, and meanwhile, our reported net income is impacted by a write-down in T-Systems, which reflects recent challenges in the IT part of the business, especially a much weaker-than-expected order book. Year-to-date free cash flow growth is consistent with our guided 10% midterm CAGR, and well on track with our around EUR 5.5 billion target for this year.

Now moving on to Slide 10 then. In Germany, our sales were stable this quarter driven by growth in total service revenues. Our EBITDA grew 4.5%. Remember, we told you last time, our EBITDA growth for the year would be back-end loaded, and we're now seeing the benefits from the operating expense reductions we expected, including, for example, the merger of our sales and technical field service. So clearly, we are well on track for our guided EBITDA growth this year.



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On the next slide, you can see that our reported total service revenues swung to slight growth in Q3, both in fixed and mobile service revenues. And this is after the effects from roaming in the fixed and mobile termination rate cuts that went into effect in December last year.

Underlying mobile service revenue growth amounted to almost 4%, and underlying total service revenue grows to almost 2% year-over-year. We're currently tracking a bit ahead of our mobile service revenue midterm growth CAGR that we guided towards at the 2015 Capital Market Day. On the other hand, we are tracking a bit below the promised growth rate on broadband. So I think net-net, it's very fair to say that we are pretty much where we thought we would be.

Looking at mobile on Slide 12. Our service revenues grew 0.9% this quarter. Based on our innovative tariffs, we are seeing shift to higher value plan with continued growth in our own-branded contract base. And that way, we are able to monetize the growth in the data consumption. Despite various competitive promotions, our commercial performance has been very steady. Our own-branded customer base grew by 137,000.

And as we can see on Page 13, mobile data growth remains very strong at 55% year-on-year. But the average usage now at 1.6 gigabytes a month, and we are making good progress with convergence. This quarter, we further increased the percentage of homes with MagentaEINS contract to 80% (sic) [18%] and 40% of our Magenta branded mobile contracts are now part of the convergent relationship, up 9 percentage points in the last 12 months. Our up-selling remains very successful and contributes to our improving service revenues. MagentaEINS home spend on average now EUR 8.8 per month more with us than before.

So moving on to fixed line on Slide 14. Here we rebounded to add 70,000 broadband customers this quarter. Our hard IP migration will continue through year-end 2018, but we could offset this through the strength of our commercial offerings. Line losses also improved sequentially. Demand for our fiber product remained very strong with 700,000 additions this quarter, again with the majority coming on our retail platform.

TV net adds benefited from the launch of our new StartTV in May and our Telekom Sport packages in August. The launch of Entertain TV (inaudible) last month with the exclusive titles should further increase the attractiveness of our TV offerings going forward.

Now turning to our fixed product on Slide 15. Our retail revenues fell 0.6% year-on-year. Our broadband revenues grew 0.6% this quarter. This reflects the impact of promotions we launched last year plus the ongoing headwind from our IP hard migration. We continue to expect a slight improvement in this run rate in coming quarters as last year's Test the Best promotion begin to roll over.

On Slide 16, you can see that we now pass 68% of German households with our fiber network. Let me remind you that next year, we will ramp up speeds for most homes in our vectoring footprint to 250 megabits per second. 65% of our access lines are already on IP, up from 49% a year ago. This accelerating run rate takes us towards our target of migrating our B2C access lines to all-IP by the end of 2018.

Now moving on to our usual 2 slides on T-Mobile US. As Tim said, our momentum remains very strong. We won 0.6 million branded postpaid phone customers, 2/3 of the total market growth, and we kept ARPU generally stable with prepaid ARPU reaching a new record level of nearly \$39. Service revenue grew by 6.5% and IFRS EBITDA grew 11%, and this was in spite of a \$148 million headwind from the recent storms. And as mentioned already, T-Mobile raised its EBITDA outlook for 2017 by \$200 million.

On the next slide, as usual, we show some selected performance metrics for our U.S. business. Our branded postpaid phone churn improved further and reached a record third quarter low of 1.23%. Our bad debt expenses remain stable as cost of service affected by the storm costs, but better on an underlying basis.

As you can see, our U.S. network has underpinned that performance, keeps getting better. The recent Ookla data shows that T-Mobile 4G upload and download speeds has been improving, while at the same time, our competitors' network performance is worsening. By the end of this year, we will have deployed 600 megahertz spectrum to 62 million POPs over 1.2 million square miles and launch 3,000 retail shops. Many of these in new geographies to monetize our network and brand proposition. To sum it up, it was another great quarter for T-Mobile US.

So moving on to our European segment. We continue to show positive commercial momentum. We added 265,000 new contract customers, including 56,000 in Poland, and we added 167,000 new converged homes. Our revenues in Europe were up 1.6% this quarter and up 0.7% organically.



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Reported EBITDA was down 2.9%, but adjusted for our recent reorganization and FX, EBITDA would have been down only 1.3% in line with the trend we continue to expect for the year as a whole.

And the next chart shows that we now have migrated 66% of our homes in Europe to IP. Our LTE coverage now stands at 93% and our fiber coverage has reached 30% with accelerated penetration forthcoming in Greece especially.

Now moving on to Systems Solutions on the next slide then. Revenues rose 2% while EBITDA fell 5.8%, but we continue to expect around EUR 0.5 billion of EBITDA for the year as a whole. We are seeing good momentum in the cloud and security and in our road tolling business. Our connectivity business is growing as well, but we still experienced headwinds from classical IT business. These headwinds have manifested themselves in a weaker-than-expected order book and the management goodwill write-down.

Looking forward, we are delighted to welcome Adel Al-Saleh as our new board member for T-Systems from beginning of January on, and I'm really looking forward to his contribution in the business.

The next slide shows group development, which now comprises mainly T-Mobile Netherlands and our German towers. We're now showing the numbers on the slide here without the STRATO business.

We had another good quarter in the Netherlands with 66,000 contract net adds. And this is now the ninth consecutive quarter of contract customer growth. Dutch service revenue reflected headwinds from regulation and termination rate cuts, while EBITDA reflected changes in Dutch consumer protection laws and roam like home. Excluding regulation, our mobile service revenues would have been up 1.1% year-on-year. Our tower business is still absorbing transition costs following the carve-out from our German segment. From 2018 on, we expect growth in revenues and EBITDA from newbuilds and increased colocation and amendment activity.

As already mentioned, our third quarter free cash flow was very slightly down year-on-year, but clearly above consensus expectations, and we are well on track to generate around EUR 5.5 billion for 2017 as a whole.

Growth in our adjusted net income was driven mainly by higher adjusted EBITDA and benefits from interest expense optimization. Higher taxes and higher share for the minorities driven by the strong performance of the U.S. partially offset this positive impact.

Our net debt reduction reflected: a, the growth in free cash flow this quarter, and b, FX due to the euro appreciation against the dollar. Recall at the end of this quarter, the U.S. convertible will be exercised and result in further deleveraging.

Slide 25 shows our financial metrics. And as mentioned, despite by the U.S. spectrum auction, our net debt fell to 2.3x adjusted EBITDA. Remaining within our comfort zone of 2 to 2.5x adjusted EBITDA and we're now particularly pleased with that.

My final slide, as always, summarizes the strategy we presented to you at the last 2015 Capital Market Days. We continue to execute well against our target. It was a good quarter across most, if not all our markets, and the best is yet to come.

And with that said, we'll be delighted to answer your questions. And I guess, I will hand back to the operator or Hannes.

Hannes Wittig - Deutsche Telekom AG - Head of IR

Thank you very much, Thomas. So back to me. We can start with the Q&As now. (Operator Instructions) So with that, we move on to your questions.



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QUESTIONS AND ANSWERS

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

I think the first question is from Dhananjay at Bernstein, please.

Dhananjay Mirchandani - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

My question is related to fiber to the premise and the role of government subsidies to facilitate the potential roll-out in rural Germany. It sounds your competitors are suggesting that up to EUR 24 billion in subsidies could be allocated to such infrastructure upgrades to about 8 million premises outside your target VDSL footprint. But can you give us a sense of how likely you think this scenario really is? And what role you expect to play as Deutsche Telekom should this scenario, indeed, materialize?

Timotheus Höttges - *Deutsche Telekom AG - Chairman of Management Board and CEO*

It's Tim. Welcome. So a quick answer on that one. Today, we have 1.7 billion subsidies in the market, and municipalities, now let's the government were able to spend the money. So we're talking about EUR 718 million, which have been spent yet. The reason for that one is not that there is no willingness to spend it, major is the approval phase and the construction capacities in Germany. One of the reasons, as you know, that Deutsche Telekom is building big time on the fiber deployment in Germany. You heard the numbers from Thomas just a few minutes ago. We are opening up, let's say, a fiber connected street coming in every 4 minutes, every 4 minutes while we are sitting here. And next year, it's going to be every 3 minutes. On top of that, we have this huge infrastructure progress going on in Germany for any other infrastructure. So the (inaudible), the construction capacity is very, very limited. The Chancellor, by the way, mentioned that already in several speeches because she knows about the situation. What we have done to compensate for the shortage is we are hiring people, around 1,000 people from Spain. We have people from Romania. We have people from Weißrussland so -- and working here for us already to fulfill this requirement. If these subsidies would go up significantly, I can tell you, we do not have a money problem. We have a capacity problem. That's the first thing. The second thing is, sometimes Vodafone, they are jumping forward and then they are jumping back. Look, we are used to that one, but independent from that, they seems to find out that they have no interest if somebody's overbuilding cable. So I got already messages from Berlin that they are not interested in a high subsidized program, and I know from the small players in Germany that they are very concerned about this huge subsidization program and that they are losing control about, let's say, the roll-out of the footprint, which they are aiming for. So there will be in the new government, however, it might be constituted, a group of -- an amount of local subsidization. I strongly recommend it's in the vicinity of EUR 1 billion to EUR 2 billion on an annual basis. The capacity will be hard to find. Hopefully, there is some elasticity going forward, but I do not expect that there will be problems significantly beyond that. And even the discussion that may be the proceeds of selling Deutsche Telekom would help to fund this. And if you talk to the leaders in this regard, I think there is now even more realistic approach to us. And the first ideas, but we will see. So that's my way looking forward. What it means for us? We will move on in our fiber build-out, in our FTTC build-out. We will fill, let's say, the commitments which we have given to the public. And we see that we are doing absolutely the right thing. We will have 10 million households being connected to vectoring by the end of the year. Think about that magnitude, and what we see is with 700,000 on an average customers a quarter, you see that the customers are voting with their feet, and we are very happy and very successful on the take-up rate, which we currently see.

Thomas Dannenfeldt - *Deutsche Telekom AG - CFO and Member of Management Board*

Maybe to add to that. On the specifics of and the experiences we have right now on those subsidization programs, as we are participating in those programs and have a good success rates. So basically we're talking about 2/3 of success rate. For instance, in just last week, we won a public subsidy program to connect 40,000 FTTH homes in rural East Germany, the biggest one in Germany right now. As long as we take a fair share, the terms are reasonable and subsidies are not per se a bad thing. I think that's the way we look at it.

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

Thank you, Thomas and Tim. So we move on with the next question from Polo at UBS.



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Yin Kin Tang - UBS Investment Bank, Research Division - MD and Head of Telecom Research

Just 2 questions. The first one is on the U.S. and really a bigger-picture question about potential M&A going forward. So if the DOJ are pushing back against the horizontal deal like AT&T, Time Warner, can 4 to 3 mobile consolidation happen? Or can fixed mobile consolidation ever happen in the U.S.? And my second question really just a clarification in terms of the German election outcome. So specifically, do you think a new coalition government will push for you to do more in terms of FTTH? And can I clarify also your comments about what politicians think about DTE stake sale that was -- sorry, I wasn't quite clear in terms of what you're saying in response to that -- the first question?

Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board and CEO

Look, the first, whatever Deutsche Telekom is investing in this EUR 4.2 billion or whatever number for this year, it's fiber, it's fiber. We are not building copper. We are building fiber everywhere. And we are connecting street cabinets with fiber. So in the new construction areas, we're building fiber. And even you know in the areas of our business communities, we are building only fiber. So, therefore, if some of our competitors criticize us not building the right technology, I don't know what the right technology might be, but we are building fiber. So that said, this will not change going forward. Now the government is talking about a technology and I make everywhere clear and the ones being in Germany and reading, let's say, my interviews or my statements on that one, I think we should keep the customer in mind. The most important thing are the needs of our customers. And the first need is that he is able in his private life to consume all kind of service today and tomorrow in a sufficient, I call it, *tadellos* in a kind of 0 defect manner. This is our ambition. And that is what we are building the capacity for, and that is why we are trying to get as many customers as possible into this infrastructure. I think going forward, there will be a mix of technologies. There will be fiber to the home deployment in the cities, and I appreciate highly the possibilities, which are given now that we have 2 kind of construction possibilities like micro trenching and other subsidies. Second, there will be cooperation models. We have an alliance with all the small carriers, which is M-net, which is [EVE-Tel], which is the wilhelm.tel, which is NetCologne and others that we are trying to fight that the regulation gets changed that when we're doing a cooperation model and when we're building fiber, there should be no regulation for none of the other players. So we have to now convince only Vodafone and (inaudible) that they're supporting us. I understand that they would love to use our technology. But I think this is unfair from our way going forward. So cooperation model is the second way of deploying it. The third area is we should be technical agnostic. I think the new technologies like WiFi to the home, a kind of OMT outdoor, so that we do not have to go for the rose garden of every house here in Germany but still deploying 1 Gig into private homes or that we have 5G technologies for the rural areas where fiber deployment doesn't make sense or even G.fast in certain areas. So I will fight, and I will constantly fight for a technology-agnostic approach. And if you look to the election programs or to the programs of the big parties, they are likely, CDU and CSU, the conservative ones, there is a technology agnostic build-out. So a more customer driven build-out, and this is, let's say, what we're going to do. I do not see that at the end of the day that one of the parties, nor the Jamaica coalition, will really, let's say, intend to force people only to go into the fiber to the home build-out and anyhow, they cannot force private companies to build a specific technology. So therefore, I think our build-out scenario is very clear. It's built on first, deploying now fiber to the curb and really connecting the people who are not connected today, especially in the rural areas. This is a big political issue as well. Second, going to fiber roll-out then in areas where we are fighting huge competition with cable. In parallel to that one, we are deploying the industrial zones, because we want to enable digitization in Germany and maybe some offers to schools. And then we're going to improve our intensity to cooperate with the smaller players that we do not have redundant fiber to the home build-out and faster deployment of that one, all was under the assumption that we have no regulation anymore on that one. And in the other areas, we want to deploy a technology mix, which is supporting customers demand. This is the way going forward, and we have a clear path towards this one, and that's the one I'm lobbying for.

Hannes Wittig - Deutsche Telekom AG - Head of IR

Polo, on your -- answer...

Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board and CEO

Yes. I just wanted to add one thing. I think the situation in Germany you should remember is such that by the end of 2018, 70% of the population will have access to cable footprint. That's quite different from various other European companies, and we will connect over 80% of the population



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with fiber to the street. So we have a situation where, let's say, 85% plus of German households have us vote for choice. And then you have a section of the population, which isn't. I just want to make this -- bring this into awareness because it's quite a different situation from other countries in Europe.

Thomas Dannenfeldt - Deutsche Telekom AG - CFO and Member of Management Board

And Polo, on your question on the M&A, U.S. perspective, let me emphasize again how committed and convinced we are about our standalone story in the U.S. So we are not worried about the T-Mobile U.S. running out of steam. Our network leadership is becoming more and more apparent. We're enhancing the distribution footprint B2B opportunities. So not only geographic expansion, but also segment expansion. You've seen the financial performance. So there's enough firepower available. We are convinced that there is a very, very good standalone perspective. And in convergence, the U.S. picture, as you know, is different from Europe. We believe there is scope for a successful mobile-only player, and our approach is always to be a front footed when it comes to content. So first, we have (inaudible), then we had Netflix offering there. So as Tim said, it's a quite simple story. We won't stop. What we're not going to do is speculate about potential combinations in the market. As you know, we're never speculating on that one. Our way to deal with that is if there's something to talk about, we will find ways to talk about and then find out.

Hannes Wittig - Deutsche Telekom AG - Head of IR

Thanks, Thomas. Thanks, Tim. So next we move on to Simon from Citi. Simon?

Simon Weeden - Citigroup Inc, Research Division - MD and Head of European Telecoms Research

I wondered if you wouldn't mind just talking a bit about Germany. And first question would be what contribution price rise has made to the growth rates that you've posted in the third quarter, particularly taking into account the nice improvement you saw over the second? And I think, particularly perhaps posted on fixed, but maybe mobile as well to some extent. And then the second question is just on the customers that you've migrated to all-IP. Do you see differences in behavior? Are there any helpful or possibly unhelpful changes in churn or the propensity to take up some product or that sort of thing in terms of the customer side of that equation?

Thomas Dannenfeldt - Deutsche Telekom AG - CFO and Member of Management Board

Simon, this is Thomas. First of all, the simple answer on the question of price rise is [EUR 200 million] for growth rate, it's very little. It's, as you know, is we've made a price rise in Q2 in single play that is coming through, but it's a very minor share of the whole improvement. The basic improvement is by a richer mix. So more customers on the M and L rather than the S tariff plans. By the way, this holds true for fixed and mobile side and not for raising price points per se. And second question is the customer migrate to all-IP, what we've seen there is a better after migration sometimes we still have to struggle and trouble in the migration phase with customers. But after migration, a good experience to customers. But let me remind you, our churn anyway is around 6% to 7% on a yearly basis. So there is no fundamental change in the churn here. But we know from the customers side that obviously there are some things you can do more easily (inaudible) and the way you experience our business and our product is for our customer is improving. But as the churn is already so low, no significant changes here.

Hannes Wittig - Deutsche Telekom AG - Head of IR

Thanks, Thomas. Next we move on to Akhil at JPMorgan.

Akhil Dattani - JP Morgan Chase & Co, Research Division - MD and European Telecoms Analyst

Two questions, please. Firstly, we've spoken a lot about CapEx, but I guess, the other thing that people in the sector are debating quite a lot at the moment is the joint dominance regulation issue. So I guess, I'm just keen to understand what your thoughts are on that? And I guess, on top of



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that, how likely or not do you think that is just a general update around that would be useful. And then secondly, on the U.S. and M&A. I guess, another big-picture question I was just wanting to follow-up on was just in terms of how you think about or what you're able to say about the process and what happened? Yesterday, Sprint CEO commented that the big issue was masses' unwillingness to relinquish control, which would seem to make that somewhat insurmountable issue given that historically, you've said very similar things yourselves in terms of control being important. So I guess, what I'm really trying to get to is, are the issues things that you think are very substantial, very hard to address? Or is there any possibility that at some point, the conditions could once again mean you could revisit?

Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board and CEO

The German discussion about the regulation currently is as follows. We have what we highly appreciate this market consultation phase going on, how strong the market dominance is at that point in time from Deutsche Telekom and on a regional basis. And we know that this has changed since the regulation of Deutsche Telekom was invented 20 years ago. So we hope that we will see regional-wise significant less regulation on German fixed line than more regulation. The second thing is, we do not expect that there are any kind of significantly price adjustments to the layer 3 bitstream access, which is part of the upcoming regulation because we hear everywhere the support to say we understand that you're investing heavily. And therefore, we expect that you have to earn this money back, and therefore, we support, let's say, the cost-based approaches, analytics, which we bring to their attention. A joint dominance regulation is nothing which is currently discussed here in Germany. Unfortunately, the Parliament and Council have both reacted to the pressure by national regulators organized doing direct on this kind of things. So they do not want to see any kind of significant market power from one of the players here, but that there is a need for further regulation here is not the case even in the paper, in the court, we are discussing more the intention to deregulate companies who are investing into fiber. So it's not ready. And to be fair, there is a certain amount of frustration of the big players in this fixed line environment. I hope that we can convince the parliament to change their approach to this one before it goes into the national consultations here. But what I've seen from the court so far is disappointing. It's not really motivating or encouraging us to invest more, but it's not worsening the situation, to be fair as well.

Thomas Dannenfeldt - Deutsche Telekom AG - CFO and Member of Management Board

And I'm going to answer the second question, and Tim, then can share later on, on the -- if he wants to on the U.S. and M&A big picture. First of all, as always, we and I don't comment on Marcelo's messages. I think what is important, and you may recall that we've been always very clear on the criteria we set out to evaluate a potential transaction and its valuations to governance, antitrust issues and sound financial framework and all of those dimensions in totality are important to a discussion like this. I'm not sure whether it's right to single out one factor. But your second question I think was, whether there is -- that deal is off the table forever. And I think the answer is two-folded. First of all, never say never. I think that's clear. We continue to see a strong industrial logic. We've always been clear about that since the AT&T deal failed. So there is an industrial logic for a wireless market consolidation, and we always said it can make sense on the right -- under the right terms. On the other hand, believe me, we surely did not make an announcement like this in our talk news this week, and because we wanted to continue the discussion anytime soon. So never say never, but I guess, the talk is giving you kind of indication where we are.

Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board and CEO

Let me give a little bit more flavor to the situation with Sprint and T-Mobile US and the parent companies. The first, the relationship, my and -- with SoftBank and in person with Masa Son is very important, and I would have loved to see an even closer working relationship between the 2 companies. I very much admire Masa Son, and his entrepreneurial spirit, his visions and even his braveness to move forward with a lot of things being it, let's say, in the Internet of Things, being it in the artificial intelligence, being it in even the satellite communication services, I admire Masa and I call him a friend. Nevertheless, business first, always business first, and it's much more difficult in this relationship to say no than to say yes. We had a very intensive and good relationship, and honestly, I respect much more the partners on the other side than ended before in the way how we work together, how we build up the business cases, how we came up, let's say, over the due diligence phases, how we understood the different angles of this deal and of a joint activity. Now that said, at the end of the day, you have to look on the situation of how is the valuation? How is an effective governance? How is the antitrust risk? And how is a sound financial framework to be established for this kind of entity? And all of these criterias have been important for us on a decision, and you can be sure that we did our homework along all of them. And to just improve that, Thomas and myself, we flew 50,000 kilometers in 1 week to just check with everybody what's the right way going forward, and what's, let's say, the total equation



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of the deal. At the end of the day, I always said, I'm not doing bad deals. And since I'm in this office, I'm very proud that so far, I haven't made a mistake on that one. So I hope that you respect our decision on that one even if maybe the intention at the beginning was a little bit different. I think there are lot of big synergies in this case. It's a great opportunity. The doors to this great entrepreneur Masa Son and his team are never closed at Deutsche Telekom. But for now, I think we had to take a decision, which has been communicated then in the last days.

Hannes Wittig - Deutsche Telekom AG - Head of IR

Okay. Thank you, Tim. Next question I'll take from Ulrich at Jefferies.

Ulrich Rathe - Jefferies LLC, Research Division - Senior European Telecommunications Analyst

I have 2 questions, please. The first one is an operational one on Germany. In mobile, the postpaid churn is down really quite far beyond sort of historical track records. And I was just wondering whether that's something that's happening in the branded base or in the service provider base or whatever else you can say about that? And my second question is on T-Mobile. Maybe asking it a different way. In the past, well before potential discussions were sort of being integrated in the market, I've heard you comment that T-Mobile doesn't really produce returns on investments that U.S. investments -- sorry, U.S. returns on capital, that returns on capital in the U.S. overall even at the leaders are lower than in Europe on average, that there is no organic path for T-Mobile to reach returns on capital. So I'm just wondering, when you talk about being well positioned with T-Mobile, you could sort of interpret this as saying T-Mobile is in a good position to continue growing and taking share but with no returns. So eventually you're building up something that will be ever stronger deal partner at some point? Or are you now saying, no, there is really an organic part of producing commensurate return on capital with the sort of growth trajectory that we have built up for T-Mobile?

Thomas Dannenfeldt - Deutsche Telekom AG - CFO and Member of Management Board

Yes. Ulrich, I'm going to start with the first question on the postpaid churn. It's quite simple. Our contract churn rate without (inaudible) or the famous element of fluctuation we always have in the numbers is basically if you look at last the 5, 6, 7 quarters, it's more or less always 1% or it's 0.9, 1.1. So with a little bit of up and downs, it's the same magnitude. No significant change and no changes and fluctuation is around that. I think what we're seeing in the mobile market is very high loyalty of customers, high satisfactory customers on one hand and well working upselling. And in that contract part of the business, which is our own-branded, there's no significant changes in dynamics.

Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board and CEO

On the second question, with regard to the return on capital deployed and the economic value-added, Ulrich, you're absolutely right. Five years ago, this was my assessment, and I have to admit I was wrong. So if I look at -- so look -- if I look to the numbers today and into the return on capital employed comparing Europe and comparing Germany or, let's say, the U.S., this return on capital (inaudible) are very, very close. And the take-up rate on the return on capital employed in the U.S. is much faster than we have in our big entities here, for instance, in Germany. So the development on the mobile side with this huge custom growth, which we have seen over the last 15 quarters is helping us significantly in the improvements. On top of that, our capital cost came down significantly over that time. So earning our capital costs and even beyond is more likely than it ever was even for our big, huge U.S. operations. And whatever we do when it comes to new markets and new build-outs, we have this equation in mind. So with regard to this, I'm very -- I've very much changed the perspective from what it -- this was the reason why we have invested so much money over the last years because we see this positive development.

Hannes Wittig - Deutsche Telekom AG - Head of IR

Thank you, Tim. And now I would like to have Fred's question, please? Fred at Bank of America.



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Frederic Emile Alfred Boulan - *BofA Merrill Lynch, Research Division - Senior Analyst*

Two questions, please. First of all, on Germany, we had a nice pickup in EBITDA growth in the quarter. If you could detail some of the key growth driver. You mentioned the merger of the tech services, but how we should think about cost and margins for that business in the medium term. And then back to fiber, if you could help us a little bit understand how you articulate the number of different timings, being the political timings, benefit timings, the announcements from your competitors, including Vodafone, the easy to work on (inaudible) code with your own timing to define your high-speed broadband strategy beyond the targets you have for 2018.

Thomas Dannenfeldt - *Deutsche Telekom AG - CFO and Member of Management Board*

Fred, this is Thomas. I'm going to start with the question about the German margins. I think key drivers -- I mentioned one, which is the integration on the customer service and field service side. Obviously, what you have there is in operations where you had redundancy in the structure. The business was set up on one hand, and on the other hand, you had processes being delivered to the customer or running through several organizations and one part of the -- indirect OpEx reduction you see here is obviously streamlining the processes now in one organization much easier and getting rid of redundant organizational structures in there. So that redundancy element, process optimization is one part of it. By the way, there is also better capacity utilization of real estate locations in technology, which is a windfall or an effect of some part of what we're doing in the IP migration. So all that adds up to what you see here, and I think that will support further on in the margins. I think we've given the guidance in 2015 on where the margins should be, and there is no change on that one.

Timotheus Höttges - *Deutsche Telekom AG - Chairman of Management Board and CEO*

With regard to fiber in Germany and the timings, look, we have a commitment with regards to the vectoring rollout in Germany, which is 2018, our main focus and a little bit into 2019. Then we further will improve the build-out and the bandwidth in Germany, as we discussed earlier today. That said, the most recent consensus is reflecting this CapEx requirements for our build-out, with almost stable CapEx projections of around EUR 4.3 billion for the German segment through 2021 and a bit over EUR 5 billion in the region of Germany as a whole. This is including all CapEx, including, let's say, 5G deployment and the IT requirements, which we need, and that might give you an orientation. As I said earlier, we believe that from an investment perspective, it is not a money issue at that point in time, it's even a capacity issue in the world. Now the question about fiber build-out has even something to do with the decisions about the deregulation and the political support for that one. It's too early to say how Germany or the EC might decide on that one. I hope they're coming up with a clear decision on that one soon, and then we will give you our assessment of what that means from an economic terms perspective. The only thing which I can leave with you and take that serious, I will not invest into something which is not financial viable.

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

Okay. So the next question is from Russell at New Street.

Russell Waller - *New Street Research LLP - Founding Partner & Analyst*

Yes, just a quick one on the Netherlands. So yes, I was wondering if you saw potential for a value-creating deal there. I guess, [tele 2] spectrum asset might be available as of January. Now obviously, in the past [43] has been controversial in Europe. But do you think that European Union might look at that deal in a different way given the fixed-mobile asset infrastructure dominance of KPN and Vodafone? And then my second question was just on the U.S. Obviously, that asset is performing very nicely. I was just wondering though what does worry you about the medium-term outlook? I mean, I'm thinking, for example, densification for 5G, for example. Is that something that you would consider when thinking about inorganic opportunities? For example, do you worry the impact to OpEx or CapEx bill as you have to densify your network with small cells there?



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Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board and CEO

Look, coming up first with the Netherlands. And to be clear, in principle, we like market consolidation. In the Netherlands, we have 2 very strong integrated incumbents, and it seems clear that consumers would benefit if the 2 mobile-centric operators could join forces and really develop a powerful third force. But clearly, our first priority has been to strengthen our existing asset as much as is possible in the given circumstances, and I hope that the listeners here of that call would give us credit about how we are solving our challenged environments. We have fixed the Netherlands. Since 4 quarters, we are #1 in the contract net adds. We have fixed Poland, very encouraging momentum here, even from a fixed-mobile convergence offering. We have fixed the European entity, which is now on a growth pace again. So I would say more or less, our big challenges we've had 1 year ago are back to growth. And nevertheless, the good progress we are making and the good subscriber growth or customer growth which we have and the excellent network which just won the P3 [test] for another time, and we are open to the consolidation. So that said, let's see what the other side might consider on this one, and our -- the European Commission might read this, but that's our position at this point in time.

Thomas Dannenfeldt - Deutsche Telekom AG - CFO and Member of Management Board

Yes, and maybe on the U.S., what worries us most in the medium term, first of all, I think, as you know, we have great assets here. And one of the greatest assets we have here is our team, which can deliver on network densification and rollout better and faster than any other team I've seen in the world. Just remember the integration of Metro PCS network into the T-Mobile US network. So I think in 5G, we are front footed. We leveraged our new low-band spectrum. We're deploying small cells. I think other than in Europe, in the U.S., it's much easier to get the fiber access to the sites. As you know, in Europe sometimes it's more difficult to get to a good connectivity set up for your sites. We have already the densest macro tower footprint and, as I said, rolling out fast on the small cells. So I think in terms of the capabilities, ingredients for success, they are all there. And so there is no worry about that. What about the OpEx budget? It's part of the equation of running a network. If you don't own the complete fiber footprint like we sometimes do in our European operations, it's part of your financial and your economical equation, but it's non-use. It's like today.

Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board and CEO

Thomas, let me add one sentence on that one. The deployment of the 5G capabilities with Nokia and Samsung will begin in 2018 already, and the 600 megahertz spectrum, where we gained the biggest portion, this will provide us the spectrum capacity for the small cell deployment but even for the deployment of the entire country. So this is, for us, the prerequisite for the 5G deployment, and I think we are well positioned in this area.

Hannes Wittig - Deutsche Telekom AG - Head of IR

Okay. Next, we have Andrew at Goldman Sachs.

Andrew J. Lee - Goldman Sachs Group Inc., Research Division - Equity Analyst

I had a question on other opportunities in the U.S. and then one on cost-cutting maybe more domestically. So on the other opportunities, it's more on buybacks with reference to your comments that we have other opportunity to create value at TMUS. How do you think about buybacks, given the rapid deleveraging that you deliver with your free cash flow growth? Or given the IFRS changes in the treatment of operating leases, would you rather focus on degearing the balance sheet? If it is buybacks, when will you tell us about this? And would DT sell into the -- into a buyback? And then just on the cost-cutting and digitalization, you clearly have a big opportunity here. Is that something you can bring forward? Or is it something you have to wait for the all-IP migration to be complete to deliver meaningfully on?

Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board and CEO

Look, it's great to see TMUS generating increasing amounts of cash, while the (inaudible) brings down the leverage quite rapidly. That's very encouraging, even looking forward into the combination of T-Mobile US and Deutsche Telekom. So the choice you mentioned is definitely a nice



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one to make. That said, both dividends and buybacks have their merits. And I have to say at this stage, we have no decisions to communicate. But we hear you as an investor.

Thomas Dannenfeldt - Deutsche Telekom AG - CFO and Member of Management Board

Yes, on cost-cutting, the way the IP migration works in terms of the savings related to that is partly it is basically the savings depending on the completion. That's more or less the technical part of the savings, where you need to switch off platforms to get -- to ramp down the costs. And partly you can -- you see that already prior to complete shutdown or retirement, for instance, if you can simplify processes like I mentioned part of what you've seen in Q3. So it is partly something which happens while you go, and partly you need to finalize the whole thing to get the, especially, the technology savings. That's the way it works. And that kind of pattern is embedded in all the guidance we've given you. So it is partly prior to retire and partly after retire.

Hannes Wittig - Deutsche Telekom AG - Head of IR

Great. Thanks, Thomas. The next question is from Usman at Berenberg, please.

Usman Ghazi - Berenberg, Research Division - Analyst of Telecom

I've got 2, please. The first question was just on the German

(technical difficulty)

would you be able to segment the trend between the consumer and enterprise business? I know last quarter, we (inaudible) enterprises of 4%. Consumer was slightly down. I mean, has that -- has there been a significant change in that trend this quarter? And then the other question was just on the all-IP migration. I think that, Tim, you mentioned in a recent road show that the all-IP kind of migration was costing around EUR 500 million in German OpEx per annum. So the question really was as we get to end 2018, does it -- is it the case that suddenly the EUR 500 million OpEx just drops out? Or is that more phased over a number of years?

Hannes Wittig - Deutsche Telekom AG - Head of IR

Okay, Usman. So Hannes here. So I will answer both questions, actually. The first one, okay, if they let me.

Unidentified Company Representative

(inaudible)

Hannes Wittig - Deutsche Telekom AG - Head of IR

No, okay. So the first one on the B2C and B2B trend. I think we are happy to see good trends in both segments of our business. I think we are monetizing our customer base well. I think there is not really that much to add. So I think what you would see in this quarter, I think both units contribute to the strength of the performance. And we hope and are confident this will continue. So as far as the all-IP costs are concerned, and so first, it's our B2C rollout that will be completed by the end of the 2018. So we still have B2B work to do in the German segment and in systems. So we will start to see some of the benefits, as Thomas has described earlier, coming through at the network level. And others will take longer as per our guidance at the Capital Markets Day. And so I think it will be a phased and gradual development, with some improvement coming through beginning in '19.



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We'll take a question from Sam at Exane, please.

Samuel McHugh - *Exane BNP Paribas, Research Division - Analyst of Telecom Operators*

Two questions, if I can. Just first one on mobile service revenue in Germany. I think kind of quarter-on-quarter trends look like they're improving quite a lot on an underlying basis. I don't know if you could just talk about what you're seeing in terms of More for More, maybe average kind of gigabyte packages people are taking? You mentioned a bit more towards the medium and large packages. I guess it seems to be having a pretty positive impact. And then secondly, on the U.S., we didn't get to ask (inaudible) on the guide this quarter. What kind of productivity or kind of comparison can you make between some of the new stores you've opened this year compared to existing stores? And when should we expect that to start ramping up a bit more?

Timotheus Höttges - *Deutsche Telekom AG - Chairman of Management Board and CEO*

You go ahead.

Thomas Dannenfeldt - *Deutsche Telekom AG - CFO and Member of Management Board*

It's for Germany.

Timotheus Höttges - *Deutsche Telekom AG - Chairman of Management Board and CEO*

Okay, then. Go ahead. I'm lazy. Go ahead.

Thomas Dannenfeldt - *Deutsche Telekom AG - CFO and Member of Management Board*

Okay. So I'm going to start now with the German question. I think basically what we've seen during the course of the last quarters is an improvement, and I said in the mix of SMNL. What you've seen, if you just add M and L to the higher, more richer tariff plan, the percentage of customers taking those has improved by 50% roughly, and that was basically driven by, a, more volume but also StreamOn. The way StreamOn works is you only can get it if you are an M or an L customer. So what we're doing is we're using those elements to incentivize the people and the customers to choose more richer product, and that is what works well and what is shifting the rich -- the mix into a much richer shape. I think that's basically the answer on number -- question #1 and now, Tim, U.S.

Timotheus Höttges - *Deutsche Telekom AG - Chairman of Management Board and CEO*

Look, I would say it is still too early to tell you something about the productivity of the new shops. It only takes 12 months to know exactly where -- how successful they are. It's anyhow, you're much more flexible in reacting on good and bad shops. Year-to-date, T-Mobile has added 1,200 Magenta branded and 1,300 MetroPCS shops and plans to add an additional 500 shops by end of the year. And what we know for far, so the latter category has so far tracked has sales productivity quite nicely. It is always associated with the 700 megahertz deployment. So wherever we open up an infrastructure where we haven't been before and opening up a shop, the productivity of this shop is quite encouraging. So anyhow, we are much more flexible in reacting. And therefore, we are not concerned. We are monitoring it. But to give you a full, let's say, productivity analysis on that one, it's quite too early.

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

Thanks, Tim. So next question is from Mathieu at Barclays, please.



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Mathieu Robilliard - Barclays PLC, Research Division - Research Analyst

So I had 2 questions, please. First, with regards to EBITDA and CapEx at the group level. So for the second time you raised your EBITDA guidance, which is great at the group level, you haven't changed your free cash flow guidance. So my question is really if we look ahead, if you continue to do maybe better than you had expected on EBITDA, is that something that you would use to invest more because you see more projects where you can deploy that capital effectively? Or at some point, do you think the free cash flow growth can accelerate? So that's the first question. And second question is regards to costs. So we've all talked a lot on the all-IP migration and the costs associated to that, but I imagine that there are other areas where you're working, digitalization, et cetera, et cetera. And it's very hard for us to compare between companies where they stand on all of these different aspects, the network, the IT system, the customer interaction. How do you think you're doing there? And what are the big areas where you still think you can improve efficiencies? But also how you need to invest to get those efficiencies?

Thomas Dannenfeldt - Deutsche Telekom AG - CFO and Member of Management Board

Thanks, Mathieu for the question. First of all, on the EBITDA and the CapEx as a group, I think you're spot on. We've increased the EBITDA but not the free cash flow. And that's simply -- I think in Q2 you've seen that -- the U.S. raised the CapEx or moved up to the upper end of their CapEx guidance because they are accelerating 600 rollout at this time. It is the Greece operations spending more money on the fiber deployment there. And I think that's -- you know that pattern, what, for instance, from the German side what happens in Greece as well. So we accelerated the rollout there, and we'll see good network infrastructure and, for sure, also then revenue improvement and, finally, EBITDA improvement on that. So my way -- I said that last quarter already, my way to look at the whole free cash flow guidance is there is -- we've given a clear message in terms of what you should expect, and we will deliver on that one, and we'll make sure that we deliver on that one. Whenever we can create headroom, we have a discussion whether there is money to be spent in a way that we can keep going with that kind of fantastic run rate and improvement on free cash flow. And this time 600 for this year in Q2 and in Greece, the rollout that was the decision behind.

Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board and CEO

So and now we extend this call for another 2 hours because this question is very exciting and very relevant for our business, talking about, let's say, the impact of digitization on our businesses. Look, if -- from a strategic perspective, if you asked me what are the challenges of our business, the first one is the competition which we have in our market. It's still ongoing. The second is the threat from over-the-top substitution. I think it was very intensive over the last year. It has slowed down. So it's not anymore that [bad]. New kind of business, which are entering into that, into our landscape, like SDN, cloud providers are like network of network players, these are new business models, which are trying to substitute services from us. This is something which is increasing. And the fourth one, which is a challenging item for us as a telco, is more digital telcos. So telcos are really leveraging their capabilities in a more productive, digital way. So this is something for an old incumbent like us where we have to react on. So the digitization of our internal processes and the process towards the customer is one of the key amendments which we will do or which we have done already to our strategy. To give you some examples how we want to drive that, and it's the simplification, which we have to do within the (inaudible). Starting at the front end. For instance, in Germany, we have recorded 3.6 million visits on our Magenta service app. This is an increase of 28% year-over-year, and this is reducing the load on our off-line channel significantly. And I'll share another example. This is -- this company's now using a web-based chat bot, so which is helping to answer questions of customers in a much more efficient and faster way. Second topic on how we drive digitization is for me, the topic of advanced analytics. By analyzing and interpreting all the data which we have, and we are sitting on tons of data, on a personalized and individual level, we have increased the conversion rates of specific campaigns by more than 70%, much more individualized offers, which we can create and which are much more resonating than with the customer. Another one is the back end. We use robotics to automate big processes. Standardized routines are in [orange]. And to generate efficiencies, including [2,000] employees each year in Germany already today, and we're just at the beginning of that one or we even use big data analytics to improve -- to manage our field forces. This is something which we are experimenting with. And the last one just you know another flavor is we are building our own bot so that every employee can change and automate the processes the individual is using in the company. So if you are looking about your salary, if you want to go on vacation, you go into standard routines within the IT systems, and we now created the capability that every employee could build his own bot. And by using this bot, he could significantly improve his own productivity. So it's a big, big effort, which we are addressing. I think it's a more and more coming topic for our industry. And therefore, more to come in our (inaudible) talks or even later in the year to give you a flavor of what we are doing here.



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Thomas Dannenfeldt - Deutsche Telekom AG - CFO and Member of Management Board

Thank you, Tim. We're working -- just to add one element, because there was one aspect of the question I think is still open. That's not so much a matter of big investments, CapEx investments. That's what Tim mentioned, the whole process is much more about the way people work, how they address the challenges they have every day in their business rather than big investment things. So don't expect any big numbers behind that one.

Hannes Wittig - Deutsche Telekom AG - Head of IR

Thanks, Thomas. Here speaks the IR bot. Okay, so our next question is from Robert Grindle at Deutsche Bank.

Robert James Grindle - Deutsche Bank AG, Research Division - Research Analyst

Just 2 quick ones for me. The first one on T-Systems. The business has been a bit sluggish for some time. And despite cloud doing better and you have written down some goodwill, what was the -- was there a -- what was the main problem with the order book? Obviously, it was light, but was it coming from any particular segment? And I think you got new management there now. What's the prognosis on a forward-looking basis? Are we just looking at more stable EBITDA? Or should we be expecting a little bit more pressure from here? And then a follow-up on the mobile service revenue question. Any reason to think, and it was a great print this quarter, any reason to think why the trends aren't persisting into Q4? And linked is any reason to think that the handset upgrade cycle is turning in Germany. You do seem to have quite a high handset revenue this quarter, which also helps you on the service revenues.

Thomas Dannenfeldt - Deutsche Telekom AG - CFO and Member of Management Board

I'm going to start with the T-Systems question, first of all. So that is -- I missed that. Tim wanted to take the question. So bad luck, so you need to deal with me now. So okay, on T-Systems. So basically, if you look into T-systems, you have the international telco business. You have the security part. You have IoT. You have -- what have I missed other than IT? Obviously, the cloud business and our road toll business. All those are doing well. All those are growing, and so that is not where the issue sits. The issue is clearly on the classical IT business. I think that complete market is in a decline, first of all. Secondly, we've increased our levels of profitability we want to see in those deals. And that's the key reason, I think, or the key reasons why we've seen order book declining. Basically, the write-off you see in there is a reflection of what you've seen last 4 quarters in terms of the development. As you know, we hired a new guy for the IT business and having Adel on board. Both are IT experts. I think that will give new positives for that business. But to be clear, in terms of what you should expect, we feel absolutely comfortable with consensus regarding T-Systems. And so I think that should give you an idea about the forecast. Second question was mobile service revenues.

Hannes Wittig - Deutsche Telekom AG - Head of IR

Yes, I think Robert, if I understand you correctly, you wanted to get a sense for how sustainable our mobile service revenue trends are, and also you had a question on the handset cycle. I don't think there's anything particular on the handset cycle that is worth communicating. I mean, I think everyone is aware that when the iPhone arrived in Germany and so on, and -- but it hasn't -- I don't -- wouldn't look at this as something where we have anything to communicate. In terms of the service revenue performance of all, I think we're encouraged by current trends, and we have no reason to think that these trends will dramatically change at any time soon, but that will be driven by good monetization, growing data usage, you see our KPIs doing well, et cetera. But of course, to some extent, also dependent on the competitive environment here. It's fine where we are, and we are happy with where we are. And long may it last, and hopefully, it gets even better. So the next question is from Ottavio at SocGen, please.

Ottavio Adoriso - Societe Generale Cross Asset Research - Equity analyst

I have 2 questions, actually 2 follow-ups from comments made by Tim. The very first one is on the fiber and in replying to the Vodafone gigabits investment plan. Is it possible to have a bit more granularity, because in your communication, you give a lot of data points for consumers, but is it



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possible to share a bit more with businesses? Vodafone is talking about or targeting 2,000 business parks and according to them, there's something like around 32,000 in Germany. So my question is that, how many of these business parks -- first of all, are these numbers correct, so 32,000 is the current number? And how many of these business park you already connect on fiber? And what will be our target and, if possible, the timing? The second one is also another follow-up. It's on the comments Tim has made on the [CapEx envelope] until 2021. You said that you're relatively comfortable with consensus at 4.3 billion. You also mentioned that, that includes 5G. Now your fiber plan has got a lot of attention. But looking at comments made by policymakers around looks like 5G is also becoming pretty important in Germany because of the very high lobbying from the automotive industry that's very strong and a very big interest they have in self-driving cars. So my question is until 2021, is the case that 5G potential is now going to be [fully rolled out]? So it will be back-end loaded, most of this investment? Or you reckon that you just wait and see how much the automotive industry will put in terms of their own investments to go and potentially match up those investments?

Timotheus Höttges - Deutsche Telekom AG - Chairman of Management Board and CEO

So good questions. Ottavio, first thing on fiber. Now the Vodafone gigabit investment plan, which is an amount of, I think, EUR 2 billion or whatever, it's a joke. It's a joke. And so we are investing in the German entity EUR 4.2 billion into infrastructure on an annual basis. And we are moving on, and we are doing that already for the last years. So therefore, we see that. But again, Vodafone is very strong in the way of selling something, but I think in some sense, I really question the substance on that one. So that I don't say that arrogant, but even CityFibre announced then today -- I haven't looked into the details, but I do not believe that they are approaching 5 million customers, but that's just a side comment. Now that said, we have our -- on the business parks the following analytics. 10,000 business parks in Germany. From these 10,000 business parks, there are 3000 which are really relevant, because in these 3,000 business parks, more than 80% of all SMBs are registered. So this is the so-called very intense area. And this is the area which we are tackling first. This is part of our investment plan. This is part of our CapEx, which we are laying out, and we want to connect them all. I mentioned that already at the annual meeting, and that's our plan, and we have started already. Every week, we're announcing a new opening on that one. Thomas made I think 4 or 5 big cities in his speech, but there's much more. And if you're interested, we could easily release all of this. This is, let's say, our first areas on the side, and then we will see whether there is additional subsidies coming for other ones or rural ones, but it's too early to say at that point in time, and anyhow, our capacities are fully loaded on these areas.

Thomas Dannenfeldt - Deutsche Telekom AG - CFO and Member of Management Board

Yes, maybe then on the CapEx and 5G question. So first of all, is our fiber -- sorry, our 5G plan due to automotive sector development and announcement? No, it isn't. It is driven by a very simple thought. We are the network leader in Germany on mobile, and we are on 4G, and we will stay that on 5G and even increase the gap to competition. And that means we are starting basically now with a lot of preparations for 5G. We'll make sure that we have the site densification or sites in place that we have the fiber backhauling in place. By the way, as you know, the vectoring rollout is delivering to huge extent the densification of fiber you need to get to a really good 5G infrastructure. So that is driving us. And yes, there is a potential application, which is related to automotive sector in there. But as Tim mentioned, there's also potential application to deliver higher bandwidth via 5G in not so dense areas and so on and so on. So yes, there are various applications in 5G we can talk about at length. And those are obviously driving our thoughts and our investments on 5G but not just one single industry sector or application on that. But in essence, it's quite simple. We are the leader in terms of quality to the customer, and we will stay that in 5G. And that's how our investment profile is set up. It's also back-end loaded. It's just a normal ramp you see in a new technology.

Hannes Wittig - Deutsche Telekom AG - Head of IR

And as before, we think that the current consensus covers what Tim has mentioned related to the B2B build-out or residual FTTC rollout and various other things that we have mentioned as well as the 5G investments that we expect over this time. That's at least how we look at it at this point in time. So the next question is from Guy Peddy, please, at Macquarie.



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Guy Richard Peddy - *Macquarie Research - Head of Telecommunications, Media, and Technology*

Yes, just 2 very quick questions. Towards the end of the quarter and actually since then, we've seen quite substantial changes in tariffs by Telefónica Deutschland and [1 on 1]. I'm just wondering what you thought of those given you're now at a substantial premium for the sort of higher volumes in the German market? And secondly, on the broadband space, clearly, there's been a strong in-sell of your vectoring product, but the overall growth in the industry does seem to be sort of a bit lackluster for yourselves and are still very much focused on cable. Do you think there's anything you can do to continue to stimulate the broadband growth? Or do you think we're sort of starting to max out the appetite for broadband in Germany?

Thomas Dannenfeldt - *Deutsche Telekom AG - CFO and Member of Management Board*

Yes, first of all, I don't see any significant change on the mobile side. Telefónica is out with their tariffs, I think, with their structure since May. And [1 on 1] is just -- it's with a certainty laid, it's clear that there will be a similar follow-up of that. So I don't think there was any substantial change in dynamics other than normal promotional activities in the last quarter on the mobile side. What's always good, and you know that we love to see data usage going up. We're driving that. I think there are various ways to do it. There's more in terms of big buckets. We are more in StreamOn, like -- we like more the way to give the customer the clear message you use as much as you want, and you don't worry on applications like mobile video and mobile music. But other than these principal dynamics of increase of data, you see that plus 55% in the usage increase. I think there are no fundamental changes. On the B2B side, the growth -- if you look at -- I think if you look at not at the net numbers but gross numbers, you see that we are pretty much on our fair share in the market. If you exclude the headwind we're having on the IP hard migrations was, by the way, the same vicinity like last quarter. So mid-20s. If you add them back, you see that we are on the net adds as well as on the gross adds easily on our fair share. So I think that's no reason to worry on that side as well.

Hannes Wittig - *Deutsche Telekom AG - Head of IR*

So our next question is from Stephane at Raymond James, please.

Stephane Beyazian - *Raymond James Euro Equities - European Telecoms Analyst*

Yes, just one. Following up your supportive comment for a massive investment strategy and looking at around taking a surely different angle, but there's still a bold move with banking, do you have any appetite and identified possibly new fields of investment outside of the classic telecoms and to be felt in a, let's say, a more medium to long-term approach?

Timotheus Höttges - *Deutsche Telekom AG - Chairman of Management Board and CEO*

Look, the first thing is I said it I think last year in Barcelona. If you really want to buy a pure network provider who is very clean in the way of focusing his investment into a superior integrated IP network, and that's the profile of Deutsche Telekom. That's the DNA. That's why I'm investing more than the rest of the team, and we are not spreading our money around all places. We are very much focused on the way. The network is the basis for whatever we do, mobile integrated networks, mobile fixed-line [head net] and the like. Now do we have intention to go into banking? No, we don't. This is something where we believe it's better to partner. So when somebody has, let's say, a solution here in the space, we will establish a partnerships. We have 150 partners already around our infrastructure network here, which is working very, very nicely. And if we want to earn money with that one, we even have (inaudible), which is doing even very nicely, which is the DT Capital Partners, where we invested a lot of companies into -- over the last years, always in the magnitude of 10 million to 20 million investments, and this company is a possibility that we commit to some new businesses vertical solutions the moment we deploy them into our customer base and into our infrastructure. There are some areas which are helping us to create an access plus. So a kind of covering the pure access platform, services and the like. And this is something which we also consider. For instance, Entertain, our TV services, is something which is helping us to sell connectivity in an added value way. This is something we're pursuing on, and we will not change this strategy. I think we are very much focused. We have a few [bets] around it. TV is one of it. Big IoT is another one, but even here we will not go into the vertical solutions and more into providing a platform service.



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Hannes Wittig - Deutsche Telekom AG - Head of IR

Thanks, Tim. And I have a question from e-mail from Jon Dann at RBC. So he asks regarding the group excluding the U.S., whether we've now reached an inflection point. This quarter, we were up 2%. And he specifically asks this that EU and T-Systems drag has peaked and whether this is now a sustainable growth performance.

Thomas Dannenfeldt - Deutsche Telekom AG - CFO and Member of Management Board

And the answer is yes. As we said, you should expect a higher x U.S. EBITDA this year, and you should expect another growth next year, yes.

Hannes Wittig - Deutsche Telekom AG - Head of IR

The last question is from (inaudible) from BTIG, if you are still on the call. Okay, so he's left the call. And with that, I think we went through all the -- your question. If you have any more questions, please contact us at the IR department. We promise you it will not be a bot for the time being, although Thomas is working on it, and I know somebody actually contacted me and said we should not get a bot, and they still prefer real people. And -- but with that, I would like to hand back to the operator -- any final word? No. Okay, I hand back to the operator.

Operator

We'd like to thank you for participating at this conference. The recording of this conference will be available for the next 7 days by dialing +49-1805-2047-088 via reference number 514857#. We are looking forward to hear from you again. Good-bye.

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