

# Development of business at Deutsche Telekom AG.

Deutsche Telekom AG, which has various branch offices in the Federal Republic of Germany, prepares its annual financial statements in accordance with the principles of German GAAP, as specified in the German Commercial Code and the German Stock Corporation Act.

As the headquarters of the Deutsche Telekom Group, we perform strategic and cross-segment management functions and provide services for other Group companies. The profits and losses of our subsidiaries and Group financing measures have a material effect on our financial position and results of operations. For Deutsche Telekom AG, the 2010 financial year was again marked by intense competitive and price pressure in the telecommunications industry, which was also reflected in the income and loss of its subsidiaries.

Deutsche Telekom AG reported income after taxes for the 2010 financial year of EUR 3.0 billion. The development of business in the reporting year was marked by a number of very different effects, arising from both the company's day-to-day operations and income related to subsidiaries, associated and related companies, as well as from the restructuring activities carried out in the 2010 financial year.

These activities included spinning off our fixed-network business (hereinafter referred to as the T-Home business unit) to Telekom Deutschland GmbH with accounting effect as of January 1, 2010. The fixed-network business activities that were spun off include voice and data communication based on fixed-network and broadband technology. On account of the spin-off of the T-Home business unit, the figures are not comparable with the amounts for the previous year.

The German Accounting Law Modernization Act was applied in full for the first time in the reporting year. Pursuant to § 265 (2) sentence 3 HGB and Art. 67 (8) sentence 2 of the Introductory Act to the German Commercial Code (Einführungsgesetz zum Handelsgesetzbuch – EGHGB), prior-year figures were not restated.

The balance sheet of the T-Home business unit under German GAAP at the time of the spin-off is presented below in condensed form:

	millions of €
<b>Assets</b>	
Non-current assets	13,254
Current assets	1,205
Prepaid expenses and deferred charges	56
<b>Total assets</b>	<b>14,515</b>
<b>Shareholders' equity and liabilities</b>	
Shareholders' equity	2,232
Accruals	1,015
Liabilities	11,232
Deferred income	36
<b>Total shareholders' equity and liabilities</b>	<b>14,515</b>

Deutsche Telekom AG's carrying amount in Telekom Deutschland GmbH increased by the amount of the net assets spun-off (EUR 2.2 billion).

## Results of operations of Deutsche Telekom AG.

### Statement of income of Deutsche Telekom AG under German GAAP (total cost method).

	2010 millions of €	2009 millions of €	Change millions of €	Change %	2008 millions of €
<b>Net revenue</b>	<b>4,269</b>	<b>18,220</b>	<b>(13,951)</b>	<b>(76.6)</b>	<b>18,201</b>
Changes in inventories and other own capitalized costs	7	37	(30)	(81.1)	56
<b>Total operating performance</b>	<b>4,276</b>	<b>18,257</b>	<b>(13,981)</b>	<b>(76.6)</b>	<b>18,257</b>
Other operating income	5,146	7,160	(2,014)	(28.1)	5,284
Goods and services purchased	(1,596)	(6,935)	5,339	77.0	(6,411)
Personnel costs	(3,394)	(3,979)	585	14.7	(3,871)
Depreciation, amortization and write-downs	(525)	(3,526)	3,001	85.1	(3,565)
Other operating expenses	(6,081)	(9,160)	3,079	33.6	(8,682)
<b>Operating results</b>	<b>(2,174)</b>	<b>1,817</b>	<b>(3,991)</b>	<b>n.a.</b>	<b>1,012</b>
Financial income (expense), net	4,738	3,183	1,555	48.9	1,064
<b>Results from ordinary business activities</b>	<b>2,564</b>	<b>5,000</b>	<b>(2,436)</b>	<b>(48.7)</b>	<b>2,076</b>
Extraordinary income (loss)	(24)	(329)	305	92.7	-
Taxes	443	(161)	604	n.a.	(72)
<b>Income after taxes</b>	<b>2,983</b>	<b>4,510</b>	<b>(1,527)</b>	<b>(33.9)</b>	<b>2,004</b>

Operating results are not comparable with the prior-year figure on account of the spin-off of the T-Home business unit.

One of the effects of this spin-off has therefore been a shift in our results of operations between operating results and net financial income, as significant parts of Deutsche Telekom AG's business were transferred to Telekom Deutschland GmbH and, due to the transfer of its profits, the earnings from this business are now recognized in financial income for the first time.

Thus operating results decreased by EUR 4.0 billion year-on-year, mainly due to declining revenue as a result of the spin-off of the T-Home business unit, contrasted however by lower cost of goods and services purchased, depreciation, amortization and write-downs, and other operating expenses. Special factors of around EUR 0.5 billion also negatively impacted on operating results. In contrast to the prior year, revenue included in particular income from hiring out employees, renting and leasing out property, and offering training services.

Financial income improved year-on-year by EUR 1.6 billion to EUR 4.7 billion. This was due essentially to the development of the income related to subsidiaries, associated and related companies contained therein, amounting to EUR 6.9 billion (2009: EUR 5.5 billion), which, as in the prior year, was influenced by special and other factors, particularly the EUR 1.8 billion profit transfer from T-Mobile Global Zwischenholding GmbH (2009: EUR 3.5 billion). The income related to subsidiaries, associated and related companies increased primarily as a result of the EUR 5.3 billion profit transfer (2009: EUR 2.2 billion) from Telekom Deutschland GmbH. Write-downs on financial assets of around EUR 1.0 billion had an offsetting effect on financial income in 2010.

The results from ordinary business activities decreased year-on-year due particularly to lower positive special factors in financial income, as well as to special factors in operating results.

Taking extraordinary expenses of EUR 24 million and tax income of EUR 443 million and the aforementioned factors into account, income after taxes amounted to EUR 3.0 billion in the financial year.

## Financial position of Deutsche Telekom AG.

### Balance sheet of Deutsche Telekom AG under German GAAP.

	Dec. 31, 2010 millions of €	Dec. 31, 2010 %	Dec. 31, 2009 millions of €	Change millions of €	Dec. 31, 2008 millions of €
<b>Assets</b>					
Intangible assets	206	0.2	1,275	(1,069)	1,030
Property, plant and equipment	5,034	5.0	17,282	(12,248)	18,815
Financial assets	80,876	80.8	75,759	5,117	83,277
<b>Non-current assets</b>	<b>86,116</b>	<b>86.0</b>	<b>94,316</b>	<b>(8,200)</b>	<b>103,122</b>
Inventories, materials and supplies	10	0.0	84	(74)	88
Receivables	11,571	11.6	9,356	2,215	3,344
Other assets	869	0.9	1,112	(243)	803
Marketable securities	14	0.0	226	(212)	206
Cash and cash equivalents	754	0.8	2,732	(1,978)	960
<b>Current assets</b>	<b>13,218</b>	<b>13.3</b>	<b>13,510</b>	<b>(292)</b>	<b>5,401</b>
Prepaid expenses and deferred charges	738	0.7	516	222	536
Difference from allocation of assets	12	0.0	-	12	-
<b>Total assets</b>	<b>100,084</b>	<b>100.0</b>	<b>108,342</b>	<b>(8,258)</b>	<b>109,059</b>
<b>Liabilities and shareholders' equity</b>					
Capital stock and reserves	53,310	53.3	53,715	(405)	53,713
Unappropriated net income	6,018	6.0	6,421	(403)	5,297
<b>Shareholders' equity</b>	<b>59,328</b>	<b>59.3</b>	<b>60,136</b>	<b>(808)</b>	<b>59,010</b>
Accruals for pensions and similar obligations	2,662	2.7	2,769	(107)	2,630
Tax accruals	124	0.1	547	(423)	179
Other accruals	2,903	2.9	4,598	(1,695)	5,049
<b>Accruals</b>	<b>5,689</b>	<b>5.7</b>	<b>7,914</b>	<b>(2,225)</b>	<b>7,858</b>
Debt	6,711	6.7	6,195	516	6,308
Other liabilities	28,031	28.0	33,891	(5,860)	35,833
<b>Liabilities</b>	<b>34,742</b>	<b>34.7</b>	<b>40,086</b>	<b>(5,344)</b>	<b>42,141</b>
Deferred income	325	0.3	206	119	50
<b>Total shareholders' equity and liabilities</b>	<b>100,084</b>	<b>100.0</b>	<b>108,342</b>	<b>(8,258)</b>	<b>109,059</b>

In addition to shareholders' equity, our financial position is determined in particular by financial assets, receivables from and payables to Group companies, and debt.

The decrease in the balance sheet total compared with the prior year is largely attributable to the spin-off of the T-Home business unit.

This reduced our assets by a total of EUR 8.2 billion year-on-year.

This was mainly due to the decrease of EUR 12.2 billion in property, plant and equipment, which was partially offset by an increase of EUR 5.1 billion in financial assets. Property, plant and equipment accounts for 5.0 percent of total assets (December 31, 2009: 16.0 percent); this item declined year-on-year primarily due to the spin-off of the T-Home business unit. Financial assets constitute 80.8 percent of total assets (December 31, 2009: 69.9 percent) and mainly comprise investments in subsidiaries of EUR 74.5 billion and loans to subsidiaries of EUR 6.3 billion.

Financial assets increased by EUR 5.1 billion year-on-year, primarily as a result of additions to loans to subsidiaries owing to the transfer of financial contracts as part of the spin-off of the T-Home business unit to Telekom Deutschland GmbH.

Receivables from and liabilities to subsidiaries amounted to EUR 10.6 billion (December 31, 2009: EUR 8.6 billion) and EUR 22.2 billion (December 31, 2009: EUR 28.5 billion), respectively. The decrease in liabilities was mainly the result of the spin-off of the T-Home business unit.

Shareholders' equity decreased by EUR 0.8 billion year-on-year, due in particular to the net income after taxes of EUR 3.0 billion, the profit distribution of EUR 3.4 billion for the previous year, and the buy-back of Deutsche Telekom AG shares of EUR 0.4 billion. The equity ratio increased by 3.8 percentage points to 59.3 percent (December 31, 2009: 55.5 percent).

#### Statement of cash flows.

	2010 millions of €	2009 millions of €	Change millions of €
Income after taxes	2,983	4,510	(1,527)
Net cash provided by operating activities	751	5,442	(4,691)
Net cash used for investing activities	(329)	(2,903)	2,574
Net cash used for financing activities	(2,400)	(767)	(1,633)
<b>Net change in cash and cash equivalents</b>	<b>(1,978)</b>	<b>1,772</b>	<b>(3,750)</b>
Cash and cash equivalents, at beginning of period	2,732	960	1,772
<b>Cash and cash equivalents, at end of period</b>	<b>754</b>	<b>2,732</b>	<b>(1,978)</b>

The reduction in net cash provided by operating activities largely resulted from the decline in income after taxes and the spin-off of the T-Home business unit. The change in net cash used for investing activities is primarily attributable to the spin-off of the T-Home business unit.

Net cash used for financing activities includes a cash outflow of EUR 3.4 billion for the dividend payment, EUR 0.4 billion for the buy-back of the company's own shares, and cash inflows from the build-up of intercompany financial liabilities. Combined, these cash flows resulted in a decrease in cash and cash equivalents in the financial year to EUR 0.8 billion.

#### Risk management in hedge accounting.

We use derivatives to hedge interest rate and currency exposures; i.e., exclusively for hedging purposes, not for speculative gains. In the process, we continuously monitor the effectiveness of the hedge.