

Group strategy and Group management.

New Group strategy // Five growth areas // Three-year finance strategy through 2012

Group strategy.

Fix – Transform – Innovate. New strategy successfully implemented since March 2010. Telecommunications is an industry that sees permanent, dynamic change and is influenced by global trends. All relevant areas are affected: the fixed network, mobile communications, and the Internet.

Infrastructure is and will remain the basis of our business. We expect the gigabit society to need faster and faster networks. Two factors are of crucial importance here, if we are to be efficient and successful: next-generation networks and standardized IT. Telecommunications providers will also have to focus increasingly on realizing growth potential. In our opinion, the mobile Internet and Internet services, for example, provide a wealth of growth opportunities. What do customers expect? Secure and universal access to all services – from all devices. In our view, cloud computing and dynamic computing provide considerable growth potential for business customers. Furthermore, intelligent networks will in future support the upcoming changes in industries such as energy, healthcare, media, and transportation/automotive. We still firmly believe on the whole that a strong national competitive position is vital for a profitable business.

After successfully implementing our preceding strategy called “Focus, fix and grow” between 2007 and 2009, we have been developing our strategic approach further with the new Fix – Transform – Innovate strategy we presented in March 2010. We are focusing specifically on the challenges and opportunities in the market, which will safeguard our successful position in the long term. Our vision is still to become an international market leader for connected life and work. This is why we will systematically restructure our business model in the coming years – with investments in intelligent networks, with IT services and with Internet and network services. The aim of this strategic approach is to expand our activities across the entire value chain and position ourselves as an open partner for consumers and business customers as well as for the Internet sector.

We have defined five new strategic action areas:

- Improve the performance of mobile-centric assets.
- Leverage One Company in integrated assets.
- Build networks and processes for the gigabit society.
- Connected life across all screens.
- Connected work with unique ICT solutions.

We are systematically implementing the new strategy within these action areas and have achieved initial successes in all areas.

Improve the performance of mobile-centric assets.

In all countries in which our operations primarily provide mobile communications services, we are planning to enhance our performance and specifically invest in next-generation technologies, develop innovative services, and expand our portfolio of mobile devices.

In the United Kingdom, for instance, our new joint venture Everything Everywhere got off to a good start as the market leader, measured in terms of the combined customer base. In the United States, we have developed a new strategic orientation to further improve our competitive position. We increased our average data revenue per user by more than 20 percent in the U.S. market in 2010 thanks to our 3G/4G network. In addition, we improved our position in the other mobile-centric markets, for example in the Netherlands and Poland, where we also substantially increased our data revenues.

Leverage One Company in integrated assets.

We are continuing to integrate fixed-network and mobile communications – an approach we had taken under the One Company project – as planned and again in line with the new strategy. On the back of the successfully completed integration in Germany and several European markets (e.g., Croatia and Slovakia) in the course of the year, we generated additional revenues, further improved our customer service and leveraged synergies. We have also reorganized our activities in Europe with good results: EBITDA margins in the integrated markets are still at a high level despite the challenging economic situation in some countries.

New innovative services and calling plans have allowed us to set ourselves apart from our competitors more clearly. Media Center, for example, already gives our customers 24/7 access to their music, photos, and other media content, whether on their PCs, TVs, or smartphones. LIGA total!, Deutsche Telekom's soccer league service in Germany, can likewise be watched on various screens at home or on the move.

Build networks and processes for the gigabit society.

We are forecasting a rapid increase in global data volumes in the coming years. Our goal is therefore to continue to transform operations by becoming more efficient, but also by supplying the greater bandwidth required. For this reason, we are focusing on:

- rolling out the fiber-optic networks and enhancing the mobile communications networks by pushing HSPA+ and LTE
- systematically implementing the all-IP concept
- increasing the speed and flexibility of the IT factory
- systematically expanding key enabling skills.

We have already started out on the path to achieving these goals. We purchased additional mobile frequency spectrum at auction in several countries, including Germany, the Netherlands, and Austria. We made further progress with our network roll-out and put more than 3,000 additional UMTS sites into operation in Germany in 2010. On top of this, we have started to roll out the LTE network in several countries. In the United States, we operate America's largest 4G network on the basis of the fast transmission standard HSPA+, which is currently available in 100 metropolitan areas reaching 200 million people.

We are also expanding our networks on the fixed-network side. Our billion-euro investments ensure that more and more households will be covered by fast broadband lines. Put into figures: We have marketed around 12 million broadband lines in Germany, which makes us market leader. On top of this, 342,000 customers have opted for a VDSL line from Deutsche Telekom.

Connected life across all screens.

One strategic goal is the provision of innovative, non-device-specific and convergent services. In our view, the greatest opportunities for growth lie in making data services mobile, particularly on the mobile Internet. We are marketing our own key solutions for connected life, such as innovative

communication services centered around the personalized, network-based address book that we have successfully launched on the market in five countries (e.g., myPhonebook in Germany). Needless to say, we also place a great deal of emphasis on ensuring that our customers have attractive handsets. Initial sales of smartphones in Germany and the United States have been strong. Around 50 percent of all handsets now sold in Germany are smartphones, while more than 8 million of our customers in the United States own smartphones for the national 3G/4G network – more than twice as many as one year before.

Deutsche Telekom is also positioning itself as a pioneer for digital content, by linking and distributing personalized media content. We have made some targeted acquisitions (e.g., ClickandBuy and STRATO), all of which are valuable additions to Deutsche Telekom's portfolio in the high-growth Internet business. Our prominent position in the European TV market is yet another success factor. We have already sold 1.6 million Entertain packages in Germany since market launch and expanded our TV customer base in Southern and Eastern European markets to 2.3 million which corresponds to a 23-percent increase from 2009.

Connected work with unique ICT solutions.

Deutsche Telekom provides customized ICT solutions for business customers and draws on the services of T-Systems in the ongoing standardization of its internal IT solutions. In pursuit of this task, T-Systems will continue to be restructured and its profitability raised to industry level. T-Systems succeeded in increasing its external revenue from IT services in 2010, with particular gains in international markets.

We have developed intelligent, innovative offerings centering around secure cloud services that our business customers are happy to use. We are positioning T-Systems as an open partner, also for other sectors, with the aim of leveraging growth opportunities for ICT solutions in sectors that are undergoing major changes. As part of this initiative, we have created four new business areas for developing intelligent network solutions: energy, healthcare, media distribution, and the connected car. These also got off to a good start. At CeBIT 2010, for instance, we signed an agreement with Continental for the joint development of an open, flexible, and future-proof infotainment concept for connected cars. In addition, we were successful in establishing a partnership with ABB to develop smart grids of the future.

Growth areas of Deutsche Telekom.

The advances in the strategic action areas are having a positive and direct effect on Deutsche Telekom's principal growth areas.

The **mobile Internet** is our largest growth area. This includes all revenue that we generate with mobile data services. Our aim is to generate revenue of around EUR 10 billion in this area by 2015. To this end, the national companies have launched a number of initiatives.

Another very important growth area for us is the **connected home**. Here, we bundle all revenues that we generate with our existing double- and triple-play packages, i.e., our fixed-network-based voice, data, and TV services. This area also includes future innovative products for the connected home, such as the Home Gateway or the Personal Communication Suite. The aim here is to generate around EUR 7 billion in revenue by 2015.

We are also bundling all our **Internet services** in a single growth area that essentially consists of three pillars: online advertising (e.g., on the web pages of the Scout group, on cell phones, on our TV offerings); the digital content of our Load family (music, video, games, and software); and what are known as "near access services" – these include the roll-out of websites and the sale of security software. Our goal is to increase the revenue from our Internet offerings to between EUR 2 billion and EUR 3 billion by 2015.

In a further growth area, we measure all of **T-Systems' external revenue**, which includes, in particular, the business with innovative cloud services in accordance with the new strategy. Our aim is for T-Systems to generate around EUR 8 billion in total revenue with external customers by 2015.

The **intelligent network solutions** growth area comprises the new business in sectors that are undergoing major changes, such as energy, healthcare, media and transportation/automotive. Here, we have set ourselves the goal of generating revenue of around EUR 1 billion by 2015. To this end, we set up four new business areas this year that are developing and marketing innovative solutions.

Growth areas of Deutsche Telekom.

	Ambition level for 2015 Revenue in billions of €
Mobile Internet	≈ 10
Connected home	≈ 7
Internet services	2 – 3
T-Systems (external revenue)	≈ 8
Intelligent network solutions (energy, healthcare, media distribution, connected car)	≈ 1

Our overall objective is to almost double revenue in the growth areas by 2015, from EUR 15 billion in 2009 to around EUR 29 billion in 2015. We will therefore continue to systematically implement all five strategic action areas in 2011.

Group management.

For sustainable Group management we need to take account of the expectations Deutsche Telekom's **four groups of stakeholders** (shareholders, providers of debt capital, employees, and the "entrepreneurs within the enterprise") have of the Group:

- **Shareholders** expect an appropriate, reliable return on their capital employed.
- **Providers of debt capital** and banks expect an appropriate return and that Deutsche Telekom is able to repay its debts.
- **Employees** expect jobs that are secure in the long term, prospects for the future, and that any necessary staff restructuring will be done in a socially responsible manner.
- **"Entrepreneurs within the enterprise"** expect sufficient investment funding to be able to shape Deutsche Telekom's future business and to develop products, innovations, and services for the customer.

The purpose of Group management is to strike a balance between the contrasting expectations and interests of these stakeholders so that sufficient funding is available for investment, socially responsible staff restructuring, debt repayment, and an attractive dividend.

For us **ROCE (return on capital employed)** is the main benchmark for focusing all operational measures on increasing the value of the Group. We believe that ROCE best reflects the expectations of the aforementioned groups of stakeholders. It represents the result a company has achieved in relation to the assets employed in achieving that result. ROCE is calculated using the ratio of profit from operations after depreciation, amortization and impairment losses, and imputed taxes (i.e., net operating profit after taxes, or NOPAT) to the average value of the assets tied up for this purpose in the course of the year (i.e., net operating assets, or NOA). Our goal is to achieve or exceed the return targets imposed on us by providers of debt capital and equity on the basis of capital market requirements and thus to generate value. We measure return targets using the weighted average cost of capital (WACC).

For operational management, we also use the KPIs described in the following:

The development of our **revenue** is essential for measuring the Company's success, and programs to improve the top line are a fundamental building block of the Company's future.

EBITDA corresponds to **EBIT** (profit/loss from operations) before depreciation, amortization and impairment losses. EBIT and EBITDA indicate the short-term operational performance and the success of individual business areas. The Group also uses the EBIT and EBITDA margins to show how these indicators develop in relation to revenue. These relative indicators make it possible to compare the earnings performance of profit-oriented units of different sizes.

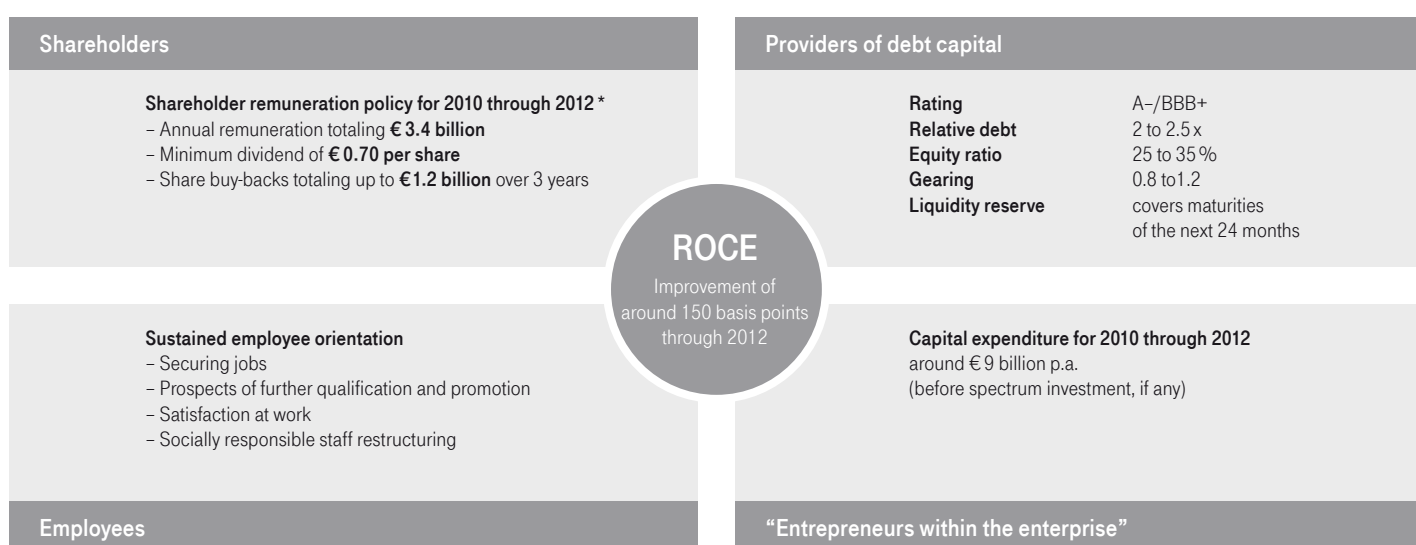
We define **free cash flow** as net cash from operating activities less net cash outflows for investments in intangible assets (excluding goodwill) and property, plant and equipment. It is the key measure used by providers of debt capital and equity as stakeholders in Deutsche Telekom. Free cash flow is indicative of the Company's potential for further development, such as the generation of organic and inorganic growth, and of its ability to pay a dividend and repay debt.

A centralized free cash flow management unit was set up in the prior year that is responsible for transparency, steering, forecasts, and performance measurement. In 2010 we continued to improve working capital, fine-tune our short- and medium-term planning instruments, and refine our steering processes. To improve working capital throughout the Group we launched CORE (Cash Optimization for ROCE Enhancement). As part of these efforts, we developed a set of Group-wide payment regulations to optimize our payables management. Furthermore, workshops were organized across the Group to identify and evaluate potential improvements in receivables management at the individual companies and to define measures. These measures are scheduled for implementation between 2011 and 2013, with the aim of bringing about a long-term improvement in working capital.

In addition to a stable rating, gearing and relative debt are the relevant factors for fulfilling the requirements of debt capital providers and ensuring financial stability. Relative debt is the ratio of net debt to adjusted EBITDA, while gearing is the ratio of net debt to equity.

Finance strategy.

Our 3-year finance strategy for the years 2010 through 2012.



* Please refer to footnote 2, page 129.