Event transcript

KPN Q2 2020 Results

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KPN Q2 2020 Results Webcast

Operator: Good day, ladies and gentlemen. Welcome to KPN's second quarter 2020 earnings webcast and conference call. At this time, all participants are in a listen-only mode. We will be facilitating a question-and-answer session towards the end of today's prepared remarks. If you would like to ask a question, you may do so by pressing *1 on your telephone. Please note that this event is being recorded. I will now turn the call over to our host for today, Bisera Grubesic, Head of Investor Relations. Go ahead, please.

Bisera Grubesic (Head of IR, KPN): Thank you, operator. Good afternoon, ladies and gentlemen, and welcome to KPN's Second Quarter 2020 Results Webcast. With me today are Joost Farwerck, our CEO and Chris Figee, our CFO.

Before turning to the core of the presentation, I would like to draw your attention to the Safe Harbour statement on page two of the slides that also applies to any statement made during today's presentation. In particular, today may include forward-looking statements, including the Company's expectations with respect to its outlook and ambitions which were also included in the press release published this morning. All such statements are subject to the Safe Harbour statement. I would now like to hand over to Joost Farwerck.

Joost Farwerck (CEO, KPN): Thank you, Bisera, and welcome to our second quarter results presentation. We delivered solid performance in the second quarter with stable adjusted EBITDA after leases and significantly higher Free Cash Flow, excluding divestments. Our balance sheet and liquidity position remain strong, and we are living up to our 2020 dividend commitments. Demand for KPN's essential connectivity services remain high, and our networks have proven to be robust through a period of unprecedented demands.

The execution of our strategy is well underway, and we saw positive developments particularly in the competitive Consumer market, where broadband and postpaid net adds showed a clear improvement trend. And we see some first signs of bottoming out there.

In B2B, we made again progress with customer migrations, though we recognise several challenges remain in the B2B segment as the economic activity in the Netherlands has decreased. As we continue our open wholesale model, we see further growth in our wholesale broadband portfolio, and we also continue to ramp up our fiber rollout.

I would like to highlight a few key figures. Corrected for divestments, adjusted revenues declined by 3% year-on-year; growth in professional services in Business and in Wholesale was offset by lower revenues from mobile and a roaming effect and fixed voice services.

Adjusted EBITDA after leases was flat as the effect of lower revenues was fully offset by strong cost savings. Free Cash Flow increased 17% year-on-year to 177 million euros. And ROCE, which we will now be reporting semi-annually, increased 80 basis points year-on-year to 9.8%. Chris will give you more details on our figures later in this presentation.

The estimated net effect of COVID-19 on Group financial results was slightly negative in the second quarter. The estimated negative net effect on adjusted gross profit was around 5 million to 7 million euros, driven by lower revenues from roaming and delayed IT projects. This was partly offset by higher fixed and national mobile traffic. The estimated net impact on adjusted indirect opex was approximately 6 to 11 million euros positive, driven by, for example, lower costs related to travel, learning and development, facilities, FTE cost, et cetera.

Uncertainty continues about the impact of COVID-19 on the Dutch economy and therefore on KPN. And with the Netherlands expected to move towards a recession, the ultimate impact remains difficult to predict. While we expect to see a higher negative year-on-year effect of roaming in Q3 due to the summer holiday season, we remain able to adjust our cost base in line with developing economic circumstances.

Our revenue risk assessments by type of customers is unchanged compared to the first quarter. Importantly, revenue in customer segments that are most exposed to the negative impact of COVID-19 accounts for approximately 10% of total Group revenue.

We remain committed to our strategy and to our 2020 outlook as provided in January this year. We delivered in the first half of the year. And outlook for adjusted EBITDA after leases, Capex and dividend per share is reiterated. Combination of COVID-related downward pressure on revenues, offset by strong cost control, enables us to reiterate our 2020 outlook for adjusted EBITDA after leases. We reiterate our Capex outlook of €1.1 billion, and we also reiterate our dividend per share outlook of 13 cents. An interim dividend of 4.3 cents will be paid in August.

We remain fully committed to grow Free Cash Flow with at least a mid-single digit percentage. There could be some limited downside risk due to a potentially worsening trend in customer payment behaviour as a result of COVID-19 in the second half of this year. However, we are not observing this, and this is not impacting us today. We remain committed to grow Free Cash Flow with at least mid-single digit percentage. KPN is well positioned to absorb the short-term and medium-term effects of COVID-19. Visibility of impact of the pandemic into 2021 is limited, so we remain fully committed to our three-year strategy. Let me now give you an update on our strategy.

In the first six months of the year, we have seen solid progress on our strategic pillars which, as a reminder are; building the best network, focus on profitable growth segments and accelerating simplification and digitalisation.

We've made good progress in building the best converged smart infrastructure. On fiber, we added 76,000 additional households in Q2, which adds to a total of 250,000 households since we started to roll out last year.

We've also significantly improved access speeds for our customers. To date, we upgraded the total of nearly 1,500 mobile sites with the latest equipment, and we only have approximately 80,000 legacy lines left to migrate by the end of 2021. We switched off ISDN 2 technology, and we are currently migrating customers to our new OSS environment, reducing the lead time of new broadband customers from around two weeks to three days, strongly improving the customer journey.

We have one of the largest fiber footprints in Europe with 2.6 million households, or 32% of the nation covered by fiber-to-the-home and 55% of households covered by fiber-to-the-cabinet. Our ambition is to cover more than 40% of households with our own fiber network by the end of next year, and we expect to continue the fiber rollout thereafter as we are just getting the machine up and running.

We acquired a small local fiber network consisting of 6,000 homes passed in May, and this was a good opportunity to enlarge our footprint at value-creating terms. This month, we successfully tested our next-gen PON technology and reached up and download speeds of 8.5 gigabit per second. And this only shows what our investment in technology will bring to our customers in the future. We will continue to develop this to further shape the digitalisation of the Netherlands.

As I mentioned, we added 76,000 households to our fiber network in the second quarter. We activated 32,000 customers, which means a solid activation rate of 47% over the past 12 months. Currently, we are rolling out an average of 5,400 fiber-to-the-home connections a week, we're active in 83 areas and we are starting construction in the largest cities of the Netherlands.

We are committed to our fiber investments, and we see continued commercial proof points that our fiber strategy is driving value. Fiber is now more than half of our consumer broadband net sales. We see a higher network penetration in fiber areas, fiber ARPU is 9% higher than copper driven by higher inflow ARPU and better take-up of value-added services, convergence penetration of fiber is higher and NPS is higher resulting in lower churn. Consumer fiber revenues grew 6.3% year-on-year in the last quarter, driven by growing base and attractive ARPU. Overall, our fiber investment generates returns that exceed the Group's cost of capital and have a positive net present value.

While the speed of our mobile network modernisation was somewhat impacted by COVID-19, KPN upgraded approximately 560 sites with the latest mobile RAN equipment in the second quarter. And this brings the total modernised sites to around 1,500 since we started in September last year. In the latest spectrum auction, we obtained an attractive combination of frequency licenses totalling 75 megahertz for a total of €416 million.

We're satisfied with this outcome, and the new licenses allow us to further improve the quality of our mobile services. And we are excited to launch 5G services for our customers tomorrow. KPN initially foresees the most potential of 5G for new business applications such as innovations in the field of safety, healthcare, mobility, logistics and the manufacturing industry.

The first new services enabled by 5G are a first step in 5G development. More new developments will be added in the coming year. And after the auction of the 3.5 gigahertz band, which we expect in 2022, a greater improvement in speed and capacity will be possible.

Let's now move on to our second strategic pillar: focusing on profitable growth. In Consumer, we aim to deliver sustainable value through our continued focus on the high-value KPN brand and by running a targeted household approach. We've reached some important milestones; integrating the Telfort brand and launching KPN Hussel.

In B2B, we migrated a significant part of our customers to our target portfolio, and we are rationalising the IT environment, we're simplifying our product portfolio. However, due to COVID-19 impact, we expect B2B end-to-end adjusted EBITDA after leases to stabilise in 2021, based on current estimates. In Wholesale, we see continued growth of our wholesale broadband access and VULA portfolio.

Our third strategic pillar is: accelerating simplification and digitalisation of our company. KPN made good progress in the digital transformation programme by migrating customers to a new operating support system. This reduces the lead time of new broadband customers and strongly improves the customer journey. Also, we've shut down three data centres and terminated several applications resulting in structural cost savings.

The second quarter was the first in which we saw the full effects of COVID-19 measures on the Dutch society. While impacting performance in some areas, this dynamic also underlined the importance of KPN's efforts to improve and enhance the quality of the Netherlands digital infrastructure. This work is essential to the country's economic recovery, as well as its ability to address the ecological and social challenges of the post-COVID world sustainably.

Throughout the crisis, we have ramped up incident monitoring and waived fees for cyber security support for hospitals, we offered free connectivity cards for vulnerable groups to stay connected and be home-schooled during the COVID-19 pandemic, and we signed the green recovery statement calling on the government to start to a COVID-19 recovery plan sustainable. Our ESG efforts are recognized by various external benchmarks: we are on the A-list of CDP, we have a triple-A status at MSCI, and we have a Gold Class distinction at Dow Jones Sustainability Index.

Let's move to the performance of the segments. In the second quarter, fixed consumer revenues were slightly up, while mobile service revenues declined 6.5% year-on-year, partly driven by lower roaming revenues. As mentioned before, this trend is expected a bit to worsen in Q3 due to lower roaming revenues during the holiday season.

The market remained highly competitive with three players focusing on converged customers, competition from local fiber operators in rural areas and mobile competition now focusing more on the high end – unlimited propositions. NPS increased year-on-year to plus 15. We are highly valued for our best-in-class network, converged services and our fiber strategy. Also, we are pleased that our fiber network is recognised as the best fixed broadband network in the Netherlands by the Dutch Consumers' Association.

A few words on our Consumer KPI's. In the quarter, our converged customer base returned to growth. Converged households grew by 3,000 customers, and we added 30,000 converged postpaid customers. Looking at our broadband base, we added 17,000 fiber customers in the quarter, while the total broadband net adds declined with 3,000. In mobile, our customer base remained broadly flat, so this is for us an important trend to focus on.

This quarter-on-quarter improvement of consumer net adds was driven by improvements by commercial strategy on fiber – our focus on the fiber strategy is important; our strong, unlimited propositions that we introduced; our new marketing campaigns; and our SuperWiFi proposition in the Netherlands. Also, we see that existing customers value the quality and stability of our network especially in this COVID crisis resulting in lower churn. Our focus and value is demonstrated by fixed ARPU growing 5% year-on-year and mobile postpaid ARPU being €17 for the sixth quarter in a row.

In B2B, we completed the sale of KPN Consulting on the 1st of April and, as a result, the second quarter results do not include any KPN Consulting revenues. Corrected for divestments, Business revenues declined 5.7% year-on-year. And this reflects the strategic actions in the segment, and it is also related to COVID-19 as we saw lower revenues from roaming and IT projects in particular. We have further simplified our B2B product portfolio, and we removed already 37% of our offerings. We are on schedule to reach the 50% target by the end of next year. NPS in B2B increased to plus 2, driven by improved scores at SME and LCE customers. KPN's mainly valued for quality and for reliability.

The operational transformation of our B2B segment is taking shape. We continue to simplify our product offerings, and most of our customers have now switched to a future-proof portfolio such as KPN Kleinzakelijk in SoHo, KPN One and KPN Smart Combinations. We have now migrated 84% of SME and 72% of LE customers. We completed the phase-out of ISDN 2 which is an important milestone, not easy in COVID times since migrations that require physical access to offices, and these were often postponed.

Then on our customer segmentation within B2B in the first half of the year, in the first six months of 2020 revenues from SME and LCE were declining, mostly driven by mobile ARPU and the proactive customer migrations. Revenue from our Integration customer segments increased as a result of more project-related work.

Now let's move to Wholesale. Correcting for the sale of NLDC, adjusted revenues in Wholesale increased 1.2% year-on-year, driven by solid performance in our fixed portfolio. Mobile revenues were broadly flat, despite lower roaming revenues. Wholesale added 16,000 broadband lines and 7,000 postpaid SIMs in the quarter.

During the quarter we also renewed a new five-year MVNO contract based on commercial terms with Youfone. Following the court ruling on wholesale fixed access regulation in March this year, KPN has reconfirmed its open wholesale policy, based on its voluntary offer for ODF, Wholesale Broadband Access and VULA and the long-term contracts it has in place with several parties. KPN believes its open wholesale policy is in line with the symmetrical access policy outlined in the European Electronic Communications Code.

While we have seen a slightly declining broadband base in Consumer, the performance of our Wholesale segment remains solid. This contributes to our strong and stable broadband network share in the Netherlands of around 52%.

Then over to network, operations and IT, adjusted operating expenses after leases declined 9.3% year-on-year for the segment, mainly driven by reduction of personnel, simplification of networks, IT rationalisation and contract renegotiations with suppliers. We are working with our main contractors to protect the 3,000 jobs involved in our fiber rollout, and we maintain the expertise around network build-out in the Netherlands. In spite of changed dynamics in the Dutch construction markets, we are securing long-term construction capacity to safeguard our rollout plans.

Now, this ends my parts of the presentation. I would now like to hand over to Chris to talk you through our financials. Thank you.

Chris Figee (CFO, KPN): Thank you, Joost. I am proud to present our KPN results to you today. It's only my second quarter as the CFO, and it was an intense quarter for all of us. We navigated through uncharted territory, and I am proud to say KPN delivered, both operationally and financially.

Our network held up very well despite a massive increase in usage. And our base dynamics started to improve, not only quarter-on-quarter but also during the quarter. And we achieved a few remarkable results. Our EBITDA after leases was flat in the quarter despite the corona headwind, it was up over the first half-year. Our net profit was up 18%, and we expanded our margin to over 44%. ROCE – we disclosed for the first time – was up towards nearly 10%, and we increased our Free Cash Flow by almost 20% year-on-year. Under that, our working capital initiatives are starting to bear fruit. On top of that, we've got a very strong liquidity – over 900 million euros in cash. Scheduled redemptions and the auction payments are payable out of existing cash. We launched a Commercial Paper programme to increase our financial flexibility and will – and be able to pay interim dividend and provide a safe haven to investors. Let me go through some detailed numbers.

On page 25, let me explain the like-for-like performance of our results, corrected for the impact of divestments. Our adjusted revenues declined by 2.4% year-over-year. The adjusted EBITDA after leases increased by 1.6% – increased by 1.6% year-on-year.

Lower revenues were more than offset by strong cost savings, and our margin improved by 180 basis points. Competition stays intense, but we've been able to expand our margins in this challenging environment. Our operating profit was 39 million euros higher due to a combination of lower restructuring costs, a book gain on KPN Consulting, partially offset by higher depreciations. And the same metrics drove our net profit 38 million euros higher than last year due to higher operating profit, lower financing costs, partially offset by lower finance income due to the sale of KPN's stake in Telefónica Deutschland.

Our cost savings programme, on page 26, is well on track. We are ahead of a linear pattern in terms of reducing our cost base and achieving the €350 million target. In the quarter alone, we realised a 33 million euros net indirect opex saving. This means a total of savings at 60% of the €350 million are €213 million since the start of the programme. These savings are driven by less personnel costs and by less IT and TI expenses.

In the light of COVID-19, we decided to postpone new reorganisation requests until the 1st June 2020. In response to that, we reduced the hiring of new employees to a minimum and also reduced our external staff to compensate this effect. We restarted restructuring projects again after the 1st June. In the quarter, we scaled down effectively [176] employees, correcting for the sale of KPN Consulting. On top of that, we also reduced our staff by 35 external staff members.

Positively speaking, our running costs were notably lower in the quarter. Our monthly indirect cost base was on average close to €10 million lower in Q2 than Q1. Also, we note that COVID-19 helped us deliver additional cost benefits in the areas of travel cost and housing and facilities. We continue to see good cost reduction opportunities. Our self-help optionality will help us going forward, and we are fully confident that we will reach the €350 million cost objective by the end of 2021.

Our operational Free Cash Flow was strong. For the first six months of the year, it ended at €588 million, a little lower than last year corrected for divestments, fully driven by the temporary of the timing of our Capex investments. In the first half, we've seen a strong increase in our Free Cash Flow, despite higher investments in fiber. Our Free Cash Flow of €257 million was €40 million higher compared to the first half of 2019 and 20% up versus the same quarter in last year, i.e. in Q2, we saw €26 million higher Free Cash Flow compared to Q2 last year.

This all is a result of a higher adjusted EBITDA after lease in the first half, lower cash restructuring, lower cash interest, lower investments in working capital and lower cash taxes, partially offset by increasing Capex, or at least the increased timing of Capex investments. We ended the quarter with a strong cash position – position, a total of 907 million euros, whilst having paid the final dividend over 2019 in April this year.

Our Capex increased €42 million year-on-year in the first six months. The share of access investments in Capex has increased towards 50%, mostly in fiber. We are confident and positive about the value case for investing in fiber. Joost already demonstrated the key metrics and key KPIs to demonstrate that fiber actually creates value.

The increase in Capex is mainly driven by a different intra-year phasing of these increased access investments. We invested €54 million less in Commercial activities as a result of better inventory management, fewer active mechanics to COVID-19 and the reclassification of IT and TI. Net-net IT/TI investments decreased €6 million following significant simplification of the IT and network architecture in prior years.

Our investment in working capital were €152 million in the first half year, lower than last year. The main drivers were lower trade receivables following lower sales levels due to COVID-19, lower trade payables mainly driven by payment of end-of-year peak of incoming invoices, lower accruals driven by bonus payments. And our working was capital also positively infected – or impacted by a number of specific initiatives on billing, invoicing and payment terms.

ROCE, return on capital employed, improved 80 basis points year-on-year to 9.8%. We promised you we'd disclose this number, and here we are showing our commitments to show our commitment to value creation and to demonstrate that we allocate cash and capital in a value-creating manner. Our ROCE is calculated on a four-quarter rolling basis, i.e. the four-quarter rolling average of our net operating profit after tax divided by capital employed.

We reported, as you can see, an improving operational efficiency, which was driven by our disciplined cost control offsetting lower revenues, consistent with our increasing operating margins. Capital efficiency was higher than last year. It was a result of higher depreciation and Capex and due to accelerated depreciation of our copper and mobile networks. Net-net an increase of our ROCE of about 80 basis points.

We have a strong liquidity position. The Group's total liquidity stood at €2.2 billion at the end of the second quarter, consisting of 907 million euros in cash and 1.25 billion euros in an undrawn revolving credit facility. Our total liquidity covers debt maturities until the end of 2022. In addition, KPN initiated a €1 billion Eurocommercial Paper programme of €105 million outstanding at the end of the quarter. We lowered our effective cost of debt to below 3% in the second quarter of this year.

As a result of all of this, our financial position remains solid. Our net debt to EBITDA ratio is 2.3 times, the interest cover ratio improved to 9.3 and as I said, the weighted average cost of senior debt was 2.95%, 55 basis points lower than last year at this time.

As mentioned during previous quarters, we believe in investing and disclosure to our shareholders; we want to be open, clear and transparent. We committed to you a disclosure agenda. In this quarter, we continue to act on that agenda. And we add ROCE, we add segment adjusted EBITDA after leases which you can find in the data pack, much more commercial information on our Consumer fiber activities, the details behind the value creation that our access investments actually deliver and a revenue breakdown per B2B customer segment. In the future, we'll continue on this agenda and plan to further enhance disclosure as indicated on the slide. We deliver on our disclosure commitments to you like we deliver on our business commitments.

So, to summarise, we continue to create value for our shareholders. We have delivered a stable adjusted EBITDA after lease in the second quarter, and this has strongly increased Free Cash Flow in challenging times. KPN's balance sheet and liquidity remain very strong, and in Consumer we see improvement in base dynamics quarter-on-quarter and during the quarter.

In B2B, we are progressing with customer migrations and simplified our product portfolio, although we recognise several challenges remain as the economic activity in the Netherlands has decreased.

In Wholesale, we see a growing broadband portfolio contributing to a Group-wide stable broadband market share of 52%. We're strong on cost, we deliver on our plan and ahead of track, and we are accelerating the rollout of fiber, which delivers a positive net present value and drives value for KPN. And finally, we remain committed to our strategy and to our 2020 outlook and are living up to our dividend commitments.

Having said that, thank you for your attention. Let's turn to questions.

Questions and Answers

Bisera Grubesic (Head of IR, KPN): Thank you, Joost and Chris. Ladies and gentlemen, we are ready to open the Q&A. Could you please limit your questions to two each, and in case there is still time left at the end, you can always request for more questions later. Operator, please open the Q&A.

Operator: Ladies and gentlemen, as said, we will start the question-and-answer session now. If you would like to ask a question, you may do so by pressing *1 on your telephone, so *1 for your question or remark. Go ahead, please.

The first question is coming from Mr Keval Khiroya, Deutsche Bank. Go ahead, please.

Keval Khiroya (Deutsche Bank): Thank you, I've got two questions, please. So, firstly, you've highlighted that the current backdrop makes it difficult to confirm the mid-term guidance out to 2021. I understand there are top line uncertainties, but is there any reason to think at least that the opex savings shouldn't continue at least in the current run rate? And if so, should we think about upside to the €350 million savings target?

And then secondly, on Capex, you've highlighted that the pace of fiber rollout continues to improve. Are you now at the maximum run rates, or should we expect further increases there?

And is there anything you can say about whether we should still expect €1.1 billion of Capex for 2021, which is what you had originally pencilled in the original guidance? And anything you can say on mid-term Capex generally would be helpful. Thank you.

Joost Farwerck (CEO, KPN): Let me start, and then Chris will take over. When it comes to 2020 and 2021, we are fully committed to our strategy. And in that strategy, we have a framework of Capex of €1.1 billion. In that €1.1 billion we have to operate, and that is what we currently do.

So, I'm happy with the results of Q2. That's why we can reiterate our 2020 EBITDA, Capex, dividend guidance, and we're convinced that we remain committed to growth in Free Cash Flow. For 2021 visibility of the impact of, yeah, the COVID-19 crisis is currently limited, so also there we remain fully committed to our three-year strategy. We have a cost-saving programme. We had a – we had one of three years, and this is the second one. And as you can see today, we are a little bit ahead of the plan. So, if everything works out well, I am convinced we can upgrade that plan in the future.

Maybe you can add something on opex and Capex.

Chris Figee (CFO, KPN): Yeah. On opex savings, as I said, in the quarter itself, you – if you look at the monthly indirect spend, it's about €10 million a month less than the last quarter. Obviously, some COVID tailwind in there, but underlying there's a strong cost savings story. Ahead of track, as Joost said, at some point we'll get back to you on our costs, but we're confident that we'll reach our cost target, and the current run rate is actually beyond what you'd expect – the initial programme.

When it comes to Capex and fiber rollout, we're not at our maximum speed; yes, we continue to ramp up. We want to achieve 1 million households at the end of next year. With that, we will allocate a bigger chunk of our Capex towards fiber. Will it fit in the current €1.1 billion envelope, in our current ambitions, yes; we just have to find savings in other, you know, Capex categories. But we want to move to 1 million households, and therefore we need to speed up the ramp up of our fiber rollout and continue on the path that we've set in.

Keval Khiroya (Deutsche Bank): That's useful, thank you.

Operator: The next question comes from Mr Joshua Mills, Exane. Go ahead, please.

Joshua Mills (Exane BNP Paribas): Hi, there. Thank you very much, just two questions from me. The first is around the tweaks you've made to the Free Cash Flow guidance and just to fully understand how we should think about fiber-to-the-home M&A going forwards. So, I think maybe the first question would just be, you know, what percentage of the fiber-to-the-home lines you plan to build this year and next? Do you expect to buy rather than build yourself? And just if you could give us a kind of rough guide about how many millions of euros you'll be spending on that over the course of this year and next, that would be very helpful.

Secondly and related to that point, could you give us an idea of the total scale of opportunity you see to buy these smaller fiber-to-the-home providers? Is it kind of tens of thousands, is it larger than that across the markets? And what parameters do you look at when you decide between building a network yourself or buying in those kinds of assets? Thank you.

Chris Figee (CFO, KPN): Look, thank you. On that question on our acquisition of fiber lines, first to let you know that the amount of money we spend on this is relatively small compared to the total Capex budget. Right? We have a €1.1 billion Capex envelope. I think to this point we've spent 1% or less than 1% actually on fiber M&A. So, we should not get carried away with the amount of M&A we can do in this space.

It's a funny thing, because what we buy is actually a network with a very small operation. Mentally, I tend to think of this as M&A which you fund out of your balance sheet. But unfortunately IFRS – like requires us to classify this as Capex. I can't frame it as a Business combination but as a network acquisition, because we are rolling out fiber ourselves and we're buying a small network without too many activities on the side. So, whilst mentally this is M&A that you fund out of your balance sheet, effectively we have to put it under – as Capex.

How do we look at it? It's opportunistic, it's on top of. So, we have an organic fiber rollout plan where we have a very specific model and approach to select regions, select areas, select zip codes where we roll out fiber. But sometimes, you bump into opportunities to accelerate and to add more fiber to your fiber portfolio.

We tend to look at it from a couple of lenses. First of all, a buy should be never more expensive than make. So, we would ask ourselves the question: if we wanted to put out fiber in this area, would it be more expensive or cheaper to buy it? Secondly, is there a real value creation opportunity because you add a network where penetration is really low and, you know, penetration is what drives ultimately the fiber case. So, can we add penetration to that network? That together will drive the case and how we look at it.

How much is there to do? Hard to say. This is opportunistic. We don't pursue a truly active M&A strategy, but once you bump into opportunities you look at it. So, it's you’re looking at probably a couple of percentage points of the total Capex envelope at max. I can’t tell you how much we do, when and where because in these transactions – we’re in this opportunistically. If we see a good deal and create value, we pursue it; if not, we're happy to walk away. So, it's all about value created to shareholders. But it's a couple of percentage points of our Capex envelope. That's kind of the maximum of what we could do. As I said, unfortunately IFRS requires us to classify that as Capex, although mentally this is, you know, an acquisition you fund out of your own balance sheet. So, you talk about couple of 1,000 – 10,000s of lines, not 100,000s of lines.

Joshua Mills (Exane BNP Paribas): And so, I mean, I suppose to ask the question a slightly different way, you know, when you initially gave the guidance for 1 million homes, fiber-to-the-home households, and this €1.1 billion Capex budget, I think the assumption was that you would meet that 1 million home coverage within that Capex budget. So, if you're pursuing additional add-on M&A on top of what is an unchanged Capex guidance, should we expect you to perhaps end up at more than 1 million fiber-to-the-home households by the end of next year, or is this just a, you know, shift of costs into a different area?

Chris Figee (CFO, KPN): We’re not going to be cheeky and say, ‘I keep this out of my Capex budget but inside the 1 million homes targets’, it’s either both in or both out. For all intents and purposes, both out. So, it’s out of the Capex, it’s out of 1 million homes. We meet – we make or we don't make the 1 million homes based on our organic rollout; we make or don't make our Capex budget within the €1.1 billion. So, we're going to continue to compare apples and apples for you.

Joshua Mills (Exane BNP Paribas): Right, thanks.

Joost Farwerck (CEO, KPN): But please be aware, this is really a small opportunity for us – 6,500 lines, maybe there are two or three more of these kinds of networks in the Netherlands. We're not sure if we are going to buy it. Like Chris said, it's all about the deal, and we compare this against rolling out ourselves. But this is, to be honest, limited opportunities, small stuff.

Joshua Mills (Exane BNP Paribas): Okay, thank you.

Operator: The next question comes from Mr Frederic Boulan, Bank of America. Go ahead, please.

Frederic Boulan (Bank of America Merrill Lynch): Hi, good afternoon. A quick question on your – your KPIs both in mobile and in broadband in the Consumer segment. So, we saw a nice improvement, but at the same time this is in the middle of a – of a pandemic, which is – which pushing churn down everywhere. So, looking ahead when we look at the next couple of quarters, should we expect that return to a more stable picture to remain, or on the contrary they should – there is scope for churn, et cetera, to pick up in the backend of the year and into next year? Thank you.

Joost Farwerck (CEO, KPN): Thank you. Yeah, this is for us super important. I said before, we have to draw a line in the sand when it comes to our broadband and our mobile base in Consumer market. After eliminating the Telfort brand, we lost customers quarter by quarter over the last five quarters. So, I'm – I'm seeing a positive trend here with minus 3,000. I would say COVID is not against us, but it's really about the way we launched the new propositions, it's about the way we combined operations and commercial people in the regions to sell fiber and to connect people to fiber, it is about how we launched unlimited, our new marketing campaign. So, the market didn't stop rotating by the way. We saw an inflow on the Wholesale side of broadband customers of 16,000 this quarter, we stabilised. So, for me these are positive signals, and we will do all we can to improve this quarter our base in Consumer market.

On the mobile side, we see the positive effect of our push to unlimited propositions, which is to support our ARPU. Of course, in Q3, we always have the biggest impact of roaming, but in general this unlimited proposition is really supporting our ARPU, and the base is also developing in the right direction. So, this is not a coincidence, it is very important. Every week we look at this as a Board, and the Company’s fully focused on improving our base earn.

Frederic Boulan (Bank of America Merrill Lynch): Thank you very much.

Operator: The next question comes from Mr Michael Bishop, Goldman Sachs. Go ahead, please.

Michael Bishop (Goldman Sachs): Yes, thank you, just two questions, please. Firstly, on the B2B you mentioned in the slides that, I think, you're pushing back the stable EBITDA target until 2021. Could you just talk us through the dynamics behind that shift and effectively how much is COVID-related?

And then secondly, picking up on your slight caution about the remainder of the year on Free Cash Flow and bad debts, it doesn't feel like you're seeing too much today. But could you give us any extra colour around your updated thoughts on bad debt and in relation to the 10% of revenues from potentially impacted areas that you’ve – that you identified at Q1? Thanks.

Joost Farwerck (CEO, KPN): Yes. In B2B, the end-to-end stabilisation is a very important target for us. In general, we're on track. In SME, we migrated 84%, and I think in SME we will stabilise this year. LCE migrated a lot, above 70%, so it really has to do with the impact of roaming that I think we're not going to make it this year in stabilisation. Having said that, when we look at the whole value chain end-to-end knowing where we are in the migrations, we are convinced that we can make it soon next year.

Free Cash Flow?

Chris Figee (CFO, KPN): Yeah, Michael, on Free Cash Flow, look, this year we've delivered on our EBITDA and Free Cash Flow objectives. Right? We delivered a better Free Cash Flow than planned, than last year, despite an increase in Capex. As Joost said, we've confirmed our EBITDA guidance, we’re committed to our Free Cash Flow guidance.

We increased our risk around Free Cash Flow a bit – not our expectation, but just the risk. And the notion is indeed that there is a risk in the second half of the year. When the economy needs to pick up and the government's support will gradually wane, we need to see how that affects, you know, payment behaviour by our customers.

At this point, and as we talk about payment extension of our customers, we don't see massive risk of bad debts increasing. For your background, bad debt is around 6% of trade receivables in Business and Consumer. I think total exposure – about 25 million euros of bad debt provision – hasn't changed, hasn’t really materialized in the first half year. We don't see an increase in bad debts, we don't see an increase in payment terms, so 30 to 60 to 90 days. But you have to reckon that that is a possibility that it’s happening. So, it's not happening today, but it’s a possibility.

So, what we're saying is look, we're committed to our EBITDA, committed to our Free Cash Flow, we expect to deliver our guidance. But when it comes to extension of payment terms, you know, payment duration, that does not affect your EBITDA, but it may temporarily affect your Free Cash Flow in the year, because that's what we're seeing. We're not seeing it today, but of course, we're cognisant of what's – you know, what's happening in the outside world, of the uncertainty around COVID. And that could be a factor in the second half.

Michael Bishop (Goldman Sachs): That’s really helpful colour.

Operator: The next question comes from Mr Luigi Minerva, HSBC. Go ahead, please. Mr Minerva, your line is open. Go ahead, please.

Luigi Minerva (HSBC): Yes, good afternoon. Thanks for taking my questions. The first is on the roaming impact in Q3. Maybe can you give us an indication of what you expect?

And secondly, I noted your positive comments on Wholesale and that you – what you're doing complies with the code. Maybe can you give us a wrap-up on where we stand on fixed line regulation in the Netherlands, and whether you see a risk of more intervention on KPN. Thank you.

Joost Farwerck (CEO, KPN): Yeah. So, compared to other telcos, our roaming impact is limited, since we, as a Dutch incumbent, are competing against T-Mobile and Vodafone in the Netherlands. And they have international networks, so they offered better online or on net propositions to B2B customers. Having said that, there's always an impact outside of EU. So, this is really a limited amount of revenues, but all – but we know it will impact our revenues a bit in Q3 as it did in Q2.

On Wholesale, we have been regulated for 20 years. Last quarter, we won a case against, yeah, our regulator, and suddenly nowadays we're no longer regulated in fixed access in the Netherlands. We appreciate regulation, and we understand we need a supervisor in the Netherlands. That's very important. We're not against regulation. I think having a regulatory framework is good. That's why we suggested to follow our open access model in the Netherlands with all the pricing on the services we do on the Wholesale side that used to be regulated, and we follow the same price scheme as before.

The only thing we do not like is the idea of getting regulated on tariffs, and that's why we have these discussions with our government. We appreciate regulation, we think it fits in the European regulatory framework. And I think that we can make a good step by using the open access model of KPN as a voluntary model introduced by us, which is, from a legal point of view possible, as the new regulatory standard in the Netherlands.

Chris Figee (CFO, KPN): Maybe – maybe on roaming I can add. If you look at roaming traffic levels, meaning our own data, our own voice since last year dropped by 50% to 60% over the comparable period; visitor data dropped by 30% to 40% over the comparable period. We saw some recovery in June, so early traffic data in June recovered a bit now the intelligent lockdown is gradually being released.

Where do we see impact? I would say in B2B probably similar as in the previous quarter, in Q2. You'll see some additional impact in the Consumer business – you know, people don't travel abroad in the quarter. We'd expect to see some compensation in the form of more national calling, out-of-bundle calling. But I cannot rule out that in this very quarter, for Consumer you may see a temporary dip in ARPU as, you know, the roaming and [inter]national calling effects kind of tend to have impact. That should be temporary. On an EBITDA level, I think we could still compensate with lower costs. But in terms of impact, continue the same impact on B2B. And impact this quarter on consumers because of the holiday season, possibly, hopefully and expectedly compensated by more out-of-bundle calling in-home calling and compensated with lower costs. That's kind of the background that I would love to give to you. And some first signs of gradual, very small improvement in June when, you know, data traffic levels start to bottom out a bit.

Luigi Minerva (HSBC): Thank you, both.

Operator: The next question comes from Ms Siyi He, Citi. Go ahead, please.

Siyi He (Citi): Thank you very much for taking my questions, I have two, please. And the first one is I'm just going to go back to your comments on mobile, especially B2B. And this quarter, we see another deterioration in the trends, so I wonder whether you can comment on how much of that is relating to roaming?

And if you now look at your B2B ARPU, it's at a similar level to your Consumer. I'm just wondering if you can say if we should expect some underlying stabilisation of the B2B mobile ARPU?

And then my second question is related to your previous comment on the fiber acquisitions. I was wondering if there – you can give us some more data points in terms of the return on investment you see on it, and how long will it take to cover the cost of capital? Thank you.

Joost Farwerck (CEO, KPN): Yeah, your first question was referring to the roaming effect, if I'm not mistaken, and the mobile consumer ARPU.

Siyi He (Citi): Yes.

Joost Farwerck (CEO, KPN): So, we see an improving trend on mobile ARPU, because, yeah, not that long ago we were facing a decline in ARPU every two quarters. And now, for the sixth quarter in a row, we are around 17 euros, and we stabilise our base. And that's all related to our commercial approach in the market. So, underlying development is good.

Like Chris just mentioned, there is a roaming effect in our current revenue trend. And Q3 is always a bit more higher on roaming than Q2, although we have this EU roaming. So, in EU countries, it doesn't make any difference if you're in the Netherlands or outside, same tariff accounts there. So, it's really outside EU we're talking about on roaming, so the effect in Q3 on roaming will be a bit more than in Q2, but not significantly.

And your second question –

Chris Figee (CFO, KPN): – was on the ROI of the fiber acquisition. When we look at this we always do, first of all, an NPV analysis, where we look at bespoke fiber-specific cost of capital, which is higher than KPN's Group cost of capital. With that, it's NPV positive. For competitive reasons, let me not dive too deeply into the ROIC or IRR, but, you know, it's a low double-digit number that we think we can achieve on this transaction. That's all, you know, dependent on us meeting our penetration goals, but we think we can do it. And you're looking at a low double-digit IRR over time.

Siyi He (Citi): Thank you very much, that's very clear. And just I want to follow up on the mobile comment. Do you see the underlying trends also improving for your B2B mobile?

Joost Farwerck (CEO, KPN): Well, the base for sure is improving in B2B. We added [11,000] net adds in this quarter, if I'm not mistaken. So, I think there is a lot to repair in the Netherlands when it comes to mobile. We all invested a lot in networks. We have the best networks in Europe in the Netherlands, so it's super important that we all understand that we have to create value. This market in the Netherlands is eliminating lower price points and moving more to unlimited high-priced, for us about 30 euros, 27.50 in the package – in a converged package. So, I'm a bit – a little bit positive here, but yeah, let's wait and see. But today, currently, it's moving a bit in the better direction, to put it that way, yeah.

Siyi He (Citi): Thank you very much.

Operator: The next question comes from Mr Simon Coles, Barclays. Go ahead please.

Simon Coles (Barclays): Hi, thanks for taking the question. Just on cost cutting, you said you're running ahead of expectations. And I think before you said there's some uncertainty around FTE reduction, given the macroenvironment. You said you started talks again at the beginning of June. I was just wondering if you can give us some more colour on how that's going, and does it mean that you could potentially still be on track? Thank you.

Joost Farwerck (CEO, KPN): Yeah, so when Corona started, we froze all our reorganisations, and we worked on how we could facilitate our people working from home. But having said that, we still reduced on FTE, because we had a couple of reorganisations already ongoing. And end of this quarter, we announced that we restart our reorganisations. Because we think it's not fair to our people, and it doesn't make any sense to keep waiting with improving the operating model of KPN and simplifying our organisation. And our people agree, as long as we do it according to plans and in a fair way, and that's what we always do.

So, we restarted our reorganisations, and we will in the coming six months reduce people. But having said that, in a – yeah, in the way we always do, in a very decent way.

Yeah, on opex reduction, we're running ahead of plan. And like I just said, yeah, we are ambitious, so we would like to beat our plan. And not for today, but if we continue like this, we will upgrade the programme.

Chris Figee (CFO, KPN): Yeah, when it comes to FTEs, I mean what we did was at some point, once the lockdown started, we froze our reorganisation requests, restructuring charges –

requests. But in exchange for that, we started effectively a hiring freeze, so new hires have dried up considerably. And secondly, we reduced external staff significantly. For example, we – when we used to have our shops around 200 external staff, we closed them and reopened them today – the reopening is about 80 staff. So, we saved on 100 external staff members from the closing, reopening of our shops. So, we compensated the slowdown of the freezing of our restructuring with less external staff and a hiring freeze.

Now, we've started restructuring again. And basically, it's a function: if you simplify your business, digitise your business, then it makes no sense to have people employed that do not – you know, can make any meaningful contribution anymore. It has been aligned, discussed with the unions and the works council. So, that's going to be kicking off again, and we're starting it again.

But it's fair to say the biggest restructuring will probably take place in Q4 of this year. And the coming summer and the coming Q3, we'll focus on keeping a lid on internal inflows – you can keep a lid on external staff – and gradually ramp up our restructuring requests for advice again.

Simon Coles (Barclays): That's very clear. Can I just ask a follow-up link to the '21 Free Cash Flow guidance then, because you say you are confident that in the B2B that EBITDA could stabilise in 2021. Admittedly, that's pushed back from 2020. And the cost cutting sounds like it's ahead of expectations, and the conversations on redundancies are going well. So, is it – should we just take it as it's purely the COVID uncertainty that's causing you to have some apprehension for now and little else is causing that? Thank you.

Chris Figee (CFO, KPN): Yes, it's really all about COVID, which is kind of really all about the impact of the pandemic that's uncertain to us. KPN underlying is delivering as planned, probably even better than planned. Sometimes, Joost and I look at each other: what if COVID had not happened, what kind of quarter, half year would we have had? So, I think KPN underlying is delivering according to plan. It's the uncertainty around COVID and, for example, the payment behaviour or the depth of the recession that is hard to gauge. So, that's kind of the only risk we are flagging.

Simon Coles (Barclays): Perfect, thank you very much.

Operator: The next question comes from Mr Paul Sidney, Credit Suisse. Go ahead please.

Paul Sidney (Credit Suisse): Yeah, thank you very much. Good afternoon, just a couple of questions from me, please. Firstly, I have a question on fiber. Now that you're back up and running on the – the FTTH build, and you're seeing the clear benefits to ARPU, churn, NPS. How much fiber do you think it makes sense to build in the long-term? Or how much could you economically see KPN building in the long-term, given those benefits you're seeing?

And then just secondly, a question on the balance between Wholesale and Consumer fixed voice and broadband lines. And the question is are you less concerned over the retail customer trends now versus a year ago, given that you're getting an offset on Wholesale? And obviously, wholesale customers come with lower ARPU but also lower costs. I was just wondering how you think about the balance there, and maybe how your thinking has changed over the last year? Thank you.

Joost Farwerck (CEO, KPN): Yeah. So, when we look at the fiber case, we see the proof that it's working. We are doing better than the original fiber case we built ten years ago. On ARPU, on penetration we're doing good. And we aim to do better in existing fiber areas, because having a penetration of 60% still means that 40% is not active yet. So, for us, it's important not only to focus on new built areas, but also on the existing footprint we built over the years.

Currently, we're working on a plan to roll out 1 million until the end of next year, and that is very important. The machinery we’re building means that we can build the fiber against lower costs per household, because the more we build the lower it gets, the more efficient we will become. We innovated a lot in the rollout of fiber, so we can go faster in areas to connect more houses and against a lower price. So, that is our focus for now.

It doesn't make any sense to stop end of next year – I don't think so. So, we will probably keep on building fiber, but, of course, it's very important to stick in our Capex framework as well. So, that’s where we are on fiber: we're doing good and we're scaling up, and it’s against a lower cost per household.

The balance between Wholesale and Consumer, I would say we’ve played this game for a long time. I think over the last quarters, we saw outflow on Consumer and a bit higher inflow on Wholesale, so it's our leverage on the Consumer side. But having said that, it's not healthy to lose that much customers in Consumer for a couple of years in a row. So, I'm satisfied with the results of this quarter that we more or less stabilise that consumer base – a bit of loss minus 3,000. But against that, the inflow of 17,000 or 16,000 on the Wholesale side means that others are losing customers, and they are moved to our network. And all in that, a balancing act between Consumer and Wholesale delivers a lot of value, I think.

Paul Sidney (Credit Suisse): That's perfect, thank you very much.

Operator: The next question comes from Mr Roman Arbuzov, JP Morgan. Go ahead, please.

Roman Arbuzov (JP Morgan): Thank you very much for taking my questions. I just wanted to go back to a mobile ARPU perspective. So, given your comments on roaming and [inaudible], I’ll just ask directly, do you think it's reasonable to expect you to maintain the €17 local ARPU postpaid consumer going forward? Or – or do you think there might be some downside risk to that, even though that may be temporary?

And also, you know, when you talked about positive underlying trends related to consumer mobile, I just wanted to double check whether you meant that’s up on an underlying basis excluding roaming – consumer ARPU was actually positive, in positive growth territory in Q2?

And then the second question is just on Telfort’s broadband customer migration. Could you give us some colour on where you stand on that and whether you've managed to migrate more customers in Q2? And how much of that remains to be done, please?

Joost Farwerck (CEO, KPN): Yeah, I apologise because the sound is not that good so difficult to hear you correctly. But if I'm not mistaken, you asked a question around mobile ARPU of – and the 17 euro and on the Telfort customer migrations. Let me start with the Telfort customer migrations.

We migrated the full mobile base of Telfort to KPN in a very smooth way. That was done, and all these customers have been migrated to KPN against the former Telfort price points, so that's done.

On the broadband side, we are going to migrate the Telfort customers in the second half of this year to KPN, but we – and we're piloting that now with friendly users, as we call it. But that's also very important that it goes smoothly in a couple of batches and then to the new environment. So, that's an important migration, and we will do it in the second half of this year. And once that's done, the base is more stabilising, so that is important, you are right there.

On the mobile ARPU, yeah?

Chris Figee (CFO, KPN): Yeah. On the mobile ARPU, a couple of trends at play: the underlying trends supporting mobile ARPU are positive. I mean, if we look at the renewal of older, you know, cohorts of clients, the drag – the ARPU drag from renewal is actually getting smaller and smaller. So, there's still a bit of ARPU leakage from repricing older cohorts, but that leakage is getting smaller and smaller.

Secondly, the inflow-outflow mix is also improving. Behind it is a bigger share of unlimited, so we're upselling our clients towards unlimited propositions. So that together should provide some support to our mobile ARPU going forward. As I said, in the short-term, in the summer, you may have temporary roaming effects – roaming and international calling that may distort the Q3 numbers.

And thirdly, the one thing that we just do not know is whether our clients will look for more no-frills solutions as a response to COVID, whether they'll look for lower cost solutions or not. It's not happening today; we don't see it at all. We actually see an increase in the share of unlimited, but it's something we need to be very mindful about.

So, my summary would be underlying trend from the renewals, inflow-outflow cohort repricing should be positive towards ARPU, a temporary dip in Q3 and the uncertainty around the COVID outlook. But given the stuff that we can control, especially the increasing share of unlimited, supports our – supports our mobile ARPU.

Roman Arbuzov (JP Morgan): Thank you very much.

Operator: The next question comes from Mr Usman Ghazi, Berenberg. Go ahead, please.

Usman Ghazi (Berenberg): Hello, thank you for taking my question. I've got two-and-a-half questions, please. The first question's, I guess, on the – the capital employed at the Group level. I was wondering if you could tell us how much of that is related to FTTH?

And just related to the ROIC, which is really impressive at around 10%, you know, I mean logic would dictate, if you're generating a ROIC of 10% versus let's say, a cost of capital, I don't know, 5%, 6%, then you should be increasing Capex to create more value, you know, provided obviously that the income returns stay this high; and I'm assuming that fiber-to-the-home returns are even higher than the Group ROIC of 10%. So, how do you manage that almost inconsistency between, you know, in theory how to create value versus what the equity markets would like to see, which is Capex either flat or even come down? So, that was the kind of broad question around ROIC.

And then the second question was around B2B. You've disclosed that SME and large Corporate are around similar in terms of size of revenues at €300 million each in H1. I mean is the – are the margin dynamics different for these segments in the end-to-end EBITDA, or is it broadly a similar kind of contribution? Thank you very much.

Joost Farwerck (CEO, KPN): To start with your B2B question, SME is not the largest segment when it comes to revenues, but from a profitability point of view it is very important for us. So, it's the highest profitable B2B segment for us. Why is that? Because we standardised the portfolio – it's called KPN [EEN]. We migrated [84]% of the base to KPN EEN, and we can support that full base with less people than we do in LE or Corporate. At Corporate, we migrated [72]% but against lower margins, and that's what we are focusing on.

Yeah, maybe on ROIC?

Chris Figee (CFO, KPN): On ROIC, well, it was – on your question on the share of fiber in total capital employed, let me look it up for you; I think we'll get back to you with that detail. But I do agree that, you know, a ROIC of around 10% is a nice number – would love to grow that further.

Wouldn't you want to do more Capex if you had the ROIC of that? I think it's the marginal ROIC that counts, so we do monitor that carefully. But to put you at ease, we are comfortable that the ROIC on fiber is actually value creating. Without giving you the details on the numbers, I think the numbers in the sheets Joost present show you that there is value creation in fiber.

Could we do or would we want to do more? That's a 64 million dollar question, something for us to think about. One thing we'd note, of course, you may want to do more, but you need to have the construction capacity locked in. So, there's no point throwing money at fiber if you can't have the field services work that dig holes and pull all these lines. So, step one is locking in the construction capacity; step two is make sure you've got the operational capability to actually convert all those homes passed into active clients. So, it's a logistical and commercial operation that needs to count as well, because if you look at the fiber case it is actually the penetration that counts.

If you look at the fiber NPV – and sorry to give you a bit of a lecture here – but it's not so much the cost for home passed that makes a difference, it's the amount of penetration and the ARPU realised that actually drives the NPV.

So, for us it's the question: can we get the building capacity to actually build these lines and make this money work? And secondly, can we get our operation to actually sell those, you know, homes passed, or homes activated and get the revenues? If you're there, you're right, theory would predict that more Capex is actually – is better, but we're cognisant of the, you know, sensitivity of the shareholders, of the capital markets, of our Capex. So, it's something else to think about, to chew on and to communicate very carefully about, but I mean theoretically you're absolutely right.

Joost Farwerck (CEO, KPN): And adding to that, we reported a Capex of €1.1 billion in the total year, which is a lot in the Netherlands considering a rollout of let's say 300,000 fiber lines that is not most of the €1.1 billion. So, 300,000 households is representing less than €300 million Capex. So, it is also important for us to really focus on all the Capex buckets in that €1.1 billion and trying to reallocate Capex from one bucket to another bucket. And the more we migrate to Capex, the more profitable it is when it is to our concerns. So, it's also about reallocating Capex from one theme, to fiber-to-the-home.

Usman Ghazi (Berenberg): Thank you very much.

Operator: The next question comes from Mr. Ulrich Rathe, Jefferies. Go ahead please.

Ulrich Rathe (Jefferies): Thanks. So, for my two questions, the first one would be on the coming back to this acquired fiber operator. I mean you're framing this as a bit of a build or buy choice, I think. And could you just then, in that context, explain where the acquired operator, and also the ones you would further look at in this area – where they would stand in a priority list for – for the build?

And I mean, I suppose the thesis behind that is if that's where you're currently buying, it is not where you'll – you probably would build next. So, I'm just trying to figure that out, or whether there's actually a big overlap, that it's really like you would build in that sort of area or you would – you would buy in that sort of area, and whether that's actually the question you're currently answering.

My question is – the second question is on the payment behaviour. Now, you're calling this out as a risk, and then you insist that you're not seeing this in actual behaviour. So, I'm then struggling to understand why you then call it out. Is it prior experience from prior situations? Is it in former conversations that you have with the purchasing managers in these companies? It just feels that you're adding a degree of uncertainty here that some of your peers aren't adding, and there must be a reason. I'm just not entirely sure what that reason is. Thank you.

Joost Farwerck (CEO, KPN): Yeah. So, we have third [party] fiber initiatives in the Netherlands, and that's also had to do with the slow rollout of KPN of a couple of years ago; we gave them room to manoeuvre. There's been fiber rollout in rural areas where we didn't roll out; we prioritised in other areas. And so, the business case in the Netherlands: a third party rolls out fiber, and then you sell to KPN. And this is not the way we would like to do business. But it's important that we speed up our rollout to lock in all the capacity, to avoid others to do it. Secondly, our message to these initiatives is go to Germany, there's more room there to manoeuvre, there are more rural areas, probably better business model as well. Because we are now in the lead of rolling out fiber, and so it's not that they all can roll out fiber, we buy it.

The consolidation we recently did was a very small one, 6000 lines. For the first time, we have to book it in Capex because we didn't buy a company; we only bought the access network. So, it's really a network we bought, that's it – no people involved or whatsoever. But we know these people from the beginning. So, we know where they were rolling out, and we didn't roll out there ourselves. There are also areas in the Netherlands where others start, and we go in because – to protect our customer base, and because we have that area on our list as well.

Currently, we worked out a plan for all municipalities in the Netherlands. So, in 295 municipalities in the Netherlands, KPN has a network plan. And currently, we are working in 85 regions. So that's big operations in the Netherlands; we are a small country. And I think that will, yeah, delay and decline the introduction of more parties in the Netherlands. And only when we can do a good deal and only when it fits our network, we consider to buy. There's no overlay in the Netherlands, there's no overlap, and it is very important that we make sure that it will not happen in the Netherlands. So, that's why it's again important that we speed up our rollout as well.

Chris Figee (CFO, KPN): Yeah. And when it comes to the payment behaviour, you're asking the question: is it fair to flag a risk when you don't see it yet? If you look at what happened in the first quarter, the one thing we were really cautious about is payment behaviour. So, we had a very intense monitoring scheme and a very clear protocol how to deal with requests for payment extensions.

We did receive some requests, we granted some. We did not grant others, we had a protocol in place. I think in total, it cost us a couple of million of working capital in this quarter, so at this point very limited, but something like this we want to be very mindful and vigilant about. Maybe other telcos don't show it, I don't know. I think we perhaps have a slightly bigger Business market, because it's a Business market thing rather than a Consumer market thing, so that may be the difference between us and them. But again, at this point, it's not there yet. We wanted to – we wanted to be able to flag it. Is it naive to flag it if it's not there? Perhaps. Is it honest? Yes, for sure. So, we want to be transparent and clear to you that this is a risk, I want to be honest with you. But again, we'll need to see how it evolves.

Ulrich Rathe (Jefferies): Right, thank you very much for both answers.

Operator: The last question comes from Mr Steve Malcolm, Redburn. Go ahead, please.

Steve Malcolm (Redburn): Yeah, good afternoon, guys, and I for one can express my thanks to your honesty; I think you were just expressing a fairly commonsensical, honest view with the Free Cash Flow outlook, which I think is very sensible in the circumstances. I had a question related to that though, I guess just from financial priorities.

You know, clearly, you're flagging that the visibility is not great; you know, things remain pretty opaque, there is a lot of economic uncertainty. As you look into the next 12 or 18 months, can you just sort of help us understand your financial priorities? You know, should we think that the €1.1 billion of Capex is written in stone, and that you're going to build that fiber almost come what may? If your EBITDA slips and working capital slips a bit and cash flow comes under pressure, you know, would you be committed to building that fiber because the returns are so good?

And how do you weigh that up against your dividend commitments? Are you confident that under sort of most foreseeable circumstances, the balance sheet can take a bit of strain on the dividend and continue to pay the Capex? So, that would be very helpful.

And just coming back to the sort of fiber machine that you said you've got up and running, clearly one of the big problems last year was the sort of big shift in working capital that you flagged, or your predecessor, Chris, flagged as sort of shifting payment terms. Now, I guess as one of the most reliable payers of construction crews in Holland at the moment, have you been able to take advantage of COVID to sort of change those payment terms and maybe give yourself a better runway in terms of payment over the next two or three years to improve the cash outflow on building more fiber? It would be interesting to know that. Thank you.

Joost Farwerck (CEO, KPN): Well, before I hand over to Chris, I must say I'm happy with Chris coming in, because we improved the way we run our Capex and we improved the way we run our working capital. And there is room to improve there, and that's what we currently see.

We always said fiber rollout means that we have to pre-finance a lot. But on the other hand, if we are responsible for a fiber chain in the Netherlands, with 3,000 to 5,000 people at work and with all the construction going on in 85 areas, we can do better in the negotiations on payment terms than when we only do 100,000 lines per year. So, I would say that we improved there, and that's why the impact is less than we mentioned when we presented our fourth quarterly results.

Chris Figee (CFO, KPN): Yeah, on that point, the – on – on the working capital environment and payment environment, we do see some, of course, underlying pressure on working capital from fiber access investments and the working capital strain from that. I think we've been able to counter or do some of it already. We're got a – as Joost said, we've got a working capital programme ongoing that consists of both, you know, the incoming side, and the outgoing side. So, its payments and invoices together that allow us to mitigate it to a significant extent, possibly not all of it but at least a significant chunk of it.

And to your first question: is your €1.1 billion Capex cast in stone? I tend to think, you know, we've committed 13 cents dividend per share, and that is cast in stone.

Joost Farwerck (CEO, KPN): Yeah.

Chris Figee (CFO, KPN): Certainly, we've got a balance sheet where your leverage is less than 2.3 times EBITDA. Our dividend is cast in stone, not our Capex. At the same time, if you look at the value creation that we're able to – able to achieve with our Capex, it would be a shame to pause it if you've got a balance sheet that is able to support it and – yeah, support it like this.

So, our dividend, that is rock solid, that's pretty sacred, certainly the 13 cents that we've committed, also showing the – you know, the fact that we're paying an interim dividend on the basis of 13 cents per share. So, that is cast in stone. Capex really is a function of can we create value to our shareholders by deploying all this capital? If we can, then I think we should do it as long as we can safeguard the dividend.

Steve Malcolm (Redburn): Can I just ask one more quick one, Chris?

Chris Figee (CFO, KPN): Sure.

Steve Malcolm (Redburn): You obviously had – you've had a few weeks of the price rise now, which I guess was not something you anticipated you could do a few months ago. Can you just give us an update on how the price rise has landed and, you know, the sort of competitive response to you and Vodafone raising prices?

Chris Figee (CFO, KPN): The competitive response has been, you know, very benign. I mean, interestingly, the newspaper wrote that KPN and Vodafone both had a more moderate price increase than last year, which is factually true; it was a more moderate price response. It was the price response that we'd hoped for. So, I think the price increase has landed reasonably well. Of course, most of our customers would rather see a price decline than a price increase, but then the standards are linked to, for example, the wage inflation, the wage price – wage increase that we experienced. So, we have not seen any major fallout in terms of volumes from the price increase; I mean the price elasticity has still worked for us.

Steve Malcolm (Redburn): Great, thanks very much.

Bisera Grubesic (Head of IR, KPN): Okay, thank you everybody, this ends today's webcast. If there are any further questions, please let our IR team know. Thank you very much, and operator, you can close the call.

Joost Farwerck (CEO, KPN): Thank you.

Chris Figee (CFO, KPN): Thank you.

Operator: Ladies and gentlemen, this concludes today's presentation. Thank you for participating. You may now disconnect your line. Have a very nice day.

[END OF TRANSCRIPT]