Event transcript KPN Q2 2023 Results

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KPN Q2 2023 Results

Operator: Good day, ladies and gentlemen, and welcome to KPN's Second Quarter 2023 earnings webcast and conference call. Please note that this event is being recorded. At this time, all participants are in 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 might do so by pressing star one on your telephone keypad.

I will now turn the call over to your host for today, Mr Reinout van Ierschot, Head of Investor Relations. You might begin.

Reinout van Ierschot: Good afternoon, ladies and gentlemen. Thank you for joining us today. Welcome to KPN's second quarter and H1 2023 results webcast.

With me today are Joost Farwerck, our CEO; and Chris Figee, our CFO. As usual, before turning to our presentation, I would like to remind you of the Safe Harbour on page two of the slides, which also applies to any statements made during this presentation.

In particular, today's presentation may include forward-looking statements, including KPN'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.

Let me now hand over to our CEO, Joost Farwerck.

Joost Farwerck: Thank you, Reinout, and welcome, everyone. Our 'Accelerate to Grow' strategy was launched in November 2020, and we're now on the final leg of our ambitious three-year plan. And today's results show the continued progress on that strategy.

Our Group service revenues are growing sustainably with growth visible across all segments. We continue to see positive developments in business with SME again making a strong contribution. Consumer service revenues inflected to growth, driven by higher mobile service revenues and improving trends in fixed. And wholesale made a solid contribution again, thanks to our open wholesale policy.

We saw good commercial momentum across the board, especially in Consumer, driven by ongoing commercial improvements and the strong execution of the teams.

In June, we announced the acquisitions of Primevest and Youfone. Primevest strengthens our fiber footprint in larger cities and the households will be added in the third quarter this year. And the intended acquisition of Youfone will reinforce our position in the no-frills mobile segment.

Together with our joint venture, Glaspoort, we added 184,000 households to our fiber footprint. And whilst our cost base was impacted by inflation, we were still able to deliver flat or slight adjusted EBITDA growth compared to last year. Free Cash Flow in the first half of 2023 was mainly impacted by intra-year CapEx phasing. And return on capital employed continues to move in the right direction.

Looking ahead, our EBITDA and cash flow generation are expected to improve further in the second half of the year. And therefore, we reiterate our 2023 outlook with confidence.

As usual, Chris will give you more details on our financials and walk you through our outlook for this year. First, I'll take you through the business details.

We are now nearly halfway through our ambitious fiber build plan. And as we have almost reached the end of the current strategic period, we look forward to providing a strategy update, where we will focus on the key pillars of our strategy for the next period.

We will host our Capital Markets Day on the 7th of November at our headquarters in Rotterdam.

Let's now look at the first pillar of our strategy, our best-in-class networks.

In the second quarter, we rolled out fiber to 125,000 households. And together with Glaspoort, we now cover 53% of the Netherlands with fiber. Our fiber business case is centred around market share gains, ARPU uplift and lower maintenance costs of fiber. And as we continue to roll out fiber, our growing footprint results in an improved penetration rate for both Retail and Wholesale.

And all this is visible in our financials. Looking at our second quarter results, we currently generate €1 billion of annualized fiber service revenues in B2C, and this number is growing strongly, driven by a growing base and an attractive ARPU. All in all, fiber is at the heart of our strategy to create long-term value for all stakeholders.

In Q2, we announced the acquisition of the Primevest fiber network, and this consists of an additional 127,000 homes passed in The Hague, Rotterdam and Eindhoven. And this acquisition is a welcome addition to our existing fiber footprint. The deal was closed early July, so therefore not included in our second quarter results, but visible in the footprint as of Q3.

Let's now move to mobile.

We are proud that Ookla, for the sixth time in a row, recognized our mobile networks as the best in the Netherlands. And with this recognition, we retain our leading position with the highest up and download speeds, best coverage and the fastest 5G in the Netherlands.

Let's now move to the second pillar of our strategy.

Consumer service revenues inflected to growth and increased by 1.3% in total year-on-year. We see consistent mobile service revenue growth, driven by good postpaid inflow and an improving ARPU. And as expected, our fixed service revenues continued to be impacted by declines from our legacy portfolio. However, the trend is gradually improving, driven by continued fiber broadband service revenue growth.

Customer satisfaction remains one of our top priorities. And it has been pleasing to see that KPN continues to lead the Dutch market as reflected in our Net Promoter Score. And next to this, we announced the acquisition of Youfone's Dutch activities. And with this, we strengthened our positioning in the fast growing no-frills mobile segment. This enables us to play a more effective base management strategy by positioning the Youfone brand as a flanker brand of our main brand, KPN, next to Simyo and XS4ALL. The transaction is subject to regulatory approval, which we are confident to obtain.

Now, let's take a deeper look into our second quarter KPIs.

On the back of active base management and strong commercial execution, we managed to turn the tide in our broadband base, and this led to 14,000 broadband net adds, a good improvement compared to previous quarters. Our fixed ARPU grew slightly and combined with a somewhat lower base than a year ago, our fixed service revenues decreased 0.4% year-on-year.

With the price increase implemented as of the 1st of July, we expect fixed service revenues to improve further in the second half. Our postpaid base increased by 31,000 and postpaid ARPU grew 3%. And combined, this led to a solid 5.3% growth in the mobile service revenues.

Let's now move to the B2B segment.

We saw continued strong service revenue growth in our business segment. B2B adjusted service revenues grew by 4.5% year-on-year in the second quarter, with growth seen across all segments. Business Net Promoter Score improved compared to previous year. We remain the Dutch market leader as customers continue to value KPN for stability, reliability and quality of our networks and services.

SME is the main engine of B2B growth, driven by solid commercial momentum, especially in mobile. We serve our customers via our cloud-based KPN EEN platform and the customer base is doing well. Also, LCE continued to move in the right direction, showing slight growth for the third quarter in a row. And tailored solutions continue to perform in line with expectations. And this business remains subject to the timing of projects and related hardware sales, but the performance is moving to a more profitable level.

In Wholesale, service revenues increased 3.8% in the second quarter. We added 17,000 postpaid SIMs and broadband lines grew again by 10,000 after two quarters with a stable base.

As promised and in line with our commitment to sustainability, you will be able to track our performance on carbon reduction, circularity and diversity on a quarterly basis.

Over the past decade, we made a conscious choice to be a front-runner in sustainability, and we've achieved some important milestones in this regard. And by working more energy efficiently and implementing circular operations and services, we have been able to significantly reduce our carbon footprint. Looking ahead, we want to be almost 100% circular by 2025, whilst being net zero in the whole value chain by 2040.

We also attach great importance to diversity in our workforce, and we aim to have at least 35% of women across our senior management by 2025 from a current 29%.

And with this, KPN will not only deliver financial results, which enables us to continue our progressive dividend policy. We will also connect the Netherlands to a sustainable future.

Let me now hand over to Chris to give you more details on our financials.

Chris Figee: Thank you, Joost. Let me now take you through our financial performance. Let me start by summarising some key figures for the second quarter and the first half of the year.

First, the adjusted revenues for Q2 increased by 1.6% year-on-year, driven by service revenue growth across all segments, partly offset by lower non-service revenues. Second, in accordance with the indications we gave last quarter, adjusted EBITDA after leases increased slightly in Q2, despite some margin pressure from inflationary effects due to the wage indexation and higher energy costs.

Third, our free cash flow decreased 13% compared to the first half of last year, mainly due to CapEx phasing. I will offer more detail on underlying cash developments later in the presentation.

And finally, our ROCE, return on capital employed, continues to improve and increased compared to last year by almost 170 basis points to 13.7%.

Group service revenue growth accelerated and increased 2.8% compared to last year, underpinned by growth in all segments. Business service revenues grew by 4.5%, and as Joost said, mainly driven by the strong performance in SME, while also both LCE and Tailored Solutions contributed to growth. SME delivered more than 9% growth versus last year.

Wholesale showed solid growth again with service revenues up almost 4% year-on-year and improving versus flattish service revenues reported in Q1.

And in Consumer, mobile service revenues continued to grow strongly and drove service revenue growth for the entire segment. In fixed, the service revenue trend improved compared to the previous quarter, although still marginally negative. Growth in broadband was offset by the anticipated decline in legacy services and less voice traffic. Although service revenues in Consumer fixed are still down year-on-year, we see encouraging KPI developments, which show that our strategy is working. We are confident that the year-on-year trend will improve further, supported by our implemented price adjustments and commercial improvements, with Consumer fixed showing service revenue growth as of Q3.

Adjusted EBITDA grew slightly compared to last year. This was driven by ongoing service revenue growth.

The decrease in cost of goods sold is mainly related to lower non-service revenues in B2B. The indirect cost base was affected by inflationary headwinds such as wage indexation, higher energy costs and higher lease costs. This translated into 30 million higher indirect OpEx. As per the start of Q3, we've implemented the announced price indexations on broadband to help counter these effects. However, we've effectively locked in most of the energy procurement for the year. There remains some modest scope for upside to our 2023 EBITDA guidance, provided we are also able to limit future non-energy-related inflationary effects.

At a free cash flow of €354 million, our cash margin declined to about 13% of revenues in the first half year. This decline is mainly explained by different CapEx phasing of fiber-related CapEx and some higher taxes. We expect this year's free cash flow to be more weighted towards the second half of the year, reflecting a timing of EBITDA generation, CapEx phasing and further improvements in working capital.

So looking ahead, we expect a gradual improvement in this number throughout the year and remain confident of delivering on our free cash flow target of €870 million.

Finally, we ended the quarter with a cash position of €367 million, absorbing the final dividend payment over 2022 and the completion of our €300 million share buyback programme.

On slide 20, we report our return on capital.

KPN's focus to create long-term value is evidenced by strong return on capital employed. Our ROCE improved 169 basis points year-on-year to 13.7%, driven by the increased operational efficiency. For the coming years, we see scope to further enhance ROCE as part of our continuous pursuit to deliver long-term shareholder value creation, driven by fiber investments, cost savings and an improving top-line profile.

We continue to have a strong and resilient balance sheet at the end of June. As a result of higher rates on floating debt and other corporate actions, the average cost of senior debt increased by 159 basis points year-on-year to about 4.1%. Our exposure to floating rates in our bond portfolio was reduced to 21% of our debt. And with a leverage of 2.4 times, still below our self-imposed ceiling of 2.5 times.

Also, our interest coverage ratio remains strong at above 11 times. For the year, we expect our leverage ratio to stay well below 2.5 times. Year-on-year, net debt increased by around €360 million, mainly driven by the earlier finalization of the share buyback and different intra-year free cash flow phasing versus last year.

Total liquidity remained robust. It consists now of about €1.4 billion in cash and short-term investments and our undrawn revolving credit facility.

Furthermore, on 3rd July of this year, we issued a €600 million senior bond, which further strengthens our liquidity position and increases the average maturity of KPN's outstanding debt. With this, we also expect to retain ample flexibility to pursue bolt-on growth investments as they may arise, such as, for example, Primevest and Youfone recently and to acquire spectrum in the 3.5 gigahertz auction, which we expect to take place early next year.

Now, let's turn to our outlook and ambitions for 2023.

We are on track to deliver the ‘23 outlook we provided to you in January. On 7th June, we completed our € 300 million share buyback programme and bought back 92 million shares, of which approximately 90 million will be cancelled after the summer.

So to summarize, we generated solid results in Q2, driven by strong and improving commercial momentum. We see sustainable growth in Group service revenues with positive signs across all segments, and that's before the implementation of most price increases. On the back of commercial improvements and strong execution, we saw strong momentum across the board, especially in the Consumer segment.

Our fiber rollout programme has maintained a solid pace and has a proven attractive return profile, and we continue to lead the Dutch market in customer satisfaction.

Finally, as expected and planned, we had a relatively slow start compared to the previous year this year in terms of EBITDA and cash generation. However, the sustainable service revenue growth run-rate and measures we put in place provided us confidence for the rest of the year. We delivered on the expected flat performance for EBITDA in Q2 and we see positive EBITDA growth in H2 of this year. We expect a similar pattern for our free cash flow, and therefore confidently reiterate our outlook.

Thanks for listening. Let's turn to your questions. Back to Reinout.

Reinout van Ierschot: Thank you, Chris, and thank you, Joost. We will start with the Q&A right now and I would like to remind you to limit the number of questions to two. Operator, over to you, please.

Questions and Answers

Operator: Thank you. Ladies and gentlemen, we will start the Q&A session right now. So if you would like to ask a question, please press star one now on your telephone keypad. The first question comes from the line of Andrew Lee calling in from Goldman Sachs. Please go ahead.

Andrew Lee (Goldman Sachs): Yeah. Good afternoon, everyone. Just had a couple of questions. Obviously, broad-based growth delivered in your results today. The one area that's still not quite in positive territory is fixed service revenues, so I had two questions around that. First one is, do you think the fixed service revenue growth would improve in Q3 if you weren't seeing higher inflation-linked price rises. Obviously, those – the inflation linkage makes it quite hard for us to follow the underlying trends. So if you could comment on what is driving underlying growth in fixed service revenue? And if you think that fixed service revenue growth is about to turn to sustainable structural growth, that would be really helpful.

And then second question, just be good to know where your net adds are coming from in fixed broadband. Is VodafoneZiggo still a modest customer donor? Or are you seeing altnets taking fewer customers? Any change in where market share is going would be helpful. Thank you.

Joost Farwerck: Yeah, thanks for the question. On the net add growth, we see a very strong inflow coming on our fiber network that is coming from all competing service providers. And indeed, probably most of it is coming from Ziggo's base, but it's not that simple. So customers rotate from one to the other, and we see an inflow and an outflow.

But all in all, the most important message here is that we grow strongly on fiber, and we see the churn reducing on copper. That's very important to run the base also with that perspective on churn management. And at the end, the net result is a plus 14,000.

On your question on fixed service revenues, Chris?

Chris Figee: Yes, I'll take the first one. Look, if you look at our – first of all, our momentum in net adds, I mean, it has been quite good in Q2. At least to be continuing in Q3. Obviously, July is just about to end. But when I look at my weekly numbers, the order balance, it feels that net add momentum is quite okay, maybe not the 14k, but still positive and nice into July, and because of our order balance being good, possibly also into August. So I think the underlying momentum is solid. So that's the most important thing to underline here.

Your question, would we say in Q3, we will have positive growth in fixed service revenues?. Would there be positive growth without price increases at all? Well, first of all, on broadband you can see on the page in our pack, the broadband service revenues are growing. It's just a legacy decline that's kind of tilting it slightly negative today. So broadband itself is growing and will continue to grow even without price increases.

If we had zero price increase, probably would just not be zero, not be flat at the quarter. But then again, historically, we've always on price increases maybe not the 6.4% that we did this year. We had like 3% to 3.5% like normally. So I would say on broadband service revenues, there is growth and will be growth. If you take the average price increase that we have in the last few years, you'd probably just be crossing the zero line or just flat. And with the price increase that we have today, we're positive. But also net add momentum appears to be quite solid.

Andrew Lee: Thanks. Was very helpful.

Operator: The next question comes from the line of Luigi Minerva calling from HSBC. Please go ahead.

Luigi Minerva (HSBC): Yes. Good morning, everybody. Thanks for taking my two questions. The first one is on the Youfone acquisition. You gave some details during the presentation, but I was wondering if you can go back on the rationale for doing it. And the reason I'm asking is that if I think about your capital allocation priorities, the first thing I think of is fiber, shareholders' return. So acquiring an MVNO in the retail market doesn't quite fit there in people's expectations.

The second question is on the competitive dynamics. Obviously, VodafoneZiggo did do some promotions in Q2, but they were far less effective than previously and your commercial activity has been excellent in this quarter. So I was wondering if you can flag what was different this time around? And why were you able to defend yourself much better? Thank you.

Joost Farwerck: Yeah. Thanks, Luigi. Youfone. First of all, we're happy with the growth we see in mobile. And we're also happy with the quality we can show on our network and the move to unlimited, which is really a KPN thing, high ARPU, and there's a good shift from customers moving to unlimited.

But having said that, there's also a good shift in the market to the no-frills segment. And I think it's very important to run the base in the optimal way, and that is by running the KPN brand as our main brands, supported by some flanker brands. So that's what we did with Simyo and XS4ALL. And we think Youfone is perfect adding to that strategy, delivering growth, base and EBITDA in the years to come.

So we're happy with the Youfone deal, and we think this will fit perfectly in a segment KPN was not really present. So it will add value to our total strategy. Yeah, competitive dynamics. The Netherlands is competitive. So I think the main reason that we see a better performance on KPN side is, first of all, how we run the base today, a bit of a shift to base management and churn reduction instead of focus on acquisition.

We also invest heavily. I'm happy with being the best service provider, number one, two and three in the Netherlands. And so customers pay for the service we deliver. And on the other hand, there's also discounts in the market coming from – well, everywhere. So that continues.

Having said that, it's very important that we all understand in the Dutch market that we want to create value. And we're not price fighting whole day. So this quarter was a bit quiet. We see a good performance in this month, and we expect growth in the third quarter as well.

But yeah, we have to do it quarter by quarter. I'm happy with the growth we showed in Q2. And we will continue with the shift to base management loyalty on existing customers and acquisition as well, but it's a bit of a rebalance in our strategy team.

Luigi Minerva: Yeah. Thank you. And if I may just follow up on Youfone, am I correct that they are an MVNO on your network currently, so it's also a way for you to preserve your wholesale revenues from them?

Joost Farwerck: Sure. Yeah. I mean it's an important contribution in our MVNO business in the first place. So by this deal, we are sure we keep that on our network. And what will be added, of course, is the retail margin on their side. So we will shift financials from wholesale bit to retail, but we also see EBITDA added because of the consolidation of Youfone. So all in all, it's to keep that business on our network, but also to add more consumer service revenues.

Luigi Minerva: Okay. Great. Thank you.

Operator: The next question comes from the line of Georgios Ierodiaconou calling from Citi. Please go ahead.

Georgios Ierodiaconou (Citi): Yes, good afternoon. Thank you for taking my questions. The first one is on mobile and the acceleration in mobile service revenue growth. I was curious if you could give us some indications as to how sustainable this is, because obviously it's not bound to back book price increases this time. So you mentioned the unlimited plans. I'm just curious whether you are seeing a structural shift towards higher ARPU products that could give you, let's say, a dual way of growing more the revenues beyond the annual CPI increases.

And then the second question is around the phasing of energy costs. I know you've already given some indications for the first half, but I'd be curious if you can give us an update on where we are right now? What you've seen in Q1 and Q2? And based on how you see things, what's left in the second half of the year? I just want to make sure we get the phasing right on it. Thank you.

Chris Figee: Let me answer the question on mobile. Yes, indeed, we had solid mobile net add growth. Actually, net add growth on a monthly basis accelerated versus Q1. There was a bit of a churn gap because some of the churn was moved to Q1 that could have been in Q2. So to some extent, there's a bit of overflow from one quarter to the other. But even if you look at the gross adds, we saw an acceleration of gross adds in mobile. So basically your base growing faster than we planned. There is an increased uptake in unlimited plans. So that actually definitely helps show up in our total revenues.

When you look at the ARPU, there's some ARPU dilution for what I could call non-committed ARPU. So that's keeping the ARPU – I think, restrain the ARPU a bit, but that's going to lapse probably next year. So my story on mobile is solid development of net adds. Gross adds doing better. Churn with a bit of support from churn that was booked in Q1 that could have been in Q2. But underlying for net add growth, ARPU stable and supported by move to more unlimited.

And I think you'll see the kind of the downturn on non-committed ARPU probably lapse by the end of the year, so that should support our ARPU growth going forward.

And on cost, when you look at our cost drivers, we spent a lot of time and effort on reducing energy consumption. That has been brought down a lot from, say, 455 gigawat hours to about 420 gigawatt hours this year. We could see continued scope to reduce that.

On staff, we reduced our external staff in the first half of the year. So internal workforce grew a bit. External staff declined. We were able to translate lower sick leave levels into reduced external staff. It's clearly on our path to reduce internal workforce and FTEs a lot further in the second half of the year, also what we need to do to counter inflation.

So there is significant inflationary headwinds that are – make no mistake, they're there. But we think in the second half of the year, we should be able to get some more momentum getting the underlying cost drivers down.

Georgios Ierodiaconou: Sorry, if I can ask a follow-up on this non-committed ARPU in mobile. Do you mind just giving us a bit more colour as to what that entails?

Chris Figee: It's – people calling outside the bundle, it's MTA, it's COVID-related revenue that we had, where people dialled in the 0800 COVID numbers, a little bit roaming. So it's other stuff as people are basically paying money outside of their contracted bundles, which often is outside of bundle dialling, COVID numbers and some roaming. That was down a bit in the beginning of the year.

But I guess when you look at the year-on-year numbers and the quarterly numbers, that effect will lapse into the next year. And the committed ARPU is growing by 4-5% per year.

Georgios Ierodiaconou: Very clear. Thank you.

Operator: The next question comes from the line of David Vagman calling from ING Belgium. Please go ahead.

David Vagman (ING Belgium): Yes. Good afternoon, everyone. Thanks for taking my question. I've got two on fiber actually. The first is on the speed of the rollout. You had a very good Q2. Could you comment on whether you would hope in the end to achieve better than the 600,000 goal, let's say, new gold that you had new target? That's my first question.

And then secondly, on the – a bit – if you could explain your capital allocation thinking behind buying Primevest versus an organic rollout, so especially in light of the price you've paid. So how you are thinking about this, let's say, the choice between doing it yourself and then buying? Thank you.

Joost Farwerck: Yeah. So the big goal we set for ourselves is end of '26, we want to reach roughly about 80% of the Netherlands, cover 80%. So currently, we are at 53% and we're accelerating the rollout. Last quarter was a very good quarter. But if you take the average of the whole first half year, it's more or less 300,000 what we did. And we expect to do another 300,000 in the second half. Perhaps it will be a bit more.

But I'm pretty sure that we'll end up somewhere around 600,000 and then do a bit more in the years after. And that rollout speed is very important because we don't only pass households, but we also connect. So what we do in the Netherlands is homes passed and homes connect at the same time to make sure that we can – after that can serve our customers. So we're doing good there.

Primevest, yeah, was an interesting deal for us because the choice we had is, yeah, roll out ourselves or buy Primevest. We know the company quite well after different discussions. And it perfectly fits our plans, where we were ready to roll out in larger cities. We could also acquire Primevest. Of course, it's all about the price and taking it to that one, we think we made a good deal. We can skip that part to roll out ourselves and integrate it in our footprint.

David Vagman: Thank you.

Operator: The next question comes from Polo Tang calling from UBS. Please go ahead

Polo Tang (UBS): Hi. Thanks for taking the questions. I have two. The first one is, can you comment on what's happening with your equipment or non-service revenues in both consumer and business, and whether the trends in Q2 that we've seen will continue for the rest of the year? I know there are a little margin, but in particular, the B2B non-service revenues, they're quite weak in Q2. So I'm just trying to understand what's happening there?

And then second question is, you're highlighting you'd be open to more bolt-on M&A. I'm just trying to understand in terms of what's this mean your share buybacks going forward? Is it one or the other, or can you do both? Thanks.

Chris Figee: Well, Polo, on the non-service revenues, it is really all about B2B. So consumer non-service revenues are relatively stable. On B2B, they were down, less equipment that we placed. Frankly speaking, I'm not that worried. It's very low margin revenues. So it's something you don't even – we don't steer it. We don't control it. We steer and we control service revenues and non-services model as a given, except that sometimes might take up some CapEx. But basically, on non-service revenues, we expect it to probably have come back a bit, but stay muted relatively compared to last year.

But it's – again, it's a low margin service revenues that are there to enhance your service revenue. So if we can do without, I'm completely fine with that.

On bolt-on M&A, look, let's not overdo it. We bought an MVNO. We bought a fiber network. Obviously, there are a few other fiber networks in the country, smaller ones that are definitely rethinking their future, given increased interest rates, given inflation, given the threat of overbuild and low penetration rates. So we might just snaffle up some of these smaller parties, but they will certainly not come at the expense of our buyback programme. So these small bolt-on transactions are only – and are all executed in line with our total capital allocation strategy and should not come in the – in exchange of our capital return strategy. That should be very clear on that. Small transactions, bolt-ons do not conflict with our buyback programmes.

Polo Tang: Thank you.

Operator: The next question from Joshua Mills from BNPP Exane. Please go ahead.

Joshua Mills (BNP Exane Paribas): Just following up on that last comment around limiting the scope of your M&A activity. I just wanted to hear a bit more about your thoughts around the larger overbuilders, so DELTA Fiber and ODF at the moment. So the first kind of part of the question is what level of overlap are you seeing now between areas that are rolling out fiber and where they're rolling out fiber? And have they been any more aggressive or change their strategies in going to market?

And the second question is, have you thought about and considered maybe a partnership or tying up with these companies in certain areas? And if so, do you think that's something the regulator would support?

And then the final question is a very quick clarification, but the 600,000 target for the year, which you're reiterating. That is excluding the 127,000 fiber lines, which we'll see next quarter from Primevest. Is that correct? Thanks.

Joost Farwerck: Yeah. So on your third question, the answer is yes. So that's excluding the Primevest footprint, we will consolidate in the third quarter. Yeah, I mean, we're always interested in partnerships, in opportunities. So, of course, we consider every possible deal in the Dutch market.

Having said that, it's very important that we believe in our own strength and that we execute on our own strategy. We're doing good. I just mentioned our strategy to pass households but also connect. We also see other initiatives in the Netherlands on fiber, where they mainly pass households but don't connect. And so that is why I think that we are very strong in our rollout on fiber and that our execution, we will do fine as well also since our customers are in these regions.

And yes, we are also interested in partnerships. And every now and then, we meet our competitors to see if there's a possibility to join forces in certain areas. But then it comes with, yeah, all the rationale and the right conditions until now. We believe in our asset-heavy strategy. We're a network company. We yield or manage our own networks, and we serve our customers via our own networks end-to-end. That's our strength. And so far, until now, we do not hold by on our networks.

Joshua Mills: Got it. And the number of households or the percentage of households would you connect at the moment. Would you be able to give that figure rather than just the homes passed?

Joost Farwerck: Yeah. So our blend on homes passed and homes connect is different than in other countries, to be honest. We reached levels of 70% of the installed base on homes connect. So that enables us to do the aftercare and the service delivery part in a very smooth way. And every region is a bit different. So in some regions, we go higher; in some regions, we go lower. But the average looks quite good.

Joshua Mills: Very clear. Thanks.

Operator: The next question comes from Keval Khiroya calling from Deutsche Bank. Please go ahead.

Keval Khiroya (Deutsche Bank): Thank you. And I've got two questions, please. So firstly, are you able to share how much energy is now hedged for 2024? And at what price now you're thinking about the extent of potential tailwind in '24 from energy?

And then secondly, would you be willing to run above the 2.5 times leverage ceiling at all if there's an opportunity for bolt-on M&A, whilst you're wanting to maintain buybacks? Thank you.

Chris Figee: Look, on the energy part, we've now, for next year we’re hedged about 60%. Just to give you a reference this year, we are – our total energy consumption is about 420 gigawatt hours. Average price will be around € 150 with the mix of what we brought forward in the spot market. For '24, we bought about 60% at around that price, € 150 to € 160. The spot market is a bit lower, around € 120.

So if you add it all up, we'll probably get to a flat energy spend next year versus this year, possibly a bit lower if the energy market continues to soften. But I'd be – I don't want to run ahead of myself. Let's first see if we have a relatively soft winter, but we feel confident that energy spend next year will not be higher than this year and possibly a bit of upside depending on how the market develops and 60% hedged. So we've got increasing visibility on that.

On the leverage, well, we think 2.5 times is a reasonable leverage for KPN. It's not high. It's not low. It's in the mid of the pack. And we said, look, to my view, if it were to increase a tiny bit, I can live with that for the right reasons, not organically, but inorganically is acceptable. But then again, I think discipline is worth a lot. So our perspective is, one, stay within a 2.5 times leverage ratio, also make sure we continue to reward our shareholders and don't fatten our policy. So we do pay out and we intend to pay out and expect to pay out our free cash flow to our shareholders next year.

And smaller bolt-ons should fit into the framework of less than 2.5 times leverage ratio and make sure we pay out our entire free cash flow to shareholders.

And when I look at the agenda, that still definitely fits in there in – at 2.3 times, 2.4 times, we still have €250 million to €300 million headroom on this year's EBITDA until that 2.5 times leverage. And of course, next year, we'll add next year's free cash flow to it. So when you look at the financial headroom we have – and the leverage ratio, it's been perfectly feasible to continue our current shareholder reward strategy, prioritise that, stay within a reasonable leverage. And then if small transactions happen, we'll take them. It's not a given that we'll do them. But of course, if the fiber market consolidates, we need to be on the lookout and any deal that makes more than the cost of capital could be worth doing. But then again, that should all be fitting in very well into our shareholder reward programme and our leverage.

Keval Khiroya: That’s very clear. Thank you.

Operator: The next question is from Usman Ghazi calling from Berenberg. Please go ahead.

Usman Ghazi (Berenberg): Hi, everyone. Thank you for the opportunity. Just two questions, please. The first one was, if you can update us on the situation with Huawei, please? And how do you see the risk of an accelerated rip and replace being imposed by the European Commission next year? How do you expect to manage that situation if it was to arise?

And then the second question was just, again, on mobile. I can see that DELTA Fiber and T-Mobile have kind of deepened their cooperation a bit. I think T-Mobile has given them access to unlimited tariffs. And I was just wondering if you expected that development to have any implications for competitive in terms of market or not? Thank you.

Joost Farwerck: Yeah, Usman, yeah, first on Huawei. Yeah, we carry a multi-vendor policy that's important. So we always have different options in our networks and systems, and we always have fallback plans. Having said that, we have continuous dialogue with the Dutch government, and we are monitored by the Dutch authorities. So we fully comply with the laws and regulation in the Netherlands and in Europe.

The Netherlands, from an EU perspective, have made good progress on the implementation of the 5G toolbox for instance. So I think the Netherlands is doing fine when it comes to EU. We also announced a longer time ago that we have the strategy to only run critical systems with, yeah, as we call it, Western vendors. For that reason, we're rebuilding the 5G mobile core network with Ericsson that's also known in the market.

So having said that, all in all, I think we do fine. We're confident in the strategy we have, and we report to our government on a frequent base. And we always have alternatives since we have that multi-vendor strategy in the first place.

Yeah, your second question was about the cooperation between DELTA and T-Mobile. That's not completely new for us. Of course, DELTA is an internet service provider without a mobile network. So they partner with others. And in some regions, they have fiber, and we have not. So T-Mobile making use of that asset is not surprising for us either.

So all in all, I think it's clear that we have an open network policy and T-Mobile is making use of that asset nationwide, and that's also the success of our wholesale strategy. In some regions, they use other networks, and that's perfectly fine with us.

Usman Ghazi: Can I just follow-up? Sorry, my second question was just on – I mean it seems like DELTA wants to improve the positioning of their own retail brand by offering kind of fixed mobile convergence using the T-Mobile network on their own kind of retail brand. So it is more a question of do you see kind of the overbuilders trying to improve their connection rates on the infrastructure by launching their own retail bands? Or is this not a trend in the Netherlands?

Chris Figee: Well, I think when you look at DELTA, I mean, obviously, I don't know the intricacies of those deals, right? We have not seen any contracts. But if I would be in a situation, I would probably cap or limit the amount of unlimited SIMs that you would give away.

So first of all, I don't think DELTA would be going out on a mobile-only strategy. It's really, I think, it's a converged option. And today, I read it's more a converged option to limit churn than anything else. So it's something that could happen. But then again, DELTA is the only really other big ISP out there. All the other ISPs either T-Mobile, which has a fixed mobile proposition, Ziggo has one, and we have one and Delta is the fourth and the other ones are much, much smaller. Even though the other MVNO have not been very successful in doing a convergence.

So this is the situation. I think it will not be mobile-only. I don't know, but I would suspect some cap on the amount of unlimited customers that are in there. And that is probably more churn reduction effort than anything to grow a lot faster. And when you look at, for example, the total customer experience, we find, for example, KPN is still rewarded as the best fixed ISP on fiber and on copper. We've got the best TV experience, and we've got the unlimited converged plan. So to that extent, we're not that worried about this transaction immediately hurting our competitive profile and to be more a churn reducer for delta than anything else.

Usman Ghazi: Okay. Thank you.

Operator: And the last question is for Konrad Zomer calling from ABN AMRO-ODDO BHF. Please go ahead.

Konrad Zomer (ABN AMRO-ODDO BHF): Hi, good afternoon. Thanks for taking my questions. So I've got two as well. The first one is on your return on capital employed. Can you share with us how the returns that you generate on your fiber assets relate to the 13.7% that you achieved in Q2? Are they still significantly below? Or are they already close to that sort of level?

And my second question is on future buybacks. You've indicated at the start of this year that we can now look at them as more or less structural. But given that the spectrum auction is likely to be delayed into the first half of next year, there's an increasing chance that it won't have happened before you actually report on your full year results. Could that potentially endanger any future buybacks to be announced at that sort of stage of the year? Or is structural significant enough for them to be announced whatever happens? Thank you.

Joost Farwerck: Well, I'll hand over to Chris in a minute. But on the buyback this year, of course, we also anticipated on an auction in our financial framework. So in our financial framework, we anticipate on an auction, either it takes place in the fourth quarter or in the first quarter or second quarter next year. And indeed, you're right. The rumour is that it will delay again in the Netherlands, so probably will be next year, but that's all covered in our financial framework. So no reason to do no share buyback because of an auction delaying in the Netherlands.

Chris Figee: Yes. On the second question Konrad, we always have a certain amount of money we kept aside for the spectrum auction. We try to be conservative there, and that fits into our long-term planning, including our buyback planning. So at this point, no reason to presume that the auction will have any bearing on the buyback capacity for KPN.

On ROCE, our favourite topic, we discuss every week, Joost and myself. Now on the fiber return on capital, it's in line with the Group ROCE. I mean it varies a bit per region. It varies a bit over time. You need to grow in there. But overall, the return on fiber investment, the return on capital is still very much in line with the total ROCE of the Group.

Konrad Zomer: Okay. Thank you very much.

Reinout van Ierschot: Thank you very much. That concludes our call. If there are any further questions, please let the Investor Relations team know. Thank you very much, and have a good day.

Joost Farwerck: Thank you.

[END OF TRANSCRIPT]