Event transcript
KPN Q3 2022 Results

Wednesday, 26th October 2022

Operator: Good day, ladies, and gentlemen. Welcome to KPN's Third Quarter 2022 Earnings Webcast and Conference Call. Please note that this event is being recorded. 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 star one on your telephone.

I will now hand the conference over to your host for today, Reinout van Ierschot, Head of Investor Relations. You may begin.

Reinout van Ierschot: Thank you, and good afternoon, ladies, and gentlemen. Thanks for joining us. Welcome to KPN's third quarter 2022 results webcast. With me today are Joost Farwerck, our CEO, and Chris Figee, our CFO.

As usual, before turning to our presentation, I'd 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. Let me first walk you through some of the highlights of this quarter. We continue to make good progress against our strategic and financial ambitions. Group service revenues grew for the fifth quarter in a row.

We saw a healthy customer inflow in consumer and business, especially in mobile. Business service revenues grew for the second quarter, with SME again making a strong contribution. And we see ongoing growth in consumer mobile service revenues, partly offsetting the competitive dynamics in fixed.

The improving revenue trends and sequential improvement in net promoter scores in business and consumer show that our commitment to customer centricity has paid off. ACM declared our improved fibre wholesale offer binding. The new offer has been effective since the end of August and is applicable for a period of eight years. This enables us to continue to roll out fibre at a fast pace and maintain our successful open network policy.

With solid adjusted EBITDA growth in the third quarter and a strong year-to-date free cash flow, we remain confident to deliver on our recently upgraded full year 2022 outlook despite the current economic environment.

And looking ahead, we keep working hard on mitigating inflationary headwinds. We are fully committed to our accelerate to grow strategy. We stand out as a stable company and taking into account the pricing mechanisms we have in place, our cost reduction programme, and the stable CapEx envelope, we are confident we will deliver some growth next year as well.

In the third quarter, we've made solid progress and rolled out fibre to 76,000 households. We are on track to roll out speeds in terms of homes passed slowed a bit in the third quarter, partly due to the holiday season, but also because of a change in rollout strategy, where we accelerated the roll out of the streets and delayed a bit in connecting households to optimise the use of labour capacity available.

Together with Glaspoort, our joint venture with APG, we connected fibre to 123,000 households and we currently cover approximately 46% of the Netherlands with fibre. As we continue to roll out fibre, our growing fibre footprint will result in an improved penetration rate for retail and wholesale, and we see all this effort bearing fruit in our financials.

Looking at our third quarter results, we currently generate about €940 million of analysed fibre service revenues. And this number is growing rapidly, driven by a growing base, and improved and attractive ARPU. All in all, fibre is clearly at the heart of our strategy to create long term value for all stakeholders.

Let's now move to the consumer segments. Adjusted consumer service revenues decreased by 0.8% year-on-year as consistent mobile service revenue growth was offset by lower fixed service revenues. Consumer fibre broadband revenues showed continued growth, while copper and legacy maintained its anticipated decline.

Customer satisfaction remains one of our top priorities, and it has been pleasing to see our effort pay off in this area with an NPS level that is rising again to 18.

Now let's take a deeper look into our third quarter KPIs. Our retail fibre base increased by 37,000 new customers offsetting copper churn, and this led to 4,000 broadband net adds, which we consider solid, given the aggressive promotion by our main competitor in a part of Q3. Our fixed ARPU remained broadly stable at €53.

As you can see, the fixed service revenue trend is slightly better than seen in the previous quarter and appears to be bottoming out. We continue to see solid trends in mobile. Our postpaid base increased by 38,000 and our postpaid ARPU was broadly stable, and combined, this led to 2.2% growth in mobile service revenues.

Let me now move to the B2B segment. We saw continued service revenue growth in our business segments. B2B adjusted service revenues grew more than 3% year-on-year in the third quarter. SME is the main engine of B2B growth, driven by solid commercial momentum in both the broadband and mobile portfolio. And also LCE service revenues were almost stable, partly supported by a small one-off. Nonetheless, underlying the overall trend continues to move in the right direction and we expect inflection in LCE next year.

Tailored Solutions continue to perform in line with expectations, as you notice business always remains subject to timing in projects and related sales, but also on the Tailored Solutions side good performance in Q3. Business NPS returns to plus 4 despite volatility economic environment. Customers continue to value KPN for stability, reliability and quality over our network and services. And so, I am happy with both on the consumer and business side the high NPS, especially when you compare KPN with our competitors.

As you can see on this slide, we see improving revenue trends across the board. And this, combined with a sequential improvement in net promoter score, bodes well for the future.

In Wholesale, service revenues increased around 1% in the third quarter and growth rate levelled off a bit compared to the other quarters. But this was mainly due to a tougher comparison base. Adjusted for a positive one-offs in the third quarter last year, underlying growth was still around 4%. In Q3, we've added 18,000 postpaid SIMs and 10,000 broadband lines.

Now with this, 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 third quarter. First, adjusted revenues increased 1.9% year-on-year, mainly driven by growth in business and consumer mobile and higher non-service revenues. Please allow me to point a cumulative 92,000 net adds in consumer mobile we've gained since the beginning of the year.

Second, adjusted EBITDA after leases increased by 1.8% year-on-year. In this inflationary environment, we were able to keep EBITDA margins stable at 46.2% as cost savings from further simplification, digitisation were partly offset by inflationary effects, such as raise in activation and rising energy costs. This all translated to €30 million of net indirect corporate savings in Q3 or €34 million year-to-date. Please note that in this €30 million, we absorbed €3 million of increased energy costs.

Third, year-to-date free cash flow increased 26% compared to previous year. This is mainly due to higher EBITDA and low CapEx because intra-year phasing. Our free cash flow margin has improved throughout this year. More on the underlying cash developments later in the presentation.

Group services revenues increased by 1.1% compared to last year. It is mainly underpinned by strong growth in our business segment, both mass market service revenues continue to grow as well. Business services revenues grew by more than 3%, driven by a continued strong performance in SME, while the trends in LCE is gradually improving. The shrinkage is declining according to plan. It also grew about 1% year-on-year, despite facing a tough comparable quarter from last year.

And in consumer, our services revenues declined by about 1%. The trend improved a bit compared to previous quarter, though it's still negative. In this number, mobile service revenues continue to grow and recorded a 2.2% increase. In fixed, we report a decline in service revenues of 2%, as growth in fibre was still offset by declining legacy services, less voice traffic, and the accounting effect for content packages.

For the remainder of the year, we still expect to see some technical headwinds, but the trend in consumer fixed is clearly bottoming out, supported by implemented price adjustments and commercial improvements. And of course, by Q1 next year, we'll see the lapping of the accounting effect. Overall, we're proud on the all definitions, whether it's mass market or group revenues, sales revenues, or total revenues, in any perspective, our revenue base grew in the third quarter.

Adjusted EBITDA grew by 1.8% compared to last year, driven by service revenue growth and lower indirect costs, partially offset by €27 million higher direct costs. Factored for the increase in cost of goods sold with the impact of higher non-service revenues, such as handset and hardware sales. Third-party access costs such as Glaspoort and a change in service revenue mix in B2B.

Personnel expenses decreased by €13 million, despite a one-time employee benefit of about €5 million paid out in July. This reflects a structural shift in personnel efficiencies due to the digitisation of KPN, as well as from natural attrition. Other OpEx was up almost 6%, mainly due to higher energy costs.

For 2022, we expect energy costs to be about €10 million higher compared to last year. As said before, year-to-date, we saved €34 million of indirect costs after having absorbed this increase in spend on energy.

With respect to 2023, next year, we expect energy usage to decline about 5%, driven by several measures. We have now hedged about 75% of our expected energy consumption for 2023 at an average price, which is unfortunately twice the level of this year. At good energy prices and taking into account the 25% energy consumption, we've about to buy on the spot market, we expect about €50 million to €60 million higher energy costs next year.

In 2022, we have been able to offset the industry wide inflationary pressures on energy and labour cost. We are, of course, not completely immune to this and next year will be more challenging. To manage the impact of inflation on our EBITDA, we've increased prices and have implemented a series of additional cost cutting measures.

This year, we've seen strong underlying cash generation at €673 million. Our free cash flow year-to-date is substantially higher than last year and the cash margin over revenues moves up to 70%. There is an improvement, which mainly results from EBITDA growth, low CapEx due to intra-year phasing and less cash interest rate.

So we continue to have a strong and resilient balance sheet at the end of September. As a result of higher interest rates on floating debt and other corporate actions, the average cost of senior debt increased by 46 basis points year-on-year. Early September, we issued a new hybrid bond and put out a tender for a March 2023 dollar hybrid.

The successful placement in combination with the tender enables us to protect our hybrid equity credits from the rating agencies, while limiting interest costs as we managed to match the existing interest rate of the new and the old bond. Our next point redemption only takes place in 2024, which gives us plenty of time and flexibility in the current volatile markets.

In Q3, net debt increased by €184 million compared to the previous quarter, driven by the final dividend payment in August and our share buyback programme. This, of course, is partially offset by the free cash flow we generated during the quarter. Our leverage ratio now stands at 2.3 times EBITDA, comfortably below our ceiling of 2.5 times. The acceleration of growth of our cash margins increases our flexibility around capital deployment.

Total liquidity of KPN remained robust at the end of the quarter. It consists of €1.4 billion in cash and short-term investments and our undrawn revolving credit facility. And this cash – this liquidity comfortably covers debt maturities for the next two years.

In Q3, we made very good strategic progress and delivered solid financial results. Therefore, we repeat and confirm our recently upgraded 2022 guidance of at least €2.4 billion of EBITDA and a free cash flow of about €850 million. CapEx will remain stable at €1.2 billion in ’22, but also, let me stress, but also for 2023. With this, we believe KPN demonstrates resilience in the current economic climate.

Looking ahead, though, there is obviously a degree of uncertainty about the impact and duration of inflation, mainly on energy. We continue to work hard on mitigating measures to help offset these headwinds. Moreover, demand for our essential core activity and communication services remains solid, and we have a robust liquidity position.

We continue to manage our business and closely monitor several business drivers, including payment behaviour of our customers and our data credit quality. So far, we've seen limited impact on this front, but we remain alert.

Even though, our earlier set of EBITDA and free cash flow for '23 ambitions and are not likely to fully materialise, KPN's positioning remain stable and defensive in a dynamic environment. At current inflation levels, we actually expect to deliver slight EBITDA growth next year. Hence, 2023 will not dip below 2022. As some say, we're not immune, but we are quite stable, resilient. As is customary, we'll specify our full year 2023 outlook at the Q4 2022 results.

So to summarize, KPN generated solid results in the third quarter and is trading well. We see sustainable growth in Group service revenues with positive signs across all segments. Our EBITDA and cash margins continue to grow, and we feel confident about the cash generating ability of our Group.

To me, KPN demonstrated healthy margin, earnings, and cash flow resilience in turbulent times. Our fibre rollout programme has maintained a solid pace and has a proven attractive return profile. As such, driven by a solid performance year-to-date and successful execution of our strategy will repeat our 2022 guidance. Obviously, there are headwinds out there, particularly around inflation, and we're implementing measures to mitigate the impact as much as possible to remain on track, physically and operationally, and still deliver some slight growth next year.

Thanks for listening. Let us turn to your questions.

Reinout van Ierschot: Thanks, Chris. We'll now move into Q&A. And as usual, please limit your questions to two each. Operator over to you, please.

Questions and Answers

Operator: Thank you. Ladies and gentlemen, we'll now start the question-and-answer session. If you would like to ask a question, you may do so by pressing star one on your telephone keypad. We will now take the first question from Keval Khiroya from Deutsche Bank. Please go ahead.

Keval Khiroya (Deutsche Bank): Thanks for taking the questions. And I have got two, please. So firstly, Chris, you mentioned that you don't expect 2023 EBITDA to dip below 2022. Is it possible for you to say anything more about free cash flow and whether we still expect the 2023 free cash flow to be above 2022?

And secondly, you've previously described buybacks as being part of the structure of the digital return of capital. Should we still expect you to carry out the buyback in 2023, bear in mind the current backlog? And if so, should it still mean you're distributing roughly 100% of free cash flow through dividends and buybacks? Thank you.

Chris Figee: Yes, Keval. On EBITDA, as said, we've given some indication. Obviously, we'll give you a more detailed number, if you wish, around our Q4 results, where we will do and EBITDA shows slight growth, but not to initially aim for a certain level.

On free cash flow, we're looking at a similar story. In free cash flow, there are multiple moving parts. If you peel down – peel the onion, your EBITDA will be up slightly. CapEx will be stable around 1.2. We'll obviously pay more taxes next year. We flagged that before. The way the government enables to treat our net operating losses, our taxes will go up significantly. You'll save some of on interest costs. We see opportunities on working capital.

I think on the line item delta provisions will improve. So I think the cash element of our earnings will go up. Restructurings are stable. And pensions, I think there's a small opportunity. So if you take all those moving parts, we've slight growth in EBITDA but increase in taxes. I think our free cash flow will show a similar pattern, a similar growth profile as our EBITDA AL. So flat to slightly up certainly not below this year. We see opportunities for a slight growth in free cash flow. But again, we'll give you the formal guidance by Q4.

And your latter point on capital return. Look, our balance sheet is healthy. We're still running at 2.3 times net debt to EBITDA. Now we probably dropped around 2.2 times per year-end, as in the last quarter we generate cash but have limited cash outflows. We have got significant headroom. And for all intents and purposes, I still work on the assumption that we return our free cash flow to our shareholders in a mix of dividends and buybacks. So at this point, I see no reason to change that.

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

Operator: The next question comes from Georgios Ierodiaconou from Citi. Please go ahead.

Georgios Ierodiaconou (Citi): Good afternoon. Two questions from my side as well. The first one is just a bit more clarity around energy cost increase. In the previous conference call, you mentioned around 1.5% impact. Now it looks like it could be roughly €20 million more than the second quarter. Do you mind just giving us indications as to how you arrive at this outlook for next year? Are you being a bit more conservative because of how the prices turned out during September? Or is it purely spot that you are using right now?

And my second question is around the fibre deployment. I appreciate you just mentioned the €1.2 billion for next year as far as CapEx is concerned. I was wondering, you mentioned also the bottlenecks you are facing now in terms of the rollout and the fact that you are prioritising connections; should we assume perhaps a slightly slower rollout than previously guided, given some of the inflationary pressures in terms of labour costs? Or do you still stand by the previous rollout targets? Thank you.

Chris Figee: Yeah. Okay. Georgios, on energy, I think we saw a sad state that we're all becoming energy specialists these days. So we're going to give you a comprehensive answer to how we look at energy, right?

First, allow me say, on total energy consumption, we're reducing our consumption. Think about 2020, we had a total 460 gigawatt hour energy consumption. We move down to 435 next year and possibly down below for 420, 425 next year. So step one is to reduce the energy consumption.

For '23, we're now 77% hedged, so 77% of our energy consumption has been bought. For the remainder, we'll buy on the spot markets. So details, the average price is about €145,000 per gigawatt hour, which is, a mix of different purchasing moments, right. The remainder will be bought on the spot market. And the spot market is trading around, depending what is peak load or base load around €350,000, €330,000 to €350,000 per megawatt hour, that will buy the remaining 23%.

With that, you get to about €50 million to €60 million more on the commodity for next year. And that's mostly a function on the hedges that we took, the investment or the energy we purchased during the summer.

Now it has come off a bit. Let's see what is we feel comfortable that we are moving towards spot purchases from here on. But the function is on average so far at 145,000, the remainder will be probably north of 300,000, at least it is what current trading is, and that will give you a €50 million to €60 million energy price increase.

The volatility around it is relatively limited in a sense that if you look at our aim to reduce the energy spend, the remaining 23% and a reasonable volatility in industry prices, I think the range around is probably plus or minus €8 million to €10 million, right? It could be €8 million better. It could be €8 million worse. So to some extent, we've got a reasonable visibility on the energy spend, as we bought 77%.

And as said, €8 million plus or minus is the range that we can see around it for the next year. So, to some extent, it has been locked in. And then the biggest question is where does spot market will come? Interestingly, if you look at spot energy for – the spot market today is still a lot below the forward market. So the way the spots and forward energy price will converge, will drive where you end up in the €8 million bandwidth. Obviously, it's a bit of comfort on control – details on our energy spend.

When it comes to fibre, as said, indeed, our CapEx will be €1.2 billion next year. When it comes to our rollout strategy, there are two things at play. One is KPN rolled out 76,000, but Glaspoort did more. So the entire KPN ecosystem, KPN plus Glaspoort together did 120,000 fibre rollouts. So that's actually still on track. KPN and Glaspoort together will have a record year in terms of how much fibre we rollout.

So we don't intend to slow down the pace. I think we are trying to see if we can actually increase the pace a bit. How will it fit into the CapEx envelope? Optimising the rollout strategy, but optimising our homes connects percentage, as Joost said, but looking at how we mix and manage the homes connect strategy and where you balance going to the street and connecting homes. So I don't see a slowing down on fibre. That would be strategically unattractive.

It would be kind of keeping up the pace, probably do a bit more on the KPN side, but optimising the way we roll out.

Georgios Ierodiaconou: Very clear. Thank you.

Operator: The next question comes from Luigi Minerva from HSBC.

Luigi Minerva (HSBC): Yes, good afternoon. Thanks for taking my questions. The first one is on the broadband promotions that we saw in September. So I mean, generally, it's a question about the competitive environment going forward. I'm wondering what is your view in terms of what kind of prompted your competitors to launch those promotions that obviously you followed? So what was the trigger there? And most importantly, how to avoid that this becomes a sort of a recurring pattern in the market? Because, I mean, the market structure is actually, a very constructive one I find. And so it should be possible to avoid this recurring promotions.

The second question is about the cost of debt now is going up. Of course, 36% of your debt is on variable rates. And I'm wondering, Chris, how do you feel about this and how to reduce the rate risk going forward? Thank you.

Joost Farwerck: Yeah. On the broadband promotions, indeed in the third quarter, we saw a pretty aggressive discount on the prices on the competitor side. I think it was for almost two months in the market. So, that's a bit of a traditional approach to be honest, I think, and also something we really should try to avoid.

In total, I see the market – value of the total market growing. ARPUs go up in general in the Netherlands. Mobile is growing on all the service provider sites. So on broadband, I think there's a lot of value for all to protect. But every now and then, people, I don't know, get nervous and sometimes there's a lot of pressure. I mean, we did grow last quarter 4,000. Other players on our network grow faster. So there's a bit of pressure then on the other side.

For us, it's very important to stay away from that and to differentiate ourselves us in a different way, not on pricing, but on the services we deliver, on the quality we deliver. There are things one can do with fibre. You cannot copy with coax for instance. I mean, we can go to every household with 10 gig. We can go to every room with 10 gig. We can offer three or four connections to a household via one fibre connection.

So in the future, we will for sure that is one of our strategic objectives. Make sure that we differentiate on the services and not only on the tariffs. For now, we are – we did pretty, okay. We did grow 4,000, although that campaign was out. So I think all in all, super important that we do not follow all kind of pricing things out there in the markets. We should play the game of be a market leader on quality and people pay for this. And Chris, cost of debt?

Chris Figee: Yeah. On cost of debt, you said rightly. So our book is out 36% floating. This year, our interest expense will be roughly flat. We're just ahead of last year interest saving, where there will be some coupon payments at the remainder of the year. So this year, interest payments will be flat.

I think next year, a few things are at play. Of course, we've got some senior bond redemption this year that we issued. We did a tender on the US dollar hybrid. So I think net debt, we – I think reported interest in our free cash will be down about €10 million next year. That's under the assumption that on a scenario that short term rates six months Euribor gradually moves toward 3%, which I think also what is the concern of the way the ECB handles its rate hiking process.

So under the assumption short term rates move to about 3%, our reported interest will be going down by €10 million next year. Now that’s a bit not completely fair comparison because the new hybrid will be no longer in our free cash flow. It’s equity credited instrument. If you correct, we’re at the underlying cash out from rate will be up about €10 million next year. So I think it's a manageable amount.

Of course, if we do a refinancing earlier or change our refinancing of the 2024 bond, that changes. But underlying – assuming scenario, the short-term rates move to 3%, we’ll be paying €10 million more, but are reporting €10 million less, simply because of reclassification of the hybrids. I think that's all a very manageable amount.

Can we do something about it? Well, we could re-strike some of our floating rates to fixed. We're always looking at opportunities. It depends a bit on, frankly, on the steepness of the curve, how the yield curve looks. We look at some FX restriking. But overall, I think the floating rate exposure is manageable, given that – it's a €10 million swing in the year that should be manageable in light of our total free cash flow.

Luigi Minerva: Great. Thank you very much.

Operator: The next question comes from Andrew Lee from Goldman Sachs. Please go ahead.

Andrew Lee (Goldman Sachs): Yeah. Good afternoon, everyone. I just had one question on your 2023 guidance, just to come back to that and the lowered EBITDA guidance you gave today. Could you clarify is that simply a timing issue of a lagged impact from your price rises in 2023 that won't fully offset cost inflation until the back end of 2023, and therefore there should be no change to 2024 expectations? Or have you changed your structural view on your ability to offset cost inflation with price rises? So is it either a timing issue or a structural change in your view on your ability to mitigate cost inflation? Thank you.

Joost Farwerck: Good question. I'd say it's too early to say what's going to happen in 2024 because what energy price will be in 2024? I think we have been able so far to reflect all the price increases – the cost increase and the price increases, right, and still we can be reasonably moderate. But our estimate is that our price increases will give us €100 million-plus into revenues next year if you just simply multiply delta price by base.

I think that will then be absorbed by energy cost, labour cost and lease cost. I think if I'm completely fair, the total now of price increases, given the energy freeze is slightly above what we can price the customers. And the difference is that compared to last year, price increases cannot, at this point, be used to expand your margins, right? You use your price increase to compensate for cost, not to boost your margins. So margin growth will have to come from volume increase in sales or lower unit costs.

Is it a time issue? So look, if energy prices correct later on and energy spend of 2024 become less. The whole thing looks pretty rosy, because then you see a significant price increase – EBITDA increase. I mean, look, if you look at EBITDA next year on like – EBITDA ex-energy, even if there would be a significant increase.

So I think my answer is this. One is, price increase at this point are very close to compensating for cost increases but cannot expand margins. For 2024, it depends on how energy evolves. If energy prices correct and normalise, and we can discuss what normal is, but at least drop, there you see a lot more tailwind for 2024, but unfortunately I can't promise that.

Andrew Lee: Thank you. Very helpful.

Operator: The next question comes from Joshua Mills from Exane BNP Paribas.

Joshua Mills (Exane BNP Paribas): Hi there. And thank you for the two questions. The first one, which is related to cost savings. I think you said in the past about what's your overall ambition to deliver the €250 million of cost savings remains. It might take longer to deliver. And muddling through the headwinds you've talked about so far during the call, it looks like you're delivery on costs next year will be one of the key drivers of getting that EBITDA to positive again. So my question on costs is based on the run rate you see today, what kind of magnitude do you expect to save next year, and will it be higher than in 2022? So that's the – that was the first question.

And then second question, Chris, just coming back to your comments on free cash flow being possible to grow in line with EBITDA next year. Are you referring that to the KPN defined free cash flow or the real free cash flow post the hybrid coupon interest, which, as you say, is going to be higher? Thanks very much.

Joost Farwerck: Yeah. So, on cost savings, of course, we've built a track record on saving costs in the past. Two years ago, we moved to the ways to accelerate the growth of our top line. And for the fifth quarter in a row, I'm satisfied with the growth we are developing. So it's important for a company like KPN to shift from only cost cutting to grow.

Having said that, and looking at inflation effects on costs, we are installing an additional cost saving programme to make sure that we will gain additional cost savings. Last quarter was better than the previous quarters on OpEx, and we think it's super important to make sure that wherever we can, we drive the company to more efficiency than before.

Having said that, it's also important that we're cutting the right cost, indirect OpEx, and that we are sure that we do not make the mistakes, as KPN has made in the past, that we go so far on cost cutting that we also cut in the direct OpEx, the good costs that is supporting the revenue growth. So that is very important. With having said that, indeed, we will focus very tight on cost savings for the quarters to come.

Chris Figee: Just on your – on our free cash flow, I refer to the KPN free cash flow, which is the report free cash flow that will deliver a similar performance as EBITDA. Of course, if you adjust for the re-class of the hybrid interest expense, it does more work to do. It's our aim to have it grow as well. We – definitely we're working on that. But we'd like to give a commitment on the KPN free cash flow.

Joshua Mills: Understood. Thank you.

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

Usman Ghazi (Berenberg): Hello. Thanks for taking the question. I've got two, please. The first question, Chris, was just one, again, on the free cash flow bridge that you built out for 2023. I mean, it's interesting that you said that potential there could be a small opportunity, given obviously the decline in asset values and KPN does have a defined benefit scheme. So could you talk us through how you see this as a potential tailwind rather than a headwind? And then on working capital as well, given, comments from peers that there they might have to support SMEs and things. So, just I mean, if we could give us some comfort that those two areas could be tailwinds for 2023. That would be helpful.

And then just on my second question was on the copper shutdown that will start in Q1 2023, I mean 2.3 million premises. Is that on plan? Is there – because I know that the wholesalers are pushing back against this. But I mean, is there any risk to that gets delayed? And if assuming it does go through, just from the outside, it would seem that that could have quite a transformative effect on your cost base, given it's a big portion of the homes passed – of the homes that could be shut down. So how are you thinking about that? Thank you.

Chris Figee: Yeah, Usman. On free cash flow, on pensions, indeed, we – by and large, we pay a DC free cash flow or DC pension arrangement, but it doesn't really affect us because we're paying a fixed type of premiums. However, we still have some old Gentronic pension funds in the UK and US at a defined benefit. So it's about €70 million DBO on our balance sheet. And interestingly, it's actuarial. But because interest rates increase and the rate curve has changed, the DBO is declining. So there might be opportunities to close those pension funds, you lift outs, buyouts, etc., and reduce on pension payments there.

So it's a matter of trying to use the opportunities at the US and UK rate environment provides to the actuarial provisioning for these pension funds. So that's actually a small opportunity to optimise cash flow this year and next year. And a working capital – we still see opportunities. We have – we not used any handset financing or hardly. I mean, we have some vendor financing but not a lot in place.

And I don't mean, I really want to massively go out of active handset financing because we have to look at rates of that. But the different opportunities there. The fact is that, for example, we see some opportunities to build early or to optimise the sending of invoices earlier to manage our inventory levels a bit smarter. And also to point out that legally there will be a requirement in the country to pay our SME clients within 30 days. We – that's what it take – what happen next year. We've already implemented that this year. So we're trying to reduce risks in cash for next year as much as possible and bring forward as much as possible around payment terms, around invoicing times, and then see if we can optimise some of our handset and vendor financing without going overboard on financial engineering or paying too much interest rates.

Joost Farwerck: Yeah, on the copper shutdown, you could say we are on track, although perhaps you could also say we should have started a couple of years ago on shutting down some of the areas. We had long discussions with our regulator on how to communicate the shutdown per area and that rule we now follow. So that's why we announced a lot of areas to start with in 2023, we have full preparation for that. Of course, some of the players on our network complaint about that. Also recently, some complaints have been received and also T-Mobile started a lawsuit against KPN, on us shutting down copper areas where they're still active on the passive layer, but they lost that all over. In my words, we did win that. And that's all because we just pulled out what we agreed on with our regulator years ago. So we're migrating actively customers in old copper areas. Two fibre in a copy gets kind of portfolio. And after that, we're good positioned to sell up to these customers.

So I expect us to start early in 2023 with the shutdown of the first copper areas. Of course, in the beginning, on cost saving side, that will not be that significantly noticeable, but moving on in time, it will be significant because goals related to the usage of energy and the maintenance on the network, maintenance on real estate and especially on service tickets on a copper network.

So all in all, the fibre network is far more efficient than a copper network. So that will kick in. And at the end, the whole idea is that we're building a fibreco, longer further up on the road, KPN, yeah, will be complete, 100% fibreco with all our customers on fibre. And that has then an end to end, far more efficient company to run than where we are today. So I consider that copper migration from copper to fibre has very important and a strategic milestone for us to start with.

Usman Ghazi: Just to follow up on your last point. I mean, are the bulk of these savings going to come when every last copper home has been shut down? Or can they start to come in already?

Joost Farwerck: No. The most important part is really the maintenance and service costs on a copper network in general. So more – the more customers we have on a fibre network in an area, the more efficient we are. Then with service tickets, I mean customers calling our company with a problem. Field engineer goes out to fix it and in – on the copper network, we have far more to fix than on the fibre network. Fibre, you can really run from a distance. In copper, we have to do all kinds of things, street cabinets, a number of exchanges, at the customer's premises. So I think it's really on the costs how to run that network.

Usman Ghazi: Okay. Thank you.

Operator: The next question comes Jakob Bluestone from Credit Suisse.

Jakob Bluestone (Credit Suisse): Hi. Thanks for taking the question. I've got two further short questions. One, just getting back to the issue of cost inflation. Can you just update us on when do you have your next round of negotiations on wages? I'm not sure if you'd be able to sort of comment on the sort of parameters of those discussions. But I think the Dutch minimum wage went up by 10%.

And then secondly, can you maybe just comment on how your latest price hikes in mobile landed? I think for 3-6% price hike in October. So just sort of curious if we're seeing any higher churn on the back of, I guess, what are a bigger increases than in previous years? Thanks.

Joost Farwerck: Yeah. On wages, we expect our formal meetings with the unions to start beginning of November. So – and of course, we're preparing for that also together with unions. So we are not communicating on that topic. We first want to sit together and see where we can find a reasonable outcome. And so we are – hopefully, later in the year, we can communicate on that.

And the mobile price increases, I think they did quite well. We did a steeper increase of prices than previous year's almost 6%. We also communicated that we kept it at €2, so no increases above €2 per month. So – and that landed quite well in the market. So I would say all-in-all, our price increase on the mobile side landed very smoothly in the Dutch markets.

Jakob Bluestone: Okay. Thanks.

Operator: The next question comes from Steve Malcolm from Redburn.

Steve Malcolm (Redburn): Yeah. Hi there. Steve Malcolm. I'm sure you probably realise that. Yeah. Afternoon guys. And a couple of quick questions, if that's okay. First of all just on the wholesale business. Can you maybe – I mean I know the underlying growth is around 4% this quarter. You've got to sort of make a few tweaks to get there. But in light of the recently sort of slightly tweaked wholesale agreement you have with the Dutch regulator, can you just give us a sense of whether you think you can maintain that low mid-single digit growth going at fourth quarter and going into 2023 as you look at the different mix of WBA versus ODF, I guess, upselling the fibre and all those different moving parts? That'd be super helpful.

And then just on the cost saving, as you've mentioned, I guess in the past, KPN has been a little guilty of cutting into muscle, instead of fat. And as a company, I think we all recognise you're very efficient, you're very lean. So maybe you can give us a bit of help as to where these incremental cost saving opportunities are, as you try and offset the obvious sort of inflation going into 2023? Thanks a lot.

Joost Farwerck: Yes. On wholesale, growth in service revenues in Q3 was low, but that was really due to comparable to last year. If you look at the numbers, you see broadband growth actually nice, mobile growth is nice, but the category other was less, which has to do with the one-off benefits last year in the category other.

If I look at the underlying drivers, we saw in the summer, reasonably new small broadband upticks but in September already a good number. Let's see how it goes. But somehow my intuition tells me that broadband growth will recover, although, reasonably well. It's mainly on ODF. Not too much yet on VULA. But the new VULA range has only started since September, so it's probably too early to say. And we see solid growth in postpaid.

So I don't think also we'll grow 7-8% like we did last year, but we could do up to mid-single digit too, where the revenue growth is definitely feasible into next year. Also and then maybe even especially on the back of a new wholesale ACM arrangement, where it is, I'd say, not unattractive for a third party to sell KPN lines.

So the trend of broadband I guess will be fairly okay. ODF, possibly some VULA, as VULA will be ARPU enhancing for the wholesale business. And postpaid continues to be strong. So I would say low-to mid-single digit growth in wholesale revenues is really not a strange idea.

Chris Figee: Yeah, Steve, on the cost reduction side. Yeah, one of the pillars of our accelerated growth strategy is simplification and digitalisation of everything we do. And we have a lot to do them. So we're super convinced that we can do with far better than we do today. At KPN, we have more or less 10,000 people working for KPN and we probably hire around 2,000. So that's 12,000 people working on a daily basis for the company.

And I expect that in future to be much less. So it's about end-to-end steering and simplifying customer processes, where we can benefit from. But we also added programmes like looking at overhead. So in – yeah, there's a difference between people working on a daily basis on the customer interface that we simplify and then we can reduce on FTE. But we're also looking at the FTE reduction on the overhead side, how can we simplify the way we work in offices and that we will do next year as well.

So although I know that we should not focus on direct costs, that is supporting revenue growth, I am convinced that we can do a lot there. And we started to also close down offices. So our former head office in The Hague, we will close at 1st January to reduce our cost. And there are more buildings we will close, also since people work in a different way today. The way we work is different than post-COVID or before COVID started. So there's a lot of opportunities we identified to do on top of the simplification and digitalisation to make sure that we can boost the OpEx reduction a bit for coming quarters.

Steve Malcolm: Perfect. Can I ask one quick follow-up, just on your fibre build. I mean, you mentioned that sort of restriction of resources. I mean, are you seeing your competitors having to rein in their ambitions? It sounds like you're still costing a bit more. Are you seeing a slowdown from like the KRR or is it something else you noticed so far?

Joost Farwerck: No, I think others are struggling there even more than we are. We locked in a lot of capacity. But it's fair to say that the field mechanics are different to find to these days because there's a lot to do in construction anyway. So we're working a lot with foreign teams to roll out in the streets. We're working more with Dutch teams to connect in households, and the blend of that is different than it used to be. So staffing is really on the top of our list and we have deep discussions with contractors how to, on the longer term, reinvent ourselves.

So the way we connect households is completely different than three years ago. I mean, we always moved into a house to pre-connect. We now do that from the outside, which is an innovation we did together with contractors. So it is with the labour capacity available, we try to be more efficient than in the past. And I think in the blend and compared to the others, we have far more capacity. But all – in general labour capacity is scarce and is a challenge for – yeah, for the whole industry.

Steve Malcolm: Okay. Thanks a lot.

Operator: The next question comes from Konrad Zomer from ABN AMRO-ODDO BHF. Please go ahead.

Konrad Zomer (ABN AMRO-ODDO BHF): Hi, good afternoon. I'd like to ask a couple of questions on CapEx. Year-to-date, your fibre rollout has been slightly below expectations every quarter for reasons you just explained. And as a result, your CapEx has also been on a run rate, let's say, below the €1.2 billion that you guide for, for the end of this year. Do you really think you're going to spend, I think it's like €385 million in the final quarter of the year, given that labour scarcity in fibre will continue to be tough? And does that imply that you're going to spend it on other things than fibre? And as a follow up on that, let's say you end the year with CapEx below €1.2 billion. Does that make it easier for you to look at your free cash flow and the fact that you've done a really good job there to maybe come up with a slightly bigger share buyback in February next year? Thank you.

Joost Farwerck: Well, before I hand over to Chris for a difficult part of this question, I would say that I think Q4, fibre roll out will be better than in Q3. But the way we organised our CapEx management is that there is no communication between the fibre CapEx bucket and other things we do, where we invest in. So if we will perform below the plan on fibre, that will be visible in our CapEx.

Chris Figee: Yeah, it's pretty clear. I'd say fibre CapEx and non-fibre CapEx are different buckets and there's no communication between the two. As you look at our CapEx spent year-to-date, fibre is spending less, but often non-fibre spending a bit less than last year. I think we'll still get close to €1.2 billion, given that – we may end up a little bit below the €1.2 billion.

But let's see where we end. This is still a quarter to go. What to do for free cash flow? I think we're still sticking to our free cash flow guidance. I mean, this will give us ample of opportunity also to manage our working capital smoothly over the coming years. Do we then come up with a bigger share buyback? That's – Steve, I'm not going to prelude to what we're going to announce in January.

In January, we'll announce our free cash flow and our final specific EBITDA guidance and the corresponding remuneration strategy, where principal as we return our free cash flow to shareholders and take a bit of a long-term view there as well.

But I think the most important thing to us as a management team is that there's no flow between fibre and non-fibre CapEx. You're not going to spend more in one bucket because you spend less in the other. That to me is a very important principle how we run this Group.

Konrad Zomer: Okay. And then maybe just as a quick second question on your guidance. Several investors that I spoke to today still refer to your old 2023 EBITDA guidance as a slight improvement versus 2022, i.e., the 2,450 versus the 2,400. That's like a 2% increase. You obviously do not consider the 2% increase to be slight. Is that the correct assessment?

Chris Figee: Well, look, we're seeing indeed the guidance or the ambition we gave at the Capital Markets Day back in 2020, when the world was rosy, the sky was blue, we said we aim for 2,450 with 2% EBITDA growth for next year and we set the updated guidance, given all that's happening is above this year. So it's above zero, but less than two. Well – and then I'd to dig into your models to figure out what number to pull in, what's the number in between. But it's – and it's slightly – it's a bit less than 2%. So I think our growth in EBITDA that would be between 0% and 2%. I leave it to your imagination to see what number you can come up with.

Konrad Zomer: Okay. That's clear. Thank you very much.

Operator: Next question comes from Maurice Patrick from Barclays.

Maurice Patrick (Barclays): Hi, guys. Thanks for taking the question. Two from me. First one, you talked about LCE inflecting next year being sort of starting down this year. Just curious as to why your confidence will grow next year? I mean, clearly, it's going to be difficult macro climate. What do you hear that we don't in terms of the drivers of that?

And second one is, if I understand correctly, you talked about energy consumption being down 5% next year, so actually falling 5%. If you can articulate a bit about what will drive out the decline, that would be super helpful.

Joost Farwerck: Yeah, thanks. So, on LCE, I mean it's a long roadmap we follow. So it's not as we hope for the best. By the way, we almost inflected this quarter, but that's a bit too early to call victory, because there was a couple of million to one-off in it. But still, I think organically, the run rate is improving in a bit better than planned for. But what we do there is that we migrate the whole customer base to a new platform like we did in SME, but then a different platform. And so it goes a bit slower. It's more difficult to handle because these are larger customers and sometimes they don't want to swap hardware on their sides.

But now we're over 80-85% of the migrations and the last 5% you never do. So learning from what we did on SME and following the plan and the road maps, I think that mid next year we, for sure, will show inflection on that. And that is – sometimes, it's just following run rate and keep on executing on the plan and then it will inflect.

And SME is a good proof point that have worked that way. So that's what we're doing on LCE, although it's a difficult market. And what we do is that we migrate these customers to the future. It's lower priced. It's all IP. It's much better, simpler. So that, at the end, not that much of a reason to disconnect from KPN once you're on the new platform. And that's also why SME is growing as it is today. So I'm pretty confident that we'll do that. And I'm – to be honest, I missed your second question.

Maurice Patrick: Sorry, the second one was about the 5% energy reduction you spoke about.

Joost Farwerck: Yeah, on the – Maurice, on the drivers of energy reduction. If you think very big numbers on our energy spend, it's about 60% of our energy spend is in our network, which is basically all the central locations, the fibre, and the copper network, 25-30% is in the mobile network. So the network of towers and rooftops that we have. Another 10% is the rest, which is offices, buildings, cars, etc.

So it would be savings, and of course, we’re shifting from copper to fibre. So shutting down part of the copper network will move us to a much more energy-efficient fibre network. We're trying to optimise heating and cooling, especially in our larger locations. So I'm experimenting with various degrees of temperatures and optimise our cooling there.

Then when you look at the mobile network, there is now increasingly services software available to optimise energy spend and the application of certain spectra on different mobile sites. So you look at your individual sites, you look at traffic, you try to forecast traffic and you might shutdown individual sites or take out local spectra on local sites. That will take out energy.

And as Joost said, we are really thinking our office footprint to see if we can shut down our offices. That is a potential saving. And then finally, I think as mundane in shops, we say, let's not close the door more often, use less neon advertising in shops, all the small things together. So, it’s a big chunk on our core network and fibre network. It’s a chunk on optimising energy and congestion – or energy and traffic on your mobile sites. And then, there's offices and shops which you can also do things.

Maurice Patrick: Super. Thank you.

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

Polo Tang (UBS): Yeah. Hi. Thanks for taking the questions. I have two. The first one is really just on mobile pricing. You mentioned that your recent mobile price increase has landed well, but given that CPI is now double digits, do you think Dutch consumers can absorb double-digit price rises in mobile going forward?

And my second question is really just to come back to fibre CapEx, because if you look at DELTA Fibre, they appear to be building faster than KPN and spending more than KPN in terms of their fibre rollout. So, as a result, does it actually make sense for KPN to accelerate the fibre rollout in order to reduce the risk overbuild from competitors? Thanks.

Joost Farwerck: Yeah. Polo, on – first on mobile pricing for, as you know mobile customer, the lifecycle of the mobile customer is roughly two-and-a-half years. The lifecycles of broadband customer is over 10 years. So it's super important that we have the price increase in contracts on the mobile side, which we have. So our system is that we can do more or less the full CPI correction in mobile yearly, of course, if – yeah, for next year we see what we have to do. But it's also about communication. And that's why I said that we did a pretty – from our perspective pretty heavy price increase around 6% on 1st October, but it has been communicated in such a way that people accepted this positively. And that's because we installed the price cap on the €2 all in all, end result, net promoter score improved 3 points. So that can go hand-in-hand, if managed well, I would say.

And on fibre CapEx, I mean, you're right. DELTA has building quickly. You're not right if you say that they go faster than KPN, but they pick areas. When we show up, they withdraw. All the fuss that KKR also rolling out fibre in the Netherlands. So it's a bit crowded to our opinion. So that's why I also said that we changed the rollout strategy a bit. We go faster in streets, we claim areas, and we take more time to connect households. So that's a temporary difference in rollout phasing. But all in all, I think that we have a plan in place that makes us go fast. And of course, whenever we can accelerate, we will.

Polo Tang: Thank you.

Reinout van Ierschot: Good. Thank you very much for attending this call. If there's any further questions, please contact the KPN Investor Relations team. Thank you very much.

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

[END OF TRANSCRIPT]