Event transcript

KPN Q3 2020 Results

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KPN Q3 2020 Results Conference Call

Operator: Good day, ladies and gentlemen. Welcome to KPN's third quarter 2020 earnings conference call. 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 may do so by pressing star one on your telephone. Please note that this event is being recorded. I would now like to turn the call over to our host today, Mr Reinout van Ierschot, Head of Investor Relations. You may begin sir.

Reinout van Ierschot (Head of IR, KPN): Thank you. And good afternoon, ladies and gentlemen. Thanks for joining us and welcome to KPN's third quarter 2020 results webcast. With me on the call today are Joost Farwerck, our CEO, and Chris Figee, our CFO. Before turning to the Q3 presentation, I would like to remind you of the Safe Harbour statement on page two of the slides, that also applies to any statements made during this presentation. In particular, today's presentation may include forward-looking statements, including the company's expectations with respect to its outlook and ambitions, which were also included in the press release published this morning. All such statements are subject to the Safe Harbour statement.

Let's now move to the core of the presentation. I would now like to hand over to our CEO, Joost Farwerck.

Joost Farwerck (CEO, KPN): Yes. Thank you, Reinout. And welcome to our third quarter results presentation.

Let me first take you through some of our highlights. First of all, in the quarter, we saw EBITDA growing at 1.3% and we saw solid Free Cash Flow growth. We also continue to deliver cost savings, which is reflected in the results.

Operationally, there were positive signs in the Consumer segment. We saw the postpaid base returning to growth and an accelerating inflow of fiber customers fuelling stabilizing broadband base. COVID-19 continue to impact our revenues, but lower costs partly mitigate the impact on EBITDA level.

I'm proud of our employees who continue to serve our customers in these challenging times. We execute on our strategy and with a solid set of results, we're now able to give a clear picture of the full year's outlook.

Next, I would like to highlight a few key figures. Corrected for a number of divestments, revenues declined by 3.7% year-on-year. Growth in Wholesale was offset by lower revenues from Consumer and Business. Roughly 0.7% of this decline is related to COVID-19.

EBITDA increased 1.3% year-on-year as the effect of lower revenues was more than offset by good cost control. And Free Cash Flow increased more than 7% year-on-year to € 241 million. Chris will give you more details on our financials later in this presentation.

Turning to our outlook. In the first nine months, we are on track with the execution of our strategy while maintaining a robust financial position. We are now able to give a clear picture of our full year outlook. We expect Adjusted EBITDA after leases of approximately € 2.320 billion, Capex at €1.1 billion, Free Cash Flow of approximately € 750 million. And to be clear, this Free Cash Flow and Capex outlook includes all acquisition Capex as well. We reiterate our dividend commitment and we intent to pay a regular dividend per share of € 0.13 over 2020.

In the first nine months of the year, we have seen solid progress on each of our strategic pillars. As we generally do every other year, we will host a strategic update to the market in the afternoon of 24th of November. On this day, we will provide you with an update of our strategic and financial ambitions for coming years.

Fiber is the best and future-proof technology and our organic fiber build increased further in the third quarter, even though this included the summer holidays during which construction capacity is lower. Fiber activations accelerated, providing us a solid activation rate of approximately 50% over the 12 months passed. And we continue to add new areas where we roll out fiber. We’re currently active in 90 areas and we are reaching completion in six of our 25 largest cities.

Fiber clearly outperforms copper on all metrics and fuels the stabilizing broadband base. Fiber ARPU is higher than copper. The churn is much lower and the NPS is a number of points higher.

Consumer fiber revenues grew nearly 8% in the third quarter, driven by a growing base and an uplift in ARPU. Fiber service revenues are bound to exceed copper service revenue declines as our rollout is ramping up further. All in all, we see a positive net present value from our fiber investments.

Let's now move to the performance of the segments.

Fixed Consumer revenues were somewhat lower this quarter fully driven by a decline of legacy services, such as Traditional Voice and Digitenne. The trend is starting to turn for mobile service revenues. Although still declining at 4.4% year-on-year, this is an improvement compared to the first half of this year.

Q3 NPS stood at plus 12. Customer satisfaction is one of our main priorities, so this result is clearly disappointing, and we have a plan in place to restore customer appreciation. This decline has to do with our customers having more questions and need for support now that the majority is working from home, which is putting pressure on our customer service center, a bit of an industry trend, and a change in the interface of our IPTV products, leading to questions since some customers need to get used to the new layout and features.

Looking at our Consumer KPIs across the third quarter, we can see that the converged base is relatively stable around 50% of broadband customers and more than 60% of postpaid customers. The total broadband net adds were in line with last quarter and moving towards a stabilizing retail base. The commercial success of our fiber rollout is reflected in 27,000 new fiber customers, and we’re confident that this will contribute to an improving broadband base going forward.

And after a long period of decline, the mobile postpaid base returned to growth, and at the same time we kept the postpaid ARPU stable at €17. Travel restrictions due to COVID-19 led to lower roaming revenues and this was partly offset by increased national out-of-bundle usage. We’re happy to see the underlying trend developing favorably, with improving inflow ARPU from our unlimited bundles and the effect of repricing wearing out.

Now we can move to the Business segment.

Business revenues declined nearly 8% year-on-year, largely impacted by COVID-19 as we saw lower roaming revenues and delayed IT projects. Also, our strategic customer migrations continue to impact service revenues in the short term. After the migrations, the new propositions provide us significant opportunities for up and cross-sell of additional Cloud, Security and Workspace services.

As soon as we obtained the new spectrum licenses, we switched on our 5G network and introduced distinctive 5G services for our B2B customers, as mentioned in this slide. We are currently the only operator in the Netherlands offering 5G value-added services and supporting businesses in developing new applications and optimizing their process with 5G.

We are making solid progress on the migration of our business customers to the new portfolios. However, the pace was somewhat impacted by COVID as we were often unable to enter the customers' premises. We continue to innovate our business product portfolio. For KPN One customers we now provide a 4G backup facility ensuring greater business continuity. And we added several cloud communications services such as Broadcom, Microsoft Teams to our Smart Combination portfolio. And these are indispensable features for teamwork when working from home.

Let's move to Wholesale.

Correcting for the sale of NLDC, the data centres last year, revenues in Wholesale increased by almost 5%, partly supported by the sale of small assets. We added 22,000 broadband lines in our Wholesale segment. So looking at our total portfolio of Wholesale and retail, we see solid growth of broadband penetration on our network, leading to a total broadband network share of approximately 52% in the Netherlands. We also renewed another long-term MVNO contract in the quarter. All in all, another good quarter for our Wholesale division.

And we believe that sustainable business is better business. We have reached some important milestones in this respect and we also have an ambitious agenda for the years to come. We commit ourselves to the three sustainable development goals from the United Nations mentioned in this slide. And during the quarter, we made some nice contributions to these SDGs as you can see over here. Our efforts in this respect, do not go unnoticed and KPN continues to be recognized by various ratings and benchmarks.

Now I would like to hand over to Chris to give you more details on our financials.

Chris Figee (CFO, KPN): Thank you, Joost. Let me summarize our Group financials for the first nine months by explaining like-for-like performance.

The Adjusted revenues of KPN declined by 2.9% year-on-year, partly attributable to COVID-19. The Adjusted EBITDA after leases increased 1.5% year-on-year. Some lower revenues were more than offset by strong cost savings, net-net leading to a positive result. Our EBITDA margin improved 200 basis points year-over-year, to about 45%. And when we compare Q3 of this year to Q3 last year, we see a growing EBITDA.

Year-to-date, Free Cash Flow grew by 13% versus the same period last year. Our operating profit was € 150 million lower due to several incidentals like the book gain on the sale of NLDC in 2019. However, excluding these incidentals, operating profit would have increased by € 29 million year-on-year.

Similarly, net profit was € 144 million lower as it was boosted by the same incidentals last year. Excluding these, net profit would have increased by about € 31 million, mainly driven by lower financing costs.

When it comes to control, to cost and cost control, we are continuously digitalizing and simplifying our company, leading to improved services and more efficient operations. We are well on track with our cost savings program and realized an additional € 44 million savings in the third quarter. Also due to COVID, we see lower cost in areas of travel, learning and development, and housing and facilities. In total, this year we reached about € 115 million cost savings. In total, since the beginning of the program, we have saved € 256 million. And we are confident we will exceed our € 350 million target by the end of the year 2021, with about 75% of our targets after 7 out of 12 quarters have gone by.

Operational free cash flow for the first nine months of the year stood at € 900 million, stable at 23% of revenues. This number was somewhat lower compared to last year fully driven by different Capex phasing through the year. In terms of Free Cash Flow, we've seen a strong increase this year. Our Free Cash Flow of nearly € 500 million year-to-date, was 13% higher year-on-year and moved to also 13% of revenues, a high Free Cash Flow margin. This is a result of lower cash restructuring, lower cash interest, some lower investment in working capital year-to-date and lower cash taxes. We ended the quarter with a strong cash position of about € 800 million and expect this to grow further, whilst having paid € 381 million as a final spectrum payment and € 180 million interim dividend in the quarter. We refinanced a € 460 million bond in September.

We have committed to being more open about the working capital position, as you can see on this page. Notable effects impacting our working capital position to-date are lower trade receivables, mainly driven by lower sales levels. Trade payables are lower due to specific initiatives. Generally speaking, we see a peak of incoming invoices in December and we see lower accruals driven by settlements, lower interest accruals and bonus payments related to 2019.

Our working capital program has yielded tangible benefits, being much less of a drag on Free Cash Flow within the first nine months of last year. Actually, in the third quarter, working capital contributed positively to the Free Cash Flow, although year-to-date working capital is still a drag on our cash.

The prepayment related to spectrum auction is corrected at the bottom again. It is formally a prepayment, but not a working capital item. To be specific – this is the portion of the auction related to 2100 megahertz frequency.

KPN's total liquidity was strong at the end of the third quarter. It consisted of almost € 800 million of cash and € 1.25 billion undrawn revolving credit facility. During the quarter, we issued a € 600 million Eurobond at a 12-year tenure with a very low coupon of 0.875%. We initiated the issue of € 500 million but saw ample demand and the order book was 4.5 times oversubscribed.

As said, it was redeemed to € 460 million Eurobond that was swapped to a fixed rate of just over 1%, lowering cash interest by € 5 million next year. In sum, these transactions lower our average cost of debt and increased the maturity profile of our debt book to about 6.4 years. All in all, KPN's liquidity is sufficient, abundant and covers debt maturities for the next three years.

In terms of balance sheet, our financial position remains solid. At the end of the quarter, our Net debt to EBITDA ratio increased slightly to 2.4 times, driven by spectrum and interim dividend payments. We expect to drop marginally during the rest of the year. Interest cover ratio improved to 9.2 times. And the weighted average cost of senior debt was 65 basis points lower than last year.

Since we want to be open and transparent, we find it important to continuously improve our disclosure. We've consistently delivered more disclosure on critical items and are on track to fulfil and complete our disclosure agenda for the year.

In the Strategy update planned for the end of November, we'll give more insight into the open points, one, the fiber-related Capex, by splitting Capex further into fiber and non-fiber, and into household steering by Consumer to be specific and ARPA reporting, and thereby complete our disclosure agenda for the year.

So then the summary to close of this short presentation. KPN had a very healthy financial quarter of EBITDA and Free Cash Flow, both up versus last year. We'll provide more specific granular full year outlook and are on track to reach it. The encouraging signs of a Consumer segment. The mobile market showing improving dynamics, a strong fiber uptake gradually outweighing a declining copper base.

In B2B, we continue to face revenue headwinds, but are progressing with consumer migrations and product innovations. In Wholesale, we see ongoing success of our fixed and mobile portfolio, indicating a successful open network policy and we maintain a robust balance sheet and solid liquidity position.

Finally, we look forward to informing you more on our ambitions for the coming years in about one month from now.

Now back to Reinout and to your questions.

Questions and Answers

Reinout van Ierschot (Head of IR, KPN): Thanks, Chris. We can now turn to your questions. As usual, please limit your questions to two each. In case there's still time left you can always ask more questions later in this Q&A session. Operator, over to you.

Operator: Thank you sir. Ladies and gentlemen, we will start the question and answer session now. If you would like to ask a question, you may do so by pressing star one on your telephone. Star one for your questions or remarks. Go ahead please. Our first question is from Mr. Michael Bishop of Goldman Sachs. Go ahead please, sir. Your line is open.

Michael Bishop (Goldman Sachs): Thanks. Just the two questions for me then, please. Firstly on the FttH build, as we think about moving into next year and beyond, could you just give us an update in terms of the discussions with respect to contracting more build capacity in the Netherlands and how they're going and whether you're still thinking the same sort of 500 to 600k run rate is something to target in '21 and beyond?

And the second question is on the mobile service revenue. You mentioned that trends were now turning. So how should we think about the mobile service revenue again going into next year as you potentially start to have some easier comps? Thanks very much.

Joost Farwerck (CEO, KPN): Yeah. Thank you. First on fiber build. What we did is scaling up our fiber rollout production capacity to a level that we didn't do for a decade or something like that. So a lot has to do with the lock-in of the construction capacity. And that's what we did. Having said that, we're scaling up in a very efficient and solid way.

Last year, we did like 100,000 Fiber-to-the-Home connections. I think this year we will reach a level 300,000. So 500,000 to 600,000 is a little bit stretched to be honest for next year. For me, it's important to scale up in a decent way to a level of 400,000 or above. And then we're on the scale that we've never done before at KPN. And then we're on a scale that we do almost the same amount as the whole consolidated market this year in the Netherlands. For that, we have locked in the capacity and it's very important for us that we do it in such a way that it is also from a pricing perspective efficient.

Mobile service revenues, yeah. So first of all, maybe Chris you can take over. I am or we as a company are super focused on improving that trend because for a long period of time we were under pressure. I think KPN is positioning itself much better in the markets, either on the higher end of the propositions with Unlimited, also more in the lower-priced segment, although most of the real low-price propositions are eliminated in the market.

So I'm happy with the trends and it's for us very important to continue. Maybe you want to add something on the –

Chris Figee (CFO, KPN): Yeah, Michael, on the mobile service revenues, if you look at that one single revenue line, on a sequential basis, it has been actually fairly flat during the year on mobile service revenues. If I look at the progress into current and future quarters, and I break it down base times ARPU, base witnessed growth for the first time in a long time. Actually, when you look back, the numbers start to grow end of June on a monthly basis. And at this point in time, we still see continued positive base developments so far since June.

When it comes to ARPU, our ARPU has been of course had a slight decline this year but all around it's at € 17, so close around to € 17, where in the summer we expected a more negative impact from roaming and of course a negative impact was there, but countered by supported from out-of-bundle calling.

So, our ARPU over the summer kept better than we had actually hoped for. And then the two other elements are the leakage from repricing of our back book is turning less and less, so net inflow values becoming better. And secondly, we see some ARPU support from more unlimited propositions.

I don't think our ARPU will immediately go to € 18, but we see in general quite encouraging base developments and stable to possibly slightly growing ARPU going forward if we manage to hold on to an increasing share of unlimited. So for mobile service revenues, we actually see quite a good outlook.

Michael Bishop (Goldman Sachs): Thanks. Really helpful detail.

Operator: Our next question is from Mr Luigi Minerva of HSBC. Go ahead please sir. Your line is open.

Luigi Minerva (HSBC): Yes. Good afternoon. Thanks for taking my questions. The first is on your outlook for Capex and Free Cash Flow. I think you are presenting a very convincing picture with regards to the fiber case, the fiber upgrades. Likewise you signal in the presentation that you may exceed your cost savings target. So, my question is whether you can afford increasing Capex going forward while preserving still the Free Cash Flow generation that we will see this year? So, whether there is enough room on the cost saving side just to reinvest cost savings and Capex while preserving Free Cash Flow generation?

And the second question is on an update on the regulation side, as the Electronic Communication Code becomes part of a national law. What is the outlook you are envisaging in terms of particularly Wholesale fiber access? Thank you.

Chris Figee (CFO, KPN): Okay. Luigi, when it comes to Capex, you have to wait for more detail until 24th November, but I give you a few snippets, right. We see high attractive returns on fiber. We are accelerating the rollout, so going forward, Capex allocated to fiber rollout will go up. On the other hand, we see non-fiber Capex to come down. We'll save an non-fiber Capex. And then gradually with the cost opportunity kicking in, that will also provide support to our Free Cash Flow.

Now the final numbers, bear with me, it's only four more weeks, so we'll give you more integral view. But the components will be around supporting our EBITDA and cash generation of cost savings, slimming down non-fiber Capex and increasing fiber Capex. And that will lead to a final outcome. And also to point, of course, at the other day, after Free Cash Flow your dividends, the progression of our dividend, that is really sacred. I want to definitely preserve that.

But rest, Luigi, that is what I can tell you right now and first. Bear with us, in four more weeks, we'll give you the full picture.

Luigi Minerva (HSBC): Thank you.

Joost Farwerck (CEO, KPN): Yeah. And then your question on regulation. Yeah, so BEREC guidelines to be implemented mainly with respect to symmetrical access of course is what we focus on. Yeah, so what we think is that we maintained our open policy. We allow access to passive infrastructure where possible. There is abundant investments in fiber in the Netherlands.

There are at least two high-speed fixed connections in every home or premises in the Netherlands. So, that is what we think why we don't need an ACM regulation as we used to have in the Netherlands based on the EECC. Although we understand that our regulator of course is working on that and we're in close contact with them. We expect ACM to open up the consultation on their policy in the coming months.

There is some delay in the Netherlands. So they will implement, but the whole process of the consultation will take longer than planned for, so that will move deeply into next year. Yeah, so where we come from is that we appreciate the fact that we need a regulatory framework. Currently we're not regulated, that's due to all the discussions we had with our regulator. But we think that we should avoid further price regulation on our access obligation and the current framework is running quite well.

The best proof point is the market, the Dutch market. So if you look at what's happening now is that we lost 4,000 Consumer broadband customers and we saw an inflow on the Wholesale side of 22,000. So, other service providers competing against KPN are doing good business on our network. So, that's the best proof point, but we're in the middle of the process. It will take somewhat longer due to delay on the government side, but in the end it's something we had to cover of course.

Luigi Minerva (HSBC): Thank you.

Operator: Our next question is from Mr. Usman Ghazi of Berenberg. Go ahead please sir.

Usman Ghazi (Berenberg): Hello. Thank you for taking my question. My two questions are, there's one on Free Cash Flow and the other one is on network separation, please. So on Free Cash Flow, I guess, you put out the guidance for the full year €750 million, which is implying that in Q4 the Free Cash Flow could be down around €30 million roughly year-on-year. Given that the first nine months is up €50 million year-on-year, I mean, why should we expect Q4 Free Cash Flow to be down significantly, particularly, given it's a working capital – big working capital inflow quarter? You're obviously doing well on that front. So, yeah, any colour there would be interesting.

And then the second question was, I was wondering if you could update us on just the Board or the management thoughts on how you view the advantages or disadvantages of network separation at this point in the deployment cycle of fiber? Thank you.

Chris Figee (CFO, KPN): Yeah. Look, on the first question, I'll take it on our Free Cash Flow. Indeed your point mathematically is correct. A few points coming in when you look at our EBITDA, not all EBITDA is coming in in cash in this period at this point in time. You see some delta provisions. Secondly, on the interest rate side, a small point that we've got to issue the bond, a short first coupon. So, there will be some smaller interest payment in December.

And finally, indeed, we do see working capital commitment in the fourth quarter that has to do with the phasing of Capex through the year. So, our Capex is more evenly spread throughout the year. And last year we often had a spike in Q4. This year Q4 will have the repercussions of Capex increase in the year.

And then of course the fiber ramp up will also require some prepayments. So it's a combination, mainly on Capex timing on the fiber component that will have a drag on working capital in the fourth quarter and then some smaller effects being the short first coupon, so on non-cash EBITDA or EBITDA that comes in in cash with gradually over time that ultimately will lead to fourth quarter Free Cash Flow.

Joost Farwerck (CEO, KPN): Yeah. And on the topic of network separation, so of course always an interesting topic in our industry. First of all, I see the value of having a clear visible NetCo on one side and a good service provider on the other side. And that's exactly the outcome of our Simplification program.

We are simplifying the back-end and the front-end of the company at the same time. But we're moving to a far more clear, visible NetCo, ServCo model and it's very interesting to run your company like that. The current value we see is to keep it integrated as one company and by that, create the most value.

Of course, I looked or we looked a lot to what's happening in other countries. I think in some countries, network separation was a bit artificial, splitting up a company with pricing agreements between the NetCo and ServCo being artificial as well. But in the Netherlands, that part is moving to a more market pricing. It – like I just said on the Wholesale side is working.

We're simplifying the back-end of our company. We're rolling out more and more fiber and we're simplifying the ServCos. We have Solcon, Simyo, Telfort, KPN. We took our Telfort. We're migrating the broadband base as we speak.

So probably in a couple of years from now, we have a logical moment where you suddenly see a ServCo and a NetCo being KPN. And that's the outcome of our Simplification program. I don't believe in an artificial split in the wrong moment of time.

Usman Ghazi (Berenberg): Okay. Thank you.

Operator: Our next question is from Mr Polo Tang of UBS. Go ahead please, sir.

Polo Tang (UBS): Yeah. Hi. I'd like to have two questions. The first one is really just about the fiber cost per home passed. So I think previously talked about roughly €700 per home passed. But are you seeing the cost come down as you scale up the fiber build and commit to more volumes going forward?

And the second question is really just around your business unit, because we've obviously seen revenue declines there accelerate to minus 7.9% in Q3 after minus 5.7% in Q2. But can you clarify how much of this step down was because of absence of roaming and how much was because of proactive measures and transformation that you were doing away from legacy revenues or were there other factors? And are there any data points that you can share that would give us comfort that business revenue declines can ease going forward, and that underlying in business trends in the unit are resilient despite COVID-19? Thanks.

Joost Farwerck (CEO, KPN): Yeah. Thanks, Polo, for your questions. Your first question was on the fiber rollout costs. Yeah, so in the past we were above € 1,000 per house. We went down and down and down and then we aimed for something like € 750, which was also related to the areas we picked.

So it really depends on the area one picks when it comes to rollout costs. On these areas, we do like € 700 today. When we move to other areas, it could be like € 800 or € 900. So, it's really where we rollout. Others did rollout the rural areas for instance. We never did that because that's like € 4,000 or € 5,000 per household. So, it depends on the business model.

Maybe a one-off fee you can ask from your customers that you move in these kind of areas. But on the current rollout, I think, Chris, we do roughly for an activated line between € 800 and € 900 but then the activation is until the FTU included. So, it's Fiber-to-the-Home moving into a household into the cabinet with an FTU on the wall. So, the only thing you need is a modem.

So, if I look at the way we contract now, the contractors' costs are always getting cheaper because of the rollout – the numbers we give them and the areas we select and the time we give them to stay in an area like that.

Chris Figee (CFO, KPN): Yeah. It's function of, I think, the naked price per home is gradually coming down. It's not a revolution, but gradually coming down. At the same time if you move from the more dense cities to slightly more the outer suburban areas, they tend to have more digging distance. So, you'll dig more metres in the ground, that means that it has a upward effect on our cost. So the clear cost per house is coming down a bit, but you sometimes have to dig a bit further if you move away from the highly populated areas to the more suburban areas. To us it's important when you lock in your production capacity at the right numbers, at the right price and that makes it kind of predictable.

Polo, your second question on the business segment. Do you mean roaming or COVID has a significant impact on the business segment mostly on the roaming. Interestingly for example in the consumer segment, we saw the roaming drop compensated by about more out-of-bundle calling. But you don't see that in business. So I'd estimate that the EBITDA decline in business is about 60% driven by COVID-related revenues, 40% other. And COVID is, to a large extent, is roaming. But it's also networking, IT, hotspots and IT revenues. Now of course the roaming at some point it's not going to decline any further. So the year-on-year comps will start to look better in 2021. So, I would estimate 60% of the EBITDA decline is COVID, 40% is not. The other 40% has to do with some ARPU pressure in mobile, underlying and the structural decline in fixed voice, that is counted by increasing base numbers. But net-net, it leads to a decline.

So for a chunk of the decline, the year-on-year I think the comps will start to look better next year as, for example, roaming cannot drop below zero and also the uses of hotspots to WiFi locations cannot drop below further next year.

Joost Farwerck (CEO, KPN): And when it comes to B2B, we always talk about the top line pressure in B2B and when it's going to inflect in the future. I hope to give you more insights in how this is build up between SME, LE and the real Corporate customers, because 50% of the EBITDA we make in B2B is SME. So – and there we're much further than on the Corporate customers. So, it is important that we give you more insights there.

So, we're more positive than we were on B2B or at least I am more positive than I was on the B2B outlook than perhaps two years ago. It will not inflect soon, but parts of it will and that's the higher value part. So, that is important for us to focus on and to give you more insights in.

Polo Tang (UBS): Thanks.

Operator: Our next question is from Mr Keval Khiroya of Deutsche Bank. Go ahead, please, sir.

Keval Khiroya (Deutsche Bank): Thank you very much. Two questions please. One on the FTE reductions and one on working capital. So firstly headcount reduction. Obviously we have seen a slowdown in the rates of cuts this year and also quite a modest cut in Q3. Would you mind giving us an update on how we should think about the pace of reductions going forward? And then if you can share that discussions with the unions as well?

And then secondly on working capital. You've obviously done a very good job at improving the working capital outflow. Previously you have discussed that it looks to be negative as the fiber rollout ramps up. Is there anything you could share about how we should think about that going forward, whether that would still be the case as fiber continues to ramp up? Thank you.

Joost Farwerck (CEO, KPN): Yeah. Thank you. On FTE reduction, yeah, first of all, when COVID-19 started, we took the decision somewhere in March to stop the reorganizations and the request of devices we were going to send to our works councils for the period Q2 and Q3. So, we stopped that for six months and we gave it a go a couple of months ago.

So, we delayed in FTE reduction. We didn't delay in FTE spend. We immediately took the action to send a lot of hired personnel homes. So, we have a blend of like roughly 10,000 KPN people and 2,500 hired people on a daily basis. And we really did a tough action on the hired staff. And now we're scaling up the reorganizations again.

So on FTE, we will not meet our original plans, although things are moving up to a speed we are used to, a level we're used to. We're in good conversation with our works council and our unions. And we will continue there. I mean, we're simplifying the organization and we all understand our works council as well that it doesn't make any sense to stop since the laying off people when you simplify, because that's not good for the people either. You can't hostile them in KPN. We're good for our people. We increase salaries. We took all kind of measures to make them comfortable at home. We give them additional pay-out per month to support them at home. So, I think all in all, we did a good job. And that allows us now to continue our reorganizations as well, which is at the end good for the company and so good for the people working in KPN.

Chris Figee (CFO, KPN): When it comes to your working capital question, I mean, the upward push on working capital from fiber definitely is there. I mean, it's an inherent linked to that piece of that business activity, where fiber you tend to pay more upfront versus the non-fiber Capex. So that investing in fiber has an upward push in working capital.

We've been able to mitigate some of it both in our fiber contracting, so arranging payment terms with some of our construction companies and contracting partners. And improving the working capital on the non-fiber space by invoicing earlier or paying later, changing payment terms, think about rolling billing solutions for our customer, etc.

So, our working capital program has been kind of all-inclusive and broad encompassing many features. So, we have been able to mitigate some of that fiber impact. At the same time, I can't fully mitigate it because the inherent shift to fiber will create upward push in working capital. And again, we're trying to compensate in many other areas.

And I'm proud of what we have seen so far. The successes have been pretty good, but there still is an undercurrent of working capital increase that is most – you feel it when you see an increase in fiber. So, as we said also at the beginning of the year, the delta in fiber, the increase in fiber commitments actually that drives that working capital push and that's what we experience this year. But again, pretty proud of what we've achieved and how we've been able to counter some of that. But I can't take it fully away.

Operator: Our next question is from Mr. Paul Sidney, Credit Suisse. Go ahead please.

Paul Sidney (Credit Suisse): Yes. Thank you. Good afternoon. Just a couple of questions, please, from me. The first one just on fiber. Can I just clarify some comments you made on the fiber build in response to an earlier question? Did you say that you've done 120,000 by the end of 2019, around 300,000 likely this year, but reaching the 1 million by end of '21 perhaps looks a bit of a stretch, just so I have understood that correctly?

And then second question on the Dutch broadband market. Your retail broadband adds have stabilized helped by fiber and Wholesale continues to do very well. Do you see this now as a much healthier balance between retail and Wholesale, especially post the move away from Telfort? Thank you.

Joost Farwerck (CEO, KPN): Yeah. I think to start with your second question, I think the balance is much healthier because in the past we saw like us losing 20,000 customers and we saw 20,000 customers coming in on the Wholesale side. So, that's not a good picture. The current balance looks much better.

Of course, on the retail side, we aim for crossing that zero line and grow, but it's pretty good leverage on the Wholesale side. So we are successful on fiber. The fiber case works. We go above 60% penetration of lot of areas, but that's done with the other service providers our wholesale customers as well.

And a long time ago, I was part of the team that built the fiber case and we always included wholesale as important part of the business case because if you want reach levels of 70% or 80% penetration, yeah, it's best for the market to do it together with any other providers. So, this is a good balance.

On fiber build, I didn't mention 1 million not to reach next year. But I think if you look at the line of 120,000 last year, this year 300,000, yeah, then we are going to reach that 1 million for sure, that I promise you. But probably it's not going to be end of next year but a quarter later or two quarters later.

For me it's not that important. That's just a number and we will continue to rollout fiber, but we should do it in an efficient way, in a prudent way, keeping an eye on our financial but also operational excellence. We come from an era where fiber NPS was -14 because of everything we did in areas before we connected customers.

So, the current thing is that we execute end-to-end on the fiber value chain and that's working quite good. It's a careful process. If we scale up above 400,000, reach a level of 450,000 next year, we do almost 100,000 more than we ever did. So I like the idea of 1 million in three years, but doing like 600,000 per year is a bit too stretched for next year. So, I would aim more for 450,000.

Chris Figee (CFO, KPN): Look, I think, Paul, we've done 73,000 homes passed in this quarter in the summer and we'll continue to ramp up. You can see the weekly production scheme going higher and higher. And we'll continue to increase our weekly production in these weeks. So, expect a quarterly production of the third quarter with at least 75k, to possibly a bit higher.

So, that means if you think about that, we'll get very close to 1 million. We may miss it by a few months. But if you look at the speed that we rollout on a quarter and I think you're going to get to 80,000 to 100,000 per quarter pretty quickly, then the million we will reach. It may take a month or two longer but that's kind of the scale of the deviation that we're talking about.

And as Joost said, I think I'd rather do it in a measured way being effective and try to convert customers. That to me is the most important thing to be controlled and the million we will reach, it may take a month or two longer but that's kind of what we're talking about. Given the scale of what we do.

Paul Sidney (Credit Suisse): And then just a quick follow-up. Once you hit the million, presumably the plan is still to just push on and keep on going?

Joost Farwerck (CEO, KPN): Yeah. So that's why I say it's – I mean, I don't wake up in the morning with that 1 million in my head. Our TDO does by the way. That's his target. But we're not going to scale up and then suddenly stop. We've been there. And it's super inefficient. So we need a machinery that is working consistently against low cost efficiently first time right. And we want to see these kind of numbers.

We want to see that the connection is first time right and that we don't have to send two or three field engineers. I'll give you an example. We always talk about rollout cost per homes passed, but behind that is a service engineer, field engineer cost that – in the past we used to send field engineers three times to a household before we connect a customer real-time. So fiber rollouts, engineer and one engineer into the home to install the FTU and then at the end an engineer to the households to activate the customer. We now decide the way of one engineer taking care of everything. So maybe these contractor cost are not going down, but they do much more for the same amount of money and they activate customers for us as well.

So, that all is now in the machinery. We're improving there. And scaling that up in the first time right way. And then ending above 400,000. Then I feel pretty good. And we don't meet 1 million next year, but we will meet it, like Chris said, couple of months later.

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

Operator: Next question is from Steve Malcolm of Redburn. Go ahead please, Sir.

Steve Malcolm (Redburn): Yeah. Good afternoon, guys. Yeah, two questions please. One just on B2B. I think you don't give us an EBITDA. Can you give us an idea of what the drag on Group EBITDA is from the underlying declines in B2B is at the moment? And I guess what the price is from a Group perspective when stabilizing that number, that'd be really helpful. And then just on the price rise. I mean, you take a price rise every June-July every year, but it's slightly different this year. So just understood – any comments you've got any feedback from the customer behaviour arriving at that price rise? It seems like all the KPIs were pretty solid, or whether you were seeing a sort of particularly different behaviour on TV kind of spin down, fiber, those kinds of things. It'll be interesting just to understand how the price rise landed this year relative to previous years. Thanks.

Joost Farwerck (CEO, KPN): Yeah. Thanks. Yeah, to be honest, it landed much better than last year. We are – yeah, we have a communication chief by the way and we really worked on the introduction of the price rise this summer.

So, we made it less aggressive and we explained that we do it on a level that we do on the CLA to our own employees. So we increased the CLA to our employees, and on the same level we increased our tariffs, because we think that all companies should increase their CLAs, the salaries for the people because of the CPI and little bit on the positive side that we were there for us I should say. But at the end, we had a whole story line build up. Listen, this is what we do on salaries increase to our people. But we have to do – yeah, more or less the same to the increase of tariffs out in the market because of that.

And it landed quite well. It landed much better than last year. So what we learnt is that if you not only plan for the price increase and how to do it and introduce it technically, but also anticipate on the way you inform the media, you're preparing the media for that and it's very helpful. So, not much of a negative impact there. And we did in the middle of COVID by the way.

Chris Figee (CFO, KPN): Yes, last question – sorry, go ahead.

Steve Malcolm (Redburn): Yeah. I mean, I guess those are lessons that you will maintain in the business for the price rise next year. So we should expect the communication to be similar around increased prices [inaudible].

Joost Farwerck (CEO, KPN): Yeah. No, absolutely. I mean, we aim for a price rise every year as you know. And like I said, what I learnt is that communication helps. And when you really hired one of the best people in the Netherlands, and yeah, although we are in communication, we always can do better on communication ourselves and that's what we did very well here. So we learned from that and we will continue to be better on that next year.

Steve Malcolm (Redburn): Okay. Great. Thanks.

Chris Figee (CFO, KPN): Steve, to your first question, if you think about the EBITDA to date and if you think of the delta EBITDA Q3 to Q3 or Q3 ’20 to Q3 ’19, I mean, rounded numbers, think about B2C being about €5 million off the business segment in €20 million off and the rest is made up by Wholesale and cost savings in the rest of the business. That gives you the EBITDA delta Q3 ’19 to Q3 ’20. That’s kind of where it is order of magnitude. So the €20 million of business segment off, I think 50% to 60% of that is COVID, the rest is underlying business pressure. So, that gives you a bit of a feel for the underlying dynamics of results.

Now you need to take it with a bit of a grain of salt because of course some of our TDO network business works for these segments. So, these are not end-to-end numbers but simply the EBITDA as a reported internally. Not with forecast allocation. But to give you a feel for what the drag is on – of the business segment which – in COVID and non-COVID part. Hope that helps you.

Steve Malcolm (Redburn): Okay. So I’m just sort of trying to revisit the lines. You’re saying just over half the €20 million quarterly in B2B is COVID. The rest is underlying. Would it be right to say that if you can stabilize that, there’s mid-tens of millions annual benefit to the EBITDA line. Is that a fair assessment?

Chris Figee (CFO, KPN): If you stabilize the COVID portion you mean?

Steve Malcolm (Redburn): Well, assume the COVID portion comes out or even reverses in next year, who knows what next year will look like, but if we assume that it is one-off and just under half is underlying, you can stabilize that bit. Then the underlying improvement is what I’m trying to say is like to get to stable would be a mid-tens of millions benefit to the EBITDA line. Is that fair?

Chris Figee (CFO, KPN): Mathematically you’re correct. If you do that, that’s the right. The hard work is stabilizing it, right? I mean, I’m not sure when we could stabilize it that, but in an Excel world you’re correct.

Steve Malcolm (Redburn): It’s just that it’s not happened, yeah, but I get the message. Great. Thank you.

Operator: Next question is from Mr. Joshua Mills, Exane. Go ahead please.

Joshua Mills (Exane): Hi there, thanks for taking the questions. Two from me. The first was just on the net promoter scores. You showed it for B2C and B2B. Could you give us an idea of how the market NPS was developed over this period? I'm just trying to understand this – if this is a general frustration around COVID issues and that your position is still quite strong relative to peers, or if there’s a more KPN specific issue here?

And then the second question just around your network strategy. So we’ve spent a lot on this call discussing your own rollouts and in the past you’ve also done kind of bolt-on acquisitions. Just be interesting to hear your high-level thoughts on network co-investments. So, have you ever thought about doing rollout alongside partners like DELTA Fiber. And if so, do you think that that would be allowed by the regulator or there are additional conditions to think about? Thanks very much.

Joost Farwerck (CEO, KPN): Yeah. On the NPS, like I said in my introduction, it is a bit of an industry trend that the NPS is under pressure and not surprisingly because, yeah, suddenly from one day to the other, all people started to work from home. And yeah, asking for a better support on whatever, TV, WiFi and also suddenly full family, especially in the Netherlands when the schools closed, I mean, we saw the traffic pattern changing after people started to work from home and that was a more or less the peak capacity on 18:00 in the evening. But when the school closed, we more or less that – the peak went up and we have a lot of capacity. So that wasn't the problem. But that means that the whole family is depending on that one broadband connection, that's the lifeline of a household suddenly. And that's when people start calling. We have a product out in a market, very successful, twice sold out during COVID called SuperWiFi. It's a mesh-based. You just plug it in and you have much better WiFi. But always people call for this kind of service. So that's what we saw.

We also see there's an industry trend. The thing is that we are – on NPS, we were much higher than Ziggo. We used to all – in the years ago be below zero and we increased to a super high level of 18 I think beginning of this year. But if you go high, you can fall deeper than the others as well. So we see it coming down over all service providers in the Netherlands and in the industry. Since we are far out the highest in the market, we are falling more points than the others. And yeah, it is an important target, a holy grail, the bonus payment for all employees in KPN depends on the NPS scores. So we are obliged to really focus on that.

And our network strategy, we did do every once in a while, a co-invest deal, smaller ones. Usually, we move on a network or we share a rollout plans and after a while we consolidate, that's done on a small scale. We did one last quarter. I forgot the name of that – Giesselanden - footprint but that's so small. So, we're always interested in those kind of opportunities when it works out in a positive way for KPN. So if there's anything new on the horizon on that matter then we will, of course, mention that.

Chris Figee (CFO, KPN): Yeah. I mean, just having the regulator would not necessarily be against it as long as you continue to apply an open network policy on wherever you partner with. If you get an open network policy, so as long as whoever you partner with is open to that. I think that I don't see any major regulatory objections.

Joost Farwerck (CEO, KPN): And the interesting point is that now we have complaints about us pushing others aside when they try to roll out fiber. And it always leads to questions from municipalities. So, if you share forces with another, yeah, that one is solved as well. But, so we've worked in the past. Maybe it can work in the future as well.

Joshua Mills (Exane): Great. And so just one very small follow-up. On the net promoter scores, are you still on the consumer side ahead of VodafoneZiggo or have you dipped below them as a result of the NPS drop this quarter?

Joost Farwerck (CEO, KPN): Yeah. So we are on plus 12 by head. I think they are around eight. But yeah, I always focus more on my own performance than Ziggo's, that's my problem probably, but I think we're above them still.

Joshua Mills (Exane): Very clear. Thank you.

Operator: Next question is from Mr Ulrich Rathe of Jefferies. Go ahead please.

Ulrich Rathe (Jefferies): Thank you. I have two questions please. The first one would be the personnel cost reduction excluding any divestments was -15% in the third quarter and that was -9% last quarter. So it's much, much faster. And I think during your prepared remarks, you talked about slowing down the hired work quite sharply. And I was wondering of that -15%, is it possible to get a sense of how much of that is sort of the step down in hired work due to the COVID situation and how much is a more sort of underlying sustainable rates?

And my question is – second question is, at what point under Dutch rules would KPN have to disclose the approach of an interested party or a party that might want to take over KPN? And what part of the rules that would point these situation has escalated to a point where you have to sort of announce that or talk about it? Thank you.

Joost Farwerck (CEO, KPN): Yeah. Okay. Thank you. Yeah, on personnel spend, I mean, 15% is not what we do an annual level and not what we do year-after-year. So, that is pretty tough. So parts has to do with COVID in the first place. When we realized that we had to close all shops and send all our service centres home, we stopped field engineers for a couple of weeks to work in customer premises. And we realized that we had to do something. We kept on playing also all the hired hands I think for a month and that was much better than other companies did in the Netherlands. But then we took the action since we stopped the reorganizations to – yeah, to lay them off. And by that, keep very good eye on the cost side. Also costs related to people working like travel expenses, we really stopped and we did cut a lot there.

So, also reduction we were planning to do anyway. And by the way, what we also learned is that inefficiencies in our company are suddenly very visible due to COVID-19. And after this pandemic crisis is over, we will benefit from that because we will never go back to the same cost level of hired people, travel expenses, office spend, etc.

So, what part of the COVID reduction we will probably keep for the years to come. So still it was a good quarter on personnel spend, I would say, a little bit helped by COVID in some kind of a funny way.

Chris Figee (CFO, KPN): Yeah. I think you look at on KPN, if you look at the staff developments, it was before the restructuring reorganizations have been delayed somewhat that are being picked up right now. But at the same time we've installed a pretty drastic hiring freeze, so we've looked at the number of new hires in the – real new hires in the group. We look at about five to eight a month, so which is quite little when you look at 10,000 people staff level. So, effectively installed the hiring freeze. With that, we can still shrink our FTE base somewhat because as natural attrition has ongoing, people are still retiring.

I think we said a lot on – as we always said on hired staff, external staff. We're restructuring our shops and the way we operate our shops. So, finding ways to cut back on cost. I think we're going to continue to be low and reducing on FTE spend, but again maybe not at the same magnitude and pace of this quarter.

Joost Farwerck (CEO, KPN): Then your second question was when we are obliged to publish information in case of approach by PE. Yeah. So, we're obliged to immediately publish price sensitive information in general, provided it's sufficiently concrete. So, the necessity to publish anything in case of an approach by a party will highly depend on the concreteness of any proposal and of course on our consideration on, yeah, on such a proposal.

So yeah, whenever there is price sensitive information, we have to inform you there. Yeah. There's no reason to publish anything on the rumour I mean.

Ulrich Rathe (Jefferies): Makes sense. Thank you very much. Thank you.

Operator: Our next question is from Ms Siyi He of Citibank. Go ahead, please.

Siyi He (Citi): Hi, good afternoon. Thank you for taking my questions. I have two please. The first one is your B2B top line. I understand that the business migration has been one of the biggest drags to your top line development over the past few years. And now given that the majority of the heavy lifting of customer migration almost done, I wonder if you can help us to think about what's the next step for your B2B plan and how we should we think about the trajectory going forward.

And my second question is on Huawei. I understand that you are in a process of replacing Ericsson with Huawei in your antenna network. Do you consider there could be a potential risk to your current mobile network strategy given what happened in Europe in general towards Huawei equipment? And I wonder if you can just give us idea hypothetically if the Netherlands were to ban Huawei in both core and antenna networks, how do you think the potential costs incurred and whether there is contingency plan built into the current Capex budget? Thank you.

Chris Figee (CFO, KPN): Well, on the first question on the B2B top line, some of the revenue decline has been self-inflicted due to migrations. We've made quite some progress there especially on the SME side. I think in the large corporate segments some migrations are still to be done and possibly a few may have revenue consequences. We're carefully weighing the timing of that. We have taken into account the lessons learned from the previous migration and seeing well how manage it and how to limit the revenue implications. So we're not done there yet. But we've made quite some strong progress.

What does it mean going forward? Well, look, if you look at our SME – our B2B business, SME is about one-third of revenues but over 60-70% of EBITDA in the business. There most of the migrations are behind us. Our focus will be on cross-sell and upsell. Already we're seeing gradually clients taking on more than two products are taking up our integral product proposition.

So our focus will be on the SME segment growing there through higher ARPU and mobile getting Unlimited in the SME segment out and increasing our cross-sell. In the Corporate segment, you'll see making some remaining migrations, has been some revenue implications but on the large corporate segment we really focus on the value not on the volume because volume there immediately goes at the expense of your margins.

So, that's kind of how we think about the business segment. We have some migrations to be done and focus on SME on cross-sell, up-sell increasing. It's like a more-for-more strategy also with regards to Unlimited in a mobile base and in the larger Corporate segment continue to focus on value first and volume later.

Joost Farwerck (CEO, KPN): Yeah. On the Huawei, yeah, let me first say we have a multi-vendor policy. So we use, in our networks, Ericsson, Nokia and also Huawei in some areas. We're in constant dialogue with our government on the topic of Chinese technology. We also look a lot at what's happening in other Western European countries. We had a lot of contact with Deutsche Telecom, BT, etc., and what they are doing.

We already announced our policy before our government did anything on this topic when we said we were going to replace our critical systems for Western technology over time. So, in the lifecycle of assets, that's a very important one. And you're right. We are moving Huawei in our radio access network, but last week we announced that we will build a new 5G core network with Ericsson. We were working on a tender for a long time because in the lifecycle, we need to upgrade our core network in the coming two years. And Huawei is in that domain as well present and we're going to phase them out and move Ericsson in.

So, when it comes to critical domains, we think it's best to move in other suppliers. When we are in the process of upgrading or rebuilding an asset. And on the radio, yeah, we are in constant dialogue with our government and we think we move according the guidelines we get from our government.

Siyi He (Citi): That is very clear. Thank you.

Operator: Our next question is from Mr. Frederic Boulan of Bank of America. Go ahead please sir.

Frederic Boulan (Bank of America): Hi, good afternoon, gentlemen. Two questions from my side. First of all on the Free Cash Flow outlook. So, if I understand your 1 million fiber ambition for 2021 is unchanged. If anything, you might be a few quarters late. And beyond that, you're saying that the incremental rollout could be to a degree absorbed by a reduction in elsewhere. So, I'm trying to understand a bit what it means for your Free Cash Flow. You've not reiterated the 2021 outlook today, which implies a step up in cash flow in 2021. So can you detail whether the broader framework is still valid, or is there other moving parts we should be aware of working capital elsewhere?

And then second just to follow up on the previous question on potential PE interest, whether you can just clarify for us whether you've had discussions with any potential partners? And what do you think would be – can guarantee that a potential buyer would have to put on the table for an offer to be acceptable for KPN, the Board, the foundation, etc.? Thank you.

Joost Farwerck (CEO, KPN): Yeah. So, to start on the PE topic, I think, like I said, there were some rumors in the market and I have nothing to add to that. We don't react on rumors. If there's anything we have to mention to the market, we will do that in a prudent way, but we don't react on rumours. So that's for the PE topic.

Free Cash Flow next year, maybe – so we gave more than clear guidance for 2020. We're planning to provide you a regular strategy update on 24th November. And since we're entering 2021 and it's the final year of the plan we announced in 2018, and we have new management in place and we think it's a good moment in time to inform you further on the 24th. And like usual that will include our strategic ambitions not for 2021 only but for the period of 2021-2023.

And we will give then a full integrated picture of our strategy. And without going into further details today and maybe, yeah, Chris, you can give some background to our thinking.

Chris Figee (CFO, KPN): Yeah, I think, I mean, so like – so what I will do we protect our progressive dividends. You see – you may see the more allocation to fiber in different forms, see how we can do more, can we do faster. I mean, of course we talked about of the 1 million homes but there are other opportunities as well, for example, in business parks, where you can invest in.

So, there's a number of fiber initiatives we'll undertake. So fiber Capex will go up. And we'll be scaling non-fiber Capex down. And then some of that will lead to more guidance for next year. But yeah, just bear with us until 24th November, if you don't mind.

Frederic Boulan (Bank of America): Thank you.

Reinout van Ierschot (Head of IR, KPN): Okay. That's it. Thanks for joining us today on the Q3 call. If you have any further questions, please contact the IR team at KPN. Thank you.

Chris Figee (CFO, KPN): Thank you.

Joost Farwerck (CEO, KPN): Thank you.

Operator: Ladies and gentlemen, this concludes today's presentation. Thank you for your participation. You may now disconnect your line. I wish you all a very good day.

[END OF TRANSCRIPT]