Event transcript KPN Q1 2023 Results

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Analyst Coverage

Operator: Good day, ladies and gentlemen, and welcome to KPN's First Quarter 2023 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 might do so by pressing star one on your telephone keypad. I will now turn the call over to your host for today, Mr Reinout Van Ierschot, Head of Investor Relations. You may begin, sir.

Reinout Van Ierschot: Thank you very much. And good afternoon, ladies and gentlemen. Thanks for joining us for today's call. Welcome to KPN's First Quarter 2023 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 2 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: Yes. Thank you, Reinout. And welcome, everyone. Thank you for calling in. Well, let me start with some highlights from the quarter. In the First Quarter, our group service revenues continued to grow. And within the mix, our business service revenues grew for the Fourth Quarter in a row, and that's mainly driven by continued strong growth in the SME segment. And consumer fibre and mobile service revenues showed continued growth, partially offsetting the competitive dynamics in the broadband markets. And together with our friends from the joint venture Glaspoort, we added 113,000 households to our fibre footprint.

In the First Quarter, customer satisfaction levels improved across the board and we once again received an award from Umlaut at this time for having the best mobile & fixed network in the Netherlands. And moreover, KPN was also recognized as the best, all-in-one provider of the Netherlands. And the good news is both on fibre on the first place and copper, we come in on the second place, demonstrating that our investments in qualities of our customer service are working well. As expected, EBITDA declined somewhat due to the cost inflation, and the free cash flow was impacted by intra year CapEx phasing. We expect our EBITDA and cash generation to improve throughout the year in the coming quarters and therefore we confidently reiterate our outlook.

Now, as usual, Chris will give you more details on our financials and walk you through the outlook of this year. But first, I'll take you through the business details. And once again, we've made good progress with our accelerated growth strategy. We started more than two years ago. We continue to focus on the key pillars of our strategy.

The first is to leverage and expand our superior networks. Second, grow and strengthen our customer base. And lastly, to continue to simplify and streamline our operating model. We intend to present a strategy update to the market at the Capital Markets Day later in the year.

The fibre rollout is on track to cover approximately 80% of the Netherlands end of 2026. In the First Quarter, we rolled out fibre to 85,000 households. I already mentioned Glaspoort. Together we did 113,000 households and we currently cover more than half of the Netherlands with fibre. We expect a gradual uplift in fibre rollout numbers in the coming quarters.

Our continued fibre rollout and growing fibre footprint is delivering an improved penetration rate for retail and wholesale. Looking at the results of the First Quarter, we currently generate almost €1 billion of fibre service revenues per year. This is in consumer market and this number is growing strongly driven by a growing base and an attractive ARPU. So all in all, fibre is clearly at the heart of our strategy to create long term value for all the stakeholders.

So now let's move into the consumer segment. Adjusted consumer service revenues were nearly flat in the First Quarter. On one hand, we see consistent mobile service revenue growth driven by base development and growing ARPU. And on the other hand, our fixed service revenues were impacted by anticipated declines from KPN's legacy portfolio. Now, despite the rising cost of living impacting general customer sentiment, I must say, at KPN, we continued to lead the Dutch market in customer satisfaction.

I'm happy to mention our investments in service and quality of our products and the support of all the colleagues working in that environment are really paying off. Net Promoter Score improved sequentially and remains one of our top priorities. Now let's take a deeper look into our First Quarter KPIs. Retail fibre base increased by 35,000 customers. Despite a solid subscriber inflow, our total broadband net adds showed a small decline. In March, we observed a gradual improvement in our order intake. So going forward, this together with the new portfolio line-up and the customer focus should support an improvement of our broadband base trend again.

Fixed ARPU remained broadly stable at €53 and combined our fixed service revenue decreased 1.7% year-on-year. Our postpaid base increased by 11,000 and the postpaid ARPU grew almost 1%. And combined this led to a solid 3.4% growth in mobile service revenues. Then look at the B2B segments, we saw continued service revenue growth in our business segment. The B2B adjusted service revenues grew more than 3% year-on-year in the First Quarter with growth across all segments.

Business Net Promoter score improved further despite the volatile economic environment. So also B2B customers continue to value KPN for the stability, reliability and quality of our network and services. SME is the main engine of B2B growth, driven by solid commercial momentum, especially in mobile. We serve our customers via our cloud based KPN EEN platform, and the customer base is doing good, But also LCE continues to move in the right direction, showing growth for the Second Quarter and we are finalising the migration of our customers from legacy portfolio to the new environment and we are confident we are on track here to create more growth in the segment.

Tailored solutions continued to perform in line with expectations. And as we communicated previously, this business remains subject to the timing of projects and related hardware sales. In wholesale, service revenues were broadly flat in the First Quarter and the growth trend levelled up compared to previous quarter due to the impact of several positive smaller one offs in Q1 last year. But looking forward, I'm confident that we get back to the growth trends in wholesale again. We added 25,000 postpaid sims in the First Quarter while our broadband base was stable.

Now, before I hand over to Chris, I would like to mention that we included our ESG disclosure in today's presentation. In the appendix, we include a slide with more insights and additional KPI’s regarding some of our non-financial ambitions in this respect. And from today, and in line with our commitment to sustainability, we will be able to track our performance on carbon reduction, circularity and diversity on a quarterly basis.

And with that, let me now hand over to Chris to give you more details on our financials.

Chris Figee: Thank you, Joost. Let me take you through some more financial numbers. Let me start by summarising some key figures for the First Quarter. First, our adjusted revenues increased 1.9% year-on-year, mainly driven by growth in business and consumer mobile and higher non-service revenues. Second, adjusted EBITDA after leases decreased 1.6% year-on-year as sustainable top line growth was offset by higher costs.

In the First Quarter and in line with our expectations, our cost base was affected by inflationary headwinds such as wage indexation, rising energy costs and higher lease costs. This translated into €12 million higher indirect Opex. But actually, if you were to exclude our higher energy costs, adjusted EBITDA would have been in line with last year. And while it's still early days, if the moderation in energy spot prices continues, there remains some scope for modest upside to our 2023 EBITDA guidance. In the meantime, we keep working hard to further reduce our energy consumption.

Third, free cash flow decreased 20% compared to Q1 last year, mainly due to higher CapEx as a result of intra-year phasing. We'll offer more detail on underlying cash developments later in this presentation. Group service revenues increased by 1.2% when compared to last year, underpinned by especially strong growth in our business segment. Business service revenues grew by 3.1%, mainly driven by continued strong performance in SME, while both LCE and tailored solutions also contributed to growth. SME again outperformed against our expectations with about 7% growth in service revenues versus last year.

Wholesale service revenues were broadly flat year-on-year, but should resume positive growth in Q2 again. And in consumer, the service revenue trend improved slightly compared to the previous quarter, but still marginally negative. Mobile service revenues continued to grow. In fixed, we reported a decline as the growth in fibre was offset by declining legacy services, less voice traffic and the accounting effect of content packages.

For the remainder of 2023, we continue to expect some headwinds, but the year-on-year trend is expected to improve, supported by our implemented price adjustments and commercial improvements. Moreover, the accounting treatment held back our reported broadband service revenue growth in the past 12 months will have lapsed when we meet again and we present our second quarter numbers.

At €164 million, our free cash flow margin declined to 12% of revenues. The delta in free cash flow is explained by different phasing of fibre-related CapEx. For 2023, we expect a more evenly distributed CapEx level throughout the quarters. For the other free cash flow items, the impact of higher cash taxes, working capital phasing and lower EBITDA were offset by lower interest expenses and restrained restructuring charges. All in all, and in contrary to 2022, we had a relatively soft start to the year in terms of cash generation.

As highlighted to our full year results, we expect this year's free cash flow to be somewhat back end loaded, reflecting also the timing of EBITDA generation, CapEx phasing and improvements related to working capital and other items such as cash taxes. So looking ahead, we expect gradual improvement in this free cash flow number throughout the year and remain confident to deliver on our free cash flow targets.

Finally, we end with a strong cash position. We continue to have a strong and resilient balance sheet at the end of March with a leverage ratio of 2.2 times comfortably below our self-imposed ceiling of 2.5 times. Also, our interest rate coverage ratio remains strong, although the sequential increase is related to the phasing of interest payments and expected to normalize in the remainder of the year. As a result of higher interest rates and floating debt and other corporate actions, our average cost of senior debt increased by 146 basis points year-on-year to 3.9%.

In March, we redeemed the remaining outstanding principal amount of about $150 million of our US dollar hybrids. Our next bond redemption only takes place in 2024, which gives us plenty of time and flexibility in current volatile markets. Moreover, due to the current volatility, where we swapped some of our floating debt back into fixed, and as a result, our exposure to floating rates was reduced from 36% to 17% of our debt. Total liquidity remains robust.

It consists of €1.5 billion in cash and short-term investments and our undrawn revolving credit facility. So overall, we're very much on track and confident to deliver on the 2023 outlook we gave to you in January. So to summarise, KPN generated results in line with expectations and we continue to make good progress with our accelerate to grow strategy. We see sustainable growth in group service revenues with positive signs across all segments, especially gradually improving order balances in the retail segment.

Our fibre rollout programme has maintained a solid pace and has a proven attractive return profile, and KPN continues to lead the Dutch market in consumer satisfaction, as evidenced by the awards that Joost mentioned and our NPS improvements.

Finally, it is expected as indicated earlier to you, we had a relatively slow start compared to the previous year in terms of EBITDA and cash generation. However, the sustainable service revenue growth run rate and the measures we have put in place provide us with confidence in our ability to return to EBITDA growth this year and therefore we constantly reiterate our outlook. We expect the coming quarter, Q2 to be around flat versus last year and in Q3 and Q4 to show solid positive EBITDA growth again. And we observe and expect a similar pattern for our free cash flow. Thanks for listening. Now let's turn to your questions.

Reinout Van Ierschot: Thanks, Chris. As usual, I'd like to remind you to please limit your questions to two. Operator, over to you, please.

Operator: Thank you very much. Ladies and gentlemen, we will start the question-and-answer session now. So as a reminder, if you would like to ask a question, you may do so by pressing star one on your telephone keypad. To withdraw your question, please press star two, star two to withdraw your question. The first question comes from the line of Luigi Minerva calling from HSBC. Please go ahead.

Questions and Answers

Luigi Minerva (HSBC): Yes. Good morning. Thanks for the presentation and thanks for taking my questions. The first one is on the outlook for B2C service revenues starting from Q2 onward. I'm wondering what are your expectations based on the phasing of promotions in the market and yeah, the competitive dynamics that you've observed in recent weeks.

And the second question is on just to get some more colour about management change. So Marieke Snoep is transitioning from head of B2B to head of B2C. And I'm wondering what kind of B2B lessons can be helpful for B2C, particularly I'm thinking about managing the transition away from legacy services, fixed services products, which is basically what is keeping your fixed service revenue in B2C in negative territory. Thank you.

Joost Farwerck: Luigi, on the outlook for B2C service revenues, if you start with the underlying drivers, obviously we had some negative net adds in broadband in Q1 and slightly subdued postpaid net adds in Q1. On postpaid, we had some bringing forward of churn due to a number of technical measures that will revert in Q2. So I expect in Q2 for the mobile net adds to go back to the – net adds closer to the run rate we had on the average of last year.

And when you look at the underlying order balances on broadband, we've seen in the last few weeks since mid-March and the markets are to normalise, they look a lot better. So I expect to also see better and possibly positive net adds in broadband. If not, it will not be spectacular, but at least no longer the decline in broadband net adds if the market stays where it is. Which means that I think in Q2 you'll see mobile service growth to go up, now at 3.4%, it will get closer to 4 I think.

Fixed service revenues will – is bottoming out, will not be flat in Q2, but getting closer to zero. So that means the total consumer revenues should be positive in Q2. And if you then implement the price increases, it's my understanding or expectation that even fixed will cross the line in Q3 and become positive. So basically underlying gradual improvement in market circumstances, reversion of temporarily increased churn in mobile with better net adds if not spectacular, but at least positive that will support, as I said, improving service revenues in mobile and bottoming out in fixed. And if you think through price increase possibilities bearing of course a market that goes and preserved again, but normally speaking, you'd expect also fixed to cross the zero line and start showing some positive service revenue numbers as of Q3.

Yeah, Luigi, that one on the management change. Good. By the way, you mentioned it. Yeah. So not unexpected for me, but Babak Fouladi decided after four years – four-and-a-half years in KPN to move back to the UK and he did a great job. Jean-Pascal Van Overbeke decided to step down as KPN board member for personal reasons. So that then gives me – us the opportunity to do a bit of strengthening the team and do a reset where needed.

So we decided to move Marieke Snoep from B2B to B2C. I think Marieke did a great job on B2B by reorganising the business in a more logical way, split it up in three business segments and then motivating the teams to do the job. And that is the real challenge in B2C.

We have a plan. We know exactly what to do. It's based on fibre, but it's also about improvements we do in customer environment. It's about a regional approach we installed in the Netherlands because we compete against players in different regions with different tactics. So all in all, it's not on what we have to do but on how we do it. And that is where Marieke comes in. So I'm confident that she can really encourage the teams to go faster on the execution of our plans. And I'm happy with the move from Marieke to B2C.

Then on B2B Chantal Vergouw moves in from a Dutch insurance company. She knows KPN because she was in the supervisory board for a year. Yeah, she's super-motivated and a high talent. She understands the Dutch market quite well. She's in the content of B2B, so she makes a flying start and already in touch with the different team members. And in our technology and operations department, Wouter Stammeijer who is already working in KPN for more than 12 years, did a great job on strategy and other projects. Last six months, he was in the heart of the end-to-end fibre steering to improve that part of our business. So he's now moving into operations and also he has the ambition to go faster on the execution of things.

So all in all – and then again, Chris here sitting besides me is still unchanged. It's still the same Chris. And myself didn't change. So all in all, I'm happy with the new team. It's really working and I'm looking forward to work together with the team.

Luigi Minerva: That's great. Thank you, Joost, for the explanation. And Chris, if I may quickly follow-up with regards to price increases in H2, I think Ziggo has announced they will apply inflation. In the past, KPN has matched salary increases with the price increases. Should we expect same rationale?

Joost Farwerck: Well, Chris mentioned the cost increases we faced in Q1 and the energy, labour costs pretty high up because we do CLA increase of 6.5% this year. Yeah. And when we take the decision on price increases, especially in consumer internet, we always take a look at what we do on the CLA. So it's pretty – I think our expectations were quite well that we will work a bit in that line, but of course we have to take the final decision somewhere in the coming months. But it will be higher than last year.

And we also now follow a kind of a bit different strategy because last year we changed all contracts in consumer segments on broadband and we installed a clause that gives us the opportunity to do a price increase so we don't have to go out on a communication scheme two months in advance to inform the whole base. So of course, we will communicate to the base the price increase, but will be a bit less loud than last year.

Operator: Thanks for the question. The next question comes from the line of Maurice Patrick calling from Barclays. Please go ahead.

Maurice Patrick (Barclays): Yeah. Thanks for taking the question. Just that – well, I thought we’re talking pricing too much. I just wonder your thoughts in terms of how much of the price increases that you'll put through or flow through to ARPU, one of the big discussions seems to be amongst companies that net and gross price increase offset by down spending, some churn. From your experiences, how much of the price increase that you put through do you think will flow into ARPU?

And just a quick follow-up on the previous question, if I may. On the broadband net adds, did you say that you said it will go back to growth in Q2 or should be broadly flat in Q2? I wasn't quite sure what you said in the broadband net adds. Thank you.

Joost Farwerck: Well, broadband net adds, yeah, we plan for growth. It's always a bit tricky to predict what's going to happen in the coming two months, but looking at the current flows, I'm – we're in a better shape than Q1, let's put it that way. But let's wait and see. But of course we aim for growth. At the end, that's why we do all the fibre instalments.

And on pricing, yeah, you're right. That's a good question. There's a base, we do a price increase and one suspects – expects that the price increase to be reflected in service revenues, and it depends a bit on the base and the back book and the front book, etcetera. So in mobile we have a consumer base postpaid which is growing and there's two movements in that base. It's KPN moving customers more to unlimited improving ARPU, and it's Simyo doing more the growth of the Simyo base. So in Simyo, our strategy is to grow the base. In KPN, the strategy is to improve the ARPU and the plan of that is reflected in ARPU improvements. Anything to add to that, Chris?

Chris Figee: Look more on the growth and development. The first month of the Second Quarter is not yet final. So it's early days. But as I said if I look at order balances, they look increasingly positive. Of course, they will take some time to convert into net adds and as always the cancellation risk. But Q2 will not be spectacular but we've not given up hope on small positive broadband numbers. So it's not spectacular, but certainly better than Q1 and an opportunity for some positive broadband numbers.

And ARPU, yes, right. There's – ARPU drop, there's a couple of things, right? There's always the secular decline in voice. So fixed voice is gradually fading out. That is a structural development. We've seen some migrations on back book to front book, although that slowed down a bit after we have a commercial action slowdown. So that could also be supportive. So we have some comfort that of the price increase it will be slightly more sticky than last year given the underlying developments that we see at this point. But again, it's something for us to also be very watchful when it comes to that point.

Maurice Patrick: Great. Thanks so much.

Operator: The next question comes from the line of Usman Ghazi calling from Berenberg. Please go ahead.

Usman Ghazi (Berenberg): Hi, gentlemen. I just wanted to make sure you can hear me first.

Joost Farwerck: Yeah.

Chris Figee: We can hear you.

Usman Ghazi: Great. Thank you. So I just wanted to look at the fibre revenue growth trend versus the corporate revenue growth trend in the consumer market or in the consumer segment. And what I can observe is that the growth rate in the fibre service revenues, they used to be roughly 14% through most of last year. It's come down to roughly 10% in Q1. Meanwhile, the copper declines that were roughly 14% or above 14%. If I adjust for the various revisions that took place in Q1 last year, obviously reported, you're seeing copper is down 11, but excluding these one offs, it seems to be down less than 10%.

So given the accelerating kind of migration from copper to fibre, it seems somewhat counterintuitive that fibre revenue growth has come down and copper declines have come down as well. So could you perhaps provide more colour just as to function of more price promotions in fibre or something else? That was the first question.

And then the second question was just on the – if there's any update on the market analysis that the regulators are preparing on the broadband market. Thank you.

Chris Figee: We've seen normally fibre growth higher than copper growth. We have some net add decline in fixed service revenues. Fibre growth came off a bit interesting. When you look at the fibre numbers, it was still net add positive. So if you take net adds fibre and if you exclude whatever copper migrations there were, so growth net adds minus migration from copper, there is underlying growth in fibre. So fibre still is attracting net add new customers to KPN and KPN network.

Slightly less in the First Quarter than what we had last year and we relate that to the commercial intensity in the market. Actually, fibre gross sales were higher than ever in the last quarters, but also churn was higher. And I think that's all to do with the severe price competition. So my explanation is that, yes, you're right in your observation, Gross adds fibre is very high, churn is also a bit higher in fibre. But the net adds copper migrations were still positive, but a bit less than what we were used to.

Although if you look in the quarter, you can see from Jan to Feb to March, gradual improvement of the net adds in fibre. So I'd expect this trend to be supportive. And thirdly, on the European side, we did see some more discounts and customers who then went and went in for a full discount. So that also showed up in some of the fibre numbers. So, it's – to me it's a function of the commercial intensity. And I think the fibre growth relative to copper growth would normally stabilise in the rest of the year.

And when it comes to the ACM, the answer is we don't know. I think they're working on a review of the market. I don't know exactly where it stands. We do not expect any surprises from them. Interesting then they pointed out in a press release some time ago that they were looking in parts of the cable market in Amsterdam particularly, but also they said that there was no concern on the fibre market. They felt competition in the fibre market was safeguarded and safe. So I don't know what their timing is, but I don't expect anything that – any surprises there. Yeah.

Joost Farwerck: And these market analyses is something they have to do on an annual basis. So that's not a surprise for us. But so we are pretty confident that our wholesale framework stands as supported by ACM recently.

Usman Ghazi: Great. Thank you. Just to follow-up on the wholesale, so the question is going to come up anyways. But the volume intake is a bit lower on wholesale. You mentioned obviously cable being aggressive so the alternative providers struggling a bit. Are you considering maybe taking a tactical approach to incentivizing wholesalers a bit, given the cable strategy?

Joost Farwerck: Well, in wholesale, we saw the same development, similar development as in KPN so affected by the commercial intensity of the market that's faded a bit during the quarter and normalised. So you saw also a gradually improving wholesale order balance. What I find interesting is in wholesale we have a large client and some other clients. We saw also the smaller clients recover. So the summary answer is one, similar development as in consumer affected in our view by the commercial intensity of the market. And the good news is recovery during the quarter and a broadening base of wholesale customers in broadband.

And now that you're not asking it, we're talking about wholesale. I just want to make sure you guys will see we had some lower growth in wholesale mobile, but that was very much a year-on-year effect. If you go back to Q1 last year, we saw a really big spike in service revenues mobile, which was driven by a one off. That caused a year-on-year mobile growth to be negative, if you correct for that. And that was a one off in service revenues last year which was not even all margins, but a one off in service revenues.

If you correct for that, the underlying mobile growth in wholesale in mobile is still positive. So summary is encouraging trends in, if not spectacular, but encouraging trends in broadband wholesale in the quarter and similarly underlying growth in mobile better than what was reported to this one year-on-year comparison. And that will also show up into improving wholesale service revenue growth in Q2. So you got a full bonus question on you.

On the broadband market in general, the Netherlands, it's fair to say, okay, there was one broadband service provider introducing pretty aggressive discounts. We decided not to react on that because we're, like I said, differentiating ourselves on quality, on the quality of the customer service and products. But other players on our network didn't either. So the good news is that it's not a market where we all follow the sharp discounts of one player. And so, I think that broadband market is repaired a bit in March on that.

Usman Ghazi: Thank you.

Operator: The next question comes from the line of Konrad Zomer calling from ABN AMRO ODDO, BHF. Please go ahead.

Konrad Zomer (ABN AMRO ODDO BHF): Hi, good afternoon. Thanks for taking my questions. The first question is on your free cash flow development related to a more smooth CapEx development throughout the year. Is it fair to say that you also think that your fibre rollout might be more evenly spread throughout the year, as in we're likely to see more quarters with less than 100,000 homes passed from KPN than we might have seen in the past?

And my second question is on your price increase again. It seems that the main date that you might put that through will be the 1st July. Why would you not bring that forward? Is there a contractual reason not to do it or is that a commercial reason not to do it, given that your two competitors already put through significant price increases before you did?

Joost Farwerck: Well, to start with the second one, and then I'll hand over to Chris. But so what we saw is that usually T-Mobile is doing a price increase beginning of the year. So no change there. We saw an announcement of another player in the market early, but not followed with the edge by the execution that will be done later. So that was a bit of an odd. And I like the idea of just following the pattern we usually do, which is always 1st July. That's how we treat our customers. We do it 1st July every year. So it would be a bit of a rough move to gain the advantage of six or eight weeks or two months to do it faster than that.

So it's also a process we play delicately to explain why we do it, how we do it. And yeah, I just mentioned that we looked at the CLA increase on our side. So that means that this year could be a much bigger than other years. And especially in B2B, we do higher than that. So there we also follow our contracts. So it is a process we play very carefully not to annoy our customers, to put it that way. Yeah.

Konrad Zomer: So it's a commercial decision?

Joost Farwerck: Well, it's in the contracts that we do it annually. Probably we could do it a month earlier, but I think that is not the way we play this to our customers. They are used to the process versus the 1st July, so good, easy, quiet moment in the year to do it. So we're in the long term value creating businesses and that's why we stick to the plan.

Konrad Zomer: Okay.

Chris Figee: And then the free cash flow question. It's really about timing of CapEx, not so much growth fibre numbers. We had more CapEx in Q4 last year and also more CapEx in Q1 this year, and especially in fibre, the business is – so that if you start a building stream, you start to pay up, you pay a little bit more cash in the beginning of the project and later less in the later phase of the project. So basically the CapEx increase last year and the CapEx step up this year will have some negative cash implications year-on-year on Q1, and also to a tiny bit in Q2, because you start up new fibre buildings and we started up more fibre new building streams and that will come into CapEx.

What does it mean for HP? Actually, I expect the amount of homes passed to gradually improve in the year as well. So the, CapEx cash out is not immediately linked to the amount of HP you provide during the quarter, is actually the CapEx and then the cash out are linked to the starting of building streams that will deliver homes passed in six to nine months later.

So, two processes; one is free cash flow driven by CapEx increase last year and CapEx step up this year, which are a function of an increase in the number of building streams. And that's a separate development that has some implications for the timing of our free cash flow during the year. And then secondly, I would not be surprised if we could see some ramping up of the weekly and monthly delivery of FTTH homes passed numbers, but those are not immediately linked to one another, at least not in the same quarter.

Konrad Zomer: Okay. Thanks for that.

Operator: The next question comes from the line of Nawar Cristini calling from Morgan Stanley. Please go ahead.

Nawar Cristini (Morgan Stanley): Thank you very much for taking my questions. I've got two. Firstly, starting by B2B. So, clearly your top line growth is trending nicely. I have a question on profitability precisely. Could you talk a bit about the profitability profile of the incremental growth in B2B, how does the new business compare to your current B2B margins?

And then my second question is more of an industry-related question on the fair share debate. So a number of telcos are pushing really hard in here to get a CapEx recovery payment from big tech. Could you talk a bit about where you stand in this debate? The consultation is ongoing and it would be helpful if you could share your views, latest thoughts, and expectations here. Thank you.

Chris Figee: Yeah. Nawar, let me take the first question on the B2B business. When you look at the SME growth, that actually is quite high margin because our SME business is not mobile business, it's cloud and workspace business, cloud and workspace business in there, some broadband. So in SME, I would say new business has a similar margin to existing business, slightly diluted possibly because we have a little bit more cloud and workspace, which is lower EBITDA margin than typical mobile broadband. But in general, broadly speaking, the SME business is similar contribution margin as the old business. In the large corporate segment is slightly negative or it's still as positive margin business, but slightly margin dilutive, but also cheaper to present, to produce.

So what you see in the LCE business is that the contribution margin of some of our new business is lower, but it's much cheaper to produce; and we take out cost and then you see cost savings in the TDO unit in the network. So end-to-end the margin is healthy and similar. It shows up less in B2B, but it shows up in the cost reduction in our TDO business because it's simpler, more standardised business. So that leaves us opportunity to take our costs. So in SME you can look at it almost like an isolation in SME. In LCE, you have to also look at the cost improvement in our TDO business to look at the end-to-end opportunity and to show that some of standardised low contribution margin business also leads to lower costs upstream in KPN when it comes to the unit that produces products and you can tell that cost there.

Joost Farwerck: Yeah. And on your point of the debate in Europe on going on a fair share, on one hand, I should say we see more and more European telcos taking a stance in the debate. And KPN in general, we support that debate and we follow it closely. And there's a lot of growth rates of IP traffic coming from over-the-top players that have big impact on our network. And the whole discussion is on reasonable and efficient use of the network. So not on net neutrality.

But on the other hand, it's a bit of voice from the past, I must say, personally. So I understand where it comes from, but it's the model we introduced long ago. And you could also say it's mainly the end user paying for the usage of all the capacity. So balancing that out in a different way could be helpful. But for me and for us, the main challenge is to approach these over-the-top players and see them not as a threat but more as a partner.

We have built our strategic locations in the Netherlands and together with our new network environments, the fibre network edge we're rolling out around these locations. We think we have a unique position in the Netherlands to support Microsoft or Netflix to make use of our strategic locations, our edge solutions and be close to the customers. So I would like to think more and more of these big players as future partners than as a threat to doing all kind of IP traffic, downloads dumps on our network. But formerly I say we support the whole discussion.

Nawar Cristini: Okay. That's helpful. Thank you very much.

Operator: The next question comes from the line of Steve Malcolm from Redburn. Please go ahead.

Steve Malcolm (Redburn): Yeah. Good afternoon, guys. Two questions if that's okay. First on coming back to SME, it continues to grow very healthily, 7.5-8% in this quarter. Can you just help us get under the bottom a little bit in terms of what the volume price mix drivers behind that growth and the visibility you have over future growth? You mentioned, I think the move to unlimited mobile bundles, an idea of what proportion of the base in the SME segment is on unlimited and what the scope for further upselling would be really interesting.

And then just back to fibre, to just hear your thoughts on the overbuilding and what you're seeing in the market today maybe versus what you were seeing 12 months ago. I think we all probably think that higher interest rates and inflation as a fairly major impediment to those business plans. But curious to know what you're seeing on the ground and whether the level of activity has changed materially over the last 12 months. Thank you.

Chris Figee: Yes. Steve, on SME, it's actually less price, more volume because the price increase is on SME actually, have not been put through this year as well. So it's more of a volume thing than a pricing thing. And it's volume driven by increase number of triple play customers. So customers who have multiple products, we see an increase in mobile penetration and repeat buying of existing customers is still good employment development in the SME part of the economy. So our customers are still hiring new staff, hiring new staff need to be equipped with a workspace, a mobile phone subscription, etc.

So it's on one hand an increase in mobile base and it's increasing cross-sell with the amount of fixed customers, with subscription ARPU stabilizing increasingly the share of unlimited on the SME as well, good base growth. On broadband, I think we could do better. There is growth in the SME base as positive broadband growth in SME, also driven by our strategy to roll out fibre in business parks. But I think we could do more. We're certainly not satisfied there. And then there's a decline in traditional voice and voice being stable.

Steve Malcolm: Chris, is that volume coming from competitors? Is it – how much is market, how much you share, any colour on that and how sustainable that those trends are?

Chris Figee: I think a lot of these are from the market.

Joost Farwerck: So I – in all reality, part of it that's coming from competition and that also has to do that we cleaned up the base, moved it all to a cloud based portfolio. During the migrations we lost some customers over the last years. So that part, it's coming back now because you gave me one solution is working perfectly fine in SME. And so we really see, especially on the connectivity part, customers coming back. And also I think, Chris, SME market in general is growing on our side.

Chris Figee: Yes, the SME grows, and we do have a very large share in SME. So, I think, without thumping our chest too much. But our KPN EEN platform with all products in there, increased security solutions is actually differentiating and distinguishable from others. So there's a significant portion of market growth with SME customers employing more staff and, as you said, is also increasing that our platform is in place. It's all cloud-based. It has no legacy products anymore.

You do see that customers are bringing back business to us because we have a broader set to offer that shows also in the amount of triple play customers, which is now increasing. I think over 50% of our SME base is now double or triple play. And that's a good sign, of course.

Steve Malcolm: Okay. And do you think you can keep going in that sort of run rate in terms of growth or is that credible?

Joost Farwerck: I think actually – first thing, I would bet that probably Q2 looks a bit better than Q3. I think in the long run, 5-7% is probably where SME should be and for quite some time now. But then again, we'd expect it to flatten out. It hasn't stayed on with a higher growth path than for longer. And especially, I wouldn't be surprised if you could see a small reacceleration in Q2.

Steve Malcolm: Great. Thanks.

Steve Malcolm: Sorry. I was asking, fibre as well, level of overbuild.

Joost Farwerck: Yeah. So on overbuild the Netherlands is until today doing quite good as you know. So in the Netherlands we have our rollout programme. There's one big player that obviously picks the regions we are not in. And there's another one that is mainly targeting the larger cities where we are as well. So either we come to a conclusion or we are going for a bit of overbuild in the Netherlands. But all in all, I must say that until today we really avoided overbuild in the Netherlands on a big scale.

Steve Malcolm: Great. Thank you.

Operator: Next question comes from Georgios Ierodiaconou calling from Citi. Please go ahead.

Georgios Ierodiaconou (Citi): Yes, good afternoon and thank you for taking my questions. Firstly, I follow up on some of the comments you made earlier around churn being a bit higher on the broadband base in the First Quarter. I'm just curious whether that was mainly the result of promotions from the cable player. There was also, if I'm not mistaken, last year, some promotions from you around TV that may be with the first anniversary of that, there is a bit of impact from this. But I'm just curious as to how you are thinking about churn for the rest of the year, whether you remain confident. I know you commented a bit about the Second Quarter being better. But also in the second half with the price increases, whether you remain confident in stabilising, maybe slightly growing the broadband base. And if not, then maybe give us a bit of an indication as to how you expect to compensate that.

And then the second question is around working capital. And I think, Chris, you mentioned the fact that CapEx will be very linear this year. Normally what we've seen from other telcos is when you have significantly higher CapEx in the second half in one year, in your case in 2022, and then more linear the year after, that tends to be naturally some working capital outflow linked to the CapEx payments. So I'm – if I remember correctly, you expected working capital to be slightly positive for this year. Is that still the case, and do you mind just giving us a few point to us as to how you get there? Thank you.

Joost Farwerck: Yeah. Georgios to start on that turn point in broadband in simple terms, it's pretty fair to say that the First Quarter was impacted by promotions by others in the market. And you're right that we did something on TV last year. I think for Chris and myself, it's very important to keep our sales teams disciplined on how to react, where we try to act as a market leader and not as a follower. So that's the strategy we choose for Q1 and we see things improving looking at the trend in March and further. So I expect a better trend on Q2 and looking forward today, I must say.

So we are in – the market is in a – is competitive on one hand, on the other hand, in a good shape because the large service providers all introduced pretty large price increases. So that was announced by T-Mobile and VodafoneZiggo and we will communicate in May on that. So that works quite well because we all do large investments in our infrastructure. And so, I think that that's needed in today.

On the other hand, a bit of a strong competition discounts etcetera, we didn't follow. A bit of impact on the Q1, and now we see the improvements.

Chris Figee: Yeah. And Georgios, on the working capital, you're completely right. If your working capital is flat or dependent as you described would lead to some working capital headwinds in the first half of the year. You saw some of that on the Q1. Look for example, our trade payables, the trade payables numbers made quite a big swing from Q4 last year to Q1 this year compared to one last year. So that actually is to do with the timing of our fibre. New fibre building schemes being put on line, being put out and your invoices go a bit faster. So that's one.

Secondly, so we see an opportunity to improve working capital in the second half of the year, first of all, because of this timing effect. Secondly, there are still measures we can take, for example, in smarter invoicing, not even shorting payment terms, but you're sending out the invoice earlier. We've identified a number of areas with large corporate customers where we find that the time lag between finishing a product and then actually sending the invoice is somewhat uneconomical for us. So that's where we can prove.

We talked earlier to you about inventory management. We have quite a large stock of CPE, consumer premises equipment, mostly in line with our Android TV that we launched, we bought quite a new set top boxes for Android TV. Last year we built a significant stock of CPE, given potential supply chain issues. I think they were a bit overstocked in that area. So expect us to run down that inventory over time. We have some stock of materials for consumer support activities, so it's a gradual rundown of inventory. It's smarter continuous optimization of your working capital, of your invoice terms to some extent on payment terms, and more on the invoice terms. And then a gradual fading of the working capital drag from the CapEx spike. So expect working capital to be also a bit of a headwind in Q2 and then improve in the second half of the year.

Georgios Ierodiaconou: Just clarify, you still expect it could be positive for the full year or around flat positive?

Chris Figee: Well, slightly positive. It's not going to be a massive number, but it's slightly positive, I would think, for the year.

Georgios Ierodiaconou: Okay. Thank you.

Operator: And the last question comes from Kevel Khiroya calling from Deutsche Bank. Please go ahead.

Kevel Khiroya (Deutsche Bank): Thank you. I've got two questions and slightly longer term. So you've talked about the scope for CapEx for post 2026. I appreciate this is a topic for the CMD, but at this stage, would you be able to share any thoughts on how we should think about longer term CapEx? You've talked about non FTTH CapEx to sales running at less than 14%. And does this still make sense at the group level after fibre?

And then secondly, as we think about you reaching the 80% fibre to home coverage target, what are your latest thoughts and what to do with the remaining 20%? It sounds like you want to avoid overbuild. So would you consider wholesaling off the alternatives or M&A at all? Thank you.

Joost Farwerck: This is an important part of our strategy. So we're building a fibre network. We think we have to cover 80% of the Netherlands, not because we don't want to serve 20% of the Netherlands, but we think it's pretty fair to assume that third party players will cover the other 20%, and that's what we're building. And then at the end of that program, our CapEx will go below a billion and our free cash flow will go above a billion. So take that in mind, the number of a billion that that's an important one on our Capital Markets Day, I would say.

And yeah, wholesaling that is our business. So we're opening up our network for other players. We're not making use of other networks because in our vision that would encourage other players to speed up their rollout because then we feed the business case. So we currently see third party fibre struggling on getting the right penetration to make the business case work. And so we take the decision in these areas to benefit from our upgraded copper network until we are there with our fiber ourselves. At the end when we're reaching the point of 70%, 80%, that could be a moment to consider the usage of third-party networks, but not today. That would be a strategic mistake. I would say.

Chris Figee: Yes, to the point as you're saying, you will see a significant drop off in CapEx after 2026, when we will continue as there will always be some fibre CapEx after 2026 or 2027, there's new builds, there's some connection homes, homes activated if you need to do , there maybe some final zip codes if you want to do above and beyond the 80%, but expect a certain portion of fibre CapEx and the rest of non-fibre CapEx. And we still stick to those number, which is 2026, 2027 we do see that it might take a few months longer in 2027 to get there, but it will be around that zip code that will see that drop in CapEx. So we're pretty confident in that.

And given the fact we're moving KPN to run with non-fibre CapEx at the current spend, by the time that the company is used to that spending level, right? That's our job to make sure we get used to that level of spend on non-fibre capex. So when the fibre drops, you keep this portion for new builds for homes connect, for homes activated and then we stick with that. And I was pointing to the final 20% is there is no point at this point in being wholesaler on a competitive network that would be a strategic mistake.

We'll continue to build. We believe that overbuild, selective overbuild creates value, creates return over across the capital. We did carefully look at that. And for the remaining 20%, you might do some wholesale there. We might also look at because it's rural areas, right? You might look at a combination of fixed wireless and copper connectivity for hybrid solution. So we have something to offer there as well.

Joost Farwerck: 5G.

Chris Figee: 5G also. But again, your point on a significant fibre drop, once we've reached the 80% fibre mark, that is absolutely still part and parcel of our strategy.

Kevel: That's very clear. Thank you both.

Reinout Van Ierschot: Okay. Thank you, Joost and Chris. That concludes today's conference call. If you have any further questions, please contact the KPN Investor Relations Team. Thank you very much.

Joost Farwerck: Thank you.

Operator: Thank you for joining today's call. You may now disconnect.

[END OF TRANSCRIPT]