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KPN.AS - Q3 2012 Koninklijke KPN NV Earnings Conference Call

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OVERVIEW:

Co. reported YTD revenue decline (excluding impact of sale of Getronics) of 1.6% and 3Q12 YonY revenue decline (excluding certain impacts) of 2.8%.



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PRESENTATION

Operator

Good morning, ladies and gentlemen. Thank you for holding, and welcome to the KPN conference call. At this moment, all participants are in listen-only mode, and later, we will conduct a question-and-answer session. I would like to hand over the conference to Mr. Hans Sohngen, Director Investor Relations. Go ahead, please, sir.

Hans Sohngen - KPN NV - IR

Good morning. Welcome to KPN's Q3 2012 results conference call. Today, our CEO Eelco Blok and CFO Eric Hageman will take you through our third-quarter results and address your questions during Q&A.

Let me briefly point out that the Safe Harbor statement applies to this presentation and that any forward-looking statements made in this presentation do not differ from those already made in the press release published this morning.

I would now like to hand over to Eelco Blok.

Eelco Blok - KPN NV - CEO

Thank you, Hans, and good morning, everyone. Over the past nine months, we have made further progress to strengthen our domestic market positions in the Netherlands, where we have accelerated our investment strategy. And internationally, we focus on balancing revenue growth and EBITDA margins.

Against an uncertain and challenging macro environment, we have seen mixed performance across the Group. Specifically, I would say we are on track in the Netherlands towards reaching our 2012 targets of stabilizing our broadband market share in Consumer Residential and of maintaining our stable market share in the Business segment. But, we faced conditions of increased competition in all our mobile markets.

We continue to upgrade our mobile and fixed networks in the Netherlands to provide the highest-quality service for our customers and we continue to increase customer-driven capital expenditures to strengthen our domestic market positions.



In Dutch Mobile, we are starting to upgrade the network to enable LTE, while in the fixed segment, the hybrid approach of corporate network upgrades and the continuous fiber-to-the-home rollout is working well.

Our commitment to our customers through direct and accelerated investments is a key part of our strategy, whose success is illustrated by rising net promoter scores in the consumer market, driven by improved customer service, such as free 24/7 call centers and a strong focus on quality.

We are also doing well on customer satisfaction in the corporate market but still have to do better in the business markets.

We are making good progress with our 4,000 to 5,000 employee reduction program, which is currently on track and expected to be finalized by the end of 2013.

In Germany, competition has intensified in recent quarters, which is leading to a slowdown in our top-line growth. Even in Europe's strongest economy, customers are increasingly looking for and receptive to opportunities to reduce their costs and improve their tariffs. As a result, all network operators have launched new initiatives with a strong focus on price.

As a challenger, e-plus is adjusting in several ways. Innovative all-net flat postpaid propositions were launched, leading to higher postpaid net adds. The growth from higher postpaid net adds is, however, being offset by the fact that existing customers are optimizing their tariffs. We are continuing to drive cost discipline. And we are on track with the accelerated high-speed data network rollout.

KPN Group Belgium performed strongly in 2012 year to date. They have launched a number of initiatives under its challenger strategy to protect and enhance its market positions.

An integral part of our Group strategy is to focus on corporate social responsibility. And I'm proud to say that this has been recognized. KPN has, again, been included in the Dow Jones Sustainability World Index. And furthermore, the Carbon Disclosure Project 2012 declared KPN as the number one telecom operator worldwide with respect to emissions reduction performance.

We are all focused on strengthen, simplify, and grow our businesses and to deliver successful results from the accelerated investment strategy in the Netherlands. We confirm the financial outlook for the full year 2012. At the same time, we acknowledge that, also, in the coming period, market conditions are set to remain challenging.

Nevertheless, we are confident that the accelerated investment strategy in the Netherlands and our challenger strategy in Germany and Belgium are succeeding in supporting a solid future for KPN.

We recognize that we are outside our self-imposed financial framework, and we expect that this situation could continue for the coming quarters. We will continue to strive for a balance between a prudent financial framework, investments in our business, and shareholder remuneration.

All in all, KPN is on track to realize its full-year 2012 outlook for EBITDA, CapEx, free cash flow, and dividend per share. Therefore, I confirm the outlook.

Now, I would like to hand over to Eric.

Eric Hageman - KPN NV - CFO

Good morning. As Eelco just highlighted, we recognize that we are still outside our self-imposed financial framework.

Net debt at the end of the third quarter was stable compared to the previous quarter at EUR12.4b. The stable net debt was mainly the result of free cash flow generation during the quarter, offset by the interim dividend payment in August and some smaller items, like a tax recapture repayment. Combined with a lower EBITDA over the last 12 months, this resulted in an increase in the net debt-to-EBITDA ratio to 2.7 times.

Also, this year, we will see phasing-in free cash flow with a significant part still to come in the fourth quarter, which will positively influence the leverage ratio. However, in the short term, the evolution of this ratio may be impacted by strategic investments.

In the third quarter, we strengthened our liquidity position by issuing a EUR750m bond at a low coupon of 3.25% compared to our current average coupon of 5.1%. This illustrates that KPN continues to have very good access to the debt capital markets at attractive rates.

This quarter, we also extended our EUR2b revolving credit facility with all our 14 relationship banks to July 2017.

The chart in the bottom-left corner indicates that there will be a EUR1b redemption coming up in November, the 13th to be precise. This can easily be financed by the EUR1.5b in cash we currently hold on our balance sheet.

Let me continue with our Group results for the third quarter. Revenues were down 2.8% year on year, excluding the impact from the loss of revenues as a result of the sale of Getronics International earlier this year. The decline in revenues in the Netherlands was mainly due to the performance of Consumer Mobile and NetCo.

EBITDA decreased by EUR153m or 12% year on year, which was mainly caused due to NetCo, Germany, and Consumer Residential.

Operating expenses this quarter were down 6.5% year on year due to lower OpEx because of the sale of Getronics International and the EUR72m lower restructuring costs compared to the same quarter last year.

These OpEx savings were in part offset by investments to strengthen our Dutch market positions, increased commercial investments in Germany, and higher pension costs.

Furthermore, depreciation was up 12% as a result of a one-off depreciation charge of EUR42m in Germany related to assets under construction as a result of a reclassification to PP&E.

Let's now move onto the year-to-date Group results. Revenues year to date were down 1.6%, excluding the impact of the sale of Getronics. In line with what we just saw for the third quarter, this decline is mainly due to the performances of Consumer Mobile and NetCo and to a lesser extent is attributable to our Residential and Business segments.

EBITDA decreased by EUR440m or 11% year on year, which was mainly the result of NetCo and Consumer Residential's performance.

Taxes year to date were up EUR59m compared to the first nine months last year when KPN benefited from a one-off innovation tax facilities related to the 2007-2010 period.

Let's now skip one slide and move to the Group cash flow year to date. Year-to-date 2012, we generated EUR917m in free cash flow, EUR600m less compared to last year. This delta can be explained as follows, EUR415m lower EBITDA, EUR184m higher tax payments, EUR80m more negative change in working capital, and EUR48m higher CapEx, mainly related to an increase in customer-driven investments in the Netherlands, such as TV and fiber-to-the-home activations, and handsets.

The decrease in cash flow is partly offset by EUR74m higher change in provisions, mainly due to higher additions to provisions caused by actuarial losses of EUR55m at Getronics UK and US, and EUR66m lower interest paid, mainly due to bond redemptions in Q3 of 2011 and a shift of coupon payment to Q4.

In Q3, we have seen a positive impact on our pension funds, largely driven by the implementation of the ultimate forward rate as of September 30th, which led to the positive effect on the coverage ratio of 3 percentage points. The ultimate forward rate is a part of the discount rate for pension liabilities used by the Dutch pension regulator.

The coverage ratio of our largest pension fund increased to 104% in the third quarter. And the coverage ratio of our other smaller pension fund increased even higher to 109%. This led to an average coverage ratio of KPN pension funds of 104% at the end of Q3.

In Q3, a recovery payment of EUR19m was made. Based on the coverage ratios at the end of Q2 and Q3 2012, KPN will have the obligation to make recovery payments of EUR23m in the fourth quarter and EUR19m in the first quarter next year.

Let's now review in more detail the financial results of our segments, starting with our Dutch Telco Division. Q3 2012 saw a continuation of trends within our Dutch Telco businesses. Revenues and other income were down EUR94m or 5.7%, including a negative impact from regulation of EUR27m. The lower revenues were mainly observed at Consumer Mobile and NetCo.

EBITDA, excluding restructuring costs, decreased by EUR101m or 11% as a result of lower revenues and the EUR60m regulatory impact. The EBITDA margin decreased to 50.3% from 53.5% in the same quarter last year, but was higher than the first two quarters of this year, which was around 49%.

At the same time, improvements in our underlying cost structure are planned to support our margin at Dutch Telco going forward, which I will talk about in a moment.

Let's move onto the financial review of the segments within Dutch Telco. Revenues at Consumer Mobile were down EUR51m or 11% year on year as lower traffic was only partly offset by higher committed revenues. Service revenues were down by 10% and impacted by regulation to the tune of EUR13m.

EBITDA at Consumer Mobile increased to EUR145m in the third quarter from EUR135m in the second quarter, driven by the introduction of the new commercial propositions, including a handset lease model. As a result, we have seen an increasing margin over the last quarters to 34.4% this quarter.

Revenues at Consumer Residential were relatively stable over the last quarters at EUR457m as the positive trend in TV and fiber-to-the-home revenues were offsetting the lower revenues from a smaller fixed voice customer base.

The EBITDA at Consumer Residential was also stable Q on Q at EUR100m. This led to a stable EBITDA margin Q on Q albeit at a lower level than last year as a result of the increased activation costs for IPTV and fiber to the home as the number of customers continue to increase, higher content cost, and a continued decline after additional services.

Revenues and other income at our Business segment were down by EUR31m or 5.2%, impacted by EUR10m regulation, lower traffic, the continued decline in high-margin traditional services, and price pressure in a competitive market environment.

Wireless data revenues continue to show a good performance, though. And the challenger brands Telfort and Yes Telecom also performed well. There is a noticeable revenue step down Q on Q. And this is due to lower hardware sales.

In line with lower revenues, EBITDA for our Business segment was also lower at EUR194m in the third quarter compared to EUR200m in the second quarter and EUR210m in the same quarter last year. This led to a relatively stable EBITDA margin of 34.1% in Q3.

Revenues at NetCo were down 6.5% year on year. The top-line performance of this segment follows the revenue trend across our Dutch Telco operating segments. EBITDA at NetCo declined to EUR354m this quarter due to increased fiber activations.

This quarter, we announced a partnership with Tech Mahindra, which will lead to a more efficient IT spend in the Netherlands and result in EUR200m IT savings over a five-year period, of which the majority will fall in the NetCo segment.

Revenues at Corporate Market in Netherlands were down 5.2% year on year at EUR291m, due to the adverse macro environment, which continues to negatively impact the ICT sector in the Netherlands. Prospect from clients continue to postpone larger ICT investments.

The underlying EBITDA margin was 7.2%, where we now start to benefit from lower personnel costs as a result of a successful FTE reduction program.

Revenues at iBasis were up EUR8m or 3.1%, including a positive US dollar-versus-euro currency effect of 4.6%. The EBITDA margin in iBasis was higher in Q3 at 3.4%, supported by a focus on cost control and some smaller one-offs.

On the next slide, we set out that we continue to make good progress with our 4,000 to 5,000 FTE reduction program, as we have recorded EUR208m restructuring cost related to approximately 2,500 FTEs since the start of the program in the beginning of 2011.

We have been able to reduce the number of FTE in the Netherlands by 1,150 since the start of the program. However, the number of FTEs that left KPN as part of the reduction program is actually higher at around 1,300. The offsetting increase of 150 is due to the accelerated investment strategy implemented at start of the year. Here, you need to think about more customer-facing staff in, for example, our stores and at contact centers.

You may have seen the relatively higher amount of provisions per FTE. This is mainly because the provisions are related to a relatively higher number of efficiency reductions than originally planned.

Let's now move onto the financial results of our International Division. Revenues and other income was stable in Germany in the third quarter at EUR839m. Underlying service revenue growth of 0.9% was lower than we expected at the beginning of the year, when we presented to you in London.

The top-line growth has slowed down, following increased competition in Germany in the last quarters. Eelco will further elaborate on this when covering the operating performance of Germany.

The EBITDA margin in Q3 for Germany was in line with the previous quarters at 38.5%. Compared to last year, it's a couple of percentage points lower as we are seeing higher costs related to commercial investments needed to support the introduction of our new mobile propositions.

In Belgium, we have again seen very strong profitable growth. Underlying service revenue growth was 9%, adjusted for 5.1% regulation impact, driven by growth in mobile data, our B2B, and wholesale businesses, very much in line with what we saw in previous quarters this year.

The EBITDA margin in Q3 for Belgium was 36.8%, fueled by strong underlying EBITDA growth of 17% year on year, which in turn is driven by this solid top-line growth and continued focus on cost containment.

Revenues at Rest of the World decreased by 36% year on year due to the sale of KPN France at the end of the fourth quarter last year and the highly competitive environment in which Ortel Mobile continues to operate. The negative EBITDA of EUR2m in Q3 is a slight improvement compared to the previous quarter.

As you may have seen last week, following the approval of the Dutch competition authority, we announced completion of the acquisition of four fiber service providers in the Netherlands. This is an example of an acquisition which is at the heart of our accelerated investment strategy to strengthen our domestic market positions.

In addition to that, over the past years, we've also continued to streamline our portfolio of businesses, making clear choices around core versus noncore businesses, always adhering to our principle of creating value.

On top of the encouraging organic growth in Consumer Residential, the acquisition of the fiber service providers will add approximately 120,000 broadband customers. All in all, this will lead to a broadband market share of 41% and a fiber penetration level of 29%.

Our product offering for the Business segment has been strengthened by two acquisitions, bringing portfolio improvements much to the benefits of our customers. We have also successfully divested part of our noncore assets in order to focus on our core footprint and most profitable businesses. The divestments of the former Getronics subsidiaries, like Getronics International, and selling part of our mobile towers in the Netherlands are a testament to that.

With this, I would like to hand back to Eelco.

Eelco Blok - KPN NV - CEO

Thank you, Eric. Let's now look at Consumer Mobile. Mobile service revenues were down 10% year on year as lower traffic and a 3% regulation impact were only partly offset by higher committed revenues.

This quarter, the retail postpaid net adds were at minus 14,000. This is mainly due to aggressive promotions by competition following our Hi and Telfort portfolio launches in the second quarter. Furthermore, our commercial spending was relatively low in Q3. To improve the net adds trend, we have increased commercial activity again in the last weeks of September.

The postpaid retail ARPU remained under pressure at EUR34, partly driven by increasing SIM-only subscriptions within the mix and lower traffic. The committed ARPU percentage was up by 7 percent points year on year to around 66% as new propositions have now been launched for all brands.

Our distribution footprint has, again, been strengthened in the third quarter by opening multibrand stores and XL shops.

All in all, the total Dutch service revenue market share remained relatively stable over the last quarters around 44% to 45%.

We are seeing encouraging trends in Consumer Residential. Both TV as well as fiber continued to show positive developments, leading to an uptake of 63,000 triple-play customers in Q3. Total triple-play packages are now at 816,000, an increase of 34% year on year. This led to average revenue generating units per customer of more than two.

IPTV growth, with 88,000 net adds for the quarter, led to a TV market share of 20%, 3 percent points higher compared to the same period last year. We took another step to improve our market-leading IPTV proposition by introducing IPTV on the smartphone.

Another encouraging development is an improving broadband customer base trend. We have shown organic growth in the customer base for the first time in several years. As a result, the broadband market share is stabilizing around 39%. We were able to grow the broadband customer base while at the same time slightly increase the average ARPU per customer.

As mentioned by Eric, the acquisition of the four fiber ISPs brings our broadband market share to 41%.

The performance in our fiber areas remains strong with the highest organic number of quarterly fiber-to-the-home activations to date. The increase of 34,000 activations this quarter led to almost 200,000 homes activated at the end of the third quarter. The growing fiber-to-the-home customer base is supporting the take-up of high-value propositions.

Our fiber penetration level increased to 18%, showing a 7 percent point improvement year on year. Including the 120,000 customers from the acquired service providers, we'll bring the penetration further up to 29%.

The rollout of fiber to the home continued at a good rate, reaching well over 1m homes passed in KPN areas.

Let's now move onto the operating review of Mobile International. In Germany, increased price competition resulted in a slowdown of service revenue growth. Postpaid net adds remained at a high level, driven by the continued successful rollout of all-net flat propositions introduced in Q2. However, the growth from higher postpaid net adds is being offset by customers optimizing their tariffs plans.

Prepaid net adds of 284,000 increased quarter on quarter but are still below the 2011 level. The main reasons were increased competition in the ethnic segment and the value focus on customer acquisition.



e-plus's market share in service revenues remains relatively stable at 15.9%, supported by continued data service revenue growth of 40% year on year.

Customers in Germany are increasingly looking for opportunities to reduce their costs and improve their tariffs. As a result, in recent quarters, all network operators have introduced new tariff plans with a strong price focus in both the postpaid as well as the prepaid market.

In the postpaid market, high-value customers are trading down in tariff plans, offsetting the growth from new customers. In the prepaid market, competition has mainly increased in the ethnic segment, where we have seen aggressively priced new entrants in the market.

As a challenger, e-plus has adjusted to this trend by the introduction of new base tariffs earlier in the year and attractively priced all-net flat postpaid propositions in Q2, leading to a higher level of postpaid net adds.

Together with our partners, new prepaid propositions have been launched to capture data growth in the wholesale markets. At the same time, the rollout of our high-speed data network is on track to support further growth in data revenues.

Belgium continued to show strong underlying service revenue growth of 9%. Like in previous quarters, the strong service revenue growth was driven by B2B, wholesale, and data. We expect to have grown our service revenue market share to 20%.

Postpaid net adds were 3,000 negative this quarter due to higher churn caused by increased competition in the market for both business to consumer as business to business.

Prepaid net adds corrected for cleanup grew to 234,000. The prepaid cleanup contained to disconnection of 930,000 expired SIM cards, leading to a negative prepaid net adds of 696,000 in Q3.

Several commercial initiatives were launched this quarter as a countermeasure to maintain price leadership in the market. For instance, Jim Mobile as well as the BASE portfolio were revamped. Besides introducing new commercial initiatives, we have made further investments in our network and are on track with the rollout of high-speed data.

In my concluding remarks, I would like to, again, highlight the following. We have seen some mixed operational performances across the Group in Q3. On the one hand, we are seeing encouraging trends in Consumer Residential, such as the growing broadband customer base and strong IPTV and fiber-to-the-home net adds.

Our TV market share increased to 20%, supporting a further take-up of triple-play packages, while the fiber penetration level increased to 18%. And as a result, the broadband market share is stabilizing around 39%.

On the other hand, we face conditions of increased competition in our mobile markets. The total Dutch Mobile service revenue market share remains relatively stable around 44% to 45% in a competitive environment.

In Germany, the increased competition on price has resulted in a slowdown of service revenue growth as the growth from higher postpaid net adds is offset by customers optimizing their subscriptions, while Belgium continued to show strong underlying service revenue growth of 9%.

All in all, we are on track to realize our 2012 outlook.

With this, I would like to open the floor for Q&A. Thank you.

QUESTIONS AND ANSWERS

Operator

Ladies and gentlemen, we will start the question-and-answer session now. (Operator Instructions). The first question's coming up from Mr. Akhil Dattani, JP Morgan. Go ahead, please.

Akhil Dattani - JPMorgan - Analyst

Yes, hi, good morning. Akhil from JP Morgan. Just two questions, please. Firstly, just be interested in a bit more color on your comments on the Dutch mobile market. You started by saying that competition's picked up a bit. So, I guess I'd be interested to understand who's driving that. Where were you seeing the pressure?

And adding to that, you said that commercial spend from yourself would pickup in Q4. So, could you maybe just help us understand whether you think trends will improve or deteriorate into Q4 and just a bit more color around the outlook there?

And then secondly on Reggefiber, I guess, just keen to understand a bit better how you think about the impact of that on your net debt once we get to 2014, which is when you'll be consolidating that asset.

I guess, in terms of helping us with that, maybe you could walk us through the debt moving parts, so specifically where the debt was at the end of 2011, what you see happening to that debt profile at the next couple of years. And I guess also with that, what are the final costs of buying out the Reggeborgh equity minorities out to that period as well? That would be very useful. Thank you.

Eelco Blok - KPN NV - CEO

Okay, I will start with answering the first question and then Eric will take the second set of questions. On Dutch mobile, both Vodafone and T-Mobile, after we have introduced our new propositions in the second quarter, have increased their marketing spend and have also increased their promotional actions. And we have only taken actions on this response of the other MNOs in the Netherlands, in the second part of the last month of the third quarter, to be able to accelerate the growth of net adds again, and we expect the results coming up in the fourth quarter. We don't expect trends to worsening but, as I said, competitiveness has increased in the Dutch market and we have responded to that.

Eric, maybe you can take the second question on debt (multiple speakers)?

Eric Hageman - KPN NV - CFO

Yes, sure. I think let me start by saying that we are very happy with the progress that we are making. On the one hand, I think we are very much on track with making sure that the right numbers of homes get passed but, more importantly, that the activations are picking up. And in that light obviously also the inorganic approval that we got from the competition authority is extremely helpful to us.

Just on the net debt implications, Akhil, most of part of the options are exercisable in 2014 and 2017. We put out a clear document on that on November 11, if I recall correctly, last year. In essence, if you look at the combination of the CapEx that we put in, the shareholder loans that are within the business, plus the payments for exercising the options, you are looking at an impact of around 0.15 to 0.2 times on net debt to EBITDA, and that is by 2014. So exercising option one, and exercising option two, that's what we're then talking about and this is what the impact would be.

Akhil Dattani - JPMorgan - Analyst

Great. If I could just follow up on that last point from you, Eric, would you happen to be able to give us some rough color in terms of the absolute net debt increase, because obviously I appreciate the SME EBITDA contribution as well? But just so we can understand how you get to the 0.2.

And then, I guess adding to that, just as a -- border point to that, at the moment you're as you said slightly outside of your leverage range. You are saying that this would take that a little bit higher. So I guess I'm just interested in how you are thinking about the whole balance sheet situation at the moment. Is your confidence on the '13 dividend because you're quite positive on the outlook, or are there other items we also need to consider here?

Eric Hageman - KPN NV - CFO

Yes, so let's -- so two questions. Let me then first answer the question on the debt so you understand that number a bit better. So the 0.15 to 0.2 you have to assume a debt of around EUR900m. So if we would now consolidate that's what would be added to the number, so it's around EUR900m, of which about half of it are shareholder loans. And about the other half is the current external financing that this JV has assumed. So these are lines of loans that they have received through other funding, other means than the two shareholders. So that's where the EUR900m comes from.

If you then look at our confidence with the outlook, in essence, what we have said is two things. One, if you look at the current performance year to date, and if we look at what Q4 will bring, then we are very happy to confirm that. But also we put in the extra comment that we do see that the market conditions remain challenging. And if you then link that to the financial framework, this is the second quarter that we are outside the self-imposed range of 2 to 2.5. And that we continue -- we expect that that will continue for the following quarters.

However, the main variable that is affecting this on the positive side is we typically expect more cash in the fourth quarter. This is a phasing that we always talk about that obviously will help this ratio. But there's potentially also some strategic investments that we have to make in the fourth quarter, which is obviously -- is negatively affecting that.

We really think, yes, that -- we have taken some very good actions early this year already. If you look at the share buyback in January, if you look at the dividend cut that we did in July -- certainly the last one that saves you around EUR800m in cash. So we are quite happy that we could confirm that outlook, but also look clearly with a good commitment to our financial profile for the future.

Akhil Dattani - JPMorgan - Analyst

All right, thanks, Eric.

Operator

The next question is from Mr. Hugh McCaffrey, Goldman Sachs.

Hugh McCaffrey - Goldman Sachs - Analyst

Good afternoon, or good morning rather. Thanks for taking the questions. I've two questions, firstly -- just following up around the balance sheet, there are two levers really there in terms of capital allocation, just cutting the dividend potentially or lower capital intensity. So can you just talk about how you see capital intensity evolving in the business over the next year or two?

And then secondly, just in terms of migration to new tariff plans in the Netherlands, and SMS volumes are still very negative. How far along in the migration do you feel like you are, and when do you think that that kind of decline in SMS volumes is likely to stop?

Eelco Blok - KPN NV - CEO

On CapEx intensity, as you know, the customer-driven investments in the Netherlands will continue to be high, in line with our accelerated investment strategy and CapEx in 2012, as a result of our accelerated investment strategy will be in Europe and of the outlook range of 2 to 2.2. And in 2013 it's, well, not expected to have a lower CapEx level than in 2012, as a result of the continued investment strategy that we have implemented. So that's on CapEx.

Then on where are on the mobile trend in the Netherlands, we say we see a continued migration to the new tariff plans at the end of the third quarter. We were at a 66% level of committed ARPU and, well, we still have a part of our base in the old tariff plans. We need another year to fully migrate the customer base to the new tariff plans and we foresee an increase of the committed ARPU over the next period.

Hugh McCaffrey - Goldman Sachs - Analyst

That's clear, thanks.

Operator

The next question is from Mr. Nick Lyall, UBS. Go ahead, sir.

Nick Lyall - UBS - Analyst

Hi, morning, it's Nick at UBS. Could I just ask a couple, please? On the -- have you seen any rise in Ziggo marketing spend into the fourth quarter, because it sounded like their spending levels were quite depressed in Q3? So is that maybe a bit of a risk to some of the fixed trends in the fourth quarter?

And then secondly, back to the debt question, you've mentioned self-imposed targets. Can you just discuss how the credit rating agencies look at you being out with, or above your ceiling for debt for the time being as well? Thanks.

Eelco Blok - KPN NV - CEO

Eric will take the second question on the credit rating. On Ziggo, well, it's up for Ziggo to answer that question. We are convinced that our current strategy that we have started to execute on last year is resulting in a positive trend in this part of our business. As I've said, a growing broadband customer base for the first time in several years, stabilizing our market share at 39%, and increased, continued growth of IPTV and fiber to the home, net adds. And we will not make any changes to this strategy because we are convinced that this will bring the results we need.

So -- and well, we'll have to see what the competition will do in the fourth quarter, but we will do everything to continue the actions we have put in place. Our broadband market share, including the customers of the small acquisitions, is now at 41% on IPTV. On TV our market share has grown to 20%; it's growing 1% per quarter.

And on fiber-to-the-home the penetration increased to 18%, 7 percent points higher than one year ago. And including the customers, the fiber customers of the acquired ISPs, the penetration of fiber-to-the-home will increase to 29%.

Eric Hageman - KPN NV - CFO

On the discussions with the rating agencies, well, let me, Nick, first and foremost say that we cannot speak on behalf of them. It's obviously up to them to do their own analysis and assessment. But needless to say we are in very close contact with them, so we have regular updates also before the Q results.

They know the exact details of our business plan, including the potential for other strategic investments, I think fiber, I think for example Spectrum. And what is clear from our conversations during the year is that some of the actions that we have taken, like stopping the share buyback and taking the dividend down, have been very credit-positive for them. I think what they also understand and we talked about it also in January, is if there is a justified reason why you are outside the band, then that is something which is acceptable. And what is acceptable then is when you are investing in your business to improve your positions, and that's exactly what we are doing.

We also shared with them that the market conditions are challenging in the coming period, but we are very confident that the accelerated investment strategy will yield results in the Netherlands, but also in Germany and Belgium.

I think the main point that we reiterated in our last conversation is that we take a lot of comfort from many of the positive operational KPIs that we are seeing, some that Eelco just mentioned. So if we look at broadband, if we look at TV, if we look at fiber, all of those are very positive developments. Ultimately that has to be translated in improved financial results. That is what gives us comfort in those discussions.

Nick Lyall - UBS - Analyst

That's great. And they don't give you a specific timescale to get back within the bounds or any sort of -- their imposed bounds you're seeing?

Eric Hageman - KPN NV - CFO

If you -- if you look -- our discussions is much broader than just the band. That's the one that we talk about to, I guess, also make it -- it's a simple KPI to discuss with the outside world, but also internally.

With them, if you look at the Ba2 and also the BBB, they are giving us time to really make sure that the results of the new strategy that that pays off. They understand that we are in a transition period. They understand that certainly in this telco climate that we're in, it takes time for those investments and those decisions that we've taken to be translated in financials. But again, the operational KPIs give us a lot of encouragement.

Nick Lyall - UBS - Analyst

All right, thank you.

Operator

The next question is coming from Mr. Dimitri Kallianiotis, Citi. Go ahead please.

Dimitri Kallianiotis - Citi - Analyst

Good morning. I've got two questions please. The first one is regarding Germany. The revenue growth obviously is slowing down quite significantly. I just wanted to get your expectation for the coming quarters, if you expect revenue growth in Germany to turn negative now, even pre any regulatory impact.

And then my second question was regarding the strategic investment. I understand there is the Spectrum auction coming up soon. But apart from that do you see any gap in your portfolio in terms of assets you want to buy? You've mentioned the small fiber acquisition that you've done, that you got the approval. Anything like this that you think you need to do to improve the business going forward? Thank you.



Eelco Blok - KPN NV - CEO

Let me start with the question on Germany. We are seeing in Germany a trend of customers optimizing their tariff plans and increased price competition in the market. As you know, we have already started to introduce new propositions at the beginning of 2012, and we introduced our all-net flat propositions in the second quarter, resulting in a high number of net adds -- postpaid net adds.

But it's difficult to predict how long the effect of customers trading down to new tariff plans will be there And how long we have to wait until we see the impact of the growth rate of the net adds in Germany. Also helpful is the continued rollout of our high-speed data network. That is on track and that will support further growth on data in Germany.

Eric Hageman - KPN NV - CFO

On your question, Dimitri, on M&A, we -- as always, we continue to be focused on creating value, whether we are buying or selling assets. From a strategic point of view we obviously look at in-country consolidation first. This is also why we put an additional slide in the deck today, to show to you that we continue to invest in improving our positions in the Netherlands.

We've highlighted two small acquisitions that we've done to strengthen the portfolio in our business segment. If we see opportunities where we can also expect to get approvals from the regulation, then we also will look at opportunities on the ISP side, which has helped our broadband market share. So we are very happy with that.

But from a financial impact that we are looking at, these are not big numbers and, if they are bigger numbers, they can easily be offset by some of the divestments that we continue to do. I think, for example, about the tower sales that we've been doing in the Netherlands.

Dimitri Kallianiotis - Citi - Analyst

Thank you.

Operator

The next question is coming from Mr. Frederic Boulan, Nomura. Go ahead sir.

Frederic Boulan - Nomura - Analyst

Hi, good morning, gentlemen. Three questions, if I may. Firstly back on the fixed trend in Holland, good progress on broadband driven by fiber. Can you comment on the cost associated to this growth? Margins seem to be holding up pretty well there as well.

And also if you could comment on where the churn in market -- market share going in the VDSL areas? And then in general is there any need to expand fiber much further in the long run to secure market share, if you continue to see churn in the copper area, even with the VDSL upgrade to 80 megabytes?

And secondly, sorry to come back on the debt question, but I'm struggling a little bit to reconcile your comment around the financial framework and the fact that you reiterate this morning the target of growing this next year. So if we put some cash for Spectrum, even with the stable EBITDA next year, your EBITDA -- your leverage should remain above 2.5 times. So would it make sense to look at reducing dividend to strengthen the balance sheet? Thanks a lot.

Eelco Blok - KPN NV - CEO

Let me start with the first question on the fixed trends. We are investing in this part of our business, by upgrading the copper network, continued investments in fiber and continued improvement of our IPTV products, resulting in the trends you have seen in the third quarter.

We are not planning to increase our investments either in the network services and the marketing and the customer acquisitions, so we expect to continue the growth with the cost level that we have seen in the third quarter.

On churn in copper areas, we have implemented a hybrid strategy, fiber-to-the-home rollout and upgrading the copper network, to be able to offer the high-end, triple-play packages also to our single- and dual-play customers. Given the penetration on copper of the fiber-to-the-curb VDSL coverage, we now are able to offer in a larger part of the country, our high-end triple-play services resulting in a reduction of the churn. Together with the continued high growth in fiber-to-the-home areas we were able to stabilize our share and believe in one of the next quarters we can start growing again. And given the results, we will take decisions on the balance between continued rollout of fiber-to-the-home and the numbers of homes passed and the focus on VDSL fiber-to-the-curb areas.

Eric Hageman - KPN NV - CFO

On the financial framework, Fred, as I said and we said during the presentation as well, we recognize that we this quarter is the second quarter that we are outside the self-imposed net debt to EBITDA range and also that we expect that we might be outside this frame for the coming quarters. And that also mainly has to do in the short term with potential strategic investments that we have to make.

Again, we have taken some firm decisions already earlier this year. I repeat that the share buyback in January and then the saving of around EUR800m by taking the dividend down from EUR0.90 to EUR0.35.

Maybe another important point to make is the following. There's phasing in the cash flow, as we see every year. I think it will be even more phasing in this year than we have seen in previous years. Then we will know where we will end up the year. I think if you look at some of the steps that we've taken, that's the main reason why we have EUR1.5b in cash on our balance sheet at the moment. So that's, from a liquidity perspective, a very healthy position to be in.

What is more, we talked about the operational KPIs, which we are very happy with. At some stage that has to translate into financial results. So with that we are okay with what we are currently seeing around the financial framework, because we can explain it, but also we look with confidence to the future.

Frederic Boulan - Nomura - Analyst

Okay, thanks a lot.

Operator

The next question is coming from Mr. Matthew Bloxham, Deutsche Bank. Go ahead please.

Matthew Bloxham - Deutsche Bank - Analyst

Yes, hi there. Two questions. First on Germany, I'm just wondering if you can give us a little bit more -- or a few more numbers around the tariff optimization process, how much longer you see that happening for, how much more there is to play for there.

And secondly, on domestic mobile, obviously we heard from Ziggo earlier this week that they are extending their Wi-Fi trial. We've seen Telenet get good traction with their own Wi-Fi overlay in Belgium. That's something that (inaudible) Deutsche look at as well in Germany. Could you just

give us your perspective on the magnitude you see from that cable threat into mobile and what assets you've got that you can use to either match that kind of Wi-Fi offering, or other ways you can compensate for it? Thanks.

Eelco Blok - KPN NV - CEO

First, on Germany, customers in Germany are increasingly looking for opportunities to reduce their cost and improve their tariffs and, as a result, we see that the high-value customers in the postpaid markets are trading down in their tariff plans, offsetting the growth from the new customers we acquire on a level somewhat higher than 200,000 per quarter. And it's very difficult to predict how long this effect will impact the growth rate in Germany. But we are confident that with the growth we have seen the previous quarters that we will be able to get back on growth in Germany again. And then I'm talking about underlying growth, because you have to understand that there will be an MTR cut on December 1 in Germany.

And then on Wi-Fi, for us of course it's important what competition is doing, but it's also important what we are doing. We have Wi-Fi as part of our mobile strategy already implemented, by using the KPN hotspots in the Netherlands. We are preparing our network for LTE with our investments in the network in the Netherlands, and we believe that we will be able to be very competitive using all technologies that, as a fixed operator, we have available. So 2G, 3G, 4G Wi-Fi and leveraging our fixed assets and fixed customer base.

Matthew Bloxham - Deutsche Bank - Analyst

Okay, thanks.

Operator

The next question is coming from Mr. Luis Protá, Morgan Stanley. Go ahead, sir.

Luis Protá - Morgan Stanley - Analyst

Yes, thank you. Two questions. This one is on Netherlands and the mobile business, which has deteriorated a bit sequentially. But not so much on the consumer part of the business; it's been more around business mobile. So if you could elaborate a bit on the trends you are seeing there, whether it's about pricing or customers asking for discounts, competition and what could we expect would be useful.

And secondly, in Germany your new no-frills contract tariffs [Gefone], etc., were supposed to be mostly advertised through social media, no nationwide campaigns. Is this going to change now, or are you planning to turn probably more aggressive to boost growth? And, if so, what could be in the impact on margins going into the next few quarters? Thank you.

Eelco Blok - KPN NV - CEO

Let me start with answering your first question. We have seen no deterioration in the business market mobile, except for a continued pressure on prices. Particularly in the corporate and large business segments we see an increase in price competition. And in September we introduced new propositions and we expect that combination of all the measures we have taken in the business market, but also the consumer market, that we will maintain our stable market revenue share positions, combined in the range of 44% to 45% but increased price competition in the business market and increased migration from -- driven by the change of the tariff plans and the change in customer behavior.

And then the other question was (multiple speakers).

Eric Hageman - KPN NV - CFO

Can you repeat the second question, Luis, sorry?

Luis Prota - Morgan Stanley - Analyst

Yes, no problem. I was asking about the Gerni and no-frills contract tariffs in Germany, which I seem to remember you were always saying that you were not planning to make a nationwide commercial campaign. And that was going to be supposedly to be advertised only through social media. So the question is whether this is going to change now that -- do you need probably to boost growth, and whether this could have any impact on margin.

Eric Hageman - KPN NV - CFO

Yes, so OpEx in Germany, driven by the new propositions, have increased in the recent quarters due to the higher commercial investments we had to make, after the introduction of new propositions and of course we have higher traffic costs due to the growing customer base. And for the near future we will target the margin in Germany to be somewhere in the range of 35% to 40%. And, as you have seen in the third quarter, we ended up with a 38.5% margin. And the objective is to have a margin in the range of 35% to 40%.

Luis Prota - Morgan Stanley - Analyst

Okay, thank you.

Hans Sohngen - KPN NV - IR

Okay, everyone, thank you for joining our Q3 results conference call and please do contact the Investor Relations Team for any further questions. Thank you.

Operator

This concludes the conference call of KPN. Thank you for attending and you may disconnect your line now.

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