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EDITED TRANSCRIPT

KPN.AS - Q2 2014 Koninklijke KPN NV Earnings Call

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OVERVIEW:

Co. reported 2Q14 YoverY Group adjusted revenue decline of 7.0%.



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PRESENTATION

Unidentified Company Representative

Good afternoon, everyone. Welcome to KPN's second quarter 2014 results presentation.

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, CEO of KPN.

Eelco Blok - Koninklijke KPN NV - Chairman & CEO

Good afternoon, everyone. Thank you for joining us at the presentation of our second quarter results. With me today are Steven van Schilfgaarde, our Interim CFO; and Joost Farwerck, Managing Director, The Netherlands.

Before I go through the strategic and operational progress we are making, I would just remind you of the impending changes to our management structure.

We announced last week that Jan Kees de Jager will start at KPN in August and take over as CFO at the start of November. Jan Kees brings extensive financial experience and operational leadership in the technology sector. I'm very pleased he is joining the KPN Management Board.

That means that Steven will step down in November, after his transition with Jan Kees. Steven has been a tremendous help to us by stepping up into the Interim CFO role.

It was announced four weeks ago that Thorsten Dirks will become the CEO of Telefonica Deutschland on completion of the sale of E-Plus. Thorsten has been my Board colleague since 2011. KPN, and I personally, owe him many thanks for his achievements and leadership in recent years. We wish him the very best of success in his new role.



As a result of the sale of E-Plus, we'll realign and simplify the management structure. We are giving Joost Farwerck the new Board role of Chief Operating Officer, with main responsibility for networks and operations.

Furthermore, we are creating the Board position of Chief Commercial Officer to take leadership for our commercial activities in consumer and business markets. I will fill in that position at interim until we make an appointment.

I'm confident that the new management structure enables us a functional and more direct control of our operating activities, and this will lead to an even stronger customer focus and cost control.

Let me now run through the key points of the second quarter.

On July 2, the European Commission conditionally cleared the sale of E-Plus to Telefonica Deutschland. We're confident that the sale of E-Plus will be completed in the third quarter.

The sale is a milestone for KPN. It will leave us more focused, and with the financial resources we need to continue to successfully execute our strategies in The Netherlands and in Belgium.

It also allows us to recommence dividend payment to our shareholders.

Finally, please note that as a result of the EC approval, the deferred tax asset related to the sale of E-Plus has now increased by some EUR200 million to EUR1.1 billion, and will support free cash flow in the coming years.

We've continued to make good progress with the execution of our strategy in the second quarter. That success can be seen in high postpaid net adds in consumer mobile; continued good IPTV net adds; and growing 4G and multi-play customers in our consumer and business segments.

The size of the Dutch business market continued to decline, due to customer rationalization and optimization.

Next, to our focus on new revenue streams. We've started to accelerate the Simplification program in the business segment to adjust the organization to the new market environment and to lower the cost base.

BASE Company and E-Plus, once again, showed further improvements in service revenue and outperformed the market.

Financially, our performance from continuing operations, in the second quarter, was impacted by lower year-on-year price levels, as a result of the competitive environment in our mobile markets and, as I said, pressure on the size of the business market.

Despite this, our income statement for the second quarter shows slightly improving year-on-year trend compared to the first quarter.

The benefits of the Simplification program are starting to emerge in the cost base, with around EUR75 million savings realized already.

So far, in 2014, we reduced headcount by about 350 FTEs under the new program, which has a target of 1,500 to 2,000 by 2016. So there's more to come.

The execution of the Simplification program will further support CapEx and OpEx reductions in the second half of 2014, and beyond.

Our free cash flow in the first half of 2014 reflects intra-year phasing. You will hear more about that later from Steven.

This slide shows the fundamentals that underpin our strategy as presented at the Capital Markets Day in February. Today, we will summarize the progress we are making on all of these.



On closing of the sale of E-Plus, we'll receive EUR5 billion in cash, partly from Telefonica Deutschland and partly from Telefonica. That will leave us with a lower financial leverage than in the past, and allows us to start paying dividend again.

We'll use the majority of the proceeds to increase financial flexibility, including reducing gross debt, to improve efficiency of our balance sheet. We will maintain sufficient flexibility to support our strategy. Final decisions will be made following closing of the transaction, but all options we are considering should be shareholder value accretive.

Although we much regret losing Thorsten, we'll keep benefiting from the skills while we remain a shareholder of Telefonica Deutschland.

The 20.5% holding will give us further financial flexibility, exposure to the strong synergies of the combination, and the potential to receive dividends.

Also, with respect to the 20.5% stake in Telefonica Deutschland, I would like to state that any future decisions will only be taken with a view to creating shareholder value.

The hybrid upgraded copper fiber strategy, we have pursued in the year, is delivering great progress. We are on track to acquire full control of the fiber to the home joint venture [with] Reggefiber.

By the end of this year, we'll have three-quarters of the Netherlands at speeds of 40 megabits per second or more.

Also by accelerating the rollout of factoring in the second half of the year, over half of the Dutch households will have access to 100 megabits per second at the end of 2014.

We completed the rollout of 4G in the Netherlands in the first quarter, just 15 months following the spectrum auction.

We've already reached 1.4 million 4G subscribers in the second quarter, and we are leveraging that first-mover advantage into fixed mobile combinations.

With strong focus on high quality services, through best-in-class networks, and market leading products, such as 4G, IPTV and cloud services, it's strongly supporting the uptake of multi-play, by consumers, as well as businesses, which, in turn, significantly reduces churn.

And in Belgium, the combination of high network quality and price leadership, is supporting our continued good operational performance.

The Netherlands today has a strong and dynamic competitive landscape, in both fixed and mobile. We've proven that bundling services in the consumer residential market strongly reduces churn.

We believe that convergence of fixed and mobile services will be an ever-growing factor in the future.

As the only true integrated access provider in the Netherlands, with our own fixed and mobile networks, we can fully leverage these assets to meet customer demand for convergence and high-quality networks.

Last year we introduced our quad-play offering for the KPN brand, which has already resulted in good customer uptake.

Recently, we also started to broaden our range of converged offerings, by introducing new consumer fixed mobile bundles, for our KPN, and Telfort brands, which combine a mobile subscription with one or two fixed services.

We told you earlier this year how we expect our CapEx levels to fall in the coming years. And we also set out the target for the Simplification program.

We are very much on track on both fronts, with around EUR75 million savings from the simplification program, in the first half of 2014. Steven and Joost will say more on CapEx and simplification later on.



In Belgium, our clear market position that combines a high quality of networks and services, with pricing leadership, puts us in exactly the right position to stay successful as a mobile challenger, and deliver continued market outperformance.

This is evidenced by consecutive quarters of good postpaid net ads and growing market share. We continue to make good strategic and operational progress. And, on that basis, we are on track for stabilizing the financial performance, towards the end of 2014, and free cash flow growth in 2015.

We are conscious of, and grateful for, the support we have had from our shareholders in the recent years. And are pleased to be able to restart dividend payments.

The EUR0.07 dividend in respect of 2014, is at a sustainable level, and we intend to grow this in respect of 2015.

Shortly after the closing of the E-Plus sale, we plan to pay the 2014 interim dividend, and we will inform you about the details once the E-Plus sale is completed.

Now I will hand over to Steven for the financial review; Steven?

Steven van Schilfgaarde - Koninklijke KPN NV - Interim CFO

Thank you, Eelco; good afternoon, everyone. I will start with the financial profile of the Group.

In the second quarter, our pro forma net debt level increased slightly, by about EUR100 million, compared to the end of Q1, 2014. It included the expected net cash proceeds of the sale of E-Plus, and the expected consolidation impact of Reggefiber.

The increase is mainly related to (inaudible) payments E-Plus, related to previous years, which are for accounts of KPN. The increase is partly offset by deposits of free cash flow in Q2.

At the end of the second quarter, pro forma net debt over EBITDA was around 2.2 times. This is slightly higher than in the first quarter, due to EUR133 million lower 12-month rolling EBITDA, and the EUR95 million higher net debt.

Gross debt increased by EUR650 million in the quarter, as a result of a bond redemption for that amount.

Moving onto pensions. On June 24, the trade unions approved the implementation of a defined contribution plan for KPN's main pension plan, which covers the majority of KPN's employees in the Netherlands, by January 1, 2015.

As part of the implementation of the new pension plan, KPN will make a one-off lump sum cash payment of EUR200 million.

In that respect, there has been a release of provisions this quarter, of EUR451 million, EUR361 million net of tax, which positively impacted reported EBITDA. Any remaining provisions will be released at the end of this year.

As a result, any accounting risk related to KPN's main pension plan, is removed from the balance sheet, which reduces cash flow volatility and also positively impacts the adjusted leverage ratios as used by the current rating agencies.

Let me now take you through our Q2 Group results.

Adjusted revenues for the second quarter were down 7.0% year-on-year compared to minus 7.7% in Q1. The EUR150 million decline was mainly driven by EUR86 million lower revenues in the business segment; EUR35 million lower revenue in consumer mobile; and EUR33 million lower revenue in NetCo.

The underlying OpEx continued to decrease as a result of the execution of our FTE-reduction programs.

The adjusted EBITDA, excluding the impact from phasing out of handset lease of EUR48 million, decreased by 13% year-on-year, as a result of lower revenues. Again, a slight improvement compared to the minus 15% we showed in the first quarter.

Also related to the P&L, that only affected discontinued operations, is an impairment related to the 20.5% stake in Telefonica Deutschland that we will receive following the sale of E-Plus.

As the conditional decisions by the European Commission regarding the sale of E-Plus has been announced, KPN's best estimate of the share value of this 20.5% stake at the end of Q2 is now based on the share price of Telefonica Deutschland, instead of the implied value at the announcement of the transaction. This leads to an impairment of EUR744 million.

The text book loss, related to the sale of E-Plus, increased to EUR4.6 billion, resulting in a total deferred tax asset of EUR1.1 billion, an increase of EUR210 million. This deferred tax asset will limit tax cash out in the Netherlands in the coming years.

Let's skip one slide and move to the Group cash flow for Q2. In the second quarter our free cash flow from continuing operations of EUR20 million higher than in Q2 2013. The main items that explain this improvement are EUR105 million lower CapEx, which I will explain later; EUR35 million more cash from change in working capital; and a EUR23 million improvement related to other items, such as lower tax payments for continuing operations.

It was partly offset by EUR143 million lower reported EBITDA, excluding the pension provision release. This release is a non-cash item and, therefore, also visible in the line change in provisions. The free cash flow from continuing operations for the first six months amounted to minus EUR220 million.

The numbers on this slide reflect the usual intra-year phasing. Free cash flow is largely generated in the second half of the year. We expect this to be driven by working capital development, lower interest and tax payments, and the simplification program.

Compared to last year there is a large difference in working capital timing as the first half of 2013 was supported by significant repayments in Q4 2012.

Now, let's take a look at our CapEx development. As a result of our investment-led strategy in the last years we have seen elevated investment levels at KPN compared to our European peers. We now see CapEx coming down and have provided a CapEx outlook of less than EUR1.4 billion for 2014.

Compared to the first half of 2013 we spent about EUR200 million less in the Netherlands. This was mainly due to lower customer-driven investments, such as phasing out of handset lease model, which contributed about [EUR100] million, and the use of a more cost efficient hardware and set-top boxes in our residential segment.

Also, the completion of some major investment programs, such as 4G in the Netherlands in Q1 have led to lower network investment.

In addition, the Simplification program is already showing the first results in both CapEx and OpEx savings. Around EUR35 million out of the EUR75 million Simplification savings were related to CapEx, driven by lower IT spend as part of fixed and mobile network investment.

Now, let me hand over to Joost for the review of the Netherlands.

Joost Farwerck - Koninklijke KPN NV - MD, The Netherlands

Thank you, Steven; and good afternoon. I would like to kick off by reviewing the operational results in the Netherlands we are making, and we have been making until today.



In consumer residential, we are executing a clear strategy based on the increased quality of our networks and products, in particular our market-leading IPTV proposition. Quarter over quarter, we are growing on IPTV and RGUs per household.

In the residential market we find ourselves in competitive, though rational, market. Competition continues to be active with promotions, upon which we have to balance our market shares with profitability.

In mobile our propositions are now really gaining traction, and after all the things we've done in the last years, supported by 4G, multi-play and improved positionings of our brands. Including the business market, we now have about 1.4 million 4G customers, which is an increase of 34% versus the first quarter.

In the Netherlands the size of the business market continues to decline. However, we maintained our strong market position.

Going forward, we will further strengthen our excellent position as the integrated-access provider in the Netherlands. We have already taken significant steps with respect to quality improvements and our large Simplification program will be a key driver.

The operational progress in the network company is also supporting the financial performance in this segment.

Commercially we've implemented a number of initiatives to support our operational progress. In consumer residential we implemented the series of programs that should lead to an uptake in RGU growth and support our market shares. I will come to this when we get to the residential part in my presentation.

In mobile we increased the size of data bundles in consumer and business. And in consumer mobile we have increased the pricing of our low-end SIM-only offerings to further reduce the gap between the higher and lower-priced segments of the market.

In business, we continue to focus on growing multi-play and news services, and we have accelerated the simplification in these parts of our organization especially.

We are making good progress with the Simplification program, as we realize the first operational results, since the start of the program, based on the three pillars I presented at our Capital Markets Day in February.

As you see on this slide, we are rationalizing our product portfolio across all segments. With the simplification of our portfolio we create greater clarity for our customers. Supported by a number of quality improvements, we've already seen a reduction of inbound calls and significant increase in network promote score, more than 20% up.

Finally, the investments in our network quality and quality of services are bearing fruit, leading to a better operational performance of our network organization with, for example, a 30% reduction in downtime and 50% reduction in call ratio for IPTV.

Now, these for us are important KPIs to focus. In total, we've now realized around EUR75 million savings through our Simplification program, splitting EUR30 million CapEx and EUR40 million OpEx savings, mainly coming from less IT spend and FTE reductions.

The IT spend reduction is not only driven by a firm prioritization of projects with a focus on simplification and efficiency, but also by running these programs in a more disciplined way and in control of our centralized simplification office.

OpEx savings are mainly related to FTE reductions and, in the first half of the year, we reduced the number of FTEs by around 350. In the second half of 2014 and onwards the Simplification program will further support a reduction in CapEx and OpEx.

Let's now look at the numbers of the Netherlands as a whole. In the second quarter we've seen that our financial performance in the Netherlands continued to be impacted by competitive mobile markets and declining business market size.

And the second quarter very clearly demonstrated the phase we are in. On the one hand, we've seen that our year-on-year financial results were still under pressure, as the positive operational trends were not yet able to offset the impact from, for example, declining ARPUs year on year.

And on the other hand, quarter on quarter, our EBITA grew slightly and we clearly see positive operational progress with KPI trends developing in the right direction. For example, consumer mobile is showing high postpaid net adds and ARPU is now stable for three quarters at EUR28, whereas this was still down EUR4 year on year.

So as Eelco already said, the operational progress shows that we remain on track for stabilizing financial performance towards the end of 2014.

KPN has shown good operational trends in both fixed and mobile for several quarters, supported by investments in our networks, our products and customers.

Our traditional fixed triple-play offering continued to gain traction, and penetration increased by 5 percentage points, year on year.

Now, the next step after bundling services in fixed has been bundling fixed and mobile services, where KPN is good positioned as the only integrated access provider in the Netherlands.

Next to our quad-play products, we introduced another type of fixed-mobile bundles. These are bundles with at least one fixed product and one mobile subscription.

We have launched these offers by Telfort in the second quarter and also this month in our main KPN brand. The key is that the fixed-mobile offers revolve around additional benefits to our customers. Customers respond positively to these offers, evidenced by the uptake and the high NPS score on KPN Compleet.

By combining fixed and mobile, we are seeing a reduction in churn, in both fixed and mobile. In the second quarter, the number of fixed-mobile bundles kept growing to 285,000, of which 273,000 were quad-play customers, mainly KPN Compleet.

In addition, the percentage of the mobile postpaid customers having a subscription as part of a fixed-mobile bundle increased to 11% from 2% a year ago.

In consumer residential, we have seen a continued level of promotional activities by the competition. Their actions were mainly focused on growth by our increased marketing and sales; free hardware; and promotional triple-play pricing.

Coupled with the ongoing decline of traditional voice services, top line was somewhat impacted in the second quarter with adjusted revenues 0.8% lower year on year.

Also, in the second quarter, we remained disciplined in the market with a strong focus on growing IPTV. This is leading to an increased profitability with adjusted EBITDA increasing by 19% year on year.

Interactive TV continues to grow, which has led to 2 million TV customers at the end of the second quarter. As I already mentioned, we've implemented several initiatives to support further growth in IPTV and to get back to growth in broadband. These include the following.

A new simple integrated fiber to the home and copper line-up was introduced this month. We are now in the second stage with fiber to the home and we will connect all new customers in fiber-to-the-home areas to fiber. No longer different shaping between fiber to the home and copper, except for the premiums piece. The first results are promising and with clear upsell opportunities to premium bundles.

We've introduced new KPN and Telfort fixed-mobile bundles. We are accelerating the rollout of vectoring and 50% of the households will have access to speeds of 100 megabits per second by the end of this year.

And, when necessary, we are swapping hardware to allow customers access to new and unique IPTV features we offer to our customers.

These, and other initiatives, should support better IPTV and broadband trends and market share. We will continue to focus on balancing revenues, EBITDA and market shares in the residential market. The actions taken should further improve this balance.

Now let's move to mobile. Underlying service revenues at consumer mobile declined 9.3% compared to minus 12% in the first quarter. Service revenues continued to be impacted by the shift to SIM-only, lower above-bundle usage and lower pricing compared to last year. Our mobile market share in the Netherlands was 43% at the end of the second quarter, stable compared to the last two quarters.

Adjusted EBITDA was EUR86 million lower year on year, largely driven by the phasing out of the handset lease and lower service revenues, but also driven by an increase in subscriber acquisition costs, as a result of our high net adds.

We managed to get fairly good commercial traction with our propositions, which led to high postpaid retail net adds of 53,000 in the second quarter. We are convinced that we're now in a strong competitive position, supported by 4G; new fixed-mobile bundles; improved brand positioning; and stopping the handset lease model at all our brands.

Finally, we've seen the stabilization of postpaid retail ARPU around EUR28 in the last quarters as the continued trend towards no frill and SIM-only was offset by an improved performance of the higher-end KPN brand.

When I consider the Dutch business market, I see that KPN has maintained its strong positions in a declining market size. That being said, we can adjust our operating model to retain margin in a value market. Therefore, we focus on a number of elements that should support the top line and increase our cost focus further.

Our 4G customer base grew towards over 0.5 million customers representing nearly one-third of our mobile base in the business market. We consider this an important metric as 4G customers have ARPU upside, due to increased data usage and are more loyal, thereby reducing churn. The number of multi-play seats grew by 22%, thereby increasing multi-play revenues.

And on the cost side, we decided to accelerate the simplification in this part of our organization, which will lead to FTE reductions and less spent in general in our business segment.

Furthermore, we are focused on simplifying our product lineup. As I mentioned, more than 40% of the total number of propositions will be reduced this year in this market.

Also, as part of the Simplification, we will focus on optimizing supplier contracts. We're in the middle of that. We look at both the top 50 suppliers and the long-tail suppliers across our telco and IT activities. I'm convinced we are implementing and executing on the right areas to improve the performance in the business segment going forward.

In terms of financial performance, we have seen a continuation of the trends we've seen in the first quarter, with a somewhat better EBITDA margin in business. The number of access lines reduced, driven by customers optimizing their demand. And, on the other hand, the wireless base increased by 16,000 in the second quarter as the take-up of multi play continues.

But to conclude for the Netherlands, we've made good operational progress across all segments and implemented several initiatives to further strengthen our position as the integrated access provider. We are ahead of the curve with our upgraded networks and market-leading products.

I'm really pleased with the progress we are making on the execution of the simplification of the Netherlands, which is on track and already delivering the first benefits. The continued execution will be one of my key focus areas in the coming period.

I will now hand over to Eelco for the operating review of Germany and Belgium.

Eelco Blok - Koninklijke KPN NV - Chairman & CEO

Thank you, Joost. Although we are nearing the end of the sale process, we've been able to continue the good performance of E-Plus.

Also in the second quarter, we have outperformed the market. Underlying service revenues increased by 5.3% year on year, growing our market share to over 16%. The continued improvement is mainly driven by growing postpaid service revenues and stabilization of prepaid.

Also, the EBITDA margin was higher year on year at 32.4%, as a result of strong cost focus. The 89,000 postpaid net adds show a continued good operational performance, although somewhat lower than previous quarters.

Let's move to Belgium. Here we see continued good operational development in the second quarter, although the market remained competitive with competitors launching new propositions. The underlying service revenue declines continued to improve to 1.9% in the second quarter. This was driven by the good performance of postpaid and data usage. And data revenues are growing, while prepaid remains under pressure.

As a result of the market outperformance, we estimate a year-on-year increase of market share to around 21% in the second quarter. The adjusted EBITDA margin was impacted by higher traffic costs as a result of the flat fee propositions and the provision related to the Walloon site taxes.

In the second quarter, we saw continued good postpaid net adds of 16,000, driven by a combination of high-quality networks and services at attractively priced propositions. Postpaid and prepaid ARPU remained relatively stable Q on Q.

BASE Company continued to make good progress with the rollout of its 4G network, now reaching approximately 55% outdoor coverage to Belgian population including Brussels.

Let's now move to my concluding remarks. We continue to make good strategic progress driven by our market-leading products and best-in-class networks. Our unique multi-play propositions supported by our excellent position as new integrated access provider are clearly showing results as churn significantly reduces.

Conscious of market development in our fixed and mobile markets, we will continue to carefully balance revenue, EBITDA and market share going forward. This is evidenced by the high postpaid net adds in consumer mobile in the first half of 2014 and initiatives that have been implemented to support our market shares in consumer residential in the second half of the year.

In Belgium, a high quality network combined with price leadership, puts us in exactly the right position to stay successful as a mobile challenger.

The sale of E-Plus will create a solid financial profile for the KPN Group and allows us to start paying a dividend again.

With the good strategic progress we are making and the execution of the Simplification program beginning to demonstrate positive results, we remain firmly on track to show stabilizing financial performance towards the end of the year.

Thank you. And now we're happy to take your questions.

QUESTIONS AND ANSWERS

Unidentified Audience Member

UBS. I just have three different questions.

The first one is just in terms of the portfolio. If you look at your 20.5% stake in Telefonica Deutschland and if you look at BASE in Belgium, are these core to KPN longer term and would you consider divesting them and returning the cash to shareholders?



My next two questions probably for Joost in terms of if you look at consumer mobile, if we look over the coming quarters, can we expect postpaid ARPU to remain broadly stable at [EUR28]?

And also, if you look at the momentum that you've been seeing in terms of net adds, can this accelerating momentum continue? And where are the net adds coming from? Is it from any particular player?

And actually the second question for you, Joost, is just in terms of pricing. You mentioned that pricing for the SIM-only offers, you're actually increasing the prices. So can you just talk us through that in the context of Tele2 launching 4G at some point later in the year? Isn't it a strange move to actually increase your prices ahead of a new entrant coming in? Thanks.

Joost Farwerck - Koninklijke KPN NV - MD, The Netherlands

I will start with the portfolio question, starting with the 20.5% stake in Telefonica Deutschland. As you know we are in the final stage of the process of closing the transaction. We don't know today all the details we need to take a decision on our next step with the 20.5% stake. But I can assure you that we will do everything to take the right decision to create as much as possible shareholder value as we can.

As I said we still have to wait 'til we have all the information needed to take this decision.

That on the 20.5% in Telefonica Deutschland.

On BASE, it's a subsidiary that is really performing well; out-performing the market. We see also some upside in the financials going forward.

But we are pragmatic. Meaning that if somebody knocks on our door and presents an offer to us that is attractive also from a shareholder perspective, then we will do exactly the same as we have been doing with E-Plus.

Eelco Blok - Koninklijke KPN NV - Chairman & CEO

Then, Joost, so it takes us to questions on consumer mobile [and net adds].

Joost Farwerck - Koninklijke KPN NV - MD, The Netherlands

Yes. As you know, our consumer market is competitive, that's what we concluded on two years ago. So we really invested first in the most important thing the network, and we decided to rollout 4G as fast as we can. So we ended up ahead of competition on 4G.

We really worked on our propositions. On all the brands we made a simpler, better overview for our customers to choose and the price points are very important.

Then what you see is that the net adds come in. So last quarter was okay, this quarter is better and we are working on this trend.

It's not that you lose it from one day to the other; you really have to work for it. So I expect this trend to go forward on the net adds.

It's fairly important that you look at the health of the net adds, so and that's what we do. We look at the high-value brands, compared to the no-frills segments. I think it's very important to be in the market, and as being the market leader, to make choices to run the most profitable base. That's why we decided to increase tariffs in the no-frills SIM-only brands, because we would like to have our high-value brands in the base.

And we see a good ARPU inflow and that's very important KPNs. We look at the average and you look at the inflow, and when it's above then we do the right thing.



So that's where we are. And like I say it's a machinery so what's not going to disappear from one day to the other, but it's very important that you run it in the right direction, invest in the right net adds, and that we continue to do this quarter after quarter.

So we just more or less started this, and I expect to deliver more net adds in the coming quarters.

On ARPU, stable for a couple of quarters now, I can't predict it will be like that, but I will work very hard to make it happen. And that's why, like I just said, it's important to increase on the lower side and move your customer base to the higher -- high-end customers.

You mentioned Tele2, it's a competitive market like I said. But good news for me was that also the other high value player in the Dutch market showed net adds. So there is a market for high value net adds, especially when you are on 4G.

So, as a market leader, we have to understand that and direct ourselves in first place to that route.

And Tele2, you mentioned they are rolling out 4G. We are not sure where they are now they are on MVNO and they do less net adds. I think the churn is coming in. But, yes, it's up to Tele2 to explain how they run their business, but we follow that, of course, also very carefully.

Roman Arbuzov - Barclays - Analyst

Roman Arbuzov, Barclays; a couple of questions please, on mobile and actually starting with multi-play. You're saying that you're now going to offer multi-play with single-play fixed products and double-play. Can you please just explain a little bit how exactly that's going to work?

Are you going to double the mobile allowances as you are currently doing with triple-play? Yes, a little bit more color on that that would be great?

And on FTTH and copper no longer making a distinction, could you please talk about pricing for that? Does that mean FTTH prices have come down or copper prices have come up?

And also a question on your discontinued operations, perhaps you can give a little bit of color on why the German margins were very high in the quarter? Thank you.

Unidentified Company Representative

It was difficult for me to understand the last question.

Roman Arbuzov - Barclays - Analyst

The Germany margins, why were they so high in the quarter?

Eelco Blok - Koninklijke KPN NV - Chairman & CEO

I will start with the last question about the German margins. That's just driven by the decision to balance postpaid net add growth and EBITDA, and a continued strong cost focus. Joost?

Joost Farwerck - Koninklijke KPN NV - MD, The Netherlands

Your first question I didn't get completely, I think you referred to our fixed-mobile combination?

Roman Arbuzov - *Barclays - Analyst*

Yes the fixed mobile offers, I currently understand the way to work it out with the triple-play is that you basically double the minutes, the SMS and data allowance with the triple-play, plus you give away some additional channels on the fixed side.

How is that going to work if it's a double-play or a single-play customer?

Joost Farwerck - *Koninklijke KPN NV - MD, The Netherlands*

Okay, right.

Roman Arbuzov - *Barclays - Analyst*

Does it work in exactly the same way, or will there be a pricing element, for example?

Joost Farwerck - *Koninklijke KPN NV - MD, The Netherlands*

So on triple-play we decided when a customer moves to quad-play, which we call KPN Compleet, we don't offer discounts; we offer more services on a more or less fixed cost base. So that's free calling in the family, more data on the mobile and more TV channels on IPTV.

On fixed mobile so the dual play, what we call multi-play in the presentation, we make a price package for the combination of fixed and mobile minutes. Also there, it's benefitting -- it's a combination of the two, we are not having any discount on the dual-play.

Now, you had a question on the fiber to the home and on the new lineup and if this means that we will lower tariffs on fiber to the home.

What we did until today, or last month in fiber areas, customers can still choose between a fiber or a copper connection. Now, we stopped that and we made it more simple. We made one lineup, which is called our Free Choices Step In, a basic package or a premium package.

Now, if you are on fiber in a fiber area you pay EUR7.50 more for a 100 megabit connection, or EUR17.50 for a 500 megabit connection. That's adding up to the ARPU we want to have for fiber.

So it's not leading to a lower ARPU in fiber. It's very important in our fiber case that we run a better ARPU. It's one of the key drivers in the fiber business model. So I think that we will have more fiber customers with this lineup on a high ARPU.

Akhil Dattani - *JPMorgan - Analyst*

Akhil, JPMorgan; three questions. Firstly, just a question on your fixed-line infrastructure strategy.

You've seemingly accelerated your vectoring plans, given the early uptick that you've seen through that. Could you just explain to us what that might potentially mean for a Reggefiber rollout?

Is there a bit of an opportunity to save further slowing the rollout there, or is this something you want to continue at the same pace you highlighted at the full-year results? And just what that might potentially mean for CapEx.

Secondly, on the earnings trajectory over the course of this year. You're sounding a lot more confident on the consumer mobile space. Can you just walk us through, in addition to the revenue trend changes that we might see going forward, how we might think about the cost-saving phasing from H1 into H2? Is there a bigger weighted savings, as we move forward? And again, what could that potentially mean?

And then, finally, just, I guess, as a follow-up to one of the earlier questions we had around portfolio management. I'd just be interested to get an update on your thoughts around Tele2; obviously something that's debated a lot in the market, in terms of whether KPN strategically would have interest in that asset.

Just -- if you could update us around how you think about that, both in terms of the rationale? But also from a regulatory standpoint, if there are any key data points or timing issues we need to think about, before you can even consider that as an option? Thanks a lot.

Eelco Blok - *Koninklijke KPN NV - Chairman & CEO*

Joost, so you first take the fixed-line question?

Joost Farwerck - *Koninklijke KPN NV - MD, The Netherlands*

Yes. So we are very enthusiastic on the developments on the copper technologies, especially since we have a high-quality copper network with double-twisted pairs to our households.

We rolled out, as you are aware, the new technologies, pair bonding and vectoring. Now, we are now connecting households in a pilot, and we are very enthusiastic with what we see over there.

So we have a hybrid exit strategy. That means that wherever we can, we will use the copper network to deliver the speeds to our residential customers. In very weak areas, we will still make use of the fiber to the home.

So if we look at the investments that are [now] coming 18 months, my first priority is to invest in VDSL and vectoring, since I cover many parts of the Netherlands in a very efficient way.

Of course, fiber will deliver a higher speed at the end. But fast moving is the combination of vectoring and VDSL and pair bonding. So that's what we aim for.

We also have to run the budgets and the expense we do. So if I look at the coming year, then I think we will roll out lower on fiber to the home, and first make use of the benefits the investments in copper.

Having said that, of course, we will also very much focus on existing fiber areas to upgrade the penetration there.

Eelco Blok - *Koninklijke KPN NV - Chairman & CEO*

Yes, you had another question on consumer mobile. No, you referred to cost savings.

Akhil Dattani - *JPMorgan - Analyst*

Sorry, the question was just really, at a Group level, it sounds like we are at a bit of a turning point, in terms of the revenue story. I just wondered whether that is purely the driver of the earnings stabilization you're talking about, or whether there's any incremental points you want to highlight in terms of H2 versus H1 cost savings.

Eelco Blok - *Koninklijke KPN NV - Chairman & CEO*

Stabilization of the financial performance is, of course, partly driven by the improved top-line trends, but mainly driven by the Simplification program and cost savings going forward.

We are seeing improved trends in consumer mobile, as Joost experienced. So that's underlying the stabilization.

On consumer residential, we see clear EBITDA improvement, year over year. We are convinced that we can continue this trend in business. Trends are stabilizing. With the decision we have taken to accelerate the Simplification program, we are convinced that we can mitigate a continued negative top-line decline in the business market. And NetCo, as you can imagine, will benefit from the Simplification program, both on OpEx and CapEx.

The first positive change of trends we have now seen in the second quarter, compared to the first quarter. And we are convinced, and firmly believe, that we will continue this trend in the third and fourth quarter. That's underlying about the statement I made that we are confident that we will stabilize financial performance towards the end of 2014.

Then, the question on Tele2. Well, our clear focus, also discussing M&A, is on value creation; meaning, looking at the right assets for the right price. Strategically, income fee consolidation makes a lot of sense.

But from a regulatory point of view, yes, it's a hurdle, and that's where we are today. Of course, we know that timing is of the essence, given our strong position of today compared to where Tele2 is.

Simon Weeden - *Citi - Analyst*

Simon Weeden, Citigroup; a couple of questions. One is, you've mentioned re-farming and the introduction of LTE Advanced in your press release. I just wondered if you could elaborate on what that's going to look like in terms of a consumer offer. I'm not asking for your pricing, but just what does LTE Advanced give you that you wouldn't have had before?

And whilst you're on that, I wondered if you could touch on whether voice over LTE is a feature that you'll be offering with that, or if that comes further down the line, and if so, when? That was my first question.

And the second question is, if I remember rightly, I think you've said in the past, please correct me if I'm wrong, that you felt that the offer or the wholesale proposition made by one of your competitors for Telenet in Belgium was a mistake. Could you comment today on whether you think, therefore, that when that comes up again, or in general, that wholesale prices should be pricing for MVNOs? Thank you.

Eelco Blok - *Koninklijke KPN NV - Chairman & CEO*

I never said that the wholesale offer of Mobistar was a mistake. I only shared with you that we were also negotiating a wholesale deal with Telenet, and that we stepped out at a certain point in the process, because we believe that the prices Telenet was asking were destroying value in the market and not creating value.

Yes, the contract will come to an end, but I don't know what will happen when we reach that point.

I think, Mobistar should have done a better job than they did when they negotiated the deal with Telenet and it, well, destroyed also a lot of value for the Mobistar shareholders.

So that's my position on the wholesale contract in Belgium. Maybe, Joost, you could answer the question on LTE Advanced in Belgium?

Joost Farwerck - *Koninklijke KPN NV - MD, The Netherlands*

Yes. We rolled out the LTE on the 800 spectrum in the Netherlands, almost full coverage of the total country. Now, we roll out also on 1800s on several locations; the most important ones in the Netherlands.

The combination of the two will be used as one LTE service. We are, as enthusiastic. Of course, we piloted this first and we see real high-speed connections in those areas.

We've just started to roll out, by the way. But we see very good results there. I can't tell you how the propositions will look like, but I can tell you that speeds are 50 megabits or more already measured on the combination of the two frequencies used as one service.

Of course, we are also piloting VoLTE. Also there, we are enthusiastic on what we see in our own pilots. High quality, we experience. We do that together with our suppliers and everything is according to plan.

Having said that, we have an excellent combination of 4G and voice already today, since we have the best 2G and 3G networks in the Netherlands. So on the KPN network you can have a 4G subscription and make a use of our voice networks as well. But, of course, we are also working on VoLTE.

Paul Sidney - *Credit Suisse - Analyst*

Paul Sidney, Credit Suisse; just a couple of questions please.

Firstly, a general question on 4G. A very interesting data point you shared with us on data usage (inaudible) how data usage and 4G is evolving versus 3G, or how usage on 4G has evolved over the past 12 months. Quite interesting, given you seem up pretty upbeat about the way usage is going.

Just the second question on consumer mobile. You increased the amount of data within your bundle from July 1 on the KPN brand this year, when it seemed as though Q2 in terms of your share of net adds was getting better.

It's just really to understand a bit more about what was the rationale behind increasing the data within the KPN bundles. Thank you.

Eelco Blok - *Koninklijke KPN NV - Chairman & CEO*

Joost, will you take those questions?

Joost Farwerck - *Koninklijke KPN NV - MD, The Netherlands*

Yes. What we see is a real big difference between 3G and 4G users, especially on the KPN and Hi. And on the KPN it's, if I'm not mistaken, almost twice as much and on Hi 3.5 more data usage than on the 3G.

So we really see, when customers move to 4G, that they really make use of more data. So that's a very important conclusion and we think we should encourage our customers, of course, to use more data on 4G.

Now, why did we make the bundles on KPN bigger? I think that's what our customers want. We want really differentiate our KPN brand and our Hi brand as high quality brands compared to the other brands in the Dutch market. We see good net adds coming in, but we really want to see KPN net adds coming in.

Yes, on everything we do nowadays we really see that KPN the high quality and the high ARPU brand customers come in, and that's important when we run the net adds. I can run a lot of no-frills net adds, but that's not adding the value we're focusing on. So I'm really focusing on the KPN brand there.



Paul Sidney - *Credit Suisse - Analyst*

Sorry, Joost, just a quick follow-on from that. Is that one of the reasons why you raised SIM-only pricing as well? Is that how we should think about it?

Joost Farwerck - *Koninklijke KPN NV - MD, The Netherlands*

Yes, I think that it's very important to -- we invested a lot in the Netherlands in frequencies; in networks; in handsets; in everything. So we want to make sure that there's also profit at the end of the line and, therefore, we raised the tariffs in the no-frills segment and I think that the market is responding to that.

It's very important to understand that we are a market leader, with all the brands we have, and that every now and then we really should consider the role we have in the market. I think it was very good that we moved the SIM-only brand, Simyo, (inaudible) and that we moved KPN in a higher data bundle and then you see your base also moving. That's very important.

Tim Boddy - *Goldman Sachs & Co. - Analyst*

Tim Boddy, Goldman. I had a couple of questions. First of all, on the consumer residential business. Any color on, I guess two things, one is the mix of gross adds between the KPN brand and Telfort, and how that's progressing there? Whether that's changed in recent quarters?

And related to that, as you've added value to those bundles, how have you done that and is that, essentially, an implicit price cut?

And then, secondly, Telefonica, obviously has a focus on deleveraging and I wondered if, as a minority in Telefonica Deutschland, you have any protection, whether it be a minimum leverage commitment or something like that, that makes you feel confident you can get an attractive dividend from an asset that, when it becomes part of Telefonica Group, will actually be significant deleveraging for Telefonica? Thanks.

Eelco Blok - *Koninklijke KPN NV - Chairman & CEO*

We are 20.5% shareholder in Telefonica Deutschland and in the shareholder meeting we can have influence on what they are doing. So at the end, it's Telefonica who will decide what to do with the financial framework, leverage, and things like that.

So that's one of the items we need to know to be able to take a decision what to do with the 20.5% stake. Of course, the dividend policy will be one of the very important information that we need to be able to take the decision. We expect that to be known shortly before the sale will be closed.

Unidentified Company Representative

Joost, on residential?

Joost Farwerck - *Koninklijke KPN NV - MD, The Netherlands*

Yes, residential, our triple-play base, or multi-play base it's mainly focusing on KPN and Telfort. Both brands do quite well.

KPN is somewhat more extensive than Telfort in residential and, thus, offering more. On KPN the combination really offers the double speed, free calling in family, and more TV channels. In Telfort triple package is slightly cheaper than KPN with less speed and less TV channels. So that's the main differences.



There's a market for both, especially in the Dutch market, people are very price-sensitive. So we really look at the customer segments; and we target for the Telfort segment and the KPN segment. Both look -- do quite well.

Now, for the coming quarters, we will focus on the BASE, because we really think it's important to show revenue growth and BASE growth again in the third -- in the fourth quarter. That's why we improved our lineups, not only on fiber and copper combination, but also in fiber. We made it more simple. And, we are improving our marketing campaigns for the coming quarter, to really see -- yes, us growing in the residential market.

I already mentioned in my presentation that for us it's a balancing act. It's not when competition is doing something like giving away free devices, or free field engineers, or strong discounts that we follow. It's very important for us to have a balancing act between profitability and market share.

We think the coming quarter we will make benefit of all the preparations we did. Again, we're happy with the 90% year-on-year EBITDA growth, and it's also where we keep an eye on.

So it's a balancing act between market share, profitability, and customer base.

Ulrich Rathe - *Jefferies & Co. - Analyst*

Ulrich Rathe, Jefferies; two questions. The first one is again on the residential fixed market in the Netherlands.

Given that [Ziggo] is subject to a takeover at the moment, would you consider their current market approach normal? And do you expect a fundamental shift in the commercial situation, the competitive situation, post-consolidation, if it happens? That would be my first question.

The second question is for Eelco. At the very end of the Q1 presentation, Eelco, you said that the implications of the guidance, which is probably a bit up for interpretation, you said that ultimately it boils down to free cash flow for the year being roughly flat, year on year; roughly give and take.

Is this something based on the current trend you would reiterate apart from the EUR200 million for the pension settlement? Thank you.

Eelco Blok - *Koninklijke KPN NV - Chairman & CEO*

Starting with question on the -- on guidance. No change in guidance compared to what I said after -- during the Q1 presentation.

Yes, of course, taking into account, Steven just telling me to reiterate that excluding the EUR200 million of the pension.

Steven van Schilfgaarde - *Koninklijke KPN NV - Interim CFO*

The pension EUR200 million is an exceptional, and also as discounted as such in the press release.

Unidentified Company Representative

Joost, shall we take the residential on the MVNO of [Ziggo]?

Joost Farwerck - *Koninklijke KPN NV - MD, The Netherlands*

Yes. So we see -- saw an experience -- lots of activities from [Ziggo].

And yes, you ask me what I expect after the consolidation. I don't know what to expect, and I can't speak for [Ziggo].



What -- I think it -- you can't just keep on giving away something, devices, for a very long time, field engineers, and heavy discounts at the same time. At least, that's what I think.

So therefore, I just said, for us it's all -- also about profitability. And I hope, and maybe expect, the new owner of [Ziggo] to think in the same line.

So we can sometimes see one quarter -- one player in the market that's very active in a marketing campaign. The other quarter, another player in the market. I never experienced one player in the market being very aggressively in marketing discount, etc., for five quarters in a row, to give you just an example.

So I expect rational behavior, let's put it in that way.

Unidentified Audience Member

Deutsche Bank. You've obviously shown some momentum with the growth in the number of bundle customers, but [this] only represent 11% of the postpaid customer base. Can you give us a sense of what potentially you'd like to see in the near future?

And is there not an opportunity to be a lot more aggressive with bundling, ahead of the Tele2 launch and the enlarged [Ziggo] entity entering as well?

Joost Farwerck - Koninklijke KPN NV - MD, The Netherlands

Yes, we call ourselves the integrated access player in the Netherlands since a lot of players and all players in the Dutch market claim convergence. We are the only Company with both fixed and mobile assets.

And so we really can make the combination and the packages. So we are very enthusiastic of what we prepare, and what we launched in the market; and also on the growth we currently see, both in consumer and the business market. And I think it's a very important KPI to focus on, since we really see a reduction of churn when customers move in the triple-play or quad-play.

The combination of fixed and mobile here is very important. Now, other players have to buy the mobile by an MVNO, or the fixed on our network. So that's more difficult, that's where we want to make benefit from.

So for the coming quarters this will be very important for us to grow our base in the combined combination of broadband and mobile.

And I expect us to be more successful there than the other players you mentioned.

Sasu Ristimaki - BofA Merrill Lynch - Analyst

Sasu Ristimaki, Bank of America. I had two questions, really.

First is, notice that the ACM has placed your increase in ownership in Reggefiber in Phase 2 review. Do you anticipate this will lead to any significant remedy discussions that will change the structure of the fixed-line market in the country?

And then secondly, there's already a mention of MVNOs or a wholesaling in Belgium. And I notice that you recently offered a wholesale deal to, I think, [FreedomPop]. Do you think that's on significantly more attractive rates than what Telenet has Mobistar? And if there's any indication of how do you see MVNO's [FreedomPop] or others in [premature] [telemarket] in Netherlands from here on? Thanks.



Eelco Blok - *Koninklijke KPN NV - Chairman & CEO*

ACM took the decision to move the Reggefiber merger approval process to a Phase 2 process. Meaning that they are doing some additional investigations on this consolidation. But we don't expect major changes to be the outcome of this process.

So we are confident that without major changes ACM will take a positive decision in Phase 2, somewhere in the fourth quarter of this year.

And on the MVNO, can you repeat the question, because I --?

Sasu Ristimäki - *BofA Merrill Lynch - Analyst*

In Belgium, does [FreedomPop] have similar rates as Telenet in your impression, or are [they talking to you], in view of your earlier comments. And is this any indication of how you see MVNOs -- or hosting MVNOs Netherlands?

Eelco Blok - *Koninklijke KPN NV - Chairman & CEO*

Right, so first of all I don't know the details of the MVNO deal you mentioned, and I can assure you that we will not end up in the Netherlands with the same situation as in Belgium.

Unidentified Company Representative

Time for one or two more questions, so.

Unidentified Audience Member

(Inaudible). I have three questions, if I may; two are credit-related.

The first one is you mentioned increasing financial flexibility after you receive the proceeds from this quarter. But do you have any rating target in mind or any leverage target in mind? That's my first one.

The second question is related to a comment made by Eelco regarding lowering the gross leverage, the gross debt. Does it mean we should expect some [bond] tenders after the deal is closed?

And my final question is more general question about your current relationship with America Movil. Just a few comments would be great. Thanks.

Eelco Blok - *Koninklijke KPN NV - Chairman & CEO*

The first question about the target. The only thing we shared with the market is that we want to continue to have an investment rate, a credit rating. That's at this moment the only thing we want to share with the outside market, so no net debt over EBITDA target, because we believe that could limit really our flexibility if we put a number or a range in the market.

Yes, one of the [usual] proceeds is reducing gross debt. First of all, it's just a normal redemption of the debt. And, yes, we are looking at several other options. But we'll take a decision later this year when the sale is really completed.

Our relationship with AMX is improving; was already okay at the beginning of this year but is improving. Supervisory Board Members are participating -- continue to participate in the Supervisory Board meetings in a constructive way, supporting the strategy of the Group.



As I explained to you at the beginning of the year, we have restarted some of the operational working groups and we continue to work on those operational working groups, targeting procurement, our bases and technology. And also, the last few months, the relationship improved on the operational side.

So first benefits are coming. We are, especially on VDSL and vectoring and bonding, much further than America Movil and they are using our knowledge, our experience, to translate that to their footprint.

So improving relationship operationally and continued good relationship with two Supervisory Board Members representing America Movil.

Unidentified Audience Member

I have three questions please. The first question was just on KPN's view on over-the-top MVNOs, and specifically the logic of, given what's happening in MVNO deals in Germany.

And then again as the earlier questioner asked about [FreedomPop] in Belgium. Just wondering if you see any risk of cannibalization there for your voice revenue through voice over IP over LTE, or something like that.

The second question was I'm just wondering how long can your EBITDA in consumer residential keep growing double-digit when revenues aren't growing. Does a point come when your SAC has rebased down to a level where you have to grow revenues again to grow EBITDA? So if you could just comment on that.

And then the third and final question was just on the B2B ARPU, whether that was a surprise to you in terms of the decline that we've seen in the second quarter? And if so, is there something in the economy that's going on that explains it? Thanks.

Eelco Blok - *Koninklijke KPN NV - Chairman & CEO*

Joost will take the residential and B2B question and I will start with the first question about the MVNOs.

The MVNO deal with WhatsApp is just a deal in Germany fitting within the framework we have. Well, as E-Plus [said, set] in the market and everybody is on top of it, because it's WhatsApp. But I can assure you that there are no strange or disruptive party in the agreement with WhatsApp.

And again, with FreedomPop, as I said, I don't know the details of the agreement. But I'm convinced that this will not put more pressure in the Belgian market and will not have any impact on what's happening in the Dutch market on MVNOs.

Joost Farwerck - *Koninklijke KPN NV - MD, The Netherlands*

And on your question on residential. You mentioned top-line growth being very important, and I agree with you. So that's why I already mentioned that we have a new line-up. We have, of course, an upselling in the combination with mobile. We increased tariffs, by the way, beginning of this month. So over the six months of the second half this year we will benefit from higher tariffs.

But it's also about running more customers. So that's what we will focus on, and everything is focusing on that.

And you mentioned the B2B ARPU in the business segment, we see a decline in wireless. And, like I said, it's a EUR1 step-down, but there is pressure in the business market in the Netherlands.

We have a very strong market position, but the market on itself is under pressure. That's because customers are optimizing their customer demand, the contracts. Big banks are closing buildings, sending people home, and that means less mobiles and pressure on the pricing when they put the tender out in the market.



Having said that, also here it's very important to look at the health of the base and the prices we put in the markets. Also there, we are working on the ARPU so there's a pressure in the business market.

As a market on itself, we have a very strong position and we keep the strong position and we will mainly also benefit from cost reductions to keep our margins up in the business market.

Unidentified Company Representative

Okay, with this last question, I would like to end this Q&A session and thank you all for coming over for our second quarter results; also the ones on the webcast. Let us know if you have any further questions.

Thank you.

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