Company Name: Telenet
Company Ticker: TNET BB
Date: 2022-07-28
Event Description: S1 2022 Earnings Call

Market Cap: 1712.54823061
Current PX: 15.19
YTD Change($): -16.87
YTD Change(%): -52.62

Bloomberg Estimates - EPS
Current Quarter: 0.997
Current Year: 3.642
Bloomberg Estimates - Sales
Current Quarter: 652
Current Year: 2620.444

# S1 2022 Earnings Call

## Company Participants

- Rob Goyens, Vice President Treasury & Investor Relations
- John Porter, Chief Executive Officer
- Erik Van den Enden, Chief Financial Officer,

## Other Participants

- Nawar Cristini, Analyst
- Joshua Mills
- David Vagman, Analyst
- Simon Coles
- Yemi Falana, Analyst
- Emmanuel Carlier, Analyst
- Ulrich Rathe, Analyst
- Polo Tang, Analyst
- James Ratzer
- Ben Lyons, Analyst
- Martin Hammersmith

## Presentation

### Rob Goyens, Vice President Treasury & Investor Relations

Thanks operator, and welcome everyone to our second quarter earnings webcast and conference call. As always, all earnings materials including this presentation can be found in the results section of our Investor Relations website, and after this call, we will also provide replay and a transcript for those that may have missed this call.

Last week, we announced the groundbreaking NetCo partnership with Fluvius. So following the many interactions with investors, shareholders and analysts, the past few days, we would like to start today's call with a recap of this transaction. And why it is strategically important and beneficial for Telenet. After this overview from our CEO, John Porter our CFO, Erik Van den Enden, will guide you through our operational and financial results. We'll then open it up for Q&A.

Given, the number of participants on this call, and in order to allow an equal treatment, we're limiting to two questions each. Any follow-up questions can be directed to the Telenet Investor Relations team afterwards. Before we start, however, I would like to remind you that certain statements of this presentation are forward-looking statements. More information on the statements can be found in the safe harbor disclaimer, at the beginning of our presentation. As of this quarter, we've also started to report an adjusted EBITDA after lease basis or adjusted EBITDA as it is often called. Adjusted EBITDA differs from the adjusted EBITDA we report, in the sense that this metric also captures depreciation on leases and interest expense on leases. And this both are so-called operating and finance leases.

Following the successful closing of our tower sale in June and given the lease-related payments to DigitalBridge as of that moment on the passive infrastructure that we are renting back, we believe that adjusted EBITDA provides a good indication on the health of our underlying business. For more details, I refer to Section 6.2 in this morning's earnings release and to the investor and analyst doc. With that introduction let me now hand over to John. John, the floor is yours.

## John Porter, Chief Executive Officer

Thanks, Rob, and good afternoon or morning to all of you. Thanks for joining this call. I would like to kick off today's call with a short recap on last week's NetCo partnership announcement with Fluvius. There are six key attributes where I, my leadership team our Board and our employees at Telenet are all very excited about this landmark transaction. Together with Fluvius, we're creating a highly valuable digital infrastructure company what we call NetCo, which is well positioned to attract additional interest from external strategic and or financial investors. NetCo has a clear roadmap to provide speeds of 10 gigabit per second to all customers in its footprint, using a mixture of HFC DOCSIS and fiber technologies. With a network penetration of close to 60%. NetCo starts from a leading position by generating revenue and cash flows from day one. This makes it unique to most other fiber initiatives in the market. Secondly, NetCo has a well-defined investment program to future proof its network and realize the economic benefits associated with fiber. NetCo intends to cover 78% of Flanders with FTTH by 2038 through a mixture of own build and or potential collaboration with partners to drive incremental returns.

The EUR2 billion investment we presented last week presents a view as if NetCo was going to achieve the 78% coverage fully on its own, and is fully self funded through its own free cash flow generation. However, through partnerships and the right strategic choices there is scope for NetCo to drive down this investment envelope further. Thirdly NetCo will operate an open access network and will offer non-discriminatory access conditions to access seekers ensuring further tenancy growth over time.

A fourth important attribute is the conversion of the Fluvius long-term lease agreement or erfpacht which brings along improved network ownership economics in the remaining one-third of Flanders versus more onerous rental economics we had under the lease, and which would have matured in 2046. As discussed last week, the removal of erfpacht will free up around $0.5 billion of debt on our balance sheet on a pre-IFRS 16 basis. And this would have grown to around $1.2 billion over time under our planned investment program otherwise. Therefore seriously hampering our balance sheet capacity.

Next, we see the NetCo partnership as a clear organic value creation path for both Telenet and Netco and we'll talk more about it in our upcoming Capital Markets Day in the latter part of September. And finally, we presented a fully funded and derisk investment plan for Telenet, which is not require any additional external financing, which I believe is a strong asset in today's volatile markets. In order to maintain consolidated net total leverage of up to four times throughout the bill period the Board has reset the shareholder remuneration policy after the bill period we expect CapEx to return to more normalized levels and hence see scope for incremental shareholder dispute disbursements.

Earlier top-ups are not part of our investment plan but can and will be considered by the Board in the event of a partial NetCo sale by Telenet or network deployment optimization of our CapEx. On the next slide, you can find a snapshot of our partner Fluvius with whom we have been having long-term partnership through a network lease across approximately one-third of Flanders, which has allowed us to offer fixed services to end customers in that part of the Flemish footprint. We have been working together for over 25 years so this partnership is one more step in a long journey.

Turning to Slide 6, I said earlier, that one of the merits of this deal is that the conversion of the Fluvius long-term lease agreement, which was put in place since 1996, and we subsequently extended in 2008 as part of the Interkabel acquisition. As you'll see later on, we're making substantial payments to Fluvius under these arrangements, which adversely impact our adjusted free cash flow. It's fair to say that the borrowing rate under these leases is 6.25% to 7.2% by far the most expensive in our debt stack. Furthermore Telenet pays for all our OpEx and CapEx on the Fluvius footprint including a close to 17% markup on CapEx investment.

And finally, there was a legal right for Fluvius is to take back the network in 2046, which is unhelpful in the context of major network upgrade projects. As such, the conversion of the lease will not only bring along improved network economics for us, but will also lead to improved build economics and remove the uncertainty regarding the future one-third of our network.

To conclude on this point. Slide 7 gives you a snapshot of the financial ramifications of the Fluvius agreements. On a P&L basis it mainly impacts our net income, as these lease depreciations are recorded below adjusted EBITDA and so as the interest. On our cash flow, the impact is already much more outspoken with both interest and principal repayments captured in our adjusted free cash flow definition. And at the bottom of the table you see the balance sheet impact, as I already alluded.

So as you can see on the next slide, our new partnership with Fluvius eliminates the erfpacht lease creating a highly valuable digital infrastructure business. We believe NetCo is well set up for the future with a highly attractive financial profile, including a 76% EBITDA margin and a long-term CapEx to sales intensity of around 10%, and a market-leading network penetration of close to 60% with potential to add further tenants. For these reasons, we believe NetCo has all the right attributes that will make it attractive to potential infrastructure investors and-or you partners. On Slide 9, we've tried to visualize the impact of the NetCo transaction on our combined valuation. This view includes a 100% ownership of Telenet's remaining ServCo business and a proportionate 6.8% stake in the NetCo which was valued at an EBITDA multiple, in line with comparable NetCo assets. The picture is very clear. At the current share price level there is significant intrinsic value upside. On the next slide, you can see an overview of the transaction structure as announced last week. With us owning a majority stake of 66.8% in NetCo.

Which set up the NetCo as an independent fully funded and self supported company with a net total leverage of close to five times were equivalent to a net debt of around EUR2.4 billion. The NetCo will close with no cash on the balance sheet and the debt is primarily coming from Telenet's contribution of a EUR2.4 billion intercompany loan. 33% of which will be a proportionate liability for our partner Fluvius through their ownership in the NetCo. As with any intercompany loan NetCo will settle interest on these loans and this will also be applied to additional loans as the case may be.

When considering the equity contributions of each party and the expected net debt of EUR2.4 billion we are looking at an implied low double-digit EV multiple. One of the consequences of setting of NetCo as an independent entity is that, there will be clear demarcation lines between Telenet and NetCo with full business model autonomy and separate governance NetCo will operate on a fully-neutral and independent basis offering gigabit speeds day one across the entire footprint.

As such, we believe NetCo is very well placed to capture additional network tenancy and penetration over time. Moving on to the next slide. As I mentioned earlier NetCo will invest up to a maximum EUR2 billion to reach 78% FTTH coverage in Flanders by 2038. This EUR2 billion investment plan excludes success-based termination-related capital expenditures and assumes that NetCo will build FTTH on its own to reach the affirmation target.

However, we see a realistic salient area, whereby the 78% FTTH its target will be achieved through a combination of own build and potential collaboration with partners with further flexibility to optimize CapEx spend to drive incremental returns. We see attractive build economics in a substantial part of our footprint with over 50% of homes carrying an estimated FTTH upgrade cost of around EUR650 On the bottom of the slide, you get a sense of how the CapEx is likely to be spent going forward with the vast majority being earmarked within the next eight years. As part of this transaction our team's spent a considerable amount of time identifying value creation opportunities for both NetCo and ServCo. We will further detail such value drivers during our upcoming Capital Markets Day in the latter part of September, but already provide a scoop during today's call. So in terms of next steps we'll soon get back to you with more details on our upcoming Capital Markets Day. As mentioned last week, we are in constructive discussions with the competition authorities regarding this transaction and expect NetCo to launch at the beginning of 2023.

Slide 13, summarizes the pro forma effects of this transaction on our financials with the aforementioned decline in debt and net total leverage. Both Telenet and NetCo will have an attractive financial profile and drivers for long-term value creation. We will further detail these value drivers during our upcoming Capital Markets Day in the latter part of September, but already provide a scoop during today's call.

So in terms of next steps we'll soon get back to you with more details on our upcoming CMD. As mentioned last week, we are in constructive discussions with the competition authorities regarding this transaction and expect NetCo to launch at the beginning of 2023. Before diving into our second quarter results I'd like to end with a short update on the, multi-band spectrum auction which just ended.

We've obtained a total of 215-megahertz of spectrum across various frequency bands for a total cost of just over EUR300 million. Together with the continued densification of our mobile network this will allow us to accelerate our 5G deployment in order to maintain our current leading position in terms of mobile network quality. So with that, I'd like to hand it over to Erik for a review of our Q2 operational and financial results.

## Erik Van den Enden, Chief Financial Officer,

Thanks, John, and good afternoon everyone. Let me take you through the operational and financial highlights of the second quarter in the first half of the year. Our operational performance in the second quarter was broadly consistent with the trends that we observed in the first quarter of the year characterized by generally low flux in the market. You can see this from the continued historically low churn with the annualized rate for all of our products further decreasing on a quarterly basis.

This relatively quiet market environment translated into a broadly stable broadband Internet subscriber base for Q2, indicating that the tailwinds that we and the rest of the markets enjoyed last year during the COVID pandemic has now come to an end. Mobile side, we managed to add another 8,100 postpaid net adds in the quarter on an organic basis which was broadly in line with the first quarter. Our FMC customer base continues to grow, adding another 16,500 subscribers in Q2 driven by the success of our ONE and ONE Up bundles. As such, we now have almost 799,000 FMC subscribers. As far as the ARPU is concerned there was a slight contraction year-on-year to just over EUR58.

This was mainly a result of the bundle revenue allocation effect from our one and one of the bundles where we allocate a larger portion of the bundle review to mobile. As we've already discussed in previous calls this more than offsets the positive impact of FMC growth customer up tiering and the August 2021 rate increase.

Moving over to our financial performance now. For the first six months of the year, our revenue came in at almost EUR1.3 billion. This was broadly stable compared to the same period of last year, which contained certain positive one-offs on our video revenue. In the second quarter our revenue was up almost 1% year-on-year to EUR645 million with nearly a 3% growth in our other revenue reflecting a higher contribution from our wholesale business and higher revenue from handset sales within the quarter.

In line with our full-year outlook, we expect to achieve a stronger topline performance in the second half of the year driven by the 4.7% rate increase, which became effective as of mid-June and which will start to have a meaningful effect as of the third quarter. In terms of our operating expenses on the next slide, you can see the inflationary impact on some of our cost lines, leading to an increase of almost 4% on a rebased basis.

This is mainly visible in our staff-related expenses, which were up 7% year-on-year as a result of the mandatory wage indexation at the beginning of this year. Our network operating costs were up 3% year-on-year, driven by higher energy prices as a result of the war in Ukraine, which resulted in a year-over-year impact of almost EUR8 million for the first six months of the year.

As mentioned in previous earnings calls around half of our energy costs are hedged until the end of the year, and our full year outlook assumes a similar uplift on energy cost in the second part of the year. The sum of our revenue and operating expenses brings me to our adjusted EBITDA. Our adjusted EBITDA reached almost EUR671 million for the first half of the year a 3% decline versus year ago as a result of higher operating expenses. We saw a similar trend in the second quarter with our adjusted EBITDA reaching EUR342 million. As embedded in our full-year outlook, we expect an improved EBITDA trend in the second half of the year, driven by the rate adjustment of June and continued focused on cost control.

As of this quarter we have also started to report on an adjusted EBITDA after lease basis. Our adjusted EBITDAal as Rob mentioned at the beginning of this call. Adjusted EBITDAal differs from adjusted EBITDA in the sense that it capture both depreciation and interest expenses on leases applicable to both operating and finance leases. Given the sale of our mobile tower business to DigitalBridge on June 1, we consider adjusted EBITDAal to be a relevant financial metric to assist our underlying financial performance while also improving comparability with peers who often report on a similar basis.

Let's have a look at our capital expenditure now, on the next slide. Excluding the extension of the 2G and 3G mobile spectrum licenses the recognition of certain football broadcasting rights and lease-related capital additions our CapEx totaled EUR294 million in the first half of the year.

This was up 11% compared to the same period of last year, and reflected higher spending on both our fixed and mobile network infrastructure as well as higher CPE related CapEx as a percentage of revenue we spend around 23% of CapEx in the first six months of the year. In the second quarter, our accrued CapEx was almost EUR155 million representing around 24% of revenue and reflecting the same drivers as just mentioned. In line with our outlook our investment levels started to pick up relative to the first quarter as we target the 25% CapEx to sale ratio for the current fiscal year.

Let's have a look now at our adjusted EBITDA less property and equipment additions or operating free cash flow as we used to call it. As a result of a 3% year-on-year contraction in our adjusted EBITDA and the higher investments, we discussed in the previous slide we recorded an 11% decline in adjusted EBITDA less property and equipment additions to EUR376 million of which EUR188 million in the second quarter.

On the next slide, you can see where we landed in terms of adjusted free cash flow. Our adjusted free cash flow reached EUR167 million for the first half of the year which was down almost 14% compared to H1 of last year. This reflected a decline in our OCF and then the EUR11 million lower contribution from our vendor financing program compared to last year. These headwinds were partially offset by EUR9 million lower cash taxes paid.

Let's now zoom in, in our debt maturity profile. Our debt maturity profile remains robust with a weighted average time to maturity of around six years and no debt amortizations prior to March 2028. In addition, we continue to have full availability of over EUR555 million of additional liquidity under our revolving credit facilities. In addition to the cash at hand, this brings total liquidity to almost EUR1.4 billion at the end of June.

Important to note, especially in today's volatile market environment is the fact that we've hedged substantially all of our floating interest rate and foreign currency risks until the end of the respective maturities. We generally enter into such hedging arrangements at the moment when we issue the loans or bonds. As John mentioned before when discussing the NetCo partnership Fluvius, the fact that we are contributing a EUR2.4 billion intercompany loan to NetCo will not impact our external bonds or loans, which continue to remain in place.

Turning to leverage, the move to adjusted EBITDAal triggers a change in the way we calculate our net total leverage ratio going forward. In terms of the denominator our net debt previously included lease-related liabilities and in terms of the denominator we divided by the last two quarters annualized EBITDA. Going forwards on the one hand our net debt now excludes leases and on the other hand we divide by the last two quarters annualized EBITDAal. Under the old definition our net total leverage would have been 3.9 times as the favorable impact from the tower sale was partially offset by the recognition of the 15 years lease liability under the master lease agreement with DigitalBridge.

Under the new definition our net total leverage reached 3.4 times at the end of June, which is exceptionally low as EBITDAal for H1 only contains 1 months of lease expenses for mobile site rentals rather than containing these expenses for the full year, which will be the case on a going concern. And secondly leverage at the end of Q2 does not yet include any liability with respect to the recent spectrum auction. The effect of that auction on leverage will be included as of the next quarter. Before we move to the Q&A session, I would like to close off with a reconfirmation our full-year 2022 outlook. As detailed in the release, we expect a better growth trends in both our revenue and adjusted EBITDA in the second half as opposed to the first half. This is driven by the favorable impact of the 4.7% rate adjustments implemented in June, as well as our overall focus on cost control. Our full year outlook on adjusted EBITDA assumes a similar impact of energy prices on our cost lines in H2, as was the case in H1.

Moreover, it does not take into account, around $5 million of one-off preparatory cost for the NetCo Grow Life which is planned for early 2023. This so-called cost to capture was not included in the outlook we gave in February 2022, as at that time, we have not yet concluded network partnership with Fluvius. And with that let me hand back to the operator for the Q&A session.

# Questions And Answers

## Operator

Thank you. We will now begin the question-and-answer session. [Operators Instructions ]. One moment for the first question. Our first question comes from the line of Nawar Cristini of Morgan Stanley. You may now proceed.

## Nawar Cristini, Analyst

Thank you very much. I have two questions on the shareholder remuneration. So firstly, your confidence in executing in the fiber upgrade with no disruption to the shareholder remuneration and keeping the previous dividend flow was quite high. So it would be really helpful if you could discuss with us what has changed over the period, which has led to the cut of the dividends?

And related to this, I guess, there are a still a number of open questions regarding the NetCo in terms of whether it will be monetized or not of balance sheet on balance sheet, but also the opportunity to optimize CapEx through CapEx sharing. So it will be helpful if you could discuss with us, how have you reached the one new dividends quarter, how it was constructed and what are the main building blocks going through the thought process here? Thank you very much.

## Rob Goyens, Vice President Treasury & Investor Relations

Yeah, Nawar. I'll take those questions. So the way that dividend policy was constructed is needless to say that the last couple of months we have seen very volatile financial markets and on one hand rampant inflation and the other hand we've also seen the debt markets have become much more nervous, which means that cost has gone up in liquidity has been used. So the way that we have constructed the plan was to find the balance between at the one hand the shareholder remuneration and on the other hand to desire not to increase leverage in these volatile times. As you know, we have been around 4.0 times for a very long time and our total leverage framework goes from 3.5 to 4.5 times. We have decided to stay at the 4.0 times. So that was one element of the plan that the company the Board have decided to do as such.

The second was also to avoid any reliance on incremental borrowing from the markets. As we have explained earlier on deck the net cost is fully self funded physical, which means that it will be funded based on our current existing arrangements. There will be intercompany loan put in place of EUR2.4 billion, but there is no reliance on external debt. So really the trade of that have been made was really also inspired by the external markets, which have changed the lot and where they shareholder remuneration against those two features not increasing leverage and not being reliant on external debt have been taken into account.

## Erik Van den Enden, Chief Financial Officer,

As we said in the, in the presentation, there's two avenues to the board's reconsideration of shareholder remuneration one of course is ultimately a sell down of additional ownership in either through a strategic or financial investor of which we would be at this stage rather optimistic about. But first things first we need to establish this business, we want to control the business while we are in the establishment phase and we also need to see if there is an opportunity for further network rationalization and CapEx optimization.

We have all the flexibility within our agreement with Fluvius to to provision parts of this network through hold by opportunities with other fiber constructors, and we obviously are interested in increasing the utilization on our own network. Both of these things would improve the free cash flow profile of the NetCo and enable us to reconsider potential shareholder remuneration on top of the one year of floor, which we've already, the Board's already endorsed and articulated. But the Board's decision was to was to maximize flexibility in the establishment phase of the business until we found out where we were both from a macroeconomic standpoint. As Erik said, but also from the standpoint of the other levers in the market.

## Operator

Thank you. Our next question comes from the line of Joshua Mills of BNP. Your line is now open.

## Joshua Mills

Hi guys. Hopefully you can hear me. I had two questions please. The first wrong would just be following up on the NetCo deal. It'd be great to just get a sense or an idea from you of well the key for this debates over the last of getting still signed have been obviously it's been a long process. And I'll say one of the questions we might ask and having feedback from Orange Belgium the other day is the 78% fiber coverage target. How did you arrive at that? And and what fill rate do you think you need to hit in the areas of the NetCo coverage in order to justify that level of fiber investments?

It is interesting that Orange Belgium on their own conference call seem to indicate they may be less ambitious with their own network upgrades of various deal closes. And then secondly, if I could come back to the EBITDA question. I think the guidance reiterated today implies a very sharp positive swing in EBITDA growth in the second half going from minus 3% in the first half of our quarter four. I think on slide number 21 new layouts and detail on cost headwinds thus far in the year, which I expect will continue. So is it the case that the guidance reiteration is entirely predicated on you seeing a very high drop through the price increases while the underlying cost drivers and cost cutting efforts you can do to help hit that number as well.

## Erik Van den Enden, Chief Financial Officer,

Thanks. I'll answer the first one and Erik will answer the second question Josh. The target of 78% over 15 years is more than achievable on the basis of the existing utilization of network. Orange and approximates both have would have more tension in their spreadsheet based on less utilization. So, with the utilization well over 50% and hopefully, potentially through the additional participation of other access seekers. The IRRs are building that 78% are quite strong. They're even stronger when you consider what the upside to the cases is, which is 55% or so of the network, it can actually be constructed at 50% of the average rate of the total network. So the returns on on certain sort of what we would say our area A, which is a much more dense areas and not just cities but the inside towns and things like that. They're even higher returns. And we have to look at those return relative to rental economics. And rental economics look more attractive when you don't have much penetration.

So it's all a function of the utilization and the penetration of the network. The more revenue per kilometer of fiber that you can build the quicker and higher returns are. So the objective of the venture is to deliver 10-gigs, if you will, or above to the to a 100% of the market and that can be achieved through build and the assumption of course at the numbers that we presented our worst case scenario in that that shows us building all of the 78%, but there is those high speed that high-speed network and also be delivered through whole by sort of access of alternative networks even alternative technologies for that matter, as well as DOCSIS 4.0.

So in the long-term over the 15 years obviously we will focus on the areas that deliver great returns as long as we we continue to be by far the highest penetrated telco in under our footprint.

## Rob Goyens, Vice President Treasury & Investor Relations

And then the second question. Joshua, we can confirm that indeed the price adjustment is a very important driver for the top line and for EBITDA in the second part of the year. Obviously we have quite a bit of experience with price increases. So we have seen in previous terms how the price increase hits some of the P&L and also how it impacts the value to volume equation where of course every time we do a price increase there is some impact on volume. But especially the fact that the churn is historically low even though the fact that we have announced rate adjustments in spring and in the meantime also has been implemented. Gives us a lot of confidence that, that's even more than in previous years, we will see a lot of benefits from the rate adjustment in P&L. And I think that has definitely changed in the market is the fact that Orange has adjusted prices, which they have not done in the past.

So definitely in the second part of the year we will see a strong value creation on the P&L level and EBITDA from the rate adjustments, but at the same time we are also looking at costs because absolutely we are feeling the pressure from inflation mostly through wages and there is also something where we are putting cost control plans in place. But the majority of the uplift H1 versus H2 will definitely be through the price adjustment.

## Operator

Thank you, sir. Our next question comes from the line of David Vagman of ING. Your line is now open. You may proceed.

## David Vagman, Analyst

So good afternoon, and thanks for taking my question. And so with two. First on the geopolitical. Could you help us understand all your goals ahead as supposed to reverse all the basically the rents that Telenet is going to pay to the NetCo going to evolve over time as the NetCo invest in fiber. So and what kind of inflation is built in the rates, it's on the contract basis. So I would imagine post 2029. So that's my first question.

And so, don't know shifting back to Telenet. You explained in the slide to a multi-brand strategy. Is this related to DG entry in the market or rather view potential entry in Wallonia? Could you basically use the base brand to launch fixed product and then positive both in Flanders and Wallonia as well? Thank you.

## Erik Van den Enden, Chief Financial Officer,

Yeah, Rob you can say that the wholesale.

## Rob Goyens, Vice President Treasury & Investor Relations

Well, I mean on the wholesale side, obviously the business plan is assuming for the Telenet brand as it is for the expected wholesale all the tenants on the NetCo. There is a composition between HFC and fiber are in to go. So needless to say, that Telenet will start predominantly with HFC and over time, we will evolve into fiber. And those two components has slightly different rates as well. But I think especially with the pro forma that we have now included in this presentation where you see the total top line is of our customer base and also the one from mobile Orange Belgium those are by and large the wholesale customers on a pro forma basis, that would be there in the NetCo today. It gives you probably a good view on on the wholesale rates.

## Erik Van den Enden, Chief Financial Officer,

I mean on the multi-brand strategy, I mean basis has been our stand-alone, we really don't have much in the way of stand alone mobile for Telenet and base has been our brand for standalone mobile. Beyond that we have no immediate plans that we announced. And in terms of any other activity in the South, other than what we are already doing with the base brand and a bit of our wireless product stack and we have, we are just, we are waiting for the outcome of the regulatory process with the competition European Competition Authority. So it's, it would be very challenging for us to move outside of our current footprint.

## Operator

Thank you. The next question comes from Simon Coles of Barclays. Your line is now open.

## Simon Coles

Hi guys, thanks for taking my question and for the extra disclosure around the cash flow generation of the NetCo and the ServCo. I rightly recall you that one of the delays is to do with sort of tax treatment, so I just wondering if you could give us any indication of how the tax payments will be split between ServCo and NetCo with just an indication on that front given. You have already helpfully given us the interest portion. Thank you.

## Rob Goyens, Vice President Treasury & Investor Relations

So I mean I will take this question. So indeed one of the reasons that the whole process to quite a bit of time is because we wanted to have clarity on the tax side. But this was mainly to understand if carving out the fixed business the NetCo business from Telenet Group also in a separate legal entity would, what would be the tax consequences for them. It is also an exercise that we had to do on the mobile tower disposal transaction and there was a definitely the reason they so that loading has been obtained not only on the Telenet side, but also in the Fluvius because of course also Fluvius is contributing and in certain activities. So in terms of the split I think you asked also about the split between the NetCo and the ServCo. So, that of course we will go together with at the one of the profitability but also with the pickup with investments. So there is something that we are not necessarily disclosing exactly here. But of course to the extent that there will be higher investments, they will probably also includes some tax interactions going forward that the NetCo side.

## John Porter, Chief Executive Officer

And I think also, I mean in addition to this, so a lot of John mentioned in the presentation NetCo will be paying interest on the intercompany loans both the one from Telenet, but also the one that Fluvius will be contributing, so obviously that will also be incremental interest payments that NetCo will be making, which of course also has certain tax attributes as well. In addition to the CapEx investments that they we will be doing over time.

## Simon Coles

That's great. The Netco probably to pay much tax initially and any reason to think much changes in the ServCo?

## John Porter, Chief Executive Officer

I wouldn't necessarily. So because the external debt all stays pretty much in place. So that is actually not that much.

## Simon Coles

Okay, great, thanks so much.

## Operator

Thank you. Our next question comes from the line of Yemi Falana. Your line is now open. And you may proceed.

## Yemi Falana, Analyst

Good afternoon. Thanks for taking my questions guys. Firstly, you've laid out some comps on the NetCo sides kind of ranging in multiple from high-single digit to kind of mid-teen levels. Given your asset is very highly penetrated about 60% through your base. Is it fair to say. You'd expect to command multiple towards the higher end of that range? Any color there would be super appreciated. And then secondly just on the network ambition side, clearly you've provided a lot of detail here on just the dynamics around the fiber investment the NetCo et cetera. But I think the question still remains around your strategy in the south of Belgium. Is it, is it more of a case that you'll pursue kind of rental wholesale economics in that region kind of what's the kind of the long-term strategy there?

## Rob Goyens, Vice President Treasury & Investor Relations

Yeah, let me maybe start with the second question. As John already mentioned the regulatory process for Wallonia is fully ongoing. Yesterday there was also some announcements around that so unfortunately we will not be able to discuss this strategy today. I think the second question was about the NetCo multiple if I got it right. So we have included multiple flow from other transactions at the same time of course, they are not always exactly the same, so there's definitely some differences there. And as you can see indeed they range from high-single digits, all the way up to almost 20 times.

I guess you know when and if we know the transaction, we will see what kind of multiples we can attract. But definitely in the way that the exchange ratio between Fluvius in our sales was constructed resulting in the 67% ownership by Telenet and 33% of Fluvius that is based on a solid double-digit multiple.

## Erik Van den Enden, Chief Financial Officer,

I mean the positive is that utilization is very high and the income is certain and predictable. As a question of what's the growth? I think that's a very important dynamic. And obviously it's the wholesale income grows and can grow through both the growth in Telenet but also third-parties. You could expect a pretty solid multiple in that regard.

## Operator

Thank you. Our next question comes from Emmanuel Carlier of Kempen. Your line is now open.

## Emmanuel Carlier, Analyst

Yes, hi, good afternoon. Two questions as well from my side, so I will take them one by one. And the first one is on the presentation that implicitly shows that you believe the equity value of Telenet that is worth around EUR40 based on the NetCo and the ServCo. So, the question I have is what will you undertake and to make the market getting convinced on that? In other words, do you believe that you might quickly start to buy back some stock? And a bit related to that and I know that you consider to sell part of your stake in the next call. But what is the earliest date that you could communicate on such a type of transaction?

I guess that will probably taken almost 12 months now.

## Rob Goyens, Vice President Treasury & Investor Relations

And then will maybe on the first question, I'm not sure we were exactly kind of trying to imply that the share is worth EUR40. I think what we do, I mean very clearly see by the numbers that as we just mentioned, I mean the not produced and will definitely double digit. So what you do see is based on the valuation of the NetCo alone is at probably the entire company is very close if not inferior to a proportionate stake on the NetCo. So there is definitely some intrinsic value to be released there. In terms of the catalyst to release that for sure further developing the NetCo is a very important one. On the one hand, making sure that utilization can be optimized as well as, the CapEx profile that is one way to do it. Year one is definitely to consider say take to a strategic investor or an operational investor that will take some time and it should not take the full two years that we have just spent on getting to the first stage. I mean there must be with the business plan now clear and but also the expected results that should be a more straightforward transaction. So difficult of course to pinpoint exact timings, but definitely, when we see the opportunity we will try to capitalize on that as soon as we can.

## Operator

Thank you. The next question comes from the line of Ulrich Rathe of Jefferies, your line is now open. You may proceed.

## Ulrich Rathe, Analyst

Yeah, thanks very much. My first question would be why the staff cost was up 8% in the second quarter year-on-year versus 2% in the first quarter when the indexation actually happened at the beginning of the year. And how that staff cost might trend in the second half? And the second question is, so having another go at that how Josh find his question. I mean if we want to frame it a bit more directly. Was the fiber upgrade really the request of Fluvius, and you sort of traded your negotiation ships against that or how would you sort of frame how the conversation with the partner went with regards to the prior upgrade to target?

## Rob Goyens, Vice President Treasury & Investor Relations

Maybe only on the question of the staff related expenses, so obviously there is a mandatory rate indexation of 3.6% that kicked in as of the beginning of the year. At the same time that we have also with our Q2 numbers we re-based our full-year 2021 numbers as if I do basically account for the impact of the Dow transaction as if this transaction has already occurred on June 1 on the same basis, so that actually creates some different drivers and the overall dynamics. So when we look at the first quarter I think underlying the growth in staff expenses was around 4%. 5% and for the first six months, that is around 8% in total. So I think apart indexation, but there is probably some element of headcount in there, but I would say most of the impact of staff related expenses, it's going to be the wage indexation. Wage indexation which for us by the way is going to be an annual indexation so unlike approximates which is on a different scheme of indexation we only apply this on an annual basis, so those Orange Belgium. So the new reset of that wage indexation is going to come in early 2023.

## Erik Van den Enden, Chief Financial Officer,

On your second question, we have to consider how this all began two years ago, which was Fluvius issued a RFI RFP to the market for industrial fiber project across Flanders. And approximists was already pursuing a fiber build. We have fiber our sales quite heavily in our B2B area, we have it down to on average 300 to 400 home nodes. So we are very well positioned to take the next step and bring fiber all the way to the residential premise. So if we had sat on the sidelines, the RFP phase we would have potentially had at least two fiber projects going on and we probably would have had to shift to rental economics in the next phase of the evolution of our network.

We were reaching an inflection point anyway from the context of DOCSIS 4.0 a technology which ultimately will achieve 10-gig downstream capability, although not fully symmetrical and so we were at a crossroads. We decided that the benefits of terminating the erfpacht and the benefits of retaining owner economics and being able to challenge in what is admittedly an increasingly competitive world, outweighed the status quo and sort of defending with DOCSIS and the expenses of DOCSIS. So, once you are able to get to a much more robust fiber to the premise architecture there are also significant operate OpEx savings of which we've baked in $65 million per year as the business matures. More sustainable less reliable energy less maintenance less active devices where things can go wrong so standing at the crossroads of DOCSIS 4.0. We might have made a different decision if we didn't have the overhang of the FPAQ. But because of that and combining that with the market advantages of moving forward with a good mix of build and whole buying on fiber it was the best decision with the highest IRR. It may be is a longer payback period that than we would of course like or that the equity investor is comfortable with, but it is a very strong payback. And the when the build starts to phase out or if we're able to do sort of smart mobile access in certain parts of the network, the cash flow will very rapidly improve to a point where the dividends and shareholder remuneration would be very robust. And that's why we made a decision and we did.

## Rob Goyens, Vice President Treasury & Investor Relations

I mean, very important part of this project was also for us together with our engineers doing very detailed on our network where we talk fiber would make more or less sense than DOCSIS. John ahs already and what we did there is depending on the density of where the customer sits in our network we considered indeed, the long-term operating expenses, which we know fiber is much more economical in terms of maintenance and energy and we have set that off against the CapEx growth not only now but also for the next X number of years.

Well, it's clear that even in the city centers, obviously the initial CapEx outlay to dig up the streets and to put the network there at the very beginning of course higher than we would do DOCSIS 4.0 upgrade, the further upgrades once the infrastructure is there are significantly less costly. So fiber is very much a very big investment upfront and then smaller follow-up investments, whereas for DOCSIS every time would have been more meaningful upgrade.

So in this, we have set out as I mentioned, one of the key parameters there to understand where each of the technologies economic or not specifically you know the length. I mean, so the kinds of density and based on that analysis, we have indeed come up with a 78% versus the 22%, 78%, the more dense part and then 22% and the DOCSIS 4.0, for the more rural parts. And so, this would be from that angle very clear that also in our network makes more sense.

## Operator

Thank you, sir. Our next question comes from the line of Polo Tang of UBS, your line is now open.

## Polo Tang, Analyst

Yeah, hi, thanks for taking the question. Just have one and it's just regarding slide 7 in your presentation. So just on the erfpacht and your current lease agreement with Fluvius I'm just try to understand why the total cash flow impact was actually growing over time. So it's EUR100 million in 2019, EUR103 million and EUR105 million and 2021 or another way of asking the same question is why were the balance sheet liabilities relating to this lease agreement expected to grow from EUR0.5 billion to EUR1.2 billion over time.

## Rob Goyens, Vice President Treasury & Investor Relations

Yeah. So hey, Polo, Rob here. So there are probably two elements to your question. I think first of all, on the cash flow and we will have to, we would need to look at the way the erfpacht is actually constructed and this goes back partly to 1996. Part of it goes back to 2018 when we have this so-called in the couple of transaction. So obviously in the way the lease was set up is that Telenet basically runs the network as if it was only the network, but of course the legal ownership was sitting with Fluvius, so Fluvius was also pre-financing the network investments that we wanted them to do.

And those were actually done at a market that was also disclosed on slide 6. And on that basis so all the investments we've got added back to the lease arrangement that we were being back over a 15-year period. And you've seen also there the interest rate and I think John also referred to them in the beginning of the presentation. So, by far those leases are the most expensive debt to components we go. We clearly have our debt stack at over 6% for to common lease, so that the biggest part, but then still historically more than 7% for some of those leases. And today the value of that lease represents in total around EUR0.5 billion of debt on our balance sheet.

This is on a EBITDA basis. So when you look at it from that angle. So moving that erfpacht will actually feel per the EUR0.5 billion translating into 0.4 times leverage capacity. And the reason why we mentioned it would have grown over time is just by taking a snapshot of the network investment program that we have just announced to modernizing our footprint by 78% with fiber. If you would have done this on the under the lease agreement what it actually would have meant is that first of all, we would have spent this CapEx or Fluvius would have spend the CapEx, we would have actually had an important market on that the CapEx.

But at the same time, it would also have led to situation where even though the work, we would have been upgraded in 2046 the legal ownership rights with have moved back to Fluvius. So all those network investments in terms of the footprint actually our lost at that point in time. So the 1.2 basically the adverse impact of the higher investments that are part of the plan that we just announced.

## Operator

Thank you. Next question comes from James Ratzer of New Street Research. Your line is now open.

## James Ratzer

Yes, good afternoon. Thank you very much indeed. So I have two questions please. The first one was just regarding the commentary you've made around potential stake sale in NetCo. I mean, I understand that it's hard for you to comment on timing of this process. But can you confirm it is definitely your intention to go ahead with the sale of the state? Are you planning to engage advisors and go through a sale memorandum process for stake in NetCo.

And if you do go ahead with that process would you be willing to sell the entirety of your stake in NetCo or would you just be looking to down to 50%. Would love to hear your thoughts on what you think an optimal stages is in NetCo. And secondly, just a quick point of clarification. Mostly you said you're talking four times leverage for the group at the moment. As you move to EBITDAR accounting going forward could you let us know what your leverage target on that basis, please. Thank you.

## Erik Van den Enden, Chief Financial Officer,

The first question as I sort of said maybe not quite clearly necessary earlier is that if you look out over the next few months, our priority is to establish the net get through first of all, the administrative processes that we need to get through for over the next couple of months sell Fluvius side. And then to work on establishing the separation of the network operations and build program into this discrete entity, that's going to take quite a bit of focus. And we're going to have to drive that and drive that from a control position that we're in it with 66%, 67% of the network of the NetCo. So that's going to be status quo.

At the same time I think our second priority is to understand the access environment and to ensure that we are an attractive company for access seekers existing and potential in the future there. There is certainly scope in this market for further network rationalization. We are sitting on 60% utilization so we think we are, it is critical that we are a driver for the form and the shape that network rationalization takes. So we're, that's the next most important thing. And of course equity in the NetCo may be in play with strategic access seekers, so we can get the corporate workforce and just circling the process until we know what's happening with access seekers.

And then finally, once we do know that, how much are we up for that's really a matter for the market at that time. Where do we sit from a utilization standpoint and how many participants that we have in this NetCo? What is a meaningful stake for a financial investor. All these things we are open to understanding. And I think we've said before we're quite comfortable taking this off balance sheet. What we're probably not comfortable with is, certain control mechanisms that we have in the agreement that give us comfort that isn't going to be the business that we expect it to be over the next 20 years.

So that's the truth lies somewhere in between. And but we're ready to find out how those competing priorities play out over the next few months not years.

## Rob Goyens, Vice President Treasury & Investor Relations

And then James, with regards to your question on leverage. Perhaps good to refer back to slide 28 in the deck that Erik presented. And so first of all, when you look at it under the let's say, the definition of net leverage as we have reported it consistently in the past. So basically, including leases in our net debt divided by the last two quarters annualized EBITDA, you would get to 3.9 times, which is only fractionally lower compared to what we had in the previous quarter and the result is that, yes, we have recorded to the benefit of the tower disposal in cash but at the same time we have also recognized that 15 years of lease liability with DigitalBridge that offset most of that favorable impact.

So that's why I think it's also interesting to move to an adjusted EBITDA after lease view because given the more substantial payments that we will be making over time and there was only like a one-month payment in our six-month results. That course is a better reflection of the underlying profitability of the business. It will of course also allow you to a better compared to be so on that metric as the leverage is 3.4 times. However, as Erik also mentioned, it's a point in time where this leverage is probably exceptionally low for two reasons. First of all, as I just mentioned that it only includes like a one-month payment of tower leases to DigitalBridge. So you would need to annualize that impact to get a better underlying view on the leverage, but also importantly is that the spectrum auction that took place with in all fairness, we have not fully decided yet whether we pay in one go or where do we go for the deferred payments that we're still analyzing both options. But at the same time from a leverage perspective, they will have a bit of a similar impact either the cash is gone or either you recognized the debt which is not going to be a lease-related liability. So as a result also the leverage will go up over this metric. So to cut a long story short to your question, what is the leverage started on the new definition. So including EBITDAal there is also going to be 4 times. So in that sense there is no change to the headline number.

## Operator

Thank you. The next question comes from Ben Lyons of Credit Suisse. Your line is now open.

## Ben Lyons, Analyst

Hello. Thanks for taking my question. Most of mine have been probably been asked, but I do have one on the guidance. I'm sort of looking at what you're implying H2 in terms of EBITDA. And if I take the 1% growth, the new re-base number. I think it's implying that the OpEx continues to be flat year-over-year in H2 I guess I'm not so wrong. Do you mind explaining what are the evidence you can control. I appreciate you're going to have energy and still a wage indexation coming through. Is there any benefit from the tower OpEx being moved off balance sheet? And there is a little bit follow-up to that if I look at the rebased numbers, it looks like OpEx in fact goes up on a rebased amount despite moving the tower assets off balance sheet. Do you want explaining why that is. Thank you.

## Rob Goyens, Vice President Treasury & Investor Relations

There were a lot of questions and not sure if we captured all of them, but maybe the first one. And don't necessarily think that I think you were suggesting that the OpEx in H2 was flat versus last year and that is not, we don't think that is going to be the case. So, that will definitely be continued inflation, but at the same time, the evolution of OpEx is going to be more than offset by the benefits of the adjustment. And secondly, there are indeed things that that we can control. Of course price inflation and energy things are to a large extent not in our control. Although also for the second part on the energy side we still have partial hedges so that does give protection. But on the rest of the OpEx I mean, we will be or we are actually reviewing very carefully projects. Basically all expenses from an index perspective that we make we are putting them against the light and really analyzing and deciding whether they have to be done within the second half of the year. When they can be done late or when they can be done more efficient those things we are doing. Then the second question.

## Erik Van den Enden, Chief Financial Officer,

Yeah. Your Second question. Ben was with regards to the tower transaction and the impacts that you typically see on our P&L from going from the reported to the rebased numbers. So first of all, on the revenue, you see a slight reduction in revenue. This is typically the revenue that we previously earned from other operators on our towers. This revenue is now with DigitalBridge as we sold our tower portfolio. So there is a limited impact overall of around EUR2 million. Then on the cost side, there is some impact as we have also shown, which is primarily through in some staff-related expenses, but then also offsetting to other elements. I think the biggest impact is of course in the EBITDAal number, because there is where you would typically expect that lease payment to be to be recorded. Not to be fair and to be transparent, there is of course on the one hand, there is the tower lease with DigitalBridge, which is a result of the sale of our portfolio.

On the other hand, there is also the removal of the site rentals that we previously had. Site rentals being the rental for the ground leases where our towers located. So the net effect is not going to be the full EUR50 million to EUR60 million. It's going to be much lower than this because you need to net off those two elements as I just mentioned. So that I think is an important element. And then I think also with regards to towers.

I think also a topic that is sometimes a bit under-appreciated is on the escalator mechanism that we've recently seen some commentary also from other operators on that. In previously, previous tower deals and what we can see also hear is that the escalator we have in the contract is actually much lower than the current inflation rate that we are seeing in the market. So also providing a kind of a hedge mechanism to us in perspective.

## Operator

Thank you. Our last question in queue comes from the line of Martin Hammersmith. Your line is now open.

## Martin Hammersmith

Yeah, thank you for taking my question. And I have two, please. And the first one is, you guide for similar levels of free cash flow versus last year. And if I look at the first half. I think you're trending roughly EUR30 million compared to last year. So apart from the recovery in EBITDA could you just help us understand how you expect the other free cash flow to develop in the second half in order for you to hit the free cash flow target especially as I think CapEx is probably going to in the second half. And then my second question is and coming back to the multi-brand strategy. And I mean did you coming in into the market probably over the next and couple of years. How are you preparing your defenses against them. I mean, a multi-brand strategy with like clipping base with convergence capabilities, what sort of lower the exposure of the mobile-only customer base. And we've seen proximal selling them other Scarlet and Mobile Vikings, we've seen Orange Belgium has launched. So why is do you feel comfortable not including sort of convergence in the baseband? Thank you.

## Rob Goyens, Vice President Treasury & Investor Relations

Maybe however we can tackle the question on the free cash flow first. So, I think Martin your question is probably a bit twofold. On the one hand, you have the referral to the H1 free cash flow where there actually sits compared to last year. So when you look at the delta that we had, first of all, there was of course a decline in free cash flow, as Eric mentioned in the presentation. Despite a favorable movement on the tax, because on the year-to-date basis, we are paying around EUR9 million lower cash taxes on that basis. But it is also true that we have like EUR48 million of lower OFCF operating free cash flow, EBITDA minus CapEx as a result of local and higher CapEx.

Then of course we also have the deferred acquisition cost that will help year-over-year. As we said last time, in our Q1 call, these are typically deposit are M&A related. So we think about all the cost that we are doing for the tower disposal, but also for the Fluvius transaction for instance. And then there is also an EUR11 million lower contribution from vendor financing. And this has been offset by favorable movement in working capital of around EUR23 million year-to-date in the first half.

So I think all that puts us in a good position for the remainder of the year in order to hit our free cash flow number. Where does that essentially coming from? On the one hand we have of course the EBITDA growth that is embedded in the guidance, as Erik mentioned. We believe that also when the financing will be stable, so the EUR11 million is a negative contribution we had in H1 will turn out to be a positive contribution of the same magnitude in H2 in order to get to zero contribution over the full year.

And then, although we do expect indeed CapEx to go up in H2, related to the guidance we provided in the H1 results. We should not forget that from a cash CapEx perspective the suppliers typically have a longer payment term and throughput time, which means that the impact on the cash flow is not going to be fully visible in H2. So on all these drivers and we believe that free cash flow should come in broadly stable flat compared to full year 2021.

## Erik Van den Enden, Chief Financial Officer,

Yeah, on your second question Martin putting aside effective we're not going to outline our commercial strategy for the next few months and year ahead. I will say that we are still very confident in our portfolio. As you've seen, we continue to get good growth in our one portfolio, which is really an unbundling strategy as TV becomes optional at various levels that just Smart TV level but also getting a set-top box or whatever. And we've actually had we've added two points of market share improvement in the use and what we say under 34 non-family segment of the market.

So just in the last year since the launch of the one product suite. So we think we compete very favorably there. The other area that we've seen some good strength in is in our standalone mobile where base with its base 15 and data carryover and also the the Discount for Life campaign has really put a very strong floor under the base postpaid subscription base. We think that these things compete very favorably.

Also in the ONE P space we're seeing ONE P broadband space, we're seeing a move to quality our EUR30-ish ONE P is 200 megabits per second downstream and our EUR40ish ONE is unlimited. And these are very higher speeds in the area of the home office are very attractive. So we think our portfolio works pretty well right now. However we with our new CRM platform coming online at the end of this year. We, you can anticipate additional evolutions to the portfolio, which will position us we think very favorably in the markets that would be most attractive to new entrants.

## Operator

Thank you very much. Just the last question in queue. I will now hand it back over to Mr. Rob Goyens for his closing remarks.

## Rob Goyens, Vice President Treasury & Investor Relations

Okay. Thank you, operator and thanks everyone for having joined today's call on what was indeed an extremely busy day in European telco reporting. As I mentioned at the beginning, there will be a replay of this call soon on our Investor Relations website and also the transcript. Porter and I, we are around if you have any further follow-up questions, and we look forward to reconnecting with you post summit, as we get back to you with more details on our Capital Markets Day. So stay tuned and speak later. Bye-bye.

## Operator

That concludes today's call. Thank you all for your participation, you may now disconnect.