

Company: Versatel AG
Conference Title: Q3 2009 Investor & Analyst Conference Call
Presenters: Alain Bandle, Max Padberg
Date: Thursday 12th November 2009 – 14h00 CET

Operator: Good day and welcome to the Versatel AG Q3 2009 Investor & Analyst Conference Call. Today's conference is being recorded. At this time I would like to turn the conference over to Mr. Alain Bandle, CEO. Please go ahead sir.

Alain Bandle: Thank you. Ladies and gentlemen, I would like to warmly welcome you to the presentation of Versatel's Third Quarter Results. First of all I would like to thank those of you who have taken the time to join the conference here personally in our offices in Düsseldorf, thank you for coming. Secondly I would like to thank all participants who have dialled in for joining the Q3 results presentation via our telephone conference call.

The presentation we will refer to during the call can be downloaded from the Versatel IR webpage. Looking ahead I will walk you through the overall operational developments and Max will then take you through the financial details of the third quarter. Following the presentation we will be ready to answer all your questions. We have blocked one hour for the conference call including the Q&A session. Our presentation is based on a year on year comparison but I will draw your attention to the sequential development where it is relevant.

Let me now start with the headline news of the third quarter 2009 on chart number 4. First I would like to draw your attention on the outstanding improvement of our free cash flow in Q3 2009. With €21 million of free cash flow in the third quarter we achieved a cumulative figure of €37 million for the first nine months of this year and are therefore on a good way to reach our full year target of at least €40 million of free cash flow. As the overall focus of the company in 2009 and beyond is to strengthen the sales financing capability, I am more than satisfied with this improvement. In terms of top line we saw a stable development compared to Q3 '08 with €181 million. Adjusted EBITDA rose to €51 million supported by a renegotiation of a long term

finance lease contract that will result in lower backbone network cost for Versatel, a point Max will explain in detail later on.

Let's now come to chart number 5. The development of our group revenues was slightly below our expectations. The wholesale and the business segment are not able to clearly overcompensate the expected decline in the residential segment. For that reason it is our firm intention to expand the positive trend that we already see in the business and wholesale segment to grow our revenue line in the medium term. In the second part of the session we will share with you some of our thoughts how we want to achieve this target by several opportunities we see in the wholesale segment.

On chart 6 in the residential segment we saw a decline in top line development as we expected. Third quarter revenues fell by approximately 8% in a year on year comparison. This decline was driven by a further decrease in broadband revenues affected by an ARPU cut of €1 in Q3 '09 compared to the previous quarter and the drop in our broadband customer base by 15,000 contracts. As we have already mentioned in our last conference call we removed 9,000 defaulting customers at the beginning of July and therefore we'll save approximately €1 million per year in our ULL fee. Excluding this removal our quarterly churn rate was stable at an annualised run rate of below 10% which I believe is still industry leading.

In terms of our broadband customer base we expect a negative development for the next quarter as we shut down uneconomic sales channels like multi-level or our outbound call centres. Cable TV revenues climbed to €3.4 million in Q3 '09 due to the consolidation of Versatel Media.

On chart number 7, in our business segment we recognise a stable improvement of revenues despite the overall negative economic environment. The promising development in our IP VPN with a revenue increase of 26% continues. As broadband revenue grew by 8% and we saw a stabilisation in our voice business for the first time, the total business revenues contributed with a 4.6% growth to the group top line. Order entry in Q3 '09 was on a very high level with an all time high in the third quarter that makes us confident that we will see an ongoing positive trend in the business segment.

Let's move to chart 8. Wholesale was once again the growth driver of the Versatel Group with a revenue increase of approximately 11%. The contract with DTMS closed at the end of last year contributed to wholesale revenues of €5 million. Due to the delayed technical realisation of this project we are still lagging behind the full run rate. Additionally to the DTMS revenues, the minute volume in mobile termination increased in the third quarter of 2009. At worst impact on wholesale revenues had the reduction of the mobile termination fees in an amount of approximately €2.5 million.

On chart 9 you see and I would like to draw your attention on the development of our capital expenditures. Total Capex in Q3 '09 amounted to €38 million. This number includes the capitalisation of the renewed finance lease contract I mentioned earlier. Max will explain the details of this contract in a few minutes. So if you adjust Capex for the effect of the finance lease, the contract amount to about €17 million, you see that we have reduced our Capex to €21 million. This number proves that our strategy to focus on profitable customer acquisitions in all our segments is fruitful.

The restructuring measures and the realignment of our distribution channels in the residential segment were completed in August 2009. The strong focus on the return on invested capital is naturally not limited to our residential segment. In the wholesale and business segments you are analysing the economics of our product offerings and sales teams to ensure profitable production and sales.

I would like now to hand over to Max for the financial details.

Max Padberg: Thank you very much Alain. Good afternoon and welcome from my side as well. Before I start with a detailed analysis of our group P&L I would like to give you a bit more information about the finance lease contract which Alain already mentioned. We are talking about a long term finance lease contract for infrastructure for Versatel. The dark fibre is part of our nationwide backbone network. As you are aware Versatel is the result of the merger of more than 20 city carriers in the past. Nearly each city carrier had long term backbone lease agreements with one of our backbone capacity providers. As a result of this history we had

redundant backbone capacities leased, partly inflexible backbone contracts, higher leasing fees and higher maintenance costs. After two years of negotiation we were now able to renegotiate and consolidate all these contracts in one frame agreement and to extend and secure backbone capacity for 15 years. At the same time we see reduced costs by approximately 30% in the future. Through the termination of the old leasing contracts we were able to release provisions of about €12 million whereof approximately €9 million are shown under other operating income and improved the adjusted EBITDA.

On the next page you find our standard P&L slide and as usual I will now guide you through the relevant positions. Alain already explained the development of our top line so I would like to start with the position capitalised on services and other operating income. As just mentioned the increase in this line resulted from the termination of the old finance lease contract. The impact is around €9 million. Network costs increased by 6.7% due to the enhancement of our wholesale voice revenues. Here we had two effects. The first is the impact of the DTMS deal. Secondly the minute volume of our mobile termination business increased significantly. On the SG&A side we see a rise of our personal expenses by roughly €2.5 million. This was caused by the increase of our bonus provisions for all employees due to the expected overachievement of our business plan as well as the implementation of the new tranche of our virtual stock option programme. Additionally we raised our bad debt reserves on the books. Excluding these effects we would have seen SG&A costs well below €50 million in Q3 '09.

All this resulted in an adjusted EBITDA figure of €51 million. Depreciation and amortisation decreased by 6.3% to €47 million in the third quarter of '09. The reduction is mainly driven by savings and capitalised commissions. This resulted in a positive EBIT of €4.5 million compared to just break-even last year.

The financial result in Q3 '09 was impacted by lower interest rates for deposits. Last year we posted an income from our fixed interest hedge and we also received higher interest on our cash on hand. Again we were able to improve our bottom line. Net loss stood at €7.5 million in Q3 '09, an improvement of 27% compared to Q3 '08.

Let's move to the next page. Besides the positive EBIT of €4.5 million the next highlight of the third quarter is the strong free cash flow of €21 million. We closed the third quarter with an adjusted EBITDA of €51 million, adjusted by a positive one-off effect of €1 million, our accounted EBITDA stood at €52 million. Alain already pointed out that our total capex amounted to €38 million in Q3 '09. This figure needs to be adjusted by the non-cash balance sheet effect of the new finance lease contract of €17 million. The change in working capital had a positive impact of €4 million in the third quarter mainly driven by the significant reduction of receivables. Net interest payments amounted to €6 million. Non-cash adjustments we had to adjust for summed up to €9 million. Overall this resulted in a positive free cash flow of €21 million in Q3 '09. Cumulated Versatel generated a positive free cash flow of €37 million in the first nine months of the current year versus €25 million negative free cash flow in the first nine months of 2008.

Moving to the next page, the chart on page 13 shows the development of our net debt position excluding IRUs. We ended the second quarter 2009 with a net debt position of €447 million. That has been reduced by €21 million positive free cash flow as I just explained. IRU and other payments for the third quarter of 2009 amounted to approximately €3 million. The full consolidation of Versatel Media increased net debt by €15 million. This all adds up to a net debt decline to €444 million at the end of the third quarter of 2009. If you look at the net debt position that we started with in the beginning of this year, you see a reduction of €19 million also to be fully consolidated Versatel Media and assumed bank debt in an amount of €15 million.

Our liquidity reserve amounted to €120 million at the end of the third quarter consisting of a cash position of €65 million and freely available credit lines of €55 million. As you can see on the spreadsheet on page 14 we repaid the majority of our revolving credit facility.

So far with the results. Now Alain will end the presentation with our targets for 2009.

Alain Bandle: Thank you Max. Ladies and gentlemen, I would like to give you now an update on our guidance we gave you in May 2009. As I have mentioned earlier our group revenues were below our expectations. The wholesale segment was expected to grow stronger but is now

below our budget because of two effects. First, the delayed technical realisation of the DTMS contract; and secondly the reduction of the mobile termination fees. Therefore our growing segments business and wholesale were not able to more than compensate the planned decline in the residential segment. The new guidance for our top line is approximately €730 million.

In terms of adjusted EBITDA we increased our guidance for 2009 by €5 million from previously approximately €180 million to now approximately €185 million. With a free cash flow of €37 million in the first three quarters of 2009, we clearly affirm our guidance for free cash flow which is at least €40 million for the full 2009.

Ladies and gentlemen, thank you very much for your attention. Max and I are now happy to take your questions.

We'll now take our first question from Benjamin Kohnke from Deutsche Bank. Please go ahead.

Benjamin Kohnke: Yes, good afternoon gentlemen. A couple of questions from my side please. First of all Mr. Bandle you said that you're obviously not satisfied with the progression in your wholesale segment. You also mentioned that you have lots of ideas. Could you maybe elaborate on that, what do you mean with lots of ideas and how to drive your wholesale business going forward? Could it also include a switch to let's say wholesale offerings for residential DSL for example? Secondly could you maybe share some words on the consolidation of MediaHome, what drove your decision to basically exercise that option earlier now? Lastly maybe some words on your level 4 cable strategy. At what stage...are you still looking to consolidate the market and maybe some words on a potential timeframe. Are you comfortable with your balance sheet position here, some words on that please.

Alain Bandle: Thanks Benjamin. Let me answer the first and the last question and Max will take care of the MediaHome. As you know and you have seen also from the results, our wholesale segment actually is growing quite nicely. We actually see opportunities for our future in the wholesale segment in basically two areas. We are currently investigating how we could eventually act as a wholesale alternative on the VDSL market. Given the fact that we are next to Deutsche Telekom, the only provider who has this very high dense city network, we are in a

position to probably offer a VDSL alternative that is more cost effective than what you can get out of a resale agreement from Deutsche Telekom.

Secondly we also believe that this is an opportunity to cope with the ever increasing demand on mobile data. As you probably know mobile operators are currently suffering under the tremendous increase on demand for bandwidth in mobile operations. We understand there is a doubling of the capacity every 40 weeks and we actually see or hear from our colleagues in the mobile field that in some of the metropolitan areas they are actually reaching capacity limits. Given the fact that we have such a dense network in the metropolitan areas, we believe that we could eventually become an interesting alternative to provide that bandwidth. Now what's important is that this is not something that we're going to invest a lot of Capex up front but we would only do that basically on demand with a wholesale agreement. So I believe that our core asset which is the dense network that we have which is second after Deutsche Telekom is clearly putting us in an interesting position for the future.

Now on level 4 we are currently operating with 157,000 households in our cable operations. We are upgrading the ones that are back channel capable. We are upgrading them at a level of about 11%. We are growing organically and continue to grow organically and we actually have a sales funnel that is quite impressive. It is also a fact that from organic growth alone we are not going to reach the scale that is necessary to become a big player in there.

Now I'll hand over to Max on the MediaHome consolidation.

Max Padberg: Yes, we are quite satisfied with the development of MediaHome. We modified the contract under which Versatel could increase its share in MediaHome to 100%. Versatel is now allowed to exercise this option at any time, therefore we had to fully consolidate MediaHome in Q3 '09.

Benjamin Kohnke: Ok, thank you very much. Maybe I just missed that but did you disclose what you paid for the second 50% of MediaHome?

Max Padberg: We didn't buy the second 50% and there we have a fixed purchase price. The only thing that we acquired was the right already to exercise the option immediately. That's the reason under IFRS you need then to consolidate.

Benjamin Kohnke: What's the timeframe for an exercise of the option?

Max Padberg: We have not solved yet and we are there in discussions with the bank and that we could do any time. The price will not change on the other 50%. It's fixed at €150,000.

Benjamin Kohnke: Ok, thank you.

Operator: We will now take our next question from Daniel Morris from JP Morgan. Please go ahead.

Daniel Morris: Yes, good afternoon, a couple of questions please. Firstly I wanted to understand all of that 9 million one-off flows through to EBITDA and also if there were any offsetting one-offs in the quarter as well? Secondly I wonder if you could comment specifically on the likelihood of any bid for the Orion assets in Germany and what you're thinking around that type of asset? Thank you.

Alain Bandle: Let me start with the Orion question and Max will answer your first one. As I mentioned already in the last call, we are looking at organic and inorganic growth in our assets and yes, we have been actually looking at the Orion assets, but quite frankly looking at the process we came to the conclusion that this is not necessarily a true sales process. It is probably more a market testing and when you read the news today, notably in Börsen Zeitung or others, you realise that we were not alone in thinking that way because I understand there was about one or two offers coming in for that asset. Now given the fact that I considered the transaction probability below 20%, we did not want to invest massive resources from our teams but also extra expenses in the neighbourhood of about €1.5 million to go through due diligence just to be basically used as a market tester. That's why we have not made an indicative bid last Friday. Nevertheless let me tell you that we still believe that the industrial logic is still there. We are quite happy as we told you about our cable assets we have and we are happily trading along to grow organically but it is

also fair to say the big move to grow inorganically is at least not likely given the situation around Orion.

Max Padberg: Let me answer the question around the €9 million we have just discussed. It's about an old IRU and there the provisions were €9 million higher than the asset value. So if you terminate such an agreement, you take a €9 million hit on the balance sheet and that we showed under other income. At the same time if you look at the SG&A costs, we put that in a number between €3-4 million of extra costs.

Daniel Morris: Ok, that's very helpful. Thank you.

Max Padberg: You're welcome.

Operator: We will now take our next question from Stefan Borscheid from Landesbank Baden-Württemberg. Please go ahead sir.

Stefan Borscheid: Yes, thanks, good afternoon. A couple of questions please. First of all could you give us some indication on your data revenues in wholesale. In Q3 they dipped quite a bit so should this recover in Q4 or is this an ongoing trend? Secondly your Capex, if I adjust the 17 million you just mentioned quite on a low level so should we assume that 2010 we should be clearly below the €100 million in terms of Capex? Then finally will this renegotiation of this finance lease agreement have any material impact on the P&L in Q4 and also in 2010? Thank you.

Max Padberg: Ok Stefan, good questions. In regards of the data revenue on the wholesale side, we saw a little bit of a dip in Q3 but if you look at the voice revenues there was some shift between data and voice, that was one driver. The second driver, what we see at the moment and we believe it's a temporary thing that due to the economic crisis, some industries are somehow holding their money back. So we expect a recovery in Q4 and going forward. If you look at the Capex figure I think it fits perfectly our strategy, what we said. We want to focus on profitable customer acquisition. That means probably we will see a lower growth in regards to DSL customers and therefore you will see a lower Capex spending. To give you a number already for

2010 is a little bit early. We are just in the planning mode in our company there. With regards to the renegotiation of the finance lease agreement, what you will see in the future, you will see in the future lower network costs. As I just mentioned before we see savings of around about 30% for these backbone capacities, so you will see it's not a two digit number but we see some savings. It will also be cash savings in the future.

Stefan Borscheid: So high single digit would be a cash saving number for the network costs?

Max Padberg: I think you would see there a figure slightly below €3 million.

Stefan Borscheid: Maybe I can add another question here on your DSL subscribers. The loss you have seen in the third quarter of around about 15,000. Are there any special one-offs? Is it the available churn customer base was higher than in the previous quarters, so is this a decline we should expect also for the next couple of quarters or will this recover towards the zero line within the next month?

Alain Bandle: Stefan, the 15,000 DSL customers that we have taken out, out of those 15,000 9,000 were defaulting customers that we carried on, which we basically took out and that actually results in a saving of about €1 million because of the ULL fee. So we are still I believe trading at an industry leading below 10% churn rate and there is no reason to believe that we won't maintain that.

Stefan Borscheid: Excellent, thank you.

Operator: We will now take our next question from Joeri Sels from DZ Bank. Please go ahead.

Joeri Sels: Hello gentlemen, it's Joeri Sels from DZ Bank, I have two questions. The first one is on your reiteration of your free cash flow guidance. This implies that you have just a few million euros free cash flow in the fourth quarter. Can you run us please through the factors why you believe that we should be a little bit more pessimistic on free cash flow development in the fourth quarter, the factors here that play a role. The second question is on, I know it's a little bit early for 2010 but you said that profitable growth remains your strategy and I see the

profitability on the free cash flow side but I'm not really seeing the growth here. The growth, what does that correspond to? To EBITDA or to revenues? Is it really your intention or do you believe you can grow EBITDA and/or revenues in 2010? These are my questions.

Alain Bandle: Ok, Joeri, hello. The free cash flow that we showed for Q3 '09 is indeed impressive and we are very confident to reach our full year target of 40 million. Please bear in mind that our free cash flow in Q4 '09 will be affected by the interest hedge payments, we only pay in the second and the fourth quarter of the year. So don't just extrapolate the same free cash flow number for next quarter. With regard to our expectation for 2010 we are as Max mentioned in the middle of our planning process but the 2009 level should be a minimum target for free cash flow in 2010. When we talked about goals for 2010 it's very clear that we will maintain our objective around generating free cash flow at least at the level of 2009 and the same is true for EBITDA.

Joeri Sels: Thank you.

Operator: As there are no further questions I would like to turn the call back over to Mr. Alain Bandle for any additional or closing remarks. Please go ahead sir.

Alain Bandle: Before we come up with the closing remarks we have one question in the room.

Frank Knowles: You've added an extra by my calculations about 5 million of EBITDA just in the third quarter through the lease renegotiation, plus you get an extra something like I don't know how much extra EBITDA you get from Versatel Media, so is there anything more to your guidance raising than just incorporating that or does it actually imply a slight decline in the underlying business excluding those factors?

Alain Bandle: You should actually get to know me as somebody that under promises and over delivers.

Frank Knowles: Thank you.

Alain Bandle: Any more questions in the room? Well then ladies and gentlemen, I would like to thank you for joining the third quarter call and I wish you a great afternoon. Thanks a lot.