S&P Global
Ratings

Research

Koninklijke KPN N.V.

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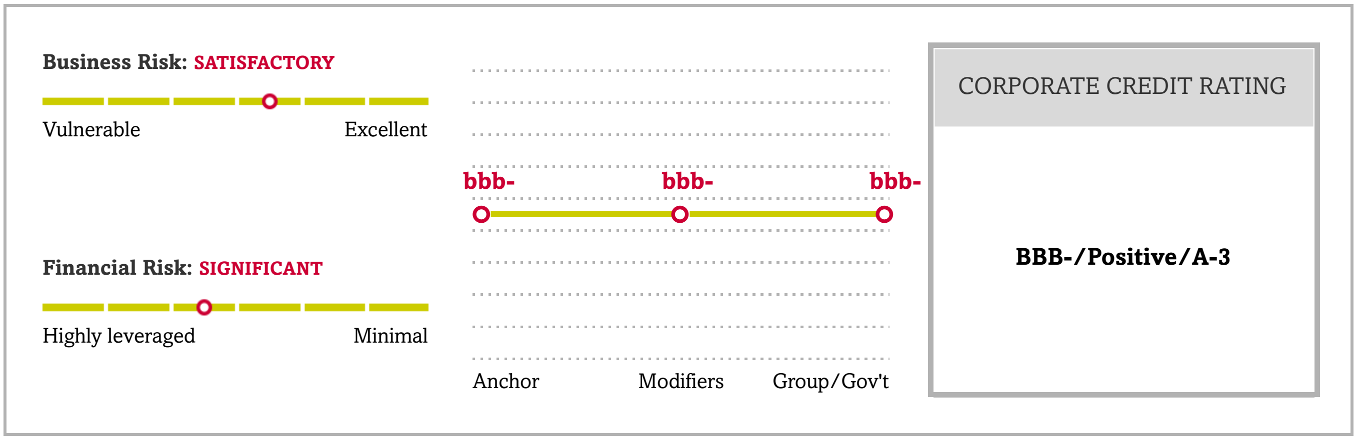

Rationale

Business Risk: Satisfactory

- Solid incumbent telecom position in the Netherlands: No.1 in mobile and No.2 in fixed-line (broadband and TV).
- High-quality infrastructure, supporting a leading 43% penetration of its customer households with more resilient and value-added convergent services.
- Stiff customer competition in a rapidly converging Dutch market.
- Price pressure in the enterprise and wholesale segments, driving protracted negative growth in these segments, which represent almost half of the KPN business.

Financial Risk: Significant

- Adjusted debt-to-EBITDA ratio above 3x on average, but gradually declining.
- Solid generation of free operating cash flow (FOCF).
- Flexibility provided by 7.7% stake in Telefónica Deutschland at end of first-quarter 2018.
- Our view that management's financial policy could translate into stronger credit metrics over the next year.

Outlook: Positive

The positive outlook on The Netherlands-based Koninklijke KPN N.V. reflects S&P Global Ratings' view that management will continue to reduce debt through a mix of positive discretionary cash flows and proceeds from the monetization of group financial assets. The positive outlook also incorporates our opinion that group EBITDA has stabilized on a sustainable basis and could grow slightly as KPN executes its cost-saving measures, despite ongoing topline pressure.

Upside scenario

We could raise our rating in the next 12-24 months if KPN demonstrates progress toward stabilizing its business-to-business (B2B) segment revenues and follows a financial policy that we considered would ensure the achievement and maintenance of an S&P Global Ratings-adjusted debt-to-EBITDA ratio approaching or below 3.0x from 3.2x in 2017, funds from operations (FFO) to debt remaining near 30% (28% in 2017), and FOCF to debt remaining between 10%-15%, excluding spectrum costs (12% in 2017).

Downside scenario

We could revise the outlook on KPN to stable if our adjusted debt-to-EBITDA ratio remained materially and sustainably above 3.0x due to financial policy measures, such as larger shareholder distributions than we currently foresee, or with weaker operating performances than we expect. These could stem from unabating decline in B2B or renewed pricing pressures in the market that impact KPN's consumer segment.

Our Base-Case Scenario

Despite continuing headwinds in the B2B segment, which we think will subside only gradually, bundled offerings will likely continue to support stabilization, with fixed-line in particular providing positive revenue contributions. We believe that KPN will sustain its EBITDA turnaround, thanks to declining churn levels and aggressive cost-cutting through process simplification and progress toward a full internet protocol (IP) network that is less expensive to maintain.

Assumptions

- We continue to forecast an organic revenue decline of 2%-3% in 2018 and 2019 (a drop of 13%-14% in 2018 after the iBasis sale), reflecting the tough competitive environment, particularly in the B2B and wholesale segments. We also expect pressure in consumer mobile, but think KPN's push to increase bundled offerings will gradually stabilize revenues.
- An increase in the adjusted EBITDA margin, above 40% by 2018 from about 36% in 2017, translating into flat to slightly increasing EBITDA in 2018-2019, owing to the group's aggressive restructuring and simplification program, and also sale of the low margin iBasis business.
- We expect capital expenditures (capex) to remain high in 2018, at about €1.1 billion, as the company continues fiber rollout and upgrades its very-high-bit-rate digital subscriber line (VDSL) upgrades. Our inclusion of the scheduled spectrum license renewals, amounting to about €400 million in our projected base case, accelerates our capex intensity in 2019 and lowers FOCF.
- Dividends of up to €470 million in 2018 (excluding hybrid coupon payments of €67 million and any pass thru dividends from TEFD).

Key Metrics

	2017A	2018E	2019E
Revenue growth (%)	(6.4)	(13)-(14)*	(2)-(3)
EBITDA margin (%)	36.4	41-43	43-45
Debt/EBITDA (x)	3.2	3.0-3.2	3.0-3.2
FFO/debt (%)	27.7	26-27	26-28
FOCF/debt(%)	12	11-12	7-9
Capex/sales (%)	17.9	19-21	27-29§

A--Actual. E—Estimate *Reflects sale of iBasis. FFO--Funds from operations. FOCF--Free operating cash flow. Capex--Capital expenditures. §Includes spectrum cost.

Company Description

KPN is the incumbent and leading integrated telecommunications and IT services provider in the Netherlands, offering fixed-line and mobile telephony and broadband to business and retail customers, and TV to retail consumers. As of Dec. 31, 2017, the company generated about €6.4 billion in revenues and about €2.3 billion in adjusted EBITDA.

Business Risk: Satisfactory

KPN has a solid domestic competitive position based on well-established market shares in the fixed-line broadband segment and in mobile services. KPN has 14.8 million retail revenue generating units (RGUs), of which 2.4 million are TV (32% market share based on company reporting), 3.0 million are broadband (41% share), 2.4 million fixed-line telephony, and 7 million mobile (43% service revenues share).

KPN protects these shares with continued large investment in its fixed-line, IPTV, and mobile infrastructure, and growing success with its convergent strategy supported by the group's high-quality integrated networks. KPN has nationwide long-term evolution, or LTE, coverage with average speeds of 58 megabits per second (Mbps), and about 76% coverage of the population with very-high-speed fixed broadband of more than 100Mbps at year end-2017. The company managed this through a mix of fiber-optic lines to the home and upgraded VDSL technologies.

The combination of high-quality networks and mounting demand for data-centric converged services in The Netherlands has translated into growing penetration of quadruple-play (4P) products among KPN's customers, including a fixed-mobile penetration level at KPN of about 43% of its household customers at end of first-quarter 2018 (up from 29% in 2015) increasing its RGU per household to 2.19 for 2017 (2.16 in 2016). Compared with nonbundled products, 4P products are more value-added and less subject to churn. They consequently underpin KPN's average revenue per user and its overall drive to reduce costs. We think that 4P penetration will likely continue to increase, which should help KPN further improve its customer mix toward a more stable and higher-paying subscriber base.

KPN's strengths are partly offset by fierce competition in a converging market, which includes the recently merged Vodafone-Ziggo, and the announced merger between T-Mobile and Tele2. Vodafone-Ziggo in particular has a dominant TV market share in its service area, and with its own nationwide mobile network, the group is well positioned to increase the penetration of 3P and 4P services. KPN also faces sharp pricing pressures in the domestic B2B market, particularly from T-Mobile and Tele2 who have low network utilization.

We consider the Dutch market to be one of the most highly competitive markets in Europe. This, along with its single country operations, constrains our assessment of KPN's business risk profile versus other, more diversified, European telecom incumbents.

Peer comparison

Table 1

Koninklijke KPN N.V. -- Peer Comparison			
Industry Sector: Diversified Telecom			
	Koninklijke KPN N.V.	**TDC A/S**	**Telekom Austria AG**
Rating as of April 28, 2018	BBB-/Positive/A-3	BBB-/Watch Neg/A-3	BBB/Positive/A-2
(Mil. €)	**--Fiscal year ended Dec. 31, 2017--**		
Revenues	6,363.0	2,722.5	4,382.5
EBITDA	2,314.5	1,158.7	1,357.9
Funds from operations (FFO)	2,047.1	951.4	1,178.4
Net income from cont. oper.	390.0	205.1	344.5
Cash flow from operations	2,029.9	1,005.8	1,100.9
Capital expenditures	1,140.0	603.2	699.6
Free operating cash flow	889.9	402.6	401.3
Discretionary cash flow	392.1	281.8	251.3
Cash and short-term investments	1,185.0	237.3	202.4
Debt	7,395.8	3,749.4	3,338.7
Equity	3,168.8	3,008.7	2,604.1
Adjusted ratios			
EBITDA margin (%)	36.4	42.6	31.0

Table 1

Koninklijke KPN N.V. -- Peer Comparison (cont.)			
Return on capital (%)	7.9	5.4	6.1
EBITDA interest coverage (x)	6.4	8.2	10.1
FFO cash int. cov. (X)	6.6	6.9	10.7
Debt/EBITDA (x)	3.2	3.2	2.5
FFO/debt (%)	27.7	25.4	35.3
Cash flow from operations/debt (%)	27.4	26.8	33.0
Free operating cash flow/debt (%)	12.0	10.7	12.0
Discretionary cash flow/debt (%)	5.3	7.5	7.5

Financial Risk: Significant

In our base case, we anticipate that KPN's adjusted debt-to-EBITDA ratio will improve to 3.1x in 2018 from 3.2x in 2017, mainly thanks to reduced adjusted debt from positive discretionary cash flows.

In addition, we think management has several financial policy levers that they may use to produce stronger credit metrics over the next year, including:

- An 7.7% stake in Telefonica Deutschland at end of first-quarter 2018, with a fair value we estimate at about €900 million to €1 billion. In our base-case, we assume the current pace of monetization is maintained for 2018, but assume no subsequent sales. If this pace accelerates or continues beyond 2018, and KPN applies the ensuing proceeds to debt reduction, deleveraging could be significantly more pronounced.
- A first call on €1.1 billion of its Euro hybrids in September 2018. In lieu of announced plans, we have conservatively assumed no replacement. A partial replacement of the bonds could further improve our leverage forecast.

KPN has applied International Financial Reporting Standards rule 15 starting with its 2017 financials. The upfront recognition of handset revenue and slowing rate of unit sales negatively impacts our EBITDA margin forecast by about 2% and increases adjusted leverage by about 0.13x. However, this does not impact cash flows, and we do not view this accounting-related change as negative to our credit view.

Financial summary

Table 2

Koninklijke KPN N.V. -- Financial Summary					
Industry Sector: Diversified Telecom					
	--Fiscal year ended Dec. 31--				
	2017	**2016**	**2015**	**2014**	**2013**
(Mil. €)					
Revenues	6,363.0	6,801.0	7,006.0	7,999.0	11,578.0
EBITDA	2,314.5	2,553.0	2,485.0	2,772.9	4,305.9
Funds from operations (FFO)	2,047.1	2,002.5	2,036.0	2,047.1	3,312.7
Net income from continuing operations	390.0	363.0	503.0	225.0	286.0
Cash flow from operations	2,029.9	2,025.8	2,107.2	1,698.2	3,272.7

Table 2

Koninklijke KPN N.V. -- Financial Summary (cont.)					
Industry Sector: Diversified Telecom					
	--Fiscal year ended Dec. 31--				
	2017	**2016**	**2015**	**2014**	**2013**
(Mil. €)					
Capital expenditures	1,140.0	1,219.0	1,304.0	1,473.0	3,750.0
Free operating cash flow	889.9	806.8	803.2	225.2	(477.3)
Discretionary cash flow	392.1	329.7	303.7	126.7	(483.3)
Cash and short-term investments	1,185.0	1,319.0	1,446.0	2,276.0	3,946.0
Debt	7,395.8	8,066.2	8,606.1	9,558.8	14,316.6
Equity	3,168.8	3,361.6	4,963.5	4,542.5	5,175.5
Adjusted ratios					
EBITDA margin (%)	36.4	37.5	35.5	34.7	37.2
Return on capital (%)	7.9	8.2	6.5	4.5	5.9
EBITDA interest coverage (x)	6.4	3.8	4.4	4.2	4.5
FFO cash int. cov. (x)	6.6	5.7	5.4	3.9	6.5
Debt/EBITDA (x)	3.2	3.2	3.5	3.4	3.3
FFO/debt (%)	27.7	24.8	23.7	21.4	23.1
Cash flow from operations/debt (%)	27.4	25.1	24.5	17.8	22.9
Free operating cash flow/debt (%)	12.0	10.0	9.3	2.4	(3.3)
Discretionary cash flow/debt (%)	5.3	4.1	3.5	1.3	(3.4)

Liquidity: Strong

We assess KPN's liquidity as strong, with sources of liquidity to cover uses by more than 1.5x over the next 12 months and even stronger in the following 12 months. This assessment also reflects our view that KPN maintains high credit standing in the capital markets and has solid relationships with banks.

Principal Liquidity Sources	Principal Liquidity Uses
As of Jan. 1, 2018, we estimate liquidity sources of about €4.3 billion in the following 12 months. These include: • Cash and liquid investments of around €1.18 billion; • Undrawn long-term committed credit lines of €1.25 billion with maturity up to 2022; • Positive FFO of about €1.8 billion; and • Marginal working capital inflows and proceeds from the sale of iBasis and TEFD securities to date.	As of Jan. 1, 2018, we estimate KPN's liquidity needs in the following 12 months at about €2.7 billion, including: • Annual capex of about €1.1 billion; • Annual ordinary dividends of €470 million; • Small bolt-on acquisitions of about €100 million; and • Potential outflows related to the redemption of the outstanding equity hybrid of up to €1.1 billion; and • Limited debt maturities outside of the hybrid first call.

Debt maturities

As of Jan. 1, 2018 (excluding hybrids):

- 2019: €600 million
- 2020: €461 million
- 2021: €614 million
- 2022: €616 million
- Thereafter: €3.9 billion

Other Credit Considerations

Our 'BBB-' rating reflects the combination of KPN's relatively strong business profile, given its solid and diversified positions in the domestic market, and improving margins. It also reflects credit ratios at the strong end of the scale for its rating.

Ratings Score Snapshot

Corporate Credit Rating

BBB-/Positive/A-3

Business risk: Satisfactory

- **Country risk:** Very low
- **Industry risk:** Intermediate
- **Competitive position:** Satisfactory

Financial risk: Significant

- **Cash flow/Leverage:** Significant

Anchor: bbb-

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Reconciliation

Our main financial adjustments are for surplus cash, which we net in full with no haircut, and for operating lease commitments that we add to debt on a present value basis using a 7% discount rate. Capitalizing these reported expenses adds around €600 million to reported debt, and increases EBITDA by about €130 million.

In addition, we ascribe intermediate (50%) equity content to the bulk of KPN's hybrid capital instruments--denominated in euros, sterling, and U.S. dollars. This treatment applies to the hybrid balance up to 15% of KPN's adjusted capitalization (about €1.6 billion of the €2.0 billion total outstanding). We assess the remaining €400 million as having minimal equity content.

Table 3

Reconciliation Of Koninklijke KPN N.V. Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €)

	--Fiscal year ended Dec. 31, 2017--								
Koninklijke KPN N.V. reported amounts									
	Debt	**Shareholders' equity**	**Revenues**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**	**Dividends paid**
Reported	7,596	3,479	6,364	2,193	769	338	2,193	1,952	513
S&P Global Ratings' adjustments									
Interest expense (reported)	--	--	--	--	--	--	(338)	--	--
Interest income (reported)	--	--	--	--	--	--	69	--	--
Current tax expense (reported)	--	--	--	--	--	--	27	--	--
Operating leases	582	--	--	132	42	42	89	89	--
Debt-like hybrids	242	(242)	--	--	--	--	--	(15)	(15)
Intermediate hybrids reported as debt	(361)	361	--	--	--	(25)	25	26	26

Table 3

Reconciliation Of Koninklijke KPN N.V. Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €) (cont.)

Intermediate hybrids reported as equity	429	(429)	--	--	--	--	--	(26)	(26)
Postretirement benefit obligations/deferred compensation	164	--	--	(15)	(15)	7	(23)	4	--
Surplus cash	(1,185)	--	--	--	--	--	--	--	--
Share-based compensation expense	--	--	--	6	--	--	6	--	--
Asset retirement obligations	31	--	--	--	--	--	--	--	--
Non-operating income (expense)	--	--	--	--	70	--	--	--	--
Debt - Accrued interest not included in reported debt	161	--	--	--	--	--	--	--	--
Debt - Guarantees	8	--	--	--	--	--	--	--	--
Debt - Foreign currency hedges	(271)	--	--	--	--	--	--	--	--
Revenues - Other	--	--	(1)	(1)	(1)	--	(1)	--	--
Total adjustments	(200)	(310)	(1)	122	96	24	(146)	78	(15)

S&P Global Ratings' adjusted amounts

	Debt	Equity	Revenues	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations	Dividends paid
Adjusted	7,396	3,169	6,363	2,315	865	362	2,047	2,030	498

Related Criteria

- General Criteria: Methodology And Assumptions: Assigning Equity Content To Hybrid Capital Instruments Issued By Corporate Entities And Other Issuers Not Subject To Prudential Regulation, Jan. 16, 2018
- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Telecommunications And Cable Industry, June 22, 2014
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013

- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Criteria Clarification On Hybrid Capital Step-Ups, Call Options, And Replacement Provisions, Oct. 22, 2012
- Criteria - Financial Institutions - General: Methodology: Hybrid Capital Issue Features: Update On Dividend Stoppers, Look-Backs, And Pushers, Feb. 10, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	**bbb-/bb+**	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of May 2, 2018)

Koninklijke KPN N.V.	
Corporate Credit Rating	BBB-/Positive/A-3
Junior Subordinated	BB
Senior Unsecured	BBB-
Short-Term Debt	A-3
Corporate Credit Ratings History	
29-Mar-2017	BBB-/Positive/A-3
06-Nov-2013	BBB-/Stable/A-3
15-Aug-2013	BBB-/Watch Pos/A-3
26-Jul-2013	BBB-/Positive/A-3

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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