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Koninklijke KPN N.V.

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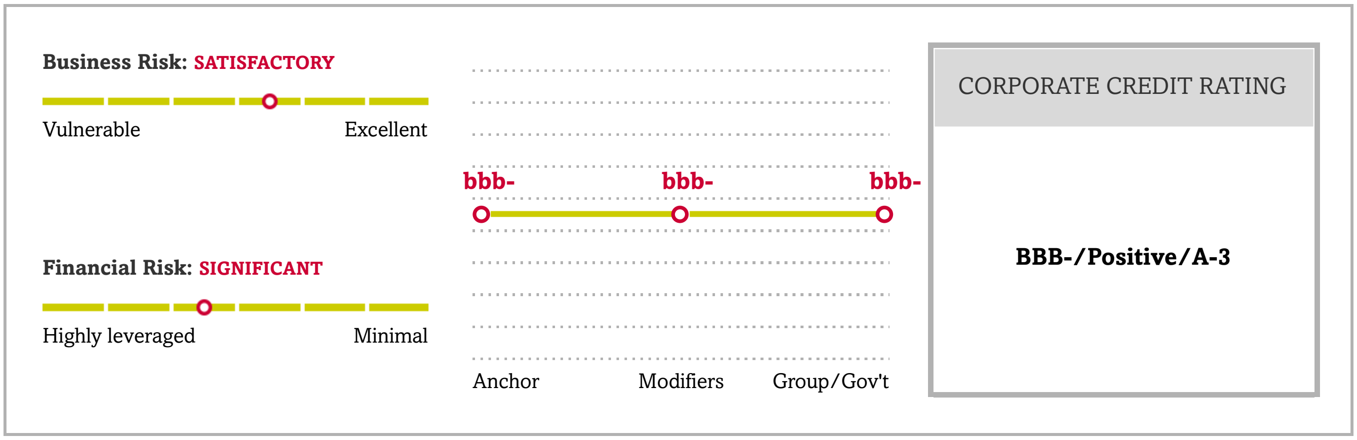

Rationale

Business Risk: Satisfactory

- Solid competitive position in the Dutch fixed-line and mobile telecommunications markets.
- High-quality infrastructure, supporting the increasing penetration of more resilient and value-added convergent services.
- Stiff competition with three wireless, network-based competitors and a well-established cable operator in The Netherlands.
- Challenges in the enterprise segment.

Financial Risk: Significant

- Adjusted debt-to-EBITDA ratio above 3x on average.
- Solid generation of free operating cash flow.
- Flexibility provided by KPN's 9.5% stake in Telefónica Deutschland and a stake in Spain-based Telefónica S.A.
- Our view that management's financial policy could translate into significantly stronger credit metrics within two years.

Outlook: Positive

The positive outlook on The Netherlands-based Koninklijke KPN N.V. reflects S&P Global Ratings' view that management will seek to steadily and significantly 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 now stabilized on a sustainable basis and could grow slightly as KPN executes its cost saving measures.

Upside scenario

We might consider a positive rating action in the next 24 months, if KPN demonstrated progress toward softer revenue decline in the business-to-business (B2B) segment and followed a financial policy that would ensure the achievement and maintenance of an S&P Global Ratings-adjusted debt-to-EBITDA ratio comfortably and sustainably below 3x from 3.2x in 2016, an FFO-to-debt ratio of about 30% from 25% in 2016, and FOCF-to-debt within 10%-15%, after 10% in 2016.

Downside scenario

We could revise the outlook on KPN to stable if our adjusted debt-to-EBITDA ratio remained within 3.0x-3.5x, 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.

Our Base-Case Scenario

Despite continuing headwinds in the B2B segment, which we think will subside only gradually, the consumer segments will likely continue to provide some positive revenue traction. We believe that KPN will sustain its EBITDA turnaround, thanks to the combination of the better trends in consumer segments, the favorable impact of receding churn levels, and the aggressive cost cuts that the group seeks to achieve through widespread measures, including process simplification and progress toward a full internet protocol (IP) network that is less expensive to maintain.

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Assumptions

- An organic revenue decline of about 3% in 2017, moderating to approximately 2% in 2018-2019, primarily due to tough pricing conditions in the B2B segment, exacerbated by a onetime impact from lower roaming charges this year, largely but not entirely offset by progress in the consumer segment on the back of favorable customer mix effects
- A further increase in the fully adjusted EBITDA margin, toward 40% by 2018 from about 38% in 2016, translating into flat to slightly increasing absolute EBITDA in 2017-2018, owing to the group's aggressive restructuring and simplification program.
- Annual capital expenditures (capex) of about €1.1 billion, slightly lower than in 2016, given the efficiency gains and the relatively low investment requirements in the mobile division because long-term evolution (LTE) coverage is already high.
- Our assumption of 10%-12% annual growth in common regular dividends.

Key Metrics

	2016a	2017f	2018f
Revenue growth (%)	(2.9)	(3)	(2.0-3.0)
EBITDA margin* (%)	37.5	38-39	39-40
FFO to debt (%)	24.8	27	28
Debt to EBITDA* (x)	3.2	3.0	2.9

*S&P Global Ratings fully adjusted. a--Actual. f—-Forecast. FFO--Funds from operations.

Company Description

KPN is the largest integrated telecoms services provider in The Netherlands.

Business Risk: Satisfactory

KPN has a solid domestic competitive position based on well-established and defended market shares in the fixed-line broadband segment and in mobile services. These market shares derive from continued large investments in KPN's fixed-line, IPTV, and mobile infrastructure, and a successful convergent strategy supported by the group's high-quality integrated networks.

KPN has nationwide LTE coverage and a high 75% coverage of the population, with very-high-speed fixed broadband of more than 100 megabits per second at end-2016, through a mix of fiber-optic lines to the home (FTTH) and upgraded very-high-bit-rate digital subscriber line (VDSL) technologies.

The combination of high-quality networks and mounting demand for data-centric converged services in The Netherlands has translated into rapid penetration of quadruple-play (4P) products among KPN's customers, with a penetration level at KPN of about 37% of its household customers at end-2016 (twice as much as at end-2014). Compared with non-bundled 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 to further improve its customer mix toward a more stable and higher paying subscriber base.

The aforementioned strengths are partly offset by fierce competition from a well-established cable operator and three other mobile network operators in The Netherlands; IP-based voice, messaging, and video applications; as well as sharp pricing pressures in the domestic B2B market.

That said, with four mobile operators and widespread cable coverage, we consider the Dutch market to be one of the most highly competitive markets in Europe. This constrains our assessment of KPN's business risk profile versus other, generally more diversified, European telecom incumbents.

Our Base-Case Operating Scenario

- An organic revenue decline of about 3% in 2017, moderating to approximately 2% in 2018-2019.
- A further increase in the fully adjusted EBITDA margin, toward 40% by 2018 from about 38% in 2016.

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 May 3, 2017	BBB-/Positive/A-3	BBB-/Stable/A-3	BBB/Stable/A-2
(Mil. €)	**--Average of past three fiscal years--**		
Revenues	7,268.7	3,075.9	4,076.2
EBITDA	2,603.6	1,301.3	1,243.7
Funds from operations (FFO)	2,028.5	1,046.9	1,012.0
Net income from continuing operations	363.7	95.6	86.4
Cash flow from operations	1,943.7	1,032.8	1,016.7
Capital expenditures	1,332.0	573.2	1,080.0
Free operating cash flow	611.7	459.6	(63.3)
Discretionary cash flow	253.4	251.1	(100.5)
Debt	8,743.7	4,630.6	3,856.1
Equity	4,289.2	2,580.3	1,734.4
Adjusted ratios			
EBITDA margin (%)	35.8	42.3	30.5
Return on capital (%)	6.2	7.4	7.0
EBITDA interest coverage (x)	4.1	7.3	6.3
FFO cash interest coverage (x)	4.8	5.9	6.0
Debt/EBITDA (x)	3.4	3.6	3.1
FFO/debt (%)	23.2	22.6	26.2
Cash flow from operations/debt (%)	22.2	22.3	26.4
Free operating cash flow/debt (%)	7.0	9.9	(1.6)

Table 1

Koninklijke KPN N.V. -- Peer Comparison (cont.)			
Discretionary cash flow/debt (%)	2.9	5.4	(2.6)

Financial Risk: Significant

We think that management's financial policy, geared toward preserving its investment-grade credit profile, could translate into significantly stronger credit metrics within the next two years.

In our base case, we anticipate that KPN's adjusted debt-to-EBITDA ratio will improve to 2.9x in 2018 from 3.2x in 2016, mainly owing to reduced adjusted debt through positive discretionary cash flows.

In our base-case, we don't at this stage factor in the potential benefits of cash proceeds that we think KPN may receive from the monetization of its financial assets. If the monetization occurs and the group dedicates the ensuing proceeds to debt reduction, however, deleveraging would be significantly more pronounced.

Our Base-Case Cash Flow And Capital Structure Scenario

- Annual capex of about €1.1 billion.
- Our assumption of 10%-12% annual growth in common regular dividends.

Financial summary

Table 2

Koninklijke KPN N.V. -- Financial Summary					
Industry Sector: Diversified Telecom					
	--Fiscal year ended Dec. 31--				
(Mil. €)	**2016**	**2015**	**2014**	**2013**	**2012**
Revenues	6,801.0	7,006.0	7,999.0	11,578.0	12,409.0
EBITDA	2,553.0	2,485.0	2,772.9	4,305.9	4,881.0
Funds from operations (FFO)	2,002.5	2,036.0	2,047.1	3,312.7	3,753.3
Net income from continuing operations	363.0	503.0	225.0	286.0	691.0
Cash flow from operations	2,025.8	2,107.2	1,698.2	3,272.7	3,501.3
Capital expenditures	1,219.0	1,304.0	1,473.0	3,750.0	2,263.0
Free operating cash flow	806.8	803.2	225.2	(477.3)	1,238.3
Discretionary cash flow	329.7	303.7	126.7	(483.3)	259.3
Cash and short-term investments	1,319.0	1,446.0	2,276.0	3,946.0	1,286.0
Debt	8,066.2	8,606.1	9,558.8	14,316.6	17,568.1
Equity	3,361.6	4,963.5	4,542.5	5,175.5	1,426.0
Adjusted ratios					
EBITDA margin (%)	37.5	35.5	34.7	37.2	39.3
Return on capital (%)	8.2	6.5	4.5	5.9	11.1
EBITDA interest coverage (x)	3.8	4.4	4.2	4.5	5.3

Table 2

Koninklijke KPN N.V. -- Financial Summary (cont.)

Industry Sector: Diversified Telecom

	--Fiscal year ended Dec. 31--				
(Mil. €)	**2016**	**2015**	**2014**	**2013**	**2012**
FFO cash interest coverage (x)	5.7	5.4	3.9	6.5	7.1
Debt/EBITDA (x)	3.2	3.5	3.4	3.3	3.6
FFO/debt (%)	24.8	23.7	21.4	23.1	21.4
Cash flow from operations/debt (%)	25.1	24.5	17.8	22.9	19.9
Free operating cash flow/debt (%)	10.0	9.3	2.4	(3.3)	7.0
Discretionary cash flow/debt (%)	4.1	3.5	1.3	(3.4)	1.5

Liquidity: Strong

The short-term rating is 'A-3'. Our assessment of KPN's liquidity as strong is supported by our expectation that the ratio of liquidity sources to uses will be comfortably higher than 1.5x in the 12 months from Dec. 31, 2016, and likely even stronger in the following 12 months. Our assessment also reflects our view that KPN maintains a high credit standing in the capital markets and has solid relationships with banks.

Principal Liquidity Sources	Principal Liquidity Uses
As of Dec. 31, 2016, we estimate liquidity sources of more than €4.5 billion in the following 12 months. These include: • Cash and liquid investments of around €1.3 billion. • Undrawn long-term committed credit lines of €1.25 billion with maturity up to 2021. • Positive FFO of about €2 billion.	As of Dec. 31, 2016, we estimate KPN's liquidity needs in the following 12 months at €2.4 billion, including: • €0.7 billion of debt maturities. • Capex of about €1.1 billion. • Moderately negative working capital requirements. • Ordinary dividends of €0.4 billion.

Debt maturities

As of Dec. 31, 2016 (excluding hybrids):

- 2017: €0.7 billion
- 2019: €0.6 billion
- 2020: €0.5 billion
- 2021: €0.6 billion
- Thereafter: €4.6 billion

Other Credit Considerations

We apply our 'bbb-' anchor to KPN--the higher of two possible outcomes for the combination of a business risk profile of satisfactory and a financial risk profile of significant--to reflect the group's good position within its business risk category, given its solid and diversified positions in its domestic market.

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

We assess the bulk of KPN's hybrid capital instruments (about €1.7 billion for a total outstanding of €2.0 billion)--denominated in euros, sterling, and U.S. dollars--as having intermediate equity content. We assess the remaining €0.3 billion as having minimal equity content because it exceeds 15% of KPN's adjusted capitalization, our threshold under our criteria.

Table 3

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

	--Fiscal year ended Dec. 31, 2016--								
Koninklijke KPN N.V. reported amounts									
	Debt	**Shareholders' equity**	**Revenues**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**	**Dividends paid**
Reported	8,632.0	3,601.0	6,806.0	2,429.0	884.0	641.0	2,429.0	1,924.0	487.0

Table 3

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

S&P Global Ratings' adjustments

Interest expense (reported)	--	--	--	--	--	--	(641.0)	--	--
Interest income (reported)	--	--	--	--	--	--	112.0	--	--
Current tax expense (reported)	--	--	--	--	--	--	9.0	--	--
Operating leases	622.8	--	--	133.0	42.3	42.3	90.7	90.7	--
Debt-like hybrids	165.0	(165.0)	--	--	--	--	--	(12.1)	(12.1)
Intermediate hybrids reported as debt	(393.1)	393.1	--	--	--	(25.8)	25.8	30.6	30.6
Intermediate hybrids reported as equity	467.5	(467.5)	--	--	--	--	--	(28.5)	(28.5)
Postretirement benefit obligations/deferred compensation	196.5	--	--	(11.0)	(11.0)	7.0	(25.0)	21.0	--
Surplus cash	(1,319.0)	--	--	--	--	--	--	--	--
Share-based compensation expense	--	--	--	7.0	--	--	7.0	--	--
Asset retirement obligations	25.5	--	--	--	--	--	--	--	--
Non-operating income (expense)	--	--	--	--	111.0	--	--	--	--
Debt - Accrued interest not included in reported debt	197.0	--	--	--	--	--	--	--	--
Debt - Guarantees	8.0	--	--	--	--	--	--	--	--
Debt - Foreign currency hedges	(536.0)	--	--	--	--	--	--	--	--
Revenues - Other	--	--	(5.0)	(5.0)	(5.0)	--	(5.0)	--	--
Total adjustments	(565.8)	(239.4)	(5.0)	124.0	137.3	23.5	(426.5)	101.8	(9.9)

S&P Global Ratings' adjusted amounts

	Debt	Equity	Revenues	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations	Dividends paid
Adjusted	8,066.2	3,361.6	6,801.0	2,553.0	1,021.3	664.5	2,002.5	2,025.8	477.1

Related Criteria And Research

Related Criteria

- 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: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, 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 For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 07, 2013
- General Criteria: Methodology And Assumptions: Assigning Equity Content To Corporate Entity And North American Insurance Holding Company Hybrid Capital Instruments, April 01, 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 2008Edition, Sept. 15, 2008
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 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 3, 2017)

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
08-Feb-2013	BBB-/Stable/A-3
18-Dec-2012	BBB/Watch Neg/A-2
21-Nov-2012	BBB/Negative/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable

Ratings Detail (As Of May 3, 2017) (cont.)

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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