MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms KPN's Baa3 ratings; stable outlook

14 May 2019

Madrid, May 14, 2019 -- Moody's Investors Service ("Moody's") has today affirmed the Baa3 senior unsecured rating of Koninklijke KPN N.V. ("KPN"). Concurrently, Moody's has affirmed the company's (P)Baa3 senior unsecured and (P)Ba1 subordinated MTN program rating, as well as the Ba2 rating on the company's hybrid securities and the Prime-3 (P-3) short-term issuer rating. The outlook is stable.

"The Baa3 rating reflects KPN's solid position as the leading integrated operator in the Netherlands with a strong quality network. KPN has a conservative financial policy with a target net leverage below 2.5x in the medium term, and the company's 3.5% stake in Telefónica Deutschland enhances its financial flexibility," says Laura Perez, Vice President-Senior Credit Officer and lead analyst for KPN.

"We expect EBITDA to grow by low single digits in the next two years, mainly driven by cost savings, offsetting revenue declines owing to high competitive pressures and structural pressures in its business segment. At the same time, we expect KPN's cash flow generation to improve from 2019 driven by modest EBITDA growth, lower restructuring costs and interest savings," adds Mrs. Perez.

A full list of affected ratings can be found at the end of this press release.

RATINGS RATIONALE

KPN's Baa3 senior unsecured rating is supported principally by the company's (1) leading position in the Dutch market; (2) integrated business model, with a strong quality network; (3) good free cash flow generation driven by its high margins and its significant investments in the network; (4) conservative financial policy with a target net leverage below 2.5x, which is equivalent to a Moody's adjusted net leverage ratio of approximately 2.8x (as defined by Moody's, including IFRS 16 and expected spectrum liabilities); (5) solid liquidity profile; and (6) ownership of a 3.5% stake in Telefónica Deutschland ("TEFD"), which provides some additional financial flexibility.

These considerations are balanced by (1) fierce competition in the Dutch telecom market; (2) Moody's expectations of continuing revenue declines mainly driven by competitive pressures and structural declines in its business segment, although trends are somewhat improving; (3) the company's lack of international diversification; and (4) a relatively high dividend payout, broadly aligned with industry average, which will weigh on its cash flow generation.

KPN operates an integrated business model and remains the leader in the domestic wireless segment, with an estimated 43% market share in terms of service revenue. In retail broadband, KPN is the second-largest operator in the country after VodafoneZiggo Group B.V. (B1 negative), holding an estimated 41% market share by revenue. KPN's residential TV business has grown solidly, achieving an estimated 32% market share, although it remains behind VodafoneZiggo.

The company benefits from a strong quality network, which would enable it to improve underlying revenue trends. KPN expects to increase its FTTH coverage by an additional 1 million homes by 2021, which would represent a coverage greater than 40%, up from 30% as of December 2018. Furthermore, it will continue to invest in fibre-to-the-cabinet to upgrade its capacity and broadband speeds. The company aims to deliver broadband speeds in excess of 1 Gbps and 200 Mbps to 45% and 70% of the households by 2021, respectively, compared to around 30% and 50% as of 2018.

Moody's expects competition and structural pressures in the business segment will continue to weigh on the company's top-line growth prospects, although to a lesser degree than in 2018. The rating agency expects KPN's revenue declines to slow to around 1%-1.5% over the next 24 months from an expected -3% in 2019, driven by easing competitive pressures in mobile and slower declines in the business segment.

Moody's expects underlying EBITDA (excluding the impact of IFRS 16) growth in the low single digit in the next two years, mainly driven by cost savings, offsetting fading declines in revenue.

Moody's expects KPN's free cash flow (FCF) to decline in 2019 driven by higher restructuring costs, but to improve in 2020-2021 driven by modest underlying EBITDA growth and lower cash interest payments. The rating agency expects KPN's free cash flow generation/net debt will remain at around 4% over the next 24 months.

Moody's expects KPN's adjusted net debt/EBITDA (including IFRS 16 and IFRS 15) to improve slightly to around 3.0x over the next two years, down from 3.1x in 2018, mainly driven by improving cash flow generation and the monetization of its stake in TEFD, which will help to pay for acquisition of spectrum (700, 1400 and 2100MHz in 2020 and 3.5GHz in 2022).

KPN's liquidity profile is adequate and benefits from (1) cash and cash equivalents excluding short-term investments of €392 million as of March 2019; (2) full availability as of March 2019 under its €1.25 billion credit facility maturing in 2023, with no financial covenants; (3) a €300 million EIB facility signed in April 2019 and (4) internally generated cash flow (defined as EBITDA net of cash interest, tax obligations and dividends received) of around €2 billion per year.

RATIONALE FOR STABLE OUTLOOK

The stable outlook reflects Moody's expectation of modest underlying EBITDA growth and improving cash flow generation, which in combination with the monetization of the TEFD stake will lead to a net adjusted leverage of 3.0x and a retained cash flow (RCF) to net adjusted debt of around 21% in the next two years.

WHAT COULD CHANGE THE RATING UP/DOWN

Upward pressure on the rating could arise if KPN sustainably improves its underlying revenue and operating performance with growing revenue and improving key performance indicator trends (e.g. ARPU, churn etc..), which would lead to stronger debt protection ratios, such as adjusted RCF/net debt of at least 25% and adjusted net debt/EBITDA comfortably below 2.5x, while experiencing a significant improvement in the business environment.

Negative pressure on the rating could arise if KPN's underlying operating performance significantly weakens with a deterioration in credit metrics, including RCF/net adjusted debt falling below 20% or adjusted net debt/EBITDA exceeding 3.2x on an ongoing basis.

LIST OF AFFECTED RATINGS

Affirmations:

..Issuer: Koninklijke KPN N.V.

....ST Issuer Rating, Affirmed P-3

....Junior Subordinate Regular Bond/Debenture, Affirmed Ba2

....Subordinate Medium-Term Note Program, Affirmed (P)Ba1

....Senior Unsecured Medium-Term Note Program, Affirmed (P)Baa3

....Senior Unsecured Regular Bond/Debenture, Affirmed Baa3

Outlook Actions:

..Issuer: Koninklijke KPN N.V.

....Outlook, Remains Stable

PRINCIPAL METHODOLOGIES

The principal methodology used in these ratings was Telecommunications Service Providers published in January 2017. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

COMPANY PROFILE

KPN is the leading integrated provider of telecom services in the Netherlands. The company offers fixed and mobile services, and fixed and mobile broadband internet and TV to retail consumers. The company also supplies mobile, wireline network and ICT services to business customers in the Netherlands. KPN generated adjusted revenue from continuing operations of €5.6 billion and adjusted EBITDA of €2.3 billion.

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Laura Perez Martinez
VP - Senior Credit Officer
Corporate Finance Group
Moody's Investors Service Espana, S.A.
Calle Principe de Vergara, 131, 6 Planta
Madrid 28002
Spain
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Ivan Palacios
Associate Managing Director
Corporate Finance Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Investors Service Espana, S.A.
Calle Principe de Vergara, 131, 6 Planta
Madrid 28002
Spain
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

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