

Rating Action: Moody's confirms KPN's Baa2 rating; negative outlook

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Madrid, February 06, 2013 -- Moody's Investors Service has today confirmed the Baa2 senior unsecured rating of Koninklijke KPN N.V. (KPN). Concurrently, Moody's has confirmed the company's (P)Baa2/(P)Baa3 senior/subordinated MTN program rating and the Prime-2 (P-2) short-term issuer rating. The outlook on all ratings is negative.

The confirmation follows the release of KPN's FY2012 results and outlook for 2013 as well as its plans to raise EUR4 billion through a fully underwritten rights issue in order to strengthen its financial profile. KPN may consider whether, subject to market conditions, part of the EUR4 billion capital raise could alternatively be raised through equity-linked or other capital instruments.

Today's rating action concludes the review for downgrade that Moody's initiated on 18 December 2012.

RATINGS RATIONALE

"Our confirmation of KPN's Baa2 rating reflects the company's strong commitment to maintaining its investment-grade rating. This is demonstrated by the announcement of a sizeable rights issue, which broadly offsets the expected impact of the company's deteriorating operating performance on its credit metrics," says Iván Palacios, a Moody's Vice President -- Senior Credit Officer and lead analyst for KPN.

Moody's estimates that the rights issue will enable KPN's Net reported debt/EBITDA to improve by around 0.9x. "Therefore, we now expect the company's reported net leverage to remain within the 2.0x-2.5x range through the 2013-2015 period," adds Mr. Palacios.

KPN's announced rights issue is sizeable, amounting to around two thirds of the company's market capitalisation before the announcement, and represents further proof of the company's commitment to strengthen its balance sheet. The rights issue follows KPN's other credit-positive moves like the cancellation of the share buyback in early 2012 and the material reduction in dividends to only EUR0.03 per share, compared with EUR0.85 per share paid in 2011. However, the rights issue also reflects that the company has exhausted all available internal options to protect its financial profile and can now only revert to external options, reflecting its very limited financial flexibility.

KPN's operating performance remains weak and is the main source of concern for Moody's. In FY2012, KPN's reported EBITDA declined to EUR4.5 billion from EUR5.1 billion in the previous year, although the reduction would be larger if the impacts of tower sales and handset lease accounting are excluded.

Moody's expects KPN's performance in the 2013-2015 period to continue to be impacted by the combination of a weak macroeconomic environment, tough regulation and fierce competition. In the Dutch market, the company will have to face a new mobile competitor, Tele 2, which has recently secured spectrum in the 800 MHz band. In its Mobile International segment, KPN is recording a slowdown in its growth rate as existing customers are trading down to cheaper tariffs. In order to mitigate some of these negative trends, the company is pursuing a more aggressive quadruple-play offering in The Netherlands to reduce churn. In Germany and Belgium, the company is changing its strategic focus, targeting long-term market share growth, at the cost of lower margins in the near term. In Moody's view, this strategic shift is not free from execution risk.

Liquidity will materially strengthen with the proceeds from the rights issue, as the amounts raised will be enough to cover the bond maturities in 2013 (EUR1.1 billion), 2014 (EUR1.4 billion) and 2015 (EUR1 billion). In addition, the company has also recently strengthened its liquidity position by means of an additional EUR500 million backstop facility provided for the March 2013 bond redemption and ahead of refinancing in the capital markets. This backstop facility will be cancelled if it remains unused by the end of Q1 2013.

The Baa2 rating continues to be supported by KPN's leading position as incumbent in the Dutch market and the benefits derived from its geographical diversification in Germany and Belgium, where KPN operates as a mobile-centric market challenger. The rating also reflects the expected solid liquidity profile further to the successful completion of the announced rights issue. These considerations are balanced by KPN's relatively weak metrics for the rating category, with net debt/EBITDA (as adjusted by Moody's) trending towards 3.0x through the rating

horizon, the track record of declining operating performance and profit warnings, and the lack of financial flexibility as the company has run out of internal options to protect its financial profile.

RATIONALE FOR NEGATIVE OUTLOOK

The negative outlook reflects (1) Moody's expectation that KPN's credit metrics will be weakly positioned for the Baa2 rating for a sustained period of time, (2) the current lack of visibility in light of the rapid deterioration in operating performance, and (3) the execution risk embedded in the business plan. The rating confirmation assumes that the EUR4 billion rights issue will be successfully completed. However, Moody's notes that while the rights issue is fully underwritten, there is a risk that the EGM may not pass the resolution approving the transaction. In that event, KPN's rating would likely be downgraded in the absence of alternative measures to strengthen its financial profile.

WHAT COULD CHANGE THE RATING DOWN/UP

Downward pressure on the rating could potentially result from any further deterioration in KPN's operating performance beyond Moody's expectations for 2013. More specifically, the rating could come under negative pressure if the company's credit protection measures weaken, such that its retained cash flow (RCF)/net adjusted debt drops below 20% and its net adjusted debt/EBITDA (as adjusted by Moody's) does not trend towards 3.0x. Moody's expects a one-off deterioration in metrics in 2014 following the consolidation of Reggefiber, but the rating agency also expects leverage ratios to improve thereafter.

In view of today's action, Moody's does not currently anticipate upward rating pressure. However, the outlook on the ratings could revert back to stable if KPN demonstrates a stabilisation in operating performance in the Dutch market and a successful implementation of its strategy in Germany and Belgium leading to growth in profitability, while maintaining a net adjusted debt/EBITDA ratio (as adjusted by Moody's) sustainably below 3.0x and an RCF/net adjusted debt in the 20%-25% range.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was the Global Telecommunications Industry published in December 2010. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

Koninklijke KPN N.V. (KPN) is the leading integrated provider of telecommunication services in the Netherlands. KPN also provides mobile telephony services in Germany and Belgium through its subsidiaries e-plus and BASE. In 2012, the company generated revenues of EUR12.7 billion and EBITDA of EUR4.5 billion.

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