

## FITCH DOWNGRADES KPN TO 'BBB-'; OUTLOOK STABLE

Fitch Ratings-London-17 December 2012: Fitch Ratings has downgraded Royal KPN N.V.'s (KPN) Long-term Issuer Default Rating (IDR) to 'BBB-' from 'BBB'. The Outlook is Stable. A full list of rating actions is below.

The downgrade has been triggered by KPN's purchase of frequency licences in the Dutch spectrum auction at a total cost of EUR1.35bn, almost EUR1bn higher than Fitch's expectations. After reducing the dividends to be paid in 2013, KPN will have very limited financial flexibility within the constraints of an intensely competitive domestic market to deal with leverage which is high for a 'BBB' rating.

### KEY DRIVERS

#### - High Leverage To Persist

KPN's higher than anticipated spectrum costs means that actions that could have been used to reduce leverage, such as a reduction in dividends and asset disposals (tower sales in the Netherlands and Germany), have only prevented leverage from increasing. Fitch expects KPN to end 2012 with net debt/EBITDA (as defined by Fitch, including Reggefiber-related liabilities) of 3.2x, with only a slight reduction in 2013, even after cutting the dividend. This is higher than the key 3.0x leverage threshold which Fitch had previously stated would lead to a downgrade.

#### - More Headroom at 'BBB-'

The agency continues to believe that management's plan to stabilise KPN's core domestic business involves execution risk, which along with macroeconomic headwinds, could keep KPN's EBITDA and cash flow under pressure beyond 2012. Management's actions to offset the high spectrum costs means that Fitch does not expect leverage (including Reggefiber-related liabilities) to increase after 2012. KPN has some headroom at the 'BBB-' rating level as net debt/EBITDA (including Reggefiber-related liabilities) needs to approach 3.5x before negative rating pressure builds.

#### - Mobile New-Entrant Threat

KPN has managed to obtain a good spectrum in the auction, which should help underpin the company's longer-term competitive position in the Dutch mobile market. However, Tele2 plans to launch the fourth mobile network in the Netherlands after purchasing attractive 800MHz spectrum in the auction to complement its previously acquired 2.6GHz spectrum. This new entrant is likely to be intent on gaining market share, which could lead to increased price competition.

#### - High Domestic Fixed-Line Competition

Competition also remains intense in the fixed-line segment, where Dutch cable TV operators are the main threat. Although KPN stabilised domestic residential broadband subscribers in Q312, profitability remains under pressure. In response to the cable threat, KPN is upgrading its network through Reggefiber, KPN's joint venture to rollout a fibre-to-the-home (FTTH) network in the Netherlands. Fitch acknowledges the strategic nature of this fibre business to defend KPN's core fixed-line business against cable TV competition. However, Fitch calculates that the full consolidation of Reggefiber from 1 January 2014 (subject to regulatory approval) could increase KPN's net debt/EBITDA ratio (as defined by Fitch) by as much as 0.35x by 2014 (including the 2017 put liability to gain 100% control of Reggefiber).

#### - Investment Grade Profile

KPN's operating profile as an incumbent in the Netherlands offsets some of its weak financial metrics. If the domestic business can be stabilised, and leverage brought under control, Fitch fundamentally views KPN as an investment grade credit.

### WHAT COULD TRIGGER A RATING ACTION?

Negative:

- Continued deterioration in KPN's domestic fixed and mobile operations
- An expectation that net debt/EBITDA (including Reggefiber-related liabilities) could exceed 3.5x on a sustained basis could lead to a downgrade

Positive:

- A sustained improvement in KPN's domestic fixed and mobile operations
- An expectation that net debt/EBITDA (including Reggefiber-related liabilities) could fall below 3.0x on a sustained basis could lead to an upgrade

#### LIQUIDITY AND DEBT STRUCTURE

KPN ended Q312 with EUR1.5bn of cash and a EUR2.0bn undrawn revolving credit facility which expires in July 2017. KPN expects to pay the EUR1.35bn spectrum costs from existing cash balances and drawings under the RCF. Further liquidity of around EUR470m comes from the tower sales in Q412 and a total reduction of around EUR800m in dividends paid in 2013 and 2014. Even with the increase in KPN's Reggefiber stake by 10% to 51% for an amount of EUR 99m, KPN should be able to cover the EUR3.4bn of debt maturities coming due up until the end of 2014. This amount includes a EUR960m bond redemption that took place in November.

#### FULL LIST OF RATING ACTIONS

Long-term IDR: downgraded to 'BBB-' from 'BBB', Outlook Stable  
Senior unsecured debt: downgraded to 'BBB-' from 'BBB'

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The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable criteria, 'Corporate Rating Methodology', dated 8 August 2012 is available at [www.fitchratings.com](http://www.fitchratings.com).

#### Applicable Criteria and Related Research:

Corporate Rating Methodology

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=684460](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=684460)

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