Dresdner Kleinwort

Initiating coverage

18 January 2007

Buy

Current €11.37
Target €14.00

Current price equivalent
US$14.65

ADR
US$14.67

Market cap
€21,908m
US$28,261m

52-week high/low
€11.52/€7.72

Price performance	1M	3M	12M
Price (€)	10.83	10.36	8.16
Absolute (%)	4.9	9.7	39.2
Rel market (%)	3.3	3.0	18.1
Rel sector (%)	1.4	-6.0	10.9

Source: Dresdner Kleinwort Equity research

Reuters	Bloomberg
KPN.AS	KPN NA Equity

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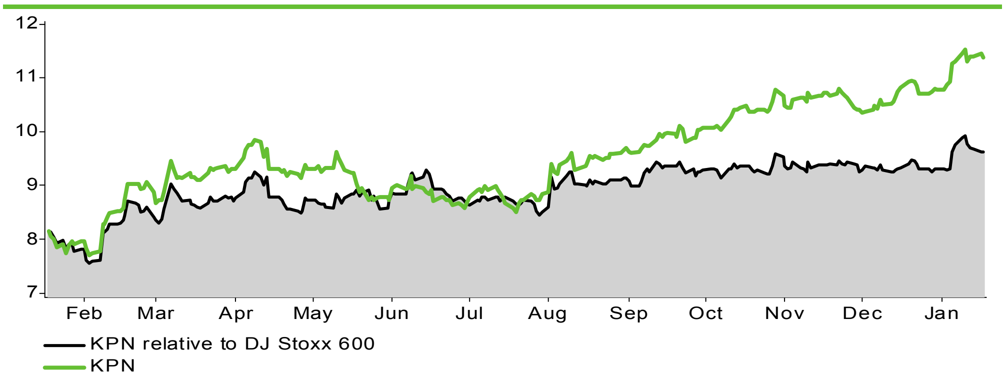
KPN

Good strategy, value and management

We initiate on KPN with a Buy and a €14 DCF based price target. Our positive stance is based on strategy, value and management. Strategically, we think that management is making the right moves in all its markets, in particular with its multi-brand approach and that with cash returns of €2.6bn a year the shares are cheap. KPN management is the most focused in the sector on the shareholder.

- **KPN is pragmatic in its choice of strategy,** with the only givens being a multi-brand approach coupled with tight cost control and back-end integration. It does not blindly follow fashion (eg convergence) or push to get into markets where it has no need to be.
- **The resulting multi-brand approach has driven the top line,** starting in Belgium and then in all its markets. It allows the company to maximise market segmentation and take good advantage of price elasticity without losing the benefits of its loyal customer base.
- **This is combined with a cost focus,** exemplified by E-Plus, which grew service revenues by 9.5% in 9M 2006, but reduced operating costs by 9.1% in parallel.
- **KPN could return €18.1bn to shareholders between 2007 and 2013** in the form of dividends and buy backs compared with a market capitalisation today of €21.9bn, whilst still having a net debt / EBITDA of less than 2.5x.
- **Management is focused on the shareholder:** Apart from its delivery of good cash returns, KPN is very open about its strategy and makes an effort to explain it to investors.

Price relative to DJ Stoxx 600



Source: RIMES

Year to end Dec	Sales €m	EBITDA excl assocs €m	Attrib profit excl except, gw €m	Act EPS excl except, gw €	P/E x	FCF Yield %	Yield %	EV/EBITDA x	Net debt/ EBITDA ex assocs x
2005	11,936	4,230	1,931	0.88	12.9	9.8	3.5	8.2	2.1
2006E	12,066	4,273	2,096	1.03	11.0	10.5	4.2	7.5	2.0
2007E	12,242	4,257	2,006	1.08	10.5	10.3	4.6	7.2	2.2
2008E	12,262	4,266	1,992	1.18	9.7	9.3	4.9	7.0	2.4

Source: Company data, Dresdner Kleinwort Equity research estimates

Online research:
www.dresdnerkleinwort.com/research

Bloomberg:
DKIB1<GO>

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Introduction

With a yield of 4.6% and the potential to return cash equivalent to more than 11% of today's entire market cap each year for the foreseeable future, the shares are cheap. We reinitiate coverage on KPN with a Buy recommendation and a €14 per share price target, based on our DCF. We like management's choices of strategy and in particular the effectiveness of its multi brand approach, coupled with cost containment and shared core functions.

Strategy

Operational

KPN is unique among integrated operators in Europe in actively pursuing a multi brand strategy

We like KPN's approach. It is unique amongst integrated operators in Europe in actively pursuing a multi brand strategy. This enables it to market effectively to multiple segments and harness elasticity of demand with less dilution to its main brand. Management is acutely aware of the balance that it has to strike between enough brands to have this effective segmentation strategy and too many from a cost perspective. The company is making great efforts to have a common back office and network for all of its brands, thus keeping costs down.

KPN has extended this approach to all of its operations, having started in its mobile business in Belgium. The move has been accelerated by acquisitions, notably of Telfort, a mobile operator in the Netherlands which had supported many MVNOs at the time of the acquisition and several Dutch ISPs, including Demon Internet and the planned acquisition of Tiscali Netherlands.

But it is not trying to do exactly the same thing in all of its geographies

KPN is also playing to its strengths and not trying to do exactly the same thing in all of its geographies. Essentially, this means being willing to be a mobile only business in Germany and Belgium and an integrated operator in its home market, without any pretension of trying to offer eg fixed services to German customers. This is in contrast to some peers who have more of a 'one size fits all' strategy, to their detriment, in our opinion.

Although it is willing to offer convergent services should demand prove large, it is not pushing this approach – thus saving itself development costs and avoiding confusing the customer. However, the company is getting into TV over DSL and via DVB-T in the Netherlands, but this is a perfectly rational response given the competition it faces from a consolidating cable sector with 97% penetration.

Financial

Management is focused on costs as well as the top line and is fully aware that it still has a way to go – for example management claims that a customer in the Netherlands could have details entered on 33 separate databases. One is the target. So although KPN has come a long way since the current management team took over in late 2001, it can still make changes which deliver further value for investors.

Planning to spend a net €0-500m on an all-IP network to reduce costs and the ability of altnets to compete

KPN also has a medium term plan to move to an 'all-IP' network, which it estimates will cost €1-1.5bn, partly financed by the sale of local exchanges rendered obsolete by the new network, which should raise €1bn. To put the remaining maximum €500m in context, that is much less than a typical year's capital expenditure for the fixed business and should lead to significant opex and capex savings further down the line. Such a move also reduces the number of ways that alternative operators can compete with KPN, although this advantage is reduced by proposed regulation.

KPN has won friends among investors for a very consistent performance, meeting or exceeding its targets. At the start of 2006, it increased its target leverage from 1.5-2 times net debt / EBITDA to 2-2.5 times. We assume that KPN moves gradually to the top of this range from just under two times at the end of Q3 2006. We believe that this is a sensible level and to go much higher on a conventional financing basis would probably not be sensible in an equity market where there are still unpleasant memories of the fall out from over leveraged stocks earlier this decade.

M&A

KPN is certainly a potential acquisition target, but this is not essential to our recommendation

KPN is often spoken of as a potential acquisition target. For a PTT it is relatively small, with an enterprise value of just €32bn. Recent news flow from private equity indicates that this would be a manageable deal size. Telefonica has also been mooted as a potential buyer (see E-Plus section) but it does have a net M&A ceiling of €1.5bn before the end of 2007 which would have to be breached for a deal for KPN to go through this year.

The Dutch government made its final exit from KPN in 2006, so there is no obstacle there, but bear in mind that various parts of Capital Group own around 25% of KPN's equity. Also, some of KPN's issued bonds have change of control terms written in to them which would make any deal more complicated, but we do not think they are insurmountable.

Management's defence from a takeover is to be as expensive as possible, driving share price performance via good returns to shareholders and the good operational performance.

Overall, we do not think a deal is very likely or indeed priced in to the equity at these levels, but more speculation about this can only provide upside.

Risks

Key risks to our positive stance are:

- Cable: The newly merged cable operators could prove to be a bigger ongoing threat than we assume and be less concerned about the bottom line. This could for instance be driven by a revenue risk sparked by cable network unbundling.
- Capex: We are positive on KPN's all-IP plan, but we do assume that the net extra cost is towards the lower end of management guidance. There is also the possibility that KPN might feel compelled to spend extra and go for FTTH rather than VDSL2, with a consequent significant capex hike. We believe that VDSL2 should offer plenty of capability.
- Regulation: KPN seems to have convinced OPTA of the merits of its all-IP plan, but there is still some negotiating to be done over the continuing business model for altnets.
- Business voice revenues: We assume some more growth in access revenues per line and a significant slowdown in line losses going forward. This could be too optimistic, but it is balanced by assumptions of continuing large falls to traffic revenues.
- Wholesale and operations revenues: We model 5% declines here for 2007 and 2008 (excluding and iBasis transaction), falling to 3% in the longer term. This could be too optimistic, but even in tough years previously falls have not breached 5%.
- Mobile data growth: We assume a modest pick up in data's share of mobile revenue in the medium term, up to around a third of revenue in the case of E-Plus and the domestic mobile business by 2013. We believe that this is supportable: some operators are already almost at this level.

Valuation

At least €2.5bn is coming back to shareholders each year in the form of dividends and buy backs: more than 11% of today's market capitalisation

KPN shares are good value in our opinion on both a relative and absolute measure, with a DCF implying a 23% upside, a 9% cash flow yield and consistently more than €2.5bn in cash coming back to shareholders each year in the form of dividends and buy backs. €2.5bn equates to more than 11% of today's market capitalisation. There is also potential upside from M&A and financial engineering, although we would emphasise standalone value first.

Absolute

In absolute terms KPN is attractive, with a DCF giving €26.9bn enterprise value, or €14 equity value per share. We use this to set our share price target.

KPN sum of parts valuation

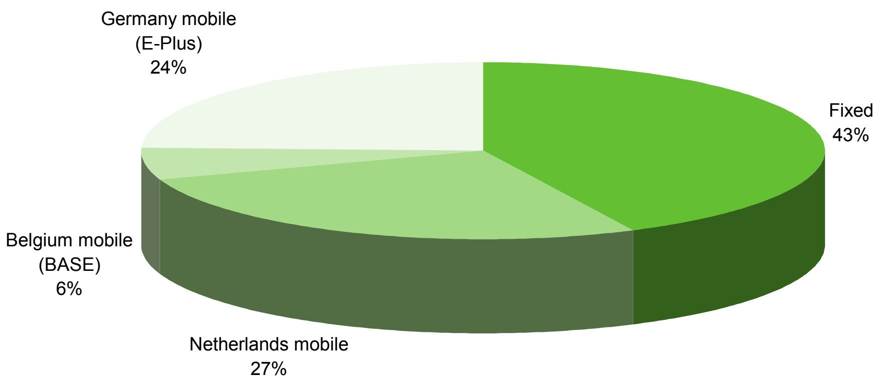
	Stake	Basis	2007 EV / EBITDA multiple	Value (€m)	Per share (€)
Fixed	100%	DCF	7.9	18,847	9.8
Netherlands mobile	100%	DCF	10.0	11,846	6.1
Belgium mobile (BASE)	100%	DCF	8.3	2,546	1.3
Germany mobile (E-Plus)	100%	DCF	10.5	10,727	5.6
Total EV before holding company discount				43,967	22.8
Holding company discount		-10%		-4,397	-2.3
Net tax asset		DCF		237	0.1
Net debt		end 2005		-8,941	-4.6
Dividend paid in 2006				-982	-0.5
Buyback in 2006				-1,664	-0.9
Net acquisitions in 2006				-253	-0.1
Pension liability				-1,021	-0.5
Equity value				26,945	14.0

Source: Dresdner Kleinwort Equity research estimates

Each operation is valued using a DCF, detailed assumptions for these are in the respective sections of this report. KPN's pension liabilities are modest compared with some in the sector, at just over €1bn, or €0.5 per share. KPN's tax position is very complex but it is our view that the liability in Dutch mobile does not fully offset the tax assets in fixed and international mobile, to the tune of €237m of €0.1 per share. We assess these values using DCFs of the difference between cash tax and nominal tax.

The most valuable asset is the fixed operation (43% of value), followed by domestic mobile, E-Plus and BASE.

Value distribution



Source: Dresdner Kleinwort Equity research estimates

Relative

KPN's multiples also look attractive relative to the sector for 2007, with cash flow yield as usual our first choice of metric. Here KPN delivers 9%, with the sector on 8%. It is also attractive on forecast returns, with a 12.7% yield, including dividend and share buy backs (4.6% just from dividend), compared with 4-6.5% for other major stocks in the sector. We include buy back for KPN as it is a stated target for management to continue with buy backs for the foreseeable future as a means of returning cash to shareholders. In general we still prefer dividends as they send a simpler message of more consistency.

Relative valuation

	Share price	EV/EBITDA				Clean P/E				Dividend yield (%)				FCF pre-interest / EV min & div adj (%)			
Company	(local)	2005	2006	2007	2008	2005	2006	2007	2008	2005	2006	2007	2008	2005	2006	2007	2008
Belgacom	€35.38	5.9	5.9	5.9	5.9	12.4	14.2	14.8	14.9	4.5	4.2	4.1	4.0	7.1	6.9	6.4	6.5
BT Group	£3.12	6.7	7.1	6.7	6.6	17.5	15.7	13.9	13.2	3.3	3.8	4.5	5.0	6.1	3.6	4.1	4.6
Deutsche Telekom	€14.75	5.4	5.8	5.5	5.1	13.6	18.1	16.4	15.0	4.9	4.9	4.9	5.3	7.9	4.0	10.5	11.2
France Telecom	€22.17	6.1	5.7	5.4	5.0	10.6	12.7	12.2	10.6	2.2	4.5	5.4	5.7	10.3	9.4	10.1	11.4
KPN	€11.37	8.2	7.5	7.2	7.0	17.3	15.4	14.8	13.7	3.5	4.2	4.6	4.9	8.6	9.0	8.9	8.4
OTE	€23.72	14.4	6.9	7.2	6.1	NM	16.7	21.6	15.0	0.0	4.2	3.2	4.7	7.0	5.4	8.8	12.5
Portugal Telecom	€10.12	6.8	7.8	7.4	7.2	18.1	19.2	20.7	17.1	3.8	8.8	8.8	8.8	8.4	6.5	8.5	6.1
Swisscom	CHF477.00	6.7	6.4	6.1	6.0	13.9	14.2	13.7	13.2	3.7	4.0	4.1	3.9	8.1	7.6	8.1	9.0
Telecom Italia	€2.38	7.9	7.4	6.9	6.5	18.8	20.7	17.0	15.7	5.9	6.2	6.5	6.8	3.8	8.8	7.3	8.0
Telefonica	€16.85	7.6	7.2	6.7	5.9	18.5	17.5	16.9	12.5	3.0	3.6	4.0	4.5	7.1	7.7	8.2	9.2
Telekom Austria	€20.80	7.5	6.4	6.1	5.7	24.9	17.9	15.6	13.6	2.7	3.6	4.2	4.8	7.6	9.4	9.8	11.2
Telenor	NOK127.00	10.5	7.9	6.7	6.0	27.4	20.5	17.5	15.0	1.6	2.0	2.4	3.0	4.0	4.9	5.1	7.0
TeliaSonera	SEK57.50	8.5	8.0	8.1	8.2	19.3	14.3	16.1	15.6	6.1	6.5	6.5	6.6	6.5	6.0	5.3	5.9
TPSA	PLN25.60	5.4	5.2	5.0	5.0	15.5	14.4	12.0	11.0	3.9	8.0	9.5	11.9	10.6	12.1	13.0	16.3
Weighted average		7.2	6.8	6.4	6.0	16.7	17.0	16.0	14.0	3.7	4.6	5.0	5.4	7.1	7.0	8.2	9.0

Source: Dresdner Kleinwort Equity research estimates

We believe that these returns are sustainable going forward at similar absolute levels

We also believe that these returns are sustainable at similar absolute levels in terms of DPS and absolute amounts spent on buybacks for the next several years, as although the top line growth of KPN is lower than most of its peers at less than 1% CAGR 2006-8 vs the sector on around 3%, it is paying plenty of attention to cost cutting and is targeting a modest increase in leverage. We are also of the view that returns will continue to flow – this is a management team as focused on the investor and the share price as any we have seen in the sector with a solid track record of delivering on guidance and avoiding expensive acquisitions. On our current estimates, KPN could return €18.1bn to shareholders between 2007 and 2013, compared with a market capitalisation today of €21.9bn, whilst still having a net debt / EBITDA of less than 2.5x.

Dresdner Kleinwort forecasts

Dresdner Kleinwort estimates versus consensus

(€m)	Consensus	Dresdner Kleinwort	Difference
Mobile sales			
2006	6,521	6,432	-89
2007	6,859	6,921	62
2008	7,082	7,187	105
Mobile EBITDA			
2006	2,274	2,259	-15
2007	2,403	2,483	80
2008	2,493	2,627	134
Fixed sales			
2006	6,608	6,632	24
2007	6,555	6,369	-185
2008	6,367	6,135	-233
Fixed EBITDA			
2006	2,579	2,561	-17
2007	2,506	2,388	-117
2008	2,439	2,248	-190
Group sales			
2006	12,108	12,066	-42
2007	12,352	12,242	-110
2008	12,393	12,262	-132
Group EBITDA			
2006	4,898	4,861	-36
2007	4,921	4,841	-81
2008	4,952	4,848	-104
Capex			
2006	1,745	1,667	-78
2007	1,918	1,722	-196
2008	1,949	1,695	-254
Dividend			
2006	1,008	982	-26
2007	1,041	1,000	-41
2008	1,041	971	-70
Buy back			
2006	1,511	1,664	153
2007	880	1,700	820
2008	830	1,700	870

Source: Company, Dresdner Kleinwort Equity research estimates

We are slightly more bullish than consensus on mobile and more bearish on fixed, the net effect is for our forecasts to be a touch below consensus. Some of this is due to consensus including iBasis, which we will not do until the closing date has been confirmed. We are also more optimistic on capex, partly due to lower sales expectations but also because we believe that KPN's good track record on guidance suggests that the net cost of the all-IP network will be at the low end of the current €0-500m range.

Fixed

KPN's fixed businesses together account for 43% of our sum of parts valuation. They have suffered from shrinking revenues for some time, at a rate of between 2% and 7% since the start of 2005. KPN has fought hard to keep customers and margins but has been in a very tough market, with significant cable competition, mobile operators fighting for voice revenues and unbundlers. It has managed to consolidate a good part of the ISP market, its cable competitors are themselves consolidating, and it has a plan for its international voice business.

Regulation and network strategy

KPN is moving to VDSL2 from its cabinets and out of its local exchanges

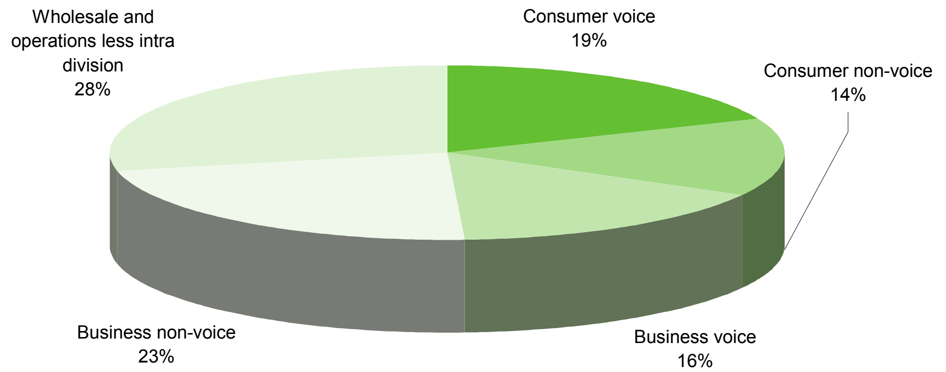
KPN is planning to move to VDSL2 run from its 28,000 cabinets, in the medium term which it calls the move to an "all-IP" network. It currently estimates that this will cost €1-1.5bn, partly financed by the sale of around 1,300 local exchanges rendered obsolete by the new network, which should raise €1bn. To put the remaining maximum €500m in context, that is much less than a typical year's capital expenditure for the fixed business.

The Dutch regulator (OPTA) released a policy note in 2006 entitled "Is Two Enough?". This is a detailed analysis of the economic impacts of having a cable network and a single telco as the only networks in a country. Although couched in "regulatorese", it essentially suggests that two networks are not enough for full competition, but that there is little likelihood of more than two establishing themselves nationally. We therefore assume that the regulator is here to stay for the foreseeable future.

It has the broad backing of the regulator for this move

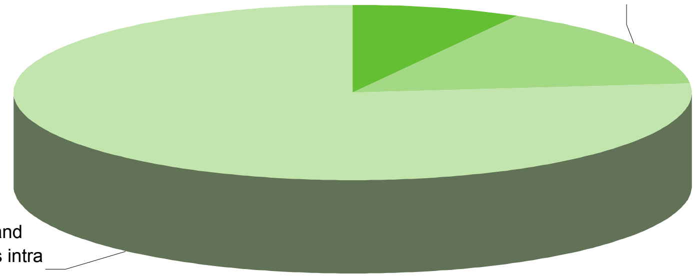
OPTA has essentially sanctioned the All-IP strategy in an October 2006 consultation, although there remains much to be worked out, notably around pricing for access to the network and how long local exchanges should be kept open to allow unbundlers to make a fair return on the investments. However, we believe that there is enough in the position paper to give confidence that the implementation can go ahead.

KPN fixed revenue breakdown, 2007E



Source: Dresdner Kleinwort Equity research estimates

KPN fixed EBITDA breakdown, 2007E



Source: Dresdner Kleinwort Equity research estimates

Fixed summary forecasts

(€m)	2004	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E
Revenues										
Voice	1,756	1,674	1,464	1,185	1,018	966	966	966	966	966
Internet	683	699	728	783	855	916	1,008	1,058	1,090	1,112
Other (Including inter company)	2	11	66	138	169	188	237	243	247	249
Consumer revenues	2,441	2,384	2,258	2,105	2,041	2,071	2,211	2,267	2,303	2,327
Voice	1,387	1,238	1,109	1,017	955	905	854	826	802	782
Connectivity	788	736	691	650	611	592	592	592	592	592
Integrated & Managed solutions (IMS)	423	410	402	406	398	390	382	374	367	360
EnterCom	439	406	447	469	469	455	442	428	416	403
Other (Including inter company)	-88	-137	-117	-76	-74	-72	-71	-70	-69	-68
Business revenues	2,949	2,653	2,533	2,466	2,359	2,271	2,199	2,151	2,108	2,069
Wholesale and operations revenues	5,256	4,985	4,757	4,519	4,293	4,165	4,040	3,918	3,801	3,687
Other (Including intra division)	-3,397	-3,139	-2,916	-2,722	-2,559	-2,470	-2,428	-2,379	-2,335	-2,299
Fixed revenues	7,249	6,883	6,632	6,369	6,135	6,036	6,021	5,958	5,877	5,785
EBITDA										
Consumer	396	380	273	190	203	305	454	502	529	544
Business	449	358	345	365	343	335	321	330	341	355
Wholesale and Operations	2,264	2,038	1,926	1,802	1,684	1,660	1,610	1,562	1,515	1,469
Other (Including intra division)	9	16	18	31	19	5	-40	-68	-70	-77
Total fixed EBITDA	3,118	2,792	2,561	2,388	2,248	2,305	2,345	2,325	2,315	2,292
Margin (%)	43	41	39	37	37	38	39	39	39	40
Capex	609	706	737	758	712	687	625	590	577	565
Capex / sales (%)	8.4	10.3	11.1	11.9	11.6	11.4	10.4	9.9	9.8	9.8

Source: Company, Dresdner Kleinwort Equity research estimates

Consumer

KPN's consumer fixed business generates 33% of fixed sales and 8% of EBITDA, based on our 2007 estimates.

The Multi-brand strategy has allowed market share growth while maintaining ARPUs for existing customers

Despite strong competition in the Dutch broadband market, KPN is well placed to continue to deliver. This firstly comes from KPN's multi-brand strategy which has allowed market share growth while maintaining ARPUs for existing customers. Secondly consolidation amongst the cable operators should be broadly neutral, from an increased service offering balanced against price rises. Thirdly cable network unbundling is being discussed which could in time allow KPN to take customers directly from cable, in the same way as unbundlers of the PSTN are able to take customers from incumbent fixed operators. We address each of these in the following sections.

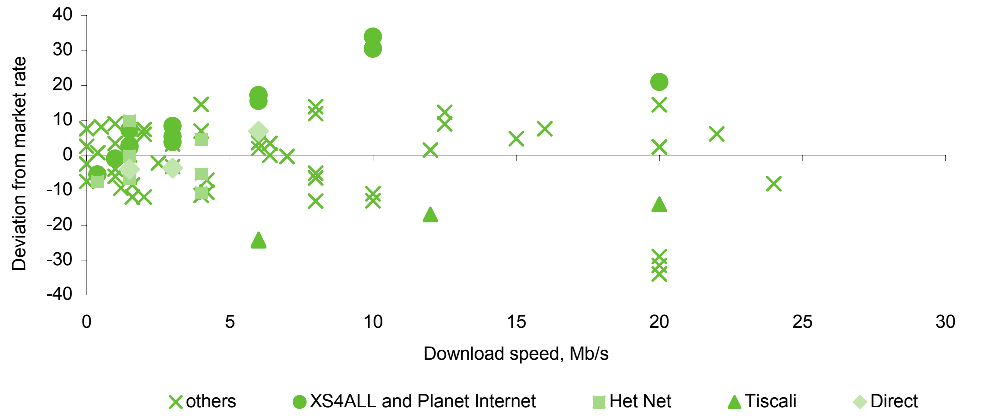
On top of this, the sector has been consolidating, including KPN's purchases of Demon and Attingo and its purchase of Tiscali currently being studied by NMa, the competition authority. The cable industry now has only two major players.

Multi-brand strategy

KPN's multi-brand strategy allows existing customers to be kept on high ARPU packages while separate brands offer much cheaper products to attract new customers. This has helped KPN to increase its broadband market share from 34% to more than 40%.

To analyse the range of packages currently offered by the different ISPs we calculate a market rate dependent on a range of characteristics, such as download limits, TV channels, voice allowances and software bundles. We then plot the difference from this market rate against the download speed, a positive deviation being expensive to the market rate.

Dutch broadband propositions compared



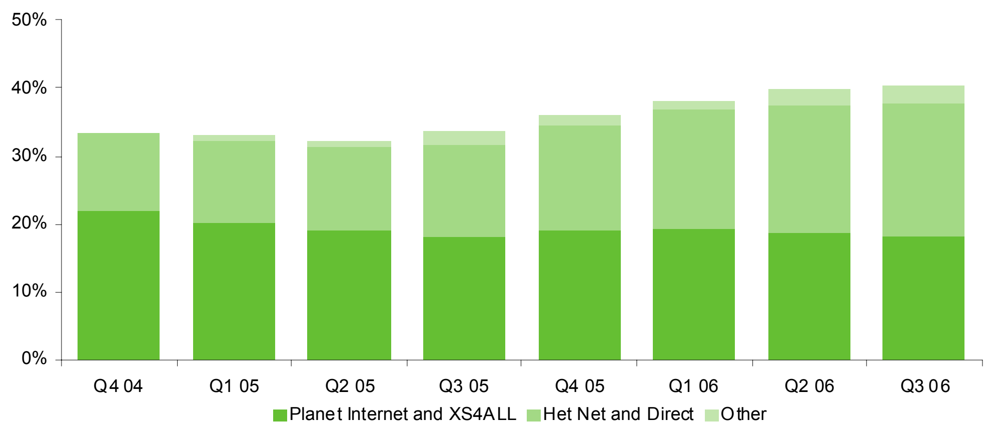
Source: Dresdner Kleinwort Equity research estimates

KPN brands (XS4ALL, Planet Internet, Direct, HetNet and shortly Tiscali) are shown all over the resulting chart, with each brand in a specific segment. For example, XS4ALL and Planet Internet offer premium packages while HetNet and Direct offer discount packages. It also highlights KPN's lack of a relatively cheap high download speed package prior to the planned Tiscali acquisition.

Recent growth has come from discount brands

The success of this strategy can be seen in the chart below. The premium brands have had broadly flat subscriber numbers resulting in falling market share while the discount brands have had strong growth. This strategy has allowed solid growth while not sacrificing the ARPU of existing customers.

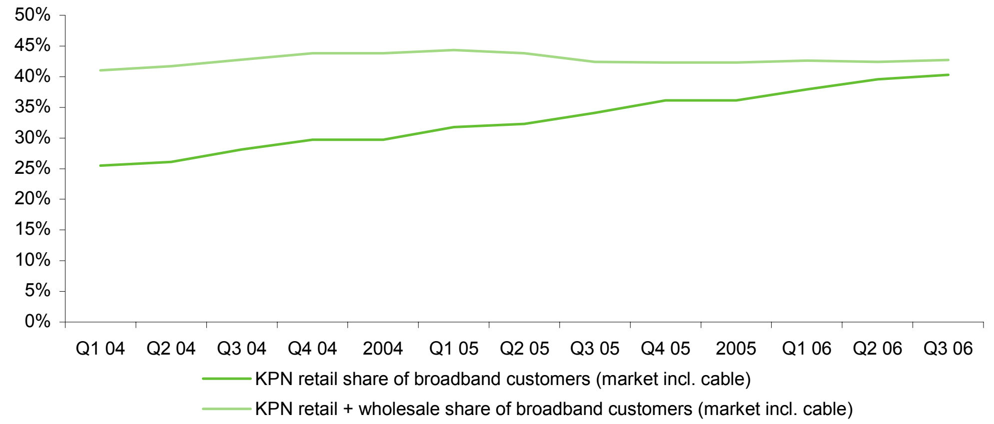
KPN brand shares of the Dutch broadband market



Source: Dresdner Kleinwort Equity research estimates

At the same time, KPN has kept its share of the Dutch broadband market, based on retail plus wholesale, broadly stable around 43%, but increased its retail share up from just over 25% at the start of 2004 to more than 40% now.

KPN's share of Dutch broadband market



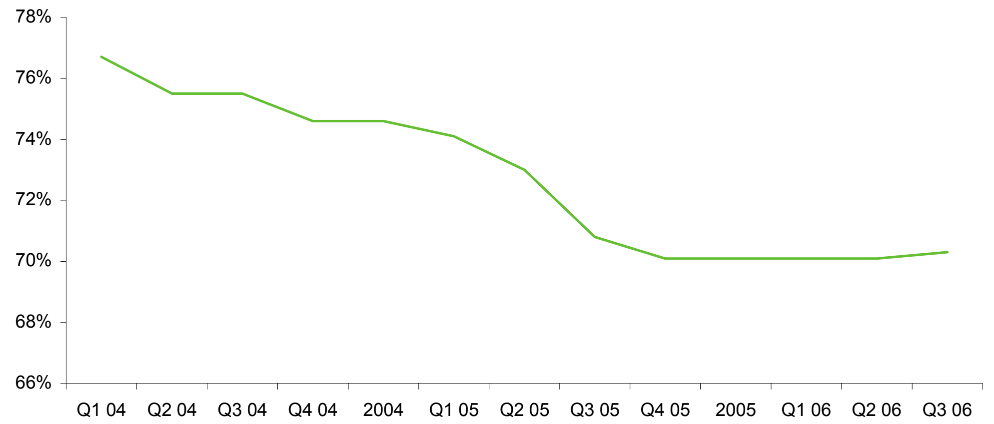
Source: KPN

This is in a market which has seen a gradual shift towards non-DSL (ie cable) broadband, although that trend has stabilised over the last year, with cable now providing around 30% of broadband subs.

Though this would appear as a negative trend, there is an argument that these customers will convert to higher packages once they see what broadband has to offer

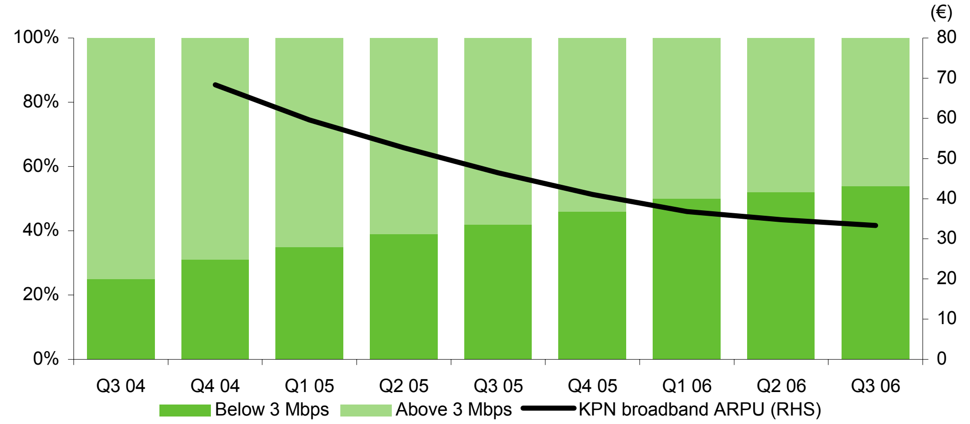
This strategy has partly led to a relative shift towards lower download speed packages, as shown in the graph below. This trend has also been driven by new customers only wanting broadband for e-mails and searching and hence opting for the cheaper lower speed packages. Though this would appear as a negative trend, there is an argument that these customers will convert to higher packages once they see what broadband has to offer. It is from this group of customers choosing broadband for the first time that KPN is achieving its subscriber growth, with existing customers who want a higher download service switching to other providers notably cable.

DSL share of Dutch broadband market



Source: KPN

KPN broadband ARPU and speed mix progression



Source: Dresdner Kleinwort Equity research estimates

KPN's multi brand strategy uses the high stickiness of existing customers. The acquisition of Tiscali gives KPN a relatively cheap high download speed offering, which should at least capture some of the lost price sensitive customers at the top end of the market. Churn should also be reduced by new triple-play offerings such as IPTV and also KPN's ongoing push into VoIP.

Variations on the same approach are used in all of KPN's consumer businesses, with the additional twist of targeting communities other than purely by price, for example with the introduction of *Ay Yildiz*, a prepay mobile offering targeting Turks in Germany which is also available in Belgium.

Other ISPs are getting squeezed out

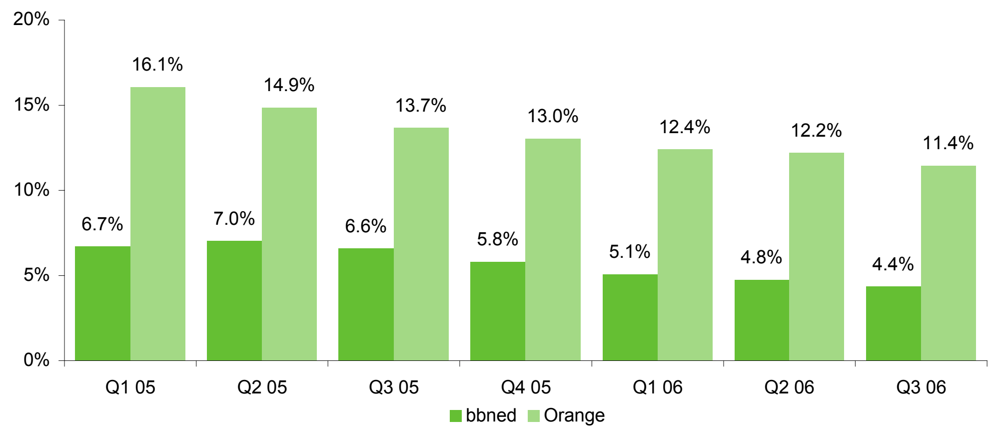
Other ISPs are getting squeezed out of the middle

Other ISPs are getting squeezed out of the middle by the growing duopoly of KPN and cable. Two important examples are bbned (owned by Telecom Italia) and Orange (owned by France Telecom).

bbned's packages are attractively priced but it has seen large falls in market share. This is largely attributable to a misplaced multi-brand strategy which has left it with an average 50,000 subs per brand compared with more than 200,000 for other operators. This low number doesn't create the necessary scale for word of mouth advertising. bbned has also lost wholesale contracts as some of the ISPs that KPN has bought used bbned and their customers have been transferred to KPN itself.

Orange offers some very attractive packages, but is still suffering from falling market share. It is also worse than the graph implies since in recent years it has been losing narrowband customers to broadband, but they have typically not been choosing Orange for broadband. However, note that the offerings have recently been improved with the addition of Livebox, which could boost Orange's market share potential.

bbned and Orange broadband market share



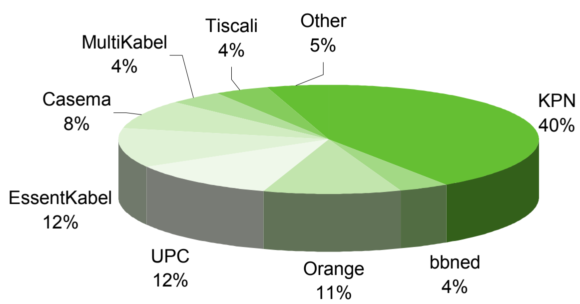
Source: Dresdner Kleinwort Equity research estimates

Cable operator consolidation

There has recently been significant consolidation in the cable sector

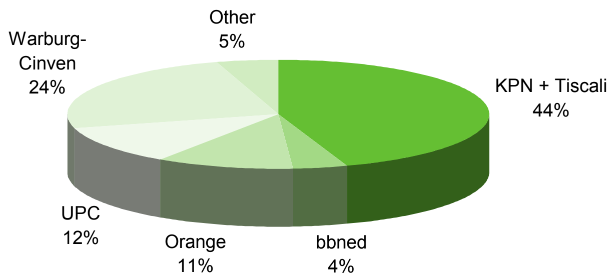
In the Netherlands 97% of households have cable TV and hence cable offers strong competition to KPN as TV, broadband and voice start to be bundled. There has also recently been significant consolidation in the cable sector, with acquisitions by private equity. This has created two large cable operators, UPC (owned by Liberty Global) and a group owned by Warburg-Pincus and Cinven. Though this creates the ability for a higher quality service, the likely strategy of the private equity group will be to raise prices.

Pre cable consolidation broadband market shares



Source: Dresdner Kleinwort Equity research estimates

Post cable consolidation broadband market shares



Source: Dresdner Kleinwort Equity research estimates

The joint venture between private equity firms Warburg-Pincus and Cinven now has 54% of the Dutch cable market. This was created by acquisitions of Casema and Kabelcom as well as Warburg-Pincus' previous acquisition of MultiKabel. UPC has 37% market share with the remainder split between a few smaller operators, we assume that these smaller operators will be brought out by the two large players in the near term.

Warburg-Pincus has stated that it will have a strong focus on triple play "We believe that the intended combination of Kabelcom, Casema and MultiKabel creates a strong platform for delivering compelling and high quality triple-play services to customers in the Netherlands". This strategy fits with market trends towards convergence and also emphasises competition via quality not price.

A potential upside for KPN is that the private equity consortium will raise prices in order to gain a short term return on their investment

The potential upside for KPN is that the private equity consortium will raise prices in order to gain a short term return on their investment. This is supported by the fact MultiKabel is already pricing at the higher end of cable packages, therefore if Casema and Kabelcom are brought in line with this, KPN will benefit. The high price of the two transactions also suggests they will raise prices to achieve an adequate return.

The cable operators do not as yet use a multi-brand strategy and therefore face more elastic demand, and hence face a sharper trade-off between maintaining ARPUs for existing customers and lowering prices to gain market share. This lack of brand flexibility means that cable operators should not be as aggressive on pricing and goes some way to explaining the falling broadband market share for cable operators.

Cable network unbundling (CNU) is in the first stages of going through the Dutch parliament. This would be positive for KPN since the chance of entirely new players coming in via this route is low due to the already competitive market and CNU would allow KPN to provide a fuller triple-play product.

This would allow KPN to offer more channels via cable while still providing the additional services such as missed programs with IPTV. KPN's IPTV service Mine already has 60 TV channels, with CNU this could be increased to match the 120 channels offered by cable. Though given KPN's roll-out of VDSL which will deliver 30-50Mbps, it seems unlikely that it will need CNU.

Fibre roll-out

The trend towards relative lower end growth that we explored earlier in this section has implications for the all-IP project. To some extent, KPN would find it tough to justify the VDSL roll out based on recent demand trends, but given the cost saving potential and the need to compete on TV we believe that there is a sensible business case.

Convergence / media rights

Although KPN is willing to offer convergent services should demand prove large, it is not pushing this approach

Although KPN is willing to offer convergent services should demand prove large, it is not pushing this approach, thus saving itself development costs and avoiding confusing the customer. We like this approach and are sceptical of spending large sums early, as for example BT has done with Fusion. KPN has however been getting into TV in the Netherlands, using both DSL and DVB-T. We view this as a perfectly rational response given the competition it faces from a consolidating cable sector with 97% penetration. It has also cut a deal with Tele2 to share Versatel's football rights, which is proving to have some traction with customers.

Forecasts

We assume that access lines continue to fall in 2007, with 700,000 more lines lost, but that this tails off rapidly as there is no extra competition launching and that access revenue per line should remain stable.

For voice traffic, we assume ongoing declines driven by line loss and some price declines. The pricing declines are less than might be expected as the more price sensitive customers should tend to use alternative providers.

For broadband, we forecast slight organic growth in subscriber numbers in 2007 and 2008, boosted by 176,000 Tiscali customers assumed to be acquired in mid 2007. Estimated broadband revenue per line fell 31% in 2006 and we assume there will be further competition and mix driven falls in 2007 but that after that, new services such as TV will contribute to some ARPU growth.

Operating costs should continue to erode for the medium term with the move to all-IP and management's cost focus. However, our modelling suggests that there will be a period of margin pain for the next few years.

Capex for this division of fixed is quite modest, being mostly CPE, although the move to more advanced services impacts our forecasts over the next few years. This also has an impact on our forecast depreciation, as this type of spend tends to be depreciated over a short time frame. We assume three years.

Fixed consumer forecasts

	2004	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E
Voice										
Access lines (000s)	5,359	4,999	3,985	3,285	2,985	2,985	2,985	2,985	2,985	2,985
Access revenue per access line (€)	198	198	196	196	196	196	196	196	196	196
Access revenues (€m)	1,077	1,031	889	713	615	586	586	586	586	586
Traffic revenue per minute (€c)	5.6	5.4	5.4	5.4	5.3	5.3	5.3	5.3	5.3	5.3
Change (%)		-2.4	-0.1	-1.0	-1.0	-1.0	0.0	0.0	0.0	0.0
Minutes per average line per month	183	176	175	173	173	173	173	173	173	173
Traffic revenues (€m)	661	596	515	405	345	326	326	326	326	326
Other voice revenues (€m)	18	47	60	67	58	55	55	55	55	55
Internet										
KPN Broadband ISP customers (000s)	936	1,485	2,031	2,331	2,431	2,431	2,431	2,431	2,431	2,431
Net adds (000s)		549	546	300	100	0	0	0	0	0
Rev / broadband customer / month (€)		49	34	30	30	31	35	36	37	38
Change (%)			-31	-12	0	5	10	5	3	2
Internet revenues (€m)	683	699	728	783	855	916	1,008	1,058	1,090	1,112
Other consumer fixed revenues, including inter company (€m)	2	11	66	138	169	188	237	243	247	249
Total revenues	2,441	2,384	2,258	2,105	2,041	2,071	2,211	2,267	2,303	2,327
Change (%)		-2.3	-5.3	-6.7	-3.0	1.4	6.8	2.6	1.6	1.1
Operating costs (€m)	2,045	2,004	1,985	1,915	1,839	1,765	1,756	1,765	1,774	1,783
Change (%)		-2.0	-1.0	-3.5	-4.0	-4.0	-0.5	0.5	0.5	0.5
EBITDA (€m)	396	380	273	190	203	305	454	502	529	544
Margin (%)	16	16	12	9	10	15	21	22	23	23
Capex (€m)	50	59	155	158	153	145	111	91	92	93
Capex / sales (%)	2.0	2.5	6.9	7.5	7.5	7.0	5.0	4.0	4.0	4.0

Source: Company, Dresdner Kleinwort Equity research estimates

Business

KPN's business fixed segment generates 39% of fixed sales and 15% of EBITDA, based on our 2007 estimates.

We expect continuing declines in voice revenues of 15-16% pa for each of the next three years

Market shares have stabilised and our modelling suggests that revenue erosion should slow a little in 2007, from 10% in 2005 and 4-6% in Q1 to Q3 2006 to 3%. This is driven by a view that line losses should slow and access revenues per line increase, as add on services gain more traction. But we expect continuing declines in voice revenues of 15-16% pa for each of the next three years as VoIP and its cohorts carry on biting.

For non-voice revenues, we assume that connectivity continues to fall somewhat, offset by modest growth from integrated and managed solutions (IMS, eg outsourcing) and EnterCom, which installs communications hardware. The last two segments have benefited from various small acquisitions KPN has recently made.

We model EBITDA by looking at cost changes. Operating costs for this segment fell by 8% in 2005 and by an average of 4.2% in the first three quarters of 2006. Three trends should impact on this figure going forward, acquisitions, unit costs and volumes. First, there is likely to be upward pressure from acquired businesses. We expect this impact to be small, as the businesses acquired are also small. Second, unit costs should continue their decline. For example in voice, we expect termination costs to fall at c.10% each year on average. Finally, volumes should also fall, especially in the voice business.

On balance, this gives us confidence to forecast a 4% annual cost decrease for the medium term. This should drive a modest margin recovery, to nearly 15%.

Capex for this segment is driven by similar patterns to consumer. With the move towards selling more complex services, we assume a kick up to capital intensity, but it should still remain modest at 3-4% of sales.

Fixed business summary

	2004	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E
Access lines (000s)	1,988	1,908	1,814	1,814	1,814	1,814	1,814	1,814	1,814	1,814
Access revenue per line per month (€)		24.6	25.0	25.5	26.0	26.6	26.8	27.1	27.4	27.6
Access revenues (€m)	597	575	560	556	567	578	584	590	596	602
Minutes (bn)	13.3	10.2	8.2	6.8	5.6	4.7	4.0	3.6	3.2	2.9
Revenue per minute (€c)	6.3	6.8	7.0	7.2	7.4	7.4	7.3	7.1	7.0	6.9
Traffic revenues	829	687	577	488	413	350	292	257	227	200
Other business voice revenues	-39	-24	-28	-26	-24	-23	-22	-21	-21	-20
Voice revenues	1,387	1,238	1,109	1,017	955	905	854	826	802	782
Connectivity revenues (€m)	788	736	691	650	611	592	592	592	592	592
Integrated & Managed solutions (IMS) revenues (€m)	423	410	402	406	398	390	382	374	367	360
EnterCom revenues (€m)	439	406	447	469	469	455	442	428	416	403
Other revenues (€m)	-88	-137	-117	-76	-74	-72	-71	-70	-69	-68
Total fixed business revenues	2,949	2,653	2,533	2,466	2,359	2,271	2,199	2,151	2,108	2,069
Change (%)		-10.0	-4.5	-2.6	-4.3	-3.7	-3.2	-2.2	-2.0	-1.9
Operating costs (€m)	2,500	2,295	2,188	2,101	2,017	1,936	1,878	1,822	1,767	1,714
Change (%)		-8.2	-4.6	-4.0	-4.0	-4.0	-3.0	-3.0	-3.0	-3.0
EBITDA (€m)	449	358	345	365	343	335	321	330	341	355
Margin (%)	15.2	13.5	13.6	14.8	14.5	14.7	14.6	15.3	16.2	17.2
Capex (€m)	76	64	92	99	83	79	66	65	63	62
Capex / sales (%)	2.6	2.4	3.6	4.0	3.5	3.5	3.0	3.0	3.0	3.0

Source: Company, Dresdner Kleinwort Equity research estimates

Wholesale and operations

Although wholesale and operations accounts for the bulk of KPN's fixed EBITDA, there is not a great level of detail in KPN's disclosure. We would like to see more, and hopefully the proposed iBasis transaction will help with this.

iBasis is a global VoIP company, into which KPN has agreed to merge its international voice wholesale business. This transaction has not yet completed and we have not assumed that it will in our forecasts, due to uncertainty over timing, even though it was agreed in the middle of 2006.

For the ongoing business, we assume revenue erosion, at similar levels to those delivered recently. This has been driven by falling unit prices and by the replacement of more specialised solutions with cheaper off the shelf products.

On the plus side, we do not expect any EBITDA margin erosion below 40%, partly because our expectations for margin pain from tough retail competition are contained in our forecasts for consumer and business fixed. We expect more stability in transfer and wholesale pricing. Similarly capex should be helped by the move to all-IP, so we expect capex / sales to be broadly flat.

Wholesale operations summary

(€m)	2004	2005	Q1 06	Q2 06	Q3 06	Q4 06E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E
Revenues	5,256	4,985	1,203	1,194	1,167	1,193	4,757	4,519	4,293	4,165	4,040	3,918	3,801	3,687
Operating costs	2,992	2,947	703	697	713	718	2,831	2,718	2,609	2,505	2,430	2,357	2,286	2,217
Change (%)		-1.5	-1.8	-6.7	-3.1	-4.0	-3.9	-4.0	-4.0	-4.0	-3.0	-3.0	-3.0	-3.0
EBITDA	2,264	2,038	500	497	454	475	1,926	1,802	1,684	1,660	1,610	1,562	1,515	1,469
Margin (%)	43	41	42	42	39	40	40	40	39	40	40	40	40	40
Capex	483	578	88	130	117	149	484	497	472	458	444	431	418	406
Capex / sales (%)	9.2	11.6	7.3	10.9	10.0	12.5	10.2	11.0	11.0	11.0	11.0	11.0	11.0	11.0

Source: Company, Dresdner Kleinwort Equity research estimates

Valuation

Based on these assumptions and using a WACC of 6.9% and a terminal growth rate of -1%, our DCF for KPN's fixed business gives an enterprise value of €18.8bn, or 43% of KPN's total group value. We use normalised tax rates for our DCFs and handle tax assets and liabilities at the group level in our sum of parts valuation. This enterprise valuation equates to 7.9x 2007E EBITDA, slightly higher than BT Group's 7 times. The premium can be accounted for in part by the lower tax rate in the Netherlands.

Fixed DCF sensitivities

(€m)	Long term growth rate (%)		
WACC (%)	-2.0	-1.0	0.0
5.9	19,693	21,403	23,691
6.9	17,594	18,847	20,463
7.9	15,922	16,867	18,052

Source: Dresdner Kleinwort Equity research estimates

German mobile (E-Plus)

We believe that E-Plus' recent good performance can be maintained, driven by price elasticity elegantly harvested for profitable growth using a multi-brand approach. E-Plus accounts for almost a quarter of our KPN sum-of-the-parts valuation and is the key driver for top line growth for the group. In aggregate the rest of the group would show a declining top line trend if E-Plus were to be deconsolidated. Performance has turned round in the last two years, firstly at the top line and more recently in terms of margins.

The key issue for E-Plus is whether its good performance since the strategy change in 2005 is a one off or can be sustained. It also faces tough incoming interconnect cuts of 20% which took effect on 30 November 2006, which will weigh on 2007's top line. It is also worth considering Vodafone and T-Mobile's price cuts of late Q3 2006, which will have a bearing on E-Plus' relative competitive positioning.

Multi brand strategy and elasticity

We believe that there is good evidence from KPN's other multi-brand operations, in particular BASE in Belgium and its domestic broadband market, that supports the view that the better performance of late can be sustained. We are also encouraged by evidence that poorly performing German mobile operators can be turned around – one only has to look at O2 Germany, which was a key driver of O2 Group's share price performance.

Elasticity in voice in the German mobile market as a whole which is also supportive of a positive outlook for E-Plus

We have also written in the past (eg "German mobile pricing" 15 September 2005) about our view of elasticity in voice in the German mobile market as a whole which is also supportive of a positive outlook for E-Plus. Remember that mobile voice is on average 3.6 times more expensive than fixed voice in Germany (high in a European context) and that only 16% of German voice minutes originate on mobile, lower than is typical in western Europe.

German mobile market

	2003	2004	2005	2006e	2007E	2008E
Revenues (€m)						
T-Mobile	8,479	8,745	8,621	8,294	8,012	8,000
Vodafone	7,968	8,335	8,435	8,175	8,238	8,475
E-Plus	2,450	2,608	2,822	2,890	3,207	3,422
O2	2,172	2,728	3,312	3,503	3,760	3,788
Market	21,070	22,416	23,190	22,861	23,217	23,685
Revenue growth (%)						
T-Mobile	9	3	-1	-4	-3	0
Vodafone	10	5	1	-3	1	3
E-Plus	6	6	8	2	11	7
O2	32	26	21	6	7	1
Market	11	6	3	-1	2	2
EBITDA growth (%)						
T-Mobile	13	1	-1	-8	-6	-3
Vodafone	12	10	2	-9	2	1
E-Plus	-4	13	-4	40	9	10
O2	671	54	53	13	16	5
Market	15	8	3	-3	1	1
EBITDA margin (%)						
T-Mobile	42	42	42	40	39	38
Vodafone	44	47	47	44	45	44
E-Plus	25	27	24	33	32	33
O2	15	18	23	25	27	28
Market	38	39	39	38	38	38
Capex / sales (%)						
T-Mobile	6.3	6.3	5.9	7.7	8.3	8.9
Vodafone	16.8	15.5	11.0	8.3	9.2	9.2
E-Plus	26.3	34.0	16.3	20.5	18.3	17.2
O2	29.0	26.4	27.8	26.0	31.0	23.2
Market	13.8	13.9	10.8	11.2	12.4	11.5

Source: Companies, Dresdner Kleinwort Equity research estimates

Forecasts

We expect 1.5m net adds in 2007 (cf est. 2m in 2006)

This view that elasticity and growth can continue for E-Plus informs our forecasts. In the short term we expect 1.5m net adds in 2007 (cf est. 2m in 2006), and ARPU declines of 3.8% YoY driving a top line growth of 11.5%, compared with O2 Germany at 32% at its peak after its own change of strategy (2003) and KPN management's target of double digit growth. This ARPU change is based on average revenue per minute continuing to fall strongly (by 24% YoY), partly driven by interconnect cuts (see the table below) but also KPN's aggressive multi-brand strategy and use of MVNOs to target particular segments.

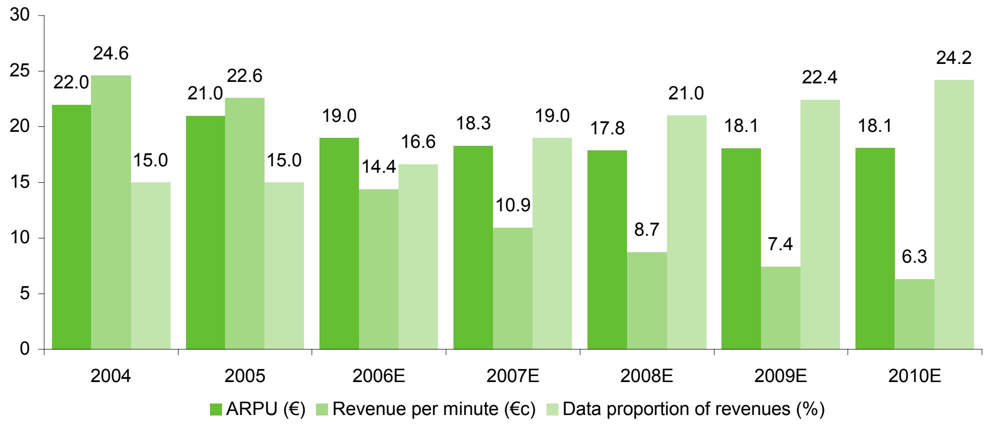
German mobile termination rates

(€ cents)	Vodafone and T-Mobile	O2 and E-Plus	Cut (%)
Before 15 December 2005	13.3	14.9	
15 December 2005 to 23 November 2006	11.0	12.4	17
23 November 2006 - 30 November 2007	8.78	9.94	20

Source: BNetzA

Note that the 2006 cuts were slightly earlier in the year than the 2005 cuts, so Q4 2006 will suffer from just under a month of double cuts.

E-Plus KPIs



Source: Company, Dresdner Kleinwort Equity research estimates

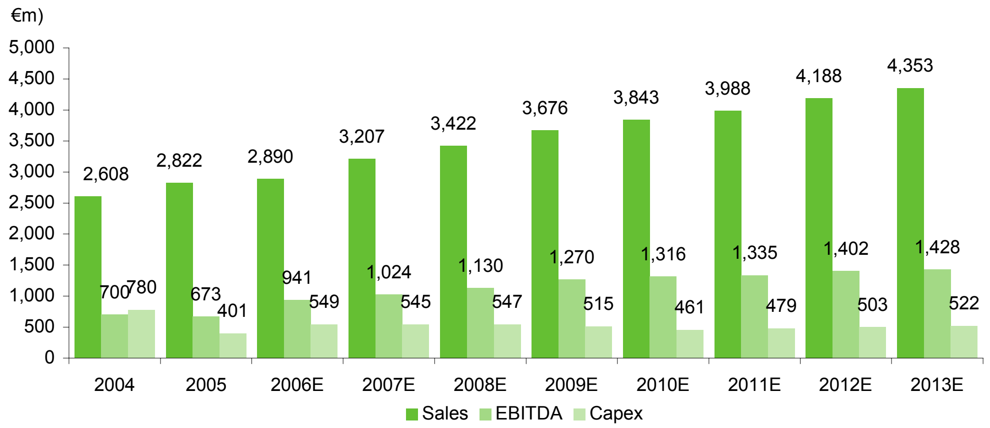
For EBITDA, we assume margins are stable in 2007 relative to 9M 2006 at 31.9%, well up on 23.8% in FY 2005. This implies an increase in operating costs of 12% YoY, reflecting increasing traffic volumes and falling unit prices. This is conservative when compared with an estimated 9.3% fall in 2006 costs YoY, but reflects our relatively bullish view on the top line.

There is some risk to our capex forecast on the upside if E-Plus feels the need to move more aggressively into UMTS

For capex, we assume broadly flat spending of €545m in 2007, after an expected more than 35% increase in 2006, as the network continues to grow to accommodate traffic increases. There is some risk to this on the upside if E-Plus feels the need to move more aggressively into UMTS, but we believe that a more steady approach to roll out fits better with its wider commercial strategy.

Our longer term modelling assumptions reflect our view that Germany remains a four player mobile market, with two larger competitors in T-Mobile and Vodafone, and two small in O2 and E-Plus. We assume E-Plus generates a revenue CAGR of 5.2% 2007-13, based on modest subscriber growth and some ARPU growth from data services and stable voice ARPU. For margin and capex, we use our standard assumptions for a smaller player in a big Western European market, and assume EBITDA margins in the low 30s and capex / sales of 12% for the terminal year.

Sales, EBITDA and capex



Source: Dresdner Kleinwort Equity research estimates

Taken together, these forecasts means that operating cash flow (EBITDA – capex) moves from €272m in 2005 to an estimated €906m by 2013.

E-Plus forecasts

	2004	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E
Mobile customers (000s)	9,511	10,748	12,715	14,215	15,215	16,015	16,615	17,015	17,115	17,115
Net additions (000s)		1,237	1,967	1,500	1,000	800	600	400	100	0
ARPU (€ per month)	22	21	19	18	18	18	18	18	19	20
Change (%)		-4.5	-9.6	-3.8	-2.4	1.2	0.0	0.7	3.5	3.6
Data proportion of ARPU (%)	15.0	15.0	16.6	19.0	21.0	22.4	24.2	25.5	26.1	26.7
Voice price per minute (€c)	24.6	22.6	14.4	10.9	8.7	7.4	6.3	5.7	5.4	5.2
Change (%)		-8.2	-36.4	-24.0	-20.0	-15.0	-15.0	-10.0	-5.0	-3.0
Service revenues (€m)	2,291	2,461	2,674	2,983	3,182	3,419	3,574	3,709	3,895	4,049
Change (%)		7.4	8.7	11.5	6.7	7.4	4.5	3.8	5.0	4.0
Total revenues (€m)	2,608	2,822	2,890	3,207	3,422	3,676	3,843	3,988	4,188	4,353
Change (%)		8	2	11	7	7	5	4	5	4
EBITDA (€m)	700	673	941	1,024	1,130	1,270	1,316	1,335	1,402	1,428
Change (%)		-3.9	39.8	8.9	10.3	12.4	3.6	1.4	5.0	1.9
EBITDA margin (%)	26.8	23.8	32.6	31.9	33.0	34.5	34.2	33.5	33.5	32.8
Capex (€m)	780	401	549	545	547	515	461	479	503	522
Capex / sales (%)	30	14	19	17	16	14	12	12	12	12

Source: Company, Dresdner Kleinwort Equity research estimates

Valuation

Based on these assumptions and using a WACC of 6.8% and a terminal growth rate of 1%, our DCF for E-Plus gives an enterprise value of €10.7bn, or 24% of KPN's total group value. This equates to 10.5x 2007E EBITDA, which seems reasonable in the context of recent transactions in the sector, eg O2 for c. 10x and Swisscom Mobile (which has lower growth potential) for 9.2x. We use a normalised tax rate for this DCF, and consider tax assets and liabilities at the group level. In practice E-Plus effectively pays no tax and has little prospect of paying much for the foreseeable future.

E-Plus DCF sensitivities

(€m)	Long term growth rate (%)		
WACC (%)	0.0	1.0	2.0
5.8	11,272	12,985	15,595
6.8	9,583	10,727	12,346
7.8	8,328	9,133	10,215

Source: Dresdner Kleinwort Equity research estimates

Sale potential

This is an attractive asset for KPN, driving growth as well as valuation and we do not expect it to sell it under current management. Potential buyers have been mooted, most notably Telefonica, with a view to merging it with O2 Germany but we are sceptical that this would get past the regulator as it would reduce the number of players in the German mobile market to just three, which we think, would be regarded by regulators as too few in a country with 80m citizens.

A merger of E-Plus and O2 Germany would be hard to push past the regulators

E-Plus and O2's recent improved financial performance also make a deal less likely, as they are more attractive as stand alone entities and also make a "sob-story" to the regulator of failing businesses very hard to sell. DT's comments after its pain in getting its tele.ring acquisition approved in Austria (which consolidated the market from five to four players) also make us think that regulatory approval would be hard to get.

Other buyers which do not have the potential benefit of consolidation to boost their bid price would find it hard to offer enough to tempt KPN management to sell the asset and they would have to pay a further premium for E-Plus' low tax situation. It seems likely that unwinding E-Plus from KPN's complex group tax planning would prove to be an additional barrier.

Domestic mobile

There are reasons to be cautiously optimistic on domestic mobile, particularly as the integration of Telfort is unfinished and the group is reorganising around customers in the Netherlands as of early 2007. This division accounts for 27% of our sum of parts valuation. It delivered a good 2006 performance, driven mostly by the October 2005 acquisition for €980m of rival mobile operator Telfort, which delivered an instant multi-brand strategy, consolidated the number of network players in the mobile market from five to four and bought growth for KPN's domestic mobile business.

For us, the key issue for this segment in 2007 is can the combined business maintain its momentum. We think it can, although we are slightly more sceptical on this asset's prospects than for E-Plus. This is because the Dutch mobile market has been more competitive than Germany's, a trend which doesn't show any sign of a significant easing, and because significant mobile termination cuts could well come into effect during the year.

On competition the market as a whole has less to win from fixed substitution / voice elasticity than eg Germany and has shown modest top line growth. KPN has done reasonably well in this context, with like for like growth of 4-6% in the first three quarters of 2006, stripping out the effect of the Telfort acquisition.

Dutch mobile revenues

(€m)	2004	2005	Growth (%)
KPN	2,271	2,483	9.3
Vodafone	1,701	1,721	1.2
Orange	630	635	-0.8
T-Mobile	1,046	1,064	1.7
Market	5,605	5,903	5.3

Source: Dresdner Kleinwort Equity research estimates

Regulation

Termination

Likely to be deep mobile termination rate cuts in 2007

OPTA tried to make cuts to mobile termination rates during 2006 but was defeated in court by the operators, based on the methodology that it used to make its decision (rather than the decision itself). This is the latest in a string of legal setbacks for OPTA but we expect that it will be able to redo the analysis during 2007 and achieve the cuts it wants. This will be painful for KPN for three reasons:

- There will be more than a year's worth of cuts in one go, as the last cut was made on 1 December 2005. As was seen in the UK in September 2004 this can mean very deep cuts. The UK implemented 30% cuts on Vodafone, in a sense rounding up almost three year's cuts.
- At present, customers with a Telfort number have a higher rate of interconnect than KPN (the same as Orange and T-Mobile). It is likely that the regulator will push for all of KPN's domestic mobile customers to have the same termination rate, based on the old KPN Mobile rate. This is made even more likely as the Telfort network is being switched off completely during 2007, thus removing much of the argument for a higher cost base. If the regulator got its way, these rates would be more than halved by mid 2008, from €0.124 to €0.055 per minute.
- KPN's fixed business will pass on these cuts (and those of the other mobile operators) to its customers, both wholesale and retail. Although this has no impact on absolute EBITDA, there will be a dent to top line growth.

Netherlands mobile termination rates - proposed regulation

(€cents per minute)	KPN and Vodafone	Orange and T-Mobile	Telfort
Before 1 December 2005	13	14.7	14.7
Extant rate (from 1 December 2005)	11	12.4	12.4
1 July 2006 - 1 July 2007 proposed and postponed	9.17	10.63	
1 July 2007 - 1 July 2008 proposed and postponed	7.33	8.86	
1 July 2008 onwards proposed and postponed	5.50	7.09	

Source: OPTA

Roaming

We expect roaming regulation to be delivered somewhat later than the Commission has been targeting

On top of this there will be an impact on the top line from the EC's attack on international roaming. Although we expect the regulation to be delivered somewhat later than the Commission has been targeting (summer 2007), most mobile operators have agreed to make cuts to wholesale rates and KPN has made some changes to its retail tariffs. Much of this impact will be offset by the effects of price elasticity, in particular in retail, but there is still likely to be an impact.

Costs

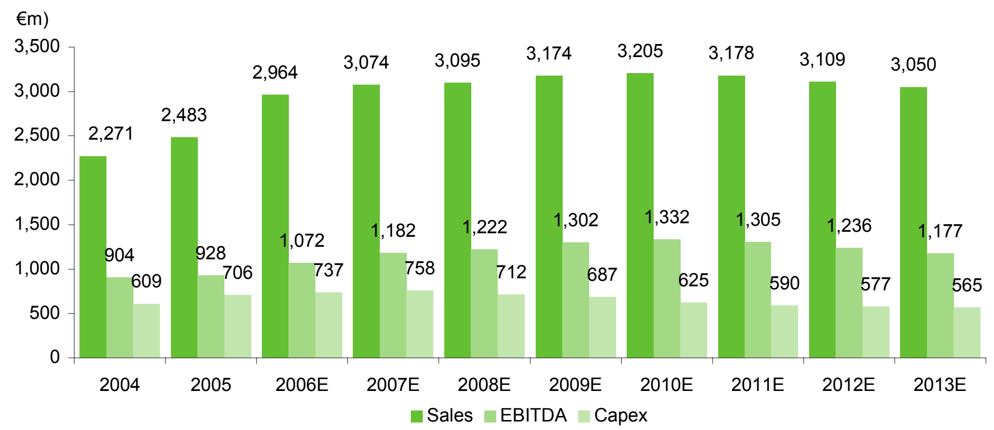
On the positive side, management is fully aware of all these revenue headwinds and has been placing a lot of attention on costs. Examples include the Telfort network switch off mentioned above and the rationalisation of the shop chain. Management is also conscious of the number of brands and the impact on costs. It realises there is a balance to be struck between the marketing advantage of having multiple brands and the cost consequences, so is constantly reviewing the number / type of brands.

Forecasts

Although there are negative revenue trends, they should not take effect until at least H2 2007. For FY 2007, we forecast top line growth of 3.7% driven by modest net adds of 400,000 and an ARPU fall of 2.3%, based on a revenue per voice minute decline of 16%, at the top end of the range of 13-16% in the first three quarters of 2006.

In the longer term we assume KPN Mobile The Netherlands generates a revenue CAGR of -0.1% 2007-13, assuming that modest subscriber growth and data revenue gains almost offset voice revenue declines. For margin and capex, we use our standard assumptions for a large integrated player in a smaller Western European market, with EBITDA margins in the high 30s and capex / sales of 10% for the terminal year.

Netherlands mobile sales, EBITDA and capex



Source: Dresdner Kleinwort Equity research estimates

Taken together, these forecasts mean that operating cash flow (EBITDA – capex) moves from €222m in 2005 to an estimated €612m by 2013.

Netherlands mobile forecasts

	2004	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E
Mobile customers (000s)	6,076	8,072	8,563	8,963	9,263	9,413	9,463	9,463	9,463	9,463
Net additions (000s)		1,996	491	400	300	150	50	0	0	0
ARPU (€ per month)	32	30	28	28	27	27	27	27	26	26
Change (%)		-6.3	-5.2	-2.3	-3.2	0.1	-0.1	-1.1	-2.2	-1.9
Data proportion of ARPU (%)	11.0	14.0	15.8	18.9	22.6	24.9	26.9	28.8	31.2	33.8
Voice price per minute (€c)	23.3	21.0	18.0	15.1	12.3	11.0	9.9	8.9	8.0	7.2
Change (%)		-10.1	-14.1	-16.0	-19.0	-10.0	-10.0	-10.0	-10.0	-10.0
Service revenues (€m)	2,139	2,368	2,830	2,920	2,940	3,016	3,045	3,019	2,953	2,897
Change (%)		10.7	19.5	3.2	0.7	2.6	1.0	-0.8	-2.2	-1.9
Total revenues (€m)	2,271	2,483	2,964	3,074	3,095	3,174	3,205	3,178	3,109	3,050
Change (%)		9	19	4	1	3	1	-1	-2	-2
EBITDA (€m)	904	928	1,072	1,182	1,222	1,302	1,332	1,305	1,236	1,177
Change (%)		2.7	15.5	10.3	3.4	6.5	2.3	-2.0	-5.3	-4.8
EBITDA margin (%)	40	37	36	38	39	41	42	41	40	39
Capex (€m)	207	159	207	277	309	317	320	318	311	305
Capex / sales (%)	9	6	7	9	10	10	10	10	10	10

Source: Company, Dresdner Kleinwort Equity research estimates

Valuation

Based on these assumptions and using a WACC of 6.9% and a terminal growth rate of 1%, our DCF for KPN's domestic mobile operation gives an enterprise value of €11.8bn, or 27% of KPN's total group enterprise value. As with E-Plus, we use a normalised tax assumption for our DCF and handle tax assets and liabilities at the group level. For the Netherlands, we use the newly lowered tax rate of 25.5%. This enterprise valuation equates to 10.0x 2007E EBITDA. This is a slightly lower multiple than that implied by our valuation of E-Plus but we believe that this is reasonable given the domestic business' relatively lower growth rate. However, it is similarly supported by recent deals, such as Swisscom's acquisition of Vodafone's 25% stake in Swisscom Mobile.

Domestic mobile DCF sensitivities

(€m)	Long term growth rate (%)		
WACC (%)	0.0	1.0	2.0
5.9	12,401	14,048	16,538
6.9	10,740	11,846	13,403
7.9	9,497	10,279	11,324

Source: Dresdner Kleinwort Equity research estimates

Belgian mobile (BASE)

We believe BASE can continue to grow profitably, albeit at a slower rate than previously. Although it only accounts for 6% of group value, it is an interesting asset as it was the pioneer of the multi brand strategy which has come to typify the group.

The impact of this strategic change can be seen in the relative revenue growth rates of BASE and the market in 2005.

Belgian mobile service sales

(€m)	2004	2005	2006E	2007E	2008E
BASE (KPN)	417	541	618	685	717
Mobistar (France Telecom / listed)	1,184	1,308	1,418	1,475	1,534
Proximus (Belgacom)	2,119	2,021	1,960	1,920	1,924
Market	3,720	3,870	3,996	4,080	4,175
Market growth (%)		4.0	3.2	2.1	2.3
BASE growth (%)		29.7	14.2	10.8	4.7

Source: Dresdner Kleinwort Equity research estimates

Regulation

Belgium has implemented very steep mobile termination rate declines, averaging 19-20% per year between 2006 and 2008. On the plus side for KPN, the regulator has allowed continuing asymmetry, with BASE able to command a premium over its rivals, of €2-4¢ at the end of these planned cuts.

Belgian mobile termination rates

(€cents per minute)	Jan-06	Jul-06	Jan-07	Jul-07	Jan-08	Jul-08	CAGR (%)
BASE	19.53	17.22	15.19	13.39	11.81	10.41	-19
Mobistar	16.27	14.19	12.37	10.749	9.41	8.21	-20
Proximus	12.93	11.29	9.86	8.61	7.51	6.56	-20

Source: BIPT (regulator)

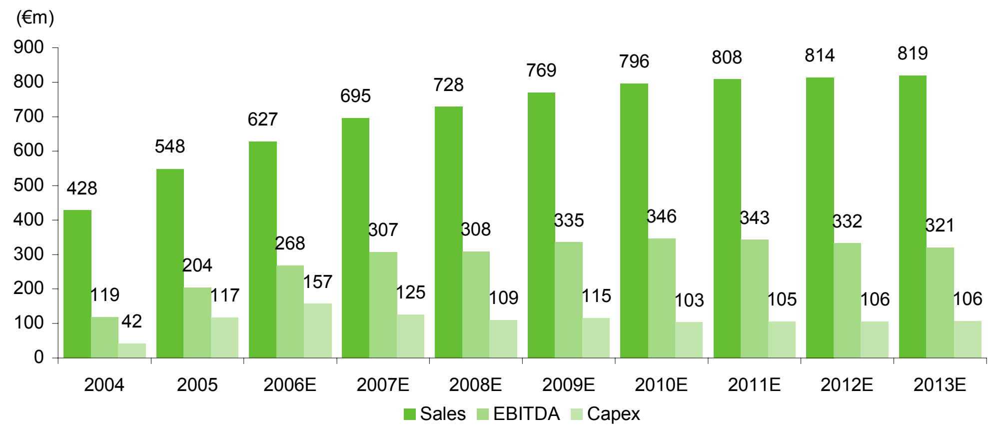
This asymmetry is important for margin support, although we assume that it will fall away further over time, as this is a stated aim of the European Commission.

Forecasts

We assume a slowdown in subscriber growth for BASE, with just 250,000 net adds forecast for 2007 (against 354,000 in 2005) as competitors, in particular Proximus up their game. We also assume a continuing fall in revenue per voice minute, of 15% in 2007. Together, this still adds up to double-digit top line growth for 2007 and there is still scope for further margin improvement. Even assuming an 8% cost growth in 2007 we forecast margin growth to 44.1%. To put that assumption in context: operating costs only grew by 5.6% in the first nine months of 2006.

In the longer term we assume BASE generates a revenue CAGR of 2.8% 2007-13, assuming that subscriber growth and an increase in data sales offset modest voice ARPU declines. We assume EBITDA margins grow a little from here before tailing off again towards the end of the forecast period. For capex, we make our standard assumption for a smaller player in a smaller market of capex / sales of 13% for the terminal year.

Sales, EBITDA and capex for BASE



Source: Dresdner Kleinwort Equity research estimates

Taken together, these forecasts means that operating cash flow (EBITDA – capex) moves from €87m in 2005 to an estimated €214m by 2013.

BASE forecasts

	2004	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E
Mobile customers (000s)	1,647	2,001	2,309	2,559	2,759	2,884	2,934	2,934	2,934	2,934
Net additions (000s)		354	308	250	200	125	50	0	0	0
ARPU (€ per month)	24	24	24	23	22	22	22	22	23	23
Change (%)		0.0	-0.6	-2.6	-4.2	-0.4	0.3	0.7	0.6	0.7
Data proportion of ARPU (%)	16.0	14.0	14.0	13.5	14.1	14.5	15.7	17.1	17.8	18.6
Voice price per minute (€c)	18.8	17.6	14.7	12.5	10.6	9.6	8.6	7.8	7.4	7.0
Change (%)		-6.4	-16.5	-15.0	-15.0	-10.0	-10.0	-10.0	-5.0	-5.0
Service revenues (€m)	417	541	618	685	717	758	784	796	801	807
Change (%)		29.7	14.2	10.8	4.7	5.6	3.4	1.6	0.6	0.7
Total revenues (€m)	428	548	627	695	728	769	796	808	814	819
Change (%)		28	14	11	5	6	3	2	1	1
EBITDA (€m)	119	204	268	307	308	335	346	343	332	321
Change (%)		71.4	31.1	14.7	0.5	8.6	3.3	-0.9	-3.2	-3.4
EBITDA margin (%)	28	37	43	44	42	44	43	42	41	39
Capex (€m)	42	117	157	125	109	115	103	105	106	106
Capex / sales (%)	10	21	25	18	15	15	13	13	13	13

Source: Company, Dresdner Kleinwort Equity research estimates

Valuation

Based on these assumptions and using a WACC of 6.9% and a terminal growth rate of 1%, our DCF for BASE gives an enterprise value of €2.5bn, or 6% of KPN's total group value. This equates to 8.3x 2007E EBITDA. This is a lower multiple than for KPN's other businesses, reflecting the high EBITDA margin (44%) that we forecast for BASE in 2007 relative to later years, when it is nearer to 40%. It is plausible relative to Vodafone's sale price of its 25% stake in Proximus to Belgacom, which was at 7.2 times EV / EBITDA given BASE's superior growth prospects.

Valuation and corporate activity

KPN shares are good value in our opinion on both relative and absolute measure, with a DCF implying an 23% upside, a 9% cash flow yield and more than €2.5bn in cash coming back to shareholders each year in the form of dividends and buy backs. That equates to more than 11% of the current market capitalisation. There is also potential upside from M&A and financial engineering, although we would emphasise stand alone value first.

Absolute valuation

Our primary valuation method for KPN is a DCF, which gives €14 per share. This is broken down as follows.

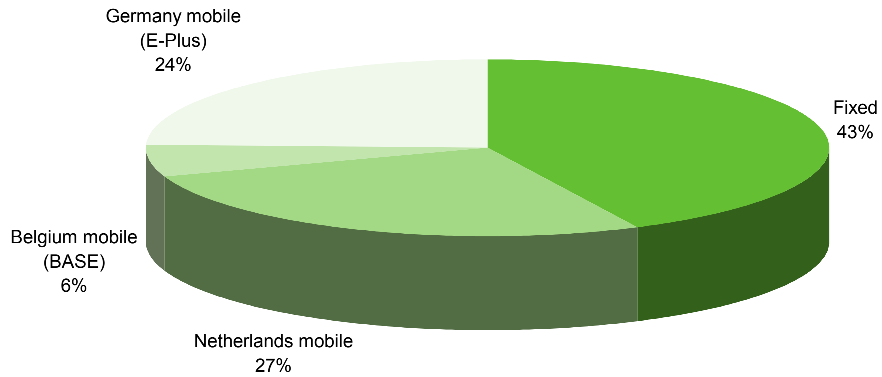
KPN sum of parts valuation

	Stake	Basis	2007 EV / EBITDA multiple	Value (€m)	Per share (€)
Fixed	100%	DCF	7.9	18,847	9.8
Netherlands mobile	100%	DCF	10.0	11,846	6.1
Belgium mobile (BASE)	100%	DCF	8.3	2,546	1.3
Germany mobile (E-Plus)	100%	DCF	10.5	10,727	5.6
Total EV before holding company discount				43,967	22.8
Holding company discount		-10%		-4,397	-2.3
Tax asset / (liability)		DCF		237	0.1
Net debt		end 2005		-8,941	-4.6
Dividend paid in 2006				-982	-0.5
Buyback in 2006				-1,664	-0.9
Net acquisitions in 2006				-253	-0.1
Pension liability				-1,021	-0.5
Equity value				26,945	14.0

Source: Dresdner Kleinwort Equity research estimates

KPN's pension liabilities are modest compared with some in the sector, at just over €1bn, or €0.5 per share. KPN's tax position is very complex but it is our view that the liability in Dutch mobile does not fully offset the tax assets in fixed and international mobile, to the tune of €237m of €0.1 per share. We assess these values using DCFs of the difference between cash tax and nominal tax. The most valuable asset is the fixed operation (43% of value), followed by domestic mobile, E-Plus and BASE.

Value distribution



Source: Dresdner Kleinwort Equity research estimates

Relative valuation

KPN's multiples also look attractive relative to the sector for 2007, with cash flow yield as usual our first choice of metric. Here KPN delivers 9%, with the sector on 8%. It is also attractive on forecast returns, with a 12.3% yield, including dividend and share buy backs, compared with 4–9% for other major stocks in the sector. We include buy back for KPN as it is a stated target for management to continue with buy backs for the foreseeable future as a means of returning cash to shareholders. As a rule, we retain our preference for dividend, however.

Relative valuation

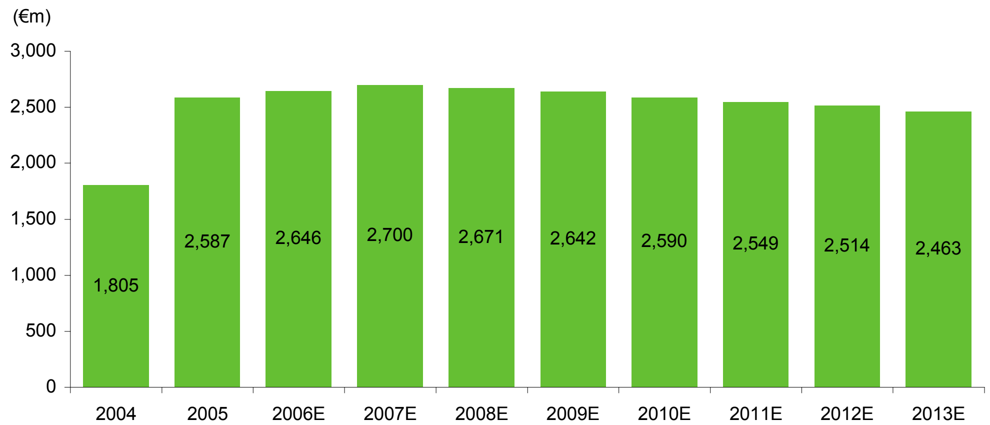
		Share price	EV/EBITDA				Clean P/E				Dividend yield (%)				FCF pre-interest / EV min & div adj (%)			
Company		(local)	2005	2006	2007	2008	2005	2006	2007	2008	2005	2006	2007	2008	2005	2006	2007	2008
Belgacom	€	35.38	5.9	5.9	5.9	5.9	12.4	14.2	14.8	14.9	4.5	4.2	4.1	4.0	7.1	6.9	6.4	6.5
BT Group	p	311.75	6.7	7.1	6.7	6.6	17.5	15.7	13.9	13.2	3.3	3.8	4.5	5.0	6.1	3.6	4.1	4.6
Deutsche Telekom	€	14.75	5.4	5.8	5.5	5.1	13.6	18.1	16.4	15.0	4.9	4.9	4.9	5.3	7.9	4.0	10.5	11.2
France Telecom	€	22.17	6.1	5.7	5.4	5.0	10.6	12.7	12.2	10.6	2.2	4.5	5.4	5.7	10.3	9.4	10.1	11.4
KPN	€	11.37	8.2	7.5	7.2	7.0	17.3	15.4	14.8	13.7	3.5	4.2	4.6	4.9	8.6	9.0	8.9	8.4
OTE	€	23.72	14.4	6.9	7.2	6.1	NM	16.7	21.6	15.0	0.0	4.2	3.2	4.7	7.0	5.4	8.8	12.5
Portugal Telecom	€	10.12	6.8	7.8	7.4	7.2	18.1	19.2	20.7	17.1	3.8	8.8	8.8	8.8	8.4	6.5	8.5	6.1
Swisscom	CHF	477.00	6.7	6.4	6.1	6.0	13.9	14.2	13.7	13.2	3.7	4.0	4.1	3.9	8.1	7.6	8.1	9.0
Telecom Italia	€	2.38	7.9	7.4	6.9	6.5	18.8	20.7	17.0	15.7	5.9	6.2	6.5	6.8	3.8	8.8	7.3	8.0
Telefonica	€	16.85	7.6	7.2	6.7	5.9	18.5	17.5	16.9	12.5	3.0	3.6	4.0	4.5	7.1	7.7	8.2	9.2
Telekom Austria	€	20.80	7.5	6.4	6.1	5.7	24.9	17.9	15.6	13.6	2.7	3.6	4.2	4.8	7.6	9.4	9.8	11.2
Telenor	NOK	127.00	10.5	7.9	6.7	6.0	27.4	20.5	17.5	15.0	1.6	2.0	2.4	3.0	4.0	4.9	5.1	7.0
TeliaSonera	SEK	57.50	8.5	8.0	8.1	8.2	19.3	14.3	16.1	15.6	6.1	6.5	6.5	6.6	6.5	6.0	5.3	5.9
TPSA	PLN	25.60	5.4	5.2	5.0	5.0	15.5	14.4	12.0	11.0	3.9	8.0	9.5	11.9	10.6	12.1	13.0	16.3
Weighted average			7.2	6.8	6.4	6.0	16.7	17.0	16.0	14.0	3.7	4.6	5.0	5.4	7.1	7.0	8.2	9.0

Source: Dresdner Kleinwort Equity research estimates

KPN could return €18.1bn to shareholders between 2007 and 2013, compared with a market capitalisation today of €14.5bn

We also believe that these returns are sustainable at similar absolute levels in terms of DPS and absolute amounts spent on buybacks for the next several years, as although the top line growth of KPN is lower than most of its peers at less than 1% CAGR 2006-08 vs the sector on c. 3%, it is paying plenty of attention to cost cutting and is targeting a modest increase in leverage. We are also of the view that returns will continue to flow: this is a management team as focused on the investor and the share price as any we have seen in the sector, with a solid track record of delivering on guidance and avoiding expensive acquisitions. On our current estimates, KPN could return €18.1bn to shareholders between 2007 and 2013, compared with a market capitalisation today of €14.5bn, whilst still having a net debt / EBITDA of less than 2.5x.

KPN cash returns (dividend plus share buy back)



Source: Dresdner Kleinwort Equity research estimates

Corporate activity and balance sheet

M&A initiated by KPN

KPN has made several moves in M&A over the last few years, with four distinct trends being apparent.

- Divesting non-core assets. For example, Xantic, Euroweb, Infonet and TeleMedia Netherland. This process is now completed.
- Consolidating in the domestic market. Most notably on mobile with the acquisition of mobile operator Telfort in 2005 for €980m, and also with numerous ISP acquisitions, including Attingo, Demon Netherlands and Speedling. The most recent move here is the planned acquisition of Tiscali Netherlands, for €255m which has been referred to the Dutch competition authority. The review process should finish by April and we assume for our modelling that KPN will be able to make the acquisition by the middle of 2007.
- Making small acquisitions to boost its position in selling to businesses, such as NewTel Essence and Enertel.
- Agreeing to merge its international voice wholesale business into iBasis, a global VoIP company. This transaction has not yet completed and we have not assumed that it will in our forecasts, due to uncertainty over timing.

KPN as potential target?

We do not think a deal is very likely or indeed priced in to the equity at these levels, but more speculation about this can only provide upside

KPN is often spoken of as a potential acquisition target. For a PTT it is relatively small, with an enterprise value of just €32bn. Recent news flow from private equity indicates that this would be a manageable deal size. Telefonica has also been mooted as a potential buyer (see E-Plus section) but it does have a net M&A ceiling of €1.5bn before the end of 2007 which would have to be breached for a deal for KPN to go through.

The Dutch government made its final exit from KPN in 2006, so there is no obstacle there, but note that various parts of Capital Group own c.25% of KPN's equity.

Some of KPN's issued bonds have change of control terms written in to them which would make any deal more complicated, but we do not think they are insurmountable.

Management's defence is for a takeover to be as expensive as possible, driving share price performance via good returns to shareholders and the good operational performance.

Overall, we do not think a deal is very likely or indeed priced in to the equity at these levels, but more speculation about this can only provide upside.

Balance sheet

In our forecasts we assume that KPN moves gradually to the top of its relatively new (as from early 2006) range for net debt / EBITDA of 2-2.5 times, from just under 2 times at the end of Q3 2006. We believe that this is a sensible level and to go much higher on a conventional financing basis would probably not be sensible in an equity market where there are still unpleasant memories of the fall out from over leveraged stocks earlier this decade.

It is possible that KPN could follow a more aggressive financing strategy on part of its assets, as for example BT is supposedly considering for its Openreach fixed access business. This makes sense where there is a highly regulated effective monopoly with utility returns.

In KPN's case, we expect management to bear this approach in mind, but not make any major moves toward it for a few years, as the regulatory, commercial and technical consequences of the move to "all-IP" become clearer.

Forecasts

Growth rates

(%)	Q1 05	Q2 05	Q3 05	Q4 05	2005	Q1 06	Q2 06	Q3 06	Q4 06E	2006E	2007E
Operating revenues growth rate											
E-Plus	8.8	11	5.9	7.4	8.2	3.9	1.7	6.0	-1.6	2.4	11.0
KPN Mobile (NL)	0.2	4.3	3.6	29	9.3	26	26	29	1.7	19	3.7
BASE	20	33	29	31	28	18	13	17	11	14	10.8
Other	20	20	20	-408	-109	-17	17	-8	-133	-1306	16
Mobile	6	10	7	22	11	15	13	17	-2.2	10	7.6
Consumer	-1.6	0.5	-3.2	-5.0	-2.3	-6.2	-4.8	-4.5	-5.6	-5.3	-6.7
Business	-11	-10	-11	-7.6	-10	-4.4	-5.6	-4.7	-3.5	-4.5	-2.6
Wholesale and Operations	-8.7	-4.6	-3.3	-4.0	-5.2	-2.4	-4.7	-6.1	-5.0	-4.6	-5.0
Other (Including intra division)	-10	-7.7	-6.1	-6.9	-7.6	-7.4	-5.9	-8.6	-6.6	-7.1	-6.7
Fixed	-7.0	-3.5	-5.3	-4.4	-5.0	-2.3	-4.6	-3.8	-3.9	-3.6	-4.0
Other	-19	-41	-38	-45	-34	2	-71	-75	-71	-45	-57
Inter company revenues	-10	-5.1	-3.3	9	-2.2	18	12	11	-8.0	7.6	-2.8
Total operating revenues	-1.8	1.4	-0.9	5.3	1.0	3.9	1.0	3.6	-3.7	1.1	1.5
EBITDA (reported) growth rate											
E-Plus	-15	-11	-4.5	13	-3.9	26	73	46	19	40	8.9
KPN Mobile (NL)	-20	4.5	3.5	25	2.7	24	24	14	3.0	16	10.3
BASE	45	108	170	23	71	27	38	33	27	31	14.7
Other	250	0.0	75	-2600	-314	-43	-17	-29	-115	-171	45
Mobile	-15	4.1	7.4	32	7.4	26	44	29	1.2	23	9.9
Consumer	38	-5.8	-18	-20	-4.0	-27	-30	-28	-29	-28	-30
Business	-23	2.7	-26	-36	-20	19	-23	-16	15.9	-4	6.0
Wholesale and Operations	-11	-13	-5.2	-10	-10	-3.3	-1.8	-10.5	-6.5	-5.5	-6.5
Other	67	100	NA	-125	78	-160	-325	71	763	11	76
Fixed	-7.3	-10	-8.1	-16	-10	-5.1	-7.3	-11.5	-9.3	-8.3	-6.8
Other	-65	-450	-141	-393	1,113	650	-129	14	-109	-58	-173
Total EBITDA	-11	-3.8	-4.6	10	-2.3	10	10	4.4	-11	2.9	-0.4
EBITDA margin											
E-Plus	21	22	24	28	24	26	37	33	34	33	32
KPN Mobile (NL)	35	40	39	36	37	34	39	35	37	36	38
BASE	37	38	39	36	37	40	46	44	41	43	44
Other	58	50	58	125	750	40	36	45	55	44	55
Mobile	28	30	31	35	31	31	39	35	36	35	36
Consumer	18	16	16	14	16	14	12	12	10	12	9
Business	13	17	14	10	13	16	14	12	12	14	15
Wholesale and Operations	42	40	41	40	41	42	42	39	40	40	40
Other	-0.6	0.5	-2.2	0.3	-0.5	0.4	-1.2	-4.1	2.4	-0.6	-1.1
Fixed	42	41	41.6	38	41	40	40	38	36	39	37
Other	8.4	25	-13	158	38	62	-25	-62	-47	29	-50
Total EBITDA	38	39	39	42	40	40	43	39	39	40	40

Source: Company, Dresdner Kleinwort Equity research estimates

Summary by segment

	2004	2005	Q1 06	Q2 06	Q3 06	Q4 06E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E
Operating revenues (€m)														
E-Plus	2,608	2,822	665	722	760	743	2,890	3,207	3,422	3,676	3,843	3,988	4,188	4,353
KPN Mobile (NL)	2,271	2,483	700	737	778	749	2,964	3,074	3,095	3,174	3,205	3,178	3,109	3,050
BASE	428	548	144	156	162	165	627	695	728	769	796	808	814	819
Other mobile	-43	4	-10	-14	-11	-13	-48	-56	-58	-61	-63	-64	-65	-66
Mobile	5,264	5,857	1,499	1,601	1,689	1,643	6,432	6,921	7,187	7,559	7,781	7,911	8,045	8,156
Consumer	2,441	2,384	572	573	557	556	2,258	2,105	2,041	2,071	2,211	2,267	2,303	2,327
Business	2,949	2,653	647	626	614	646	2,533	2,466	2,359	2,271	2,199	2,151	2,108	2,069
Wholesale and Operations	5,256	4,985	1,203	1,194	1,167	1,193	4,757	4,519	4,293	4,165	4,040	3,918	3,801	3,687
Other fixed (Including intra division)	-3,397	-3,139	-738	-740	-709	-729	-2,916	-2,722	-2,559	-2,470	-2,428	-2,379	-2,335	-2,299
Fixed	7,249	6,883	1,684	1,653	1,629	1,666	6,632	6,369	6,135	6,036	6,021	5,958	5,877	5,785
Other (not fixed or mobile)	389	255	97	16	13	15	141	60	50	40	40	40	40	40
Inter company revenues	-1,083	-1,059	-278	-291	-295	-276	-1,140	-1,108	-1,110	-1,132	-1,149	-1,154	-1,159	-1,160
Total operating revenues	11,819	11,936	3,002	2,979	3,036	3,049	12,066	12,242	12,262	12,504	12,693	12,754	12,803	12,820
EBITDA (reported) (€m)														
E-Plus	700	673	170	267	248	256	941	1,024	1,130	1,270	1,316	1,335	1,402	1,428
KPN Mobile (NL)	904	928	241	288	269	274	1,072	1,182	1,222	1,302	1,332	1,305	1,236	1,177
BASE	119	204	57	72	72	68	268	307	308	335	346	343	332	321
Other mobile	-14	30	-4	-5	-5	-7	-21	-31	-33	-36	-38	-39	-40	-41
Mobile	1,709	1,835	464	622	584	590	2,259	2,483	2,627	2,870	2,956	2,945	2,930	2,885
Consumer	396	380	80	69	66	58	273	190	203	305	454	502	529	544
Business	449	358	105	88	74	78	345	365	343	335	321	330	341	355
Wholesale and Operations	2,264	2,038	500	497	454	475	1,926	1,802	1,684	1,660	1,610	1,562	1,515	1,469
Other fixed	9	16	-3	9	29	-17	18	31	19	5	-40	-68	-70	-77
Fixed	3,118	2,792	682	663	623	593	2,561	2,388	2,248	2,305	2,345	2,325	2,315	2,292
Other (not mobile or fixed)	8	97	60	-4	-8	-7	41	-30	-28	-25	-20	-20	-20	-20
Total EBITDA	4,835	4,724	1,206	1,281	1,199	1,176	4,861	4,841	4,848	5,150	5,282	5,250	5,225	5,157
EBITDA margins (%)														
E-Plus	26.8	23.8	25.6	37.0	32.6	34.4	32.6	31.9	33.0	34.5	34.2	33.5	33.5	32.8
KPN Mobile (NL)	39.8	37.4	34.4	39.1	34.6	36.6	36.2	38.5	39.5	41.0	41.6	41.1	39.8	38.6
BASE	27.8	37.2	39.6	46.2	44.4	40.8	42.6	44.1	42.4	43.5	43.5	42.4	40.8	39.1
Mobile	32.5	31.3	31.0	38.9	34.6	35.9	35.1	35.9	36.6	38.0	38.0	37.2	36.4	35.4
Consumer	16.2	15.9	14.0	12.0	11.8	10.4	12.1	9.0	9.9	14.7	20.6	22.1	23.0	23.4
Business	15.2	13.5	16.2	14.1	12.1	12.0	13.6	14.8	14.5	14.7	14.6	15.3	16.2	17.2
Wholesale and Operations	43.1	40.9	41.6	41.6	38.9	39.8	40.5	39.9	39.2	39.9	39.9	39.9	39.9	39.9
Fixed	43.0	40.6	40.5	40.1	38.2	35.6	38.6	37.5	36.6	38.2	39.0	39.0	39.4	39.6
Group EBITDA margin	40.9	39.6	40.2	43.0	39.5	38.6	40.3	39.5	39.5	41.2	41.6	41.2	40.8	40.2
Capex (€m)														
E-Plus	780	401	90	126	151	182	549	545	547	515	461	479	503	522
KPN Mobile (NL)	207	159	37	41	59	70	207	277	309	317	320	318	311	305
BASE	42	117	38	24	32	63	157	125	109	115	103	105	106	106
Mobile	1,029	678	165	190	242	315	913	947	966	948	885	901	919	934
Consumer	50	59	48	34	34	39	155	158	153	145	111	91	92	93
Business	76	64	10	19	24	39	92	99	83	79	66	65	63	62
Wholesale and Operations	483	578	88	130	117	149	484	497	472	458	444	431	418	406
Fixed	609	706	145	185	178	229	737	758	712	687	625	590	577	565
Other	30	10	3	4	5	5	17	17	17	17	17	17	17	17
Total Capex	1,668	1,394	313	379	425	549	1,667	1,722	1,695	1,651	1,527	1,509	1,514	1,516
Capex / sales (%)														
E-Plus	29.9	14.2	13.5	17.5	19.9	24.5	19.0	17.0	16.0	14.0	12.0	12.0	12.0	12.0
KPN Mobile (NL)	9.1	6.4	5.3	5.6	7.6	9.4	7.0	9.0	10.0	10.0	10.0	10.0	10.0	10.0
BASE	9.8	21.4	26.4	15.4	19.8	38.0	25.0	18.0	15.0	15.0	13.0	13.0	13.0	13.0
Mobile	19.5	11.6	11.0	11.9	14.3	19.2	14.2	13.7	13.4	12.5	11.4	11.4	11.4	11.4
Consumer	2.0	2.5	8.4	5.9	6.1	7.0	6.9	7.5	7.5	7.0	5.0	4.0	4.0	4.0
Business	2.6	2.4	1.5	3.0	3.9	6.0	3.6	4.0	3.5	3.5	3.0	3.0	3.0	3.0
Wholesale and Operations	9.2	11.6	7.3	10.9	10.0	12.5	10.2	11.0	11.0	11.0	11.0	11.0	11.0	11.0
Fixed	8.4	10.3	8.6	11.2	10.9	13.7	11.1	11.9	11.6	11.4	10.4	9.9	9.8	9.8
Other	7.7	3.9	3.1	25.0	38.5	33.3	12.1	28.3	34.0	42.5	42.5	42.5	42.5	42.5
Group capex / sales	14.1	11.7	10.4	12.7	14.0	18.0	13.8	14.1	13.8	13.2	12.0	11.8	11.8	11.8

Source: Dresdner Kleinwort Equity research estimates

Income statement

(€m)	2004	2005	Q1 06	Q2 06	Q3 06	Q4 06E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E
Total operating revenues	11,819	11,936	3,002	2,979	3,037	3,049	12,066	12,242	12,262	12,504	12,693	12,754	12,803	12,820
Total non-D&A opex	-6,984	-7,212	-1,796	-1,698	-1,837	-1,872	-7,204	-7,401	-7,414	-7,353	-7,411	-7,505	-7,578	-7,664
Depreciation (incl. impairments)	-1,933	-1,882	-451	-469	-472	-477	-1,869	-1,769	-1,731	-1,637	-1,534	-1,418	-1,389	-1,366
Amortisation (incl. impairments)	-257	-494	-143	-142	-151	-152	-588	-584	-582	-581	-579	-578	-576	-575
Total operating expenses	-9,174	-9,588	-2,390	-2,309	-2,463	-2,501	-9,661	-9,754	-9,727	-9,571	-9,525	-9,501	-9,544	-9,605
Operating profit	2,645	2,348	612	670	574	547	2,404	2,488	2,535	2,933	3,168	3,254	3,260	3,216
Finance income	70	44	9	12	10	-10	21	21	21	21	21	21	21	21
Finance costs	-674	-566	-132	-134	-130	-127	-523	-509	-551	-589	-615	-637	-662	-688
Other financial results	15	-25	8	45	5	5	63	0	0	0	0	0	0	0
Finance costs - net	-589	-547	-115	-77	-115	-133	-440	-488	-530	-568	-594	-617	-641	-667
Share of the profit of associates and JVs	1	13	2	3	2	2	9	10	11	12	13	14	16	18
Profit on continuing operations before taxes	2,057	1,814	499	596	461	417	1,974	2,010	2,016	2,377	2,587	2,652	2,634	2,566
Income tax	-300	-360	-115	-135	-112	-102	-464	-585	-604	-712	-772	-796	-802	-794
Profit for the period	1,757	1,454	384	461	349	314	1,509	1,424	1,411	1,665	1,815	1,856	1,832	1,772
Profit attributable to minority shareholders	-50	-17	-1	3	-3	0	-1	-2	-2	-2	-2	-2	-2	-2
Profit attributable to equity holders of the parent	1,707	1,437	383	464	346	314	1,508	1,422	1,409	1,663	1,813	1,854	1,830	1,770
Earnings per share (non-diluted, €)	0.72	0.66	0.19	0.22	0.18	0.15	0.74	0.77	0.83	1.08	1.31	1.52	1.72	1.95
Earnings per share (fully-diluted, €)	0.71	0.65	0.18	0.23	0.17	0.15	0.73	0.76	0.82	1.07	1.29	1.49	1.68	1.90
DPS (using IFRS timing, €)	0.33	0.40	0.00	0.32	0.16	0.00	0.48	0.53	0.56	0.58	0.62	0.67	0.72	0.77

Source: Dresdner Kleinwort Equity research estimates

Cash flow

(€m)	2004	2005	Q1 06	Q2 06	Q3 06	Q4 06E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E
Operating profit	2,645	2,348	612	670	574	547	2,404	2,488	2,535	2,933	3,168	3,254	3,260	3,216
Depreciation, amortization and impairments	2,190	2,376	594	611	624	629	2,457	2,353	2,313	2,218	2,113	1,996	1,966	1,941
Interest (paid) / received	-623	-484	-9	-134	-108	-252	-503	-488	-530	-568	-594	-617	-641	-667
Income tax (paid) / received	8	-24	219	-5	-1	0	213	-289	-734	-827	-883	-965	-970	-963
Book gains	-73	-151	-79	-11	-9	0	-99	0	0	0	0	0	0	0
Change in provisions	-63	-248	-42	-61	-19	-18	-140	-118	-106	-96	-86	-77	-70	-63
Net cash flow from operating activities before changes in working capital	4,084	3,817	1,295	1,070	1,061	907	4,333	3,946	3,478	3,660	3,719	3,591	3,544	3,464
- Inventory	-74	64	-19	30	-1	-11	-1	-2	0	-3	-2	-1	-1	0
- Trade receivables	18	21	14	-52	32	-18	-24	-33	-4	-45	-35	-11	-9	-3
- Other current assets	166	107	-165	-14	-21	0	-200	0	0	0	0	0	0	0
- Current liabilities	-237	-176	-55	-1	82	-49	-23	-29	8	48	14	7	-13	-19
Change in working capital	-127	16	-225	-37	92	-78	-248	-63	4	0	-23	-5	-23	-22
Net cash flow from operating activities	3,957	3,833	1,070	1,033	1,153	828	4,084	3,882	3,482	3,661	3,696	3,586	3,521	3,441
- Capex	-1,668	-1,394	-313	-379	-425	-549	-1,667	-1,722	-1,695	-1,651	-1,527	-1,509	-1,514	-1,516
- Acquisitions	-77	-1,031	-110	-198	-52	0	-360	-255	0	0	0	0	0	0
- Disposals	83	208	69	15	23	0	107	0	0	0	0	0	0	0
- Other	88	11	4	10	-5	0	9	0	0	0	0	0	0	0
Net cash flow from investing activities	-1,574	-2,206	-350	-552	-459	-549	-1,911	-1,977	-1,695	-1,651	-1,527	-1,509	-1,514	-1,516
- Dividend paid	-796	-890	0	-661	-321	0	-982	-1,000	-971	-942	-890	-849	-814	-763
- Share repurchases	-1,009	-1,697	-81	-418	-1,015	-150	-1,664	-1,700	-1,700	-1,700	-1,700	-1,700	-1,700	-1,700
- Option plans	-33	-2	0	0	0	0	0	0	0	0	0	0	0	0
- Debt financing	-830	-312	896	-574	342	0	664	0	0	0	0	0	0	0
- Other	29	172	5	-8	8	0	5	0	0	0	0	0	0	0
Net cash flow from financing activities	-2,639	-2,729	820	-1,661	-986	-150	-1,977	-2,700	-2,671	-2,642	-2,590	-2,549	-2,514	-2,463
Change in cash and cash equivalents	-256	-1,102	1,540	-1,180	-292	129	196	-794	-884	-632	-421	-471	-506	-537
Free cash flow	2,289	2,439	757	654	728	279	2,417	2,161	1,787	2,009	2,169	2,077	2,008	1,926

Source: Dresdner Kleinwort Equity research estimates

Balance sheet forecasts

(€m, to end December unless otherwise indicated)	2004	1 Jan 2005	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E
Assets											
Non Current assets											
Total intangible assets	8,695	8,667	9,401	9,117	8,847	8,573	8,293	7,992	7,690	7,389	7,091
Total PP&E	8,979	8,917	8,338	7,997	7,656	7,332	7,066	6,800	6,635	6,504	6,397
Investments in associates and JVs	17	17	26	26	26	26	26	26	26	26	26
Financial assets	146	0	0	0	0	0	0	0	0	0	0
Derivative financial instruments	0	28	17	17	17	17	17	17	17	17	17
Deferred tax assets	1,606	1,677	1,348	1,348	1,348	1,348	1,348	1,348	1,348	1,348	1,348
Trade and other receivables	235	118	49	50	50	50	51	52	52	53	53
Total non-current assets	19,678	19,424	19,179	18,555	17,944	17,347	16,801	16,235	15,768	15,337	14,931
Current assets											
Inventories	190	188	130	131	133	134	136	138	139	139	140
Trade & other receivables	2,242	2,161	2,179	2,203	2,235	2,238	2,283	2,317	2,328	2,337	2,340
Available for sale financial assets	0	169	5	5	5	5	5	5	5	5	5
Derivative financial instruments	0	9	0	0	0	0	0	0	0	0	0
Cash & cash equivalents	1,551	2,158	1,033	1,033	1,033	1,033	1,033	1,033	1,033	1,033	1,033
Total current assets	3,983	4,685	3,347	3,372	3,406	3,410	3,457	3,493	3,505	3,515	3,518
Non-current assets and disposal groups held for sale	0	121	176	30	0	0	0	0	0	0	0
Total assets	23,661	24,230	22,702	21,957	21,350	20,757	20,258	19,729	19,274	18,851	18,449
Liabilities											
Group equity											
Share capital	559	559	517	478	440	403	365	328	290	252	215
Share premium	15,307	15,307	14,117	12,593	10,931	9,268	7,606	5,944	4,281	2,619	956
Other reserves	-138	-280	-787	-768	-1,096	-1,066	-958	-918	-894	-912	-944
Retained earnings	-9,317	-9,320	-8,771	-8,245	-7,822	-7,384	-6,662	-5,739	-4,733	-3,717	-2,709
Equity attributable to equity holders	6,411	6,266	5,076	4,059	2,454	1,222	352	-386	-1,056	-1,758	-2,482
Minority interests	145	145	28	27	25	23	21	19	17	15	13
Total group equity	6,556	6,411	5,104	4,086	2,479	1,245	373	-367	-1,039	-1,743	-2,469
Non current liabilities											
Borrowings	7,821	6,787	7,238	7,042	7,836	8,720	9,352	9,774	10,245	10,751	11,288
Derivative financial instruments	0	1,074	716	716	716	716	716	716	716	716	716
Deferred tax liabilities	2,184	2,184	2,229	2,906	3,202	3,073	2,958	2,848	2,678	2,510	2,341
Provisions for retirement benefit obligations	1,577	1,577	1,320	1,180	1,062	956	860	774	697	627	564
Provisions for other liabilities and charges	315	315	396	396	396	396	396	396	396	396	396
Other payables and deferred income	360	360	292	292	292	292	292	292	292	292	292
Total non-current liabilities	12,257	12,297	12,191	12,532	13,504	14,153	14,575	14,799	15,024	15,292	15,597
Current liabilities											
Trade and other payables	2,881	2,851	2,951	2,974	3,002	2,994	2,946	2,932	2,924	2,937	2,956
Borrowings	1,659	2,126	2,020	2,020	2,020	2,020	2,020	2,020	2,020	2,020	2,020
Derivative financial instruments	0	146	7	7	7	7	7	7	7	7	7
Current tax liabilities	197	197	261	261	261	261	261	261	261	261	261
Provisions for other liabilities and charges	111	111	77	77	77	77	77	77	77	77	77
Total current liabilities	4,848	5,431	5,316	5,339	5,367	5,359	5,311	5,297	5,289	5,302	5,321
Liabilities directly associated with non-current assets and disposal groups held for sale	0	91	91	0	0	0	0	0	0	0	0
Total equity and liabilities	23,661	24,230	22,702	21,957	21,350	20,757	20,258	19,729	19,274	18,851	18,449

NB change of accounting policies at start of 2005
Source: Dresdner Kleinwort Equity research estimates

Net debt

(€m)	2004	1 Jan 2005	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E
Cash & cash equivalents	1,551	2,158	1,033	1,033	1,033	1,033	1,033	1,033	1,033	1,033	1,033
Borrowings (non-current)	-7,821	-6,787	-7,238	-7,042	-7,836	-8,720	-9,352	-9,774	-10,245	-10,751	-11,288
Borrowings (current)	-1,659	-2,126	-2,020	-2,020	-2,020	-2,020	-2,020	-2,020	-2,020	-2,020	-2,020
Derivative financial instruments (interest bearing)		-1,074	-716	-716	-716	-716	-716	-716	-716	-716	-716
Net debt (cash)	7,929	7,829	8,941	8,745	9,539	10,423	11,055	11,477	11,948	12,454	12,991
Net debt / EBITDA	1.6		1.9	1.8	2.0	2.2	2.1	2.2	2.3	2.4	2.5

NB change of accounting policies at start of 2005
Source: Dresdner Kleinwort Equity research estimates

Prices of stocks mentioned

Stock	Price
Belgacom	€35.38
BT Group	£3.12
Deutsche Telekom	€14.75
France Telecom	€22.17
iBasis	US$8.89
KPN	€11.37
Liberty Global	US$30.69
OTE	€23.72
Portugal Telecom	€10.12
Swisscom	CHF477
Telecom Italia	€2.38
Telefonica	€16.85
Telekom Austria	€20.80
Telenor	NOK127
TeliaSonera	SEK57.5
Tiscali	€2.72
TPSA	PLN25.60
Versatel	€0.76
Vodafone	£1.49

Source: Reuters

Notes

Notes

Disclosure appendix

Disclosures under US regulations

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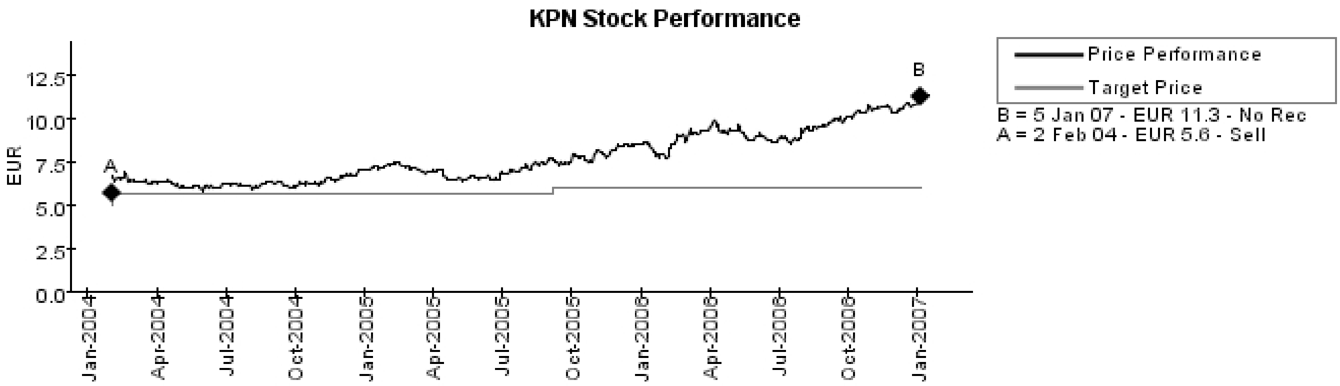
Past performance is not an indicator of future performance.



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Buy:	10% or greater increase in share price	Sell:	10% or more decrease in share price
Add:	5-10% increase in share price	Reduce:	5-10% decrease in share price
Hold:	+5%/-5% variation in share price		

Distribution of Dresdner Kleinwort equity recommendations as of 31 Dec 2006

	All covered companies		Companies where a Dresdner Kleinwort company has provided investment banking services (in the last 12 months)	
Buy/Add	306	55%	65	21%
Hold	170	31%	22	13%
Sell/Reduce	80	14%	9	11%
Total	**556**		**96**	

Source: Dresdner Kleinwort

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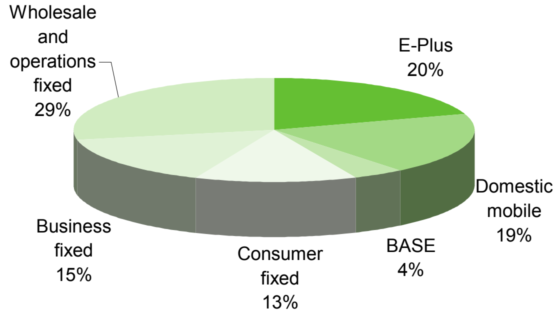
Summary financials and key valuations

Profit and loss statement

		2005	2006E	2007E	2008E
Sales	€m	11,936	12,066	12,242	12,262
EBITDA excl assocs	€m	4,230	4,273	4,257	4,266
EBITDA margin	%	35.4	35.4	34.8	34.8
EBITA incl associates	€m	2,855	3,001	3,082	3,128
EBITA margin	%	23.9	24.9	25.2	25.5
Pre-tax profit excl except, gw	€m	2,308	2,562	2,593	2,598
Pre-tax margin	%	19.3	21.2	21.2	21.2
Attrib profit excl except, gw	€m	1,931	2,096	2,006	1,992
Act EPS excl except, gw	€	0.88	1.03	1.08	1.18
Act EPS growth excl except, gw	%	7.0	16.8	5.4	8.5
DPS	€	0.40	0.48	0.52	0.56

2007E revenues split

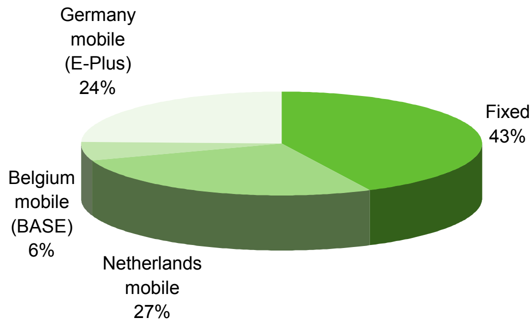


Source: Dresdner Kleinwort Equity research estimates

Balance sheet

		2005	2006E	2007E	2008E
Total fixed assets	€m	19,179	18,555	17,944	17,347
Total current assets	€m	3,347	3,372	3,406	3,410
Total assets	€m	22,702	21,957	21,350	20,757
Equity & min int	€m	5,104	4,086	2,479	1,245
Total liabilities	€m	15,882	16,295	17,414	18,160
Total provisions	€m	1,716	1,576	1,458	1,352
Working capital	€m	130	133	138	150
Capital employed	€m	15,761	14,407	13,476	13,020
Net (debt)/cash	€m	(8,941)	(8,745)	(9,539)	(10,423)

Share of value



Source: Dresdner Kleinwort Equity research estimates

Cash flow

		2005	2006E	2007E	2008E
Pre WC gross cash flow	€m	3,817	4,333	3,946	3,478
Gross cash flow	€m	3,833	4,084	3,882	3,482
Total capex	€m	(1,383)	(1,658)	(1,722)	(1,695)
Free cash flow	€m	2,450	2,426	2,161	1,787
FCF post div	€m	1,560	1,444	1,161	816

Ratios

		2005	2006E	2007E	2008E
P/E	x	12.9	11.0	10.5	9.7
P/FCF	x	10.2	9.5	9.7	10.8
Yield	%	3.5	4.2	4.6	4.9
P/B	x	4.8	5.4	8.2	15.0
EV/ sales	x	2.9	2.6	2.5	2.4
EV/EBITDA	x	8.2	7.5	7.2	7.0
Post tax ROCE	%	15.3	17.1	17.7	18.4
ROE	%	38.0	51.7	81.7	163.0
Net debt/ equity	%	175.2	214.0	384.8	837.3
Net debt/ MV	%	40.8	39.9	43.5	47.6
Net debt/ EBITDA	x	2.1	2.0	2.2	2.4
Interest cover	x	4.3	5.5	5.1	4.8
Free cash flow/ int charge	x	4.5	5.5	4.4	3.4
Capex/ sales	%	11.7	13.8	14.1	13.8
DACF/ EV	%	12.3	14.9	14.1	13.1

Key share data

Total no. of shares	m	1,929
Free float	%	100
Share information		
Capital Research & Management	%	13.8
Capital Guardian Trust	%	12.6