



Financial Review 1998

Swisscom AG

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Key Figures

(CHF in millions, except where indicated)

		1997	1998
Swisscom Group			
Net revenues		9 842	10 461
Operating income before restructuring charges and depreciation (EBITDA)		3 779	4 472
Operating income before restructuring charges (EBIT)		2 040	2 851
Restructuring charges		1 726	(50)
Net (loss) income from continuing operations		(304)	2 074
Net (loss) income		(415)	1 555
Shareholders' equity		1 230	5 347
Equity ratio	%	7.9	31.6
Number of full-time equivalent employees at end of period	FTE	22 170	21 946
Average number of full-time equivalent employees	FTE	22 145	22 069
Revenue per employee	CHF in thousands	444	474
Net cash provided by operating activities		1 335	3 574
Capital expenditures		2 374	1 305
Investments in subsidiaries, affiliated companies and other non current assets		329	240
Free cash flow		(1 142)	2 235
Swisscom AG			
Net income		n/a	1 011
Shareholders' equity		n/a	5 562
Dividend		n/a	809*
Key figures per share			
Average number of shares outstanding (at CHF 25.– each)	in mio.	66.0	67.888
Price per share (high/low) (since October 5, 1998)	CHF	n/a	588.–/376.50
Net (loss) income from continuing operations	CHF	(4.61)	30.55
Net (loss) income	CHF	(6.29)	22.91
Shareholders' equity	CHF	18.64	72.70
Gross dividend	CHF	n/a	11.00*
Pay-out ratio	%	n/a	52.0*
Market capitalization at end of period		n/a	42 291

* according to the proposal of the Board of Directors to the Shareholders' Meeting

Review of the group's results

Review of the group's results

Major events and developments

Listing on the Swiss and New York Stock Exchanges

In October 1998, Swisscom completed an initial public offering of 25,374,750 shares at an initial offering price of CHF 340. Of the total shares sold, 7,550,000 were sold by Swisscom and the remainder by the Swiss Government. The amount raised by Swisscom totalled CHF 2,462 million, net of issuance costs. These proceeds were primarily used to repay outstanding debt from the Swiss Post and the Swiss Federal Treasury. After completion of the Global Offering, the Swiss Government owns 65.5 percent of the outstanding shares of Swisscom.

Liberalization of Swiss Telecommunications Market

As of January 1, 1998, with the entry into effect of the Telecommunications Act, the market for telecommunications in Switzerland was opened to full competition. The Telecommunications Act includes the requirement that in markets where it has a dominant position, Swisscom must allow other service providers to interconnect to its network at cost-related prices.

Separation from the Swiss PTT and the Post and transformation into a stock corporation

Effective January 1, 1998 Swisscom and the Swiss Post were separated into fully independent organizations and Swisscom was transformed into a stock corporation. The separation and incorporation resulted in the following significant changes to Swisscom:

Taxation

Prior to January 1, 1998, as a governmental entity Swisscom was not subject to income or other taxes applicable to Swiss corporations, with the exception of VAT. Subsequent to privatization, Swisscom has been subject to such taxes normally applicable to Swiss corporations. Swisscom's weighted average statutory tax rate is 25 percent.

Profit distributions

Swisscom was required to distribute substantially all of its profits for the business year 1997 to the Swiss PTT and the Swiss Confederation in 1998. For the business year 1998 the distribution of dividends, subject to approval by the Shareholders' Meeting and paid in 1999, will be dependent upon Swisscom's earnings, its financial condition and various other market factors. Swisscom will also take into account the dividend payment practices of other major Swiss companies and international telecommunications operators. This represents Swisscom's dividend policy for the future.

Financing

Prior to the separation, Swisscom relied on borrowings from the Central Treasury of the PTT for its financing needs. Swisscom expects to be able to meet its future financing requirements through debt issuances in the capital markets or bank borrowings.

Acquisitions of subsidiaries

In line with Swisscom's heart of Europe strategy, effective July 1, 1998, Swisscom acquired a majority interest in UTA Telekom AG, a telecommunications service provider in Austria, for consideration of approximately CHF 150 million. Swisscom consolidated UTA's results from operations for the period from July 1, 1998. In addition, Swisscom SpA, Italy was incorporated in 1998 and Estel SA, France, a joint venture with "Electricité de Strasbourg", was formed. Swisscom now has operations in each of the countries surrounding Switzerland.

Effective December 31, 1998, Swisscom reacquired Unisource Business Networks (CH), AG, the Swiss subsidiary of the Unisource joint venture, for CHF 57 million. UBN's results from operations will first be consolidated in 1999.

Review of the group's results

Discontinuance of operations in India and Malaysia

In March 1999, the Board of Directors announced a plan to dispose of its operations in India and Malaysia due to a refocussing of its international strategy and continued losses. The estimated loss on disposal of CHF 519 million has been recorded under discontinued operations in 1998.

Results of operations

CHF in millions	Year ended December 31	
	1997	1998
Net revenues		
Access	1 243	1 343
National traffic revenue	2 561	2 426
Outgoing international traffic revenue	1 375	1 301
Value-added and information services	443	484
Customer premises equipment	1 046	1 035
Fixed-line voice telephony	6 668	6 589
Mobile telecommunications services	1 371	1 791
Data and multimedia services	824	901
Carrier services	697	860
Other revenues	282	320
Total net revenues	9 842	10 461

The decline of 1.2 percent in **fixed-line voice telephony** was primarily due to significant reductions in national call tariffs that were implemented in the second half of 1997, as well as the effects of new pricing plans for international calls introduced in 1998 driven by the advent of competition. National traffic revenue declined by 5.3 percent in 1998 compared with 1997, reflecting the reduction in tariffs implemented in August 1997. The effect of the tariff decline was offset in part by an increase in local traffic due primarily to the increased usage of on-line services and an increase in fixed-to-mobile traffic, which is billed at higher tariffs. The decrease in national and international traffic revenue was partially offset by increased revenues from access services, which resulted from the significant increase in the number of ISDN lines, and value added services, which produced increased revenues due to the increase in traffic generated from users of on-line services. It is expected that competition in national and international traffic will increase over time and that tariffs will be reduced further.

Revenues from **mobile telecommunications services** increased 30.6 percent in 1998 compared to 1997, resulting from the continued strong growth in the number of customers of Swisscom's Natel D digital mobile telephony service. Revenue growth is a result of continued expansion of the mobile market, which reached a penetration rate of 23.4 percent at December 31, 1998. Partially offsetting the 60.1 percent increase in subscribers is a 19.2 percent decline in the average monthly revenue per customer in 1998 compared to 1997, reflecting the tariff decreases that were introduced in 1998 and the rapid growth in the number of subscribers to Swisscom's prepaid rechargeable card service and the increasing penetration amongst lower use residential customers.

In April 1998, licenses for the operation of two new digital mobile networks were awarded to competitors of Swisscom. On December 24, 1998, the first competitor commenced commercial operations and the second competitor has announced its intention to begin commercial operations in the first half of 1999. Prior to the commencement of operations by competitors, Swisscom was the only mobile telephony operator in Switzerland. Swisscom expects that mobile revenues will continue to grow, but to a lesser extent due to the introduction of competition. Swisscom's focus is to maintain its market leadership by optimizing its distribution channels and improving its customer service, while continuing to increase the capacity and quality of the network.

Review of the group's results

Data and multimedia services revenue increased 9.3 percent during 1998 in comparison with 1997. Revenue from corporate communications increased significantly, due to strong increases in Swisscom's LAN-interconnect and IP-plus businesses. Swisscom expects these businesses to continue to generate growth. Revenue from multimedia activities increased significantly due principally to continued increases in Blue Window revenues as well as an increase in revenue from the publication of directories. Swisscom expects that revenues attributable to Blue Window will continue to increase as a result of its strong brand name and the increasing demand for on-line services. However, Swisscom faces intensifying competition in this area and future tariff reforms are likely. Due to the joint venture with Publigroupe SA, which will be accounted for under the equity method, Swisscom will not continue to generate revenue from directories in the future. The growth in corporate communications and multimedia activities was partially offset by a decline in revenues from leased lines and data transmission activities. Although the number of leased lines increased, customers continued to migrate to higher-capacity leased lines which experienced reductions in average prices. Swisscom expects to continue to face strong competition in leased lines which is likely to lead to average price declines.

The 23.4 percent increase in revenues from **carrier services** in 1998 from 1997, reflects a strong increase in revenue from non-traditional transit traffic as well as revenues recorded from the provision of national interconnection services which were first introduced in 1998. Non-traditional transit is an especially volatile business and Swisscom does not expect such high growth on an ongoing basis. Excluding transit traffic revenues, revenues from international carriers' carrier services were negatively affected by decreases in average settlement rates received by Swisscom from foreign operators. Swisscom expects that further erosion in average settlement rates and competition from other operators will negatively affect revenues in 1999.

CHF in millions	Year ended December 31	
	1997	1998
Operating expenses		
Goods and services purchased	1 666	1 589
Personnel expenses	2 584	2 557
Other operating expenses	2 090	1 952
Depreciation and amortization	1 739	1 621
Restructuring charges	1 726	(50)
Total operating expenses	9 805	7 669

Operating expenses for 1998 included a one-time expense of CHF 221 million for stamp tax owed upon Swisscom's incorporation. Excluding the stamp tax and also excluding the restructuring charges in both 1998 and 1997, operating expenses in 1998 decreased by 7.2 percent compared to 1997.

Goods and Services Purchased

The 4.6 percent decrease in goods and services purchased in 1998 compared to 1997 is the result of a reduction in purchases of raw materials due to more effective procurement practices, a write-down of customer premises equipment in the amount of CHF 50 million in 1997 and the reduction in international traffic fees resulting from the decline in the average settlement rates paid by Swisscom to foreign operators. These decreases were partly offset by increased fees for international traffic to foreign operators for roaming services and an increase in services purchased by newly acquired subsidiaries.

Review of the group's results

Personnel Expenses and number of employees

	1997	1998
Average number of full-time equivalent employees	22 145	22 069
Number of full-time equivalent employees at end of period	22 170	21 946

The moderate decrease in the number of full-time equivalent employees in 1998 is a result of Swisscom's ongoing efforts to reduce headcount and staff costs, offset by the effect from the acquisition of subsidiaries in 1998.

Total personnel expenses decreased by 1.0 percent in 1998 compared to 1997. These costs decreased primarily because of higher charges in 1997 related to a former early retirement program, which was superseded by the special early retirement program recorded as part of the 1997 restructuring charges. Partially offsetting this decrease is an increase in salaries and wages in 1998 compared to 1997, primarily due to a one-time bonus, as agreed with the unions, paid to Swisscom's employees in 1998. As a result Swisscom was able to increase the flexibility with respect to remuneration of civil-servant employees.

Effective December 31, 1998 all plan members of the PKB, excluding all retired employees at that date, were transferred out of the PKB plan. Swisscom will retain liability for any future pension indexation of the retirees not covered by the Swiss Government's prescribed return on assets for the PKB. This settlement resulted in a loss of CHF 125 million and has been recorded in net periodic pension cost in 1998. Pension expense excluding settlement declined by approximately CHF 100 million as a result of the large contribution that was made in December 1997.

Other Operating Expenses

Excluding the effects of the CHF 221 million stamp tax incurred in 1998, other operating expenses declined by 17.2 percent in 1998 compared to 1997. This significant decrease reflects lower EDP costs, losses on disposal of fixed assets and repairs and maintenance expense in 1998 only partly offset by an increase in advertising and promotion costs and higher miscellaneous operating expenses.

EDP expense was unusually high in 1997 reflecting the costs incurred for the introduction of SAP R/3 on January 1, 1998 and for the development of a customer care and billing system that was abandoned in favor of improvements to existing systems. There were no such unusual projects in 1998. The level of EDP expense is expected to increase in 1999 due in part to the Millennium Project.

In 1997 significant losses on disposal of fixed assets were incurred reflecting losses resulting from a first time physical count of certain telecommunication equipment and from the rationalization of its information technology assets. No significant losses on disposal were recorded in 1998.

Repairs and maintenance expense decreased substantially in 1998 compared with 1997, reflecting decreased activity primarily in connection with buildings. In 1997 these expenses were unusually high as a result of an acceleration in the timing of certain projects in advance of the separation from the Swiss Post. Rebranding associated with the name change to Swisscom in 1997 also contributed to the high level of expense recorded.

Advertising and promotion expense increased significantly in 1998 reflecting the increase in activity in the newly liberalized market, the increase in incentives for mobile telephony dealers and the introduction of incentives for Natel C customers to migrate to Natel D. These expenses are expected to increase in 1999.

Review of the group's results

Depreciation and Amortization

Depreciation and amortization expense declined considerably in 1998 compared to 1997. This decline reflects Swisscom's reduced capital expenditures in 1998.

Restructuring Charges

CHF in millions	1997	1998
Personnel restructuring charge	1 326	(50)
Write-down of long-lived assets	316	–
Miscellaneous restructuring charges	84	–
Total	1 726	(50)

In connection with the preparation for the advent of competition, Swisscom conducted a company-wide review of its staffing requirements in 1997 and determined that its aggregate staff was in excess of the level necessary for operating in a competitive environment. Accordingly, in order to reduce its total number of employees, Swisscom offered a voluntary early retirement plan. 2,840 employees (2,450 full-time equivalents) formally accepted the offer and a charge of CHF 1,206 million was recorded in 1997. The early retirement plan is expected to reduce Swisscom's personnel expenses from 1999 onwards.

As a further element of staff reduction, Swisscom adopted a plan to outsource substantially all cleaning and property maintenance staff, consisting of approximately 1,620 employees (660 full-time equivalents), and recognized a charge of CHF 120 million in 1997. During 1998, the estimated total costs were revised downwards by CHF 50 million reflecting changes in the composition of benefit payments. Swisscom expects the outsourcing to result in ongoing cost savings.

In order for Swisscom to be able to reach its goal of reducing the number of employees, further measures are planned to be initiated in 1999. The extent of these measures is currently being negotiated with the unions. Swisscom intends to record a significant restructuring charge in 1999 reflecting the outcome of these negotiations.

Included within write-down of long-lived assets in 1997 is CHF 140 million relating to the impairment of the Natel C mobile network, which will be discontinued by year-end 2000 at the latest. In addition, Swisscom recorded additional write-downs of CHF 176 million for assets impaired or related to the cessation of activities.

Swisscom recognized additional restructuring charges in the amount of CHF 84 million in 1997 relating to discontinuing selected activities and streamlining certain facilities and operations.

Financial expense and financial income

Financial expense in 1998 declined to CHF 407 million from CHF 428 million in 1997, reflecting lower levels of debt outstanding. The average interest rate on interest-bearing debt remained constant in 1998 compared to 1997. Included in financial expense in 1998 and 1997 are penalties on early extinguishment of debt of CHF 81 million and CHF 30 million, respectively.

Financial income was CHF 93 million in 1998 compared to CHF 25 million in 1997. The higher level in 1998 reflects the gain on sale of shares of a publicly listed company, as well as the significantly higher term deposits held by Swisscom in 1998 in relation to 1997.

Review of the group's results

Income taxes

The effective tax rate in 1998 was 12.3 percent. This rate reflects the deferred credit recorded upon incorporation and a benefit to write off investments in affiliated companies. These benefits will not recur in the future.

Equity in net loss of affiliated companies

Equity in net loss of affiliated companies was CHF 212 million in 1998, compared to CHF 214 million in 1997. These losses primarily reflect Swisscom's share of net losses and the amortization of goodwill during the periods by the Unisource joint venture.

Liquidity and capital resources

Swisscom's primary source of liquidity is cash generated from operations. The substantial increase in net cash provided by operating activities in 1998 compared with 1997 was principally due to a special pension fund contribution of CHF 2,100 million made by Swisscom at the end of 1997, which was partially offset by a further special pension fund contribution in 1998 of CHF 151 million and CHF 438 million reflecting the payments to the PKB associated with the early retirement program. Excluding these items, net cash provided by operating activities increased by CHF 728 million, or 21.2 percent, in 1998 compared with 1997. The major factors contributing to the increase were higher cash receipts due to increased sales activity in 1998 compared to 1997, as well as lower operating expenses paid in 1998 compared to 1997.

The principal financing transaction in 1998 included the Global Offering, which generated CHF 2,462 million, net of issuance costs. In 1997 Swisscom's main financing transaction consisted of the CHF 3,500 million loan advanced by the Swiss Government in December 1997, of which CHF 3,200 million was converted to equity, in connection with the initial capitalization of Swisscom as a stock corporation.

Swisscom's cash and cash equivalents increased significantly during 1998 primarily due to (1) the increase in cash generated from operations described above and (2) the marked reduction of capital expenditures. The level of cash and cash equivalents at December 31, 1998, is not indicative of the balance Swisscom intends to carry on a continuing basis.

Swisscom has access to uncommitted lines of credit which would provide additional sources of liquidity should the need arise.

Capital expenditures

Capital expenditures decreased by 45 percent in 1998 compared with 1997. Expenditures in the fixed-line network in 1998 were unusually low due to utilising excess capacity available combined with the high level of expenditure relating to the digitalization of the network in prior years. The level of capital expenditures in the fixed-line network in 1999 is expected to increase significantly due to the fact that the majority of excess capacity was utilised in 1998 and certain projects were postponed from 1998 into 1999.

The decrease in capital expenditures in the fixed-line network was partly offset by an increase in respect of Swisscom's mobile networks reflecting the expansion and capacity increases in the Natel D digital mobile telephony network resulting from the strong growth experienced in this business. Swisscom intends to continue to invest in mobile infrastructure as necessary in order to maintain quality of service to meet growing market demand.

Review of the group's results

Year 2000 issue

As with other companies that make extensive use of computers, Swisscom is faced with the problem arising from the potential failure by computer systems to recognize properly the change of date from 1999 to 2000. The year 2000 problem affects various aspects of Swisscom's operations, including principally: (1) the elements comprising Swisscom's networks; (2) services and products; (3) support and information systems, such as billing and accounting systems; and (4) infrastructure utilized by Swisscom, such as the supply of electricity to Swisscom's networks.

Swisscom has initiated a comprehensive Millenium Project designed to minimize the impact of the year 2000 date change. Swisscom has established a detailed company-wide plan and continually monitors progress. Swisscom has largely completed the survey of its systems and services and is in the process of remediating and testing non-compliant systems. Swisscom plans to complete remediation and testing of all systems in higher priority categories by June 1999.

The ability to successfully implement the Millenium Project depends to some extent on the availability of qualified personnel and the continued cooperation of its equipment suppliers and other parties. Notwithstanding the successful implementation of the Millenium Project, Swisscom's operations could be affected by the ability of third parties, such as suppliers, utility providers and other network operators dealing with Swisscom, to remediate their own year 2000 problems, over which Swisscom has no control. There can be no assurance that the project will be completely successful or that the date change will not materially adversely affect Swisscom's operations and financial result.

Consolidated financial statements

Report of Group Auditors

To the Shareholders' Meeting
of Swisscom AG
Ittigen (Berne)

As auditors of the group, we have audited the accompanying consolidated financial statements of Swisscom AG and subsidiaries (statement of operations, balance sheet, cash flow statement, statement of shareholders' equity and notes on pages 13 to 39) for the year ended December 31, 1998.

These consolidated financial statements are the responsibility of the Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with auditing standards promulgated by the profession and with the International Standards on Auditing issued by the International Federation of Accountants (IFAC). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the consolidated financial statements. We have also assessed the accounting principles used, significant estimates made and the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position, results of operations and cash flows in accordance with International Accounting Standards (IAS) and comply with the law and the accounting provisions as contained in the Listing Rules of the Swiss Exchange.

We recommend that the consolidated financial statements submitted to you be approved.

PricewaterhouseCoopers AG

Peter Wittwer

Julie Fitzgerald

Berne, March 19, 1999

Consolidated statement of operations

CHF in millions, except per share amounts	Note	Year ended December 31	
		1997	1998
Net revenues	3	9 842	10 461
Capitalized cost	4	277	109
Total		10 119	10 570
Goods and services purchased	5	1 666	1 589
Personnel expenses	6, 7, 8	2 584	2 557
Other operating expenses	9	2 090	1 952
Depreciation and amortization		1 739	1 621
Restructuring charges	10	1 726	(50)
Total operating expenses		9 805	7 669
Operating income		314	2 901
Financial expense	11	(428)	(407)
Financial income		25	93
(Loss) income before income taxes, equity in net loss of affiliated companies and minority interest		(89)	2 587
Income tax expense	12	(1)	(319)
(Loss) income before equity in net loss of affiliated companies and minority interest		(90)	2 268
Equity in net loss of affiliated companies	13	(214)	(212)
Minority interest in loss of consolidated subsidiaries		–	18
Net (loss) income from continuing operations		(304)	2 074
Discontinued operations	33	(111)	(519)
Net (loss) income		(415)	1 555
Basic and diluted (loss) earnings per share	14		
– on continuing operations		(4.61)	30.55
– on discontinued operations		(1.68)	(7.64)
– net (loss) income		(6.29)	22.91

The accompanying notes form an integral part of these financial statements.

Consolidated balance sheet

CHF in millions	Note	Year ended December 31	
		1997	1998
Assets			
Current assets			
Cash and cash equivalents	15	256	1 759
Securities available for sale	16	51	28
Trade accounts receivable	17	2 052	2 358
Inventories	18	169	208
Other current assets		34	221
Total current assets		2 562	4 574
Non-current assets			
Property, plant and equipment	19	11 453	11 101
Investments	20	1 238	831
Other non-current assets	21	220	438
Total non-current assets		12 911	12 370
Total assets		15 473	16 944
Liabilities and shareholders' equity			
Current liabilities			
Short-term debt	22	1 178	1 225
Trade accounts payable		889	925
Accrued pension cost	8, 10	789	452
Other current liabilities	23	2 213	1 812
Total current liabilities		5 069	4 414
Long-term liabilities			
Long-term debt	22	6 200	4 245
Finance lease obligation	26	439	517
Accrued pension cost	8, 10	1 488	1 399
Accrued liabilities	24	709	706
Other long-term liabilities	25	338	273
Total long-term liabilities		9 174	7 140
Total liabilities		14 243	11 554
Minority interest in subsidiaries		-	43
Shareholders' equity			
Share capital	27	-	1 839
Additional paid-in capital	27	-	2 273
Retained earnings		1 352	1 232
Unrealized market value adjustment on securities available for sale	16	39	1
Cumulative translation adjustment		(161)	2
Total shareholders' equity		1 230	5 347
Total liabilities and shareholders' equity		15 473	16 944

The accompanying notes form an integral part of these financial statements.

Consolidated cash flow statement

CHF in millions	Note	Year ended December 31	
		1997	1998
(Loss) Income before income taxes, equity in net loss of affiliated companies and minority interest		(89)	2 587
Adjustments for:			
Depreciation and amortization		1 739	1 621
Loss on disposal of fixed assets, net		227	41
Restructuring charges		1 726	(50)
Financial expense		428	407
Financial income		(25)	(93)
		4 006	4 513
Changes in operating assets and liabilities, net of effects of acquisitions and disposals of subsidiaries:			
Increase in trade accounts receivable		(136)	(303)
Decrease (increase) in inventories		113	(39)
Decrease (increase) in other assets		24	(97)
(Decrease) increase in trade accounts payable		(190)	6
Increase in other current and accrued liabilities		113	323
Decrease in other long-term liabilities		(146)	(65)
Increase in accrued pension cost excluding special contribution to pension fund		85	163
Special contribution to pension fund		(2 100)	(589)
Cash generated from operations		1 769	3 912
Interest paid		(458)	(369)
Income taxes paid		(1)	(26)
Interest received		14	45
Dividends received		11	12
Net cash provided by operating activities		1 335	3 574
Cash flows from investing activities:			
Capital expenditures		(2 374)	(1 305)
Proceeds from sale of fixed assets		226	181
Acquisition of subsidiaries, net of cash acquired		(12)	(79)
Investments in affiliated companies		(207)	(91)
Proceeds from sale of securities available for sale, net		–	25
Purchases of other investments		(14)	(14)
Loans receivable granted, net		(96)	(56)
Net cash used in investing activities		(2 477)	(1 339)
Cash flows from financing activities:			
Issuance (repayment) of short-term debt, net		142	(454)
Issuance of long-term debt		625	–
Repayment of long-term debt		(2 500)	(1 534)
Shareholder loans issued for conversion to equity		3 200	–
Issuance of shares		–	2 433
Purchased call options		–	(33)
Profit distribution paid		(754)	(1 144)
Net cash provided by (used in) financing activities		713	(732)
Net (decrease) increase in cash and cash equivalents		(429)	1 503
Cash and cash equivalents at beginning of year		685	256
Cash and cash equivalents at end of year		256	1 759

The accompanying notes form an integral part of these financial statements.

Consolidated cash flow statement (continued)

Significant non-cash transactions

At December 31, 1997, the Confederation advanced a loan of CHF 3,500 million of which CHF 3,200 million was converted to equity (see also consolidated statement of shareholders' equity).

Swisscom sold certain technical equipment in separate transactions for CHF 213 million and CHF 118 million in 1997 and 1998, respectively, which are included in proceeds from sale of fixed assets. Swisscom concurrently entered into agreements to lease the equipment back under finance leases.

The accompanying notes form an integral part of these financial statements.

Consolidated statement of shareholders' equity

CHF in millions	Share capital	Additional paid-in capital	Retained earnings (accumulated deficit)	Unrealized market value adjustment on securities	Cumulative translation adjustment	Total shareholders' equity
Balance at December 31, 1996	–	–	(151)	15	52	(84)
Net loss			(415)			(415)
Profit distribution declared			(1 282)			(1 282)
Conversion of loan payable to equity			3 200			3 200
Unrealized market value adjustment on securities available for sale				24		24
Translation adjustments					(213)	(213)
Balance at December 31, 1997	–	–	1 352	39	(161)	1 230
Net income			1 555			1 555
Conversion into share capital	1 650		(1 650)			–
Share capital issued, net of issuance costs	189	2 273				2 462
Purchased call options			(25)			(25)
Unrealized market value adjustment on securities available for sale				(38)		(38)
Translation adjustments					163	163
Balance at December 31, 1998	1 839	2 273	1 232	1	2	5 347

The accompanying notes form an integral part of these financial statements.

Notes to the consolidated financial statements

1 Description of business and relationship with the Swiss Confederation

1.1 Description of business

Swisscom AG and its subsidiaries (referred to as Swisscom) is the principal provider of telecommunications services in Switzerland, offering a comprehensive range of services to residential and business customers. Swisscom's major lines of business include providing national and international fixed-line voice telecommunications, mobile telephony and other mobile telecommunications services, leased lines and managed bandwidth services, integrated corporate communications solutions and wholesale network services to other telecommunications carriers. Swisscom AG is a stock corporation incorporated in Switzerland, domiciled in Ittigen (Berne), and is 65.5 percent owned by the Swiss Confederation (Confederation).

Historically, Swisscom's operations were part of the Swiss PTT, a dependent agency of the Swiss Confederation which operated the state monopolies for both public telecommunications (Swiss Telecom PTT) and postal services (the Swiss Post). Under the provisions of the Telecommunications Enterprise Act of 1997 "Telekommunikationsunternehmungsgesetz", the TUG), Swiss Telecom PTT, the predecessor of Swisscom, and the Swiss Post were separated into independent organizations and Swiss Telecom PTT was transformed into a special statutory stock corporation under the name Swisscom AG. As required by the TUG, on May 13, 1998, the Federal Council approved Swisscom's Articles and its January 1, 1998, opening balance sheet under Swiss Law.

In October 1998, Swisscom and the Confederation completed a global public offering of 34.5 percent of Swisscom's share capital. Prior to this offering, Swisscom was wholly owned by the Confederation. The details of the offering are described in Note 27.

1.2 Relationship with the Confederation

The Confederation is the majority shareholder of Swisscom. The TUG states that the Confederation must hold a majority of the capital and voting rights of Swisscom. Any reduction of the Confederation's holding below a majority would require a change in law necessitating action by the Federal Assembly, which in some circumstances may also require a referendum by Swiss voters. As the majority shareholder, the Confederation has the power to control any decision at shareholders' meetings requiring a majority vote, including the election of the members of the Board of Directors and the approval of dividend payments.

Income taxes

Prior to its transformation to a stock corporation on January 1, 1998, Swisscom AG was not subject to income taxes. Upon incorporation, Swisscom AG became subject to income taxes.

Transactions with the Confederation

Swisscom supplies telecommunication services to and acquires materials and services from various departments and agencies of the Confederation. All such transactions are made within normal customer/supplier relationships on terms and conditions no more favorable than those available to other customers and suppliers. In the aggregate the departments and agencies of the Confederation comprise Swisscom's largest customer.

In providing services to the departments and agencies of the Confederation, Swisscom deals with them as separate customers. Services provided to any one governmental department or agency or in total do not represent a significant component of Swisscom's revenues.

Profit distributions to the Confederation

Distribution of 1997 profits represents payments made directly to the Confederation in 1998 as well as required distributions to offset the losses of the other entities of the Swiss PTT.

2 Summary of significant accounting policies

2.1 Basis of presentation

The consolidated financial statements of Swisscom have been prepared under the historical cost convention and in accordance with International Accounting Standards (IAS) as issued by the International Accounting Standards Committee (IASC) as explained below and in conformity with the legal provisions of the Swiss Code of Obligations.

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of current events and actions Swisscom may undertake in the future, actual results ultimately may differ from those estimates.

2.2 Principles of consolidation

The consolidated financial statements of Swisscom include the operations of Swisscom AG and all its direct and indirect subsidiaries which Swisscom AG controls by more than 50 percent of votes.

Investments and joint ventures where Swisscom exercises significant influence but does not have control are accounted for using the equity method. Under the equity method, investments are disclosed as investments in affiliated companies and presented at their fair value as of the date of acquisition adjusted for Swisscom's share in retained earnings (losses) resulting after the date of acquisition.

Investments in which Swisscom's interest is less than 20 percent are recorded at cost less appropriate allowances in the case of a permanent impairment in value.

A schedule with all significant subsidiaries and investments in affiliated companies is presented in Note 32.

Subsidiaries and investments acquired or disposed of during the year are included in the consolidated financial statements after the date of acquisition and excluded after the date of sale respectively.

All intercompany balances, transactions and intercompany profits are eliminated on consolidation.

Significant balances and transactions with investments and joint ventures accounted for using the equity method are separately disclosed as items with affiliated companies.

2.3 Intangible assets

Differences between the purchase price of acquisitions and the fair value of net assets acquired are classified as goodwill from acquisitions. Goodwill and other intangible assets are amortized on a straight-line basis over their estimated useful life, principally 5 years and not exceeding 20 years.

2.4 Foreign currency translation

Transactions denominated in foreign currencies are recorded at the rate of exchange prevailing at the dates of transaction, or at a rate that approximates that rate. At the end of the accounting period the unsettled balances in foreign currency receivables and liabilities are valued at the rate of exchange prevailing at balance sheet date, with resulting exchange rate differences charged to income. If such balances are hedged, the hedged exchange rate is used for conversion.

Notes to the consolidated financial statements (continued)

Assets and liabilities of subsidiaries and affiliated companies accounted for using the equity method reporting in currencies other than Swiss francs are translated at the rates of exchange prevailing at balance sheet date. Goodwill arising on the acquisition of foreign entities is treated as an asset of the foreign entity and translated at the closing rate. Income, expenses and cash flows are translated at the average exchange rates for the period. Translation gains and losses are recorded as cumulative translation adjustments in shareholders' equity.

2.5 Cash and cash equivalents

Cash includes petty cash, cash at banks and cash on deposit. Cash equivalents include term deposits with financial institutions, as well as short-term money market investments with original maturity dates of three months or less.

2.6 Securities available for sale

Securities available for sale are carried at market and are comprised of marketable equity securities and bonds. Unrealized gains are reported separately as an unrealized market value adjustment on securities within consolidated shareholders' equity. Unrealized losses to the extent that they are reversals of previous gains are also recorded within the unrealized market value adjustment on securities. All other losses are recognized as an expense as incurred. Realized gains and losses, including previous market value adjustments, are recorded as income or expense as applicable.

2.7 Trade accounts receivable

Trade accounts receivable are recorded at nominal value less an allowance for receivables whose collection is considered uncertain.

2.8 Inventories

Inventories consist primarily of customer premises equipment for resale and supplies used in constructing and maintaining the network. Inventories are valued at the lower of cost and net realizable value using the weighted average method. Allowances are made for obsolete and slow-moving items.

2.9 Property, plant and equipment

Land, buildings, machinery and equipment are recorded at cost less accumulated depreciation. Leasehold improvements are depreciated over the shorter of their estimated useful life and the remaining term of the lease. Repairs and maintenance are expensed as incurred while major renovations and improvements are capitalized as property, plant and equipment and depreciated over their estimated useful lives. Borrowing costs incurred during the construction of property, plant and equipment are expensed as incurred.

Depreciation is computed using the straight-line method based on estimated useful lives:

	Years
Buildings	15–40
Cable and ducts	14–20
Transmission equipment	5–12
Switching equipment	8–10
Customer premises equipment	5–20
Broadcasting equipment	10
Vehicles	5–7
Machinery, office and auxiliary equipment	4–15
EDP equipment	3–5

2.10 Leases

Assets acquired under leasing agreements which effectively transfer substantially all the risks and benefits incidental to ownership from the lessor to the lessee are classified as finance leases. Finance leases are recorded at amounts equivalent to the estimated net present value of the future minimum lease payments which approximate the fair value at the inception of the lease. The estimated net present value of the future minimum lease payments are recorded correspondingly as a finance lease obligation. Assets under finance leases are amortized over their estimated useful lives. Unearned gains on sale and leaseback transactions resulting in finance leases are deferred and amortized over the term of the lease.

Operating lease payments are treated as rentals and charged to income as incurred.

2.11 Impairment of long-lived assets

Property, plant and equipment and other non-current assets, including goodwill and other intangible assets are reviewed for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Assets whose carrying values exceed their recoverable amount are written down to an amount determined using discounted net future cash flows expected to be generated by the asset.

2.12 Dismantlement and restoration costs

Swisscom has a legal obligation to dismantle analog transmitter stations and to restore the property owned by third parties on which the stations are situated. Such costs have been estimated and are accrued over the estimated useful life of these transmitter stations.

2.13 Revenue recognition

Net revenues include all sales of goods and services, net of any value-added taxes, rebates and discounts. Revenues are recognized when goods are delivered or services are rendered. Revenues earned from foreign carriers for international incoming calls are included in revenues in the period in which the calls occur.

2.14 Revenue received in advance

Revenue received in advance consists of rentals of private branch exchange systems received from customers in advance and prepaid telephone cards. Such revenues received in advance are deferred and recognized when services are provided.

2.15 Capitalized cost

Swisscom's consolidated statement of operations is prepared on the total-cost basis commonly used in Switzerland. Costs to be capitalized and expensed in future periods, such as costs capitalized on construction projects, are classified in the statement of operations as revenues with a corresponding amount included in expenses such that the net effect is zero.

2.16 Stock-Based Compensation

Compensation cost for shares issued to employees is measured at the date of transaction as the excess of the quoted market price of Swisscom's stock over the employee purchase price. These costs are charged directly to equity in the period of issuance. Swisscom does not currently recognize any expense associated with stock appreciation rights. See Note 7.

2.17 Retirement benefits

Swisscom contributes to the Pensionskasse des Bundes (PKB), a statutory defined benefit plan of the Confederation, which provides retirement benefits for civil servants and other public servants. The pension cost in each period is calculated on the basis of a yearly actuarial valuation. In accordance with IAS 19 "Retirement Benefit Costs" pension costs are accounted for using the projected unit credit method.

Notes to the consolidated financial statements (continued)

Swiss pension law provisions require that the employer at a minimum matches the contributions made by its employees.

2.18 Restructuring charges

Costs relating to restructuring plans for continuing operations, including the reduction of excess staffing, the cessation of certain activities or the streamlining of facilities and operations and other restructuring measures, are recorded in the period management commits itself to a plan and it is probable that a liability has been incurred and the amount can be reasonably estimated.

2.19 Income taxes

Prior to its incorporation on January 1, 1998, Swisscom was not subject to income taxes. Income tax expense is therefore not applicable for years ended through December 31, 1997. Upon incorporation, Swisscom became subject to income tax from January 1, 1998, and adopted IAS 12 (revised) "Income taxes."

2.20 Research and development

Research and development costs are expensed as incurred.

2.21 Derivative financial instruments

Derivative transactions have been undertaken for purposes of hedging U. S. dollar lease obligations. The derivative instruments have been designated and are effective as hedges of U. S. dollar foreign currency transaction exposure. Swisscom has entered into currency swaps and foreign exchange contracts that match the payment of the lease obligation. As there is a match between the lease obligation and the derivative financial instruments, the foreign currency effects on these financial instruments are offset. Thus, there is no currency fluctuation effect on the statement of operations or the lease obligation.

Swisscom also enters into limited hedging for settlement of international telephone traffic through foreign exchange swaps. Outstanding contracts are marked-to-market at the end of each reporting period, with any gain or loss recorded in the statement of operations.

2.22 Related parties

Under IAS, transactions with the Confederation, including its departments and agencies, are excluded from the scope of related party disclosures.

2.23 Earnings per share

Basic earnings per share is computed by dividing net income (loss) by the weighted-average number of shares outstanding for the year. Diluted earnings per share is similar to basic earnings per share, except that the weighted-average number of shares outstanding is increased to include the number of additional shares that would have been outstanding if dilutive potential shares had been issued.

Until the transformation of its status on January 1, 1998, Swisscom as a public sector operator had no share capital. For comparative purposes, earnings per share for 1997 have been retroactively calculated based on 66 million registered shares, the number of shares issued to the Confederation upon the transformation of Swisscom into a stock corporation, reflecting the 2 to 1 stock split on August 26, 1998 (see Note 27).

2.24 Reclassifications

Certain prior year amounts have been reclassified to conform with current year presentation.

	CHF in millions	1997	1998
3 Net revenues			
	Fixed-line voice telephony	6 668	6 589
	Mobile telecommunications services	1 371	1 791
	Data and multimedia services	824	901
	Carrier services	697	860
	Other revenues	282	320
	Total net revenues	9 842	10 461

4 Capitalized cost

Capitalized cost includes direct material and labor costs related to the construction of buildings and technical equipment with no interest allocation included.

	CHF in millions	1997	1998
5 Goods and services purchased			
	Raw material and supplies purchased	300	165
	Customer premises equipment purchased for resale	392	329
	International traffic fees	673	713
	Services purchased	108	162
	Services purchased from affiliated companies	193	220
	Total goods and services purchased	1 666	1 589

International traffic fees represent settlement payments to foreign operators for carrying outgoing international traffic and providing roaming services to Swisscom mobile customers using their handsets in foreign countries.

Services purchased from affiliated companies represent the cost of data services purchased from Unisource, an affiliated company.

	CHF in millions	1997	1998
6 Personnel expenses			
	Salaries and wages	1 877	2 017
	Social security expenses	155	148
	Pension cost	271	288
	Other personnel expenses	281	104
	Total personnel expenses	2 584	2 557

7 Stock based compensation

Stock issuance

In connection with Swisscom's public offering in October 1998, 134,907 shares were issued to employees at a discount of 20 percent from the initial public offering price. The discount awarded to employees totaled CHF 9 million and has been recorded as a reduction of the proceeds from the public offering.

Stock appreciation rights

In conjunction with Swisscom's public offering in October 1998, the Company issued shares to management and employees pursuant to three leveraged share ownership plans. The Leveraged Executive Asset Plans ("LEAPs") provided enhanced stock appreciation rights to middle and upper management, Executive Board and Board of Director members. Under these LEAPs, eligible participants purchased shares in the global offering at the initial public offering price. Such shares contain appreciation rights whereby if the market price of a share at the end of five years is equal to or greater than the base appreciation price, the participant will receive additional shares with a market value equal to a multiple of the increase over the initial public offering price. Each LEAP has different vesting periods, with all appreciation rights

Notes to the consolidated financial statements (continued)

being vested 5 years from the issuance date. Included in this program is 23,276 shares issued to employees under a SuperShare Plan that have the additional benefit that if the market price of a share at the end of five years is equal to or less than the initial public offering price, the shares will be automatically resold to Swisscom at a price equal to the initial public offering price.

Appreciation rights granted during 1998 and outstanding at December 31, 1998, under the above plans total 265,559, and have a weighted average base appreciation price of CHF 344. Vested appreciation rights at December 31, 1998, total 93,104. All rights are automatically exercised in 2003.

8 Retirement benefits

Currently, substantially all of Swisscom's employees are eligible for retirement benefits under the statutory defined benefit plan provided through the "Pensionskasse des Bundes" ("PKB"). In connection with the separation of Swisscom from the Swiss Post, Swisscom assumed responsibility for its employees' retirement benefits under Swiss law. Historically, the Confederation's practice was to fund this benefit plan in an amount of approximately two-thirds of the total pension liability. At December 31, 1997, Swisscom's assumed pension obligations under Swiss law were underfunded in the amount of CHF 2.25 billion (the "Pension Gap"). Using a large portion of the proceeds of the loan from the Confederation that was converted into equity, Swisscom contributed CHF 2.1 billion to the pension fund as of December 31, 1997, and contributed the remaining CHF 151 million to the pension fund in 1998.

The Pension Gap amount was calculated based on data provided by the PKB (the "Base Data"). The Confederation has provided a guarantee to Swisscom pursuant to which it has agreed to assume liability for any amount by which the Pension Gap exceeded CHF 2.25 billion at December 31, 1997 due to errors in the Base Data. If the Pension Gap was less than CHF 2.25 billion at that date due to such errors, this guarantee would require the PKB to reimburse Swisscom for the overpayment. In addition to providing Swisscom with protection against an over-estimation or under-estimation of its Pension Gap liability under Swiss law, the Confederation has provided Swisscom with a guarantee pursuant to which it will protect Swisscom against loss arising from an under-estimation of its accrued pension cost under IAS at December 31, 1997. The guarantee does not specify the procedure how the Confederation would fund any such increase in liability. The guarantees provided by the Confederation, with respect to both the Pension Gap under Swiss law and the pension liability under IAS, will expire subsequent to final evaluation of the Base Data by the PKB and mutual agreement as to its accuracy by Swisscom and the PKB.

The PKB plan covers the risks of old age, death and disability in accordance with Swiss pension legislation. Retirement benefits are provided based on a defined final pay formula. The cost and obligations resulting from the sponsoring of this defined benefit plan are determined on an actuarial basis using the projected unit credit method which reflects service rendered by employees to the date of valuation and incorporates assumptions concerning employees' projected salaries. The latest actuarial valuation was performed using base data as at October 31, 1998. Current service costs are charged to income in the periods in which the services are rendered. The effects of plan amendments and changes in actuarial assumptions are systematically charged or credited to income over a period approximating the average expected remaining working lives of participating employees.

The assets of the plan are invested in deposits held with the Confederation and mortgages provided to plan participants. It is Swisscom's policy to contribute to the plan at rates specified by the funding rules of the plan.

Effective December 31, 1998, Swisscom settled the majority of its outstanding pension liability for retired employees with the PKB. The PKB assumed the plan assets and benefit obligation, as calculated under Swiss law, of all retired employees as of December 31, 1998. Swisscom does not retain any real or contingent liability related to the accumulated benefit obligation, except, Swisscom will retain liability for any future pension indexation (currently estimated at 1 percent) not covered by a return on plan assets in excess of the government prescribed discount rate plus an account maintenance fee. As a result of this settlement, the plan assets and related projected benefit obligation, excluding the amount related to pension indexation, of retired employees have been removed from Swisscom's pension plan on December 31, 1998. This settlement resulted in a loss of CHF 125 million, calculated as the unrecognized net actuarial loss at the date of settlement times the percentage of the total projected benefit obligation settled, and has been recorded in net periodic pension cost during 1998.

During 1998 Swisscom decided to transfer its pension plan for active employees from the PKB to a successor plan effective January 1, 1999. In connection with this transfer, Swisscom approved certain plan amendments for active employees which will increase employee benefits upon transfer to the new plan. These amendments resulted in an increase in the projected benefit obligation of the plan of CHF 297 million and will be amortized from the effective date over the average expected remaining service lives of active employees.

Net periodic pension cost includes the following components:

CHF in millions	1997	1998
Service cost on benefits earned	107	108
Interest cost on projected benefit obligation	353	371
Expected return on plan assets	(189)	(316)
Net periodic pension cost before curtailment and special termination benefits and settlement	271	163
Curtailment and special termination benefits	1 206	–
Settlement loss	–	125
Net periodic pension cost	1 477	288

The curtailment and special termination benefits have been recorded under restructuring charges and represent accelerated pension benefits to employees who accepted voluntary early retirement offers from Swisscom in the fourth quarter of 1997. See Note 10.

Notes to the consolidated financial statements (continued)

The status of the pension plan is as follows:

CHF in millions	1997	1998
Benefit obligation:		
At beginning of year	6 875	8 377
Service cost on benefits earned	107	108
Interest cost on projected benefit obligation	353	371
Contributions of plan participants	106	108
Net transfers	–	116
Benefits paid	(270)	(289)
Actuarial gain	–	(190)
Plan amendments	–	297
Curtailed and special termination benefits	1 206	–
Settlement	–	(3 870)
Benefit obligation at end of year	8 377	5 028
Plan assets at fair value:		
At beginning of year	3 789	6 100
Actual return on plan assets	189	230
Employer contributions	186	125
Net transfers	–	116
Contributions of plan participants	106	108
Benefits paid	(270)	(289)
Non-recurring contributions made	2 100	589
Settlement	–	(4 266)
Plan assets at fair value at end of year	6 100	2 713
Benefit obligation in excess of plan assets	2 277	2 315
Unrecognized actuarial loss	–	(167)
Unrecognized prior service cost	–	(297)
Accrued pension cost	2 277	1 851
Less current portion	(789)	(452)
Long-term accrued pension cost	1 488	1 399

The following weighted average assumptions were used in accounting for the defined benefit plan:

	1997	1998
Discount rate	5.0%	5.0%
Rate of increase in future compensation levels	3.2%	3.2%
Expected long-term rate of return on plan assets	5.0%	5.0%

9 Other operating expenses

CHF in millions	1997	1998
Rent	137	132
Repairs and maintenance	577	286
Loss on disposal of fixed assets, net	227	41
Energy	81	82
Insurance	29	15
EDP	460	323
Advertising and promotion	88	226
General and administration	176	219
Stamp tax on incorporation	–	221
Miscellaneous operating expenses	315	407
Total other operating expenses	2 090	1 952

Stamp tax on incorporation

During 1998, Swisscom incurred a stamp tax of CHF 221 million that was owed upon its incorporation on January 1, 1998. Swiss law requires a company to pay a stamp tax calculated as 1 percent of the fair market value of the net assets that are contributed to the legal entity at the date of incorporation. As there is no difference in equity in Swisscom and its predecessor Swiss Telecom PTT, Swisscom considers this charge a cost of incorporation and not a cost of raising capital. Accordingly, the charge has been recognized as an expense in the consolidated statement of operations in 1998.

10 Restructuring charges

CHF in millions	Voluntary retirement plan	Outsourcing charge	Miscellaneous	Total
Balance at December 31, 1997	1 206	120	84	1 410
Cash payments	(438)	–	(49)	(487)
Other utilization of provision	–	–	(14)	(14)
Revision of prior period estimates	–	(50)	–	(50)
Balance at December 31, 1998	768	70	21	859

Restructuring charges in 1997 totaled CHF 1,726 million and is comprised of personnel restructuring charges of CHF 1,326 million, write-downs of long-lived assets of CHF 316 million and miscellaneous restructuring charges of CHF 84 million.

Personnel restructuring charges

A voluntary early retirement plan was offered to all employees aged 55 and over during the fourth quarter of 1997. 2,840 employees formally accepted the offer prior to December 31, 1997, and the liability of CHF 1,206 million was recognized as a personnel restructuring charge in 1997 (see also Note 8). This amount represents accelerated pension benefits to those accepting the offer. No severance or other costs are to be paid to these employees. All employees that accepted the offer will retire by December 31, 2000, at the latest. Payments by Swisscom to the PKB for these benefits will occur over this same period.

A plan to outsource substantially all cleaning and property maintenance staff, consisting of 1,620 part-time and full-time employees was approved in 1997, resulting in an additional restructuring charge of CHF 120 million. This estimate represented the amounts Swisscom would pay to a third party to hire these employees as part of an outsourcing contract, and is in addition to market rate costs for services to be provided in the future. During 1998 Swisscom revised its estimate of the total costs of the outsourcing program downwards by CHF 50 million. The revised estimate is less than that recorded as part of the 1997 restructuring due to employees leaving Swisscom prior to eligibility for the program as well as additional employees who

Notes to the consolidated financial statements (continued)

voluntarily opted to forgo outsourcing employment in order to receive severance payments. Severance payments to be paid to these employees are less than the total costs anticipated under the terms of the outsourcing program.

Write-down of long-lived assets

Due to the reallocation of radiocommunication frequencies to competitors under the Telecommunications Act, Swisscom decided to discontinue operation of the Natel C analog mobile telephony network by year end 2000 at the latest. This resulted in a write-down of fixed assets during 1997 in the amount of CHF 140 million reducing their net book value to a recoverable amount of approximately CHF 75 million.

Based on the review of the carrying values of long-lived assets for impairment, additional write-downs of CHF 176 million were recorded in 1997 for assets impaired or related to activities to be discontinued.

Miscellaneous restructuring charges

Miscellaneous restructuring charges in the total amount of CHF 84 million reflect various measures taken in 1997 related to discontinuing selected activities and to streamlining certain facilities and operations, the majority of which relates to penalty payments on the early termination of certain contracts.

	CHF in millions	1997	1998
11 Financial expense	Interest on debt	379	315
	Loss on early extinguishment of debt	30	81
	Miscellaneous	19	11
	Total financial expense	428	407

	CHF in millions	1997	1998
12 Income tax expense	Current income tax expense	1	409
	Deferred income tax benefit	–	(90)
	Total income tax expense	1	319

As Swisscom was not subject to income taxes prior to its incorporation effective January 1, 1998, the reported income tax expense of CHF 1 million in 1997, relates solely to income tax expense incurred by subsidiaries.

Current income tax expense of CHF 409 million excludes a benefit of CHF 37 million which was recorded directly to equity (see note 27) and CHF 121 million related to discontinued operations (see note 33). As a result, net current tax expense was CHF 251 million.

Deferred income taxes are determined using the comprehensive liability method whereby deferred income tax is recognized on all temporary differences. Temporary differences between the carrying value of an asset or liability used for tax purposes and that used for financial reporting purposes arise in one period and reverse in one or more subsequent periods. Deferred tax assets and liabilities are determined using the tax rates that are expected to apply when the asset is realized or the liability is settled. The deferred tax assets or liabilities are disclosed as long-term assets or liabilities with those changes being recorded in the statement of operations. Deferred tax assets are recognized if it is probable that benefits will be realized in the future.

The income tax expense on income before income taxes, equity in net loss of affiliated companies and minority interest is reconciled to the reported income tax expense as follows:

	1998
Income before income taxes, equity in net loss of affiliated companies and minority interest	2 587
Weighted average statutory tax rate	25%
Income tax expense at the weighted average statutory tax rate	647
Reduction in income taxes resulting from:	
Deferred tax asset recorded on incorporation ¹⁾	(230)
Swisscom AG tax benefit for loss on investments in affiliated companies	(52)
Other	(46)
Income tax expense as reported	319

¹⁾ Upon incorporation on January 1, 1998, Swisscom became subject to income taxes. At this date, the tax basis of accrued pension cost was lower than the IAS basis in the amount of CHF 920 million. This difference resulted in a deferred tax asset of CHF 230 million which has been recorded as a deferred income tax credit during 1998.

The weighted average statutory tax rate includes both Federal and Cantonal taxes. Taxable income in Switzerland is allocated among the 26 cantons, each canton has a different tax rate. The weighted average statutory tax rate is based on the relationship between the income earned in the canton and the corresponding tax rate for that canton.

The tax effects of temporary differences that give rise to deferred tax assets and liabilities at December 31, 1998 were as follows:

	1998
Assets associated with:	
Accrued pension cost	184
Other	18
Total deferred tax asset	202
Liabilities associated with:	
Accelerated depreciation for tax purposes	(112)
Net deferred tax asset	90
Deferred tax asset recorded in other non-current assets	100
Deferred tax liability recorded in other non-current liabilities	(10)

CHF in millions	1997	1998
13 Equity in net loss of affiliated companies		
Equity in net loss of affiliated companies	168	208
Amortization of goodwill	46	4
Total equity in net loss of affiliated companies	214	212

See also Note 20 for additional information.

Notes to the consolidated financial statements (continued)

14 Earnings per share

Income available to shareholders used in calculating both basic and diluted earnings per share is Swisscom's reported net income for each year. The weighted-average number of shares outstanding used in the calculation are as follows:

	1997	1998
Basic	66 000 000	67 887 500
Diluted	66 000 000	67 894 895

The difference between basic and diluted weighted-average shares results from the assumption that dilutive stock appreciation rights outstanding were exercised. All outstanding stock appreciation rights were used for purposes of calculating the weighted-average shares outstanding as they had a dilutive effect. The purchased call options were not included in calculating dilutive earnings per share as their effect was antidilutive.

15 Cash and cash equivalents

CHF in millions	1997	1998
Cash deposits	256	309
Term deposits	–	1 450
Total cash and cash equivalents	256	1 759

Term deposits in 1998 were held with various financial institutions.

16 Securities available for sale

Securities available for sale consist of listed shares with an original cost of CHF 27 million. Unrealized gains in the amount of CHF 24 million and CHF 1 million in 1997 and 1998, respectively, were recorded as an unrealized market value adjustment on securities within shareholders' equity. Realized gains from sales during 1998 totaled CHF 39 million and were recorded as changes in unrealized market value adjustment on securities. There were no realized gains in 1997.

17 Trade accounts receivable

CHF in millions	1997	1998
Trade accounts receivable	2 139	2 435
Trade accounts receivable from affiliated companies	14	57
Total trade accounts receivable, gross	2 153	2 492
Allowance for bad debts	(101)	(134)
Total trade accounts receivable, net	2 052	2 358

18 Inventories

CHF in millions	1997	1998
Raw material and supplies	54	72
Customer premises equipment for resale	130	160
Total inventories, gross	184	232
Allowance for obsolete and slow-moving items	(15)	(24)
Total inventories, net	169	208

19 Property, plant and equipment

CHF in millions	Land and Buildings	Technical equipment	Vehicles and other equipment	Total
At cost:				
Balance at December 31, 1996	5 595	22 787	1 988	30 370
Additions	334	1 677	363	2 374
Disposals	(32)	(1 930)	(239)	(2 201)
Balance at December 31, 1997	5 897	22 534	2 112	30 543
Acquisition of subsidiary	5	159	13	177
Additions	118	974	213	1 305
Disposals	(16)	(1 079)	(205)	(1 300)
Reclassifications	–	22	(22)	–
Balance at December 31, 1998	6 004	22 610	2 111	30 725
Accumulated depreciation:				
Balance at December 31, 1996	3 371	14 385	1 285	19 041
Additions	177	1 616	215	2 008
Disposals	(27)	(1 814)	(118)	(1 959)
Balance at December 31, 1997	3 521	14 187	1 382	19 090
Acquisition of subsidiary	–	106	7	113
Additions	75	1 302	226	1 603
Disposals	(9)	(995)	(178)	(1 182)
Balance at December 31, 1998	3 587	14 600	1 437	19 624
Net book value:				
At December 31, 1996	2 224	8 402	703	11 329
At December 31, 1997	2 376	8 347	730	11 453
At December 31, 1998	2 417	8 010	674	11 101

Translation adjustments were insignificant in both 1997 and 1998.

Included in 1998 additions to accumulated depreciation is CHF 33 million of asset write-downs due to impairment of cable television and paging assets. This write-down reduces the net book value of these assets to their net recoverable amount.

In 1997, additions to accumulated depreciation included restructuring related write-downs in the total amount of CHF 316 million. See Note 10.

Included within property, plant and equipment are the following:

CHF in millions	1997	1998
Assets under construction	503	579
Technical equipment acquired under finance leases:		
At cost	449	566
Accumulated amortization	(26)	(94)
Net book value	423	472

Notes to the consolidated financial statements (continued)

20 Investments

CHF in millions	Equity in affiliated companies	Goodwill from investments in affiliated companies	Other investments	Total investments
At cost:				
Balance at December 31, 1996	1 129	500	143	1 772
Additions	128	43	14	185
Dividends received	(4)	–	–	(4)
Equity in net result	(168)	–	–	(168)
Discontinued operations	2	–	–	2
Additions to discontinued operations	10	26	–	36
Disposals	–	–	(2)	(2)
Translation adjustments	(162)	(89)	–	(251)
Balance at December 31, 1997	935	480	155	1 570
Additions	90	1	18	109
Dividends received	(4)	–	–	(4)
Equity in net result	(208)	–	–	(208)
Discontinued operations	(130)	(428)	–	(558)
Disposals	–	–	(4)	(4)
Translation adjustments	61	–	–	61
Balance at December 31, 1998	744	53	169	966
Accumulated amortization/allowance:				
Balance at December 31, 1996		123	47	170
Additions		46	44	90
Discontinued operations		113	–	113
Disposals		–	(2)	(2)
Translation adjustments		(39)	–	(39)
Balance at December 31, 1997		243	89	332
Additions		4	–	4
Discontinued operations		(199)	–	(199)
Disposals		–	(2)	(2)
Balance at December 31, 1998		48	87	135
Net book value:				
At December 31, 1996	1 129	377	96	1 602
At December 31, 1997	935	237	66	1 238
At December 31, 1998	744	5	82	831

In 1997, total additions to investments in affiliated companies of CHF 171 million, including goodwill of CHF 43 million, consist of capital increases at Unisource and the purchase of a 50 percent interest in tesion. The purchase of additional shares to maintain the interest in DiGi Swisscom Berhad in 1997 has been recorded under additions to discontinued operations. Total additions to investments in affiliated companies of CHF 91 million in 1998, is comprised primarily of capital contributions to Unisource.

Other investments mainly consist of an 18.7 percent interest in Infonet Services Corporation as well as several satellite operating companies with interests ranging from 0.8 to 2.8 percent.

The following schedule provides selected aggregated key data of Swisscom's proportionate interest in joint ventures including Unisource, TelSource, Cablecom and tesion (purchased in 1997). Other equity investments are insignificant.

CHF in millions	1997	1998
Statement of operations		
Net revenues	995	934
Total operating expenses	1 089	1 128
Operating loss	(94)	(194)
Net loss	(174)	(208)
Balance sheet		
Current assets	505	472
Fixed assets	1 626	1 347
Current liabilities	599	570
Long-term liabilities	594	527
Shareholders' equity	938	722

21 Other non-current assets

CHF in millions	1997	1998
Loans receivable	111	117
Loans receivable from affiliated companies	97	96
Intangible assets, net of accumulated amortization of CHF 1 million and CHF 17 million	12	125
Deferred tax asset (see Note 12)	–	100
Total other non-current assets	220	438

Outstanding each of the two years ended December 31, 1998, is a loan due from Cablecom in the amount of CHF 80 million bearing interest at the 6-month LIBOR rate plus a margin of 0.375 percent. In addition, loans of CHF 12 million are outstanding with JászTel bearing interest at the 6-month LIBOR rate plus a margin of 0.5 percent.

During 1998 Swisscom acquired a 50 percent plus one share interest in UTA Telekom AG (UTA), a telecommunications service provider in Austria, in exchange for a capital contribution of ATS 1,242 million (CHF 150 million). The excess purchase price of UTA over the fair value of net assets acquired totaling CHF 106 million, has been recorded as an increase in intangible assets during 1998.

Notes to the consolidated financial statements (continued)

22 Debt

Short-term debt

CHF in millions	1997	1998
Employee savings deposits	–	724
Short-term loan payable to Federal Treasury	300	–
Short-term loans payable to affiliated companies	51	–
Current portion of long-term debt	825	500
Other	2	1
Total short-term debt	1 178	1 225

Employee savings deposits represent short-term deposits held by Swisscom employees. In connection with the separation of Swisscom and the Swiss Post on January 1, 1998, CHF 815 million was transferred from the Post to Swisscom, which equaled the liability assumed by Swisscom in respect of these deposits. The interest rate payable on this debt is 2.25 percent.

The short-term loan payable to Federal Treasury of CHF 300 million in 1997 represented the portion of the loan in the total amount of CHF 3,500 million, advanced by the Confederation at the end of 1997, which was not converted to equity. This loan was repaid in 1998.

Long-term debt

Long-term debt consists primarily of unsecured fixed interest rate loans, denominated in Swiss francs, granted by the Swiss Post. At December 31, 1998, maturities range from 1999 to 2003 as follows:

CHF in millions	1997	1998
Within one year	825	500
Within 1–2 years	1 250	1 200
Within 2–3 years	1 950	1 250
Within 3–4 years	1 250	1 000
Within 4–5 years	1 000	750
After 5 years	750	–
Total Swiss Post debt	7 025	4 700
Current portion of Swiss Post debt	(825)	(500)
Total long-term Swiss Post debt	6 200	4 200
Note payable to minority shareholder	–	45
Total long-term debt	6 200	4 245

Interest rates on the Swiss Post debt range from approximately 3.5 to 5.5 percent.

During 1998, Swisscom used proceeds from its initial public offering to retire CHF 1,500 of long-term debt early. This early extinguishment resulted in a penalty of CHF 81 million. See Note 11.

Note payable to minority shareholder represents subordinated loans payable by Swisscom's subsidiary, UTA. This debt does not have a specified due date and interest is deferred until UTA records a profit.

	CHF in millions	1997	1998
23 Other current liabilities			
Profit distribution payable (see Note 1.2)		1 144	–
Accrued liabilities – current portion (see Note 24)		287	121
Interest payable		103	96
Income tax payable		–	225
Reserve for discontinued operations (see Note 33)		–	132
VAT payable		57	96
Social security payable		29	63
Accrual for overtime and unused vacation		79	95
Accrued expenses		312	708
Revenue received in advance		192	237
Current portion of finance lease obligation (see Note 26)		10	39
Total other current liabilities		2 213	1 812

	CHF in millions	1997	1998
24 Accrued liabilities			
Outsourcing program (see Note 10)		120	70
Deferred tax liability (see Note 12)		–	10
Other accrued liabilities		876	747
Total accrued liabilities including its current portion		996	827
Less current portion (see Note 23)		(287)	(121)
Total accrued liabilities		709	706

Included within other long-term accrued liabilities at December 31, 1997 and 1998, are approximately CHF 300 million and CHF 316 million, respectively, for dismantlement of analog transmitter stations and restoration of property owned by third parties on which the transmitters are situated. Total costs are expected to be approximately CHF 400 million. Accrued liabilities at December 31, 1997 and 1998, also include miscellaneous restructuring charges in the amount of CHF 84 million and CHF 21 million, respectively, representing costs of various measures taken related to discontinuation of selected activities and streamlining of certain facilities and operations. See Note 10.

	CHF in millions	1997	1998
25 Other long-term liabilities			
Revenue received in advance		148	130
Deposits received from customers		137	98
Miscellaneous		53	45
Total other long-term liabilities		338	273

26 Leases

Swisscom sold certain technical equipment in separate transactions for proceeds of CHF 213 million and CHF 118 million in 1997 and 1998, respectively. These transactions, along with a similar transaction in previous years, resulted in total gains on sale of CHF 38 million. Swisscom concurrently entered into agreements to lease the equipment back under finance leases. See also Notes 19 and 28.

Notes to the consolidated financial statements (continued)

Payments for finance leases amounted to CHF 4 and 22 million in 1997 and 1998. Future minimum lease payments resulting from non-cancellable finance lease contracts are due as follows:

CHF in millions	1997	1998
Within one year	21	39
In year 2	32	40
In year 3	33	40
In year 4	33	41
In year 5	33	67
After year 5	391	430
Total future payment commitments	543	657
Less future interest charges	(94)	(101)
Total finance lease obligation including its current portion (net present value)	449	556
Less current portion (see Note 23)	(10)	(39)
Long-term finance lease obligation	439	517

27 Shareholders' equity

Share capital

At December 31, 1997, the Confederation advanced a loan to Swisscom of CHF 3,500 million of which CHF 3,200 million was converted to equity in connection with the initial capitalization of Swisscom AG as a stock corporation. At January 1, 1998, Swisscom converted CHF 1,650 million of this amount into share capital. This conversion was based upon 33 million shares with a par value of CHF 50 each. Effective August 26, 1998, the shareholder approved a 2 to 1 stock split that increased the number of shares to 66 million with a per share par value of CHF 25. All share amounts reflect the stock split. At a shareholder's meeting on September 30, 1998, it was approved to issue 7,550,000 new, fully paid-in registered shares with a par value of CHF 25 each. These new shares have full dividend rights for the business year 1998 and were subsequently sold during the initial public offering.

In October 1998 Swisscom completed an initial public offering of 25,374,750 shares at an initial offering price of CHF 340, with certain discounts offered to employees and Swiss retail purchasers. Of the total shares sold, 7,550,000 were sold by Swisscom and 17,824,750 by the Confederation. Swisscom did not receive any of the proceeds from the sale of shares sold by the Confederation. The net proceeds to Swisscom from the offering, after deducting applicable underwriting commissions, employee and other discounts and offering expenses, were CHF 2,462 million. Net offering costs totaled CHF 105 million, net of reimbursement from the Confederation of CHF 21 million and income tax benefit of CHF 29 million. These net proceeds were used by Swisscom to repay debt and for general corporate purposes.

Shares authorized, issued and outstanding at December 31, 1998 total 73,550,000.

Purchased call options

During the current year Swisscom purchased call options from an underwriter of the public offering in order to fix its maximum liability under the leveraged share ownership plans. This instrument gives Swisscom the option to call its own shares, in a quantity equal to the total appreciation rights share equivalent, at the initial public offering price. The purchase price of this option, CHF 25 million, net of CHF 8 million income tax benefit, has been recorded as a reduction of shareholders' equity in the current period.

Dividends

The amount available for dividend distribution is based on the parent company's shareholders' equity determined in accordance with the legal provisions of the Swiss Code of Obligations.

Derivative financial instruments

Swisscom has entered into currency swaps and foreign exchange contracts as hedges of U.S. dollar denominated leases. The total lease obligation at December 31, 1998, amounted to CHF 556 million (CHF 449 million at December 31, 1997). It is Swisscom's policy to hedge all currency exposure on such liabilities with foreign currency derivative instruments such as swaps and foreign exchange contracts. The terms and conditions of the swaps and foreign exchange contracts match the terms and conditions of the underlying finance lease obligations disclosed in Note 26. Accordingly all foreign exchange gains and losses on the lease obligations are completely offset by foreign exchange gains and losses on the financial instruments. Swisscom does not undertake speculative trading using derivative instruments.

Swisscom has a net foreign exchange exposure, in particular on international telephone settlements which are expected to be settled within one year. Swisscom's exposure to this foreign exchange risk is partially hedged through foreign exchange contracts. At December 31, 1998, foreign exchange contracts were outstanding to purchase DEM 3 million and USD 11 million in the first quarter of 1999.

Liquidity risk and credit risk

Liquidity risk includes the risk that, as a result of liquidity requirement in the future, Swisscom will be forced to sell financial assets or derivative positions at a value which is below their underlying worth or may be unable to exit these positions at all, or Swisscom will have insufficient funds to settle a transaction on the due date. To help counter these risks Swisscom has standby facilities and has a liquidity policy which requires a minimum liquidity level to be maintained.

Credit risk includes the risk that a counterparty will fail to discharge their obligation under a financial instrument and cause Swisscom to incur a financial loss. To help counter this risk Swisscom ensures it does not have any significant exposure relative to approved counterparty limits, and has a policy which establishes counterparty limits. Swisscom does not have any significant exposure to any individual customer or counterparty nor does it have any major concentration of credit risk related to any financial instruments.

Interest rate risk

Swisscom is subject to interest rate risks due to fluctuations in market rates. Substantially all of Swisscom's long-term debt is in the form of held-to-maturity fixed-rate Swiss franc loans with original maturities of up to 5 years. Accordingly, movements in interest rates could lead to fluctuations in the fair-value of such debt instruments but will neither impact net income or future cash flows.

Interest rates for short-term debt, consisting of savings deposits of Swisscom employees, are on a floating rate basis and are reset to market conditions periodically.

Fair value of financial instruments

The following table presents the carrying amounts and fair values of Swisscom's financial instruments outstanding at December 31, 1997 and 1998. The carrying amounts in the table are included in the balance sheet under the indicated captions. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidated sale.

Notes to the consolidated financial statements (continued)

CHF in millions	Carrying amount 1997	Fair value 1997	Carrying amount 1998	Fair value 1998
Financial assets				
Cash and cash equivalents	256	256	1 759	1 759
Securities available for sale	51	51	28	28
Trade and other receivables	2 064	2 064	2 449	2 449
Loans receivable	208	208	213	213
Financial liabilities				
Short-term debt ¹⁾	1 178	1 204	1 225	1 250
Trade accounts payable	889	889	925	925
Other current liabilities	1 983	1 983	1 536	1 536
Long-term debt ¹⁾	6 200	6 655	4 245	4 586
Finance lease obligation	449	444	556	567
Accrued liabilities and accrued pension cost	2 967	2 967	2 557	2 557
Other long-term liabilities	137	137	98	98

¹⁾ The difference between carrying value and net fair value relates principally to interest rate movements.

Estimation of fair values

Accounts receivable, accounts payable and other liabilities

The carrying amounts are a reasonable estimate of the fair value because of the short maturity of such instruments.

Cash and cash equivalents, securities available for sale, investments and loans receivable

The carrying amounts of cash and loans receivable approximate fair value. The fair value of securities available for sale is based on quoted market values.

The fair value of investments were not practically determinable because they are not publicly traded or no liquid markets exist.

Finance lease obligation, accrued liabilities and accrued pension cost

The fair value of finance lease obligations is estimated using the expected future payments discounted at market rates. The carrying value of accrued liabilities and accrued pension cost approximate their fair value.

Debt

The fair value of fixed rate debt is estimated using the expected future payments discounted at market interest rates.

29 Commitments and contingencies

Contractual commitments for future capital expenditures at December 31, 1998, are estimated to become due as follows:

CHF in millions	1998
In 1999	209
In 2000	88
Total	297

At December 31, 1998, Swisscom has guaranteed certain liabilities of affiliated companies totalling CHF 222 million. In addition, Swisscom has pledged shares in a long-term investment with a historic cost of CHF 10 million as security for a loan taken by the investee.

Swisscom, along with the other shareholders of Unisource, has committed to provide all necessary funds in order for Unisource to meet its current and future obligations towards third parties within the business year 1999.

30 Segment reporting

Swisscom's principal business is providing telecommunication services, comprising more than 90 percent of total revenues, operating income and net assets. Swisscom's business is conducted predominantly in Switzerland, which for reporting purposes is considered a single geographical area.

31 Executive Board and Board of Directors

Remuneration of members of the Executive Board and the Board of Directors in 1998 amounted to CHF 6 million.

32 Significant subsidiaries and affiliated companies

Company name	Location, Country	Interest in percent	Consolidation method
Switzerland:			
Balcab AG	Basle, Switzerland	29.7	equity
Billag AG	Berne, Switzerland	100	full
Cablecom Holding AG ¹⁾	Frauenfeld, Switzerland	32	equity
Comfone AG ¹⁾	Muri (Berne), Switzerland	50	equity
Infonet (Schweiz) AG	Berne, Switzerland	90	full
Swiss Clearline AG	Muri (Berne), Switzerland	100	full
Swisscom Immobilien AG	Berne, Switzerland	100	full
Swisscom Immobilien Invest AG	Berne, Switzerland	100	full
Swiss Key AG	Zurich, Switzerland	47.5	equity
Other countries:			
DiGi Swisscom Berhad ¹⁾	Kuala Lumpur, Malaysia	30	equity
ESTEL S.A. ¹⁾	Strasbourg, France	50	equity
JászTel Rt. ¹⁾	Jászberény, Hungary	50	equity
Sterling Cellular Limited ^{1) 2)}	New Delhi, India	32.51	equity
Swisscom North America, Inc.	Washington D.C., USA	100	full
Swisscom Re AG	Vaduz, Principality of Liechtenstein	100	full
Swisscom S.p.A.	Milan, Italy	100	full
Telecom FL AG	Vaduz, Principality of Liechtenstein	100	full
TelSource N.V. ^{1) 3)}	Den Haag, Netherlands	49	equity
tesion, GmbH & Co. KG ¹⁾	Stuttgart, Germany	50	equity
Unisource N.V. ¹⁾	Hoofddorp, Netherlands	33.3	equity
UTA Telekom AG ⁴⁾	Vienna, Austria	50.004	full

¹⁾ Joint venture.

²⁾ Held through Mobilvest Ltd., a wholly owned subsidiary.

³⁾ Holding the interest in SPT. See Note 20.

⁴⁾ Held through Swisscom Telekommunikation Holding GmbH, a wholly owned subsidiary.

33 Discontinued operations

In March 1999, the Board of Directors announced a plan to dispose of its operations in India and Malaysia due to a refocussing of its international strategy and continued losses. In addition, these businesses are not in the core geographical business area of Swisscom. Prior to the Board's announcement to discontinue these businesses, Swisscom recorded a charge to write-off the remaining portion of the investments, including goodwill, based upon discounted cash flow analyses. In addition, the loss presented as discontinued operations includes the costs Swisscom expects to incur to exit these businesses, including the realization of corresponding cumulative translation adjustments. Prior year amounts have been restated to reflect the discontinued operations. The loss on discontinued operations for the years ended December 31, 1998 and 1997, totaled CHF 519, including an income tax benefit of CHF 121 million, and CHF 111 million, respectively.

Report of the Statutory Auditors

To the Shareholders' Meeting
of Swisscom AG
Ittigen (Berne)

As statutory auditors, we have audited the accounting records and the financial statements (income statement, balance sheet and notes to the financial statements on pages 43 to 45) of Swisscom AG for the year ended December 31, 1998.

These financial statements are the responsibility of the Board of Directors. Our responsibility is to express an opinion on these financial statements based on our audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with auditing standards promulgated by the profession, which require that an audit be planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the financial statements. We have also assessed the accounting principles used, significant estimates made and the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accounting records, the financial statements and the proposed appropriation of available earnings comply with the law and the company's articles of incorporation.

We recommend that the financial statements submitted to you be approved.

PricewaterhouseCoopers AG

Peter Wittwer

Julie Fitzgerald

Berne, March 19, 1999

Swisscom AG

Income statement

CHF in millions	Year ended December 31 1998
Net revenues	10 404
Capitalized cost	133
Gain on disposal of fixed assets	29
Total	10 566
Goods and services purchased	1 576
Personnel expenses	2 563
Other operating expenses	2 290
Depreciation and amortization	2 580
Total operating expenses	9 009
Operating income	1 557
Financial expense	(443)
Financial income	141
Income before income taxes	1 255
Income tax expense	(244)
Net income	1 011

Swisscom AG

Balance sheet

CHF in millions	Note	At January 1 1998	At December 31 1998
Assets			
Current assets			
Cash and cash equivalents		248	1 587
Securities available for sale		51	–
Trade accounts receivable		2 054	2 447
Inventories		169	202
Other current assets		2 416	191
Total current assets		4 938	4 427
Non-current assets			
Property, plant and equipment	4	9 074	8 191
Investments	6	1 304	1 495
Other non-current assets		213	2 040
Total non-current assets		10 591	11 726
Total assets		15 529	16 153
Liabilities and shareholders' equity			
Current liabilities			
Short-term debt		362	1 266
Trade accounts payable		893	858
Accrued pension cost		151	–
Other current liabilities		2 619	1 710
Total current liabilities		4 025	3 834
Long-term liabilities			
Long-term debt		7 025	4 772
Finance lease obligation	5	439	517
Accrued liabilities		1 504	1 027
Other long-term liabilities		386	441
Total long-term liabilities		9 354	6 757
Total liabilities		13 379	10 591
Shareholders' equity			
Share capital		1 650	1 839
General reserves		500	2 712
Retained earnings		–	1 011
Total shareholders' equity	2	2 150	5 562
Total liabilities and shareholders' equity		15 529	16 153

Notes to the financial statements

1 General

The financial statements of Swisscom AG, the parent company, comply with the legal provisions of the Swiss Code of Obligations.

Since Swisscom AG was incorporated as a special statutory stock corporation at January 1, 1998, no comparative information is disclosed except for the balance sheet at January 1, 1998. Further information concerning the business is included in note 1 of the consolidated financial statements.

2 Shareholders' equity

See note 27 of the consolidated financial statements.

3 Contingent liabilities

Total guarantees and pledged securities in favour of third parties at December 31, 1998, amounted to CHF 232 million.

4 Fire insurance values of property, plant and equipment

The fire insurance values of property, plant and equipment are generally based on replacement or fair values of such assets.

5 Leases

Assets acquired under leasing agreements which effectively transfer substantially all the risks and rewards incidental to ownership from the lessor to the lessee are classified as finance leases. Operating lease payments are treated as rentals and charged to income as incurred. Further information is included in Notes 2.10 and 26 of the consolidated financial statements.

6 Investments

See note 20 of the consolidated financial statements. Significant balances and transactions with investments and joint ventures are disclosed separately in the consolidated financial statements as items with affiliated companies.

7 Significant shareholders and transfer restrictions for registered shares

On December 31, 1998, the Swiss Confederation (the "Confederation") as majority shareholder, held 65.5 percent of the shares of Swisscom AG. The Telecommunications Enterprise Act of 1997 ("Telekommunikationsunternehmungsgesetz", the TUG) provides that the Confederation must hold a majority of the capital and voting rights of Swisscom. In addition, Chase Nominees Ltd., London, registered in the share register as shareholder without voting rights, held 5.48 percent of the shares.

According to the Articles of Incorporation, the Board of Directors may refuse the approval of an acquirer of shares as a shareholder or usufructuary with voting rights, if the holding of this shareholder, together with his shares already registered with voting rights in the Share Register, exceeds the limit of five percent of all registered shares recorded in the Commercial Register. As to the excess shares, the acquirer will be registered in the Share Register as a shareholder or usufructuary without voting rights. On December 31, 1998, five percent of the share capital was equivalent to 3,677,500 registered shares.

Proposed appropriation of retained earnings

Proposal of the Board of Directors

The Board of Directors proposes to the Shareholders' Meeting the following appropriations of retained earnings of CHF 1 011 million for the year ended December 31, 1998:

CHF in millions	1998
Dividend of 44 percent on 73 550 000 registered shares	809
Balance to be carried forward	202
Total retained earnings	1 011

If the Shareholders' Meeting approves this proposal, the dividend will be paid to the shareholders on June 4, 1999:

Per registered share	CHF
Dividend, gross	11.00
less 35 percent withholding tax	3.85
Dividend payment, net	7.15

Four Year Review

Swisscom Group

(CHF in millions, except where indicated)

		1995	1996	1997	1998
Net revenues		9 515	9 532	9 842	10 461
Operating income before restructuring charges and depreciation (EBITDA)		4 798	4 232	3 779	4 472
EBITDA margin	%	50.4	44.4	38.4	42.7
Operating income before restructuring charges (EBIT)		3 047	2 505	2 040	2 851
EBIT margin	%	32.0	26.3	20.7	27.3
Restructuring charges		–	–	1 726	(50)
Net income (loss) from continuing operations		2 415	1 906	(304)	2 074
Net income (loss)		2 415	1 830	(415)	1 555
Net income margin	%	25.4	19.2	n/a	14.9
Shareholders' equity		(1 394)	(84)	1 230	5 347
Equity ratio	%	n/a	n/a	7.9	31.6
Number of full-time equivalent employees at end of period	FTE	20 557	21 951	22 170	21 946
Average number of full-time equivalent employees	FTE	20 219	21 311	22 145	22 069
Revenue per employee	CHF in thousands	471	447	444	474
Net cash provided by operating activities		4 674	4 115	1 335	3 574
Capital expenditures		2 173	2 278	2 374	1 305
Investments in subsidiaries, affiliated companies and other non current assets		986	764	329	240
Free cash flow		1 520	1 316	(1 142)	2 235
Key figures per share					
Average number of shares outstanding (at CHF 25.– each)	in mio.	66	66	66	67.888
Price per share (high/low since October 5, 1998)	CHF	n/a	n/a	n/a	588.–/376.50
Net income (loss) from continuing operations	CHF	36.59	28.88	(4.61)	30.55
Net income (loss)	CHF	36.59	27.73	(6.29)	22.91
Shareholders' equity	CHF	(21.12)	(1.27)	18.64	72.70
Gross dividend	CHF	n/a	n/a	n/a	11.00*
Pay-out ratio	%	n/a	n/a	n/a	52.0*
Market capitalization at end of period		n/a	n/a	n/a	42 291

* according to the proposal of the Board of Directors to the Shareholders' Meeting

Cautionary Statement

Except for the historical statements and discussions contained herein statements contained in this annual report constitute "forward-looking statements" within the meaning of Section 27A of the U.S. Securities Act of 1933, as amended, and Section 21 E of the U.S. Securities Exchange Act of 1934, as amended. These forward-looking statements rely on a number of assumptions concerning future events and are subject to a number of uncertainties and other factors, many of which are outside of Swisscom's control, that could cause actual results to differ materially from such statements. These factors include, but are not limited to, telecommunications usage levels, competitive forces in liberalized markets, regulatory changes, technological developments, the success of business, operating and financial initiatives and material adverse changes in economic conditions in the markets served by Swisscom and its affiliates. Readers are cautioned not to put undue reliance on these forward-looking statements because actual events and results may differ materially from the expected results described by such forward-looking statements. For a more detailed description of these and additional uncertainties and other factors, see Swisscom's filings with the U.S. Securities and Exchange Commission (and in particular its most recent annual report on Form 20-F).

Contact

Swisscom AG
Head Office
Corporate Communications
CH-3050 Berne
Tel. +41 31 342 36 78
Fax +41 31 342 27 79
E-mail: swisscom@swisscom.com

Investor Relations

Swisscom AG
Head Office
Investor Relations
3050 Berne
Tel. +41 31 342 25 38
Fax +41 31 342 64 11
E-mail:
investor.relations@swisscom.com