Swisscom "Moving against the trend; solid as a rock"

Dear Shareholder,

Swisscom's slogan *'moving a changing world'* becomes ever more true. The world for telecommunication companies is changing in an unprecedented way. Turmoil continues in the capital markets affecting many companies. In this environment, one of the few constants appears to be Swisscom's robust performance and consistent focus. The capital markets seem to appreciate this performance: until early August this year Swisscom and debitel were the only stocks that gained value, whereas all other stocks in the sector came down substantially – *"moving against the trend".*

Revenue, and especially EBITDA (Earnings Before Interest, Tax, Depreciation and Amortization) and Operating Profit (EBIT), were all above those of the same period in 2000. Net profit increased more than twofold to CHF 5.4 billion. Net debt of CHF 2.9 billion at year end 2000 was turned around into a net funds position of CHF 1.0 billion. Results that make a difference: Swisscom is now one of the very few companies in the telco universe to have an extremely strong balance sheet; a balance sheet created through careful management based on strong investment principles and careful selection of opportunities – *"solid as a rock".*

Our Beliefs & Strategy

During the first months of 2001, we have gone through a major exercise in reviewing our strategy. This has resulted in a confirmation of our direction and set of beliefs which we would like to share with you:

- *we do not have global ambitions* – our domestic market remains key to us. Switzerland is where we create the most substantial part of our cash flows. Growth opportunities outside Switzerland will therefore be in certain submarkets.
- *no merger of equals* – Swisscom does not believe in the business rationale of a merger with other European telecom operators at parent level, due to its complexity and limited synergies for major parts of the businesses (such as fixed line)
- *clear strategic investment focus* – realizing growth (domestically and internationally) requires a clear return orientation based on priorities for allocation of cash to investment opportunities:
  - firstly, to invest in improvements in the core business;
  - secondly, to invest in organic growth of the core; and
  - finally, to invest in non-organic growth (both domestic and international)
- *access to scale* – acquisition and consolidation to achieve scale benefits is not the only approach. Swisscom knows that scale is not equally important in all businesses and thinks that where it is important, there can be other ways to get these benefits. For example through strategic partnering as we have done in Swisscom Mobile AG, where Vodafone plc, which now holds a 25% stake, provides access to its scale advantages as the largest mobile operator.
- *systematic opportunity screening* – in both the data and (mobile) service providing businesses we have been, and are, looking for growth opportunities. We believe acquisitions in those fields can make sense for Swisscom, if we can wholly satisfy our investment criteria.

So, what are these criteria? For us, it is quite simple. In order to invest we have to believe in five things:

- *strategic fit:* if we can't explain to our shareholders why we should do it instead of them investing directly, there is no reason why Swisscom should acquire
- *a viable business model:* we have to be convinced of the sustainability and long-term cash generating prospects of a business.
- *good management:* the leadership of the target company, especially the executive team, has to have a proven track record to be able to run their business and potentially contribute to other parts of the Swisscom Group.
- *good value:* the price paid needs to be fully justified through thorough analysis. We consider the next 12 months at least to be a buyers market.
- *size of transaction:* although Swisscom has substantial funding potential, our philosophy cautions us against betting the future of the Group on one single horse. We do not believe it is in the interest of our shareholders to substantially change the risk profile of Swisscom through one single acquisition.

During the first half of 2001 we have actively and systematically screened the market, and consistently applied our thinking to several potential acquisition targets. At this point, the rather sobering conclusion after the first six months is, that we have not found a compelling opportunity that would have satisfied our criteria.

At the same time, our balance sheet strength has further improved. Partially, thanks to our strong operating cash from our domestic market, but also due to extraordinary income from the transaction with Vodafone plc and the sale of real estate, we now have a net funds position for the first time in our history. Having more cash at hand than debt, many of you raise the question as to how we intend to make use of this under-leveraged balance sheet.

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We intend to continue to scan the market for upcoming acquisition opportunities. At the same time we judge the likelihood of doing a sizeable transaction that satisfies all our criteria as limited, especially in the field of data communication. Therefore, we continue to see a share buyback program as an option. A program tailored to:

– create an optimized balance sheet, thereby reducing our weighted cost of capital
– keep sufficient funding flexibility for the company for potential acquisitions
– satisfy the requirements of all shareholders in a non-discriminatory way

We consider that our responsibility to our shareholders is to increase the company’s value. Value to us is driven by the power to generate cash, which is after all, the single most strategic asset.

First Half 2001 results

During the first half of 2001, we managed to show a set of good results. Both, operationally and financially:

– we made progress in the restructuring of the company into different business lines. The majority of these have been, or will be over the next period, established as separate legal entities. This emphasizes our belief that these are separate businesses, that share commonalities. Next to our strong Swisscom brand, the ‘Swisscommons’ are common values that form the basis for leadership and a consistent set of missions for the group companies. The increased transparency and clearly defined management responsibilities (including income statement accountability) bring focus and market orientation
– we closed an important deal with Vodafone, which now holds a 25% stake in Swisscom Mobile AG for a consideration of CHF 4.5 billion. Apart from the cash, the cooperation with Vodafone will bring important benefits: to our customers (in terms of new product offerings) and to the company (in terms of savings on product development and purchasing for network roll out)
– debitel managed to sign important agreements or letters of intent, with the 3 largest network operators in Germany, ensuring access to UMTS through an enhanced service providing model
– we successfuly sold a large part of our real estate portfolio, freeing up CHF 2.6 billion of cash out of non-core assets
– we generated consolidated revenues of CHF 7.0 billion, up 2.8% compared to last year, despite the significant price cuts of March 2000
– we generated consolidated Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA) of almost CHF 2.3 billion, representing a margin of 32.5% and an increase of 8.3% compared to the same period last year
– we generated net profit of CHF 5.4 billion, or CHF 72.85 per share, more than twice last year’s interim profit
– we had an Operating cash flow of CHF 1.6 billion

Outlook

During the first half of 2001, we exceeded our own expectations. This is largely a result of our new, clearer focus. However, the market situation and strong cost control also contributed to these results. Nevertheless, the threat of price cuts (both on fixed and mobile) remains, in the medium and long-term. However Swisscom’s pricing policy will stay unchanged: we will not cut prices first, but will follow in a determined way should competition do so.

If market circumstances and pricing do not change substantially, our aim is to achieve a similar EBITDA as last year.

Net profit in 2001 will be further boosted through the extraordinary income from the Vodafone deal and the sale of real estate.

With our dedicated and continued focus on investments that generate cash, we feel your money is put sensibly at work. To the extent we cannot ensure such investment opportunities, we plan to return this cash to you, so that you can put it at work.

Our trend is unchanged: Swisscom – solid as a rock.

Yours sincerely

Dr Markus Rauh
Chairman of the Board of Directors

Jens Alder
CEO