

2006 Half-Year Report

Dear Shareholder

The major changes currently afoot in the telecommunications sector can be summed up in one word: "convergence". New technologies are enabling a fusion of telecoms, IT, media and entertainment (TIME), which in turn is giving rise to new, attractive services and products for customers. Where does Swisscom stand in this process? What strategies are we pursuing to secure long-term corporate success? This Shareholders' Letter provides the answers.

Despite a challenging first half-year 2006, we were once more able to defend our position successfully against our competitors. The telecoms sector is currently being driven by new customer requirements for convergent services, the ongoing rapid pace of technological change, and increasing regulation.

The "TIME" strategy announced by Swisscom in the spring of 2006 and now making itself felt is driving forward a powerful process of change towards becoming an integrated, highly efficient provider of convergent services.

On the political front, the first half of 2006 was dominated by the debate on privatisation. While the proposal fell through, the associated political process has now clearly identified the areas that require clear answers before any further privatisation measures, which the company views as a welcome step, can also find political acceptance.

In this context, our corporate strategy is as follows.

Movement in the communications world

As a Swiss company, Swisscom is active in a rapidly changing sector. The main drivers of change include:

- The continually changing **requirements of our residential customers** are prompting new-style services: more content, better applications with simpler, technology-independent network access and devices that enable all types of information to be managed more efficiently. These changing needs represent new business opportunities for the company. For customers they offer substantial added value, but on the other hand they also reduce the sustainable value of our traditional voice and data transmission services.
- **Ongoing process optimisation by our business customers** is also accelerating the pace of change in terms of demand and offerings: the integration of fixed-network with mobile communications, integration of IT services with traditional telecoms services, demand for internationally standardised offerings, and the growing importance of managed services are all expressions of this change. As with residential customers, the traditional transmission business is increasingly becoming a commodity- but at the same time new business opportunities are opening up in these areas.
- **Technologies** are changing rapidly. Technological integration and standardisation are paving the way for convergent products and services. While technological change is giving rise to new business opportunities, it is also breaking down the traditional value chain and opening up the market to new, innovative providers.

- The main feature of the first half of 2006 was a **flurry of regulatory measures**: approval of the revised Telecommunications Act and the associated unbundling of the local loop (ULL) scheduled for the first quarter of 2007; the threat of sanction under the new Swiss competition law; the obligation to adjust interconnection prices for 2000 to 2005 retroactively; and the EU initiatives on roaming prices. Given the imminent implementation of ULL, the renewal of GSM licences expiring in 2007 and other moves announced by the EU, the assumption must be that regulatory measures will remain an additional strong driver of change in our industry.

The key challenge for Swisscom now is to identify ways of helping to shape these trends and grasp the associated opportunities. Thanks to our uniquely broad base in Switzerland, excellent level customer loyalty by international comparisons and a high level of technological skills, Swisscom is well placed to anticipate changing customer needs sooner than its national and international competitors, and in so doing gain market share.

«TIME» strategy

The corporate strategy announced in spring 2006 targets the following three objectives:

- Strengthen Swisscom's competitive position and expand the value chain in the core business in Switzerland,
- Harness additional major potential for efficiency,
- Identify and define growth options outside the current core business in Switzerland or abroad, based on a clear industrial/strategic logic.

The measures to implement this strategy have been divided into three pillars:

Pillar 1: Maximise performance in the home market.

- a. Thanks to internationally leading (convergent) products and services and excellent customer care throughout Switzerland, we aim to harness **new sources of revenue** and further expand our already high **customer loyalty**. Residential customers want unified access to their centrally-stored data – from different types of devices (Triple Screen instead of Triple Play). They expect simplicity and support when dealing with the growing number of technological options, for example in the context of the "digital living room". This added value encourages customers to pay for these new products and services and prevents convergence being downgraded to price cutting. We will be offering our business customers new products and services that seamlessly integrate fixed network and mobile communications from as early as the second half of 2006.
- b. The measures defined – for instance, combining the fixed network and mobile network in a single "all-IP network", setting up shared service centres for administrative applications and eliminating duplication in sales – will allow us to **achieve substantial cost reductions** over the next few years.

Pillar 2: Extend activities with business customers through organic or acquisition initiatives in the following three dimensions:

- a. We will follow our customers through international expansion or partnerships and offer them our solutions beyond the borders of Switzerland.
- b. We will gradually expand into other vertical markets where there is clear industrial logic.
- c. We will achieve additional economies of scale through important new outsourcing transactions.

Pillar 3: Expand by using our core competences in closely related business areas.

- a. We will apply our competences in other European markets which have not yet reached the level of the Swiss market and are therefore still growing, or in segments of the home market where Swisscom is not yet Number 1.
- b. We will utilise our expertise in markets that, with increasing digitalisation and broadband applications, are subject to the same pace of change as the telecommunications sector, e.g. areas such as content distribution, telemedicine, advertising and payment services.

While Pillar 1 ("Maximise") is primarily aimed at optimising our current core business, Pillars 2 ("Extend") and 3 ("Expand") are clearly focused on growth.

Summary

Swisscom's strategy pursues the following three main objectives:

- Strengthen competitive position and expand the value chain in the core business in Switzerland.
- Harness additional major potential for efficiency.
- Identify and define growth options outside the current core business in Switzerland or abroad, based on a clear industrial/strategic logic.

This opens up significant new business opportunities that will distinguish Swisscom from the competition, generate growth and, from 2009, should offset the decline in the traditional core business (voice communications and access services).

Rigorous pursuit of this strategy based on the above three objectives will allow you, as shareholders, to share in our sustainable corporate success and in Swisscom's successful future.

Swisscom: "In Time to TIME"

Yours sincerely

Swisscom AG



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