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Swisscom AG

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Major Rating Factors

Strengths:

- Switzerland's leading fixed-line and mobile telecom operator
- Strong operating margins and free operating cash flow generation
- Strong liquidity and proactive treasury management
- Our belief that Swisscom will exercise financial discipline aimed at using discretionary cash flow to reduce debt
- Moderate likelihood of extraordinary government support from the Swiss Confederation

Weaknesses:

- Wealthy, but mature domestic service area with low growth prospects
- Mounting competitive and regulatory pressure
- Growth execution risks at Fastweb
- Leverage measures for Swisscom are still below our expectations for the rating

Corporate Credit Rating

A/Stable/--

Rationale

Standard & Poor's Ratings Services' ratings on Swisscom AG (A/Stable) are supported by the group's position as the leading integrated provider of telecommunications services in Switzerland, with an extensive and modern infrastructure, strong brand recognition, and its technological skill base.

The ratings also reflect Swisscom's strong domestic free operating cash flow (FOCF) generation, strong liquidity and proactive treasury management. In addition, the current ratings are underpinned by our belief that Swisscom's financial policy will remain moderate over the long term, notably regarding its shareholder distribution policy and capitalization.

The 'A' rating on Swisscom is based on the company's stand-alone credit profile (SACP), which we assess at 'A-', and on our view that there is a "moderate" likelihood that the Swiss government would provide timely and sufficient extraordinary support to Swisscom, if Swisscom encountered periods of financial distress.

In accordance with our criteria for government-related entities (GREs) (see "Related Research"), our view of a "moderate" likelihood of extraordinary government support is based on our assessment of Swisscom's:

- "Strong" link with the Swiss Confederation, primarily because the latter defines Swisscom's strategic goals and is unlikely, in our view, to reduce its majority ownership stake in the medium term; and
- "Limited" role as the Swiss government is primarily interested by the stability of Swisscom's operations and not so much by its credit standing.

The ratings remain constrained by more difficult operating conditions in the Swiss telecoms market than in the past, including lower growth prospects as a result of market saturation and increasing competitive and regulatory

pressure. In addition, we are mindful that its 82%-owned subsidiary, Fastweb SpA, could find it increasingly difficult to maintain its growth momentum. Furthermore, Swisscom currently has leverage measures below current rating commensurate levels.

Key business and profitability developments

In the first half of 2009, Swisscom posted results in line with what we consider were likely results. Its revenues had declined only slightly by 1.2% year on year. This was mainly because slight revenue erosion at Swisscom's domestic operations and adverse Swiss franc/euro exchange rate developments offset continued revenue growth at Fastweb

Swisscom Switzerland's revenues declined slightly by 2.0% year on year. This was mainly due to continued revenue erosion of its traditional fixed network business as well as competitive and regulatory pressure on mobile and fixed-line telephony revenues.

Swisscom recorded a year-on-year EBITDA decline of 3.8% in the first half of 2009, primarily because cost cutting activities did not offset lower earnings due to the revenue decline at Swisscom Switzerland. Furthermore, Fastweb's EBITDA contribution to group results decreased by 9% year on year, however, primarily because EBITDA in the first half of 2008 was boosted by a compensation payment from Telecom Italia. Before non-recurring items, the subsidiary recorded solid year-on-year EBITDA growth of 8% in euro terms.

Despite the current economic downturn, we expect that Swisscom should be more or less able to meet its EBITDA guidance for fiscal 2009: Excluding Fastweb, Swisscom expects to generate EBITDA of CHF3.8 billion. Swisscom expects Fastweb to generate EBITDA of €560 million.

Key cash flow and capital-structure developments

In the 12 months ending June 30, 2009, Swisscom continued to generate solid FOCF of CHF1,659 million, largely unchanged from CHF1,667 million in 2008. This was because the EBITDA decline and higher financing expenses were largely offset by lower capital expenditures and cash taxes, and a positive working capital movement.

We believe that Swisscom will report resilient FOCF over the medium term. In our opinion, increasing FOCF at Fastweb, ongoing cost savings, and prudent network investments will largely offset increasing domestic competitive and regulatory pressure on revenues and EBITDA. Swisscom expects to generate CHF2.6 billion-CHF2.7 billion in operating free cash flow (defined as EBITDA minus investment expenditure plus/minus changes in net working capital minus minority interests) in 2009, up from CHF2.5 billion in 2008.

We view Swisscom's financial policy as moderately conservative; the group targets a ratio of about 2x net debt to EBITDA. However, this equates to a Standard & Poor's adjusted net debt to EBITDA ratio of about 2.5x, which is at the upper end of our guidance for the current SACP. Furthermore, the company's shareholder remuneration policy limits its ability to reduce debt quickly because Swisscom aims to distribute 50% of its operating free cash flow via dividends and share buybacks. However, in light of the current economic downturn and uncertainty ahead, Swisscom prudently adjusted its remuneration policy for 2009 and paid 20% less than targeted in dividends to support faster debt reduction.

On June 30, 2009, Swisscom's adjusted net debt to EBITDA ratio was 2.6x. According to our calculations, the group's leverage ratio is likely to decline to less than 2.5x on an adjusted basis at year end 2009, primarily through debt repayments and resilient EBITDA generation.

Liquidity

Swisscom's liquidity is strong, reflecting healthy cash balances, moderate debt maturities until the end of 2010, proactive treasury management, and solid FOCF generation.

On June 30, 2009, cash and current financial assets was CHF0.6 billion; Swisscom also had an undrawn CHF500 million committed syndicated revolving credit facility (RCF) maturing in March 2012, and an undrawn CHF200 million RCF maturing in December 2011. The group's bank syndicates currently comprise about 40 banks.

As at June 30, 2009, Swisscom had negligible debt maturities in 2009 and moderate maturities of CHF0.7 billion in 2010. Despite the issuance of a five-year CHF1.25 billion bond in April 2009, the group faces very significant bank loan maturities of CHF2.55 billion in December 2011 and CHF2.15 billion in March 2012. However, Swisscom continued to proactively address this bulky refinancing in the recent months. Firstly, in the second quarter of 2009, Swisscom signed a private placement agreement in an amount of CHF1,250 million. Swisscom had no drawings under this agreement as of June 30, 2009, but the flexibility to use the frame for advances with maturities from 1 month to 7 years. Secondly, in September 2009, the company issued a nine-year CHF1.5 billion corporate bond.

Furthermore, in the 12 months to June 30, 2009, Swisscom generated solid discretionary cash flow (FOCF minus dividends) of CHF635 million.

Swisscom expects to generate CHF2.6 billion-CHF2.7 billion in operating free cash flow in 2009, up from CHF2.5 billion in 2008. Based on slightly lower dividend payments to common shareholders of CHF984 million in 2009 (CHF1,036 million in 2008), this could support solid discretionary cash flow generation in our view, despite somewhat higher expected interest payments due to Swisscom's current debt refinancing activities.

Outlook

The stable outlook reflects our belief that Swisscom will continue to successfully defend its core domestic market positions, maintain solid operating margins, and consequently generate sustainable, robust FOCF in Switzerland. In addition, we believe it reasonable to anticipate further moderate EBITDA growth and positive FOCF generation at Fastweb. Furthermore, we expect that the Swiss Confederation will maintain its majority ownership in Swisscom over the medium term.

Although not anticipated at this stage, any significant deterioration in Swisscom's domestic EBITDA or cash flow base, or a subdued operating performance at Fastweb, could put pressure on Swisscom's stand-alone credit profile. In addition, given the group's current leverage, if Swisscom's financial policy were to deviate from the desired credit targets, including a reduction in indebtedness of less than 2.5x EBITDA on an adjusted basis over 2009, we could take a negative rating action on Swisscom.

In view of the increasing operating and regulatory pressures on the group's domestic operations and given the group's current financial policy goals, we expect limited rating upside over the medium term.

Business Description

Swisscom is Switzerland's leading telecoms provider and offers a wide range of products and services for mobile, landline, and IP-based voice and data communication and TV services via its main division Swisscom Switzerland (100% owned). On June 30, 2009, Swisscom Switzerland had 5.5 million mobile customers, 3.6 million fixed

telephony lines, and 1.8 million broadband connections.

Swisscom's 82%-owned subsidiary Fastweb SpA is the second-largest fixed network operator in Italy. It offers broadband, voice, and TV services for residential and corporate customers. In addition, it acts as a mobile virtual network operator (MVNO). On June 30, 2009, Fastweb had 1.6 million customers.

Swisscom IT services and various participations are reported under the division Other.

In the first half of 2009, the group generated revenues of CHF5.9 billion and EBITDA of CHF2.3 billion, resulting in a strong margin of 39.5% (see table 1).

Table 1

	--Revenues--*			--EBITDA--**				
	Total (Mil. CHF)	Y-o-y Change (%)	Proportion Of Total (%)	Total (Mil. CHF)	Y-o-y Change (%)	Proportion Of Total (%)	Margin (%)	Y-o-y Margin loss/gain (percentage points)
Swisscom Switzerland	4,192.0	(2.0)	70.8	1,857.0	(3.2)	79.5	44.3	(0.5)
Residential Customers	2,481.0	(1.2)	41.9	1,476.0	(2.6)	63.2	59.5	(0.9)
Small & Medium-Sized Enterprises	572.0	0.0	9.7	421.0	3.4	18.0	73.6	2.4
Corporate Business	903.0	(2.8)	15.3	470.0	1.7	20.1	52.0	2.3
Wholesale	716.0	(13.9)	12.1	252.0	(17.1)	10.8	35.2	(1.3)
Network&IT and Support Functions	0.0	N.M.	0.0	(761.0)	N.M.	(32.6)	N.M.	N.M.
Eliminations	(480.0)	(14.9)	(8.1)	(1.0)	N.M.	N.M.	N.M.	N.M.
Fastweb	1,383.0	6.1	23.4	399.0	(9.1)	17.1	28.9	(4.8)
Other	818.0	(10.3)	13.8	153.0	(14.0)	6.6	18.7	(0.8)
Group Headquarters	3.0	0.0	0.1	(68.0)	(34.0)	(2.9)	N.M.	N.M.
Eliminations	(479.0)	(5.5)	(8.1)	(6.0)	20.0	(0.3)	N.M.	N.M.
Swisscom Group	5,917.0	(1.2)	100.0	2,335.0	(3.8)	100.0	39.5	(1.0)

*Including intersegment revenues. **Contribution margin 2 for Swisscom Switzerland's segments. N.M.--Not meaningful.

Business Risk Profile: Strong And Resilient Position In Domestic Market

Swisscom's "strong" business risk profile is based on the company's strong and relatively resilient performance of its segment Swisscom Switzerland, which generated about 80% of group EBITDA and 93% of group operating free cash flow (defined as EBITDA minus capital expenditures) in the first half of 2009. Swisscom's significant competitive advantages and a moderate regulatory environment have resulted in strong fixed-line and mobile market positions and above-average margins. These advantages include a large installed customer base, modern and extensive infrastructure, a strong brand, and sound technology skills. Nevertheless, we consider that competitive and regulatory pressures will increase, but, at the same time, to remain more moderate, compared with most Western European telecom markets.

Fastweb, which accounted for about 17% of group EBITDA in the first half of 2009, somewhat negatively impacts

Swisscom's business risk profile, in our view. Despite providing some diversification to Swisscom's EBITDA generation, this is primarily because of its weaker competitive position in the Italian fixed-line market, its lower profitability and, albeit improving, so far limited free cash flow generation.

Swisscom IT services and other various participations are currently not a major rating factor due to their limited contribution to group EBITDA and largely neutral-free cash flow generation.

Attractive, but relatively small and mature domestic service area

Although relatively small—with about 7.7 million inhabitants and 3.4 million households—Switzerland has an attractive telecoms market given the country's high per capita GDP (estimated at \$40,900 for 2008, purchasing power parity adjusted). This figure is one of Europe's highest purchasing powers and compares with about \$33,400 GDP per capita for the EU. Swiss customers spend more on telecommunication services, are less sensitive to prices of telecom services, and more sensitive to service quality than the EU average. In addition, Switzerland has a very high broadband penetration rate (about 33% of inhabitants and about 75% of households). This was significantly above the level of the EU at about 23% of inhabitants in January 2009. Mobile phone market penetration is somewhat lower than the EU average, at about 115% at the end of 2008. As in other European countries, the fixed telephony market is on the decline both in terms of access lines and traffic, but at a somewhat slower pace.

Increasing pressure from regulatory authorities in Switzerland, but still at a lower level compared with other European countries

In our view, Swisscom is likely to face increasing competitive pressure for its landline telephony services, primarily due to the ruling by the Swiss Federal Communications Commission (ComCom) on Oct. 9, 2008. Until then, Swisscom faced significantly less regulatory pressure than many other European telecom incumbents, however. This was because the Swiss Telecommunication Act operates in parallel with that of the EU, but with a meaningful delay. For example, local loop unbundling (LLU) was introduced in April 2007, but at a very high price (the monthly unbundling fee for the so-called last mile was initially set at CHF31) and did not take effect until the ComCom ruling. Under the ComCom ruling, which was accepted by Swisscom, the LLU fee was reduced to CHF18.18 for the year 2008. Furthermore, interconnection prices (fixed to fixed) were reduced between 20% and 30% for 2007 and 2008 and are henceforth among the lowest in Europe. Finally, prices for co-location (competitors need to obtain access to Swisscom's local exchanges and install equipment to unbundle subscriber lines) were significantly reduced. In particular, the one-off prices for Swisscom's clarifications and implementation services were reduced by about 55%-85%.

Nevertheless, the reduced LLU fee of CHF18.18 (€11.96) is still significantly higher than the average fee in the EU of €9.28 at October 2008. In addition, in the beginning of 2009, Swisscom increased the LLU price by about 3% and LLU does not apply to VDSL (very high bit-rate digital subscriber lines). Furthermore, current regulation in Switzerland continues to be retroactive, and complaints and rulings through legal instances significantly delay the implementation of regulatory measures. This creates high price uncertainty and is clearly an advantage for Swisscom. The introduction of an ex-ante regulation (in cases where telecom operators are deemed to have a dominant market position) would require a change of the current law on telecommunications (Fernmeldegesetz) and the legislative process could take more than two years.

However, competitive pressure on broadband prices could increase, because Swisscom is now required to offer fast bitstream access to its competitors for a four-year period. In June 2009, Swisscom announced to offer bitstream access at package costs from CHF 11.40 per month (exclusive the costs for a full access line) from November 2009.

Bitstream access would allow alternative providers, such as Sunrise, a subsidiary of the Danish telecom incumbent TDC A/S (BB-/Stable/B), to offer attractive broadband services with limited investments. The prices offered by Swisscom are in the mid-range when compared with other European countries.

Similar to other European countries, mobile termination fees (fixed to mobile) are declining. Based on an agreement between the three largest mobile telephony providers—Swisscom, Sunrise and Orange—mobile termination fees were reduced to 15 centimes for Swisscom and to 18 centimes for Orange and Sunrise by 2009. Swisscom expects mobile termination fees to decline by about 10% per year in the medium term.

Swisscom's fee negotiated for 2009, however, is still about 15% above the European average for mobile termination charges of 8.55 eurocent as at October 2008.

In addition, pricing asymmetry was decreased to 20% in 2009 from 50% in 2007, and Swisscom expects a further reduction in the fee asymmetry in the medium term. In our view, this is positive for Swisscom's competitive position.

Strong domestic fixed-line operations, but under increasing pressure

Swisscom's fixed-line service offering to residential and business customers is strong from a business risk profile standpoint, as it offers good visibility and sustainable free cash flows. Nevertheless, it is gradually challenged by continued fixed-to-mobile substitution, increasing regulatory pressure, limited growth prospects due to a maturing broadband market, and meaningful competition from alternative network and cable TV operators, as well as alternative technologies such as Voice-over-Internet-Protocol (VoIP).

Swisscom's leading domestic position in fixed-line telephony services for residential and business customers is based on:

- The ownership of a high quality network, enhanced by significant investments in VDSL technology;
- Dominant access to a large established customer base through 3.56 million PSTN/ISDN (public switched telephone network/integrated services digital network) lines compared with only 82,000 unbundled lines as of June 30, 2009;
- A gradually increasing retail broadband market share (52% at Dec. 31, 2008; see table 2);
- Significant experience in product development and marketing; and
- Its strong brand recognition and higher customer loyalty relative to its main competitors.

Table 2

Swisscom Switzerland Key Fixed-Line Operations Data						
	H1 2009	H1 2008	Y-o-y Change (%)	2008	2007	Y-o-y Change (%)
Total number of PSTN/ISDN lines ('000)	3,558	3,654	(2.6)	3,623	3,686	(1.7)
Residential customers	2,764	2,854	(3.2)	2,826	2,888	(2.1)
Small & medium-sized enterprises	512	512	0.0	511	509	0.4
Corporate business	282	288	(2.1)	286	289	(1.0)
Number of unbundled lines (LLU)	82	4	N.M.	31	0	N.M.
Total number of ADSL lines ('000)	1,795	1,699	5.7	1,756	1,602	9.6
Broadband retail market share (%)	N.A.	N.A.	N/A	52	50	4.0
ADSL retail lines ('000)	1,405	1,249	12.5	1,325	1,164	13.8
Residential customers	1,222	1,078	13.4	1,148	1,005	14.2
Small & medium-sized enterprises	164	152	7.9	158	142	11.3

Table 2

Swisscom Switzerland Key Fixed-Line Operations Data (cont.)						
Corporate business	19	19	0.0	19	17	11.8
ADSL wholesale lines ('000)	390	450	(13.3)	431	438	(1.6)
Number of IPTV subscribers ('000)	165	80	106.3	118	70	68.6
Total traffic (in millions of minutes)	10,884	12,004	(9.3)		25,396	(100.0)
Retail traffic (in millions of minutes)	4,969	5,318	(6.6)	10,339	10,879	(5.0)
Residential Customers	3,121	3,385	(7.8)	6,555	7,021	(6.6)
Small & medium-sized enterprises	845	890	(5.1)	1,733	1,811	(4.3)
Corporate business	1,003	1,043	(3.8)	2,051	2,047	0.2
Wholesale traffic (in millions of minutes)	5,915	6,686	(11.5)	12,878	14,517	(11.3)

N.A. -- Not available. N/A. -- Not applicable. N.M. -- Not meaningful. Y-o-y--Year on year.

Compared with many other European telecom operators such as Telekom Austria AG (BBB+/Negative/A-2), Deutsche Telekom AG (BBB+/Stable/A-2) or TDC, Swisscom's fixed-line revenues have been relatively resilient. In the first half of 2009 and full year 2008, declining revenues from ongoing, though still limited, PSTN/ISDN line loss (down 2.6% year on year in the first half of 2009), lower local and long-distance voice traffic due to continued fixed-to-mobile substitution, and meaningful competition, have been partly offset by higher revenues from good growth of asymmetric digital subscriber line subscriptions (see table 3). However, broadband subscriber growth rates are likely to slow as penetration rates increase, but the subscriber rates should benefit somewhat from the aggressive roll-out of VDSL in the past two years, which better facilitates internet protocol TV (IPTV) or video-on-demand services. Until June 30, 2009, Bluewin TV, Swisscom's IPTV offering, attracted about 165,000 customers, up from 80,000 a year earlier.

Although we expect that the number of IPTV subscribers increase further, the revenue contribution will probably remain modest in the medium term. Consequently, Swisscom's domestic wireline revenues are likely to erode slightly over the medium term, in our view.

Table 3

Swisscom Switzerland Revenue Split						
mil. CHF	H1 2009	H1 2008	Yoy change (%)	2008	2007	Yoy change (%)
Mobile services	1,623	1,612	0.7	3,355	3,279	2.3
Wireline services	1,766	1,776	(0.6)	3,574	3,649	(2.1)
Wireline access	992	987	0.5	1,975	1,938	1.9
Of which voice access	602	624	(3.5)	1,267	1,275	(0.6)
Of which broadband access	350	322	8.7	655	573	14.3
Wireline traffic	494	530	(6.8)	1,046	1,110	(5.8)
Wireline other*	280	259	8.1	553	601	(8.0)
Wholesale services	445	500	(11.0)	994	1,036	(4.1)
Other revenue**	319	345	(7.5)	673	646	4.2
Intersegment revenues & eliminations	39	46	(15.2)	83	83	0.0
Swisscom Switzerland	4,192	4,279	(2.0)	8,679	8,693	(0.2)

*Reflects primarily revenues from data services and other wireline business in the Corporate Business segment. **Reflects primarily revenues from business process optimization and communication & collaboration in the Corporate Business segment. Y-o-y--Year on year.

Competition in the provision of broadband or IPTV services could increase due to plans by local utility companies

to build extensive FTTH networks, which they want to offer to all telecom operators in Switzerland on non-discriminating terms. This partly runs counter to Swisscom's strategy, which foresees significant investments in the next five to six years to build a FTTH network, and which aims to share the network roll-out investments with local utilities where an agreement can be reached. By the end of 2009, Swisscom expects to connect somewhat less than 100,000 households in the cities of Zurich, Basel and Geneva to its fibre-optic network. In 2009, we understand that Swisscom will extend its network to other cities, with the ultimate aim of connecting over 1 million households (equals about 30% of total households) by the end of 2015.

Competition from Swisscom's main competitors, cable TV operator Cablecom (its network covers about 1.9 million or 56% of Swiss households as of June 30, 2009) and alternative operator Sunrise, has so far only marginally affected Swisscom's competitive position. According to Swisscom at year-end 2008, it had a 89% market share for full access lines (91% at year-end 2007), a 67% market share for wireline traffic (66%), and a retail broadband market share of 52% (50%). Furthermore, the readiness of Swisscom's fixed-line subscriber base to change the operator has remained stable at about 4% in the past 18 months, while it is considerably higher for Sunrise's and Cablecom's customers, according to Swisscom.

Sunrise, however, has slightly strengthened its competitive position with the acquisition of the country's third-largest fixed-line alternative network operator, Tele2 Telecommunications Services AG in November 2008. Its broadband market share increased by about 3 percentage points to about 13% at year-end 2008. In addition, it expects that at the end of 2009, 80% of Swiss households could be reached with LLU services. Cablecom, which had a broadband market share of about 19% at year-end 2008, was not able to increase its broadband subscriber base during the first half of 2009, despite having significantly lower prices than Swisscom, which enjoyed a 6% increase in the number of broadband subscribers during the same time period.

Other competitors include the alternative network operator COLT Telecom Group Ltd. (BB-/Stable/--) and various VoIP operators, and the latter could become a threat because they can attract Swisscom customers at very low incremental costs.

Profitable and market leading wireless business

Swisscom Switzerland's mobile services are very strong from a credit standpoint. This is because of their excellent free cash flow generation and resilient competitive position, in particular in the business segment, despite meaningful regulatory and competitive pressure and the near-market saturation.

Despite the economic downturn, revenues from mobile services at Swisscom Switzerland increased by 0.7% year on year in the first half of 2009. Higher revenues from an increase in mobile subscribers, higher handset sales and increasing data revenues largely offset lower traffic and subscription prices and lower mobile termination and roaming revenues (see table 3).

Swisscom Switzerland's stable and dominant domestic position in the Swiss mobile market is based on:

- Ownership of a high-quality, dense, state-of-the-art network. At year-end 2008, Swisscom covered about 92% of the population via a universal mobile telecommunication (UMTS) or high-speed packet access (HSPA) network;
- Access to a large, wealthy customer base of almost 5.4 million subscribers at June 30, 2009, equivalent to a strong market share of about 62% (see table 4);
- A strong market position for wireless data cards and growth possibilities from the further development of mobile broadband offerings;

- A strong brand name and service quality resulting in relatively low churn (see table 4) and higher customer satisfaction than competitors;
- An alliance with Vodafone Group PLC (A-/Negative/A-2), which enables significant technical efficiencies;
- An extensive branch network. The branch network was significantly strengthened by the acquisition of the Swiss branch network of The Phone House AG on July 1, 2008, which operated an independent retail chain for mobile telecom services in Switzerland comprising 62 branches; and
- Extensive experience in product development, marketing, and retention strategies.

Table 4

Swisscom Switzerland Key Wireless Operations Data						
	H1 2009	H1 2008	Y-o-y Change (%)	2008	2007	Y-o-y Change (%)
Market penetration (%)	N.A.	N.A.	N/A	115	107	7.0
Market share by subscribers (%)	N.A.	N.A.	N/A	62	62	0.0
Mobile subscribers ('000)	5,478	5,181	5.7	5,370	5,007	7.2
Residential customers	4,353	4,166	4.5	4,293	4,069	5.5
Small & medium-sized enterprises	430	392	9.7	411	360	14.2
Corporate business	695	623	11.6	666	578	15.2
Share of postpaid subscribers (%)	61	60	1.7	61	60	1.7
Mobile churn rate (annualized in %)	12	11	10.4	11	11	(2.7)
Blended ARPU (in CHF per month)	49	52	(5.8)	52	57	(8.8)
Residential customers	41	44	(6.8)	44	48	(8.3)
Small & medium-sized enterprises	91	98	(7.1)	99	104	(4.8)
Corporate business	72	80	(10.0)	79	87	(9.2)
Mobile traffic minutes (in mio.)	3,059	2,840	7.7	5,816	5,080	14.5
AMPU (in minutes per month)	112	114	(1.8)	114	129	(11.4)
Residential customers	94	94	0.0	94	88	6.8
Small & medium-sized enterprises	198	205	(3.4)	203	204	(0.5)
Corporate business	178	198	(10.1)	191	199	(4.0)

N.A. -- Not available. N/A--Not applicable. ARPU--Average revenues per user. AMPU--Average minutes per user.

Swisscom faces competition primarily from the two other established mobile operators (Orange and Sunrise), who had a market share of about 18% and 20%, respectively, at year end 2008.

Swisscom faces ongoing pricing pressure in the low-price segment, mainly from mobile resellers such as Cablecom Mobile, Mobilezone Net or CoopMobile. To counter this competition, Swisscom has established a partnership with M-Budget Mobile, a reseller launched by Switzerland's largest retailer, Migros – Genossenschafts-Bund (A/Stable/A-1), and consequently profits from the growth of its partner.

Fastweb: Swisscom's potential growth engine over the medium term

In the first half of 2009, Fastweb continued to be Swisscom's growth engine. Revenues in euro terms increased strongly by 13% year on year to €919 million (CHF1.4 billion), primarily due to strong growth at Fastweb's Executive segment as revenues from the Italian Public Administration increased by 58% year on year (see table 5). In Swiss Francs, however, year-on-year revenue growth was less pronounced at 6% because the euro depreciated against the Swiss Franc.

We anticipated further moderate revenue growth potential for Fastweb in the medium term given the still low broadband penetration in Italy of about 19% (per 100 population) in January 2009 compared with the average of 23% for European Union. In addition, Fastweb claims that it has considerably improved its market share in the past two years. In the first half of 2009, Fastweb estimates that it had a 15.7% revenue market share in its Executive segment, which serves large corporations and the Italian Public Administration, up from 11.9% in the first half of 2008 and 7.1% in the first half of 2007. In the consumer segment, its market share improved to 8.5%, up from 7.8% and 6.5%, respectively, while its market share in the small and medium-sized enterprises (SME) segment was 6.0% market share, up from 5.6% and 5.3%, respectively.

Table 5

Fastweb SpA Key Operational Results						
	H1 2009	H1 2008	Y-o-y Change (%)	2008	2007	Y-o-y Change (%)
Customers ('000)	1,575.0	1,398.0	12.7	1,482.0	1,312.6	12.9
Revenues (Mil. €)	918.8	813.9	12.9	1,708.1	1,433.2	19.2
Consumer	347.0	330.9	4.8	808.1	727.5	11.1
Small & medium-sized enterprises	206.2	188.2	9.6	228.8	229.5	(0.3)
Executive	365.6	294.8	24.0	671.2	476.3	40.9
Reported EBITDA (Mil. €)	265.0	274.9	(3.6)	547.7	480.3	14.0
EBITDA margin (%)	28.8	33.8	(4.9)	32.1	33.5	(2.0)
Capex (Mil. €)	216.5	226.7	(4.5)	437.6	540.7	(19.1)
Capex/revenues (%)	23.6	27.9	(4.3)	25.6	37.7	(12.0)
Reported EBITDA-Capex (Mil.€)	48.5	48.2	0.5	110.1	(60.4)	N.M.

N.M.--Not meaningful. Capex--Capital expenditures.

Nevertheless, we believe that Fastweb's revenue growth rates will slow down as broadband market penetration increases and due to meaningful price pressure for fixed-line telecom services in the Italian market. In addition, in our view, the increase of the monthly LLU fee by 11% to €8.49, effective from Jan. 1, 2009, somewhat weakens Fastweb's competitive position against its main competitor Telecom Italia.

Fastweb owns a fully IP-based and triple-play-ready network covering about 11.4 million homes passed or 50% of Italy's broadband market. A potential key competitive advantage for Fastweb is that it has already rolled out an extensive FTTH network to about 2 million homes passed, through which it can offer significantly higher bandwidth speeds without further significant infrastructure investments.

With an overall about 13% subscriber market share as at June 30, 2009, Fastweb is the second-largest broadband provider, following the incumbent operator Telecom Italia SpA (BBB/Stable/A-2), which controls about 60% of the broadband market. The competitive landscape in the Italian broadband market has become more aggressive since 2007, but competition is still less fierce than in other European countries, such as Austria, Germany, and the U.K., partly due to an absence of cable operators and/or aggressive alternative telecom providers.

Besides Telecom Italia, Fastweb mainly competes with the following companies:

- Wind Telecomunicazioni SpA (BB-/Stable/--), an integrated operator focused on offering retail customers medium-to-low-cost double-play packages;
- Vodafone Group PLC, which bought Tele2's voice and Internet services provider in 2007;
- BT Italia (BT Group PLC, BBB/Stable/A-2), which focuses on business customers; and

- Tiscali SpA, a narrowband and broadband Internet operator offering medium-to-low-cost double-play/VoIP offers.

Profitability

Swisscom's strong profitability and operating free cash flow generation—compared with other European telecom incumbents—support the currently assigned ratings (see table 8).

In the first half of 2009, the group's EBITDA margin eroded by 1.0 percentage point to a still strong level of 39.5%. This is primarily due to high subscriber acquisition costs from the launch of the iPhone and because lower revenues at Swisscom Switzerland have not been compensated by cost cutting activities. In addition, Fastweb reported weaker margins mainly because EBITDA in the first half of 2008 was aided by a €30 million compensation payment from Telecom Italia.

We expect that Swisscom will be more or less able to meet its EBITDA and, particularly, its operating free cash flow guidance for fiscal 2009 (see table 6). This is based on our assumption that Swisscom should be able to sustain its leading domestic market positions and largely offset the expected modest revenue decline by reductions in operating expenses and capital expenditures. In addition, we expect an increasing contribution to the group's operating free cash flow generation from Fastweb.

Table 6

Financial Outlook For Swisscom Group			
	2008	2009*	Y-o-y Change (%)†
Swisscom Group excl. Fastweb			
Net revenue (Bil. CHF)	9.5	9.2-9.3	(2.6)
EBITDA (Bil. CHF)	3.9	3.8-3.9	(1.9)
Capital expenditures (Bil. CHF)	1.4	~1.35	(0.7)
EBITDA - Capital expenditures (Bil. CHF)	2.6	2.5	(2.5)
Fastweb			
Net revenue (Mil. €)	1,708	1,800	5.4
EBITDA (Mil. €)§	518	560	8.1
Capital expenditures (Mil. €)	438	415	(5.3)
EBITDA - Capital expenditures (Mil. €)	80	145	81.3
Swisscom Group**			
Change net working capital (Bil. CHF)	(0.3)	-0.1-0.0	N.M.
Operating free cash flow (Bil. CHF)¶¶	2.5	2.6-2.7	6.5

*Swisscom guidance as of August 2009. †Based on midpoint guidance. §Before €30 million compensation payment from Telecom Italia in 2008. **Swisscom Group includes the segments 'Other' and Group Headquarters for which no separate guidance is provided. ¶¶Attributable to Swisscom shareholders. N.M. -- Not meaningful.

Financial Risk Profile: Healthy Domestic Free Cash Flow Generation Set To Improve Credit Measures

The main support for Swisscom's financial risk profile is the healthy and sustainable free cash flow generation of its domestic business, mitigating credit ratios weaker than average for the rating level. Based on modest net debt reduction, relatively resilient EBITDA generation, and high financial discipline, we believe that Swisscom will aim to

improve its credit measures in the near term.

Table 7

Reconciliation Of Swisscom AG Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. CHF)*						
--Fiscal year ended Dec. 31, 2008--						
Swisscom AG reported amounts						
	Debt	Shareholders' equity	Operating income (before D&A)	Operating income (before D&A)	Cash flow from operations	Capital expenditures
Reported	11,792.0	5,389.0	4,789.0	4,789.0	4,111.0	2,050.0
Standard & Poor's adjustments						
Operating leases	940.7	--	129.0	47.5	81.5	61.2
Postretirement benefit obligations	875.8	(486.8)	(64.0)	(64.0)	144.4	--
Surplus cash and near cash investments	(982.0)	--	--	--	--	--
Share-based compensation expense	--	--	--	6.0	--	--
Asset retirement obligations	435.0	--	--	--	--	--
Reclassification of interest, dividend, and tax cash flows	--	--	--	--	(394.0)	--
Reclassification of working-capital cash flow changes	--	--	--	--	87.0	--
Minority interests	--	374.0	--	--	--	--
Financial assets irrevocably placed in trusts to cover obligations from cross border tax leases	(808.0)	--	--	--	--	--
Total adjustments	461.5	(112.8)	65.0	(10.5)	(81.2)	61.2
Standard & Poor's adjusted amounts						
	Debt	Equity	Operating income (before D&A)	EBITDA	Funds from operations	Capital expenditures
Adjusted	12,253.5	5,276.2	4,854.0	4,778.5	4,029.8	2,111.2

*Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

Accounting

Swisscom produces consolidated financial statements in accordance with International Financial Reporting Standards. In its assessment of the company's financial leverage, we make adjustments to Swisscom's reported figures (see table 6). Most importantly, financial debt is adjusted by operating leases, unfunded pension liabilities, asset-retirement obligations, and defeased cross-border tax lease obligations. In the first half of 2009, Swisscom early terminated the large majority of its cross-border tax leases, but this had no material impact on Swisscom's credit measures since these leases were largely defeased by financial assets. Swisscom does not rely on any cash position to finance its ongoing operations, and therefore we consider non-restricted cash and current financial assets as surplus cash and deduct it from gross debt in our calculations.

Corporate governance/Risk tolerance/Financial policies

Swisscom's financial policy, which we view as moderately conservative, is governed by its principal shareholder, the Swiss Confederation, and includes the following core elements:

- Unadjusted net debt to EBITDA of about 2x, which can be temporarily exceeded (if necessary). At June 30, 2009, the ratio was 2.13x;
- Swisscom aims to distribute 50% of its operating free cash flow (defined as EBITDA minus investment expenditure plus/minus changes in net working capital minus minority interests) via dividends and share buybacks;
- Dividend payments should remain at least stable;
- Swisscom examines each year afresh the requirement of building up financial flexibility versus the leverage target of 2x, i.e. funds not required for strategic flexibility can be returned to shareholders in addition to the distribution of 50% of operating free cash flow.

Swisscom has a good track record of meeting its forecasts and in our view, it demonstrated a high level of financial discipline during 2009.

Given its relatively high level of indebtedness, Swisscom has currently limited headroom for meaningful debt-financed acquisitions at the current rating level.

Cash flow adequacy: Domestic FOCF generation expected to remain healthy

In the first six months of 2009, Swisscom generated strong and resilient FOCF of CHF0.9 billion. Lower capital expenditures and cash taxes, and a less negative working capital change largely offset the slight decline in EBITDA and higher financing costs from its refinancing activities.

We expect Swisscom to continue to generate healthy FOCF over the medium term, supported by solid margins from its domestic operations and higher free cash flow contributions from Fastweb. Nevertheless, high competitive and regulatory pressure, increasing access line losses, Swisscom's significant planned investments in FTTH networks, as well as further customer-growth-related capital expenditure at Fastweb, are likely to constrain FOCF growth.

Table 8

	--EBITDA--		--Capital Expenditure--			-- EBITDA Minus Capital Expenditure--			
	Total (Mil. CHF)	Y-o-y Change (%)	Total (Mil. CHF)	Y-o-y Change (%)	Proportion of revenues (%)	Total (Mil. CHF)	Y-o-y Change (%)	Proportion Of Total (%)	Proportion of revenues (%)
Swisscom Switzerland	1,857.0	(3.2)	479.0	(1.6)	11.4	1,378.0	(3.7)	93.4	32.9
Fastweb	399.0	(9.1)	326.0	(10.2)	23.6	73.0	(3.9)	4.9	5.3
Other	153.0	(14.0)	61.0	(12.9)	7.5	92.0	(14.8)	6.2	11.2
Group Headquarters	(68.0)	(34.0)	1.0	N.M.	N.M.	(69.0)	(36.7)	(4.7)	N.M.
Eliminations	(6.0)	N.M.	(7.0)	N.M.	N.M.	1.0	N.M.	0.1	N.M.
Swisscom group	2,335.0	(3.8)	860.0	(6.8)	14.5	1,475.0	(1.9)	100.0	24.9

N.M. -- Not meaningful.

Capital structure/asset protection: High leverage set to decrease modestly over near term

Swisscom's reported gross financial debt as at June 30, 2009, was CHF10.8 billion; mainly comprising CHF4.9 billion in bank loans, CHF3.3 billion in issued bonds, CHF1.4 billion in private placements, CHF0.5 billion in financial lease obligations, and CHF0.7 billion in other financial liabilities. The bank loans, bonds, and private placements contain change-of-control clauses. The bank loans, for example, would be due for immediate repayment if the Swiss Confederation's ownership stake in Swisscom were to fall below 35% or if another shareholder were to take control over the company.

On June 30, 2009, Swisscom's adjusted net debt to EBITDA ratio was 2.6x. According to our calculations, the group's leverage ratio is likely to decline to less than 2.5x on an adjusted basis at year end 2009, primarily through debt repayments and resilient EBITDA generation. We are mindful, however, that a higher pension deficit resulting from deteriorating pension asset values could increase the group's adjusted debt ratio.

Peer Comparison And Financial Statistics Tables

Table 9

Swisscom AG -- Peer Comparison*					
--Fiscal year ended Dec. 31, 2008--					
(Mil. €)	Swisscom AG	Belgacom S.A.	TeliaSonera AB	Koninklijke KPN N.V.	Telekom Austria AG
Corporate credit rating	A/Stable/--	A+/Stable/A-1	A-/Stable/A-2	BBB+/Stable/A-2	BBB+/Negative/A-2
Revenues	8,249.1	5,986.0	9,417.0	14,427.0	5,170.3
EBITDA	3,229.8	2,009.2	2,909.9	4,834.3	1,913.0
Funds from operations (FFO)	2,722.4	1,766.8	2,790.2	4,007.7	1,709.9
Capital expenditures	1,494.1	827.1	1,481.8	2,118.3	840.0
Free operating cash flow	1,169.4	860.7	1,181.6	2,307.4	739.9
Debt	8,286.6	2,929.6	5,911.8	14,372.2	4,416.0
Equity	3,568.1	2,218.6	12,568.7	3,785.9	2,164.8
Total capital	11,854.7	5,148.1	18,480.5	18,158.2	6,580.8
Adjusted ratios					
Oper. income (bef. D&A)/revenues (%)	39.7	34.5	32.5	35.5	37.5
Capex/sales (%)	18.1	13.8	15.7	14.7	16.2
FFO/sales (%)	33.0	29.5	29.6	27.8	33.1
EBITDA interest coverage (x)	10.0	11.1	8.0	5.6	8.2
Return on capital (%)	16.2	25.9	14.3	11.4	11.0
FFO/debt (%)	32.9	60.3	47.2	27.9	38.7
Free operating cash flow/debt (%)	14.1	29.4	20.0	16.1	16.8
Debt/EBITDA (x)	2.6	1.5	2.0	3.0	2.3
Total debt/debt plus equity (%)	69.9	56.9	32.0	79.2	67.1

*Fully adjusted (including postretirement obligations). Excess cash and investments netted against debt.

Table 10

Swisscom AG -- Financial Summary*						
(Mil. CHF)	12 months to June 30, 2009	--Fiscal year ended Dec. 31--				
		2008	2007	2006	2005	2004
Revenues	12,124.0	12,198.0	11,089.0	9,653.0	9,732.0	10,057.0
EBITDA	4,686.5	4,778.5	4,503.1	3,818.3	4,235.3	4,490.3
Operating income (bef. D&A)	4,762.0	4,854.0	4,574.0	3,863.5	4,274.5	4,567.5
Net income from continuing operations	1,931.0	1,756.0	2,068.0	1,563.0	2,013.0	1,839.0
Funds from operations (FFO)	4,166.8	4,029.8	3,948.9	3,335.4	3,607.7	4,252.9
Capital expenditures	2,048.2	2,111.2	2,304.7	1,414.7	1,115.4	1,375.7
Free operating cash flow	2,081.6	1,831.6	1,325.2	2,012.7	2,631.3	2,793.2
Discretionary cash flow	1,057.6	783.6	343.2	808.7	1,403.3	1,572.2
Debt	12,068.0	12,253.5	12,489.7	7,264.4	1,001.0	619.5
Equity	5,450.2	5,276.2	5,844.3	3,819.0	5,907.6	6,728.8
Adjusted ratios						
Oper. income (bef. D&A)/revenues (%)	39.3	39.8	41.2	40.0	43.9	45.4
Capital expenditures/revenues (%)	16.9	17.3	20.8	14.7	11.5	13.7
EBITDA interest coverage (x)	11.1	9.9	10.3	21.1	23.8	21.6
Return on capital (%)	15.2	15.3	17.5	27.0	40.1	34.7
FFO/debt (%)	34.5	32.9	31.6	45.9	360.4	686.4
Free operating cash flow/debt (%)	17.2	14.9	10.6	27.7	262.9	450.8
Discretionary cash flow/debt (%)	8.8	6.4	2.7	11.1	140.2	253.8
Debt/EBITDA (x)	2.6	2.6	2.8	1.9	0.2	0.1
Debt/Total capital (%)	68.9	69.9	68.1	65.5	14.5	8.4

*Fully adjusted (including postretirement obligations). Excess cash and investments netted against debt.

Related Research

- General Criteria: Enhanced Methodology And Assumptions For Rating Government-Related Entities, June 29, 2009

Ratings Detail (As Of September 17, 2009)*	
Swisscom AG	
Corporate Credit Rating	A/Stable/--
Senior Unsecured (9 Issues)	A
Corporate Credit Ratings History	
30-Jun-2009	A/Stable/--
12-Mar-2007	A-/Stable/--
Business Risk Profile	Strong
Financial Risk Profile	Modest

Ratings Detail (As Of September 17, 2009)***(cont.)**

Debt Maturities

As of June 30, 2009:*

2009: Nil.

2010: CHF0.69 bil.

2011: CHF2.55 bil.

2012: CHF2.15 bil.

2013: CHF0.71 bil.

Thereafter: CHF3.31 bil.

*Excluding lease and other financial liabilities.

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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