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Summary:
Swisscom AG

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Summary:

Swisscom AG

Credit Rating: A/Stable/--

Rationale

The ratings on Swisscom AG are supported by the group's position as the leading integrated provider of telecommunications services in Switzerland. The ratings also reflect our view of Swisscom's strong domestic free operating cash flow (FOCF) generation, strong liquidity, and proactive treasury management. In addition, the 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 rating on the company is one notch higher than its stand-alone credit profile (SACP), which we assess at 'A-', based on our view that there is a "moderate" likelihood that the Swiss government would provide timely and sufficient extraordinary support to Swisscom should the company encounter periods of financial distress.

The ratings remain constrained by the limited growth prospects of the Swiss telecoms market as a result of increasing market saturation. We are also mindful that Swisscom's Italian subsidiary, Fastweb SpA, could find it increasingly difficult to maintain its growth momentum. The current rating takes also into account the recently increased ownership in Fastweb to 95%, which, despite a slight increase in the company's leverage, will eliminate dividend leakage to minority shareholders.

Key business and profitability developments

In the first nine months of 2010, Swisscom posted solid results, in our view. Revenues and EBITDA (excluding a €70 million provision to cover financial risks associated with ongoing legal proceeding at Fastweb) increased by 2.5% and 2.8%, respectively, year-on-year at constant exchange rates. Revenue growth was mainly a result of the economic recovery in Switzerland, an acquisition made by Swisscom IT Services, growth in mobile services and bundled products, and solid revenue growth at Fastweb. However, reported revenues increased by only 0.6% year-on-year and reported EBITDA fell by 1.3% year-on-year due to adverse Swiss franc/euro exchange rate developments. As a result, Fastweb reported a 5.4% year-on-year decline in revenues in Swiss francs compared with a 2.7% increase in euros.

We currently expect that Swisscom should be able to meet its slightly increased guidance for EBITDA in fiscal 2010, which assumes net revenues of about Swiss franc (CHF) 12 billion and EBITDA of about CHF4.7 billion (including the €70 million provision at Fastweb). However, the impact on Fastweb's operating and financial results in the coming quarters, in addition to the €70 million provision in 2009, from any outcomes of the current investigations of Italian authorities is not yet clear.

Key cash flow and capital-structure developments

For the first nine months of 2010, Swisscom generated strong FOCF of CHF1.7 billion, slightly down from CHF1.9 billion generated in the same period of 2009. This was primarily due to higher taxes paid and a more negative working capital change. We believe that Swisscom will continue to generate resilient FOCF over the medium term. In our opinion, increasing FOCF at Fastweb and efficiency improvements at Swisscom Switzerland are likely to

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largely offset further moderate competitive and regulatory pressure on domestic revenues and EBITDA. At the same time, we do not expect a material increase in network investments.

We view Swisscom's financial policy overall as a slightly supportive factor for the ratings, although we consider that leverage still remains meaningful for the rating level. The group increased its dividend payment in 2010 only slightly to build up headroom under its 2x net debt-to-EBITDA leverage target for potential acquisitions. Pro forma the acquisition of the additional 13% stake in Fastweb, completed on Nov. 12, 2010, Swisscom's net debt-to-EBITDA ratio, as adjusted by S&P, was 2.3x as of Sept, 30, 2010. In our base case assessment, we expect Swisscom's leverage ratio to improve slightly over 2011, based on our expectation that the company utilizes a large portion of its discretionary cash flow generation for debt reduction and relatively stable EBITDA generation.

Liquidity

We view Swisscom's liquidity as strong, reflecting healthy cash balances and undrawn committed credit lines, manageable debt maturities in the next 24 months, proactive treasury management, and solid FOCF generation.

On Sept. 30, 2010, cash and unrestricted short-term investments totaled CHF0.6 billion. In November, Swisscom signed a new five-year CHF2.0 billion committed revolving credit facility (RCF). The new RCF replaced the existing CHF2.0 billion RCF due in December 2011, which was drawn by CHF250 million as of Sept. 30, 2010.

Swisscom has only moderate debt maturities of CHF384 million in 2010 and CHF250 million in 2011. Furthermore, in the first nine months of 2010, Swisscom generated solid discretionary cash flow (FOCF minus dividends) of CHF662 million despite a dividend payment of CHF1,036 billion to common shareholders. We currently expect that the company is likely to continue to generate solid discretionary cash flow generation in 2011, primarily as a result of relatively stable EBITDA generation and a similar level of network investments compared with 2010.

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 modest EBITDA growth and positive FOCF generation at Fastweb. Furthermore, we expect that the Swiss Confederation (AAA/Stable/A-1+) will maintain its majority ownership of Swisscom over the medium term.

We would consider a rating upgrade if Swisscom's net debt-to-EBITDA ratio improved to about 2x on a Standard & Poor's-adjusted basis as a result of a more conservative financial policy. At the same time, we consider an upgrade would have to be supported by sustainable revenue and EBITDA growth prospects at Fastweb, and expectations of strong and resilient domestic free cash flow generation.

We consider a downgrade would be possible--although we view it as unlikely at this stage given the existing headroom at the current rating level--if Swisscom's operating measures and/or domestic competitive positions were to weaken materially, or if management adopted a more aggressive financial policy leading to persistently weaker credit measures or our perception of a less predictable financial policy.

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Related Criteria And Research

Methodology And Assumptions: Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010

Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009

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