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Swisscom AG

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Table Of Contents

Major Rating Factors

Rationale

Outlook

Business Description

Government Support And GRE Methodology Impact

Business Risk Profile: Strong Market Position And Profitability, But Limited Growth Prospects In Switzerland

Financial Risk Profile: Strong Cash Flow Protection, Partly Offset By Policy Of Relatively High Shareholder Distribution

Financial Statistics/Adjustments

Related Criteria And Research

Swisscom AG

Major Rating Factors

Strengths:

- Switzerland's leading fixed-line and mobile telecommunications operator.
- Strong operating margins and free operating cash flow.
- Strong liquidity and proactive treasury management.
- Our assumption that Swisscom will continue to exercise financial discipline by using discretionary cash flow to reduce debt.
- The likelihood of extraordinary government support from the Swiss Confederation, which we consider to be "moderate."

Weaknesses:

- Wealthy, but mature domestic service area with low growth prospects.
- The potential for regulatory and competitive pressure.
- Growth execution risks at Italian subsidiary Fastweb.

Corporate 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 Standard & Poor's Ratings Services' 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 assumption that Swisscom's financial policy will remain moderate over the long term, notably regarding its shareholder distribution policy and capitalization.

The Swisscom group's stand-alone credit profile (SACP), which we assess at 'a-', is lifted by one notch to '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 difficult to quickly turnaround its operating performance and regain its growth momentum.

Key business and profitability developments

In 2010, Swisscom posted solid results, in our view, albeit the resilient performance of its domestic operations was offset by weaker performance at Fastweb. Revenues were flat and EBITDA declined slightly by 1.9% year on year. (At constant exchange rates, revenues and EBITDA [excluding the €70 million provision to cover financial risks associated with legal proceedings at Fastweb] were up 2.1% and 1.7% year on year, respectively.) Swisscom's domestic operations reported a 1.5% increase in revenues mainly a result of the economic recovery in Switzerland and an acquisition made by Swisscom in IT services. Price erosion was offset by an increase in volumes in the mobile segment and bundle offers in the fixed-line segment, which compensated for declines in the company's traditional voice business.

The results at Fastweb were affected by the slowdown in acquiring new customers and several nonrecurring items.

In local currency terms, revenues were up by just 1.5%. EBITDA, however, declined by 8.8% (excluding the €70 million VAT provision). The ongoing depreciation of the euro against the Swiss franc magnified the effect of Fastweb's weaker results on Swisscom's consolidated results.

For the three months ended March 31, 2011, appreciation of the Swiss franc against the euro and the ongoing weak performance at Fastweb are the main factors behind a 3.1% decline in Swisscom's revenues, whereas EBITDA increased by 6.4% over the same period due to the absence of nonrecurring items.

In our base-case assessment, we anticipate that Swisscom will meet its EBITDA guidance for financial 2011 (ending Dec. 31, 2011), namely EBITDA slightly in excess of the Swiss franc (CHF) 4.6 billion reported in 2010. Within this forecast, we take into consideration the execution risk related to the restructuring of the Italian operations, anticipate moderate competition in the domestic market from alternative telecoms operators, and the ongoing implementation of Swisscom's bundled offer strategy.

Key cash flow and capital-structure developments

In 2010, Swisscom's cash flow generation remained strong, despite the decline in FOCF to CHF1.9 billion from CHF2.2 billion in 2009. This was because the combination of a modest decline in EBITDA, higher pension contributions, and a lower contribution from working capital items was only partially offset by lower capital expenditures (capex). We believe that Swisscom's FOCF should gradually increase over the medium term as a result of operating efficiencies at both Fastweb and Swisscom Switzerland, despite the moderate competitive and regulatory pressure on domestic revenues and EBITDA. At the same time, we do not see a material increase in network investments and expect only moderate cash outflow related to the upcoming spectrum auction in 2012.

Overall, we view Swisscom's financial policy as slightly supportive for the ratings, although we consider that leverage is still somewhat high for the 'A' rating category. The group paid lower dividends than were foreseen under its shareholder remuneration policy in 2010. Furthermore, it announced only a mild increase in dividends in 2011 to build up headroom under its 2x net debt to EBITDA leverage target for the purchase of mobile spectrum and potentially small acquisitions. As a result, in our base-case credit scenario, Swisscom's adjusted net debt-to-EBITDA ratio is likely to improve slightly to 2.2x in 2011, from 2.3x as of year-end 2010.

Liquidity

We consider Swisscom's liquidity to be strong under our criteria. We believe that the group can more than cover its needs for the coming years, even in the event of a sharp, unexpected decline in EBITDA.

Our liquidity assessment is based on the following factors and assumptions:

- We anticipate that the company's liquidity sources (including cash, funds for operations, and credit facility availability) over the next 12 to 18 months should exceed its uses by more than 1.5x.
- There are moderate debt maturities for the next few years.
- We anticipate that net sources of cash will remain positive, even if EBITDA declines by 50%.

In our analysis, we assume sources of liquidity of about CHF7.0 billion in 2011. These sources comprise cash, funds from operations, and availability under the revolving credit facility. We estimate that the company will use approximately CHF4.0 billion during the same period for capital spending, moderate working capital needs, and shareholder remuneration.

Swisscom has no debt due in 2011 and only moderate debt maturities of CHF400 million and CHF788 million in

2012 and 2013, respectively. We believe the group will continue to adopt proactive treasury management. In 2010, Swisscom generated a solid discretionary cash flow (FOCF minus dividends) of CHF810 million, despite a dividend payment of CHF1.05 billion. We anticipate that the group will continue to generate solid discretionary cash flow in 2011, primarily because of relatively stable EBITDA generation, a similar level of network investments, and only a moderate increase in dividends.

Outlook

The stable outlook reflects our view 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 a modest improvement in EBITDA and positive FOCF at Fastweb. Furthermore, we believe that the Swiss Confederation (AAA/Stable/A-1+) will maintain its majority ownership of Swisscom over the medium term.

Rating upside would be dependent on Swisscom's net debt-to-EBITDA ratio improving 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 that an upgrade would need to be supported by sustainable revenue and EBITDA growth at Fastweb and strong and resilient domestic free cash flow generation.

Rating downside is unlikely at this stage, in our view, given the existing headroom at the current rating level. However, the rating could come under pressure if Swisscom's operating measures and/or domestic competitive positions were to weaken materially, or if management were to adopt a more aggressive financial policy, leading to persistently weaker credit measures or our perception of a less predictable financial policy.

Business Description

Swisscom is Switzerland's leading telecoms provider. It offers a wide range of products and services for mobile, landline, and Internet protocol (IP)-based voice and data communication and TV services via its main division Swisscom Switzerland (100% owned). On Dec. 31, 2010, Swisscom Switzerland had 5.8 million mobile customers, 3.5 million fixed telephony lines, and 1.6 million retail broadband Internet connections.

Following the completion of the minority share buyback earlier this year, Swisscom owns 100% of Fastweb, the third largest fixed-line operator in Italy. The Italian subsidiary offers fixed-line broadband, voice, and TV services for residential and corporate customers. In addition, it acts as a mobile virtual network operator (MVNO). On Dec. 31, 2010, Fastweb had 1.7 million customers.

Swisscom lists its IT services and various participations under its 'Other' division.

The Swiss Confederation's stake in Swisscom was 56.9% as of Dec. 31, 2010.

Government Support And GRE Methodology Impact

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 it encountered periods of financial distress.

In accordance with our criteria for government-related entities (GREs), 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 in the stability of Swisscom's operations and not so much by its credit standing.

For further details of our criteria on GREs, see "Enhanced Methodology And Assumptions For Rating Government-Related Entities," published June 29, 2009, on RatingsDirect on the Global Credit Portal.

Business Risk Profile: Strong Market Position And Profitability, But Limited Growth Prospects In Switzerland

The major supports for Swisscom's strong business risk profile are:

- An established and strong domestic position in its business and residential customer segments. As of year-end 2010, Swisscom had relatively high and sustainable market shares for fixed-line telephony (about 89%), fixed-line broadband (55%, up from 54% or 72% including wholesale), and mobile telephony (stable at about 62%) subscriptions, according to company estimates. Furthermore, Swisscom estimates that it had a rapidly growing subscriber market share of about 25% for pay-TV services through its IPTV offer in 2010, up from an estimated 17% one year ago. In addition, Swisscom is among the first telecoms operators in Europe to invest significantly in a fiber-to-the-home (FTTH) network (in conjunction with local Swiss utility companies) in order to sustain its competitive position against cable operators in the medium to long term. As of year-end 2010, the FTTH network was rolled out to about 230,000 households. By year-end 2015, Swisscom aims to connect more than 1 million households (about one-third of the Swiss population) to its fiber network.
- Strong profitability and operating free cash flow generation, compared with other European telecoms incumbents. Swisscom's EBITDA margin was relatively strong at 38% in 2010, despite the lower profitability of Fastweb (a 26% EBITDA margin after adjusting for the VAT provision) that accounted for about 13% of group EBITDA. This is because, in our view, Swisscom has significant competitive advantages over its peers and benefits from a relatively moderate regulatory environment. Together, these factors result in relatively strong fixed-line and mobile market positions and above-average margins, in our view. Swisscom's competitive advantages include a large installed customer base, a modern and extensive infrastructure, a strong brand, sound technology skills, and a large distribution network. In addition, we view Swiss customers as less sensitive to the prices of telecoms services, and more sensitive to service quality, compared with customers in other European countries.
- Moderate regulatory pressure. Currently, Swisscom faces less regulatory pressure than many other European telecoms incumbents, in our view. This is because regulation in Switzerland continues to be retroactive, and complaints and rulings that pass through legal process significantly delay the implementation of regulatory measures. This creates high price uncertainty and is an advantage for Swisscom, in our opinion. Furthermore, the introduction of an ex-ante regulation (in cases where telecoms 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.
- Fastweb's fully IP-based and triple-play-ready network, which covers 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. In addition, there is no competition from cable operators in Italy.

These supports are partially offset by:

- Limited growth prospects in the wealthy, but relatively small and mature Swiss telecoms market, which has about 7.7 million inhabitants and 3.4 million households. Switzerland has a high broadband Internet penetration rate of about 35% per capita at year-end 2010, one of the highest in Europe. Mobile phone market penetration, at about 122% at the end of 2010, is in line with the EU average. As in other European countries, the fixed-line telephony market is in decline both in terms of access lines and traffic, but at a much slower pace than elsewhere in Europe.
- Growth execution risks at Fastweb, as a result of a less favorable regulatory environment and increasing competition in Italy. We believe that 2011 will be a transitional year for Fastweb due to the slowdown of broadband subscriber growth (broadband penetration increased to 44% of households at year-end 2010--a level that we consider to be low, from 43% at the end of 2009) and meaningful price pressure for fixed-line telecoms services in the Italian market. In addition, planned increases in the monthly local loop unbundling (LLU) fee of 5% in 2011 and 4% in 2012 from the current €8.70 somewhat weakens Fastweb's competitive position against its main competitor, incumbent operator Telecom Italia SpA (BBB/Stable/A-2), for residential customers. With an overall subscriber market share of about 13% as of Dec. 31, 2010, Fastweb has a significantly smaller broadband market share than Telecom Italia, which controls about 54% of the broadband market in Italy. In addition, Fastweb had to contend with significant competition in 2010 from attractively priced broadband and telephony offerings from integrated operator Wind Telecomunicazioni SpA (BB-/Stable/--) and the Italian subsidiary of Vodafone AG (A-/Stable/--).
- Possible further competitive pressure. To date, Swisscom's three main competitors--the cable TV operator Cablecom (covering about 2.1 million or 75% of Swiss households as of March 31, 2010), fixed-line and mobile network operator Sunrise, and mobile network operator Orange (part of France Telecom S.A. [A-/Stable/A-2]), have only marginally affected Swisscom's competitive position.

Financial Risk Profile: Strong Cash Flow Protection, Partly Offset By Policy Of Relatively High Shareholder Distribution

The main strengths of Swisscom's modest financial risk profile are:

- Strong cash flow protection measures, owing to the group's healthy and sustainable domestic FOCF generation. We believe Swisscom should continue to generate strong FOCF, supported by stable network investments and the FTTH network roll-out in Switzerland, stable group EBITDA, and our assumption of improving free cash flow generation at Fastweb.
- Our assumption that Swisscom will exercise financial discipline. We believe the group will use discretionary cash flow to reduce debt and remain conservative in the event of unforeseen extraordinary circumstances. For instance, Swisscom continues to prudently adjust its shareholder distributions, remaining below the publicly stated payout target in 2010, to support faster debt reduction and build financial flexibility for potential acquisitions or higher-than-expected payments in the upcoming spectrum auction. In February 2011, the group announced that it would pay out only 43% of its operating free cash flow (defined as EBITDA minus capex minus changes in working capital). We note, however, that this was in line with its pledge to pay at least the same amount as the

previous year. Furthermore, the group has consistently reduced its indebtedness and thereby improved its credit measures since the Fastweb acquisition in May 2007 (see table 3).

- Strong liquidity and proactive treasury management.

These strengths are moderated by:

- A financial policy governed by its principal shareholder, the Swiss Confederation, that aims for relatively high shareholder distributions and somewhat limits the group's ability to quickly reduce debt, if fully applied. The policy also dictates that dividend payments should remain at least stable. Furthermore, the group targets a ratio of about 2x net debt to EBITDA. This equates to an adjusted net debt-to-EBITDA ratio of about 2.5x, which is at the upper end of what we view as a compatible leverage ratio for the group's current SACP.
- A moderate pensions deficit that could negatively affect the group's adjusted debt ratios in case of materially deteriorating pension asset values. On Dec. 31, 2010, plan assets amounted to CHF7.3 billion, of which 27.5% had been invested in equity instruments.
- The fact that the group's bank loans, bonds, and private placements contain change-of-control clauses. The bank loans 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 of the company. Bondholders would be entitled to sell the bonds if a another shareholder gained a majority share in Swisscom and at the same time the corporate credit rating on the group fell below 'BBB-'.

Financial Statistics/Adjustments

Swisscom produces consolidated financial statements in accordance with International Financial Reporting Standards.

In assessing financial leverage, we make adjustments to Swisscom's reported figures (see table 1). Most importantly, financial debt is adjusted by operating leases, unfunded pension liabilities, asset-retirement obligations, and defeased cross-border tax lease obligations, which have been converted into bank loans since 2009.

Swisscom does not rely on any cash position to finance its ongoing operations, owing to its strong FOCF generation and ample undrawn credit facilities. Therefore, we consider nonrestricted cash and current financial assets as surplus cash and deduct it from gross debt in our calculations.

Table 1

Reconciliation Of Swisscom AG Reported Amounts With Standard & Poor's Adjusted Amounts										
--Fiscal year ended Dec. 31, 2010--										
Swisscom AG reported amounts										
(Mil. CHF)	Debt	Shareholders' equity	Revenues	EBITDA	Operating income	Interest expense	Cash flow from operations	Cash flow from operations	Dividends paid	Capital expenditures
Reported	9,772.0	6,256.0	11,988.0	4,597.0	2,625.0	307.0	4,024.0	4,024.0	1,044.0	1,903.0
Standard & Poor's adjustments										
Operating leases	628.5	--	--	33.8	33.8	33.8	270.7	270.7	--	177.5
Postretirement benefit obligations	898.9	(1,082.0)	--	(8.0)	(8.0)	--	237.0	237.0	--	--

Table 1

Reconciliation Of Swisscom AG Reported Amounts With Standard & Poor's Adjusted Amounts (cont.)										
Surplus cash and near cash investments	(512.0)	--	--	--	--	--	--	--	--	--
Share-based compensation expense	--	--	--	2.0	--	--	--	--	--	--
Reclassification of nonoperating income (expenses)	--	--	--	--	121.0	--	--	--	--	--
Reclassification of interest, dividend, and tax cash flows	--	--	--	--	--	--	(267.0)	(267.0)	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	(90.0)	--	--
Minority interests	--	28.0	--	--	--	--	--	--	--	--
Pledged long-term financial assets to cover bank loans that were previously cross-border tax lease obligations	(319.0)	--	--	--	--	--	--	--	--	--
Total adjustments	696.4	(1,054.0)	0.0	27.8	146.8	33.8	240.7	150.7	0.0	177.5

Standard & Poor's adjusted amounts

	Debt	Equity	Revenues	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Dividends paid	Capital expenditures
Adjusted	10,468.4	5,202.0	11,988.0	4,624.8	2,771.8	340.8	4,264.7	4,174.7	1,044.0	2,080.5

Table 2

Swisscom AG Peer Comparison						
	Swisscom AG	Telenor ASA	Koninklijke KPN N.V.	Belgacom S.A.	TeliaSonera AB	
Rating as of July 29, 2011	A/Stable/--	A-/Stable/A-2	BBB+/Stable/A-2	A+/Negative/A-1	A-/Stable/A-2	
--Fiscal year ended Dec. 31, 2010--						
(Mil. €)						
Revenues	9,589.4	12,158.1	13,324.0	6,603.0	11,818.8	
EBITDA	3,697.2	3,758.6	5,512.1	2,033.1	4,232.7	
EBIT	2,214.9	2,182.4	3,291.1	1,225.2	3,654.1	
Interest expense	270.3	316.9	964.1	140.2	277.5	
Net income from continuing operations	1,448.6	1,890.6	1,793.0	1,266.0	2,357.2	
Funds from operations (FFO)	3,321.0	3,569.3	4,141.9	1,907.9	3,353.6	
Working capital	72.0	56.5	75.0	(99.0)	(154.9)	
Cash flow from operations	3,393.0	3,625.8	4,216.9	1,808.9	3,198.7	

Table 2

Swisscom AG Peer Comparison (cont.)					
Capital expenditures	1,736.5	2,157.5	2,245.6	807.6	1,774.3
Free operating cash flow	1,656.5	1,468.3	1,971.3	1,001.2	1,424.4
Dividends paid	835.1	798.0	1,152.0	732.0	1,437.5
Discretionary cash flow	821.4	670.3	819.3	269.2	(13.1)
Cash and short-term investments	74.4	282.0	250.0	200.0	100.4
Debt	8,373.9	4,826.9	15,259.2	2,504.1	7,588.7
Equity	4,161.2	12,316.7	3,286.9	3,286.2	14,635.0
Debt and equity	12,535.0	17,143.5	18,546.1	5,790.3	22,223.7
Adjusted ratios					
EBITDA margin (%)	38.6	30.9	41.4	30.8	35.8
EBITDA interest coverage (x)	13.6	11.8	5.7	14.5	15.1
EBIT interest coverage (x)	8.1	6.9	3.4	8.7	13.1
Return on capital (%)	16.3	12.6	16.8	21.6	15.1
FFO/debt (%)	39.9	74.1	27.1	76.2	44.3
Cash flow from operations/debt (%)	40.7	75.3	27.6	72.2	42.3
Free operating cash flow/debt (%)	20.9	32.0	12.9	40.0	20.1
Discretionary cash flow/debt (%)	10.9	15.5	5.4	10.8	1.1
Debt/EBITDA (x)	2.3	1.3	2.8	1.2	1.8
Total debt/debt plus equity (%)	66.8	28.2	82.3	43.2	34.1

Table 3

Swisscom AG Financial Summary					
--Fiscal year ended Dec. 31--					
	2010	2009	2008	2007	2006
Rating history	A/Stable/--	A/Stable/--	A-/Stable/--	A-/Stable/--	NR
(Mil. CHF)					
Revenues	11,988.0	12,001.0	12,198.0	11,089.0	9,653.0
EBITDA	4,624.8	4,755.4	4,778.5	4,503.1	3,818.3
EBIT	2,771.8	2,887.6	2,799.5	2,635.1	2,520.3
Interest expense	340.8	376.6	481.5	439.1	181.3
Net income from continuing operations	1,811.0	1,926.0	1,756.0	2,068.0	1,563.0
Funds from operations (FFO)	4,174.7	4,333.9	4,068.5	3,980.9	3,364.2
Working capital	90.0	193.0	(87.0)	(319.0)	92.0
Cash flow from operations	4,264.7	4,526.9	3,981.5	3,661.9	3,456.2
Capital expenditures	2,080.5	1,987.0	2,111.2	2,304.7	1,414.7
Free operating cash flow	2,184.3	2,539.9	1,870.2	1,357.2	2,041.4
Dividends paid	1,044.0	1,039.0	1,048.0	982.0	1,204.0
Discretionary cash flow	1,140.3	1,500.9	822.2	375.2	837.4
Cash and short-term investments	93.0	85.0	146.0	142.0	174.0
Debt	10,468.4	11,102.7	12,253.5	12,489.7	7,264.4
Equity	5,202.0	6,093.0	5,146.0	5,799.0	3,625.0
Debt and equity	15,670.4	17,195.7	17,399.5	18,288.7	10,889.4

Table 3

Swisscom AG Financial Summary (cont.)					
Adjusted ratios					
EBITDA margin (%)	38.6	39.6	39.2	40.6	39.6
EBITDA interest coverage (x)	13.6	12.6	9.9	10.3	21.1
EBIT interest coverage (x)	8.1	7.7	5.8	6.0	13.9
Return on capital (%)	16.3	16.3	15.4	17.7	27.5
FFO/debt (%)	39.9	39.0	33.2	31.9	46.3
Cash flow from operations/debt (%)	40.7	40.8	32.5	29.3	47.6
Free operating cash flow/debt (%)	20.9	22.9	15.3	10.9	28.1
Discretionary cash flow/debt (%)	10.9	13.5	6.7	3.0	11.5
Debt/EBITDA (x)	2.3	2.3	2.6	2.8	1.9
Debt/debt and equity (%)	66.8	64.6	70.4	68.3	66.7

NR-Not rated.

Related Criteria And Research

- Methodology And Assumptions: Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010
- Enhanced Methodology And Assumptions For Rating Government-Related Entities, June 29, 2009
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009

Ratings Detail (As Of July 29, 2011)*

Swisscom AG

Corporate Credit Rating	A/Stable/--
Senior Unsecured (10 Issues)	A

Corporate Credit Ratings History

30-Jun-2009	A/Stable/--
12-Mar-2007	A-/Stable/--

Business Risk Profile

Strong

Financial Risk Profile

Modest

Debt Maturities

As of Dec. 31, 2010:
 2011: Nil
 2012: CHF400 mil.
 2013: CHF788 mil.
 2014: CHF1,528 mil.
 2015: CHF1,647 mil.
 Thereafter: CHF3,641 mil.

*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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