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CREDIT OPINION

7 April 2017

Update

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RATINGS

Swisscom AG

Domicile	Switzerland
Long Term Rating	A2
Type	LT Issuer Rating - Dom Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Swisscom AG

Update to Discussion of Key Credit Factors

Summary Rating Rationale

Swisscom AG's (Swisscom) A2 rating reflects the company's solid credit fundamentals and the two-notch uplift resulting from implicit government support. These fundamentals include (1) the company's quality of management and its determination to execute its strategy, as demonstrated by strong market shares in all segments, high customer satisfaction, good data revenue growth rates and the scope of new products to stimulate future usage; (2) the company's very high-quality network, supported by large investments; and (3) its strong financial profile and our expectation that the group will adhere to its public commitment of maintaining a maximum leverage (reported net debt/EBITDA) of 2.1x.

At the same time, the rating also reflects (1) Swisscom's low international diversification and medium size; and (2) increased competition and high penetration in the company's domestic markets, which will likely weigh on its underlying revenue in those markets.

Credit Strengths

- » Leading integrated telecommunications operator in Switzerland
- » High-quality network, which supports Swisscom's competitive positioning and offers differentiation
- » Prudent financial strategy, which includes a maximum leverage (reported net debt/EBITDA) of 2.1x

Credit Challenges

- » Modest geographical diversification compared with similarly rated peers, notwithstanding the company's presence in Italy through Fastweb
- » Increased competition likely to weigh on the company's underlying revenue in the domestic market

Rating Outlook

The stable outlook reflects Swisscom's operational strength, implicit support from the government and our expectation that the group will maintain a prudent financial policy.

We expect changes in Swisscom's credit metrics to be the key drivers of any future changes in the company's baseline credit assessment (BCA) of baa1. We note that our leverage ratios can be volatile as we include the accounting pension deficit, which is determined by the low discount rates under International Financial Reporting Standards; however, under Swiss law, there is actually no deficit owing to the different discount rates applied.

Factors that Could Lead to an Upgrade

Upward pressure could develop on the BCA in the event of a stronger-than-expected improvement in Swisscom's underlying operating performance on a sustainable basis. Assuming the other government-related issuer (GRI) factors remain constant, upward pressure could be exerted on the rating if the company's retained cash flow (RCF)/adjusted debt exceeds 35% and adjusted debt/EBITDA falls below 2.0x.

Factors that Could Lead to a Downgrade

Negative pressure could be exerted on the BCA if the company's RCF/adjusted debt drops sustainably below 25% and its adjusted debt/EBITDA increases towards 3.0x, with no expectation of improvement.

Swisscom's rating could be affected by changes to the Swiss government's rating (Aaa stable) or by changes in our assessment of default dependence and support. For example, if the government was to reduce its stake in Swisscom to less than 20%, we would most likely no longer consider the company to be a GRI and would likely implement a two-notch downgrade.

Downward rating pressure could also develop if there was a reduction in state support or if the government was to distance itself from the company even before the share disposal.

Key Indicators

Exhibit 1

Swisscom AG

	12/31/2016	12/31/2015	12/31/2014	12/31/2013	12/31/2012
Revenue (USD Billion)	\$11.6	\$12.1	\$12.8	\$12.3	\$12.1
Debt / EBITDA	2.5x	2.7x	2.6x	2.4x	2.6x
RCF / Debt	25.4%	24.9%	23.9%	26.1%	23.9%
(EBITDA - CAPEX) / Interest Expense	6.6x	5.7x	6.0x	5.3x	5.5x

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.

Source: Moody's Financial Metrics™

Detailed Rating Considerations

Leading integrated telecommunications operator in Switzerland

Swisscom is a long-standing operator, with one of the highest market shares amongst European incumbents.

Swisscom held a 60% market share in mobile as of December 2016, followed by [Sunrise \(Ba2 stable, 26%\)](#) and [Salt \(B2 negative, 16%\)](#). The company's market share has been largely stable with a slight improvement in recent years. In addition to the top three players, there are a number of mobile virtual network operators, but their scale remains marginal.

As the incumbent operator, Swisscom benefits from a strong market position in broadband, with a retail market share of approximately 54% as of December 2016. The company's ability to offer content and convergent services (bundled subscriptions accounted for 27% of revenue in 2016), is fundamental to its product differentiation and technology leadership. Swisscom is also the market leader in pay TV in Switzerland, with a market share of 32% as of December 2016. Swisscom retains exclusive content for football and hockey, although sports rights exclusivity is not a key growth driver in the Swiss market.

In the fixed-line business, there are currently a greater number of competitors providing telephone, TV and internet services with higher bandwidths. Cable network operators, such as Cablecom ([subsidiary of UPC, Ba3 stable](#)), with their own fixed-line infrastructure, are among the most dynamic operators owing to fairly attractive triple-play (i.e., TV/broadband/voice) bundled offers. Nevertheless, we note that competition from cable operators will be subject to their capability to invest heavily to meet the increasing demand for data.

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High-quality network supports Swisscom's competitive positioning

We believe Swisscom's high-quality network is a competitive advantage, enabling the company to expand the range of its products and services.

Switzerland has one of the most advanced telecommunications infrastructures in Europe. In this context, Swisscom has sustained a high level of investments in its infrastructure, with capex averaging 21% of sales over the past three years (including Fastweb).

In the fixed-line business, one key area of Swisscom's focus has been the development of its ultra-fast broadband network, using a combination of copper and fibre-optic lines, and G.fast transmission standards. According to Swisscom, combining network architectures with G.fast (which the company started using from the third quarter of 2016) will enable it to expand its network twice as fast and at a third of the cost of using only fibre-optic technology. As of December 2016, Swisscom had connected over 3.5 million homes and businesses, representing two thirds of the population, to its ultra-broadband service (with speeds above 50 megabits per second [Mbps]). By 2021, the company intends to connect 90% of the population to broadband speeds above 80 Mbps.

In mobile, Swisscom completed the modernisation of its network in mid-2014, creating the basis for a rapid rollout of 4G/LTE technology across all mobile sites alongside second- and third-generation mobile technologies. As of December 2016, 99% of Switzerland's population were covered by its 4G/LTE network. In 2017, the company plans to increase its speeds up to 1.6 gigabit per second (Gbps) while rolling out 5G in the medium term.

Increased competitive pressure and high penetration will likely weigh on underlying revenue in the domestic market

The Swiss telecommunications market is relatively small with 12 million subscriptions. Switzerland has some of the highest average revenues per user in Europe and relatively high EBITDA margins, especially in mobile, driven by the higher percentage of postpaid customers and the earlier adoption of smartphones in the country.

Unlike in other European countries, Swiss mobile network operators are not obliged to enter into mobile virtual network operator agreements. The market also benefits from an ex-post regulatory framework, wherein no fixed price is set by the regulator and no intervention is needed unless industry negotiations fail.

The competitive situation in the Swiss telecommunication market has traditionally been stable compared with that in other European markets. All three main mobile network operators are well established and there are sufficient barriers to market entry to prevent the emergence of a new major player.

However, competitive pressure is increasing, with greater promotional activity following the acquisition of Salt by NJJ Capital (unrated). As a result, revenue in its Swiss core business declined modestly in 2016 (down 1.1% year on year), and we expect this trend to continue in the near-term.

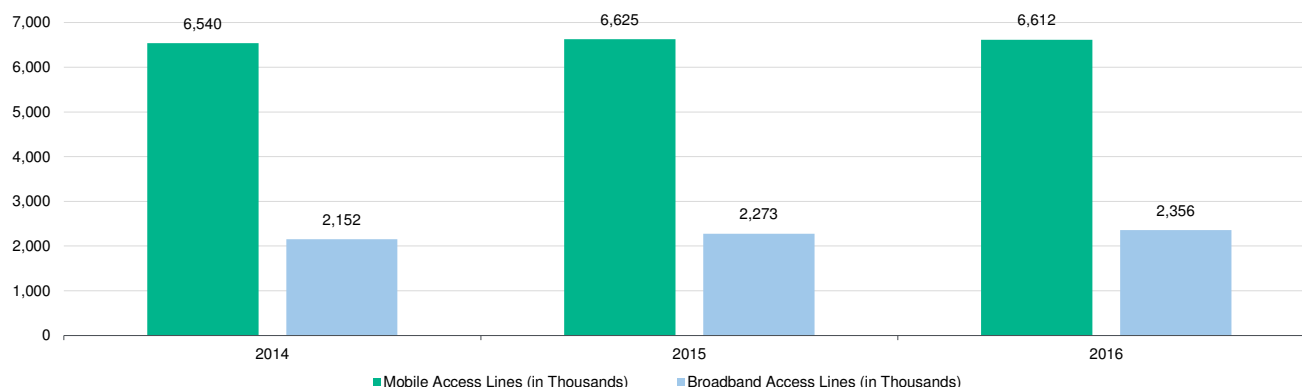
Furthermore, the Swiss mobile market is mature, with a penetration rate of around 141%, above the European average. As a result, the market is showing signs of saturation and operators are struggling to generate revenue growth.

In this context, we believe integrated players such as Swisscom and Sunrise are pushing convergent offerings by bundling mobile, broadband, landline and TV at competitive prices. They are doing so in order to defend market share and drive revenue growth by increasing revenue-generating units while reducing churn, which will be positive for operating performance and cash flow generation.

We believe Swisscom's integrated business profile, high-quality network and solid position place it strongly in a convergent market. However, Swisscom's high market share can render the company vulnerable to pricing pressure from smaller companies. For example, we note Sunrise's convergent offer provides bundled portfolios at a 27% discount to market rates, which will likely add pressure to prices. Salt is also planning an entry in fixed-line, which could add price pressure in this segment.

Exhibit 2

Number of Mobile Access Lines in 2016 Was Flat Compared With 2015, Signaling Market Saturation
 Swisscom mobile and broadband access lines (in thousands)



Source: Company reports

Modest geographical diversification compared with similarly rated peers, notwithstanding presence in Italy through Fastweb

Swisscom's geographical diversification is modest compared with similarly rated peers. However, the company is present in Italy through its ownership of Fastweb (17% of the group's revenue as of year-end 2016). Fastweb is the second-largest broadband provider in Italy, with a 16% market share. [Wind Tre S.p.A. \(B2 positive\)](#) also has a 16% market share, while [Telecom Italia \(Ba1 negative\)](#) is the largest player, with a 49% market share.

Italy's fixed broadband market is the fourth largest in Europe. As of December 2016, Fastweb covered 7.5 million households with FTTx (30% of the Italian population) and the company projects to reach 13 million homes by 2020.

At year-end 2016, Fastweb's performance was solid, with revenue up 3.4% on the back of customer acquisitions, and underlying EBITDA up 8.0%. Given the low penetration of broadband in the Italian market (55%), we expect Fastweb to continue strengthening its underlying revenue and operating performance.

Operating performance expected to remain broadly flat as cost savings offset some potential top-line pressure

We expect Swisscom's net underlying revenue to be under some pressure, given increasing domestic competition, partially offset by continuing growth at Fastweb in the next 12-18 months. Nevertheless, the impact on EBITDA should be more modest, given the company's cost-savings programme. We expect EBITDA margin to remain strong at slightly above 35%.

Swisscom plans to reduce its cost base by over CHF300 million during 2015-20 through the organisational changes implemented in 2016, adjustments to job vacancies, optimised processes and the migration to all-internet-protocol technology. The company achieved CHF50 million of cost savings in 2016 and intends to achieve CHF75 million by the end of 2017.

Swisscom targets revenue of CHF11,600 million and EBITDA of around CHF4,200 million for 2017, slightly down from CHF11,643 million and CHF4,273 million (pro forma excluding one-offs), respectively. Capex is expected to remain broadly flat at CHF2,400 million. We expect a modest impact from mobile termination rates on domestic revenue, which is EBITDA neutral.

Prudent financial strategy, including a maximum leverage (reported net debt/EBITDA) of 2.1x

We expect Swisscom to continue to prudently take advantage of its financial flexibility and make small bolt-on debt-financed acquisitions. We also expect Swisscom to maintain its current financial profile, with low leverage (adjusted debt/EBITDA at around 2.5x) and strong cash flow ratios (adjusted RCF/debt improving towards 25%).

We note that our leverage ratios can be volatile owing to the IAS 19 pension deficit that we include in adjusted debt. However, there is no deficit under Swiss law. Nevertheless, the effect of this volatility will likely be partially mitigated by the changes in accounting, which now better reflect the risk-sharing features of funding deficits between employers and employees in Switzerland. This change in

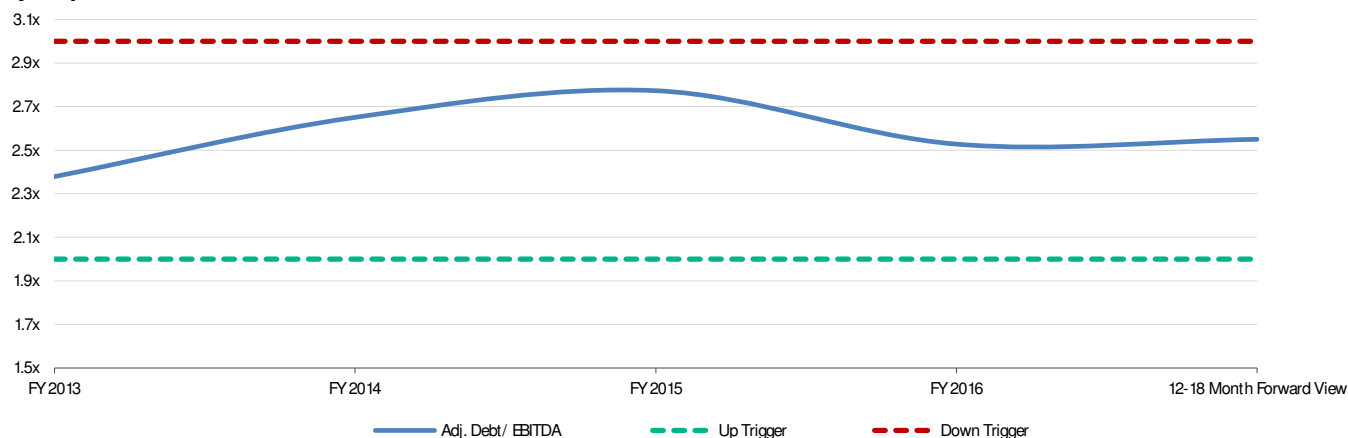
accounting was the main driver of the significant reduction in the pension deficit of over CHF1 billion to CHF1.9 billion in December 2016.

Swisscom has a conservative financial strategy, with a maximum leverage tolerance of reported net debt/EBITDA of 2.1x. Nevertheless, the relatively high dividend payout ratios will continue to weaken free cash flow generation. Dividend payments represented around 90% of the company's reported cash flow generation in 2016. Swisscom is committed to paying out similar dividends at CHF22 per share in 2017.

Exhibit 3

We Expect Leverage To Remain Within the Rating Bands in the Next 12-18 Months

Moody's-adjusted debt/EBITDA evolution



Sources: Moody's Financial MetricsTM, Moody's Investors Service estimates

Liquidity Analysis

Swisscom's liquidity profile for the next 12-18 months is adequate. We expect internal sources to enable the group to cover its 2017 debt maturities of approximately CHF1 billion (including a CHF600 million debenture bond) and its capital expenditures.

As of December 2016, Swisscom had CHF329 million of cash, and two committed facilities each of CHF1.0 billion, maturing in 2020 and 2022, respectively. As of that date, both facilities were fully undrawn. The company holds an operative liquidity reserve to meet short-term funding needs and a strategic liquidity reserve to maintain flexibility regarding financial needs over the next 24 months.

As a consequence of negative interest rates applied by financial institutions, Swisscom's liquidity policies could be potentially relaxed. The company currently has CHF0.9 billion and CHF1.6 billion of maturities lined up in 2017-18, which we expect management to be able to pre-fund in advance of the final maturity dates. The company does not have any financial covenants or rating triggers attached to any of its bank contracts.

Profile

Swisscom AG (A2 stable) is a medium-sized telecommunications operator providing mobile, broadband, TV and fixed-line telephony services. Swisscom's activities are concentrated in Switzerland (approximately 83% of reported net revenue and EBITDA), while the company's international diversification is limited to Italy via Fastweb (approximately 17% of the group's net revenue and EBITDA). As of December 2016, the company served 6.6 million mobile customers, 2.4 million fixed lines and 4.7 million broadband connections (of which 2.4 million are in Italy). In 2016, Swisscom generated revenue of CHF11.6 billion and EBITDA of CHF4.3 billion.

Rating Methodology and Scorecard Factors

Methodology Grid

The methodology grid outcome is in line with the baa1 BCA. The A2 senior unsecured rating of Swisscom benefits from two notches of uplift from the Swiss government. We expect Swisscom's credit metrics to remain broadly stable over the next 12-18 months.

Government-Related Issuer Considerations

The Swiss Confederation is Swisscom's majority shareholder, with a 51% stake. The confederation must, by law, hold a majority of the capital and voting rights. As such, Swisscom qualifies as a GRI under our Government-Related Issuers methodology.

Swisscom's A2 rating reflects the combination of the following inputs:

- (1) a BCA of baa1, reflecting Swisscom's underlying credit quality;
 - (2) the Aaa local-currency rating of Switzerland with a stable outlook;
 - (3) low default dependence between Swisscom and the government, reflecting the weak correlation between the strength of Swisscom's credit profile and Swiss economic trends (despite the group's importance to the national economy) and, more specifically, the low financial and operational links between Swisscom and the government; and
 - (4) a moderate level of government support, which is based on the following observations that: (a) there is no explicit support from the government; (b) the government's 51% ownership of Swisscom and its willingness to behave as a rational shareholder suggest that the government is unlikely to provide support alone, and instead, would only consider providing shareholder support jointly with other shareholders in the form of a capital increase; and
- (c) we consider the Swiss government's historical approach with regard to Swisscom to be highly interventionist.

Exhibit 4

Methodology Grid

Telecommunications Service Providers Industry Grid [1][2]			Moody's 12-18 Month Forward View As of 3/31/2017 [3]	
	Current 12/31/2016			
Factor 1 : Scale (12.5%)	Measure	Score	Measure	Score
a) Revenue (USD Billion)	\$11.6	Ba	\$11.7	Ba
Factor 2 : Business Profile (27.5%)				
a) Business Model, Competitive Environment and Technical Positioning	A	A	A	A
b) Regulatory Environment	Baa	Baa	Baa	Baa
c) Market Share	Aa	Aa	Aa	Aa
Factor 3 : Profitability and Efficiency (10%)				
a) Revenue Trend and Margin Sustainability	Baa	Baa	Baa	Baa
Factor 4 : Leverage and Coverage (35%)				
a) Debt / EBITDA	2.5x	Baa	2.5x - 2.6x	Baa
b) RCF / Debt	25.4%	Baa	23% - 24%	Ba
c) (EBITDA - CAPEX) / Interest Expense	6.6x	Aa	6.1x - 6.6x	A
Factor 5 : Financial Policy (15%)				
a) Financial Policy	Baa	Baa	Baa	Baa
Rating:				
a) Indicated Outcome from Scorecard		Baa1		Baa1
b) Actual Rating Assigned		A2		A2
Government-Related Issuer	Factor			
a) Baseline Credit Assessment	baa1			
b) Government Local Currency Rating	Aaa			
c) Default Dependence	Low			
d) Support	Moderate			
e) Final Rating Outcome	A2			

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.

[2] As of 03/31/ 2017.

[3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures/

Sources: Moody's Financial MetricsTM, Moody's Investors Service estimates

Ratings

Exhibit 5

Category	Moody's Rating
SWISSCOM AG	
Outlook	Stable
Issuer Rating - Dom Curr	A2
Senior Unsecured	A2

Source: Moody's Investors Service

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