

CREDIT OPINION

6 April 2018

Update

Rate this Research 

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 Credit Analysis

Summary

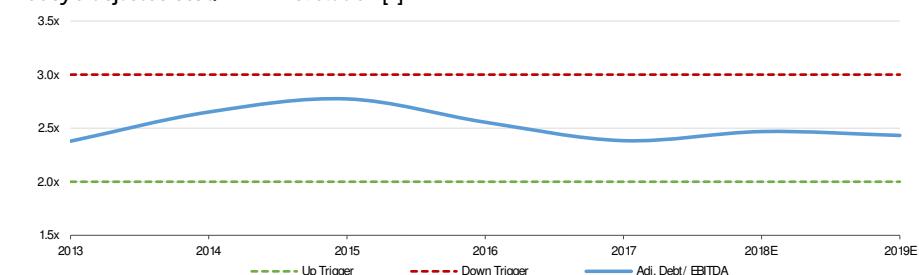
[Swisscom AG](#) (Swisscom) A2 rating reflects the company's solid credit fundamentals and a two-notch uplift owing to implicit support from the [Government of Switzerland](#) (Aaa stable). These fundamentals include (1) the quality of Swisscom's management team and its determination to execute its strategy, 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 significant investments; and (3) its strong financial profile and our expectation that the group will adhere to its public commitment of a leverage target ratio (reported net debt/EBITDA) of around 1.9x.

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

Exhibit 1

We expect Swisscom's leverage to remain well within the rating bands established for its rating category over the next 12-18 months

Moody's-adjusted debt/EBITDA evolution [1]



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

Sources: [Moody's Financial Metrics™](#), Moody's Investors Service estimates

Credit strengths

- » Leading integrated telecommunications operator in Switzerland
- » High-quality network, which supports Swisscom's competitive positioning and differentiation
- » Prudent financial strategy, as demonstrated by its leverage target ratio (reported net debt/EBITDA) of 1.9x

Credit challenges

- » Modest geographical diversification compared with similarly rated peers, notwithstanding the company's presence in Italy through Fastweb
- » Increasing competitive pressure will likely lead to moderate declines in revenue over the next two years

Rating outlook

The stable outlook reflects Swisscom's operational strength, implicit support from the Swiss 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. Moody's adjusted leverage ratios can be volatile because we include in adjusted debt the accounting pension deficit, which is influenced by low discount rates under IFRS; however, under the 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 its adjusted debt/EBITDA declines 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 declines sustainably below 25% and its adjusted debt/EBITDA increases to 3.0x, with no expectation of improvement.

Swisscom's rating could be affected by changes to the Swiss government's rating 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 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 2 Swisscom AG

	2019 Proj	2018 Proj	Dec-17	Dec-16	Dec-15	Dec-14	Dec-13
Revenue (USD Billion)	\$11.8	\$11.8	\$11.8	\$11.8	\$12.1	\$12.8	\$12.3
Debt / EBITDA	2.4x	2.5x	2.4x	2.6x	2.8x	2.7x	2.4x
RCF / Debt	25.7%	25.0%	27.7%	24.7%	24.5%	23.8%	26.1%
(EBITDA - CAPEX) / Interest Expense	7.4x	6.6x	7.7x	6.7x	5.7x	6.0x	5.3x

[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™

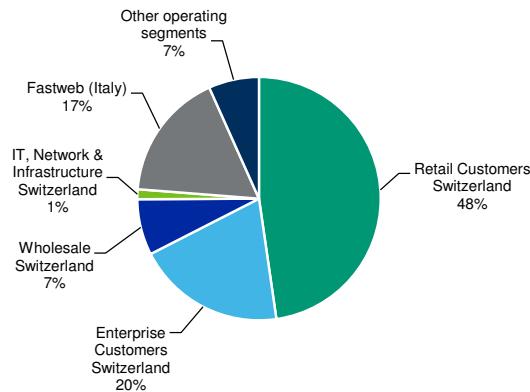
Profile

Swisscom AG is a medium-sized telecommunications operator, providing mobile, broadband, TV and fixed-line telephony services. Swisscom's activities are concentrated in Switzerland, while the company's international diversification is limited to Italy via Fastweb. As of December 2017, the company served 6.6 million mobile customers, 2.0 million fixed lines and 4.5 million broadband connections (of which 2.5 million are in Italy). In 2017, the company generated revenue of CHF11.7 billion and EBITDA of CHF4.2 billion (excluding one-offs).

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

Exhibit 3

Switzerland accounted for around 80% of revenue in FYE 2017
Revenue breakdown by segment 2017

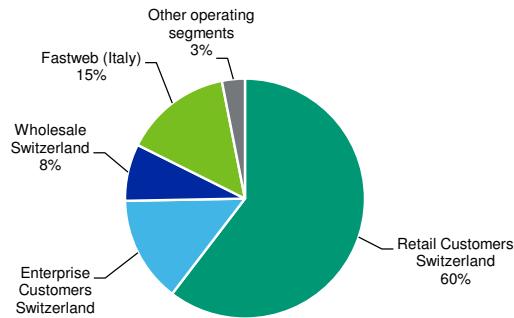


Net revenue excluding inter-segment revenue.

Source: Company reports

Exhibit 4

Switzerland accounted for 85% of EBITDA in FYE 2017
EBITDA breakdown by segment 2017



EBITDA excluding IT, Network & Infrastructure, group headquarters, reconciliation pension cost and inter-segment eliminations.

Source: Company reports

Detailed credit considerations

Leading integrated telecommunications operator in Switzerland

Swisscom is a long-standing operator, with one of the highest market shares among European incumbents. The company held a nearly 60% market share (based on subscribers) in mobile as of December 2017, followed by [Sunrise Communications Group AG](#) (Sunrise, Ba2 stable, 25% market share) and [Salt](#) (Salt, B2 negative, 17% market share). The company's market share has been largely stable, with a slight improvement in recent years. In addition to the top three entities, there are a number of mobile virtual network operators (MVNO), but their scale remains marginal.

As the incumbent operator, Swisscom benefits from a strong market position in broadband, with a retail market share of around 53% as of December 2017. The company's ability to offer content and convergent services 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 33% as of December 2017. The company retains exclusive content for football, although exclusivity of sports rights is not a key growth driver in the Swiss market.

In the fixed-line business, there is a greater number of competitors providing telephone, TV and internet services with higher bandwidths. Cable network operators, such as Cablecom (subsidiary of [UPC Holding B.V.](#), Ba3 negative), with their own fixed-line infrastructure, are among the most dynamic operators owing to fairly attractive triple-play (that is, TV/broadband/voice) bundled offers. Nevertheless, we note UPC has reported weakening operating performance and KPI trends in Switzerland in recent years.

We believe the risk of cable-mobile consolidation could increase in Switzerland. In February, [Vodafone Group plc](#) (Baa1 stable) confirmed it was in discussions to acquire certain Liberty's continental European assets. If this acquisition went ahead, the proceeds could further enhance the financial flexibility of UPC to do M&A in order to strengthen its business in Switzerland and improve its operating performance trends, as discussed in our report on [Liberty Global plc](#) (Ba3 stable) titled [Liberty Global Plc - Disposals to reduce scale, limit top-line growth potential, but proceeds to strategic M&A will revamp business](#).

However, it is uncertain whether or not consolidation will happen in the Swiss telecoms market, and which players will be involved, as there are various potential combinations of cable-mobile in Switzerland between Cablecom and challengers such as Sunrise or Salt.

High-quality network supports Swisscom's competitive positioning

Switzerland has one of the most advanced telecommunications infrastructures in Europe. In this context, the company has sustained a high level of investment in its infrastructure, with group capital spending averaging 21% of sales over the past three years (exhibit

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

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 will enable it to expand its network twice as fast and at a third of the cost of using only fibre-optic technology.

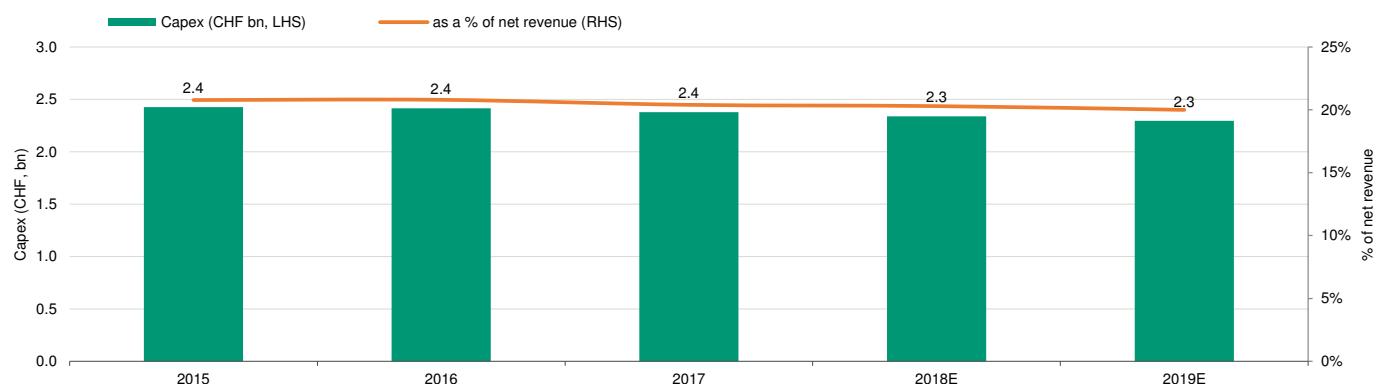
As of December 2017, the company had connected over 3.9 million homes and businesses, representing two-thirds of Switzerland's population, to its ultra-broadband service with speeds above 50 megabits per second (Mbps) and around a third of premises with speeds above 200 Mbps. By 2021, the company intends to connect 90% and 75% of the population to broadband speeds above 80 Mbps and 200 Mbps respectively.

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 2017, 99% of Switzerland's population was covered by its 4G/LTE network, and 80% had 4G+ network, with speeds of up to 300 Mbps. In addition, the company allows speeds of up to 1.0 gigabit per second in 11 cities in Switzerland and plans to reach 30% of the Swiss population with these speeds by 2018 while rolling out 5G in 2020.

Exhibit 5

Significant network investments support Swisscom's high-quality network

Actual and Moody's forecast of group capital spending and capital spending as a percentage of revenue



Sources: Company reports, Moody's Investors Service

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

The Swiss telecommunications market is relatively small, with total revenue estimated at around CHF12 billion. Switzerland has some of the highest average revenue per user in Europe and relatively high EBITDA margins, especially in mobile, driven by the higher percentage of postpaid customers.

Unlike other European countries, Swiss mobile network operators are not obliged to enter into MVNO 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 telecommunications market has traditionally been stable compared with 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 company.

However, the Swiss mobile market appears mature, with a penetration rate of mobile access lines higher than other European countries. As a result, the market is becoming increasingly saturated and competition is intensifying, particularly in the lower-end segment, driven by the greater promotional activity of challengers like Salt. In this environment, operators are struggling to generate revenue growth. For example, Swisscom's net revenue from residential customers in Switzerland was down 3.4% in 2017 from that in 2016, and we expect this trend to continue in the near term.

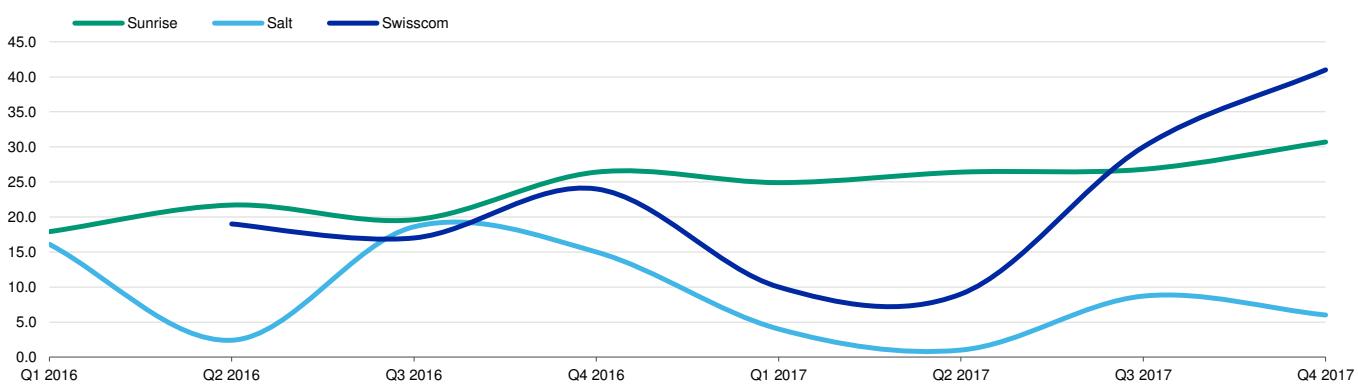
Increased market saturation has encouraged integrated Swiss companies, such as Swisscom and Sunrise, to launch convergent offerings by bundling mobile, broadband, landline and TV at competitive prices. These integrated companies are launching convergent offerings to defend market share and drive revenue growth by increasing revenue-generating units while reducing churn, which will be positive for operating performance and cash flow generation.

In this context, Swisscom has defended well its market share with mobile postpaid net adds of 90,000 in 2017 (as shown on exhibit 6) and good progress in accelerating its convergent strategy. We believe this demonstrates the strength of Swisscom's integrated business profile, high-quality network and solid position in a convergent market. However, the company's domestic revenues and ARPU has been under pressure as a result of competitive pressures with high promotional activity especially on mobile.

Exhibit 6

Swisscom's net adds have grown strongly despite competitive pressures

Evolution of postpaid mobile net adds (in thousands)



Swisscom's net adds estimated by Moody's. Swisscom's mobile net adds not available in Q1 2016.

Sources: Company reports, Moody's Investors Service

Furthermore, we expect competitive pressure to increase in an already mature fixed-line market following the launch of Salt's new triple- and quad-play offerings in the first quarter of 2018. Salt's offer include advertised internet bandwidth of 10 gigabit per second, with a significant number of TV channels, and are priced at a significant discount of around 50% on average compared with that of its Swiss peers.

While we believe Salt's new disruptive offer would probably weigh on Swiss telecoms' revenue growth, we derive comfort from the fact that Swisscom benefits from its strong network quality and has demonstrated a good track record in gaining net additions despite significant promotional activity in the market.

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 Fastweb, the country's second-largest broadband provider, with a 15% market share as of September 2017. [Telecom Italia S.p.A.](#) (Ba1 stable) is the largest company, with a 46% market share, while [Wind Tre S.p.A.](#) (B1 positive) is the third-largest company, with a market share of 15%. In 2017, Fastweb also started offering mobile services after entering into a full MVNO agreement with Telecom Italia.

Italy's fixed broadband market is the fourth largest in Europe and is characterised by intense pricing competition, as well as increased fixed to mobile convergence. Nevertheless, Fastweb's recent trading performance has been solid, with revenue and EBITDA up 8.3% and 9.6%, respectively in 2017 from that in 2016. This momentum has been driven by continued growth in net customer additions, up 4.1% to 2.5 million in 2017 from that in 2016. We expect underlying revenue growth at Fastweb to continue due to the still relatively low penetration of broadband in the Italian market (60%) compared with the European average.

Fastweb's network infrastructure comprises a fibre-optic network covering 8.0 million households and businesses with FTTx (equivalent to 30% of the Italian population). By 2020, Fastweb expects to reach 13 million homes (5 million with fibre-to-the-home technology and 8 million with FTTC technology).

We expect that the entry of Iliad S.A. in the Italian market in 2018 would increase competitive pressure on mobile. However, Fastweb's mobile segment is relatively modest.

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

Moody's expects EBITDA to remain broadly flat over the next 18-24 months as cost savings offset the declines in revenues with a good EBITDA margin of around 36%. Swisscom plans to reduce its cost base by over CHF300 million over 2018-20 through organisational changes implemented since 2016, adjustments to job vacancies, optimised processes and migration to all-internet-protocol technology. The company achieved CHF75 million of cost savings in 2017 and has upgraded its cost saving target to CHF100 million from 2018 to 2020, up from CHF65 million.

In 2018, Swisscom targets revenue of around CHF11,600 million and EBITDA of around CHF4,200 million, slightly down from CHF11,662 million and CHF4,233 million (excluding one-offs), respectively, in 2017. Capital spending is likely to be less than CHF2.4 billion (2017: CHF2.4 billion), equivalent to around 20% of revenue, above the European telecom sector average.

While Swisscom has had a strong track record in meeting its guidance and benefits from a solid business, we believe that the company's EBITDA could be under pressure if revenues continue to decline over the medium term due to competitive pressures.

In the next 12-18 months, we expect Swisscom's top line to modestly decline in the low-single digits as lower revenue in Switzerland is partially offset by continued growth at Fastweb on the back of broadband and mobile subscriber growth. We expect the company's Swiss revenue to come under pressure amid (1) market saturation, leading to a slowdown in residential customer additions and pricing pressure driven by the discounts offered on convergent offerings; (2) the continued structural decline in fixed telephony revenue in Switzerland; (3) the adverse impact of roaming regulations on outbound roaming revenue; and (4) continued pricing pressure in the Enterprise segment owing to intense competition.

Prudent financial strategy, demonstrated by a target net leverage ratio of around 1.9x

We expect Swisscom to continue to prudently take advantage of its financial flexibility and make small bolt-on debt-financed acquisitions. We also expect the company to maintain its current financial profile, with adjusted debt/EBITDA at around 2.5x and adjusted RCF/debt at around 26% over the next 18-24 months.

Our leverage ratios for Swisscom can be volatile owing to the IAS 19 pension deficit that we include in adjusted debt. However, we note that under Swiss law, there is no deficit. 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 a significant reduction in the company's pension deficit of over CHF1.0-CHF1.9 billion in December 2016.

Swisscom has a conservative financial strategy, with a target leverage ratio of around 1.9x (as reported and equivalent to a Moody's-adjusted debt/EBITDA of around 2.6x). Nevertheless, the company's relatively high dividend payout ratios will continue to weaken free cash flow generation; dividend payments represented around 66% of its reported free cash flow in 2017¹. In 2018, Swisscom expects its dividend per share to remain stable at CHF22 per share, similar to that in 2017. Since 2011, Swisscom's payout has remained stable at CHF22 per share.

Liquidity analysis

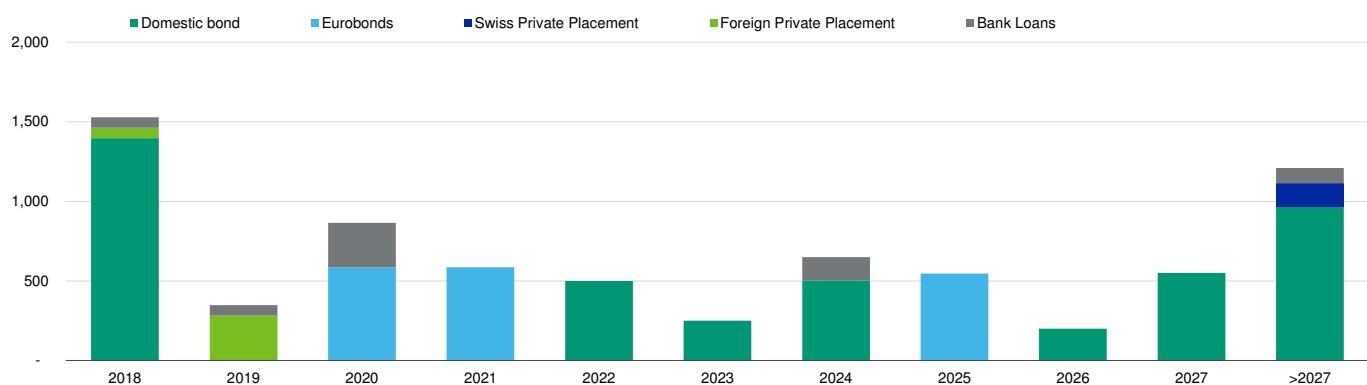
Swisscom's liquidity for the next 12-18 months is good. The company's sources of liquidity consist of internally generated cash flow of around CHF3.7 billion per year, and cash and cash equivalents of CHF525 million as of December 2017. Further buffer is provided by two undrawn committed facilities of CHF1.0 billion each, maturing in 2020 and 2022, respectively.

We expect internal sources of liquidity to cover debt maturities of around CHF1.5 billion (including a CHF1.4 billion bond) in 2018 and capital spending of around CHF2.4 billion per year. The company does not have any financial covenants or rating triggers attached to any of its bank contracts.

Exhibit 7

Swisscom has CHF1.5 billion and CHF0.3 billion debt maturing in 2018 and 2019, respectively

Swisscom's maturity profile as of 31 December 2017



Source: Company reports

Rating methodology and scorecard factors

Methodology grid

The methodology grid outcome is in line with the baa1 BCA. Swisscom's A2 senior unsecured rating benefits from two notches of uplift owing to the support from the Swiss government.

GRI 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, the company qualifies as a GRI under our Government-Related Issuers rating methodology.

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

- (1) A BCA of baa1, reflecting the company'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 the company'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 the company and the government
- (4) A moderate level of support from the Swiss government, which is based on the following observations: (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) the government's historical approach with regard to Swisscom is highly interventionist.

Exhibit 8

Methodology grid
Swisscom AG

Telecommunications Service Providers Industry Grid [1][2]			Current FY 12/31/2017		Moody's 12-18 Month Forward View As of 4/2/2018 [3]	
			Measure	Score	Measure	Score
Factor 1 : Scale (12.5%)					\$11.8	Ba
a) Revenue (USD Billion)						
Factor 2 : Business Profile (27.5%)						
a) Business Model, Competitive Environment and Technical Positioning			A	A		
b) Regulatory Environment			Baa	Baa		
c) Market Share			Aa	Aa		
Factor 3 : Profitability and Efficiency (10%)						
a) Revenue Trend and Margin Sustainability			Baa	Baa		
Factor 4 : Leverage and Coverage (35%)						
a) Debt / EBITDA			2.4x	Baa		
b) RCF / Debt			27.7%	Baa		
c) (EBITDA - CAPEX) / Interest Expense			7.7x	Aa		
Factor 5 : Financial Policy (15%)						
a) Financial Policy			Baa	Baa		
Rating:						
a) Indicated Rating from Grid			Baa1			
b) Actual Rating Assigned						
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 04/02/2018.

[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 Metrics™, Moody's Investors Service estimates

Peer comparison

Exhibit 9

Peer snapshot: Swisscom AG - December 2017 (last 12 months)

(in US millions)	Swisscom AG A2 Stable			Proximus SA de droit public A1 Stable			Telekom Austria AG (P)Baa2 Positive			Telenor ASA A3 Stable			Telia Company AB Baa1 Stable		
	FYE Dec-16	FYE Dec-17	LTM Dec-17	FYE Dec-15	FYE Dec-16	LTM Sep-17	FYE Dec-16	FYE Dec-17	LTM Dec-17	FYE Dec-15	FYE Dec-16	LTM Sep-17	FYE Dec-15	FYE Dec-16	LTM Sep-17
Revenues	\$11,821	\$11,850	\$11,850	\$6,599	\$6,450	\$6,355	\$4,564	\$4,836	\$4,836	\$15,930	\$15,648	\$15,685	\$10,262	\$9,846	\$9,162
EBITDA	\$4,485	\$4,445	\$4,445	\$2,075	\$2,026	\$2,067	\$1,683	\$1,748	\$1,748	\$5,957	\$5,966	\$6,557	\$3,075	\$3,234	\$3,099
Total Debt	\$11,110	\$10,700	\$10,700	\$3,226	\$2,813	\$3,268	\$4,058	\$4,145	\$4,145	\$10,933	\$12,587	\$12,322	\$13,790	\$12,784	\$11,880
Cash & Cash Equivalents	\$324	\$539	\$539	\$550	\$314	\$622	\$490	\$243	\$243	\$1,639	\$2,811	\$3,784	\$3,668	\$3,140	\$2,547
EBITDA Margin	37.9%	37.5%	37.5%	31.4%	31.4%	32.5%	36.9%	36.1%	36.1%	37.4%	38.1%	41.8%	30.0%	32.8%	33.8%
(EBITDA-CAPEX) / Interest Exper	6.7x	7.7x	7.7x	6.5x	7.6x	10.4x	3.2x	5.6x	5.6x	8.0x	6.4x	7.8x	1.7x	2.8x	2.7x
Debt / EBITDA	2.6x	2.4x	2.4x	1.6x	1.5x	1.5x	2.5x	2.2x	2.2x	2.0x	2.2x	1.8x	4.5x	4.2x	3.6x
FCF / Debt	1.4%	5.4%	5.4%	-4.6%	1.9%	-2.0%	3.8%	5.9%	5.9%	2.7%	1.6%	6.2%	2.7%	-6.4%	-9.9%
RCF / Debt	24.7%	27.7%	27.7%	31.8%	44.0%	39.6%	30.9%	32.3%	32.3%	24.5%	26.5%	33.3%	20.6%	10.5%	14.9%

All figures and ratios are calculated using Moody's estimates and standard adjustments. FYE = Financial year-end. LTM = Last 12 months. RUR* = Ratings under review, where UPG = for upgrade and DNG = for downgrade.

Source: Moody's Financial Metrics™

Appendix

Exhibit 10

Moody's-adjusted debt breakdown Swisscom AG

(in SFRANC Millions)	FYE Dec-13	FYE Dec-14	FYE Dec-15	FYE Dec-16	FYE Dec-17
As Reported Debt	8,673.0	8,484.0	8,288.0	8,139.0	7,851.0
Pensions	1,293.0	2,432.0	2,919.0	1,850.0	1,048.0
Operating Leases	903.0	948.0	942.0	817.2	863.1
Non-Standard Adjustments	142.0	282.0	355.0	485.0	665.0
Moody's-Adjusted Debt	11,011.0	12,146.0	12,504.0	11,291.2	10,427.1

All figures are calculated using Moody's estimates and standard adjustments.

Source: Moody's Financial Metrics™

Exhibit 11

Moody's-adjusted EBITDA breakdown Swisscom AG

(in SFRANC Millions)	FYE Dec-13	FYE Dec-14	FYE Dec-15	FYE Dec-16	FYE Dec-17
As Reported EBITDA	4,354.0	4,419.0	4,066.0	4,322.0	4,290.0
Pensions	7.0	4.0	2.0	8.0	5.0
Operating Leases	301.0	316.0	314.0	198.0	201.0
Unusual	-3.0	-131.0	150.0	-113.0	-132.0
Non-Standard Adjustments	-30.0	-26.0	-23.0	3.0	11.0
Moody's-Adjusted EBITDA	4,629.0	4,582.0	4,509.0	4,418.0	4,375.0

All figures are calculated using Moody's estimates and standard adjustments.

Source: Moody's Financial Metrics™

Ratings

Exhibit 12

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

Source: Moody's Investors Service

Endnotes

1 Reported free cash flow is defined as EBITDA net of capital spending, change in net working capital, net interest paid and income tax paid.

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