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Research Update:

Telecommunications Provider Swisscom AG 'A' Rating Affirmed; Outlook Stable

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Research Update:

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Overview

- We think that Swisscom AG will continue to successfully defend its strong market position in the domestic market, supported by superior fixed-line and mobile networks and the successful monetization of 4G, fiber, and Internet Protocol television services.
- We anticipate slightly positive discretionary cash flows after stable dividends and credit metrics remaining stable overall or slightly improving. Due to significant near-term maturities we are revising our assessment of Swisscom's liquidity position down to adequate from strong.
- We are affirming our 'A' long-term corporate credit rating on Swisscom AG and our 'A' issue rating on the company's senior unsecured debt.
- The stable outlook reflects our view that Swisscom will maintain its strong position in the domestic market and post Standard & Poor's-adjusted debt to EBITDA of about 2.5x and funds from operations to debt of approximately 35% in 2016-2017.

Rating Action

On March 23, 2016, Standard & Poor's Ratings Services affirmed its 'A' long-term corporate credit rating on Swiss telecommunications services provider Swisscom AG. The outlook is stable.

At the same time, we affirmed our issue ratings on Swisscom's senior unsecured debt at 'A'.

Rationale

As part of the affirmation, we are revising our assessment of Swisscom's liquidity to adequate from strong. This is because Swisscom has short-term debt maturities of about Swiss franc (CHF) 1 billion in the next 12 months, which lowers our estimate of the ratio of liquidity sources to uses over this period.

Swisscom continues to benefit from its superior fixed-line and mobile network, supporting strong domestic positions across both business and residential customer segments in Switzerland. Swisscom enjoys substantially higher market shares than its domestic competitors in mobile and broadband of well above 50%, and has also rapidly grown its market share in digital pay-TV services in the past few years through its Internet Protocol television (IPTV) offering. We expect the regulatory environment in Switzerland to remain relatively

benign compared with European peers, and growth potential at its Italian subsidiary Fastweb mitigates economic conditions in Italy that are less favorable than in Switzerland. Fastweb benefits from ongoing investments in its fiber network, the lack of competition from cable operators, and increasing fixed broadband penetration.

Our assessment of Swisscom's business risk is constrained by the company's moderate geographic diversification and a high degree of saturation in the domestic market for telecommunications services. Furthermore, Swisscom is exposed to increasing competition and price pressure in connectivity solutions for enterprise customers. The company is trying to compensate for these challenges by positioning itself as a full-service provider of information and communications technology (ICT) services, and is developing a portfolio of new products, including cloud-based, data center, and IT outsourcing solutions.

Our assessment of Swisscom's financial risk largely reflects the company's conservative and predictable financial policy. As of Dec. 31, 2015, Standard & Poor's-adjusted debt to EBITDA was 2.6x, and we expect leverage to stay at about 2.5x or below in coming years. Furthermore, Swisscom's dividend policy is fairly predictable, in our view. We note that Swisscom's free operating cash flow (FOCF) is depressed by the need for continued network investments, resulting in relatively high ratios of capital expenditure (capex) to sales of about 19%-21% in 2015 and in our forecast for 2016-2017.

In our base case, we assume:

- Modest revenue growth of about 1% in 2016-2017, supported by modest customer growth and rising bundle penetration in the consumer segment, new ICT services in the business segment, and growth at Fastweb.
- Stable adjusted EBITDA margins at about 38% in 2016-2017 as cost savings offset pricing pressures in the enterprise segment and lower roaming fees.
- Continued high capex of about 19%-21% of revenues in 2016-2017.
- Stable dividend payouts per share in the next few years.

Based on these assumptions, we arrive at the following adjusted credit measures:

- Debt to EBITDA of about 2.5x in 2016 and 2017, after 2.6x in 2015.
- Funds from operations (FFO) to debt of about 34% in 2016, the same level as in 2015, increasing slightly to 34%-36% in 2017.
- FOCF to debt of 11%-13% in 2016 and 2017.

Our rating on Swisscom incorporates a notch of uplift reflecting the company's status as a government-related entity (GRE) and our view that it has a moderate likelihood of receiving timely and sufficient extraordinary government support in the event of financial distress. This is based on our assessment of Swisscom's strong link with the Swiss government, primarily because the latter defines Swisscom's strategic goals and is unlikely, in our view, to reduce its majority ownership stake in the next few years; and the limited importance of Swisscom's role for the government, as the government is primarily interested in the stability of Swisscom's operations and not so much in its credit standing, in our opinion.

Liquidity

We assess Swisscom's liquidity as adequate because we expect that liquidity sources will cover uses by more than 1.2x over the 12 months from Jan. 1, 2016. We also think that the company has sound relationships with banks, a high standing in the credit markets, and generally prudent risk management.

As of Jan. 1, 2016, principal liquidity sources over the ensuing 12 months include:

- About CHF400 million in cash balances and short-term financial investments.
- An undrawn committed unsecured revolving credit facility of CHF2 billion due in August 2020.
- Annual FFO of about CHF3.8 billion.

Principal liquidity uses over the same period include:

- Capex of about CHF2.2 billion-CHF2.5 billion.
- Maturities of debt and short term borrowings of about CHF1 billion.
- About CHF1.2 billion in annual dividends.

Outlook

The stable outlook reflects our view that the company will continue to successfully defend its core domestic market positions, further increase bundle penetration in its customer base and successfully monetize its superior network. The stable outlook also factors in our expectation that the group's adjusted debt-to-EBITDA ratio will stay at about 2.5x and its adjusted ratio of FFO to debt will be approximately 35% over 2016-2017. In addition, we believe that the Swiss government will retain its majority ownership of Swisscom over the next few years.

Downside scenario

Although it is unlikely at this stage, we could consider a downgrade if Swisscom's competitive position were to weaken unexpectedly or if we observed mounting and sustained pressure on EBITDA, for example as the result of failure to offset pricing pressures with continuous cost optimization. We could also lower the rating if adjusted debt to EBTIDA were to deteriorate toward 3.0x and FFO to debt toward 30%. Alternatively, the privatization of the company could lead to a one-notch downgrade to align the rating with its stand-alone credit profile, but we think the risk is slim.

Upside scenario

We could raise our rating on Swisscom if its adjusted debt-to-EBITDA ratio improved to below 2x on a sustainable basis. This strengthening would require the group to post stronger revenue and EBITDA growth and revise its financial policy to an even more conservative level, which we think is unlikely at this stage.

Ratings Score Snapshot

Corporate Credit Rating: A/Stable/--

Business risk: Strong

- Country risk: Very Low
- Industry risk: Intermediate
- Competitive position: Strong

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: a-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Strong (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: a-

- Related government rating: AAA
- Likelihood of government support: Moderate (+1 notch from SACP)

Related Criteria And Research

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Key Credit Factors For The Telecommunications And Cable Industry, June 22, 2014
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Group Rating Methodology, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Ratings Affirmed

Swisscom AG

Corporate Credit Rating

A/Stable/--

Senior Unsecured

A

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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