S&P Global
Ratings

RatingsDirect®

Swisscom AG

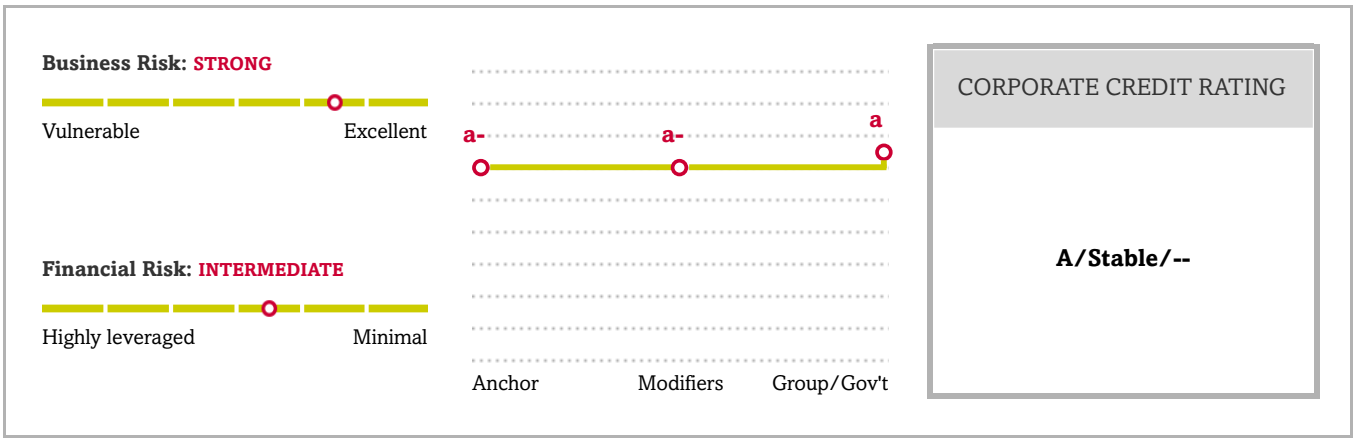
Primary Credit Analyst:
Lukas Paul, Frankfurt (49) 69-33-999-132; lukas.paul@spglobal.com

Secondary Contact:
Xavier Buffon, Paris (33) 1-4420-6675; xavier.buffon@spglobal.com

Table Of Contents

1714548 | 302337440

Swisscom AG



Rationale

Business Risk: Strong	Financial Risk: Intermediate
• Leading position in fixed and mobile markets in Switzerland, a wealthy, quality-conscious service area. • Superior domestic high-speed fixed and mobile networks. • Favorable regulation compared with European peers. • Increasing competition in certain segments, such as in connectivity services for business customers. • High capital expenditures (capex) to maintain and upgrade the high-quality network. • Mature and saturated domestic telecoms market that has limited growth prospects.	• S&P Global Ratings-adjusted debt-to-EBITDA of maximum 3x and funds from operations (FFO) to debt of at least 30% in our forecast. • Conservative and predictable financial policy. • Predictable, if somewhat inflexible, dividend policy. • Significant capex continues to weigh on free operating cash flow (FOCF). • Adequate liquidity.

Outlook: Stable

The stable outlook reflects our view that telecommunications operator Swisscom AG 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 expect the Swiss government to retain its majority ownership of Swisscom for the next few years.

Downside scenario

Although we consider it unlikely at this stage, we could lower the rating 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 through continuous cost optimization. We could also lower the rating if adjusted debt to EBITDA 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 of this occurring 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 be even more conservative, which we think is unlikely at this stage.

Our Base-Case Scenario

We expect Swisscom's credit metrics for the next few years to be influenced by its conservative financial policy, combined with its ability to stabilize or grow EBITDA margins in the low-growth domestic market.

Assumptions

- Revenues remaining approximately flat in 2016 as a result of lower roaming revenues coupled with competitive pressure in certain segments, and growth of 0%-1% in 2017, supported by rising bundle penetration in the consumer segment, new information and communications technology (ICT) services in the business segment, and growth at its Italian subsidiary, Fastweb.
- Stable adjusted EBITDA margins of about 37%-39% in 2016–2017 as cost savings in Switzerland and margin expansion at Fastweb offset the impact of domestic pricing pressures and lower roaming fees.
- Continued high capex of about 19%-21% of revenues in 2016–2017, most of which will be invested in the high-speed broadband and fourth-generation (4G) mobile networks.
- Stable dividend payouts of Swiss franc (CHF) 22 per share in 2017.
- No material increase in the pension deficit over the next 12-24 months, although this will ultimately depend on the evolution of discount rates. Our forecast carries forward the pension liability adjustments as of Dec. 31, 2015.

Key Metrics

	2015A	2016F	2017F
EBITDA margin (%)*	38.2	37-38	37-39
Debt to EBITDA (x)*	2.6	2.5–2.7	2.5–2.7
FFO to debt (%)*	33.1	32–34	34-35
FOCF to debt (%)*	11.1	11-13	11-14

f--Forecast. e--Estimate. *All data as adjusted by S&P Global Ratings. FFO--Funds from operations. FOCF--Defined as cash flow from operations after investments in property, plant, and equipment, and intangible assets.

Company Description

Swisscom is the leading telecommunications operator in Switzerland, offering fixed and mobile telephony, Internet access and TV services for residential and corporate customers, as well as ICT solutions for businesses. Swisscom also owns 100% of Fastweb, the third-largest fixed-line operator in Italy. In addition to fixed-line broadband, voice, and TV services, Fastweb provides mobile telephony services as a mobile virtual network operator (MVNO). At the end of June 2016, Swisscom served about 6.6 million mobile, 2 million retail broadband, and 1.4 million TV subscribers in Switzerland, as well as 2.3 million broadband subscribers in Italy. The largest shareholder, with a 51% stake, is the federal government of the Swiss Confederation.

Business Risk: Strong

Our assessment of Swisscom's business risk continues to benefit from its strong market positions across both business and residential customer segments in Switzerland. As of the second quarter of 2016, Swisscom's market share of mobile subscriptions was about 60%, and it held 54% of the market for retail broadband connections (all figures according to Swisscom). In addition, Swisscom has successfully used its Internet-Protocol-TV (IPTV) offering to

increase its market share in TV services in the past few years to about 31% in the second quarter of 2016, according to company estimates.

In our view, Swisscom's market position is supported by its superior fixed-line and mobile networks. By June 2016, the company was able to offer fast broadband, with download speeds of at least 50 megabits per second (Mbps), to about 92% of Swiss households, and aims to make available minimum speeds of 100 Mbps for 85% of homes and businesses by 2020. Although Swisscom employs a mix of network technologies, about 30% of its current network has been upgraded with fiber-to-the-home (FTTH), currently the fastest fixed-line technology. The company currently offers about 98% of the Swiss population 4G mobile network coverage.

In our view, operating trends at Swisscom's Italian subsidiary Fastweb are increasingly positive, balancing our assessment that economic conditions in Italy are less benign than those in Switzerland. Fastweb benefits from ongoing investments in its fiber network, the lack of competition from cable operators, and growth in Italy's fixed broadband penetration. It has therefore been able to expand its broadband subscriber base by about 20% since the beginning of 2013. Although in 2015 it ranked third in terms of overall broadband lines, with a share of about 15% (according to the national regulator), it was the market leader for ultrafast broadband connections. By 2020, the company aims to offer 50% of Italian households and businesses coverage at speeds of up to 200 Mbps. As part of a joint-venture with Telecom Italia announced in July 2016, 5 million out of the total 13 million households and businesses will be connected with FTTH technology. However, we acknowledge that recent plans by Italian utility company Enel SpA to roll out FTTH for several million homes could intensify competition and alter the competitive dynamics in the Italian broadband market.

We expect the regulatory environment in Switzerland to remain relatively benign compared with other European markets. For example, unlike other incumbent operators in EU countries, Swisscom is not subject to access and price regulation for its high-speed broadband network. Although a review of Swiss telecommunications regulation is under way, we do not currently expect a significant tightening of regulatory oversight, and the legislative process is likely to take several years.

We think Swisscom's business strengths are partly balanced by the need for substantial investments to maintain and upgrade its network infrastructure. Capex totaled about 21% of revenues in 2014 and 2015, and we expect annual capex to remain at 19%-21% for the next three years. The domestic market for telecommunications services is highly saturated, which we expect will limit Swisscom's growth opportunities. The company is exposed to increasing competition and price pressure in connectivity solutions for enterprise customers. It is trying to compensate for these challenges by positioning itself as a full-service provider of ICT services, and is developing a portfolio of new products, including cloud-based, data center, and IT outsourcing solutions. In addition, our assessment of Swisscom's business risk is constrained by the company's moderate geographic diversification.

Our Base-Case Operating Scenario

- Switzerland: Modest revenue decline of up to 0.5% in 2016 as a result of lower roaming revenues and general price pressure for a number of Swisscom's voice, broadband, and TV services, and revenue growth of 0%-0.5% in 2017, supported by increasing revenues from broadband, telephony, and TV bundle products in the consumer segment, and ICT services in the business segment.
- Italy: Revenue growth of 2%-4% at Fastweb in the next two years, based on solid subscriber growth in the consumer and business divisions.
- Adjusted EBITDA margins of about 38% in 2016-2017, as cost savings in Switzerland and EBITDA growth at Fastweb offset the adverse effect of roaming rate cuts and modest organic margin decline in parts of the Swiss business.

Peer comparison

Table 1

Swisscom AG -- Peer Comparison

	Swisscom AG	Telia Company AB	Telenor ASA	Proximus S.A.
	--Fiscal year ended Dec. 31, 2015--			
(Mil. CHF)				
Revenues	11,678.0	10,275.3	14,492.5	6,533.4
EBITDA	4,462.5	4,025.3	5,437.3	1,888.5
Funds from operations (FFO)	3,917.1	3,464.5	4,529.3	1,593.1
Net income from cont. oper.	1,361.0	935.1	386.0	523.8
Cash flow from operations	3,731.1	4,421.6	4,553.0	1,573.6
Capital expenditures	2,419.0	2,209.6	2,393.4	1,086.7
Free operating cash flow	1,312.1	2,212.0	2,159.6	486.8
Discretionary cash flow	165.1	577.5	520.0	(83.7)
Cash and short-term investments	409.0	1,738.5	1,578.0	554.2
Debt	11,824.2	10,548.0	9,648.1	2,760.7
Equity	5,242.0	12,130.7	7,137.5	3,222.2
Adjusted ratios				
EBITDA margin (%)	38.2	39.1	37.3	28.8
Return on capital (%)	13.3	8.0	11.7	14.3
EBITDA interest coverage (x)	16.1	9.1	14.5	14.3
FFO cash int. cov. (X)	20.2	10.5	23.4	17.2
Debt/EBITDA (x)	2.6	2.6	1.8	1.5
FFO/debt (%)	33.1	32.8	46.7	57.6
Cash flow from operations/debt (%)	31.6	41.9	46.9	56.9
Free operating cash flow/debt (%)	11.1	20.9	22.1	17.5
Discretionary cash flow/debt (%)	1.4	5.4	5.1	(3.2)

Financial Risk: Intermediate

Our assessment of Swisscom's financial risk largely reflects the company's conservative and predictable financial policy, which targets a maximum net debt to EBITDA ratio of 2.1x, as per the company's definition, with exceptions being permitted only on a temporary basis. Equally, we perceive Swisscom's dividend policy as fairly predictable, underpinned by a track record of constant pay-outs of about CHF1.1 billion per year since 2011. That said, we consider that the company's declared objective to pursue stable dividend levels may somewhat limit its willingness to adjust distributions downward, if necessary. We expect that Swisscom's financial policies will support adjusted debt to EBITDA of 2.4x-2.8x in the next three years. We consider Swisscom's growing pension deficit, as measured under International Financial Reporting Standards (IFRS), as a potential risk factor that could cause deviations from this range.

Swisscom's FOCF is depressed by the need for continued network investments, which are likely to prevent FOCF from improving toward 15% of adjusted debt in the next three years.

Our Base-Case Cash Flow And Capital Structure Scenario

- Significant capex of 19%-21% of revenues in 2016 and 2017, as Swisscom rolls out high-speed broadband in Switzerland and Italy and continues to invest in its mobile network.
- FOCF of about CHF1.1 billion–CHF1.4 billion in 2016 and 2017.
- Sizable, but stable dividend pay-outs of about CHF1.15 billion in 2017, including dividends to minorities.

Financial summary

Table 2

Swisscom AG -- Financial Summary

	--Fiscal year ended Dec. 31--				
	2015	**2014**	**2013**	**2012**	**2011**
(Mil. CHF)					
Revenues	11,678.0	11,703.0	11,434.0	11,384.0	11,467.0
EBITDA	4,462.5	4,580.5	4,469.0	4,490.5	4,786.5
Funds from operations (FFO)	3,917.1	3,916.6	3,846.5	3,819.3	4,167.6
Net income from continuing operations	1,361.0	1,694.0	1,685.0	1,755.0	683.0
Cash flow from operations	3,731.1	3,639.6	3,984.5	4,103.3	3,904.6
Capital expenditures	2,419.0	2,448.0	2,430.0	2,561.0	2,095.0
Free operating cash flow	1,312.1	1,191.6	1,554.5	1,542.3	1,809.6
Discretionary cash flow	165.1	35.6	400.5	388.3	714.6
Cash and short-term investments	409.0	342.0	883.0	578.0	387.0
Debt	11,824.2	11,406.0	9,690.2	11,039.4	10,717.4
Equity	5,242.0	5,457.0	6,002.0	4,318.0	4,373.0
Adjusted ratios					
EBITDA margin (%)	38.2	39.1	39.1	39.4	41.7

Table 2

Swisscom AG -- Financial Summary (cont.)					
	--Fiscal year ended Dec. 31--				
	2015	2014	2013	2012	2011
(Mil. CHF)					
Return on capital (%)	13.3	14.5	14.7	15.9	7.7
EBITDA interest coverage (x)	16.1	15.5	13.5	12.7	12.8
FFO cash int. cov. (x)	20.2	16.4	15.6	16.7	17.0
Debt/EBITDA (x)	2.6	2.5	2.2	2.5	2.2
FFO/debt (%)	33.1	34.3	39.7	34.6	38.9
Cash flow from operations/debt (%)	31.6	31.9	41.1	37.2	36.4
Free operating cash flow/debt (%)	11.1	10.4	16.0	14.0	16.9
Discretionary cash flow/debt (%)	1.4	0.3	4.1	3.5	6.7

Liquidity: Adequate

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 July 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.

Principal Liquidity Sources	Principal Liquidity Uses
As of July 1, 2016, principal liquidity sources over the ensuing 12 months include: • About CHF470 million in cash balances and short-term financial investments. • Two undrawn committed unsecured revolving credit facilities of CHF1 billion each, due August 2020 and March 2022, respectively. • Annual FFO of about CHF3.8 billion.	Principal liquidity uses over the same period include: • Capex of about CHF2.3 billion-CHF2.5 billion. • Maturities of debt and short-term borrowings of about CHF1.4 billion. • About CHF1.15 billion in annual dividends.

Debt maturities

As of June 30, 2016*:

- 2016: CHF233 million
- 2017: CHF915 million
- 2018: CHF1,562 million
- 2019: CHF343 million
- 2020: CHF818 million
- Thereafter: CHF3,295 million

*Includes bank loans, bonds, and private placements.

Covenant Analysis

Change-of-control clauses exist in the group's bank loans, bonds, and private placements. The bank loans would be due for immediate repayment if Switzerland's stake in Swisscom were to fall below one-third, or if another shareholder were to take control of the group. Bondholders would be entitled to sell the bonds if another shareholder gained a majority share in Swisscom and at the same time the long-term corporate credit rating on the group fell below 'BBB-'.

Government Influence

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. It is less interested in Swisscom's credit standing, in our opinion.

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)

Reconciliation

We increase debt at year-end 2015 to allow for a CHF186 million provision for a fine imposed on Swisscom in connection with a ruling by the Swiss Federal Competition Commission. The fine was paid in early 2016. However, we exclude from EBITDA and FFO the corresponding provision taken in the third quarter of 2015 because we consider it nonrecurring.

Other adjustments relate to our standard adjustments for operating leases, unfunded defined-benefit postretirement obligations, asset retirement obligations, share-based compensation expense, and capitalized interest.

Table 3

Reconciliation Of Swisscom AG Reported Amounts With S&P Global Ratings-Adjusted Amounts

	--Fiscal year ended Dec. 31, 2015--							
(Mil. CHF)	**Debt**	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**	**Capital expenditures**
Swisscom AG reported amounts	8,593.0	5,237.0	4,098.0	2,012.0	191.0	4,098.0	3,867.0	2,427.0
S&P Global Ratings adjustments								
Interest expense (reported)	--	--	--	--	--	(191.0)	--	--
Interest income (reported)	--	--	--	--	--	10.0	--	--
Current tax expense (reported)	--	--	--	--	--	(295.0)	--	--
Operating leases	713.4	--	151.5	51.9	51.9	99.6	99.6	--
Postretirement benefit obligations/deferred compensation	2,337.0	--	2.0	2.0	26.0	(7.5)	(62.5)	--
Surplus cash	(413.3)	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	8.0	(8.0)	(8.0)	(8.0)
Share-based compensation expense	--	--	2.0	--	--	2.0	--	--
Dividends received from equity investments	--	--	23.0	--	--	23.0	--	--
Asset retirement obligations	469.1	--	--	--	--	--	--	--
Non-operating income (expense)	--	--	--	39.0	--	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	(165.0)	--
Non-controlling Interest/Minority interest	--	5.0	--	--	--	--	--	--

Table 3

Reconciliation Of Swisscom AG Reported Amounts With S&P Global Ratings-Adjusted Amounts (cont.)								
Debt - Litigation provision	186.0	--	--	--	--	--	--	--
Debt - Non-current interest-bearing deposits	(61.0)	--	--	--	--	--	--	--
EBITDA - Litigation provision	--	--	186.0	186.0	--	186.0	--	--
Total adjustments	3,231.2	5.0	364.5	278.9	85.9	(180.9)	(135.9)	(8.0)
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Capital expenditures**
S&P Global Ratings-adjusted amounts	11,824.2	5,242.0	4,462.5	2,290.9	276.9	3,917.1	3,731.1	2,419.0

Related Criteria And Research

Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Telecommunications And Cable Industry, June 22, 2014
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Related Research

- Telecommunications Provider Swisscom AG 'A' Rating Affirmed; Outlook Stable, March 23, 2016

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	**Intermediate**	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	**a-/bbb+**	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of September 20, 2016)	
Swisscom AG	
Corporate Credit Rating	A/Stable/--
Senior Unsecured	A
Corporate Credit Ratings History	
30-Jun-2009	A/Stable/--
12-Mar-2007	A-/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

Additional Contact:

Industrial Ratings Europe; Corporate_Admin_London@spglobal.com