

Industry In-Depth

13 March 2007 | 15 pages

Swisscom AG/Fastweb SpA

The Case of the Disappearing Fastweb Dividend

- **Higher Bid Price May Be Needed** — Fundamentally, we remain negative on Fastweb (our standalone value is €37 per share). But we see room for Swisscom to raise its €47 bid price to include Fastweb's planned €3.77 dividend payment. Reflecting this, we recently raised our Fastweb target price to €50.77 (from €37.30) and our recommendation to Hold/Medium Risk (from Sell/Speculative Risk).
- **Deal Just About Justified** — For Swisscom we see the Fastweb deal as the least bad means of adding leverage (net debt/FY07E EBITDA to 2.2x versus 1x pre-deal) and some growth (4% 06A-09E revenue CAGR). We estimate the deal would however be EPS dilutive until 2009 and negative for ROIC until 2011. Pro forma 2008E PE would be 14x, a 17% premium to the sector.
- **Higher Forecasts after 4Q06 Results** — After the ahead-of-consensus operational results (especially in mobile), we raise our Swisscom group FY07 estimates by c2.5% for revenues, 2% EBITDA and 0.5% EPS. We see upside risk to the company's ever-conservative guidance and our new forecasts are 1% ahead of the company's SFr9.7bn revenue guidance and +2% versus EBITDA (SFr3,960m versus SFr3.9bn guidance).
- **Limited Positive Catalysts** — Whether Swisscom has to raise the Fastweb offer price is likely to be the key short-term driver, in our view. That aside, we see few upcoming catalysts. Swisscom continues to trade close to fair value. We reiterate our Hold/Medium Risk recommendation and SFr480 SoP-derived target price.

James Rivett¹

+44-20-7986-4236
james.rivett@citigroup.com

Mauro Baragiola¹

+39-02-8648-4703
mauro.baragiola@citigroup.com

Dimitri Y Kallianiotis¹

dimitri.kallianiotis@citigroup.com

Terence Sinclair¹

terence.sinclair@citigroup.com

Michael J Williams¹

michael1.williams@citigroup.com

See Appendix A-1 for Analyst Certification and important disclosures.

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Stock Drivers: Fastweb Upgraded, Swisscom Hold Rating Reiterated

Fastweb (FWB.MI - €48.60; 2M) – Moved to Hold¹

Fastweb rating recently raised to Hold. Target Price €50.77

Fundamentally on Fastweb (as we detail from page 3 below), we remain negative on the stock with our fundamental fair value still at €37 per share. However, following the Swisscom bid, we have raised our recommendation to Hold/Medium Risk (2M) from Sell/Speculative (3S) previously. Our new target price is €50.77. This is ahead of Swisscom's €47 offer price, reflecting our belief that the group will raise its bid to at least include Fastweb's planned €3.77 per share dividend payment.

Swisscom (SCMN.VX - SFr438.00; 2M) – Remain Neutral

Our views in the following sections incorporate comments made by the Swisscom management team on the Fastweb deal conference call (12 March) as well as at its FY06 investor meeting (13 March 2007).

We are sticking with our Hold/Medium Risk (2M) recommendation and SFr480 target price on Swisscom. The problem for us remains that Swisscom is a very well-managed, slowly declining, high-margin and ROIC-generative business with few signs of these long-term trends changing. Even the potential acquisition of Fastweb is not sufficient to materially change our stance — the company's desire to fund the deal partially through re-issuing treasury stock limits the re-leveraging and then de-leveraging potential and the overall scale of the deal is insufficient to change the group growth profile.

Catalysts limited but negative

Following the Fastweb acquisition, we see very few positive catalysts for the stock. Indeed, the market is likely to focus on whether it needs to raise the €47 offer price (marginally negative if it occurs). Other potential triggers are also negative, with the largest being the potential SFr333m fine for historical market dominance abuse in mobile termination.

Fairly valued

In addition, we see Swisscom as trading near fair value. Our SoP (Sum-of-the-Parts) value is SFr480 per share. This implies a group FY07E EV/EBITDA of c8x, a 25% premium to the sector, reflecting the lower Swiss bond and tax rates. At our target, the stock would trade at a c14x FY07E PE, broadly in line with the peer group.

¹ Rating raised in note *Brainstorming on Bid*, Mauro Baragiola, 13 March 2007.

Swisscom/Fastweb

Swisscom on 12 March 2007 launched a €47 all-cash bid on Fastweb, valuing the business at €4.9bn including the €1.1bn debt.

Other Bidders Unlikely, Swisscom may Raise

Vodafone and Sky Italia the most obvious and have ruled themselves out

We do not see another buyer for Fastweb emerging. Both Sky Italia and Vodafone have already ruled themselves out of the bidding in interviews on the news wires on 12 March. Given that the asset has been on sale since November 2005, we find it highly unlikely that private equity bidders are likely to emerge at this stage. Moreover during their investor day, Swisscom's management were also keen to stress that they are one of few companies able to complete a deal on friendly terms and retain the founding shareholders and Fastweb management team.

Fundamentally, we value Fastweb at €37 per share on a standalone basis. We would therefore recommend that investors should tender their shares. We can however identify 6 reasons why Swisscom may be willing to pay a higher price:

- Limited alternative targets: Previous deals have also taught us that the Swiss Government is very selective in the assets that it will allow Swisscom to acquire. We estimate that it would take at least six months to get to a similar position again. We would therefore be surprised if Swisscom would want to walk away for the sake of €500m.
- Reputation Risk: Swisscom (under different management) failed to acquire both Telekom Austria and Eircom. If a third deal were to collapse, this would be a serious blow to the new management team's credibility.
- At the Swisscom analyst day, the CEO went to great lengths to justify why Fastweb was the only asset of interest to the group currently (based on the lack of cable competition, clear market number 2, near-FCF positive). As a result, any collapse of the deal would mean a return to the status quo position.
- Scaglia's intentions: Mr Scaglia (Chairman and CEO of Fastweb with a 18.7% ownership) has made a non-bidding agreement to tender his take to Swisscom. The nature of the non-bidding agreement means that Mr Scaglia could potentially tender his shares to another higher bidder. Swisscom might decide to raise its bid to guarantee unconditional support from Mr Scaglia.
- Consensus points to a fair value of €48 for the standalone business. More importantly, Fastweb reached an intra-day of €46.96 per share the day before Mr Scaglia sold a 6.25% stake (the stock closed at €45.47). The average investor is likely to think that the bid price offered by Swisscom is below fair value. Swisscom may have to raise its bid to at least match the fair value at which the average investor would be willing to tender his shares.
- Large Retail Base: According to Consob, Silvio Scaglia has an 18.71% stake, while both Unicredito and Fidelity have 4.7% stake. The shareholder base is therefore very fragmented. We also believe that retail investors (sitting on €100 per share loss as most investors will have acquired stock in the IPO) could be in excess of 10%. We struggle to see why they would be willing sellers today.

How does the combined group look?

Our analysis of the combined Swisscom/Fastweb group is shown below and is based on the following assumptions:

- Consolidation from June 2007, although we are assuming linear progression in this business rather modelling quarterly growth.
- We also assume Swisscom takes 100% control over the business.
- Swisscom will re-issue the 4.9m treasury shares that it currently holds. This equates to SFr2.2bn at current market prices.

Financial Impact – Growth more in line with the Sector

25% of group revenues, 110% of group growth

Fastweb should account for around 25% of FY08E revenues, 25% of EBITDA, 17% of Group EBIT and 22% of Equity FCF. Fastweb's impact on group growth should be much more significant, accounting for over 110% of group 2007E-10E revenue growth, 108% of EBITDA improvements and around 50% of the FCF growth.

Our preliminary estimates indicate that Swisscom will see a c8% FY07E EPS downgrade from the Fastweb deal. This is broadly in line with the company's guidance on its conference call of c10% dilution. By 2008 (the first full year of consolidation), the deal should be practically value neutral. Our full Swisscom/Fastweb model is shown from page 5 below.

Figure 1. Accretion (Dilution) to Swisscom from Fastweb Consolidation

	2007E	2008E	2009E	2010E
Revenues	14%	33%	35%	36%
EBITDA	13%	32%	35%	39%
EBIT	4%	21%	26%	32%
Net Income	-8%	-2%	10%	22%
EPS	-8%	-2%	10%	22%
FCF	-5%	8%	19%	30%

Source: Citigroup Investment Research

Taking group growth to 4% revenues, 20% net income and 18% FCF

As a combined entity, we estimate that Fastweb will add c4ppt to group revenue 2006E-09E compound growth and 5ppts to EBITDA and over 14% to group net income and take group FCF growth up from 1% per year to 18%, as shown in the table below.

Figure 2. Swisscom 06E-09E Pro-forma Compound Annual Growth (%)

	Swisscom	Fastweb	Pro forma	Sector
Revenues	0%	20%	4%	6%
EBITDA	1%	31%	6%	6%
Net Income	6%	-230%	20%	8%
Equity FCF	1%	-239%	18%	2%

Source: Citigroup Investment Research

Valuation Impact – Still at a 15-20% Sector Premium

Our estimates suggest that this deal would be dilutive to Swisscom's ROIC until c2011, although at 20% in FY10E it is still clearly well ahead of our c5.5% WACC. On a PE basis, Swisscom would still be trading at a c15% premium to the sector in FY07E and FY08E and a 25% premium on EV/EBITDA metrics.

15-25% premium to the sector on relative metrics

Figure 3. Swisscom Pro-Forma Relative Valuation Metrics

	2005A	2006A	2007E	2008E	2009E	2010E
ROIC (%)						
Swisscom		49%	23%	23%	24%	24%
Pro Forma		48%	24%	18%	19%	20%
Sector		10%	13%	13%		
PE	2005A	2006A	2007E	2008E	2009E	2010E
Swisscom	13.4x	17.0x	14.8x	14.6x	14.3x	14.3x
Fastweb	-31.3x	-31.1x	106.6x	25.0x	18.5x	14.3x
Pro Forma	14.4x	18.3x	15.7x	14.1x	12.0x	10.5x
Sector		14.4x	13.6x	12.1x		
premium (discount) (%)		27%	15%	17%		
EV/EBITDA	2005A	2006A	2007E	2008E	2009E	2010E
Swisscom	7.4x	8.2x	8.0x	7.9x	7.9x	8.0x
Fastweb	16.4x	11.6x	8.0x	6.1x	5.7x	5.2x
Pro Forma	8.3x	8.7x	8.0x	7.5x	7.4x	7.3x
Sector		6.7x	6.4x	6.1x		
premium (discount) (%)		31%	25%	22%		
FCF Yield (%)	2005A	2006A	2007E	2008E	2009E	2010E
Swisscom	9.7%	7.2%	5.6%	5.5%	6.0%	6.5%
Pro-Forma	7.2%	6.5%	7.0%	8.7%	9.7%	10.6%
Sector		8.4%	9.6%	9.7%		
premium (discount) (%)		29.2%	37.1%	11.2%		

Source: Company reports and Citigroup Investment Research

New Swisscom Standalone Forecasts

We are updating our Swisscom standalone forecasts after the FY06 results. A summary of the most important changes is shown in the table below. In general, we would highlight the following issues:

- Revenues: +2.6% FY07E (to SFr9,741m versus SFr9.7bn company guidance), +3.2% FY08E and 4.1% in FY09E: we are raising our estimates in Solutions (Corporate), reflecting the lower-than-anticipated slowdown in traffic revenues. In mobile too, we now forecast a 0.5ppt market share gain for Swisscom in FY07 (at ARPUs-15% rather than -10% previously) as the new low-end Liberty tariffs become increasingly important in the base.
- EBITDA +2.2% in FY07E (to SFr3,960 versus SFr3.9bn company guidance), +2% in FY08, +2% in FY09: on the back of the revenue upgrades. We are not changing any margin assumptions at this stage and our higher EBITDA.
- EPS +0.3% in FY07E, +3.7% in FY08E, 3.7% in FY09: reflecting higher depreciation estimates. We assume flat shares in issue at 55.3m on the FY06 level.
- Net Debt -8% in FY07E and -38% in FY09: our new estimates exclude any further share buybacks after the Fastweb acquisition. Previously, we assumed the return of 100% of FCF.

Figure 4. Swisscom Forecast Changes

	NEW FORECASTS				FORECAST CHANGES (%)				OLD FORECASTS			
	2006A	2007E	2008E	2009E	2006E	2007E	2008E	2009E	2006E	2007E	2008E	2009E
Fixnet	4,130	4,102	4,058	4,043	0.1%	0.4%	0.4%	0.2%	4,124	4,085	4,044	4,034
Mobile	3,540	3,593	3,583	3,597	0.6%	0.8%	-0.1%	0.0%	3,520	3,563	3,585	3,598
Solutions	1,072	1,104	1,151	1,219	6.9%	15.1%	24.9%	35.6%	1,003	959	921	899
Other	841	872	879	887	4.3%	7.0%	6.9%	6.9%	806	815	822	829
Corporate	70	70	70	70	2.1%	2.1%	2.1%	2.1%	68	68	68	69
Total Revenues	9,652	9,741	9,741	9,816	1.4%	2.6%	3.2%	4.1%	9,522	9,491	9,441	9,428
Fixnet	1,806	1,932	1,938	1,946	2.4%	2.1%	1.9%	1.7%	1,763	1,892	1,902	1,914
margin (%)	43.7%	47.1%	47.8%	48.1%	96.7%	78.0%	73.2%	68.2%	42.8%	46.3%	47.0%	47.4%
Mobile	1,802	1,797	1,755	1,726	-0.4%	0.8%	-0.1%	0.0%	1,809	1,782	1,757	1,727
margin (%)	50.9%	50.0%	49.0%	48.0%					51.4%	50.0%	49.0%	48.0%
Solutions	66	77	81	85	-2.8%	15.1%	24.9%	35.6%	68	67	64	63
margin (%)	6%	7%	7%	7%					7%	7%	7%	7%
Other	118	131	176	177	16.6%	7.0%	6.9%	6.9%	101	122	164	166
Corporate	-6	23	23	23	-160.0%	132.5%	132.5%	132.5%	10	10	10	10
Total EBITDA	3,787	3,960	3,973	3,958	1.0%	2.2%	2.0%	2.0%	3,751	3,873	3,897	3,880
Depreciation	-1,435	-1,471	-1,385	-1,329	5.8%	7.9%	1.3%	1.4%	-1,356	-1,363	-1,367	-1,310
Reported EBIT	2,352	2,488	2,588	2,630	-1.8%	-0.9%	2.3%	2.3%	2,395	2,510	2,530	2,570
Financial Items	-50	-118	-111	-111	44.7%				-35	-118	-111	-111
Taxation	-462	-523	-544	-552	-4.1%	-1%	2%	2%	-482	-527	-531	-540
Minorities/Assocs.	-276	-25	-25	-25	-11.2%				-311	-25	-25	-25
Reported Net Income	1,599	1,822	1,908	1,941	0.0%	-0.9%	2.5%	2.5%	1,600	1,839	1,862	1,894
Cash EPS	28.27	32.96	34.51	35.10	0.9%	0.3%	3.7%	3.7%	28.01	32.87	33.27	33.84
Net Debt	4,379	3,400	2,176	966	10%	-8%	-38%	-72%	3,985	3,681	3,490	3,505
Net Debt to EBITDA	1.2x	0.9x	0.5x	0.2x					1.1x	1.0x	0.9x	0.9x
Capex	-1,324	-1,390	-1,169	-1,185	3.5%	7.6%	1.4%	1.5%	-1,280	-1,292	-1,153	-1,167
Capex to sales	13.7%	14.3%	12.0%	12.1%					13.4%	13.6%	12.2%	12.4%

Source: Company reports and Citigroup Investment Research

- Major Divisions Outperform** — 4Q06 revenues SFr2,457m (+10% yoy), +6% vs CIR, +3% vs consensus and ahead of the group's SFr9.5bn FY06 target. Group EBITDA at SFr932m (38% margin, SFr3.8bn for FY06 vs SFr3.7bn target), +3% vs consensus. EBIT was SFr543m, -7% vs CIR on higher depreciation but lower taxes took net income to SFr370m (in line with consensus).
- Mobile Revenues and Fixnet Margins the Drivers of Out performance** — Mobile revenues (+2% vs our estimate) as subscribers outperformed (at 4.6m, +69k qoq) with ARPUs at SFr65, -26% yoy as the new liberty tariffs continue to take share. Fixnet EBITDA was +10% ahead of our forecasts (divisional margins at 47% versus our 43% forecast) on the back of a c19% yoy fall in CoGs.
- Cash Generation Weaker** — DPS at SFr17 (+6% yoy) was in line with our forecast but Capex at SFr472m (19% of sales), +12% yoy and 10% ahead of our estimate on accelerated VDSL network spend. Higher capex and working capital brought Net Debt to SFr4.379bn (1.3x EBITDA), 10% higher than our estimate.

Figure 5. 4Q06 Swisscom Results at a Glance (Sfr in millions, unless per share data)

	4Q 06A	4Q 06E	Delta (%)	Delta (Sfr)	Consensus	Delta (%)	4Q 05A	y-o-y (%)	3Q 06A	q-o-q (%)	FY06E	FY06A	y-o-y (%)
Fixnet	1,004	998	0.6%	6			1,054	-4.7%	1,016	-1.2%	4,760	4,130	-4.4%
Mobile	907	886	2.3%	21			897	1.1%	913	-0.7%	3,376	3,541	-3.0%
Solutions	297	228	30.4%	69			87	242.3%	265	12.1%	931	1,072	-4.6%
Other	231	197	17.1%	34			176	31.3%	206	12.1%	833	840	47.1%
Corporate	18	16	10.0%	2			19	-5.3%	23	-21.7%	72	70	2.3%
Revenues	2,457	2,326	5.6%	131	2,397	3%	2,233	10.0%	2,423	1.4%	14,083	9,653	-0.8%
Fixnet	469	426	10.1%	43			497	-5.6%	489	-4.1%	1,870	1,806	-13.7%
margin (%)	46.7%	42.7%					47.2%		48.1%		39.3%	43.7%	
Mobile	430	437	-1.7%	-7			404	6.4%	481	-10.6%	1,978	1,802	-2.6%
margin (%)	47.4%	49.3%					45.0%		52.7%		58.6%	50.9%	
Solutions	12	14	-12.3%	-2			3	300.0%	17	-29.4%	97	66	-11.1%
margin (%)	4.0%	6.0%					3.5%		6.4%		10.4%	6.1%	
Other	37	32	16.4%	5			9	311.1%	52	-28.8%	111	118	-17.2%
Corporate	-16	-20					-11		9		198	-5	
Reported EBITDA	932	896	4.0%	36	904	3%	899	3.7%	1,041	-10.5%	4,413	3,787	-9.2%
margin (%)	37.9%	38.5%					40.3%		43.0%		31.3%	39.2%	
D&A	-389	-310	25.6%	-79			-351	10.8%	-343		-2,005	-1,435	3.0%
as a % of capex	82%	72%					84%		105%		164%		
Reported EBIT	543	586	-7.4%	-43			548	-0.9%	698	-22.2%	2,408	2,352	-15.3%
margin (%)	22.1%	25.2%					24.5%		28.8%		17.1%	24.4%	
Associates	13			13			4	225.0%			95	30	129.9%
Financial Items	-18	-6	209.7%	-12			-36	-50.0%	-7	157.1%	-311	-51	-162.6%
Profit before Tax	538	580	-7.3%	-42			516	4.3%	691	-22.1%	1,490	2,331	-18.8%
Taxation	-112	-132	-14.9%	20			-85	31.8%	-137	-18.2%	-361	-462	-13.6%
Minorities	-60	-78	-23.1%	18			-68	-11.8%	-84	-28.6%	-305	-306	-5.5%
Other Adjustments							-9				-275	36	
Reported Net	370	371	-0.2%	-1	385	-4%	372	-0.5%	470	-21.3%	1,099	1,599	-20.9%
Capex	-472	-428	10.4%	-44			-420	12.4%	-326	44.8%	-1,222	-1,324	21.8%
Capex to Sales	19%	18%					19%		14%		9%	14%	
Net Debt (Cash)	4,379	3,985	9.9%				-1,567	-379.5%	-333	-1415.0%	-642	4,379	-379.5%
Operating Stats													
PSTN Lines	2,891	2,882	0.3%	9			2,930	-1.3%	2,892	0.0%	3,163	2,891	-1.1%
Domestic Mobile Subs	4,632	4,555	1.7%	77			4,174	11.0%	4,563	1.5%	3,605	4,632	8.2%
Mobile ARPU	62	72	-14.5%	-10			84	-25.9%	75	-1.7%	142	65	-21.6%

Source: Company reports and Citigroup Investment Research

Figure 6. Swisscom Profit & Loss Account (SFr in Millions)

	2002A	2003A	2004A	2005A	2006A	2007E	2008E	2009E	2010E
Fixnet	4,760	4,600	4,552	4,319	4,130	4,102	4,058	4,043	4,007
Mobile	3,376	3,511	3,679	3,651	3,540	3,593	3,583	3,597	3,617
Solutions	931	1,081	1,278	1,123	1,072	1,104	1,151	1,219	1,311
Other	833	761	476	571	841	872	879	887	894
Corporate	72	73	72	68	70	70	70	70	70
Total revenues	14,083	10,026	10,057	9,732	9,652	9,741	9,741	9,816	9,900
growth (%)	-0.6%	-28.8%	0.3%	-3.2%	-0.8%	0.9%	0.0%	0.8%	0.9%
Capitalised costs/ Other income	266	233	195	260	296	299	299	301	304
Total revenues	14,349	10,259	10,252	9,992	9,948	10,040	10,040	10,117	10,203
Total operating expenses	9,936	5,755	5,864	5,821	6,161	6,080	6,066	6,158	6,289
Fixnet	1,870	2,128	2,170	2,091	1,806	1,932	1,938	1,946	1,939
Mobile	1,978	1,984	1,976	1,850	1,802	1,797	1,755	1,726	1,682
Solutions	97	81	133	74	66	77	81	85	92
Other	111	156	156	142	118	131	176	177	179
Corporate	198	155	-53	17	-6	23	23	23	23
EBITDA	4,413	4,504	4,388	4,171	3,787	3,960	3,973	3,958	3,914
margin (%)	31.3%	44.9%	43.6%	42.9%	39.2%	40.6%	40.8%	40.3%	39.5%
Depreciation	-1,578	-1,543	-1,542	-1,286	-1,435	-1,471	-1,385	-1,329	-1,281
Intangible Amortization			-102	-108					
Goodwill Amortisation	-427	-143	-49						
Depreciation and amortisation	-2,005	-1,686	-1,693	-1,394	-1,435	-1,471	-1,385	-1,329	-1,281
EBIT pre-exceptionals	2,408	2,818	2,695.0	2,777	2,352	2,488	2,588	2,630	2,633
margin (%)	17.1%	28.1%	26.8%	28.5%	24.4%	25.5%	26.6%	26.8%	26.6%
Reported EBIT	1,706	2,818	2,695	2,777	2,352	2,488	2,588	2,630	2,633
Financial expense	-517	-196	-285						
Financial income	206	170	141						
Net financials	-311	-26	-132	82	-50	-118	-111	-111	-111
Associate Income	95	-9	22	13	30				
Profit before Tax	1,395	2,783	2,585	2,872	2,331	2,370	2,477	2,518	2,522
margin (%)	9.9%	27.8%	25.7%	29.5%	24.2%	24.3%	25.4%	25.7%	25.5%
Income taxes	-361	-467	-394	-535	-462	-523	-544	-552	-553
Effective tax rate (%)	25.9%	16.8%	15.2%	18.6%	19.8%	21.0%	21.0%	21.0%	21.0%
Income from continuing operations	1,034	2,316	2,191	2,337	1,869	1,847	1,933	1,966	1,969
Discontinued operations (debitel)		-408	-245	9	36				
Net income for Swisscom holders	1,034	1,908	1,946	2,346	1,905	1,847	1,933	1,966	1,969
of which Minority investments	-305	-340	-352	-324	-306	-25	-25	-25	-25
Group Net income (loss)	824	1,559	1,594	2,022	1,599	1,822	1,908	1,941	1,944
Cash net income	1,099	1,416	1,643	2,022	1,563	1,822	1,908	1,941	1,944
growth (%)		89%	2%	27%	-21%	14%	5%	2%	0%
Per Share Data									
Weighted Average Shares outstanding (mns)	67.6	66.2	64.7	59.8	55.3	55.3	55.3	55.3	55.3
Underlying Cash EPS	16.25	21.39	25.39	33.79	28.27	32.96	34.51	35.10	35.15
growth (%)		31.7%	18.7%	33.1%	-16.3%	16.6%	4.7%	1.7%	0.2%
Reported EPS	12.18	23.55	24.63	33.79	28.92	32.96	34.51	35.10	35.15
growth (%)		93.3%	4.6%	37.2%	-14.4%	14.0%	4.7%	1.7%	0.2%
DPS	12.0	13.0	14.0	16.0	17.0	18.1	19.0	19.3	19.3
growth (%)		8.3%	7.7%	14.3%	6.3%	6.6%	4.7%	1.7%	0.2%
payout ratio (%) on Reported Earnings	98.5%	55.2%	56.8%	47.3%	58.8%	55.0%	55.0%	55.0%	55.0%

Source: Company reports and Citigroup Investment Research

Figure 7. Swisscom Balance Sheet (SFr in Millions)

	2002A	2003A	2004A	2005A	2006A	2007E	2008E	2009E	2010E
Cash and cash equivalent	1,967	3,501	3,672	2,707	673	979	1,225	1,210	1,189
Trade accounts receivable	2,418	2,219	1,767	1,694	2,436	2,436	2,436	2,436	2,436
Inventories	180	134	120	129	147	147	147	147	147
Other current assets	628	781	646	719	300	300	300	300	300
Total current assets	5,193	6,635	6,205	5,249	3,556	3,862	4,108	4,093	4,072
Property, plant, and equipment	7,536	7,009	6,190	6,000	5,795	5,714	5,497	5,354	5,258
Affiliates	691	53	58	191	221	221	221	221	221
Goodwill	1,544	1,210	416	722	4,726	4,726	4,726	4,726	4,726
of which: goodwill	1,190	857	153	315	2,062	2,062	2,062	2,062	2,062
of which: other intangible assets	354	353	263	407	2,664	2,664	2,664	2,664	2,664
Investments	1,584	1,383	1,275	1,163	1,164	1,164	1,164	1,164	1,164
Other financial assets incl tax	410	250	88	84	135	135	135	135	135
Total Non-Current Assets	11,765	9,905	8,027	8,160	12,041	11,960	11,743	11,600	11,504
Total assets	16,958	16,540	14,232	13,409	15,597	15,822	15,851	15,693	15,577
Short term debt	1,016	576	355	173	1,568	1,568	1,568	1,568	1,568
Trade accounts payable	1,054	1,045	511	467	1,693	1,693	1,693	1,693	1,693
Other current liabilities	1,893	1,847	1,803	2,095	923	923	923	923	923
Total current liabilities	3,963	3,468	2,669	2,735	4,184	4,184	4,184	4,184	4,184
Long term debt	1,505	1,374	1,253	2,130	5,015	5,015	5,015	5,015	5,015
Finance lease obligation	1,192	1,070	706						
Accrued pension cost	1,101	1,113	1,118	805	719	719	719	719	719
Accrued liabilities	499	429	634	580	682	682	682	682	682
Other long term liabilities	603	666	398	535	494	494	494	494	494
Total long term liabilities	4,900	4,652	4,109	4,050	6,910	6,910	6,910	6,910	6,910
Total liabilities	8,863	8,120	6,778	6,785	11,094	11,094	11,094	11,094	11,094
Shareholders Equity	7,299	7,669	6,791	6,001	4,436	4,661	4,690	4,532	4,416
Minorities	796	751	663	623	67	67	67	67	67
Equity	8,095	8,420	7,454	6,624	4,503	4,728	4,757	4,599	4,483
Total Liabilities & SHE	16,958	16,540	14,232	13,409	15,597	15,822	15,851	15,693	15,577

Source: Company reports and Citigroup Investment Research

Figure 8. Swisscom Cash Flow Statement (SFr in Millions)

	2002A	2003A	2004A	2005A	2006A	2007E	2008E	2009E	2010E
EBITDA	4,413	4,504	4,341	4,171	3,787	3,960	3,973	3,958	3,914
Changes in Working Capital	44	285	-86	99	-8				
Change in Pension Costs	-117	12	5	-288					
Interest	-20	-44	-147	-6	-30	-118	-111	-111	-111
Taxes	-535	-56	-394	-544	-496	-523	-544	-552	-553
Operating Cash Flow	3,785	4,701	4,066	3,432	3,264	3,319	3,318	3,295	3,250
Capex	-1,222	-1,165	-1,136	-1,087	-1,324	-1,390	-1,169	-1,185	-1,186
of which maintenance	-986	-702	-704	-681	-676	-682	-682	-687	-693
of which expansionary	-236	-463	-432	-406	-648	-708	-487	-498	-493
as a % of sales	8.7%	11.6%	11.3%	11.2%	13.7%	14.3%	12.0%	12.1%	12.0%
Investments in affiliates	8	491	501	-53	-4,513				
Investments in other assets	2,777	9	35	53	-222				
Other investing cash flow	9	41	-754	-330	3,126				
Investing cash flow	1,572	-624	-1,354	-1,417	-4,257	-1,390	-1,169	-1,185	-1,186
Debt Repayment	-1,591	-824	-245	-165	4,264				
Equity Issuance	-4,831	-530	-1,882	-1,985	-2,365				
Minority dividend payments	-1,032	-1,184	-1,221	-1,228	-1,204	-1,623	-1,903	-2,125	-2,085
Other financing cash flows		-12	-72	-3	-54				
Financing Cash Flow	-7,454	-2,550	-3,420	-3,381	641	-1,623	-1,903	-2,125	-2,085
Change in Cash	-2,097	1,527	-708	-1,366	-352	306	246	-15	-21
BoP Cash & Equivalents	3,788	1,512	3,104	2,387	1,023	673	979	1,225	1,210
FX Effects	-9	65	-9	2	2				
EoP Cash & Equivalents	1,682	3,104	2,387	1,023	673	979	1,225	1,210	1,189

Source: Company reports and Citigroup Investment Research

Swisscom AG

Company description

Swisscom is the incumbent wireline and wireless operator in Switzerland. It is majority owned by the Swiss government, with no expectations of any change. The company has a very strong balance sheet and is committed to returning all excess free cash flow to shareholders.

Investment Thesis

We rate Swisscom Hold/Medium Risk (2M), balancing the cash return policy and historical management execution with the downside risk in the domestic operating environment. 1) Mobile — we are concerned that TDC and Orange are likely to respond to Swisscom's flat-rate tariff offerings. 2) Fixed-line — the launch of IPTV is unlikely to offset the PSTN declines and slowing DSL growth.

In the longer term, we believe that Swisscom is a slowly declining, cash-generative business with a premium valuation and few catalysts to change this.

Valuation

Our Swisscom's target price of SFr480 is a simple average of a sum-of-the-parts (SoP) value, 2007E PE and dividend yields. Our SoP valuation is SFr450, based on our 40-year fade DCF models for the fixed-line and mobile units (using an 8% WACC, 5% long-term ROCE/WACC Spread, -1.5% ROCE growth).

On a 2007E PE basis, we believe that the stock should trade at a 10% discount to the Swiss local market, given the slower growth profile, and is in line with the average discount over the last five years. This suggests a valuation of cSFr490 per share. Using a European telecom sector average dividend yield of c4.5% would imply a SFr480 per share valuation.

Risk

We rate Swisscom Medium Risk based on our assessment of industry and company-specific risk factors. There are industry-specific risks to achieving our valuation target for all telecom companies. These include concerns about over-capitalisation, weak demand, regulatory risks, and the risk of new technology establishing cost advantages over current technology. However, we think Swisscom is probably the lowest risk stock among the integrated operators due to its strong balance sheet, a very low exposure to foreign investment risk and an attractive dividend yield with the prospect of another series of share buybacks going forward. However, if the impact of these risk factors is less negative than we currently anticipate, then the share price may rise above our target price.

Fastweb SpA

Company description

Fastweb is the leading alternative operator of fixed broadband telecommunication service in Italy's main urban areas. Fastweb provides voice, Internet connectivity, data transmission and video services over a single connection by using Fibre-to-Home/Office (10Mbps) and DSL (4-6Mbps) on a fully integrated IP network.

Investment thesis

Swisscom is launching a €47 all-cash bid on Fastweb, valuing the business at €4.9bn including the €1.1bn debt. While we tend to exclude counter-bid (but never say never), our feeling is that Swisscom will be forced to increase the bid price and we believe that market will ask for the dividend of €3.77 that Fastweb is set to pay in October. Accordingly, our target price is €50.77 and our recommendation is Hold/ Medium Risk (2M)

Valuation

DCF is the most suitable valuation approach for valuing a company whose revenues and customers are expected to boom over the next six years. However, DCF requires a host of assumptions and is highly sensitive key variables. We believe that understanding the sustainability of Fastweb strategies in the long run is as important as number crunching. Although a peer group comparison is not applicable because of Fastweb's unique business model, we draw up a number of peers for a crosschecking valuation exercise. Based on both DCF and a peer group comparison, we value stand-alone Fastweb at €37.30 per share. Being company under friendly-bid, we acknowledge that standalone valuation only provides a starting point to take a decision if tender or not the shares. Our target price of €50.77 is set in reference to the €47 bid from Swisscom, plus the €3.77 dividend that Fastweb is set to pay in October.

Risk

We rate Fastweb as Medium Risk based on our assessment of industry and company-specific risk factors. We used to assign to Fastweb a Speculative rating because of the risk that a bid might occur. The company is now under bid and accordingly our risk rating is now Medium. We think that events surrounding the Swisscom bid could cause the share price to move above or below our target price.

Appendix A-1

Analyst Certification

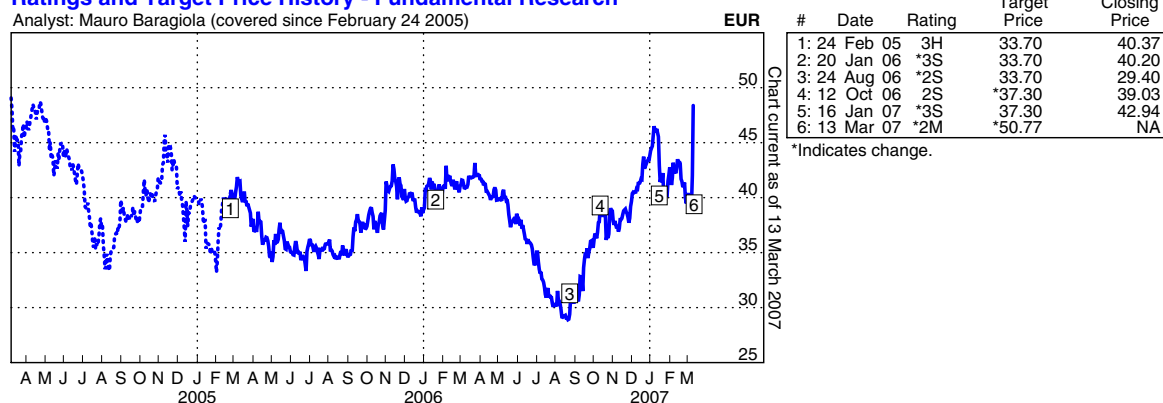
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IMPORTANT DISCLOSURES

Fastweb (FWB.MI)

Ratings and Target Price History - Fundamental Research

Analyst: Mauro Baragiola (covered since February 24 2005)

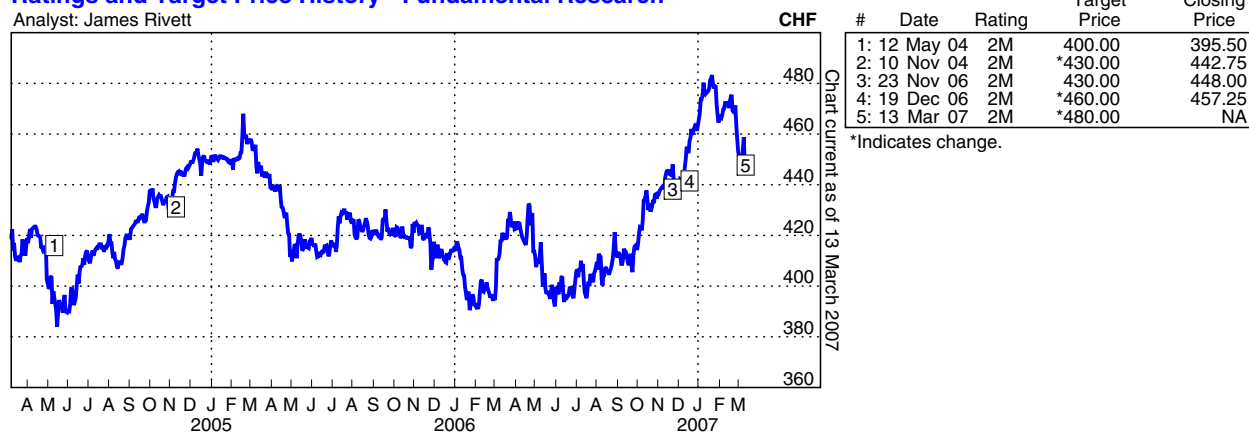


— Covered
 Not covered

Swisscom (SCMN.VX)

Ratings and Target Price History - Fundamental Research

Analyst: James Rivett



— Covered
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