MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades Ericsson to Ba1, outlook stable

Global Credit Research - 03 May 2017

London, 03 May 2017 -- Moody's Investors Service, ("Moody's") has downgraded to Ba1 from Baa3 the senior unsecured long-term rating and to (P)Ba1 from (P)Baa3 the senior unsecured medium term note (MTN) program rating of Telefonaktiebolaget LM Ericsson (Ericsson), a leading global provider of telecommunications equipment and related services to mobile and fixed network operators.

Concurrently, Moody's has assigned Ericsson a Ba1 corporate family rating (CFR) and a Ba1-PD probability of default rating (PDR), in line with the rating agency's practice for corporates with non-investment-grade ratings. The outlook on all ratings is stable.

"The downgrade of Ericsson's ratings reflects the anticipated negative impact on the company's operating earnings and cash flow in 2017 and 2018 due to rising restructuring charges and provisions, as recently announced by the company, leading to credit metrics that will no longer be commensurate with investment-grade ratings," says Alejandro Núñez, a Moody's Vice President -- Senior Analyst and lead analyst for Ericsson.

RATINGS RATIONALE

The ratings downgrade primarily reflects the negative near- and medium-term financial implications that Moody's anticipates will arise in 2017 and 2018 from the company's strategic review announcement of 28 March 2017 and detailed further in the company's Q1 2017 results.

For Q1 2017, Ericsson reported a 11% year-on-year revenue decline and a drop in its gross margin to 13.9% (30.5% adjusted to exclude restructuring charges, write-down of assets and provisions related to the strategic review) from 26.1% (29.4% adjusted) in Q4 2016. In March 2017, the company announced an acceleration of its existing restructuring program by outlining estimated restructuring charges of SEK 6 -- SEK 8 billion for FY2017 (contrasted with SEK3 billion of restructuring charges for FY2017 announced in January 2017) as well as provisions of SEK8.3 billion related to a revaluation of customers discounts, a reassessment of the value of trade receivables and certain transformation projects in the IT & Cloud division.

While Moody's recognizes the strategic review's intention to increase investment in certain core portfolio areas and that the company's cost savings initiatives should deliver longer term operating expense savings (after associated restructuring charges), the rating agency also highlights that a strategy premised primarily on cost-cutting is not sustainable over the long run and could also hamper the company's competitiveness including its ability to innovate and maintain its historical technological leadership position.

Moody's notes that the company's declining operating cash flow and restructuring charges are likely to continue to erode Ericsson's key credit metrics over the coming year. Ericsson's materially reduced EBITDA generation alongside elevated levels of debt led to a significant increase in the company's (Moody's-adjusted) gross debt/EBITDA ratio to 4.6x for FY2016 compared with 1.9x at the end of FY2015. Based on the company's revenue guidance of -2% to -6% in 2017 for its core networking equipment market and including the effects of the recently announced restructuring and provisions charges as well as its dividend cut for 2017, Moody's anticipates that Ericsson's gross debt/EBITDA ratio (Moody's-adjusted) will trend above 7x for FY2017.

Despite the company's publicly stated financial policies, its relatively high exposure to the competitive wireless networking equipment market without sufficiently offsetting earnings contribution from other market segments, coupled with its revenue headwinds and uncompetitive cost structure, will continue to hamper Ericsson's ability to exhibit credit characteristics consistent with an investment-grade profile over the next two years.

The Ba1 ratings continue to reflect: (1) Moody's expectation of a continued negative revenue and earnings growth outlook in 2017 and 2018 driven by softening market demand during a cyclical trough as well as intense competition amidst gradual structural shifts in the sector's competitive and technological landscape; (2) the lack of sufficient growth or earnings contribution from the company's IT & Cloud or Media divisions to offset weakness in the Networks division; (3) the structural challenge that Ericsson faces because of its heavy exposure to the wireless networking equipment market which is unlikely to see material growth before 2020 as the next technology investment cycle (5G) is expected to ramp up more significantly from around 2020; and (4) a weakened financial profile, driven by a relatively high cost base and declining revenues, leading to significantly reduced operating earnings and continued negative free cash flow generation. Furthermore, the unpredictable development of pending questions from US authorities, regarding Ericsson's anti-corruption program and specific cases, represents an event risk which further constrains the ratings in the short to medium term.

These negative considerations are balanced against: (1) Moody's expectation that the company's cost savings activities begin to evidence a stabilization of the company's operating earnings trajectory by the second half of 2018; (2) a maintenance of the company's good liquidity position; (3) financial policies within the limits of the company's free cash flow generation and liquidity resources; and (4) a track record of shareholder support. Moody's considers Ericsson's solid liquidity and main shareholders' support to be the company's two principal supportive credit factors in this period of structural challenges.

RATIONALE FOR STABLE OUTLOOK

The stable outlook reflects Moody's expectation that: (1) Ericsson's total revenue decline in FY2017 will not be materially higher than the -2% to -6% range guided by the company for its core networking equipment market with a subsequent material improvement in its revenue trajectory in FY2018; (2) the company will not implement restructuring charges and/or provisions, beyond those announced to date, that would require further material cash outflows over the next two years; (3) a modest improvement in the gross leverage level in FY2018 from the deterioration in gross leverage Moody's projects for FY2017; (4) modest progress in FY2018 operating margins from levels that Moody's anticipates will be near 0% in FY2017; (5) there will be no material worsening of the company's free cash flow trend compared with that of FY2016; (6) Ericsson will continue to maintain a good liquidity profile to buffer its expected negative free cash flow over at least the next year; and (7) the company maintains financial policies which balance the interests of creditors and shareholders. The outlook also reflects Moody's expectation that Ericsson's adjusted gross debt/EBITDA (Moody's-adjusted, excluding restructuring charges and provisions) will be around 7x in FY2017.

WHAT COULD CHANGE THE RATING UP/DOWN

Given today's rating action, a rating upgrade over the short term is unlikely. However, over time, Moody's could upgrade the rating if: (1) the announced restructuring program starts bearing fruit leading to a sustainable recovery of the company's operating performance such that its operating margins returned consistently into a high single-digit percentage range; (2) the company were to better diversify its earnings base which is currently highly exposed to the cyclical and highly competitive wireless networking equipment market; (3) Ericsson demonstrates a sustainably robust competitive position and technological leadership; (4) end-market demand were to rebound quicker than currently anticipated into positive revenue growth territory over a 12-month horizon; (5) free cash flow were to be materially and sustainably positive; and (6) Ericsson's own liquidity sources were to improve materially from currently projected FY2017-FY2018 levels such that it achieved a net cash position (including the company's pension deficit) and reduces gross leverage from currently excessive levels.

Negative pressure could be exerted on Ericsson's ratings in the case of: (1) negative operating margins in FY2017 with no expectation of a material margin recovery in FY2018; (2) a further deterioration of free cash flow (post-dividends) and/or gross leverage in FY2017, relative to FY2016, without the prospect of a material recovery in FY2018; (3) a diminished competitive position, particularly in the core Networking division as the 5G investment cycle approaches; (4) a further material decline in the company's own liquidity sources; and/or (5) the imposition of a material fine resulting from the pending questions from US authorities.

LIST OF AFFECTED RATINGS

Assignments:

..Issuer: Telefonaktiebolaget LM Ericsson

.LT Corporate Family Rating, Assigned Ba1

.Probability of Default Rating, Assigned Ba1-PD

Downgrades:

..Issuer: Telefonaktiebolaget LM Ericsson

....Senior Unsecured Regular Bond/Debenture, Downgraded to Ba1 from Baa3

....Senior Unsecured Medium-Term Note Program, Downgraded to (P)Ba1 from (P)Baa3

Outlook Actions:

..Issuer: Telefonaktiebolaget LM Ericsson

....Outlook, Changed To Stable from Negative

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Diversified Technology Rating Methodology published in December 2015. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

With revenues of SEK222.6 billion in FY2016, Telefonaktiebolaget LM Ericsson ("Ericsson") is a leading provider of telecommunications equipment and related services to mobile and fixed network operators globally. Its equipment is used by over 1,000 networks in more than 180 countries and around 40% of the global mobile traffic passes through its systems. In FY2016, Ericsson's Networks division contributed 49%, Global Services 46%, and Support Solutions 5% of group revenues, respectively. Geographically, revenues are well diversified across all major regions in North America, Europe, Asia and Rest of the World. The company's largest shareholders are Investor AB (Aa3 stable) and AB Industrivärden (unrated), with voting rights of 21.7% and 15.2%, respectively.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Alejandro Nunez
Vice President - Senior Analyst
Corporate Finance Group
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf

London E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Ivan Palacios
Associate Managing Director
Corporate Finance Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.