

Rating Action: Moody's changes the outlook on Ericsson's ratings to positive from stable

23 Jul 2019

Milan, July 23, 2019 -- Moody's Investors Service ("Moody's") has today changed the outlook to positive on the ratings 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 affirmed the company's Ba2 corporate family rating (CFR), its Ba2-PD probability of default rating (PDR), the senior unsecured long-term ratings of Ba2, and the senior unsecured medium term note (MTN) program rating of (P)Ba2.

"The outlook change to positive from stable reflects continued progress on Ericsson's restructuring programs and overall positive execution of the company's strategic plan" says Ernesto Bisagno, a Moody's Vice President -- Senior Credit Officer and lead analyst for Ericsson. "The positive outlook also reflects Moody's expectations for additional improvements in Ericsson's credit metrics", adds Mr Bisagno.

A full list of affected ratings can be found at the end of this Press Release.

RATINGS RATIONALE

The Ba2 ratings reflect: (1) Ericsson's significant scale and relevance with a top three global market position in wireless equipment; (2) strong geographical diversification with sales well spread across all major regions; (3) strong liquidity and evidence of support from its main shareholders.

The rating is constrained by (1) cyclicity of the telecom equipment industry; (2) exposure to intense competition and technology risk; (3) high investment needs and R&D costs, combined with material restructuring costs; (4) event risk on the back of settlement discussion with DOJ and SEC.

Following a strong set of first half results, Moody's adjusted debt to EBITDA improved to 4.1x (5.9x in 2018), with a total Moody's adjusted debt of SEK74 billion, which includes SEK10 billion operating leases post IFRS 16, and pension liabilities of SEK 33.9 billion. Using a higher discount rate based on Swedish covered mortgage bonds, pensions liabilities would have been around SEK10 billion lower, implying a Moody's adjusted debt to EBITDA of 3.6x.

Over 2019-20, Moody's expects revenues to increase in the low-mid single digit range, in line with the growth of the RAN markets, and Moody's adjusted operating margins to continue to strengthen, driven by additional improvement in the digital service, on the back of the ongoing renegotiation of the existing contracts and the increased contribution from the new 5G contracts.

However, the agency expects some quarter-on-quarter earnings volatility because of seasonality and change in contract mix. In addition, there will further material restructuring costs of around SEK2 billion - SEK4 billion (down from previous company guidance of SEK3 billion - SEK5 billion), expected to decline towards 1% of sales in 2020.

Operating cash flow in 2019 will benefit from stronger earnings, but will remain constrained by the SEK10 billion cash out of the restructuring activity, following the utilization of the existing provisions.

Moody's anticipates capital expenditure to increase in 2019 mainly due to the investments supporting the new 5G contracts, and to decline towards 2% of total sales in 2020. Following the expected improvement in profits, Moody's also expects the company to return to higher dividend payouts in 2020.

Based on these assumptions, Moody's expects additional improvements in Ericsson's credit metrics with Moody's adjusted gross debt to EBITDA to decline towards 2.5x-3.0x by 2020, which would leave the company strongly positioned in the rating category.

Ericsson's liquidity is good reflecting its: (1) gross cash balance of SEK69 billion as of June 2019 (including SEK23.5 billion of fixed income securities); (2) USD2.0 billion revolving credit facility (fully undrawn at June 2019), maturing in June 2022 with no financial covenants and material adverse change conditions for drawdowns; (3) modest positive FCF generation after dividends; (4) modest short term-debt maturity mainly including a USD 684 million equivalent EIB loan which matures in November 2020.

However, there is ongoing event risk arising from the SEC and U.S. Department of Justice investigations. While the company is in ongoing settlement negotiations no guidance was provided around the length of these settlement discussions and size of the financial impact.

RATIONALE FOR POSITIVE OUTLOOK

The positive outlook reflects expectations that operating performance will continue to improve driven by a combination of positive organic growth in revenue, additional improvements in the digital service, and increased contribution from 5G contracts.

WHAT COULD CHANGE THE RATING UP/DOWN

There will be further positive pressure on the rating as a result of Ericsson maintaining a sustainably robust competitive position and technological leadership, while continuing to execute its strategy and restore profitability. Quantitatively, upward pressure would reflect (1) operating margins and free cash flow after shareholder distributions continuing to recover towards the high single digit range; (2) Moody's-adjusted debt/EBITDA trending towards 2.25x.

The rating could be lowered if the company's operating performance deteriorates. Quantitatively, downward pressure would arise if (1) Moody's adjusted operating income turns negative on a sustained basis, (2) Moody's-adjusted debt/EBITDA remains above 3.5x, or (3) cash flow or liquidity weaken materially also as a result of the settlement discussion with the SEC.

LIST OF AFFECTED RATINGS

Affirmations:

..Issuer: Telefonaktiebolaget LM Ericsson

....Corporate Family Rating, Affirmed Ba2

....Probability of Default Rating, Affirmed Ba2-PD

....Senior Unsecured Medium-Term Note Program, Affirmed (P)Ba2

....Senior Unsecured Regular Bond/Debenture, Affirmed Ba2

Outlook Actions:

..Issuer: Telefonaktiebolaget LM Ericsson

....Outlook, Changed To Positive From Stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Diversified Technology published in August 2018. Please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

COMPANY PROFILE

With reported net sales of SEK221 billion for the twelve months ended 31 June 2019, 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 the six months ended 30 June 2018, Ericsson's Networks division contributed 66% of the group's net sales, followed by Digital Services at 17%, Managed Services at 13% and its 'Emerging Business and Other' segment at 4%. The company's net sales are well diversified geographically across all major regions, with North America, Europe and Latin America, Asia and Rest of the World each representing approximately one-quarter of the company's net sales.

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