

Rating Action: Moody's downgrades Ericsson's ratings to Baa1; stable outlook

Global Credit Research - 05 May 2014

Frankfurt am Main, May 05, 2014 -- Moody's Investors Service has today downgraded to Baa1 from A3 the senior unsecured ratings of Telefonaktiebolaget LM Ericsson (Ericsson) following the company's weaker-than-expected recovery in profitability through 2013 and cautious expectations for further improvements in the fundamentals of the communication equipment industry. Concurrently, Moody's changed to (P)Baa2 from (P)Baa1 Ericsson's senior subordinate rating. The outlook on the ratings is stable.

"We are downgrading Ericsson's ratings because of the stabilization in the company's profitability on weaker levels than experienced in the past and our expectations of an only partial recovery in the next 12-18 months, given the still intense competition across the communication equipment industry," says Roberto Pozzi, a Moody's Vice President -- Senior Analyst and lead analyst for Ericsson. "The rating action also reflects our expectations regarding the company's leverage, which is unlikely to sustainably improve below 1.25x, which would be expected to maintain the A3 rating."

A full list of affected ratings is provided towards the end of this press release.

RATINGS RATIONALE

Today's rating action reflects the company's weak profitability, which has deteriorated in recent years but slightly recovered over the last few quarters. We do not expect Ericsson to achieve the strong profitability levels as recorded till 2007 anymore. This is a result from the intense level of competition amongst telecom equipment vendors and the company's large exposure to telecom carriers, with ensuing pricing pressure. Moody's expects that Ericsson will maintain a sizeable cash position, given the intensity of competition in the telecom equipment industry and the risks associated with technology transitions, demand cyclical and volatility across the customer base.

Ericsson's Baa1 senior unsecured ratings more positively reflects its leading market position in wireless communications equipment, with consistent earnings and operating cash flows, all of which contribute to the company's solid debt protection measures. The company's deeply entrenched position within existing networks is a key advantage that helps it to maintain market share. The large portion of revenue from services and software leads to margin and cash flow stability, and Moody's expects that Ericsson's operating margin will stay at around 10% over the next 12-18 months, with positive free cash flow being generated. The Baa1 rating also considers Ericsson's moderate gross adjusted leverage, and expectations that it will maintain shareholder returns within the limits of its free cash flow generation after considering acquisitions opportunities.

Ericsson's liquidity profile is strong and supportive of the rating, although, to some extent, liquidity strength is necessary to accommodate the strong cyclical swings in demand common to the industry. Moody's expects that Ericsson will generate positive free cash flow in the coming 12 months.

RATIONALE FOR STABLE OUTLOOK

The stable outlook factors in the rating agency's expectations that the Ericsson will maintain and defend its strong market positions, adequate profitability and moderate leverage. Quantitatively, the stable outlook reflects our expectations that Ericsson will achieve a global market share in wireless equipment of around a third in 3G and LTE, operating margins in low double-digits and a debt/EBITDA ratio of between 1.25x-1.75x and a retained cash flow (RCF) to debt ratio of between 20-30%, based on Moody's adjustments and measured in terms of gross debt. The rating also factors in our expectations that Ericsson will maintain a strong liquidity position, but also that such liquidity position could be deployed to make strategic acquisitions and/or offset a cyclical reduction of demand. Higher operating margins would allow the company to support higher leverage at the current rating level.

WHAT COULD CHANGE THE RATING -- UP/DOWN

Moody's would consider an upgrade if Ericsson was able to consolidate its market positions, achieve and sustain operating margins in mid double-digits, or reduce leverage with a debt/EBITDA ratio sustainably below 1.25x and an RCF/debt ratio sustainably above 30%.

We would consider a downgrade of Ericsson's rating, if we expected a sustained erosion in the company's market positions, operating margins in single-digit territory, or leverage sustained above 1.75x and/or a RCF/debt ratio below 20%. A material erosion in the company's strong liquidity position could be justified in the event of strategic acquisitions and/or a cyclical slowdown in demand.

Both for an upgrade and a downgrade, higher operating margins would be compatible with a higher leverage.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was the Global Communications Equipment Industry published in June 2008. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

With revenues of SEK227 billion in 2013, Telefonaktiebolaget LM Ericsson (Ericsson) is a world-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 more than 40% of the global mobile traffic passes through its systems. Software represented 24%, hardware 34% and services 42% of group revenues in 2013.

RATING LIST

..Issuer: Telefonaktiebolaget LM Ericsson

...Outlook, Changed To Stable From Negative

...Multiple Seniority Shelf Apr 22, 2015, to (P)Baa1 from (P)A3

...Multiple Seniority Shelf Apr 22, 2015, to (P)Baa2 from (P)Baa1

...Multiple Seniority Shelf Apr 22, 2015, to (P)Baa2 from (P)Baa1

...US\$5000M Senior Unsecured Medium-Term Note Program, to (P)Baa1 from (P)A3

...US\$300M Senior Unsecured Regular Bond/Debenture Jun 23, 2016, to Baa1 from A3

...EUR375M Senior Unsecured Regular Bond/Debenture Jun 27, 2014, to Baa1 from A3

...US\$1000M 4.125% Senior Unsecured Regular Bond/Debenture May 15, 2022, to Baa1 from A3

...EUR500M 5.375% Senior Unsecured Regular Bond/Debenture Jun 27, 2017, to Baa1 from A3

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