

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

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26 Oct 2021

Milan, October 26, 2021 -- Moody's Investors Service ("Moody's") has today changed to positive from stable the outlook 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 Ba1 corporate family rating (CFR), its Ba1-PD probability of default rating (PDR), and the Ba1 senior unsecured long-term debt ratings.

"The outlook change to positive from stable reflects the successful execution of the company's strategy which continues to lead to a significant improvement in the company's operating performance and margins," says Ernesto Bisagno, a Moody's Vice President -- Senior Credit Officer and lead analyst for Ericsson.

"It also reflects our expectation that Ericsson's credit metrics will continue improving over the next 2 years driven by the steady growth of the radio access network ("RAN") market and the reduction of operating losses in the Digital Service ("DS") segment," adds Mr Bisagno.

A full list of affected ratings can be found at the end of this press release.

**RATINGS RATIONALE**

The Ba1 rating reflects (1) Ericsson's significant scale and relevance as the number two wireless telecommunications equipment manufacturer globally; (2) the continued growth of the RAN market owing to accelerated investments in 5G from telecom operators; (3) its good operating momentum, with numerous contract awards over 2020-21; (4) its strong geographical diversification, with sales well spread across all major regions; (5) the ongoing improvement in Moody's-adjusted operating margins, which have reached 13.8% for the 12-months ended September 2021 from 9.7% in 2019; (6) the improved free cash flow generation and low Moody's adjusted leverage; and (7) Ericsson's strong liquidity and track record of support from its main shareholders.

The rating is constrained by the cyclicity of the telecom equipment industry; its exposure to intense competition and technology risk; the weak performance of the DS segment and the market share losses in China, and its high investment needs and R&D costs.

Ericsson reported 2020 organic revenue growth of 5% year on year, driven by strong growth and market share gains in North America and North East Asia. Reported EBIT increased to SEK27.8 billion (SEK10.6 billion in 2019), while adjusted EBIT margin was 12.5% (9.7% in 2019), ahead of the company's 10% target for 2020, on the back of stronger gross margin in the Network business and reduced operating loss in DS.

Revenue for the first 9-months 2021 grew by another 6% organically (-1% including currency movements mainly reflecting weaker US dollar), while Ericsson's adjusted EBIT margin increased to 13.4% (12 months that ended September 2021). While performance remained strong, the company has lost significant market share in China in 2021. Revenue in the region declined by around 60% for Networks and DS during the first 9-months ended September 2021. The market share losses in China had a negative impact on DS's profitability and could limit growth opportunities. In addition, there is a risk of higher restructuring costs to address the loss of revenue in China.

The company's Moody's-adjusted gross debt/EBITDA improved to 2.0x in 2020 and 1.9x as of September 2021 (2.7x in 2019), reflecting a combination of stronger EBITDA and a reduction in gross debt. Moody's adjusted net debt at September 2021 included cash and short investments of SEK61.5 billion, implying a Moody's adjusted net debt / EBITDA of 0.4x.

For the full year 2021, Moody's expects Ericsson's revenue to remain flattish to declining by around 1% compared to 2020, due to a combination of market share losses in China, lower intellectual property rights (IPR) sales and adverse currency movements, partially offset by strong growth in North America, Europe, Latin America and North East Asia.

The rating agency expects Ericsson's Moody's-adjusted operating margins in 2021 to be materially stronger than in 2020, with the caveat that they might be affected by restructuring costs, potential supply disruptions and input price increases.

In 2022, Moody's expects stronger revenue growth as the 2021 headwinds from China will fade away. The rating agency also expects Ericsson to reach the high end of its 12%-14% EBIT margin guidance, driven by a reduction of the operating loss in the DS segment.

Assuming increased dividends over 2021-22, reflecting improved earnings and some volatility in working capital cash management, Ericsson would generate an average Moody's-adjusted FCF of SEK17 billion each year. As a result, Moody's anticipates additional improvements in Ericsson's credit metrics, with Moody's-adjusted gross debt/EBITDA declining below 1.7x in 2022; and Moody's-adjusted net debt/ EBITDA reducing towards 0.1x, leaving Ericsson strongly positioned in the rating category.

## LIQUIDITY

Ericsson's liquidity is strong, reflecting its cash and cash equivalents balance of SEK46 billion as of September 2021, in addition to SEK15 billion of short-term fixed-income investments; \$2.0 billion revolving credit facility (fully undrawn as of September 2021), maturing in September 2026 plus two year extension options (renewed in September 2021 and which includes interest margin linked to sustainability targets), with no financial covenants or significant adverse change conditions for drawdowns; positive FCF generation after dividends; and limited short-term debt maturities.

Ericsson made significant debt repayments in the last quarters including a \$684 million bilateral loan repaid in Q4 2020 and a €500 million bond in Q1 2021. Short-term maturities mainly include the \$1 billion bond due in May 2022.

## STRUCTURAL CONSIDERATIONS

Ericsson's probability of default rating of Ba1-PD incorporates the use of a 50% family recovery rate assumption, reflecting a capital structure comprising both bank debt and bonds. All of Ericsson's debt instruments, including its \$2.0 billion revolving credit facility, are senior unsecured, have investment-grade style documentation and have no financial covenants. All of Ericsson's rated bonds have a Ba1 rating, at the same level as Ericsson's Ba1 corporate family rating.

## RATIONALE FOR POSITIVE OUTLOOK

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

The positive outlook also reflects the potential for Ericsson's rating to migrate to investment grade owing to the combination of the company's improved resilience to industry cycles, the longer nature of the 5G cycle relative to previous technologies and its current technological leadership position and market share strength.

## FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Further upward pressure on the rating could develop if Ericsson makes progress in the turn-around of the DS segment and maintains a sustainably robust competitive position and technological leadership despite the loss of market shares in China. Quantitatively, an upgrade would require operating margins (Moody's-adjusted) to increase towards 15%, strong FCF generation after shareholder distributions, and a sustained solid liquidity profile and a strong balance sheet with a net cash position (on a Moody's-adjusted basis).

Downward rating pressure is unlikely in the next 18 months, but would reflect a deterioration in operating performance, such that its Moody's-adjusted operating margin drops below 8%, its Moody's-adjusted debt/EBITDA increases sustainably above 2.5x, or its FCF turns negative and liquidity deteriorates.

## LIST OF AFFECTED RATINGS

Affirmations:

..Issuer: Telefonaktiebolaget LM Ericsson

... Probability of Default Rating, Affirmed Ba1-PD

... LT Corporate Family Rating, Affirmed Ba1

...Senior Unsecured Regular Bond/Debenture, Affirmed Ba1

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 and available at [https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC\\_1130737](https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1130737) . Alternatively, please see the Rating Methodologies page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

## COMPANY PROFILE

With net sales of SEK231 billion and Moody's-adjusted EBITDA for the 12 months ended 30 September 2021 of SEK40.2 billion, Ericsson is a leading provider of telecommunications equipment and related services to telecom operators globally. Its equipment is used in more than 180 countries, and around 40% of the global mobile traffic passes through its systems. In 2020, Ericsson's Networks division contributed 71% of the group's net sales, followed by DS at 16%, Managed Services at 10% and its Emerging Business and Other segment at 3%.

The largest shareholders are Investor AB (Aa3 stable) with 22.8% of voting rights and AB Industrivärden with 19.3%.

## REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: [https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC\\_79004](https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004).

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