Moody's Investors Service

Global Credit Research
Rating Action
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Rating Action: Telefonaktiebolaget LM Ericsson

MOODY'S DOWNGRADES TO Baa1 ERICSSON'S SENIOR DEBT RATING; OUTLOOK REMAINS NEGATIVE

Approximately $5.2 Billion of Long-Term Debt Affected.

Frankfurt, October 26, 2001 -- Moody's Investors Service downgraded to Baa1 from A3 the long-term debt ratings of Telefonaktiebolaget LM Ericsson (Ericsson) and confirmed at Prime-2 the company's rating for short-term debt. The rating downgrade is based on Ericsson's increasing reliance on wireless infrastructure equipment and on the anticipated further slowdown and heightened price competition in this segment as wireless operators are very carefully considering their complicated technology migration strategies before moving forward on considerable capital investment plans. In addition, Moody's downgrade reflects the expected, yet controlled, build-up of working capital and debt as equipment deliveries for third-generation technology are ramped up but not yet billed. The rating action also recognises the risk mitigation resulting from Ericsson's partnerships in mobile phones and management's strategy to maintain a solid capital structure and liquidity. The outlook for the ratings remains negative in view of concerns about the slow take-up of new mobile phone standards and an outlook for weaker orders from Latin America and Asia Pacific for second-generation systems, which have so far offset falling infrastructure demand from Western Europe and North America.

Ratings lowered to Baa1 from A3 are:

Telefonaktiebolaget LM Ericsson - for Euro Medium Tem Notes, the $600 million revolving credit, and the issuer rating.

Ratings confirmed at Prime-2 are for:

Ericsson Treasury Services AB -- for guaranteed US-commercial paper,

Ericsson Treasury Services U.S. Inc. -- for guaranteed US-commercial paper, and

Ericsson Treasury Ireland Ltd.-- for guaranteed Euro-commercial paper.

In recognition of its own modest market position and the extreme price competition in mobile phones following the market saturation for second-generation phones in many regions, Ericsson has refocused its business mix towards wireless infrastructure equipment. Management has outsourced the production of mobile phones to Flextronics and concluded a joint venture agreement with Sony covering the marketing of new, jointly developed mobile phones. In view of the disposal of production facilities and inventory to Flextronics and the de-consolidation of the Sony venture, Moody's believes that this strategy will lighten Ericsson's balance sheet and mitigate some of the operating risks. However, Moody's cautions that this strategy will not completely prevent the company from encountering financial risk, as Ericsson will need to ensure access to a competitive range of leading edge phones to support its network business and so it is in Ericsson's interest to support the joint venture.

As yet, there are still no signs of a recovery in the demand for mobile phone equipment. On the contrary, Moody's expects more carriers to defer upgrades to the GPRS standard, to postpone installations of third-generation (3G) networks or to agree with partners on network sharing. All of these trends will inevitably lengthen the technology transition and delay the wide acceptance of the 3G transmission standard, which will be the prime driver for Ericsson's projected recovery to historic levels of cash flow generation. With the orders booked to date and its large installed base, Ericsson is well positioned to maintain its market leadership position through the various new wireless technologies. However, Moody's points out that, during the transition, the company will depend on continued growth in the second-generation based networks to fund development cost and utilise facilities. If demand slows further, adds Moody's, then Ericsson's internal cost savings programmes may not be enough to offset increasing price competition and return to adequate margins in the networks segment.

Financially, management has prepared the company well for a protracted transition period with low leverage and a high balance of liquid assets. Including the planned reductions of working capital and asset disposals, Moody's considers Ericsson to be on track for at least a break-even cash flow before financing in fiscal year 2001 - an expectation which underpins the Baa1 rating.

Domiciled in Stockholm, Sweden, Ericsson is a leading developer and manufacturer of mobile telecom and datacom equipment, and recorded revenues of about SEK119 billion (US$12 billion) in the first half of fiscal year 2001.

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