MOODY'S
INVESTORS SERVICE

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

18 Jul 2018

London, 18 July 2018 -- Moody's Investors Service ("Moody's") has today changed 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, to stable from negative. 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 stable from negative reflects our expectation that the company's operating profit and cash flow trends in 2018 and 2019 will continue improving relative to 2017 and with a declining level of restructuring charges," says Alejandro Núñez, a Moody's Vice President -- Senior Analyst and lead analyst for Ericsson. "Although the company's restructuring efforts will continue over the next year, we believe the worst is behind it and that 2018 is an inflection year in their turnaround."

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

RATINGS RATIONALE

The change in outlook to stable from negative reflects Moody's expectations that the company's operating earnings will be positive and rising, free cash flow will also progressively increase over the course of the next 12 to 18 months, and that cash restructuring charges will decline relative to 2017. The stable outlook also incorporates an expectation that Ericsson will maintain stable debt and liquidity levels, relative to mid-2018, and financial policies that continue to balance shareholders' and creditors' interests.

In Q1 and Q2 2018, Ericsson announced a better than expected set of quarterly results which indicate the company's initial, yet consistent, signs of tangible progress on its cost savings and restructuring programs. Given the progress the company has made to-date with its cost savings program, a reduction in expected restructuring charges and provisions, and a slightly improved market outlook relative to the prior year, Moody's estimates that Ericsson's operating earnings and cash flow generation trajectories over the next twelve months will stabilize as they trend positively, admittedly from a low 2017 base.

As such, Moody's believes that just as 2017 represented the low point of Ericsson's recent downturn as well as that of its core networking end market's cycle, 2018 represents the company's and its core end market's inflection point. Moody's expects the company to continue along a gradually improving operating trajectory toward a sustainably higher profitability level and improving revenue trends from the second half of 2018 onwards. Moody's continues to project that revenue trends for Ericsson's core market will continue to be slightly negative (on a constant currency basis) through 2019 -- although in 2018 they are likely to be marginally supported, on a reported basis, by USD/SEK tailwinds -- but could be bolstered into positive revenue growth territory from late 2019 onward, depending on the scope and pace of 5G investments ramp-up.

Most notable in the company's quarterly results in the first half of 2018 were positive revenue growth (+2%) in the Networks segment, a marked increase in the company's reported gross margin to 34.5% from 22.6% in H1 2017 (including restructuring charges) and reported free cash flow (excluding restructuring charges and pre-dividends) approaching a breakeven level (negative SEK0.3 billion in H1 2018 contrasted with negative SEK4.6 billion free cash flow in H1 2017).

Against a 2018-2019 revenue trajectory that Moody's projects will decline but at a much lower level than in 2016 and 2017, the realized reductions in Ericsson's cost base and the business' operational gearing should continue to support gradually rising gross and operating margins as revenue trends gradually improve beyond 2018. Based on Moody's expectation of a (reported) revenue contraction of approximately 2% in 2018 and a constant debt level, the rating agency expects the company's gross debt/EBITDA to improve significantly in 2018 to around 4x (Moody's-adjusted, including restructuring charges) from negative 13x in 2017 (due to negative Moody's-adjusted EBITDA). Ericsson's good liquidity, with a cash balance of SEK66.9 billion (as at 30

June 2018, including current and non-current interest bearing securities) and no debt maturities until November 2020, remains a supportive factor for the rating and Moody's expect the company to sustain at least a similar liquidity level over the next eighteen months.

The Ba2 ratings continue to reflect: (1) Moody's expectation that the company's revenue growth will remain modestly negative in 2018, driven by soft market demand during a cyclical trough, as well as intense competition amid gradual structural shifts in the telecom networking equipment market's competitive and technological landscape; (2) the revenue and earnings drag from the company's subscale and underperforming Digital Services and 'Emerging Business and Other' divisions; (3) the structural challenge that Ericsson faces because of its high exposure to the wireless telecommunications 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 around 2020; and (4) the company's weakened (relative to historic levels) but stabilizing financial profile, due to a relatively high albeit improving cost base and declining revenue, leading to low operating earnings and weak yet improving 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 that further constrains the rating in the short to medium term.

These negative considerations are offset by: (1) Moody's expectation that the company's cost saving activities will help stabilize its operating earnings by the end of 2018; (2) the company's good liquidity position; (3) financial policies (including dividend payments) 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 good liquidity and main shareholders' support to be the company's two principal supportive credit factors during this period of cyclical and structural challenges.

RATIONALE FOR STABLE OUTLOOK

The stable outlook reflects Moody's views and expectations that:

(1) Ericsson's core radio access networking (RAN) end market weakness is likely to taper significantly in 2018-2019 following a 10% (reported) revenue contraction in 2017;

(2) Reduced restructuring charges and no further provisions leading to lower restructuring cash outflows over 2018-2019 compared with 2016-2017;

(3) Gross leverage (Moody's-adjusted) for full-year 2018 to be high at around 4x yet is expected to decline in 2019 toward the 3.25x area;

(4) Operating margins (Moody's-adj., including restructuring charges) will be positive and materially rise in 2019 with free cash flow generation improving through year-end 2019;

(5) Ericsson will maintain broadly stable debt and liquidity levels (relative to 2018).

WHAT COULD CHANGE THE RATING UP/DOWN

Upward ratings momentum could develop if: (1) the company's restructuring program were to continue yielding tangible financial results, leading to a sustained recovery in operating margins into the high single-digit percentage range; (2) Ericsson demonstrated a sustainably robust competitive position and technological leadership; (3) end-market demand were to rebound quicker than currently anticipated, into the positive revenue growth territory over a 12-month horizon; (4) free cash flow were to be materially and sustainably positive; and (5) Ericsson's own liquidity sources were to improve such that the company reported a higher net cash position (including the pension deficit) and reduced gross leverage from its currently high level.

Negative ratings momentum could develop if: (1) the company reported a negative operating margin (Moody's-adjusted, including restructuring charges) similar to or worse than the 2017 level (-8%); and/or (2) there were no material improvement in gross leverage from the 2017 level; and/or (3) the company's competitive position diminished, particularly in its core Networks division, as the 5G investment cycle approaches; and/or (4) the company registered a further material decline in its internal liquidity sources; and/or (5) a material fine were to be imposed as a result of pending questions from US authorities.

LIST OF AFFECTED RATINGS

Affirmations:

..Issuer: Telefonaktiebolaget LM Ericsson

.... LT 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 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 reported net sales of SEK198.2 billion for the twelve months ended 30 June 2018, 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. The company's largest shareholders (as of 31 December 2017) are Investor AB (Aa3 stable) and AB Industrivärden, with voting rights of 22% and 15%, respectively.

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