MOODY'S
INVESTORS SERVICE

Rating Action: Moody's upgrades Ericsson's ratings to Ba1; stable outlook

15 Jun 2020

Milan, June 15, 2020 -- Moody's Investors Service, ("Moody's") has today upgraded to Ba1 from Ba2 the corporate family rating (CFR) and to Ba1-PD from Ba2-PD the probability of default rating (PDR) of Telefonaktiebolaget LM Ericsson (Ericsson), a leading global provider of telecommunications equipment. Concurrently, Moody's upgraded to Ba1 from Ba2 the company's senior unsecured long-term ratings, and to (P)Ba1 from (P)Ba2 the senior unsecured medium-term note (MTN) program rating. The outlook has changed to stable from positive.

"The rating upgrade to Ba1 reflects the continued successful execution of Ericsson's strategic plan which is leading 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.

"The upgrade also reflects the expected steady growth of the radio access network ("RAN") market, which, combined with the contribution from new contracts and subsequent market share gains, will support additional profit growth and positive free cash flow generation," adds Mr. Bisagno.

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

RATINGS RATIONALE

The Ba1 ratings reflect: (1) Ericsson's significant scale and relevance with a top three global market position in wireless equipment; (2) expected growth of the RAN market on the back of the contribution from 5G investments; (3) improved momentum with numerous contracts awards in 2020, (4) strong geographical diversification with sales well spread across all major regions; and (5) strong liquidity and evidence of support from its main shareholders.

The rating is constrained by (1) the cyclicality of the telecom equipment industry; (2) exposure to intense competition and technology risk; and (3) high investment needs and R&D costs, combined with material restructuring costs.

Although Moody's expects Ericsson's operating performance not to be materially exposed to the coronavirus outbreak, there is increased uncertainty which could weight on profits in the first half of 2020.

In 2019, Ericsson reported organic revenue growth of 4%, driven by strong growth in North America and North East Asia, more than offsetting a weaker performance in Europe and Latin America. The company's operating income (as adjusted by Moody's) increased to SEK21.8 billion (SEK3.8 billion in 2018), while the company's adjusted operating margin (as reported by Ericsson) was 9.7%, close to the 10% target for 2020, on the back of stronger gross margin in the networks business, and reduced operating loss in digital services. Moody's adjusted operating income in the first quarter of 2020 increased further by 5% to SEK4.3 billion.

Following the stronger set of results, Moody's adjusted debt to EBITDA improved to 2.7x at December 2019 (5.7x in 2018), with a total Moody's adjusted debt of SEK83 billion, which includes SEK10 billion of operating leases post IFRS 16, and pension liabilities of SEK36 billion.

In 2020, Moody's expects Ericsson's revenues to increase in the low-to-mid single digit range, in line with the growth of the RAN markets. The recent contract wins will also support market share gains in China and Europe. Any further improvement in Moody's adjusted operating margins in 2020 would mainly reflect stronger operating performance in the digital services business, on the back of the ongoing renegotiation and completion of existing contracts. However, Ericsson also expects some earnings volatility in the segment over the next quarters, because of seasonality and change in contract mix.

In addition, margin improvement would be constrained by higher opex investments, and the roll out of some strategic large 5G contracts which have lower initial margins. The uncertainty created by the coronavirus outbreak is also likely to weigh on margins in the first half of 2020, with the second half expected to improve sequentially.

In 2021, the rating agency expects further improvement in profitability on the back increased contribution from the new contracts as the 5G cycle will enter a more mature phase. Moody's also expects the company to reach the low end of the operating margin targets of 12%-14% over 2022-23.

Assuming increased dividends over 2020-21 reflecting improved earnings, Moody's expects Ericsson to generate free cash flow (Moody's definition) of around SEK6 billion -- SEK7 billion each year.

As a result, Moody's anticipates additional improvements in Ericsson's credit metrics with Moody's adjusted gross debt to EBITDA to decline below 2.5x in 2021.

LIQUIDITY

Ericsson's liquidity is good reflecting its: (1) gross cash balance of SEK56 billion as of March 2020 (including SEK7.8 billion of short term investments) in addition to SEK23.3 billion of long term fixed income investments; (2) USD2.0 billion revolving credit facility (fully undrawn at March 2020), maturing in June 2022 with no financial covenants nor material adverse change conditions for drawdowns; (3) positive free cash flow generation after dividends; and (4) limited short term-debt maturities, mainly including a USD684 million equivalent EIB loan which matures in November 2020.

RATIONALE FOR STABLE OUTLOOK

The stable outlook reflects Moody's expectation that Ericsson's operating performance will continue to improve driven by a combination of positive organic growth in revenue, margin gains and ongoing positive free cash flow generation.

The stable outlook assumes that the company will reach its 10% operating margin target in 2020 with further progression thereafter, maintain its current market share in the global telecom equipment market and keep a strong liquidity profile that would allow it to withstand potential downturns caused by technology cycles or changes in operating conditions.

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

In light of the cyclicality of this industry and the potential for rapid reversals in operating performance when there are changes in technology cycles or material market share shifts owing to changes in the competitive dynamics, further upward pressure on the rating is more limited.

However, overtime, positive pressure on the rating could develop if Ericsson maintains a sustainably robust competitive position and technological leadership, in particular by growing its market share in the global telecom equipment market, which is usually translated into further operating margin gains. Quantitatively, upward pressure would require (1) operating margins (Moody's adjusted) increasing sustainably towards 15%; (2) strong free cash flow generation after shareholder distributions; and (3) a sustained solid liquidity profile and strong balance sheet with a net cash position (on a Moody's adjusted basis).

The rating could be lowered if the company's operating performance deteriorates owing to market share losses or adverse operating conditions, such that its (1) Moody's-adjusted operating income drops below 8%, (2) Moody's-adjusted debt/EBITDA increases sustainably above 2.5x, or (3) free cash flow turns negative and liquidity deteriorates.

LIST OF AFFECTED RATINGS

..Issuer: Telefonaktiebolaget LM Ericsson

Upgrades:

....Probability of Default Rating, Upgraded to Ba1-PD from Ba2-PD

....Corporate Family Rating, Upgraded to Ba1 from Ba2

....Senior Unsecured Medium-Term Note Program, Upgraded to (P)Ba1 from (P)Ba2

....Senior Unsecured Regular Bond/Debenture, Upgraded to Ba1 from Ba2

Outlook Action:

....Outlook, Changed To Stable From Positive

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 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

COMPANY PROFILE

With reported net sales of SEK228 billion for the twelve months ended 31 March 2020 and EBITDA of SEK30.5 billion, 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 2019, Ericsson's Networks division contributed 68% of the group's net sales, followed by Digital Services at 18%, Managed Services at 11% and its 'Emerging Business and Other' segment at 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.

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Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569 .

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