Global Credit Research
Rating Action
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Rating Action: Telefonaktiebolaget LM Ericsson

MOODY'S UPGRADES TO Ba2 (FROM B1) ALL RATINGS FOR ERICSSON'S SENIOR UNSECURED LONG TERM DEBT, OUTLOOK POSITIVE

Approximately €4.2 Billion Debt Securities Affected

Frankfurt, August 10, 2004 -- Moody's Investors Service today upgraded to Ba2 from B1 the long-term debt ratings of Telefonaktiebolaget LM Ericsson ("Ericsson") including the senior implied, issuer, debt and bank loan ratings. The company's Not-Prime short-term debt rating was affirmed. The outlook for all ratings is positive.

The rating upgrade is based on: (i) Moody's view that the global mobile infrastructure market is evidencing a steady degree of growth, (ii) Ericsson's success in retaining its leading position in almost all standards of wireless telephone equipment, (iii) the company's recent track record of achieving growth in operating profits and free cash flows even including the cost of restructuring measures, but excluding any cash releases from working capital, and (iv) management's practice of retaining generated cash flows to build a highly liquid balance sheet in order to strengthen the company's financial flexibility.

However, the ratings remain constrained by the following concerns: (i) that the current upturn in demand may prove not to be robust, given that the trajectory is currently being boosted by catch-up orders, (ii) that the recent good profitability and cash flows, which are primarily based on a minimum-level cost base and high operating leverage, may not prove sustainable once growth reaches a level that requires investments in production capacity and working capital, and (iii) that management may, over time, decide to apply the company's strong cash balances for acquisitions or distributions to shareholders well before the free cash flow pattern has been firmly established, notwithstanding the absence of any such indications as yet.

The positive outlook on the Ba2 ratings reflects Moody's view that a continuation of the current trend of rising revenue, profits and cash flows, in combination with a modestly leveraged and highly liquid capital structure, will likely lead to further upgrades within a relatively short timeframe. However, the rating agency notes that any return to an investment grade rating would be dependent on reliable revenue visibility, a sustained track record of free cash flows, and a clear financial strategy with regard to appropriate cash and debt levels for a stabilised company. Nonetheless, even in such a situation, Ericsson's relatively narrow product range (mobile networks and services) would continue to weigh on its ratings.

In Moody's opinion, global prospects for mobile phone infrastructure have improved considerably -- since the beginning of 2004, orders for GSM equipment have started rising again, driven by both capacity upgrades in the developed markets and increased coverage requirements in the emerging markets, whilst WCDMA equipment (3rd generation) is being rolled out at a measured pace. However, Moody's cautioned that, given that current GSM demand is being boosted by catch-up orders that had been deferred during 2003, it is not entirely clear at this stage whether regular GSM-upgrade demand will remain strong enough to support revenues until the WCDMA network deliveries have reached full flow and product crossover is being effected at a level well above current revenues. In this context, it should be noted that orders are not a sufficiently reliable indicator of the medium-term robustness of demand given that lead-times have invariably shrunk to less than 90 days.

As a result of three years of intensive downsizings and cost-saving measures, Ericsson is now well positioned to benefit over-proportionately from sales increases in terms of margins and cash flows. Indeed, despite only returning to operating profitability in Q4 2003, it achieved a historically high operating margin in Q2 2004. Similarly, its cash burn rate turned positive in Q4 2003 and generated more than EUR500 million of free cash flow, excluding working capital effects, in Q2 2004. Although the rapid pace of this turnaround is unlikely to be sustainable, even at a more moderate, perhaps single-digit, growth rate, Ericsson would be expected to remain solidly profitable.

However, Moody's views Ericsson's revenue trend as remaining vulnerable to shocks, such as an unexpected fall-off in GSM-upgrade demand or a delayed crossover to 3rd generation equipment, which could give rise to renewed pressure on Ericsson's earnings. Although the company's break-even cost level has the capacity to absorb a reasonably substantial fall in revenues from current levels, a squeezed profitability would impair gross interest coverage levels.

Moreover, a solid growth path may require renewed investment in R&D, capacity and working capital in order to defend the company's market position against financially stronger competitors, who may now focus more on the network business as growth emerges. All such cash requirements would weigh on the proportion of Ericsson's cash flow that is available for debt service.

Ericsson has maintained a healthy and liquid capital structure throughout the downturn, which was a key factor in limiting rating pressure. Now that its cash flow performance has stabilised, management may decide to relax its caution and to distribute excess cash to shareholders or engage in large acquisitions to bring the capital structure to an efficient level. Whilst Ericsson has a long track record of conservative finances and Moody's is unaware of any intention to change this approach, the rating agency would expect shareholder pressures to rise as cash accumulates.

Moody's has upgraded the following ratings to Ba2 from B1:

- Telefonaktiebolaget LM Ericsson: Euro Medium-Term Notes, the US$600 million revolving credit, the issuer rating, and the senior implied rating -- all with positive outlook.

Moody's has affirmed the following short-term ratings at Not-Prime:

- Ericsson Treasury Services AB: guaranteed US and Euro commercial paper.

- Ericsson Treasury Services U.S. Inc.: guaranteed US commercial paper.

Domiciled in Stockholm, Sweden, Ericsson is a leading developer and manufacturer of mobile telecoms and datacom equipment, and recorded revenues of about SEK60.7 billion (EUR6.7 billion) in the first six months of 2004.

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