Moody's Investors Services

Global Credit Research
Rating Action
17 JUN 2002

Rating Action: Telefonaktiebolaget LM Ericsson

CORRECTION TO HEADLINE: MOODY'S DOWNGRADES TO Baa3 AND PRIME-3 ERICSSON'S RATINGS FOR LONG- AND SHORT-TERM DEBT; RATINGS REMAIN ON REVIEW SUBJECT TO RIGHTS OFFERING

Approximately $ 5.1 Billion of Long-term Debt Securities Affected.

Moody's Investors Service downgraded to Baa3 from Baa2 the long-term debt ratings of Telefonaktiebolaget LM Ericsson (Ericsson) and lowered to Prime-3 from Prime-2 the company's rating for short-term debt. The rating downgrade is based on a downward revision of Moody's expected transition cycle for mobile infrastructure equipment driven by the erosion of orders for 2nd generation wireless systems and additional deferrals of installation plans for 3rd generation equipment in the market. Financially, Ericsson carries substantial cash balances and plans to raise EUR 3.3 billion in new equity and has initiated a comprehensive cost reduction program. However, the projected cash consumption during the period until its cost base has been adjusted to depressed revenue levels will likely reduce the company's financial flexibility significantly compared to the rating category. In that context, completion of the rights issue and maintenance of its borrowing headroom is essential for the company to preserve its liquidity profile through the transition cycle. Moody's rating scenario expects a stabilization of annual revenues at approximately SEK 170 billion and a quick and stringent implementation of cost saving measures to return to operating profitability by early 2003. Moody's will continue to review the ratings for possible further downgrade until the rights issue is completed and the $600 million revolving credit is renegotiated or adequately replaced to preserve borrowing headroom, both of which are expected to take place over the next 100 days. In that case, Moody's expects to confirm the ratings for Ericsson as investment-grade at Baa3, but retain a negative outlook. The rating outlook reflects the low order visibility and the risk for additional cash flow deficits from rising price pressure or delays in cost saving measures all leading to a faster erosion of Ericsson's financial flexibility. The rating review was initiated on April 23, 2002.

Ratings lowered to Baa3 from Baa2 are:
Telefonaktiebolaget LM Ericsson - for Euro Medium Tem Notes, the $600 million revolving credit, and the issuer rating.
Ratings reduced to Prime-3 from Prime-2 are for:
Ericsson Treasury Services AB -- for guaranteed US- and Euro- commercial paper, and
Ericsson Treasury Services U.S. Inc. -- for guaranteed US-commercial paper.
All ratings remain on review for possible further downgrade

While global phone traffic rates and mobile phone subscribers continue to increase at a fair pace, this does not currently result in an equal growth of capital investment by the mobile carriers. In contrary, after the fast growth of the past five years, equipment purchases of the operators and consequently orders for the vendors have fallen to very low levels. In its rating scenario, Moody's expects these orders to stabilize on a low level in 2002 and broadly stagnate in 2003, following during the years its pattern of significant improvement towards the end of the year. The bottoming is likely to result from the basic maintenance levels of capital expenditure and enhancements reflective of rising traffic. The build-out of 3rd generation mobile networks, which is considered to become the main driver for an eventual industry recovery, is developing slowly and will likely not contribute substantial revenues for the suppliers in 2002 and possibly well into 2003. In addition, another contributing factor to the near-term depressed industry outlook is that many wireless operators globally are cutting back capital investments as they face maturing subscriber growth, increasingly aggressive competition, and, in a number of instances, the operators are experiencing negative free cash flow and an unfavorable capital markets environment.

In this scenario, Ericsson is diligently working to adjust its cost base to a significantly lower level of break-even sales. The plan includes a sizable reduction of workforce and consultants, a downsizing of working capital, rationalization of research & development, and outsourcing of manufacturing. This program and its strong technology base, should position Ericsson well for an eventual industry recovery, but in Moody's base scenario the company will still incur negative operating cash flows through a large part of 2003. Given the low order visibility, however, timing and extent of an order recovery is difficult to estimate which weighs on Ericsson's Baa3 rating.

Management has prepared the company well financially for the downcycle. It has shored up cash liquidity standing at EUR 6.1 billion currently, announced an intended equity offering of around EUR 3.3 billion and kept its balance sheet moderately leveraged, even when considering the contingent obligations for the securitized vendor financing portfolio and the strategic importance of the SonyEricsson joint venture. It should be noted, however, that Moody's does have concerns about draw-downs and write-downs in the vendor financing portfolio and about the possibility of further capital needs at the SonyEricsson venture. These resources, including as critical element the rights issue, well exceed the projected cash deficits - in Moody's current base scenario - and the refinancing needs for rating sensitive funding arrangements. Yet order visibility is low and further order and revenues shortfalls from the SEK 170 billion mark, or delays in cost restructuring would contribute to gradual erosion of Ericsson's financial strength.

A successful completion of the rights offering and the amendment to the rating sensitive credit facility would add critical liquidity to fund the cash consumption cycle and demonstrate the continued support of shareholders and lenders. Moody's would expect to recognize this in the conclusion of the rating review.

Domiciled in Stockholm, Sweden, Ericsson is a leading developer and manufacturer of mobile telecom and datacom equipment, and recorded revenues of about SEK232 billion (EUR 25 billion) in fiscal year 2001.

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