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Research:
Ericsson's Long-Term Ratings Lowered to 'A'; Short-Term Ratings Affirmed; Outlook Negative

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Credit Analyst: Louis Landeman, Stockholm (46) 8-440-5917; Duncan Warwick-Champion, London (44) 20-7826-3873

LONDON (Standard & Poor's CreditWire) Jan. 30, 2001--Standard & Poor's today lowered its long-term corporate credit and senior unsecured debt ratings on the Swedish mobile telecommunications company Ericsson (Telefonaktiebolaget L.M.) to single-'A' from single-'A'-plus. At the same time, Standard & Poor's affirmed its 'A-1' short-term ratings on Ericsson and related entities. The outlook remains negative.

The downgrade is a result of increasing operating losses in the consumer products segment and Ericsson's lower margin and revenue growth targets for 2001 announced last week. During the fourth quarter of 2000, Ericsson incurred an extra restructuring charge of Swedish krona (SKr) 8.0 billion ($0.84 billion) for the full outsourcing of its mobile phone manufacturing operations, in addition to the SKr4.7 billion restructuring provision announced earlier for the quarter. The company also lowered its operating margin expectations for 2001 to 6%-8% from the previous target of more than 10%. The expected lower margins for 2001 are related to continued forecast losses for the mobile phones business during the first half of 2001, together with high investments in ramping up capacity for third generation mobile networks.

Although Ericsson remains one of the largest manufacturers of mobile handsets, it has recently experienced serious technical and logistical problems in this business area, which is currently making heavy losses. During the fourth quarter of 2000, the consumer products segment's operating loss after depreciation rose to SKr10 billion, of which SKr4.7 billion represented restructuring charges. For the full year 2000, the total loss was about SKr24 billion, including the additional SKr8 billion provision. The company has implemented a restructuring program with the aim of returning to an operating profit in this segment in the second half of 2001. As part of this program, Ericsson has signed a strategic partnership agreement with its subsupplier Flextronics International Ltd. (BB+/Positive/--), whereby Ericsson will completely outsource supply and production of mobile phones to Flextronics. Ericsson will focus solely on product development, marketing, and sales of phones, and, as a consequence, expects to reduce the number of staff in the consumer products division by 11,000 during 2001.

The negative impact of the consumer products segment on Ericsson's earnings and cash flows is partially offset by the continued strong performance of the mobile networks segment, which represents the majority of the company's sales. During 2000, EBIT margin for the network operators and service providers business (representing 75% of total sales in the fourth quarter of 2000) was 17%. As continued strong growth of network sales might require Ericsson to supply operators with additional vendor finance, Standard & Poor's explicitly assumes that Ericsson's financial profile remains conservative for the company's ratings to be maintained.

Despite the strong performance within mobile networks, Ericsson's overall operating cash flow for 2000 after working capital was negative SKr11 billion. This is mainly due to a strong increase in inventory and the loss in consumer products. Thanks, however, to a SKr15.4 billion capital gain related to the sale of shares in Juniper Networks Inc. Ericsson's cash flow before financing activities was SKr6 billion for the full year 2000, and the company's balance sheet remains solid.

OUTLOOK: NEGATIVE

Operating cash flow generation will need to improve during 2001 so that growth can be financed with internally generated cash. If the production outsourcing agreement and other cost-cutting efforts allow the company to obtain sufficient economies of scale to restore profitability in the handset business, the outlook would likely be changed to stable.

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