



# Ericsson Second quarter 2018

July 18, 2018



# Peter Nyquist

Vice President Investor Relations



# Second quarter 2018

July 18, 2018

This presentation contains forward-looking statements. Such statements are based on our current expectations and are subject to certain risks and uncertainties that could negatively affect our business. Please read our earnings reports and our most recent annual report for a better understanding of these risks and uncertainties.



# Börje Ekholm

President and CEO

# Key takeaways



- Continued strong strategy execution
  - Continued investments in technology leadership
  - SEK 10 b. cost reductions program completed
  - Divested fiber assets and field service
- Strong business momentum for 4G and virtualized portfolio
  - Operators need to efficiently manage growing user demands
  - Selectively capturing footprint through 5G-ready 4G portfolio (radio and core)
- Increased 5G activity among operators
  - Operators need to manage growth of data traffic with sustained quality and without increasing cost – first use case for 5G
  - Increasing costs for field trials and R&D
- Confident in reaching our long-term target of at least 12% operating margin beyond 2020

# Q2 2018



## Financial Performance, Q218

Excluding restructuring charges

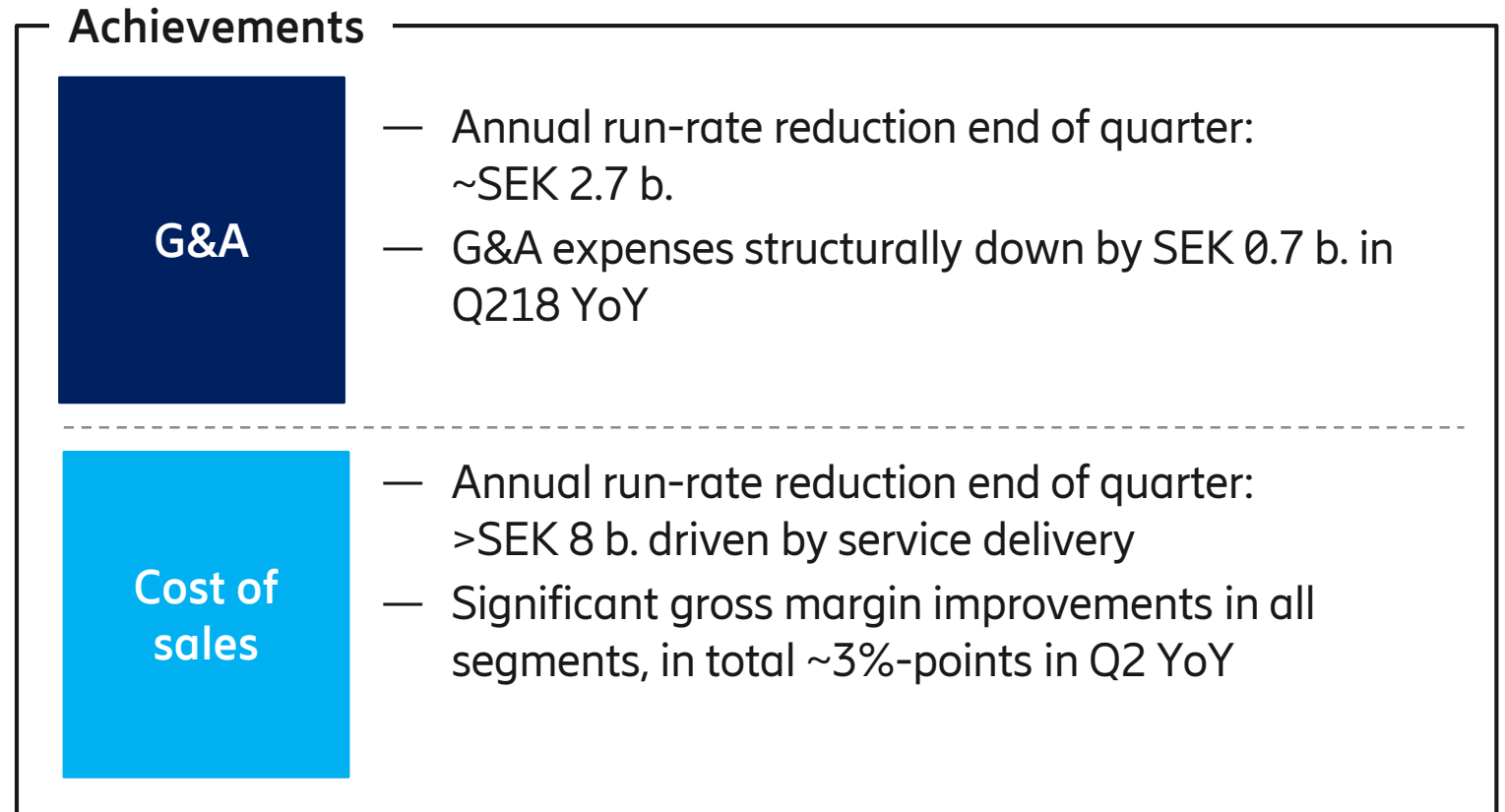
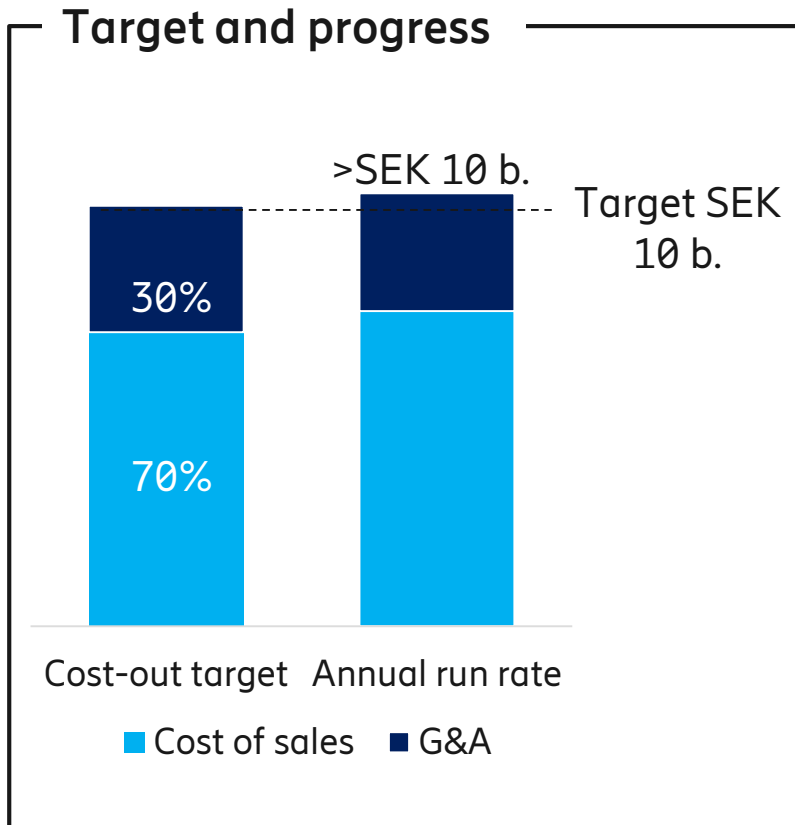
SEK b.	18Q2	17Q2	18Q1
Net sales	49.8	50.3	43.4
Gross margin	36.7%	30.9%	35.9%
Operating income	2.0	1.0	0.9
Operating margin	4.1%	1.9%	2.0%
Free cash flow	-0.6	-1.3	0.3

## Financial Targets, 2020

Group targets	2020
Net Sales	SEK 190-200 b.
Gross margin	37-39%
Operating margin	>10%
Free Cash Flow	Positive

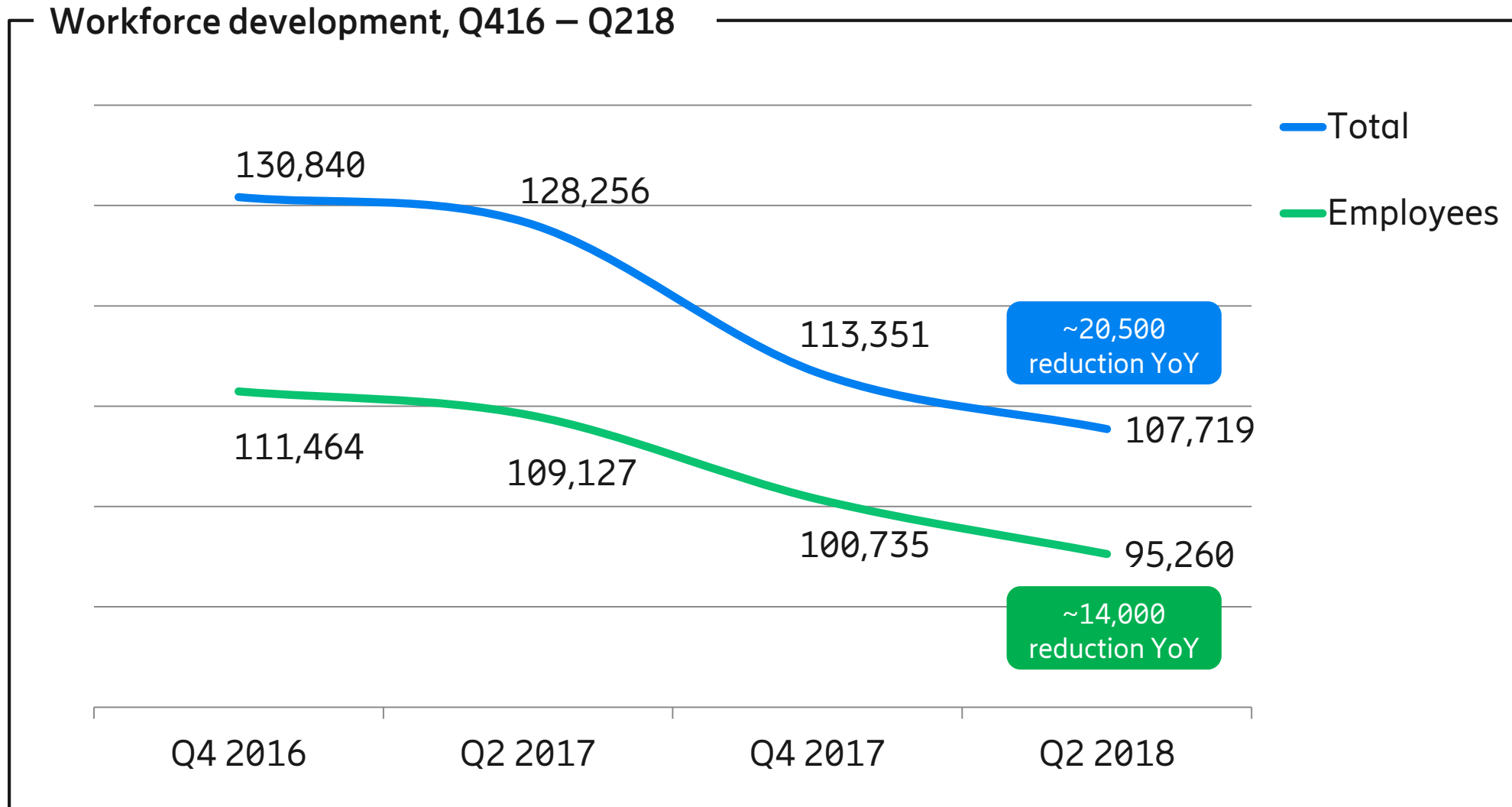
- Sales adj. for FX: -1% YoY (reported sales -1%)
  - Organic growth in Networks – good momentum in North America
- Gross margin improved 6%-points YoY
  - Cost out across all segments
  - Ericsson Radio System ramp-up
- Operating income improved YoY and QoQ
  - Cost reduction program successfully completed
  - Managed Services – second consecutive profitable quarter
  - Digital Services – significantly reduced losses
- Free cash flow improved YoY
  - Free cash flow YTD -0.3 (-4.6) b.
  - Operating cash flow SEK 1.4 (0.0) b.

# SEK 10 b. cost-out target for mid-2018



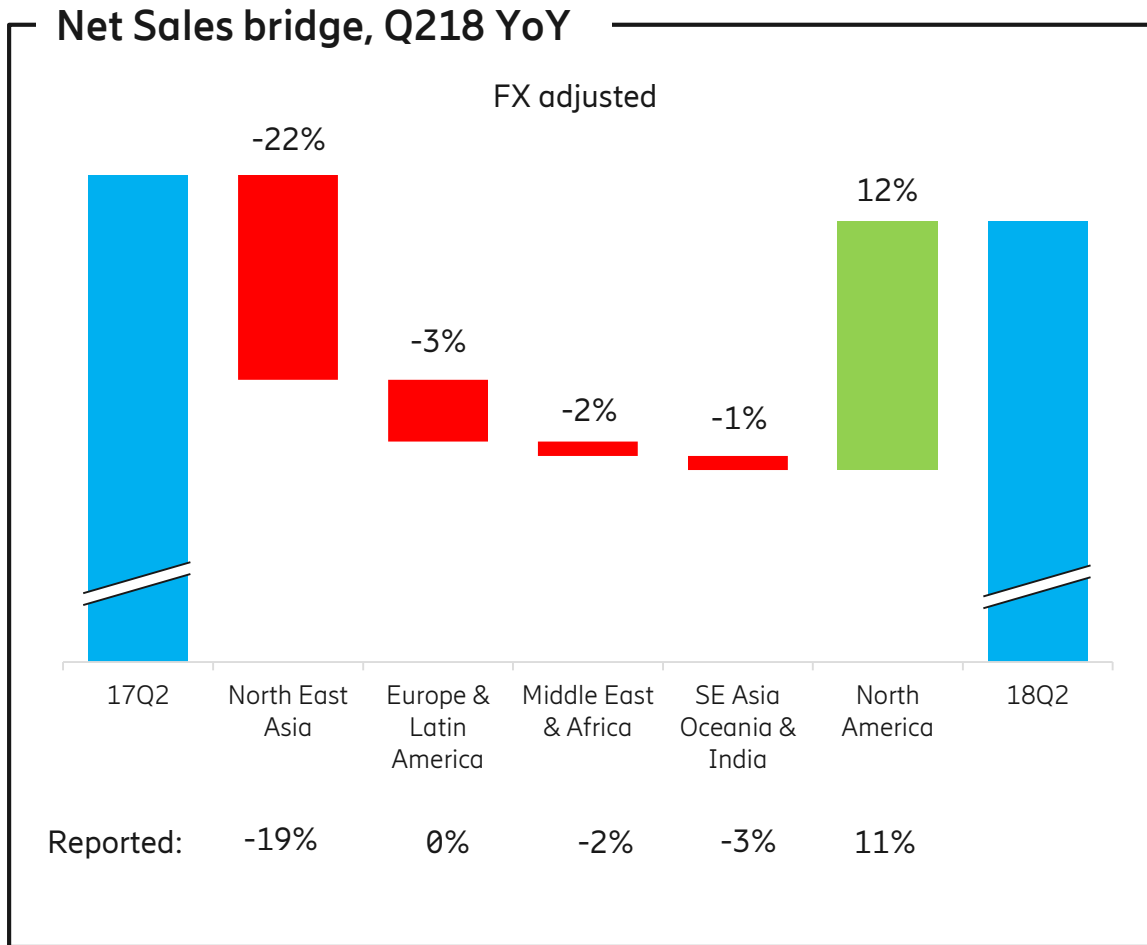
Program completed – Efficiency work continues – SEK 5-7 b. restructuring charges estimate remains

# Employees and total workforce development





# Market area sales Q218, YoY



- North East Asia
  - Reduced LTE investments in Mainland China
- Europe & Latin America
  - Continued sales growth in Latin America and parts of Europe, offset by a decline in certain markets
- Middle East & Africa
  - Monetary restrictions in a few markets in the Middle East
- South East Asia, Oceania & India
  - Large 4G deployments, however slight YoY reduction due to timing of orders
- North America
  - Strong market momentum continues – 5G readiness

# Reaching the 2020 target (CMD 2017)

## Status Q2 2018



### Networks



#### 2020 target

Net sales	Operating margin
SEK 128-134 b.	15-17%

#### Status Q2 2018

- Ericsson Radio System – 84%
- Cost savings – Service delivery and common costs
- Competitive 5G-ready portfolio
- R&D investments up >30% YoY

### Digital Services



#### 2020 target

Net sales	Operating margin
SEK 42-44 b.	Low single digit

#### Status Q2 2018

- Losses reduced
- 16 of 45 contracts addressed
- Cost savings – service delivery efficiencies and lower R&D
- Investing in 5G-ready and cloud native products

### Managed Services



#### 2020 target

Net sales	Operating margin
SEK 20-22 b.	4-6%

#### Status Q2 2018

- 33 of 42 contracts addressed
- Annualized profit improvement of SEK 0.8 b.
- Cost savings - Service delivery
- Investing in machine intelligence, automation and analytics

### Other



#### 2020 target

Net sales	Operating margin
SEK 3-5 b.	Break-even

#### Status Q2 2018

- Media Solutions - partnering
- Red Bee Media – operations and portfolio further developed
- Selective investments in Emerging Business – IoT, UDN and Emodo

Strategy execution on track – Confident in reaching long-term target of >12% beyond 2020



# Carl Mellander

Chief Financial Officer

# Networks

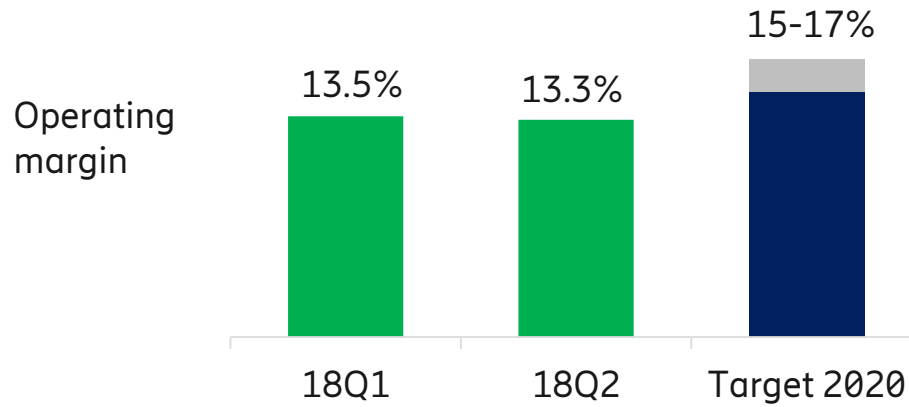


## Segment Networks – Financial performance

Excluding restructuring charges

SEK b.	18Q2	17Q2	18Q1
Net sales	32.4	31.7	28.6
Gross margin	40.2%	36.0%	40.4%
Operating income	4.3	4.2	3.9
Operating margin	13.3%	13.4%	13.5%
<i>Capitalization impact<sup>1</sup></i>	0.0	0.0	-0.2

<sup>1</sup>2017 excluding xo-items



- Sales adjusted for FX: 2% YoY
  - Strong growth in North America
- Solid gross margin increase YoY
  - Increased hardware and services margins
  - Favorable market mix
- Stable operating margin YoY and QoQ
  - Increased investments in R&D pay off with improved gross margin and sales
- Strong Ericsson Radio System deliveries, 84% YTD
  - Competitive → Stronger market position

# Digital Services

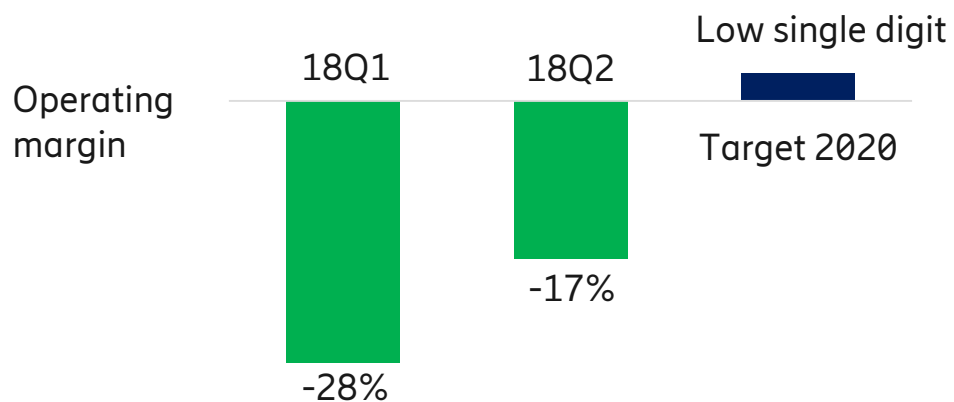


## Segment Digital Services – Financial performance

Excluding restructuring charges

SEK b.	18Q2	17Q2	18Q1
Net sales	8.8	9.9	7.3
Gross margin	42.6%	35.7%	42.9%
Operating income	-1.5	-1.8	-2.0
Operating margin	-16.9%	-18.0%	-27.9%
<i>Capitalization impact<sup>1</sup></i>	-0.4	-0.2	-0.4

<sup>1</sup>2017 excluding xo-items



- Sales adjusted for FX: -12% YoY
  - Decline in legacy products
  - Decline in new products, mainly due to delayed telecom core sales in North East Asia
- Gross margin improved significantly YoY
  - Cost reductions and improved software margins
  - Stable QoQ despite higher services sales
- Operating income improved YoY and QoQ
  - High activity in cost reductions across service delivery, SG&A and R&D
  - Continued investments in 5G portfolio
  - Additional 8 out of 45 critical or non-strategic customer contracts addressed in Q218 – 16 in total

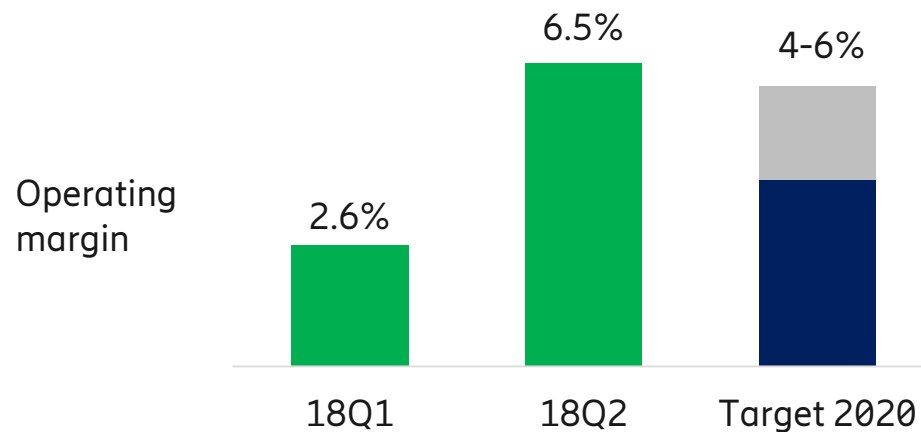
# Managed Services



## Segment Managed Services – Financial performance

Excluding restructuring charges

SEK b.	18Q2	17Q2	18Q1
Net sales	6.5	6.7	5.9
Gross margin	14.0%	2.0%	9.1%
Operating income	0.4	-0.1	0.2
Operating margin	6.5%	-2.1%	2.6%



- Sales adjusted for FX: -3% YoY
  - Lower sales due to contract exits
  - Good growth in Managed Services IT
- Gross margin improved significantly YoY
  - Efficiency measures and contract reviews
  - Provision reversal of SEK 0.1 b.
- Operating income positive – second consecutive quarter
- Additional 2 out of 42 contracts addressed in Q2 – 33 in total
  - Annualized profit improvement ~SEK 0.8 b., fully impacting gross margin
  - Ericsson Local Services AB divested. Announced July 11, closing expected in Q318.

# Emerging Business & Other

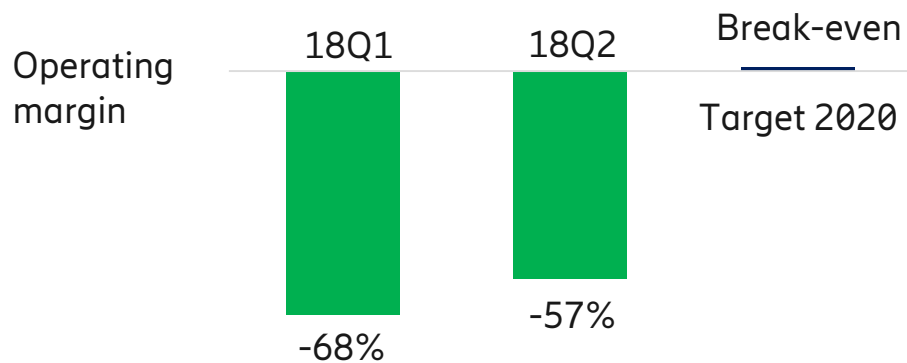


## Segment Other – Financial performance

Excluding restructuring charges

SEK b.	18Q2	17Q2	18Q1
Net sales	2.1	2.0	1.7
Gross margin	27.4%	24.3%	24.3%
Operating income	-1.2	-1.3	-1.1
Operating margin	-57.4%	-66.6%	-67.5%
<i>Capitalization impact<sup>1</sup></i>	-0.1	-0.1	-0.1

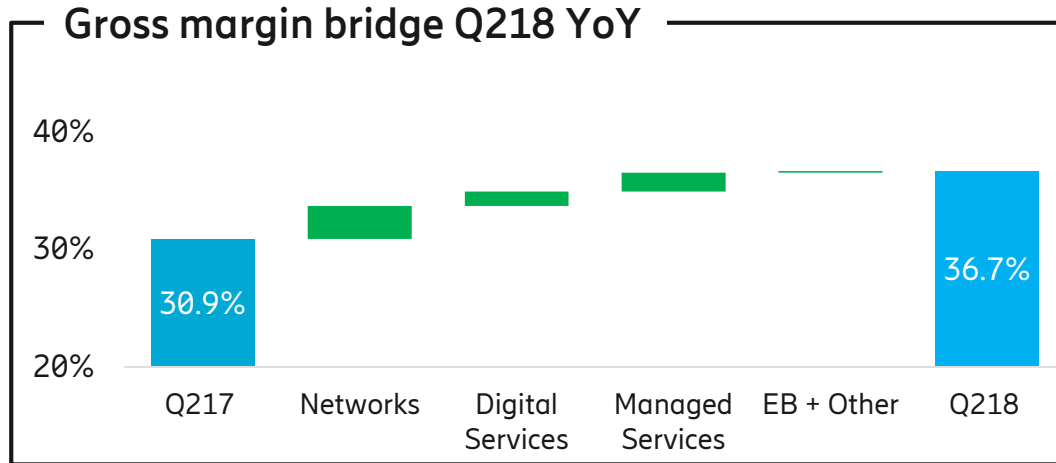
<sup>1</sup>2017 excluding xo-items



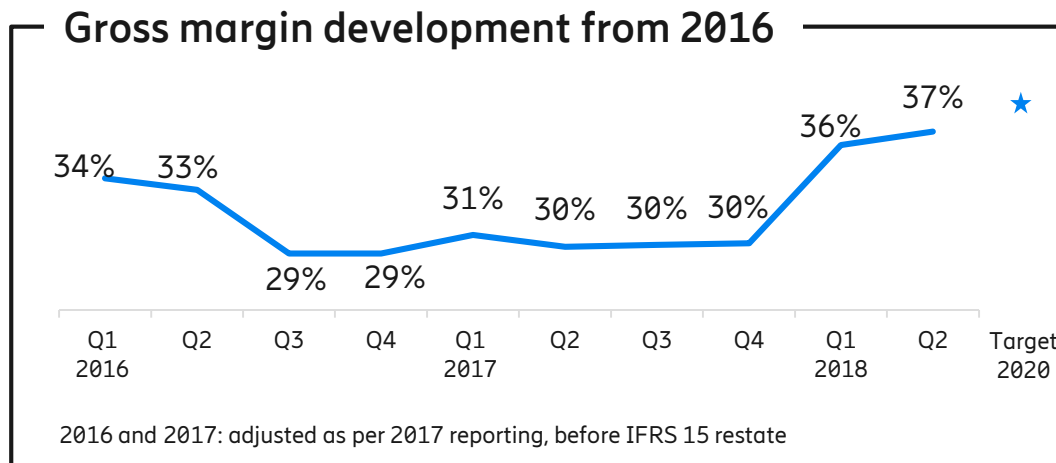
- Sales adjusted for FX: +1% YoY
  - Growth in iconectiv – Started sales on multi-year local number portability contract in North America
  - Growth in Emerging Business – IoT
  - Media Solutions legacy portfolio declined
- Gross margin improved YoY
  - Improvements in Media Solutions and Red Bee Media
- Operating margin
  - Improved income YoY in Media Solutions and iconectiv
  - Increased investments in Emerging Business – in line with strategy
  - Combined income for Media Solutions and Red Bee Media SEK -0.4 (-0.7) b.

# Gross margin Q218, YoY

Adjusted for restructuring charges



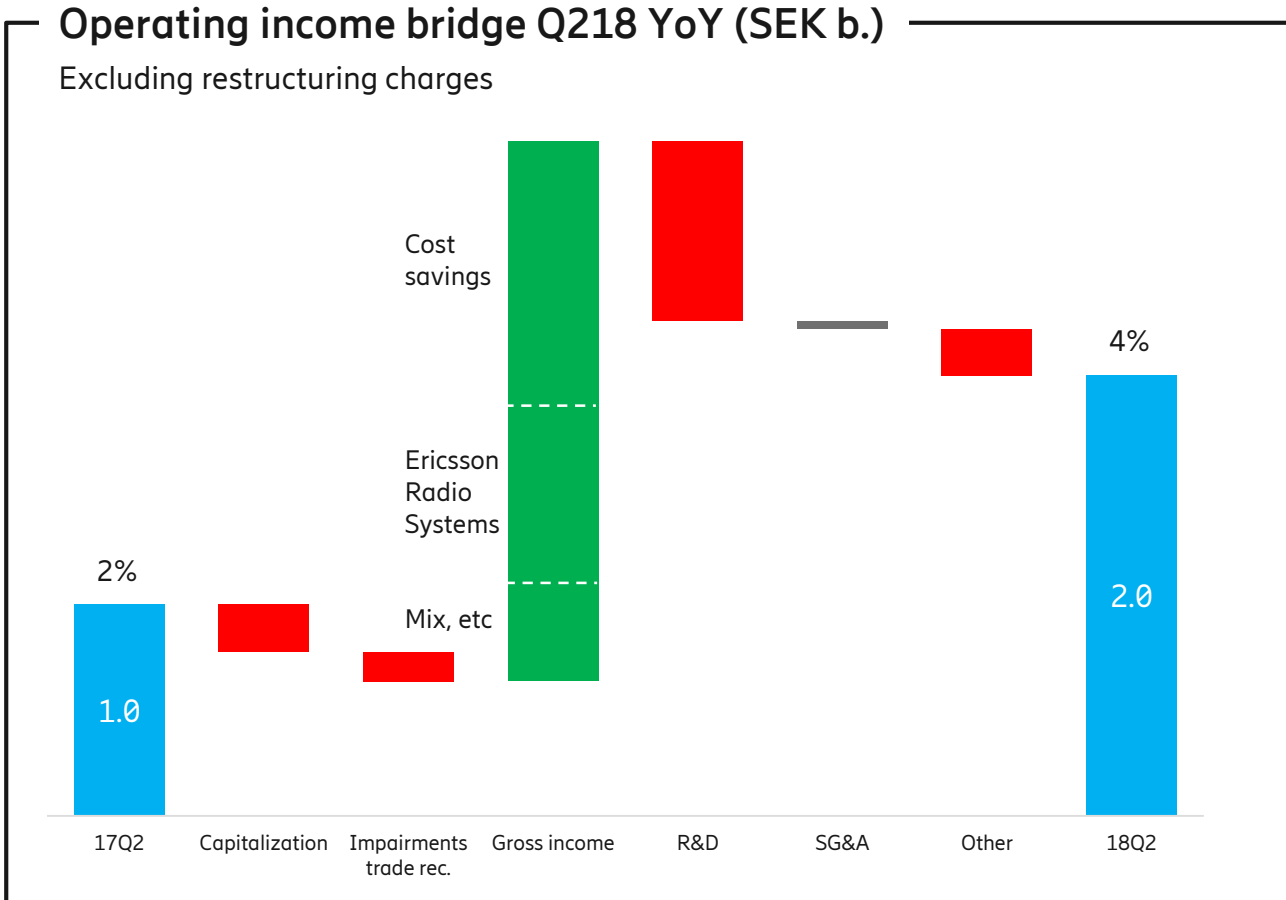
- Structural improvements YoY
  - Cost reductions visible in all segments
  - Continued ERS ramp up in Networks
  - Good progress in Managed Services contract review
- Positive market mix
- Gross margin improved QoQ
  - Driven by Managed Services
  - Networks and Digital Services stable



Strong gross margin – effects of strategy execution and control



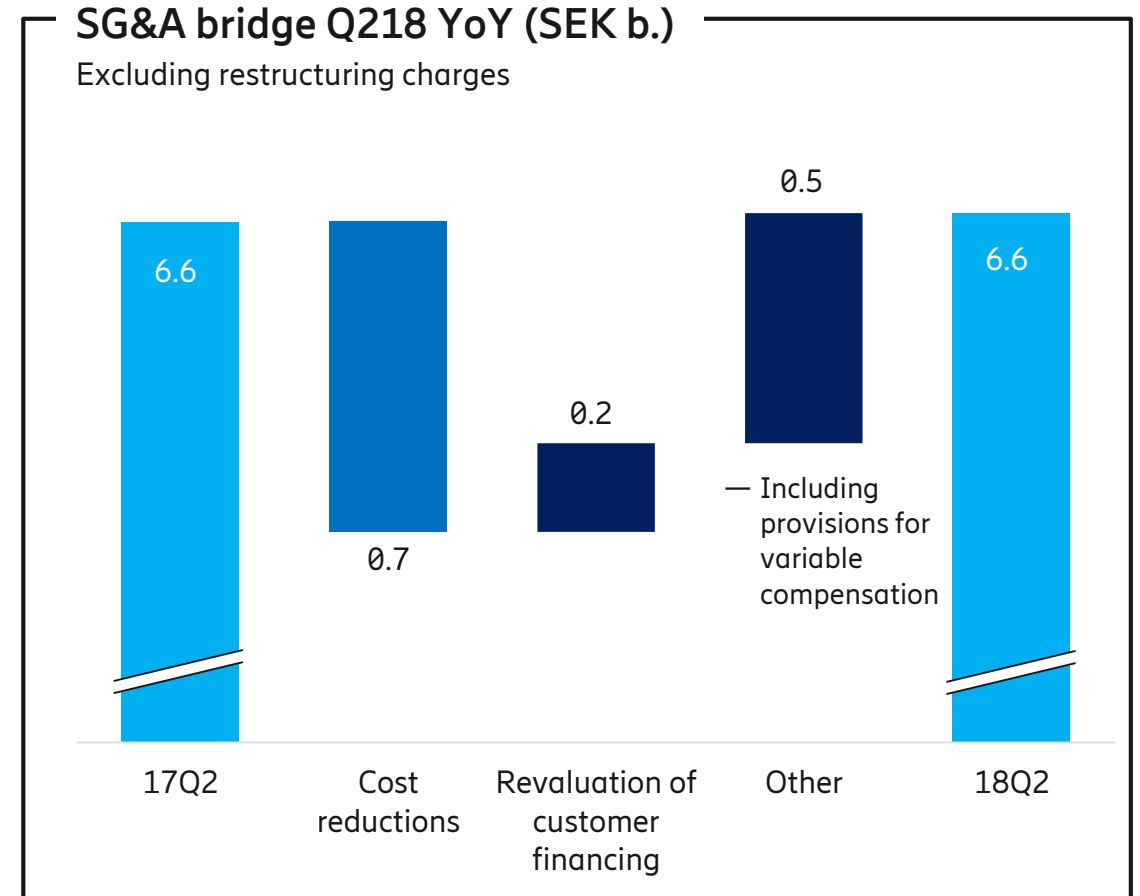
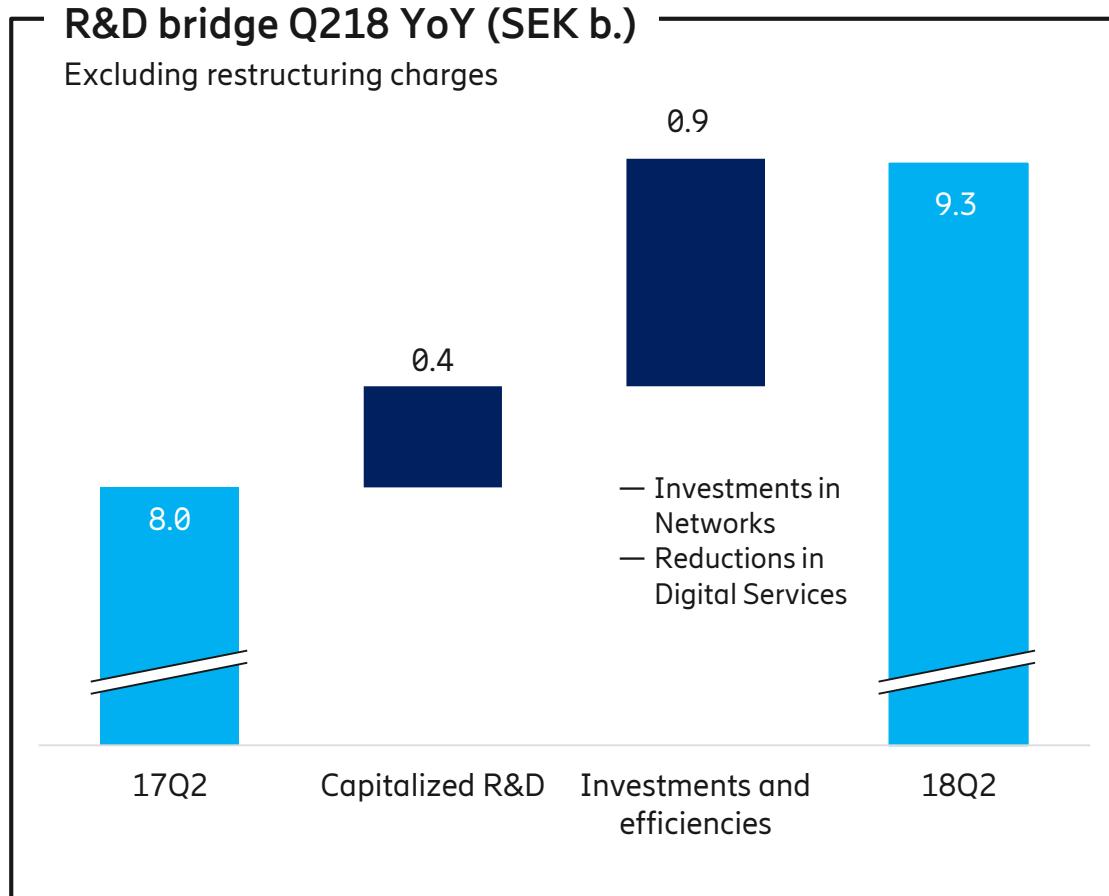
# Operating income Q218, YoY



- Capitalization impact flattening out, SEK -0.2 b. YoY
- Continuous impairment testing of trade receivables
- Gross income increase driven by gross margin improvement to 36.7% (30.9%)
- R&D investments in Networks drive growth in sales and gross margin

2020 operating margin target >10%

# R&D and SG&A Q218, YoY



**Increased R&D in Networks**

**Cost reductions in G&A**

# Free cash flow

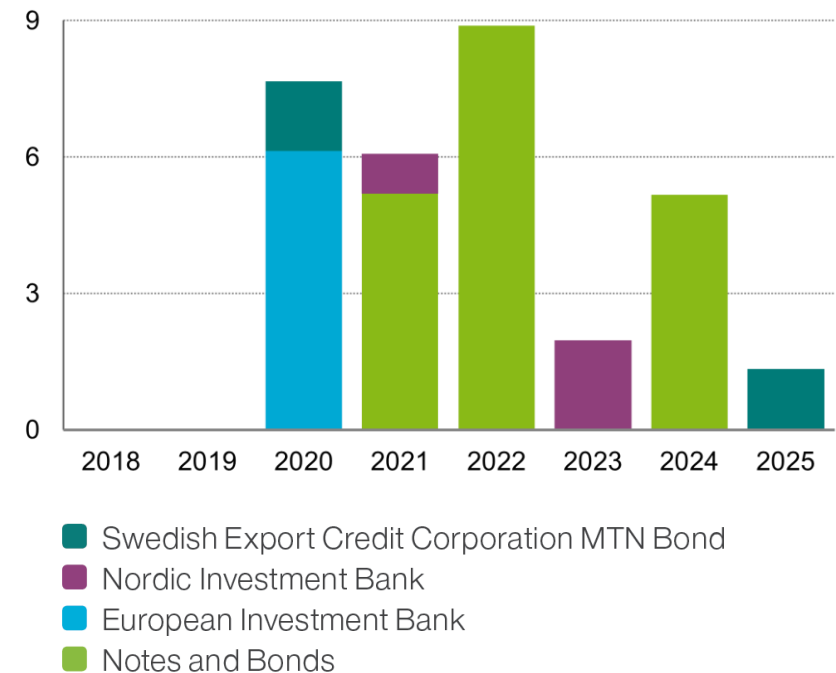


## Financial Performance

SEK b.	Q218	Q217
Net income reconciled to cash	-0.3	-0.1
Change operating net assets	1.7	0.1
<b>Cash flow from operating activities</b>	<b>1.4</b>	<b>0.0</b>
CAPEX	-1.0	-1.0
Other <sup>1</sup>	-0.7	-0.3
<b>Free cash flow before M&amp;A</b>	<b>-0.2</b>	<b>-1.3</b>
M&A	-0.4	0.0
<b>Free cash flow</b>	<b>-0.6</b>	<b>-1.3</b>
<i>Net cash end of period</i>	<i>33.1</i>	<i>24.0</i>
<i>Gross cash end of period</i>	<i>66.9</i>	<i>54.3</i>

<sup>1</sup> Change is mainly FX effects on hedging of financial assets

## Debt maturity profile (SEK b.)



Solid balance sheet – Net cash improved to SEK 33.1 (24.0) b. YoY

# Other financial items



**Impairment losses on trade receivables SEK -0.4 b. in the quarter**

- Impairment testing made continuously using a methodology where country and customer risks are assessed
- Will vary between quarters depending on payments received and aging of receivables

**Financial net decreased to SEK -0.8 (0.1) b.**

- Negative hedge effect of SEK -0.3 (0.3) b. following stronger USD to SEK

**Taxes SEK -1.2 b. in the quarter**

- Revaluation of deferred tax assets in Sweden due to changed Swedish corporate tax rate – no impact on cash

**Post-employment benefits increased to SEK 27.3 b. from SEK 25.6 b.**

- Decreased interest rates in Sweden
- Discount rate based on yields of Swedish government bonds used for Swedish Defined Benefit Obligation (DBO)
- If using Swedish covered bonds, DBO would have been SEK 8.5 b. lower as per June 30, 2018

**Segment restate between Managed Services and Digital Services**

- ADM and Business Support Solutions sales moved between the segments
- Net impact FY 2017: Sales SEK 1.9 b. Gross inc. SEK 0.2 b. Positive for MS, negative for DGS
- 2020 targets to be addressed at CMD 2018

# Planning assumptions

From the Q2 report



## Market

- RAN equipment market -2% FY18, 2% CAGR (17-22)
- Chinese market expected to decline in 2018, positive momentum in the U.S.

## Currency

- Rule of thumb: USD/SEK 10% weaker → ~ -5% sales and ~ -1pp OM. For historical FX rates, please see ericsson.com

## Ericsson, 2018

- 5-year average sales seasonality Q2→Q3: -2% and Q3→Q4: 23%
- Baseline for IPR ~SEK 7 b., on an annual basis
- Restructuring charges FY 2018 SEK 5-7 b. (est.)
- Media Solutions divestment expected end of Q3 2018 with est. additional expenses of SEK 0.3 b. in Q3. Results will be reported as share of earnings according to the equity method (Ericsson 49% of shares). Media solutions sales were SEK 3.2 b. in 2017

## Actual and estimated capitalization impact

SEK b.	Q218	Q318 est.	Q317	FY17	FY18 est.	FY19 est.
CoS	-0.2	-0.2	-0.9	-2.6	-1	-
R&D	-0.3	-0.3	-0.6	-0.3	-1	-
Total	-0.5	-0.5	-1.5	-2.9	-2	-1 to -2

Based on current visibility, assessments and FX rates



# Börje Ekholm

President and CEO

# Closing remarks



- Strong momentum in strategy execution – tracking well towards 2020 Group targets
  - Significant improvements across operations – strict cost focus also going forward
- Strategy cornerstone: Strengthening technology leadership and portfolio competitiveness
  - Investments will continue
- Increasing momentum for 5G – operators across markets getting ready for technology shift
  - Data traffic growth alone will require technology upgrades



Continue to invest to secure leadership in 5G



**Q & A**







# Second quarter 2018

July 18, 2018

This presentation contains forward-looking statements. Such statements are based on our current expectations and are subject to certain risks and uncertainties that could negatively affect our business. Please read our earnings reports and our most recent annual report for a better understanding of these risks and uncertainties.