ERICSSON LM TELEPHONE CO
Form 6-K
October 18, 2018
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**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 6-K**

**REPORT OF FOREIGN ISSUER**

**Pursuant to Rule 13a-16 or 15d-16 of**

**the Securities Exchange Act of 1934**

**October 18, 2018**

**Commission File Number**

**000-12033**

**LM ERICSSON TELEPHONE COMPANY**

**(Translation of registrant s name into English)**

**Torshamnsgatan 21, Kista**

**SE-164 83, Stockholm, Sweden**

**(Address of principal executive offices)**

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.
Form 20-F Form 40-F

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):

Announcement of LM Ericsson Telephone Company, October 18, 2018 regarding Ericsson reports third quarter results 2018 .

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## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

TELEFONAKTIEBOLAGET LM ERICSSON (publ)

By: /s/ XAVIER DEDULLEN
**Xavier Dedullen**
**Senior Vice President, Chief Legal Officer**

By: /s/ CARL MELLANDER
**Carl Mellander**
**Senior Vice President, Chief Financial Officer**

Date: **October 18, 2018**

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Third quarter report 2018

**Stockholm, October 18, 2018**

**Third quarter highlights**

Sales as reported increased YoY by 9% and sales adjusted for comparable units and currency increased by 1%.

Segment Networks showed a sales growth adjusted for comparable units and currency of 5% YoY with strong sales growth in North America as well as in Europe and Latin America.

Gross margin was 36.5% (26.9%). Gross margin excluding restructuring charges improved to 36.9% (28.5%), driven mainly by cost reductions, the continued ramp-up of Ericsson Radio System (ERS) and good progress in reviewing Managed Services contracts.

Operating margin was 6.0% (-7.4%). Operating margin excluding restructuring charges was 7.0% (-1.7%).

Networks operating margin excluding restructuring charges was 16.1% (11.9%) driven by cost reductions and ERS ramp-up, partly offset by increased investments in R&D.

Digital Services operating margin excluding restructuring charges was -15.9% (-29.9%) supported by a gross margin excluding restructuring charges of 36.9% (32.0%). Sequentially, gross margin declined from 42.6% mainly due to increased provisions related to transformation projects.

Managed Services operating margin excluding restructuring charges improved to 6.8% (-9.5%) as a result of cost reductions and customer contract reviews.

Cash flow from operating activities was SEK 2.0 (0.0) b. and free cash flow excluding M&A was SEK 0.7 (-0.8) b. Net cash increased YoY to SEK 32.0 (24.1) b.

| SEK b. | Q3 2018 | Q3 2017 | YoY change | Q2 2018 | QoQ change | 9 months 2018 | 9 months 2017 |
|---|---|---|---|---|---|---|---|
| Net sales | 53.8 | 49.4 | 9% | 49.8 | 8% | 147.0 | 147.5 |
| *Sales growth adj. for comparable units and currency* | | | *1%* | | *7%* | | |
| Gross margin | 36.5% | 26.9% | | 34.8% | | 35.2% | 24.0% |
| Operating income (loss) | 3.2 | -3.7 | | 0.2 | | 3.1 | -15.5 |
| Operating margin | 6.0% | -7.4% | | 0.3% | | 2.1% | -10.5% |
| Net income (loss) | 2.7 | -3.5 | | -1.8 | | 0.2 | -13.9 |
| EPS diluted, SEK | 0.83 | -1.09 | | -0.58 | | 0.01 | -4.31 |
| EPS (non-IFRS), SEK [1)] | 1.03 | -0.29 | | -0.09 | | 1.04 | -2.15 |
| Cash flow from operating activities | 2.0 | 0.0 | | 1.4 | 41% | 5.1 | -1.6 |
| Free cash flow excluding M&A [2)] | 0.7 | -0.8 | | -0.2 | | 1.3 | -5.4 |
| Net cash, end of period | 32.0 | 24.1 | 33% | 33.1 | -3% | 32.0 | 24.1 |
| *Gross margin excluding restructuring charges* | *36.9%* | *28.5%* | | *36.7%* | | *36.5%* | *26.2%* |
| *Operating income (loss) excluding restructuring charges* | *3.8* | *-0.8* | | *2.0* | *85%* | *6.7* | *-9.4* |

| | | | | | |
|---|---|---|---|---|---|
| *Operating margin excluding restructuring charges* | *7.0%* | *-1.7%* | *4.1%* | *4.6%* | *-6.4%* |

1) EPS diluted, excl. amortizations and write-downs of acquired intangible assets, and excluding restructuring charges. Potential ordinary shares are not considered when their conversion to ordinary shares would increase earnings per share.
2) Free cash flow excluding M&A: See Alternative Performance Measures (APM) at the end of the report.

Non-IFRS financial measures are reconciled to the most directly reconcilable line items in the financial statements at the end of this report.

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CEO comments

We continue to execute on our focused strategy, tracking well towards our 2020 targets. We see improvements across our businesses resulting in a gross margin[1]) of 36.9% (28.5%) and an operating margin[1]) of 7.0% (-1.7%). Organic[2]) sales growth was 1% for the Group, despite headwind from exited non-strategic contracts.

We continue to invest in our competitive 5G-ready portfolio to enable our customers to efficiently migrate to 5G. Operators around the world plan for launching 5G services, led by North America. The strong customer interest in 5G generates a gradual increase in costs for field trials. We expect the costs to remain on high levels, at least for the coming 12-18 months, and they are included in our 2020 profitability target of at least 10%.

Networks gross margin[1]) improved to 41.5% (34.8%) with an organic[2]) sales growth of 5%. The strong sales were mainly driven by a continued high activity level primarily in North America. Due to the strong sequential sales increase in the third quarter we expect lower effects from seasonality than normal in the fourth quarter in Networks.

Digital Services gross margin[1]) improved to 36.9% (32.0%) YoY, but declined QoQ. We see clear results of our cost-out activities and good progress in large parts of the business. At the same time, provisions related to large digital transformation projects increased in the quarter, explaining the sequential drop in gross margin. We are not satisfied with the development in these digital transformation projects and are thus increasing our efforts to turn them around.

In Managed Services, gross margin[1]) improved to 12.9% (-4.0%) supported by efficiency gains and customer contract reviews. We have finalized 40 of the targeted 42 contracts, with an annualized profit improvement of SEK 0.9 b. We are increasing our investments in R&D to reshape the offering based on automation and artificial intelligence. We see strong customer interest in the coming solutions, but sales are so far limited as we are in early stages.

1) Excluding restructuring charges
2) Organic sales growth: Sales adjusted for comparable units and currency

In segment Emerging Business and Other, sales grew by 22% driven by growth in the iconectiv business. We continue to invest in strategic future growth areas such as Internet of Things (IoT) and saw increasing momentum with one important customer win with our connectivity platform solutions in the quarter. As parts of the portfolio in Emerging Business are in an early phase, sales are so far limited. We will remain disciplined in our investments in Emerging Business by tracking each venture against delivery milestones.

Even though the cost reduction program, announced in July 2017, has been completed, we continue our efforts to drive efficiency and cost reductions to further increase competitiveness. Our estimate for restructuring charges of SEK 5-7 b. for the full year remains. Free cash flow excluding M&A improved to SEK 0.7 (-0.8) b. and our cash position remains strong. Our work to further strengthen the balance sheet continues.

As previously disclosed, we have been voluntarily cooperating since 2013 with an investigation by the SEC and, since 2015, with an investigation by the DOJ into Ericsson s compliance with the U.S. FCPA. While we cannot comment in detail we can provide the following update on the process. We have identified facts that are relevant to the investigations and these facts have been shared with the authorities. We continue to cooperate with the SEC and the DOJ and are engaged in discussions with them to find a resolution. While the length of these discussions cannot be determined, based on the facts that we have shared with the authorities, we believe that the resolution of these matters will likely result in monetary and other measures, the magnitude of which cannot be estimated currently but may be material. We continue our efforts to improve on our compliance program. See further details in Other information .

There is strong momentum in the global 5G market with lead markets moving forward. The global radio access market is recovering from several years of negative growth and our investments in R&D have positioned us well to benefit from this development. More work remains, however, to get all parts of the business to a satisfactory performance level. We remain confident in reaching our long-term target of at least 12% operating margin beyond 2020.

**Börje Ekholm**

President and CEO

**Planning assumptions going forward**

**Market related**

- The Radio Access Network (RAN) equipment market is estimated to decline by -2% for full-year 2018 with 2% CAGR for 2017-2022. (Source: Dell Oro)

**Currency exposure**

- Rule of thumb: A weakening by 10% of USD to SEK would have a negative impact of approximately -5% on net sales and approximately -1 percentage point on operating margin (based on 2017 full-year currency exposure).

**Ericsson related 2018; Sales**

- Sales growth in 2017 between Q3 and Q4 was 17%.

- Due to strong sequential sales increase in the third quarter, lower effects from seasonality than normal are expected in the fourth quarter in Networks.

**Ericsson related 2018; Operating expenses**

- Gradually increased cost for field trials.

- Operating expenses typically increase between Q3 and Q4 due to seasonality.
- To further strengthen technology leadership, R&D expenses will increase primarily in Networks in Q4.

The divestment of Media Solutions is expected to be closed around year-end 2018 with estimated additional expenses of SEK -0.2 b. in Q4.

**Ericsson related 2018; Other**

Restructuring charges for full-year 2018 are estimated to be SEK 5-7 b.

Actual and estimated net impact from amortization and capitalization of development expenses and from recognition and deferral of hardware costs:

| SEK b. | Q3 2018 Actual | Q4 2018 Estimate | Q4 2017 Actual | FY 2017 Actual | FY 2018 Estimate | FY 2019 Estimate |
|---|---|---|---|---|---|---|
| Cost of sales | -0.2 | -0.1 | -0.8 | -2.6 | -0.7 | |
| R&D expenses | -0.5 | -0.5 | -0.6 | -0.3 | -1.7 | |
| **Total impact** | **-0.7** | **-0.6** | **-1.4** | **-2.9** | **-2.4** | **-1 to -2** |

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Financial highlights

| SEK b. | Q3 2018 | Q3 2017 | YoY change | Q2 2018 | QoQ change | 9 months 2018 | 9 months 2017 |
|---|---|---|---|---|---|---|---|
| Net sales | 53.8 | 49.4 | 9% | 49.8 | 8% | 147.0 | 147.5 |
| *Sales growth adj. for comparable units and currency* | | | *1%* | | *7%* | | |
| Gross income | 19.6 | 13.3 | 48% | 17.3 | 13% | 51.8 | 35.4 |
| Gross margin (%) | 36.5% | 26.9% | | 34.8% | | 35.2% | 24.0% |
| Research and development (R&D) expenses | -9.4 | -10.5 | -11% | -9.8 | -4% | -28.2 | -27.9 |
| Selling and administrative expenses | -6.6 | -5.7 | 15% | -7.1 | -6% | -19.8 | -20.8 |
| Impairment losses on trade receivables | -0.4 | -1.1 | -63% | -0.4 | 11% | -0.8 | -3.0 |
| Other operating income and expenses | 0.0 | 0.4 | -93% | 0.0 | | 0.1 | 0.8 |
| Operating income (loss) | 3.2 | -3.7 | | 0.2 | | 3.1 | -15.5 |
| Operating margin (%) | 6.0% | -7.4% | | 0.3% | | 2.1% | -10.5% |
| Financial net | -0.6 | -0.3 | 99% | -0.8 | -21% | -2.0 | -0.7 |
| Taxes | 0.1 | 0.5 | -72% | -1.2 | | -0.9 | 2.2 |
| Net income (loss) | 2.7 | -3.5 | | -1.8 | | 0.2 | -13.9 |
| Restructuring charges | -0.6 | -2.8 | -80% | -1.9 | -71% | -3.6 | -6.1 |
| *Gross income excluding restructuring charges* | *19.8* | *14.1* | *41%* | *18.3* | *9%* | *53.7* | *38.6* |
| *Gross margin excluding restructuring charges* | *36.9%* | *28.5%* | | *36.7%* | | *36.5%* | *26.2%* |
| *R&D expenses excluding restructuring charges* | *-9.2* | *-8.6* | *6%* | *-9.3* | *-1%* | *-27.2* | *-25.5* |
| *SG&A expenses excluding restructuring charges* | *-6.5* | *-5.6* | *15%* | *-6.6* | *-2%* | *-19.2* | *-20.4* |
| *Operating income (loss) excl. restructuring charges* | *3.8* | *-0.8* | | *2.0* | *85%* | *6.7* | *-9.4* |
| *Operating margin excluding restructuring charges* | *7.0%* | *-1.7%* | | *4.1%* | | *4.6%* | *-6.4%* |

**Net sales**

Sales as reported increased by 9% YoY. Sales adjusted for comparable units and currency increased by 1% YoY. Sales adjusted for comparable units and currency in Networks increased by 5% YoY, driven by strong sales growth in North America as well as sales growth in Europe and Latin America. Digital Services sales adjusted for comparable units and currency decreased by -6% YoY mainly due to continued decline in legacy product sales. Managed Services sales adjusted for comparable units and currency declined by -8% YoY, mainly as a result of customer contract reviews. Sales adjusted for comparable units and currency in Emerging Business and Other increased by 11% YoY, mainly driven by growth in iconectiv.

Sequentially, sales increased by 8%. Sales adjusted for comparable units and currency increased by 7% QoQ, driven by increased Networks sales in market areas South East Asia, Oceania and India, North East Asia as well as in Europe and Latin America. Segment Emerging Business and Other sales increased by 15% QoQ driven by growth in iconectiv.

**IPR licensing revenues**

IPR licensing revenues increased to SEK 2.1 (2.0) b. YoY and from SEK 1.8 b. sequentially. The QoQ increase was supported by revenues from a customer agreement signed in the quarter.

**Gross margin**

Gross margin increased to 36.5% (26.9%). Gross margin excluding restructuring charges increased to 36.9% (28.5%) with significant improvements in all segments. Key drivers of the improvement were cost reductions, ramp-up of Ericsson Radio System (ERS) product platform and good progress in customer contract reviews in Managed Services. Completion in 2017 of the amortization of software release development expenses had a positive effect of SEK 0.7 b. YoY. Provisions and customer project adjustments had a negative impact on gross income of approximately SEK -1.3 b. in Q3 2017.

Sequentially, gross margin increased to 36.5% from 34.8% mainly due to lower restructuring charges. Gross margin excluding restructuring charges improved sequentially to 36.9% from 36.7%. Higher gross margin in Networks was partly offset by lower gross margin in Digital Services due to increased provisions related to transformation projects. Increased IPR licensing revenues had a positive impact on gross margin QoQ.

**Operating expenses**

R&D expenses were SEK -9.4 (-10.5) b. R&D expenses excluding restructuring charges increased to SEK -9.2 (-8.6) b., due to increased 4G and 5G investments in Networks. Sequentially, R&D expenses excluding restructuring charges were stable.

Selling and administrative (SG&A) expenses were SEK -6.6 (-5.7) b. SG&A expenses excluding restructuring charges increased to SEK -6.5 (-5.6) b. YoY. Cost reductions of SEK 0.7 b. YoY were offset by costs related to revaluation of customer financing of SEK -0.9 b. and increased costs for customer field trials. Sequentially, SG&A excluding restructuring charges decreased slightly due to seasonality, partly offset by increased costs related to revaluation of customer financing mainly related to the Middle East, including Iran.

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Impairment losses on trade receivables decreased YoY, to SEK -0.4 (-1.1) b. and were flat QoQ. From 2018, impairment testing is made continuously using a methodology where country and customer risks are assessed.

Since the United States has withdrawn from the Joint Comprehensive Plan Of Action (JCPOA), it is generally more difficult to do business in Iran. Ericsson is exploring, including with EU and US authorities, whether and how the disruptive impact on the Company s ability to maintain and support existing networks of its customers can be minimized. Ericsson s net working capital exposure to customers in Iran was SEK 0.8 b. per Sep 30, 2018.

**Other operating income and expenses**

Other operating income and expenses were SEK 0.0 (0.4) b. In 2017, the sale of the Power Module business generated a gain of SEK 0.3 b. Other operating income and expenses were flat QoQ.

**Consequences of technology and portfolio shifts**

Due to technology and portfolio shifts, the Company is reducing the capitalization of development expenses for product platforms and software releases as well as the deferral of hardware costs. As a consequence, higher amortization than capitalization of development expenses and higher recognition than deferral of hardware costs had a negative impact on operating income YoY. The amounts related to capitalized software releases were fully amortized in 2017.

Net impact from amortization and capitalization of development expenses and from recognition and deferral of hardware costs

| SEK b. | Q3 2018 | Q3 2017 | Q2 2018 |
|---|---|---|---|
| Cost of sales | -0.2 | -0.9 | -0.2 |
| R&D expenses | -0.5 | -0.6 | -0.3 |
| **Total impact** | **-0.7** | **-1.5** | **-0.5** |

**Restructuring charges**

Restructuring charges were SEK -0.6 (-2.8) b. Restructuring charges in Q2 2018 were SEK -1.9 b.

**Operating income and margin**

Operating income increased to SEK 3.2 (-3.7) b. YoY. Operating income excluding restructuring charges increased to SEK 3.8 (-0.8) b., driven by increased gross margin, higher sales and lower impairment losses on trade receivables. This was partly offset by increased operating expenses. Operating margin excluding restructuring charges improved to 7.0% (-1.7%).

Operating income improved sequentially to SEK 3.2 b. from 0.2 b. Operating income excluding restructuring charges improved to SEK 3.8 b. from SEK 2.0 b., driven by higher sales.

**Financial net**

Financial net was SEK -0.6 (-0.3) b. mainly due to negative currency revaluation effects. The revaluation and realization effects of foreign exchange forecast hedging were SEK 0.0 (0.2) b. Financial net improved sequentially to SEK -0.6 b. from SEK -0.8 b due to positive revaluation and realization effects of foreign exchange forecast hedging. In Q2 2018 these effects were SEK -0.3 b.

**Taxes**

Taxes amounted to SEK 0.1 (0.5) b.

**Net income (loss) and EPS**

Net income and EPS diluted increased both YoY and QoQ, following improved operating income and positive taxes.

**Employees**

The number of employees on Sep 30, 2018, was 94,499 a net reduction of 761 employees in the quarter and of 11,353 employees compared with Sep 30, 2017. The decrease is a result of activities under the cost reduction program.

**Focused strategy execution**

The following four measures are indicators of the progress of strategy execution.

| Area | Activity | Status Q3 2018 |
|---|---|---|
| Networks | Transition to new Ericsson Radio System | 86% (2017: 61%) YTD accumulated (ERS radio unit deliveries out of total radio unit deliveries) |
| Digital Services | - Growth in sales of new product portfolio - Addressing critical customer contracts | - Net sales 12 months rolling: -7%<br>- Out of 45 contracts identified, in total 19 have been addressed (3 in Q318 isolated) |
| Managed Services | Addressing low-performing customer contracts | Out of a total of 42 contracts identified, 40 (7 in Q318 isolated) have been addressed to result in an annualized profit improvement of SEK 0.9 b. (Q2 2018: SEK 0.8 b.) |

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Market area sales

| | Third quarter 2018 | | | | | Change | |
|---|---|---|---|---|---|---|---|
| SEK b. | Networks | Digital Services | Managed Services | Emerging Business and Other | Total | YoY | QoQ |
| South East Asia, Oceania and India | 5.8 | 1.3 | 0.9 | 0.0 | 8.0 | 2% | 14% |
| North East Asia | 4.6 | 0.8 | 0.3 | 0.0 | 5.8 | 2% | 21% |
| North America | 11.8 | 2.1 | 1.0 | 0.0 | 14.9 | 21% | 4% |
| Europe and Latin America | 8.7 | 2.9 | 3.2 | 0.1 | 14.8 | 10% | 5% |
| Middle East and Africa | 3.1 | 1.5 | 1.0 | 0.0 | 5.7 | -9% | 2% |
| Other [1)] | 1.9 | 0.4 | 0.0 | 2.3 | 4.6 | 19% | 17% |
| **Total** | **35.9** | **9.0** | **6.5** | **2.4** | **53.8** | **9%** | **8%** |

[1)] Market Area Other includes primarily licensing revenues and the major part of segment Emerging Business and Other

**South East Asia, Oceania and India**

Sales increased slightly YoY, primarily in Digital Services, driven by growth in Australia and India. Networks sales increased slightly YoY, mainly in South East Asia. Managed Services sales declined YoY due to termination of a contract in India in 2017.

**North East Asia**

Sales increased slightly YoY. Network sales in Mainland China increased with continued deployment of NB IoT, whilst Digital Services sales declined YoY, due to a telecom core contract being further delayed. Large 5G field trials are ongoing in Mainland China.

**North America**

Sales increased YoY, primarily driven by investments in 5G readiness across all major customers. Digital Services sales increased slightly YoY. Managed Services sales grew YoY, driven by strong variable sales in large customer contracts.

**Europe and Latin America**

Sales increased YoY driven by continued growth in parts of Europe and Latin America. Managed Services sales declined YoY as a consequence of addressed non-strategic contracts.

**Middle East and Africa**

Sales declined YoY. Networks sales declined due to challenging economic situations in certain markets. Digital Services sales declined due to timing of project milestones, partly offset by a slight increase in Managed Services sales.

**Other**

Sales increased YoY, mainly driven by growth in iconectiv (part of segment Emerging Business and Other). IPR licensing revenues amounted to SEK 2.1 (2.0) b.

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Segment results

**Networks**

| SEK b. | Q3 2018 | Q3 2017 | YoY change | Q2 2018 | QoQ change | 9 months 2018 | 9 months 2017 |
|---|---|---|---|---|---|---|---|
| Net sales | 35.9 | 31.9 | 13% | 32.4 | 11% | 96.9 | 95.2 |
| *Of which products* | *25.3* | *21.7* | *17%* | *22.3* | *14%* | *67.1* | *64.9* |
| *Of which IPR licensing revenues* | *1.8* | *1.6* | *7%* | *1.5* | *18%* | *4.8* | *5.0* |
| *Of which services* | *10.6* | *10.1* | *5%* | *10.1* | *5%* | *29.8* | *30.3* |
| *Sales growth adjusted for comparable units and currency* | | | *5%* | | *9%* | | |
| Gross income | 14.8 | 10.7 | 39% | 12.6 | 18% | 38.5 | 31.6 |
| Gross margin | 41.3% | 33.4% | | 38.8% | | 39.7% | 33.2% |
| Operating income | 5.7 | 2.4 | 138% | 3.5 | 60% | 12.6 | 8.5 |
| Operating margin | 15.7% | 7.5% | | 10.9% | | 13.0% | 8.9% |
| Restructuring charges | -0.1 | -1.4 | -91% | -0.7 | -83% | -1.4 | -3.6 |
| *Gross income excl. restructuring charges* | *14.9* | *11.1* | *34%* | *13.0* | *14%* | *39.5* | *33.7* |
| *Gross margin excl. restructuring charges* | *41.5%* | *34.8%* | | *40.2%* | | *40.7%* | *35.4%* |
| *Operating income excl. restructuring charges* | *5.8* | *3.8* | *53%* | *4.3* | *35%* | *13.9* | *12.1* |
| *Operating margin excl. restructuring charges* | *16.1%* | *11.9%* | | *13.3%* | | *14.4%* | *12.7%* |

**Net sales**

Sales as reported increased by 13% YoY and sales adjusted for comparable units and currency increased by 5%. The increase is mainly due to strong growth in North America as well as sales growth in Europe and Latin America, driven by investments in 5G readiness and LTE networks.

Sales as reported increased by 11% QoQ and sales adjusted for comparable units and currency increased by 9%.

**Gross margin**

Gross margin increased YoY to 41.3% (33.4%). Gross margin excluding restructuring charges increased to 41.5% (34.8%) due to improved margins of hardware and services, driven by cost reductions, a successful shift of the radio platform and a favorable market mix. The change in net impact from higher capitalization than deferral of hardware cost was SEK 0.5 b. YoY.

Gross margin increased QoQ from 38.8%. Gross margin excluding restructuring charges increased QoQ from 40.2%. The increase was driven by a higher share of both software sales, including IPR licensing revenues, and LTE capacity sales.

**Operating margin**

Operating margin improved YoY to 15.7% (7.5%) including restructuring charges of SEK -0.1 (-1.4) b. Operating margin excluding restructuring charges was 16.1% (11.9%). The improvement was driven by higher gross margin and sales, partly offset by increased operating expenses. In the quarter, operating income was negatively impacted by revaluation of customer financing and impairment losses of trade receivables of SEK -1.2 b.

Operating margin increased QoQ to 15.7% from 10.9%. Operating margin excluding restructuring charges increased to 16.1% from 13.3%. Improvements were seen across all offerings and were driven by higher sales and gross margin, partly offset by increased operating expenses.

**Net impact from amortization and capitalization of development expenses and from recognition and deferral of hardware costs**

| SEK b. | Q3 2018 | Q3 2017 | Q2 2018 |
|---|---|---|---|
| Cost of Sales | -0.1 | -0.6 | -0.2 |
| R&D expenses | 0.0 | -0.1 | 0.2 |
| Total impact | **-0.1** | **-0.7** | **0.0** |

**Strategy execution**

As presented at the 2017 Capital Markets Day, the target for Networks is to improve the operating margin to 15%-17% by 2020. Three important ongoing activities for profitability improvements are to:

- invest in R&D to safeguard a leading portfolio

- fully transition the radio unit deliveries to Ericsson Radio System (ERS) for increased competitiveness

- continue to make savings in service delivery and common costs.

The ERS, which was introduced to the market in 2015, has proven to be competitive as well as creating a strong market position. The ERS accounted for 86% of total radio unit deliveries year to date.

The plan is to have fully transitioned the radio unit deliveries to ERS by the end of 2018.

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Digital Services

| SEK b. | Q3 2018 | Q3 2017 | YoY change | Q2 2018 | QoQ change | 9 months 2018 | 9 months 2017 |
|---|---|---|---|---|---|---|---|
| Net sales | 9.0 | 8.9 | 1% | 8.8 | 2% | 25.1 | 26.9 |
| *Of which products* | *4.6* | *4.9* | *-6%* | *4.5* | *3%* | *13.0* | *14.6* |
| *Of which IPR licensing revenues* | *0.4* | *0.4* | *7%* | *0.3* | *18%* | *1.0* | *1.1* |
| *Of which services* | *4.4* | *4.1* | *8%* | *4.4* | *1%* | *12.1* | *12.4* |
| *Sales growth adjusted for comparable units and currency* | | | *-6%* | | *0%* | | |
| Gross income | 3.2 | 2.6 | 22% | 3.5 | -7% | 9.6 | 3.6 |
| Gross margin | 35.7% | 29.3% | | 39.1% | | 38.1% | 13.3% |
| Operating income (loss) | -1.8 | -3.8 | -53% | -2.4 | | -6.8 | -15.0 |
| Operating margin | -19.9% | -42.2% | | -26.9% | | -27.0% | -55.7% |
| Restructuring charges | -0.4 | -1.1 | -68% | -0.9 | -59% | -1.8 | -1.8 |
| *Gross income excl. restructuring charges* | *3.3* | *2.9* | *16%* | *3.8* | *-12%* | *10.2* | *4.3* |
| *Gross margin excl. restructuring charges* | *36.9%* | *32.0%* | | *42.6%* | | *40.7%* | *15.8%* |
| *Operating income (loss) excl. restructuring charges* | *-1.4* | *-2.7* | | *-1.5* | | *-4.9* | *-13.2* |
| *Operating margin excl. restructuring charges* | *-15.9%* | *-29.9%* | | *-16.9%* | | *-19.7%* | *-49.0%* |

**Net sales**

Sales as reported increased by 1% YoY with stable sales in the new portfolio and a continued decline in legacy product sales. Sales adjusted for comparable units and currency decreased by -6% YoY. The interest for Ericsson s 5G-ready and cloud-native products remains strong and several contracts were signed in the quarter.

Sales were stable QoQ.

**Gross margin**

Gross margin improved YoY to 35.7% (29.3%). Gross margin excluding restructuring charges increased YoY to 36.9% (32.0%) supported by cost reductions in services. Reduced amortization of software release development expenses had a positive impact of SEK 0.3 b. YoY.

Gross margin declined QoQ from 39.1%. Gross margin excluding restructuring charges declined QoQ from 42.6%, due to increased provisions related to large transformation projects.

**Operating income (loss)**

Operating income (loss) improved YoY to SEK -1.8 (-3.8) b. Operating income (loss) excluding restructuring charges improved to SEK -1.4 (-2.7) b., supported by reductions in cost of sales and operating expenses. Restructuring charges declined YoY to SEK -0.4 (-1.1) b.

Operating income (loss) improved QoQ to SEK -1.8 b. from -2.4 b. Operating income excluding restructuring charges improved to SEK -1.4 b. from -1.5 b., driven by reduced operating expenses partly offset by reduced gross margin. Total restructuring charges declined QoQ to SEK -0.4 from -0.9 b.

**Net impact from amortization and capitalization of development expenses**

| SEK b. | Q3 2018 | Q3 2017 | Q2 2018 |
|---|---|---|---|
| Cost of Sales | 0.0 | -0.3 | 0.0 |
| R&D expenses | -0.4 | -0.4 | -0.4 |
| **Total impact** | **-0.4** | **-0.7** | **-0.4** |

**Strategy execution**

As presented at the Capital Markets Day 2017, the target is to turn around Digital Services into low single-digit operating margin by 2020. Cost reduction activities continue across the areas of service delivery, SG&A and R&D. While new ways of working are improving R&D efficiency, investments continue in the portfolio of 5G-ready and cloud-native products in order to defend current market position and prepare Digital Services for future profitable growth.

In the quarter, Ericsson acquired CENX, a US-based service assurance company.

A key activity for the turnaround is to complete, renegotiate or exit 45 identified critical customer contracts and the plan is to address approximately 50% of those contracts in 2018. A total of 19 contracts had been addressed at the end of Q3 2018.

The sales shift towards the new portfolio continues. Rolling 12 months, sales of the new portfolio decreased by -7% compared with -14% in the previous quarter. However, the ongoing digitalization drives opportunities for operators to reduce costs and be more agile by; automating operations, digitally serving and engaging with customers and building programmable core networks. Consequently, operators increasingly invest in the areas where Digital Services provide solutions.

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Managed Services

| SEK b. | Q3 2018 | Q3 2017 | YoY change | Q2 2018 | QoQ change | 9 months 2018 | 9 months 2017 |
|---|---|---|---|---|---|---|---|
| Net sales | 6.5 | 6.6 | -2% | 6.5 | -1% | 18.9 | 19.6 |
| *Sales growth adjusted for comparable units and currency* | | | *-8%* | | *-1%* | | |
| Gross income (loss) | 0.8 | -0.4 | | 0.8 | 0% | 2.1 | -0.9 |
| Gross margin | 12.5% | -5.4% | | 12.4% | | 11.1% | -4.5% |
| Operating income (loss) | 0.4 | -0.7 | | 0.3 | 37% | 0.8 | -2.8 |
| Operating margin | 6.3% | -11.0% | | 4.6% | | 4.3% | -14.4% |
| Restructuring charges | 0.0 | -0.1 | | -0.1 | | -0.2 | -0.3 |
| *Gross income (loss) excl. restructuring charges* | *0.8* | *-0.3* | | *0.9* | *-9%* | *2.3* | *-0.6* |
| *Gross margin excl. restructuring charges* | *12.9%* | *-4.0%* | | *14.0%* | | *12.1%* | *-3.0%* |
| *Operating income (loss) excl. restructuring charges* | *0.4* | *-0.6* | | *0.4* | *5%* | *1.0* | *-2.5* |
| *Operating margin excl. restructuring charges* | *6.8%* | *-9.5%* | | *6.5%* | | *5.4%* | *-12.8%* |

**Net sales**

Sales as reported decreased by -2% YoY. Sales in Managed Services IT and Network Design and Optimization showed growth. Sales adjusted for comparable units and currency decreased by -8% YoY, as a result of contract exits.

Sales as reported decreased slightly QoQ. Sales adjusted for comparable units and currency decreased by -1% QoQ.

**Gross margin**

Gross margin increased YoY to 12.5% (-5.4%). Gross margin excluding restructuring charges increased to 12.9% (-4.0%) supported by customer contract reviews as well as results of efficiency measures.

Gross margin increased slightly QoQ to 12.5% from 12.4%. Gross margin excluding restructuring charges decreased QoQ to 12.9% from 14.0%.

**Operating income**

Operating income increased YoY to SEK 0.4 (-0.7) b. Operating income excluding restructuring charges improved to SEK 0.4 (-0.6) b. due to higher gross margin.

Sequentially, operating income excluding restructuring charges was flat at SEK 0.4 b.

**Strategy execution**

To reshape the solutions, investments are increasing in artificial intelligence, automation and analytics in order to further enhance user experience, improve efficiency and better manage the increasingly complex networks of tomorrow. Customer interest in the coming solutions is strong, but sales are so far limited as the solutions are in early stages.

As presented at the 2017 Capital Markets Day, the ambition for Managed Services is to improve the operating margin to 4%-6% in 2020. In order to focus the business and improve profitability, 42 managed services contracts (out of >300) have been identified for exit, renegotiation or transformation. At the end of the quarter, 40 of the 42 contracts had been addressed, resulting in an annualized profit improvement of approximately SEK 0.9 b. The divestment of Ericsson Local Services AB (LSS) was concluded on August 31, 2018.

Emerging Business and Other (includes Emerging Business, MediaKind, Red Bee Media and iconectiv)

| SEK b. | Q3 2018 | Q3 2017 | YoY change | Q2 2018 | QoQ change | 9 months 2018 | 9 months 2017 |
|---|---|---|---|---|---|---|---|
| Net sales | 2.4 | 2.0 | 22% | 2.1 | 18% | 6.1 | 5.8 |
| *Sales growth adjusted for comparable units and currency* | | | *11%* | | *15%* | | |
| Gross income | 0.8 | 0.4 | 113% | 0.5 | 56% | 1.6 | 1.1 |
| Gross margin | 32.3% | 18.4% | | 24.4% | | 26.6% | 19.5% |
| Operating income (loss) | -1.0 | -1.5 | | -1.3 | | -3.5 | -6.2 |
| Operating margin | -42.9% | -76.7% | | -63.5% | | -57.4% | -106.3% |
| Restructuring charges | 0.0 | -0.2 | -84% | -0.1 | | -0.2 | -0.4 |
| *Gross income excl. restructuring charges* | *0.8* | *0.4* | *87%* | *0.6* | *39%* | *1.7* | *1.3* |
| *Gross margin excl. restructuring charges* | *32.3%* | *21.1%* | | *27.4%* | | *28.5%* | *22.0%* |
| *Operating income (loss) excl. restructuring charges* | *-1.0* | *-1.3* | | *-1.2* | | *-3.3* | *-5.8* |
| *Operating margin excl. restructuring charges* | *-41.5%* | *-66.2%* | | *-57.4%* | | *-53.8%* | *-99.7%* |

**Net sales**

Sales as reported increased by 22% YoY. Sales adjusted for comparable units and currency increased by 11%, driven by growth in the iconectiv business through the multi-year number portability contract in the United States, which is now fully up and running. Sales in the media business (MediaKind and Red Bee Media) were stable at SEK 1.4 (1.4) b.

Sales increased by 18% QoQ, primarily driven by growth in iconectiv. Sales adjusted for comparable units and currency increased by 15% QoQ.

**Gross margin**

Gross margin increased YoY to 32.3% (18.4%). Gross margin excluding restructuring charges increased to 32.3% (21.1%), supported by an increased share of iconectiv sales and by margin improvements in the media business.

Gross margin increased QoQ from 24.4%. Gross margin excluding restructuring charges increased QoQ from 27.4%, supported by an increased share of iconectiv sales and by margin improvements in the media business.

**Operating income (loss)**

Operating income improved YoY to SEK -1.0 (-1.5) b. Operating income excluding restructuring charges improved to SEK -1.0 (-1.3) b., driven by improved results in iconectiv and media business. Operating income excluding restructuring charges and corporate allocations for the media business was SEK -0.4 (-0.6) b.

Operating income improved QoQ to SEK -1.0 from -1.3 b. Operating income excluding restructuring charges improved to SEK -1.0 from -1.2 b., driven by stronger sales in iconectiv. Costs related to the planned transaction for

MediaKind impacted the result negatively by SEK -0.1 b. in the quarter.

**Net impact from amortization and capitalization of development expenses**

| SEK b. | Q3 2018 | Q3 2017 | Q2 2018 |
|---|---|---|---|
| Cost of Sales | -0.1 | 0.0 | 0.0 |
| R&D expenses | 0.0 | -0.1 | -0.1 |
| **Total impact** | **-0.1** | **-0.1** | **-0.1** |

**Strategy execution**

As outlined at the Capital Markets Day in 2017, the target for segment Emerging Business and Other, including iconectiv, is a break-even result by 2020.

Selective investments will continue in Emerging Business in order to build a position and grow sales in new areas. Parts of the portfolio are still in an early phase, with focus on generating sales and scale the business. As sales do not yet cover the required investments this results in a negative bottom line. Ericsson will remain disciplined in its investments in Emerging Business by tracking each venture against delivery milestones.

For MediaKind, Ericsson is partnering with One Equity Partners (OEP), retaining a 49% ownership stake. This allows Ericsson to capture the upside of the business while at the same time taking an active part in the expected consolidation of the industry. Activities are ongoing to complete the transaction around year-end 2018.

For Red Bee Media, the target is to achieve a sustainable profitable business by continuing to develop and manage the business as an independent and focused media services entity within Ericsson. Operations and services propositions will be further developed, in line with the Red Bee Media tactical and transformational strategic execution plans.

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Cash flow

| SEK b. | Q3 2018 | Q3 2017 | Q2 2018 |
|---|---|---|---|
| Net income reconciled to cash | 2.9 | -0.8 | -0.3 |
| Changes in operating net assets | -0.9 | 0.8 | 1.7 |
| Cash flow from operating activities | 2.0 | 0.0 | 1.4 |
| Cash flow from investing activities | -1.7 | 3.3 | 1.6 |