Company Focus

24 October 2007 | 8 pages

ABB (India) (ABB.BO)

Change in opinion ☑
Rating change ☑
Target price change ☑

Downgrade to Hold: Running Ahead of Fundamentals

- **Downgrade to Hold** — We downgrade ABB to Hold/Low (2L) risk from Buy/Low (1L) risk upside to our new target price of Rs1,595 is limited. ABB has had a strong run over the past three years, outperforming the BSE Sensex significantly over different horizons. At 38.9x CY08E and 28.2x CY09E, it is now the most expensive stock in our Indian Electrical Equipment universe.
- **Target price Rs1,595** — We are raising our target price to Rs1,595 from 1,266 as we roll forward our target price to Dec08 from Mar08. Our target price is based on 30x (same as earlier), which is at a premium to BHEL.
- **Industry fundamentals remain robust** — Our industry view remains positive on 1) Power capex in India, given GDP growth of 8%-plus, government support for adding generation capacity and massive rural electrification; and 2) Industrial capex in India, which CRISINFAC sees as increasing to Rs4,326bn in FY06-10, up 181% from Rs1,541bn in FY99-FY05.
- **Increasing importance in the ABB group —** India is not only a promising domestic market, where ABB is well-positioned as a market leader in power and automation technologies, but also a key regional and global resource base because of lower costs and higher productivity.
- **Positive view on earnings delivery** — We expect ABB's EPS growth to remain among the highest in our Indian industrials universe at 49% over CY06-09E with RoEs in the 37-40% band over the next three years and positive FCF.

Hold/Low Risk	**2L**
from Buy/Low Risk	
Price (24 Oct 07)	Rs1,500.00
Target price	Rs1,595.00
from Rs1,266.00	
Expected share price return	6.3%
Expected dividend yield	0.2%
Expected total return	**6.5%**
Market Cap	Rs317,863M
	US$8,030M

Price Performance (RIC: ABB.BO, BB: ABB IN)

Figure 1. ABB – Statistical Abstract

Year to 31-Dec	Net Profit (Rsmn)	EPS (Rs)	EPS Growth (%)	P/E (x)	EV / EBITDA (x)	P / Book (x)	ROE (%)	DPS (Rs)	Div. Yield (%)
CY05	2,187	10.32	45.28%	145.4	98.7	35.8	27.4%	1.60	0.1%
CY06	3,403	16.06	55.62%	93.4	65.5	26.9	32.9%	2.00	0.1%
CY07E	5,261	24.83	54.59%	60.4	40.5	19.1	37.0%	2.40	0.2%
CY08E	8,163	38.52	55.17%	38.9	25.9	13.1	39.8%	2.80	0.2%
CY09E	11,268	53.17	38.03%	28.2	18.6	9.1	38.0%	3.20	0.2%

Source: Citi Investment Research estimates

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See Appendix A-1 for Analyst Certification and important disclosures.

[1]Citigroup Global Markets India Private Limited

Fiscal year end 31-Dec	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	145.4	93.4	60.4	38.9	28.2
EV/EBITDA adjusted (x)	98.3	65.5	40.6	26.1	18.7
P/BV (x)	35.8	26.9	19.1	13.1	9.1
Dividend yield (%)	0.1	0.1	0.2	0.2	0.2
Per Share Data (Rs)					
EPS adjusted	10.32	16.06	24.83	38.52	53.17
EPS reported	10.32	16.06	24.83	38.52	53.17
BVPS	41.95	55.73	78.58	114.76	165.27
DPS	1.60	2.00	2.40	2.80	3.20
Profit & Loss (RsM)					
Net sales	29,631	42,740	63,042	91,410	123,404
Operating expenses	-26,680	-38,238	-55,748	-80,106	-107,873
EBIT	**2,950**	**4,502**	**7,294**	**11,304**	**15,531**
Net interest expense	-66	-7	-70	-70	-70
Non-operating/exceptionals	511	737	870	1,325	1,875
Pre-tax profit	**3,395**	**5,232**	**8,093**	**12,559**	**17,335**
Tax	-1,208	-1,829	-2,833	-4,396	-6,067
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**2,187**	**3,403**	**5,261**	**8,163**	**11,268**
Adjusted earnings	2,187	3,403	5,261	8,163	11,268
Adjusted EBITDA	3,182	4,767	7,632	11,731	16,046
Growth Rates (%)					
Sales	31.1	44.2	47.5	45.0	35.0
EBIT adjusted	53.2	52.6	62.0	55.0	37.4
EBITDA adjusted	49.5	49.8	60.1	53.7	36.8
EPS adjusted	45.3	55.6	54.6	55.2	38.0
Cash Flow (RsM)					
Operating cash flow	**957**	**2,786**	**5,255**	**6,931**	**7,135**
Depreciation/amortization	231	265	338	427	515
Net working capital	-1,414	-962	-344	-1,659	-4,649
Investing cash flow	**-737**	**-836**	**-1,500**	**-1,500**	**-1,500**
Capital expenditure	-936	-934	-1,500	-1,500	-1,500
Acquisitions/disposals	198	98	0	0	0
Financing cash flow	**-377**	**-495**	**-420**	**-495**	**-566**
Borrowings	12	-12	0	0	0
Dividends paid	-389	-483	-592	-691	-790
Change in cash	**-158**	**1,455**	**3,335**	**4,936**	**5,069**
Balance Sheet (RsM)					
Total assets	**23,243**	**31,910**	**44,765**	**64,042**	**85,053**
Cash & cash equivalent	4,010	5,464	8,800	13,735	18,804
Accounts receivable	10,293	15,703	21,499	31,173	42,084
Net fixed assets	2,500	3,170	4,331	5,405	6,389
Total liabilities	**14,352**	**20,100**	**28,114**	**39,723**	**50,032**
Accounts payable	8,152	10,706	15,668	22,719	30,670
Total Debt	27	15	15	15	15
Shareholders' funds	**8,891**	**11,810**	**16,651**	**24,319**	**35,021**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	10.7	11.2	12.1	12.8	13.0
ROE adjusted	27.4	32.9	37.0	39.8	38.0
ROIC adjusted	56.9	54.1	68.6	80.1	73.9
Net debt to equity	-44.8	-46.1	-52.8	-56.4	-53.6
Total debt to capital	0.3	0.1	0.1	0.1	0.0

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Downgrade to Hold

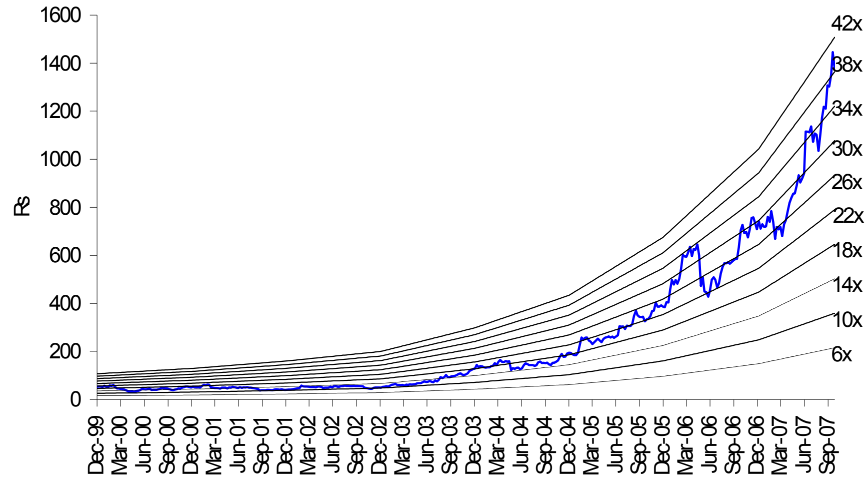
We are downgrading ABB to Hold/Low (2L) risk from Buy/Low (1L) risk upside to our new target price of Rs1,595 is limited. ABB has had a strong run over the past three years outperforming the BSE Sensex significantly over different horizons. At 38.9x CY08E and 28.2x CY09E it is the most expensive stock in our rated Indian Electrical Equipment universe.

Figure 2. ABB v/s BSE – Price Performance

Returns	3 years	1 year	6 months	3 months
ABB	882%	113%	89%	31%
BSE Sensex	231%	48%	32%	18%
ABB v/s BSE Sensex	651%	65%	57%	12%

Source: Data Central and Citi Investment Research estimates

Figure 3. ABB – 1 Year Forward Rolling P/E Band Chart



Source: Data Central and Citi Investment Research estimates

Despite our downgrade from a valuations perspective, ABB remains the best bet on the transmission, distribution and automation capex in India from a business perspective given our positive views on:

- Power capex in India, given GDP growth of 8%-plus, government support for adding generation capacity and a massive rural electrification programme;
- Industrial capex in India, which CRISINFAC sees as increasing to Rs4,326bn in FY06-10, up 181% from Rs1,541bn in FY99-FY05;
- ABB India's increasing importance in the ABB Group, with India not only a promising domestic market but also a key regional and global resource base;

- ABB India's access to parent technology;
- EPS growth, being one of the highest in our Indian industrials universe at 49% over CY06-09E;
- RoEs (in the 37-40% band over next three years) and positive free cash flow.

New target price Rs1,595

We are raising our target price to Rs1,595 (from 1,266 earlier) as we roll forward our target price to Dec08 from Mar08. Our target price is based on 30x CY09E (same as earlier) is at premium to BHEL. Our argument as to why ABB should trade at a premium to BHEL remains the same as below:

(1) Business and Financial Perspective

- ABB is the best play on the India's T&D capex, in our view, and we believe the T&D capex cycle will be stronger for longer.
- ABB has a significant presence in the automation space, which is being driven by an unprecedented corporate capex wave.
- Access to the parent (a global leader in power and automation technology) implies ABB has no technological constraints and does not have to worry about getting a technology partner for new products, as has been the case with BHEL in its tie-ups with Alstom and Siemens for super critical technology and with GE for advanced class gas turbines.
- ABB India is now increasingly important to the ABB group as a: 1) global sourcing hub; 2) global R&D centre; and 3) regional excellence centre.
- Higher RoEs without leverage and stronger earnings CAGR vis-à-vis peers.

(2) Trading Perspective

- ABB has traded at average premium of ~ 50%+ to BHEL for the last three years. The premium narrowed in CY03-06 compared to CY99-03, as BHEL has re-rated significantly in the past three years.
- ABB has also traded at an average premium of 85%+ to the BSE Sensex over the past three years.

ABB (India)

Company description

ABB is a global provider of power transmission and distribution (T&D) products and automation technologies to utility and industry customers. The ABB group operates in over 100 countries and employs about 104,000 people. ABB India employs over 4,000 people, has 10 manufacturing units, is a global engineering and operations centre and group corporate R&D facility. It has a countrywide marketing and service presence spanning 27 marketing offices, a network of more than 800 channel partners and eight service centres. Traditionally, ABB had two divisions: power technologies and automation technologies. But from January 1, 2006, it was restructured into five divisions for better management and control, and ABB India adopted the same five-division structure.

Investment strategy

We rate ABB Hold/Low (2L) given limited upside to our target price of Rs1,595. ABB has had a strong run over the past three years outperforming the BSE Sensex significantly over different horizons. At 38.9x CY08E and 28.2x CY09E it is most expensive stock in our rated Indian Electrical Equipment universe. Despite our Hold/Low risk rating from a valuations perspective, ABB remains the best bet on the transmission, distribution and automation capex in India from a business perspective given our positive views on: 1) Power capex in India, given GDP growth of 8%-plus, government support for adding generation capacity and a massive rural electrification programme; 2) Industrial capex in India, which CRISINFAC sees as increasing to Rs4,326bn in FY06-10, up 181% from Rs1,541bn in FY99-05; 3) ABB India's increasing importance in the ABB Group, with India not only a promising domestic market but also a key regional and global resource base; 4) ABB India's access to parent technology; 5) EPS growth, being one of the highest in our Indian industrials universe at 49% over CY06-09E; and 6) RoEs (in the 37-40% band over the next three years) and positive free cash flows.

Valuation

Our Rs1,595 target price for ABB is based on 30x CY09E EPS, set at a premium to our target multiple for BHEL. ABB has traded at average premium of ~50%+ to BHEL for the past three years, a premium that actually narrowed in CY03-06, compared with CY99-CY03, as BHEL re-rated significantly. ABB has also traded at an average premium of 85%+ to the BSE Sensex over the past three years. Our target multiple is supported by EPS CAGR of 49% over CY06-09E with RoE at the ~37% levels.

Risks

Our quantitative risk-rating system, which tracks 260-day historical share price volatility, assigns a Medium Risk rating to ABB India. However, we believe a Low Risk rating is more appropriate given that strong power and industrial capex in India provides ABB with significant visibility on order inflows and ABB is India's market leader in the power and automation space. Our Low Risk rating is also in line with that of BHEL. The key upside risk are: 1) Better than expected order wins and 2) Better than expected order execution. The key downside risks are: 1) Increased competition; 2) Slowdown in investments in generation, transmission and distribution; 3) Slowdown in the industrial capex cycle; 4) Substantial increase in input prices; and 5) Employee retention.

Appendix A-1

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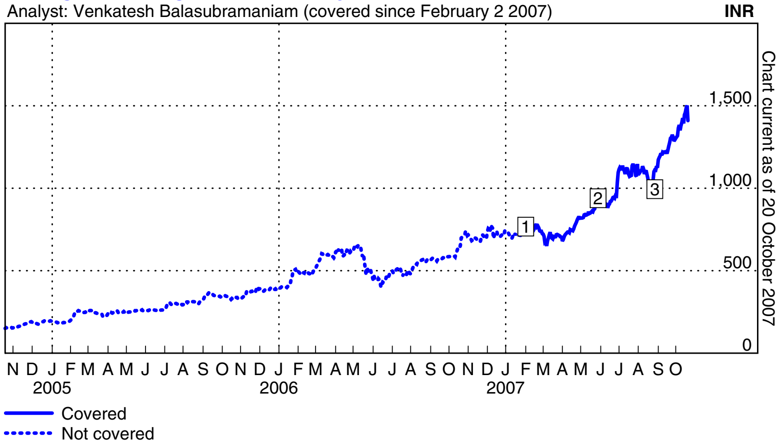
ABB (India) (ABB.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Venkatesh Balasubramaniam (covered since February 2 2007)



#	Date	Rating	Target Price	Closing Price
1:	1 Feb 07	1L	880.00	760.55
2:	29 May 07	1L	*1,103.20	914.98
3:	28 Aug 07	1L	*1,266.00	1,110.95

*Indicates change.

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