

Q1CY07 result
ABB India

Bloomberg: ABB IN
Reuters: ABB.NS
Mkt cap: INR 173.5bn/USD 4.2bn

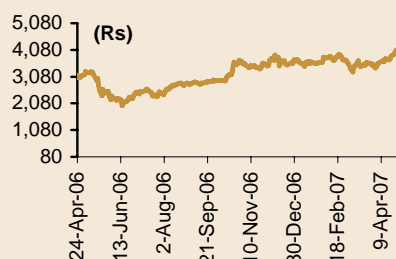
NEUTRAL
Current price: INR 4,094*
Target price: INR 4,288**
Excellent set of results

Growth prospects fully priced in: Maintain Neutral

**Revised from INR 3,694. Horizon: March 2008

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Stock performance


(%)	Absolute	Relative to	
		Sensex	Sector
3 months	14.6	13.6	4.7
6 months	16.2	3.1	6.0
12 months	34.1	11.5	18.0

Key financials

Y/E 31 Dec	FY07E	FY08E	FY09E
Net sales (INR m)	42,740	60,073	80,268
Net profit (INR m)	3,403	4,611	6,310
Adj EPS (INR)	80.3	108.8	148.9
PER (x)	51.0	37.6	27.5
PCE (x)	47.3	34.4	25.2
EV/Core			
EBITDA (x)	35.2	23.5	16.9
Price/Book (x)	14.4	10.7	7.8
ROE (%)	32.3	32.5	32.8
ROCE (%)	46.4	46.8	47.2
Consensus			
EPS (INR) *	76.5	115.7	

* Bloomberg

ABB India (ABB) declared INR 865.9m net profit on revenues of INR 13,124m for Q1CY07. This represents 69% YoY growth in net profit and 63% in revenues. Operating margin for the quarter came in at 9.8%, ahead of our estimate of 8.7%. The company's order intake grew by 43% to INR 20,003m during the same period. The order book stands at INR 42,596m in Q1CY07 compared to INR 33,723m at the beginning of the year.

We maintain our EPS estimates for CY07 and CY08 at INR 109 and INR 149 respectively. We revise our FY08-end price target from INR 3,694 to INR 4,288. We believe that the company has excellent growth prospects, given the thrust on developing power infrastructure in the country. With more visibility emerging for the 12th Five-Year Plan, we expect the growth in the 11th Five-Year Plan to continue in the 12th. To capture this growth, we have used a two-stage discounted cash flow (DCF) model.

We maintain NEUTRAL on the stock as we believe that all the growth opportunities are already factored in the current price.

Figure 1: Quarterly results

	Q1CY07	Q4CY06	Q1CY06
Net sales	13,124.0	14,263.1	8,029.1
Expenditure	11,842.6	12,315.8	7,334.6
Core EBITDA	1,281.4	1,947.2	694.5
Other income	151.7	173.6	179.5
Interest	10.0	1.0	1.9
Gross profit	1,423.1	2,119.8	872.1
Depreciation	86.2	71.2	62.0
Profit before tax	1,336.9	2,048.7	810.0
Tax	471.0	699.1	297.0
Profit after tax	865.9	1,349.6	513.0
EPS	20.3	31.6	12.1

Source: Company, Brics Research

Excellent results: Margin expansion and fabulous order book growth

ABB declared INR 865.9m net profit on revenues of INR 13,124m for Q1CY07. This represents 69% YoY growth in net profit and 64% in revenues. The EPS for the quarter is INR 20.3. The results are ahead of our expectations due to higher-than-expected revenue growth and EBITDA margin expansion by 100bp. Margin expansion was due to increasing operational leverage as evident by a YoY lower staff and Other costs (as % of sales).

The order book at the end of this quarter is INR 42,596m, up from INR 33,723m at the beginning of the year. The order intake for the quarter was INR 20,003m, a 43% YoY increase.

Figure 2: Major costs and EBITDA margin

	(INR m)		
	Q1CY07	Q4CY06	Q1CY06
EBITDA margin (%)	9.8	13.7	8.7
Increase/ Decrease in stock	-97	71	-465
Raw material cost	9847.8	10431.1	6333.5
% of sales	74.3	73.6	73.1
Personnel expenses	698	657.4	555.1
Other expenditure	1394	1156.9	911.6
% of sales	10.6	8.1	11.4

Source: Company, Brics Research

Outlook remains robust

We expect ABB to witness an order inflow of INR 490bn over CY07-CY11, driven by the following:

- Burgeoning investments in the power transmission and distribution (T&D) sector
- Rising industrial capex for automation and process control systems
- Growing investments in housing and real estate development; and,
- Renovation demand in both power and automation segments

Figure 3: ABB order intake potential by CY11

	(INR bn)		
	Total market	ABB share (%)	Expected revenues
Domestic market			
T&D equipment and services	1,231	29	360
Industrial capex towards automation systems (ex-power)	400	27	108
Building solutions	110	10	10
Total domestic order flow			478
Export revenues			12
Estimated new orders by CY11			490

Source: Brics Research

We believe that the growth momentum of the 11th Plan will be sustained in the 12th Plan. As per a report by the Central Electricity Authority (CEA), India is expected to add another 84,000MW capacity in the 12th Plan. Requirement of materials for the T&D system also is to be similar to the 11th Plan. Automation division is also expected to prosper as Indian corporates add capacities and focus on modernisation and efficiency improvement.

ABB India is one of the largest contributors to the growth of the ABB Group. India remains a focus area for the group. We believe that ABB India can act as a global outsourcing hub for the ABB Group.

We maintain our estimates

We maintain our estimates for the company (see Figure 5).

Figure 4: Key estimates

	CY06	CY07	CY08
Sales and services (INR m)	42,739.0	60,071.7	80,265.8
Core EBDITA (INR m)	4,766.5	7,014.4	9,485.9
EBDITA margin (%)	11.2	11.7	11.8
PAT (INR m)	3,402.1	4,610.4	6,310.1
EPS (INR)	80.4	109.0	149

Source: Brics Research

Valuation

We revise our price target, maintain neutral

We revise our DCF-based price target from INR 3,694 to INR 4,288. This change incorporates the company's growth prospects beyond CY11 in our estimates. Given that there is visibility emerging for the 12th Plan, we believe power spending will be at least on par with the expected spending in the 11th Plan.

We are now valuing the company using a two-stage DCF model. Our model assumes 31% CAGR from CY06-11 and 10% CAGR from CY11-16. Our terminal growth assumption is 4%. We revise our FY08-end price target from INR 3,694 to INR 4,288. We maintain NEUTRAL as the company's growth prospects are adequately captured in its current price.

Figure 5: Valuation estimates

Year ended	CY07	CY08	CY11
EBITDA (INR m)	7,015	9,486	20,227
Capital expenditure (INR m)	2,200	2,200	4,000
Taxes (INR m)	2,483	3,398	7,487
Free cash flows to Equity (FCFE)	3,655	5,611	12,501
Terminal year FCFE or EBITDA (INR m)	12,501		
PV of Terminal value (INR m)	1,04,850		
Value of equity (INR m)	1,75,653		
Fair value (INR/share)	4,153		
Target price (INR/share)	4,288		
Cost of equity	13.00%		

Source: Brics Research

Risks to our valuation

- Our valuation assumes a blue-sky scenario for the Indian power sector. It inherently assumes that all talked about reforms and capacity addition in power space will happen over the next two plan periods. It also assumes that corporate capex will continue at the unabated pace for the next few years.
- ABB's order execution cycle is 8-9 months. Hence, a continuous flow of orders is very much necessary for the sustained growth. Even little hiccups in the order flow could bring down revenue growth.
- Our valuation builds 31% revenue CAGR from CY06-11 and 10% revenue CAGR from CY11-16. At our assumed growth rate, the company will become an USD 8bn company by 2016. This would mean an eight-fold jump in revenues in the next 10 years. Even ABB in China has not been able to achieve this feat from a much lower base. Hence, it remains to be seen if ABB India will be able to sustain this growth momentum.
- Considerable margin expansion from the current levels seems difficult as the competition is stiff and asset utilisation is already very high.

Income statement						Cashflow					
INR m						INR m					
Year ended 31 Dec	CY05	CY06	CY07E	CY08E	CY09E	Year ended 31 Dec	CY05	CY06	CY07E	CY08E	CY09E
Net sales	22,602	29,631	42,740	60,073	80,268	Pre-tax profit	2,129	3,392	5,232	7,093	9,708
<i>Growth (%)</i>		31.1	44.2	40.6	33.6	Depreciation	0	234	265	439	574
Operating expenses	(20,473)	(26,449)	(37,972)	(53,058)	(70,781)	Tax paid	0	(1,208)	(1,829)	(2,483)	(3,398)
Core EBITDA	2,129	3,182	4,768	7,015	9,486	Chg in working capital	(207)	(1,414)	679	418	590
Other income	0	511	737	525	803	Cashflow from operations (a)	1,921	1,005	4,346	5,468	7,474
EBITDA	2,129	3,693	5,504	7,539	10,289	Capital expenditure	(3,630)	(896)	(2,000)	(2,200)	(2,250)
Depreciation	0	(234)	(265)	(439)	(574)	Chg in investments	(1,070)	198	0	0	0
EBIT	2,129	3,459	5,239	7,100	9,715	CF from investing (b)	(4,699)	(698)	(2,000)	(2,200)	(2,250)
Interest paid	0	(66)	(7)	(7)	(7)	Free cashflow (a+b)	(2,778)	307	2,346	3,268	5,224
Pre-tax profit	2,129	3,392	5,232	7,093	9,708	Equity raised/(repaid)	424	0	0	0	0
Tax (current + deferred)	0	(1,208)	(1,829)	(2,483)	(3,398)	Debt raised/(repaid)	15	12	0	0	0
Profit after tax	2,129	2,184	3,403	4,611	6,310	Dividend (incl. tax)	0	(387)	(387)	(387)	(387)
<i>Growth (%)</i>		2.6	55.8	35.5	36.9	Other financing activities	0	(90)	0	0	0
Balance sheet						CF from financing (c)					
INR m						Net chg in cash (a+b+c)					
Year ended 31 Dec	CY05	CY06	CY07E	CY08E	CY09E	(2,339)	(158)	1,960	2,881	4,837	
Current assets	14,064	19,871	27,907	38,740	52,860	Key ratios					
Investments	1,070	872	872	872	872	Year ended 31 Dec	CY05	CY06	CY07E	CY08E	CY09E
Fixed assets	1,949	2,651	4,386	6,147	7,823	Adjusted EPS (INR)	50.2	51.5	80.3	108.8	148.9
Total assets	17,083	23,394	33,165	45,759	61,554	Adjusted EPS growth (%)		2.6	55.8	35.5	36.9
Current liabilities	9,279	13,729	20,257	28,328	37,850	Core EBITDA growth (%)		49.5	49.8	47.1	35.2
Total Debt	15	27	27	27	27	Core EBITDA margin (%)	9.4	10.7	11.2	11.7	11.8
Other liabilities	542	596	823	1,122	1,471	Pre-tax margin (%)	9.4	11.4	12.2	11.8	12.1
Total liabilities	9,836	14,352	21,107	29,477	39,349	ROE (%)	58.8	26.8	32.3	32.5	32.8
Paid-up capital	424	424	424	424	424	ROCE (%)	54.6	39.6	46.4	46.8	47.2
Reserves & surplus	6,823	8,617	11,634	15,858	21,782	Net debt/Equity (%)	(57.3)	(44.0)	(49.3)	(54.2)	(61.5)
Shareholders' funds	7,247	9,041	12,058	16,282	22,205	Valuation parameters					
Total equity & liabilities	17,083	23,394	33,165	45,759	61,554	Year ended 31 Dec	CY05	CY06	CY07E	CY08E	CY09E
						PER (x)	81.5	79.5	51.0	37.6	27.5
						PCE (x)	81.5	71.8	47.3	34.4	25.2
						Price/Book (x)	23.9	19.2	14.4	10.7	7.8
						Yield (%)	0.0	0.2	0.2	0.2	0.2
						EV/Net sales (x)	7.5	5.7	3.9	2.7	2.0
						EV/Core EBITDA (x)	79.6	53.3	35.2	23.5	16.9

ABB India: Recommendation history

Date	Stock price (INR)	Recommendation	Price target (INR)	Report
13-Dec-06	3575	NEUTRAL	3920	Well-priced - Good play on the sector, but valuations are too rich
19-Feb-07	3801	NEUTRAL	4043	Q4CY06 result: Results in line - Growth prospects fully priced in: Maintain Neutral
26-Apr-07	4,094	NEUTRAL	4288	Q1CY07: Excellent set of results — Growth prospects fully priced in: Maintain Neutral

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