

April 28, 2008

India
India Electrical Equipment

ABB India (ABB.NS - INR 1180.55) 1-Overweight

Earnings Review/Sales Analysis

Satish Kumar

Abhinav Sharma

91.22.4037.4183

91.22.4037.4198

satishku@lehman.com

abhinsha@lehman.com

LBSPL, India

LBSPL, India

Slower growth but we maintain 1 OW

Investment Conclusion

- The company reported its Q1CY08 results below our expectations primarily because of lower-than-expected revenue growth. We reduce our EPS estimates but remain positive about the growth prospects of the company. We have also reduced our target price as we have increased our cost of equity to 13% from 12%.

Summary

- The company reported net profit of INR1176.9 mn against our expectation of INR1301 mn. The disappointment was due to revenue growth of 17% against our expectation of 34%.
- Operating margin came in at 11.3% against our expectation of 10.2%. Margins expanded by 150 bps YoY.
- Order inflows were very strong at INR26,954 mn up 35% YoY suggesting strong growth prospects going forward.
- We have reduced our CY08 EPS estimate to INR33.1 from INR33.7 and CY09 EPS estimate to INR44.4 from INR47.3.
- We have reduced our target price as we have increased our cost of equity assumption to 13% from 12%. Maintain 1 OW.

Stock Rating

New: 1-Overweight

Old: 1-Overweight

Target Price

New: INR 1394.00

Old: INR 1634.00

Sector View: 1-Positive

FY Dec	2006A	2007E		2008E		2009E	
		Actual	Old	New	Old	New	Old
Currency INR							
Revenue (m)	42740.0	59303.1	59303.1	80652.2	78280.0	109687.0	101764.0
Net Profit (m)	3400.0	4917.0	4917.0	7136.0	6997.0	10030.0	9396.0
EPS	16.0	23.2	23.2	33.7	33.1	47.3	44.4
EPS Growth (%)	55.7	44.5	44.5	45.1	39.5	40.6	33.4
DPS	N/A	N/A	N/A	N/A	N/A	N/A	N/A
P/E	73.8	50.9	50.9	35.0	35.7	25.0	26.6
EV/EBITDA	58.6	N/A	34.9	N/A	24.5	N/A	18.1
Divided Yeld (%)	N/A	N/A	N/A	N/A	N/A	N/A	N/A

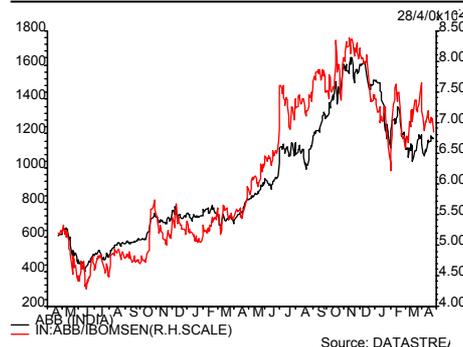
Market Data

Market Cap	250168
Market cap (US\$ mn)	6227
Shares Outstanding (mn)	211.9
6-mo daily T/O (US\$ mn)	3
Free Float (%)	48.00
Foreign Shareholding (%)	69.00

Financial Summary

3-Yr EPS Growth(%)	33.0
PEG (3-Yr CAGR)	0.9
P/B	19.9
ROE (%)	35.0
Debt To Capital (%)	0
Dividend payout(%)	9.8

Stock Overview



Reuters ABB.NS

Bloomberg ABB IN

ADR

Performance

	1M	3M	12M
Absolute %	6.9	0.8	48.9
Rel. Market %	-4.5	4.1	19.1
Rel. Sector %	-	-	-

52 Week Range 1643.70 - 818.10

Results analysis

ABB's Q1CY08 results were below our expectations. Net profit came in at INR1176.9 mn against our expectation of INR1301 mn. Disappointment was because of lower-than-expected revenue growth. Revenue growth came in at 17% against our expectation of 34%. We believe that the lower revenue growth in the quarter is a blip and revenue growth would pick up in remaining quarters as order intake is still very strong.

While revenue growth was weak, operating margins have expanded significantly. Operating margin came in at 11.3% against our estimate of 10.2%. Operating margin has expanded by 150 bps YoY. We believe the reason could be a change in revenue mix towards products in this particular quarter.

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Order intake remains strong

Order inflow for the quarter has remained strong. Total order inflows for the quarter were INR26,954 mn, up 35% YoY. Order backlog at the end of Q1 is INR61,749 mn as compared to INR50,260 mn at the beginning of the year and INR40,519 mn as at 2007 Q1 providing revenue visibility for the coming quarters. Moreover strong order intake would quell fears related to a slowdown in industrial growth.

Figure 1: Result summary table

	Q1CY08A	Q1CY08E	Q4CY07A	Q1CY07A	YoY change	QoQ change
Net Sales	15352.9	18373.6	18394.4	13124.0	17.0%	-16.5%
Other Income	185.1	200.0	253.6	151.7		
Total Income	15538.0	18573.6	18648.0	13275.7	17.0%	-16.7%
Expenditure	13625.6	16499.5	15792.0	11842.6	15.1%	-13.7%
Core EBITDA	1727.3	1874.1	2602.4	1281.4	34.8%	-33.6%
Operating Profit	1912.4	2074.1	2856.0	1433.1	33.4%	-33.0%
Interest	28.2	20.0	19.7	10.0		
Gross Profit	1884.2	2054.1	2836.3	1423.1	32.4%	-33.6%
Depreciation	83.3	80.0	81.6	86.2		
Profit before Tax	1800.9	1974.1	2754.7	1336.9	34.7%	-34.6%
Tax	624.0	671.2	946.7	471.0	32.5%	-34.1%
Profit after Tax	1176.9	1302.9	1808.0	865.9	35.9%	-34.9%
EPS	5.6	6.2	8.5	4.1		

Source: BSE, Lehman Brothers estimates

Operating margin has expanded largely because of lower RM to sales ratio. We believe that the primary reason for this is a change in revenue mix in the quarter. For this particular quarter process automation forms 18% of the revenue as compared to 15.2% in Q1CY07.

Figure 2: Margin components

	Q1CY08A	Q4CY07A	Q1CY07A
Raw material cost (INR mn)	9982.7	13508.9	9847.8
Raw material cost (% of sales)	65.0%	72.0%	74.3%
Personnel expenses (INR mn)	969.5	785.1	698
Personnel expenses (% of sales)	6.3%	4.3%	5.3%
Other Exp (INR mn)	1627.2	1764.3	1393.8
Other Exp (% of sales)	10.6%	9.6%	10.6%
Operating Margin	11.3%	14.1%	9.8%

Source: Company data

Segmental result

Revenue growth was subdued in the power division while it was very strong on the automation division. The reason for lower revenue growth in the power division was a change in revenue mix towards longer gestation projects. We believe that it is only a quarterly blip and since the order backlog is very strong the revenue growth would pick up.

Figure 3: Segmental result

	Q1CY08A	Q1CY07A	YoY change
Revenue (INR mn)			
Power systems	5121.6	4867.2	5.2%
Power products	4262.7	3803.3	12.1%
Process automation	2953.2	2284.5	29.3%
Automation products	3950.5	2879.7	37.2%
Others	110.7	54.1	
EBIT (INR mn)			
Power systems	454.6	427.2	6.4%
Power products	548.5	344.0	59.5%
Process automation	421.5	197.0	113.9%
Automation products	396.4	325.5	21.8%
Others	9.0	-1.3	

Source: Company data

We reduce our EPS estimates

We have reduced our revenue growth assumption but have increased operating margin assumption for CY08 and CY09 to factor in lower growth and margin expansion in this quarter. Following are the key changes in estimates

Figure 4: Change in estimates

	CY08		CY09	
	New	Old	New	Old
Revenue (INR mn)	78280.1	80652.2	101764.1	109687.0
Revenue growth (YoY)	32.0%	36.0%	30.0%	36.0%
Operating Margin	13.0%	12.9%	13.4%	13.3%
EPS	33.1	33.7	44.4	47.3

Source: Lehman Brothers estimates

We reduce target price but maintain 1-OW

We have also reduced our target price to INR 1394, implying 19% potential upside from current levels. The key reason for a change in target price is a change in our cost of equity assumption from 12% to 13%. At our target price the stock would be valued at 28x one year forward EPS. We are positive about the long-term growth prospects of the company and the strong order inflow along with proven execution capability ensures revenue visibility. We maintain our 1-Overweight rating on the stock.

Analyst Certification:

We, Satish Kumar and Abhinav Sharma, hereby certify (1) that the views expressed in this research Company Note accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Company Note and (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Company Note.

Other Team Members:

Nemani, Alok Kumar (LBSPL, India)

91.22.4037.4193

anemani@lehman.com

Company Description:

ABB India is the market leader in India power T&D equipment sector

Important Disclosures:

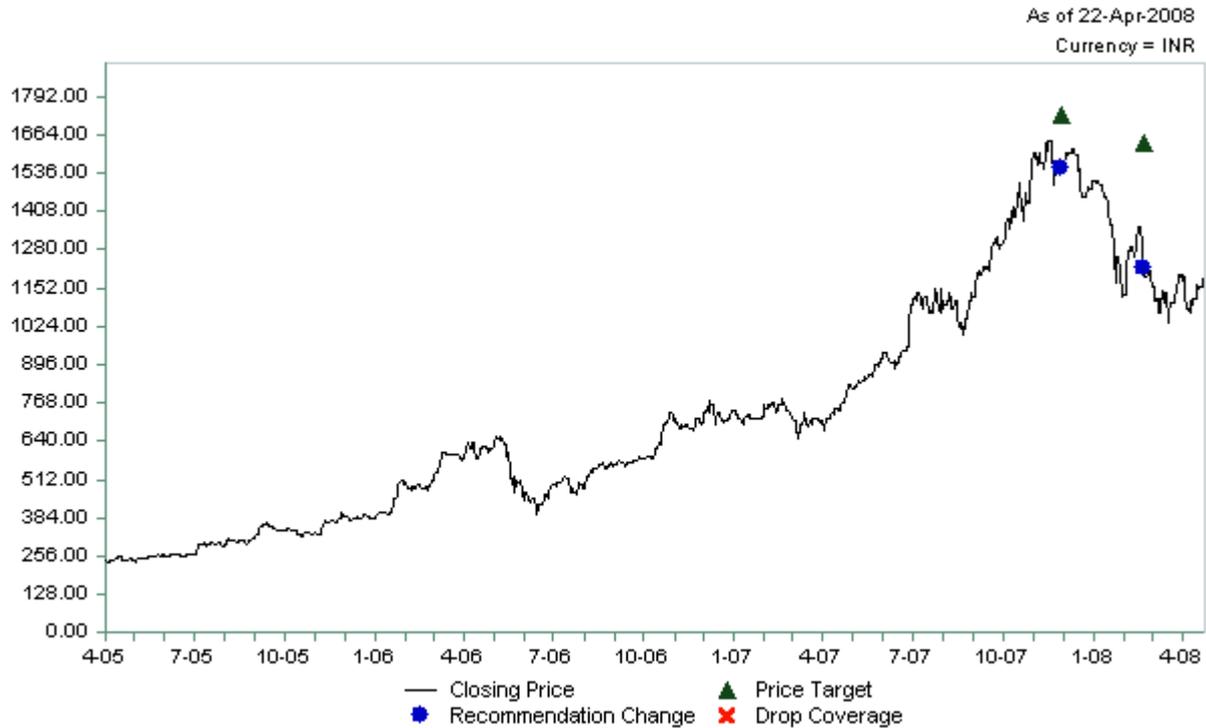
ABB India (ABB.NS)

INR 1180.55 (24-Apr-2008)

1-Overweight / 1-Positive

Rating and Price Target Chart:

ABB INDIA



Source: FactSet

Currency=INR

Date	Closing Price	Rating	Price Target
21-Feb-08	1218.90		1634.00
21-Feb-08	1218.90	1-Overweight	

Date	Closing Price	Rating	Price Target
29-Nov-07	1548.25		1730.00
29-Nov-07	1548.25	2-Equal weight	

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Valuation Methodology: We have valued the company using a discounted cash flow (DCF) methodology. Our key assumptions are (1) a long-term growth rate of 6% and a cost of equity of 13%, (2) terminal year as 2016, and (3) a terminal-year EBITDA margin of 14.1%, which we believe is possible as India is in a developing phase, when project revenue should be greater than product revenue for ABB. At a more stable stage, ABB's product revenue would be greater than its project revenue, which in turn would lead to higher margins.

Risks Which May Impede the Achievement of the Price Target: (1) Slowdown in power sector investments: The biggest risk to ABB's earning momentum will be any significant slowdown in power sector investments in India. (2) Slowdown in industrial capex: ABB derives a significant proportion of its revenue from the automation business, which is directly dependent on corporate capex in the country. Any slowdown in this momentum would impact earnings from the automation division and also for the power division to some extent. (3) Increased competition: Increased competition, especially in the lower-voltage segment, could pose a risk to the company's operating margins and, in turn, its earnings (4) Non-ferrous metal prices: Any unexpected rise in the global prices of these commodities would impact margins.

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Company Name	Ticker	Price (24-Apr-2008)	Stock / Sector Rating
ABB India	ABB.NS	INR 1180.55	1-Overweight / 1-Positive

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