VISIT NOTE

Industry	Capital Goods
Not Rated	

ABB India (ABB IN)

December 23, 2010

Order Momentum expected to pick up!!!

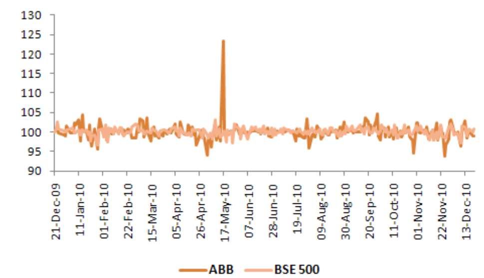
Not Rated (CMP: ₹ 761)

Market Cap: ₹. 161 bn; USD 3.6 bn

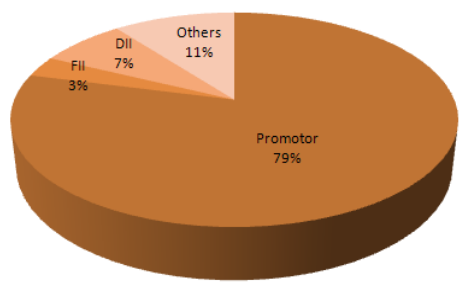
Market Data

Market Cap.	₹ 161bn/ US$ 3.6bn
Share Cap. (mn)	424
52 Wk High/Low	975/ 669
Avg. Vol. (Weekly)	33.48

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



Shareholding Pattern (As on 30th Sept 2010) (%)



Financials (₹ Mn)	CY07	CY08	CY09
Net sales (Rs mn)	59,303	68,370	62,372
EBIDTA (Rs mn)	7,295	7,698	5,274
PBT (Rs mn)	7,565	8,332	5,274
PAT (Rs mn)	4,917	5,474	3,546
EBIDTA margin	12.3	11.3	8.5
PAT margin	8.3	8.0	5.7
EPS (Rs)	23.2	25.8	16.7
Price/Earnings (x)	32.8	29.4	45.5
EV/EBIDTA (x)	21.2	20.5	29.6
Price/Book value (x)	9.9	7.6	6.7
Book Value per share	76.7	100.0	114.4

We recently met the management of ABB India in order to understand the recent development in the company and the future outlook. The key takeaways of the meeting are:

9MCY10 profitability hit due to Rural Electrification projects, Execution delay in large long cycle projects and Forex hit

During 9MCY10, ABB's profitability declined by ~77% due to the consistent losses in rural electrification (RE) project coupled with execution delay of large long cycle projects. Also the company has made provisions of ₹ 571 mn on account of Forex loss in 9MCY10. ABB entered into rural electrification work in beginning 2008 (~10% of CY09 sales). RE projects, characterized by low-voltage distribution work, require tremendous amount of sub-contracting as the work is largely outsourced. The company could not effectively manage these projects and had to suffer losses even as working capital worsened. Till date, the company had exited RE business to the tune of ₹ 8 bn and we believe that it will take at least few more months to completely exit out of the RE business. The current exposure in RE business is ₹ 2 bn. These three factors resulted in the sharp decline in profitability for the company.

Order Inflow momentum expected to pick up

The Company reported an order backlog of ₹ 91.8 bn at the end of quarter ending September 2010, up 14% YoY. Order inflow during the first nine months declined by ~22% to ₹ 49.5 bn YoY. However, 3QCY10 started witnessing pick up in order inflows of ~7% to ₹ 20.3 bn. Of the Order book of ₹ 91.8, ~ 40% is from Industrial, 50% is from Power and the rest is exports. We expect pick up in the company's power sector order book, as the company stands to benefit from the substantial investment planned in the T&D sector over the next few years. With the Industrial capex revival, we expect the company's automation sector order book to pick up.

Table 1: Order Book and Order Intake over the last 7 quarters

₹ mn	1QCY09	2QCY09	3QCY09	4QCY09	1QCY10	2QCY10	3QCY10
Order Book	70,315	76,223	80,233	84,787	87,535	85,317	91,781
YoY (%)	13.9	12.5	12.3	37.6	24.5	11.9	14.4
Order Intake	23,033	21,116	18,933	23,767	16,887	12,346	20,310
YoY (%)	(14.5)	(4.4)	0.2	88.5	(26.7)	(41.5)	7.3
Sales	13,931	15,050	14,538	18,852	14,559	14,466	13,340
YoY (%)	(9.3)	(6.9)	(4.3)	(13.0)	4.5	(3.9)	(8.2)

Source: Company

Our View:

ABB India's performance has been lackluster in the last two years in terms of moderate financials and order book. The key catalyst for ABB's dismal performance has been the slump in industrial capex (40% exposure for ABB) and strategy to exit RE business leading to non booking of revenue and increase in costs due to penalties, etc. However, with the overall momentum picking up in the Industrial space coupled with expected orders in the T&D segment, we expect the order inflow to pick up. During 9MCY10, the company has reported an EPS of ₹ 2.7. We do not have rating on the company. However, based on the current prospects of the company, we expect the company to report an EPS of ~₹ 5 in CY10.

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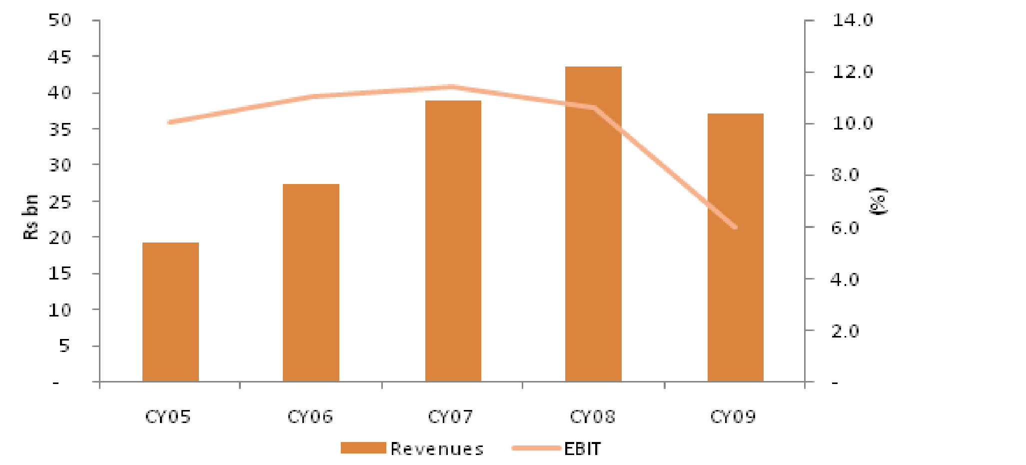
BUSINESS OVERVIEW

ABB Ltd. (ABB India), a 75% subsidiary of $31.8 bn ABB, Switzerland, is the dominant player in the Indian power and industrial automation sector. ABB India employs over 6,000 people, has 14 manufacturing units, is a global engineering and operations centre and group corporate R&D facility. It has a countrywide marketing and service presence spanning 30 marketing offices, a network of over 850 channel partners and eight service centers.

Power Technologies (55% of revenues)

Power Technologies offers turnkey solutions for substations, distribution automation, network management and power products that cover a wide spectrum of technologies across the T&D segment. The company's strength lies in setting up High Voltage Direct Current (HVDC) transmission lines, substations up to 400 kVA and switchgears, mainly medium & high voltage switchgear. ABB has impressive track record in winning HVDC projects in India and has done majority of the HVDC transmission projects so far. It is a market leader in APDRP projects.

Chart 1: Performance of Power Technologie

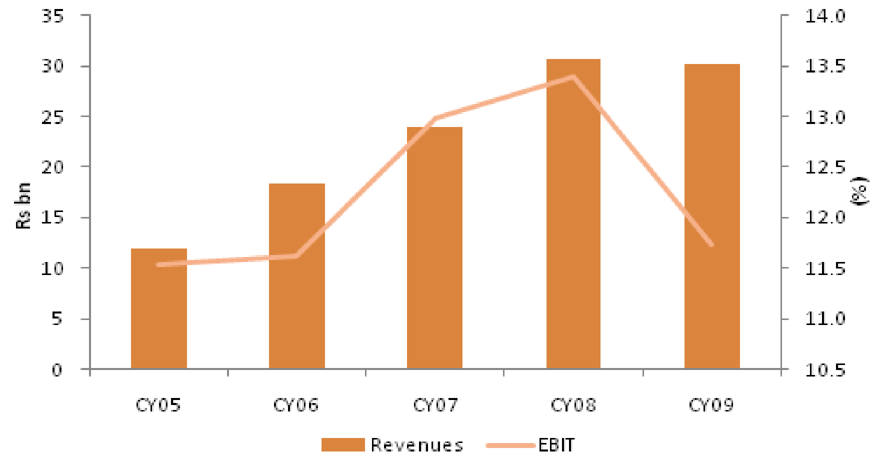


Source: Company

Automation Technologies (45% of revenues)

Automation Technologies covers two broad segments: industry products (such as motors and drives, panel, etc) and process automation (instrumentation). ABB is one of the dominant players in the industrial automation and process technologies industry and has significant penetration across several industries such as metals, automotive, oil and petrochemicals, pharma, paper, etc. ABB India has also been designated as the regional centre of excellence for metals and cement industry applications within ABB Group.

Chart 2: Performance of Automation technologies



Source: Company

Historical performance

- CY10 till date has been a moderate year for ABB due to the company's strategic decision of exiting from the rural electrification business and also due to the delay in execution of its existing turnkey projects and slowdown in order inflow. This resulted in ~2.7%, ~80.8% and 77% decline in Sales, EBITDA and PAT respectively in 9MCY10. ROCE and ROE declined to 24% (45% in CY08) and 16% (29% in CY08) in CY09 respectively.
- ABB India reported robust revenues and PAT CAGR of 36% and 40% respectively over the period CY03-08. It has consistently recorded high operating margins over the same period (excess of 40% and reported 12.3% EBITDA margins in CY07) owing to its impressive product mix which allowed the company to maintain margins, control working capital and tide over cyclicality in projects segment
- Over the past few years, ABB India has undergone a significant change in line with business restructuring exercise undertaken by the parent. The group has exited power generation and transportation businesses in the past ten years, once contributing to significant part of the company's growth. Today, ABB is focused on T&D and automation businesses worldwide.
- ABB's capability in providing cutting-edge solutions like High Voltage Direct Current (HVDC), flexible AC transmission systems (FACT), SCADA, distribution control systems, etc, is unchallenged. In the past 10 years, ABB's key to sustainable growth in the Indian T&D space is the aggressive launch of new products such as 400 kV Circuit breakers, new high-tension transformers, LT capacitors, etc.
- In the past five years, ABB has made investments to the tune of US$ 150 mn in setting up new capacities for key products across ranges. The company has also set up a 500-strong global engineering centre in Bangalore, to support ABB Group operations.
- ABB's ROCE has improved from 26% in CY03 to 45% in CY08, even though cash and investments were 53% of total capital employed and the company underwent US$ 150 mn investment programme during CY04-08. Improvement in productivity has also helped the company improve ROE from 18% in CY03 to 29% in CY08. We believe that the company will be able to further improve returns over next three years, with stable margins, effective utilization of liquid assets (doing capex in productive assets) and robust business environment.

Future Prospects

- Transmission and Distribution sector will see substantial investment. T&D investments, being back-ended, will witness a significant spurt over the latter half of the 11th Plan period. ABB's strength lies in the high voltage AC and DC transmission systems, high voltage substations. ABB has a high degree of success in projects that it bids for and it will continue to enjoy high share in bankable projects.

- We believe that Industrial investment (muted in CY09 due to credit crisis) are picking up. We attribute this to three key reasons: demand picking up, strong corporate balance sheets and low interest rates. We believe metals, autos and oil & gas industries will remain at the capex forefront for the next few years, **benefiting ABB's Automation businesses.**

- Since last one year, India's transmission infrastructure has been focused on high voltage technology such as high voltage direct current (HVDC), 765 kV and later 1200 kV transformer. **ABB has a proven experience and expertise in undertaking these projects and we believe it to be a strong contender going forward.**

- **ABB India has been and will continue to get a wider role to play in the overall network of the parent.** The company has also set up a 500-strong global engineering centre in Bangalore, to support ABB Group operations. Results are there to prove the point. Exports revenues have reported CAGR of 12% over the period CY03-08. Although as % of sales, exports have declined from 20% in CY03 to ~8% in CY09.This is primarily due to increase in demand in the domestic market.

- The current order book for ABB stands at ₹ 91.8 bn, a 35% CAGR over the last five years. **We believe that the increasing momentum in the power and industrial space over the next five years will boost the order book of the company.**

- **Key Risks:** Macro-risks will remain predominant concerns in the near term that may affect valuations. Beyond this, any additional negative in the power policy may act as a sentiment dampener.

FINANCIAL DETAILS

Profit & Loss Statement (Rs mn)	CY06	CY07	CY08	CY09
Net sales	42,740	59,303	68,370	62,372
growth (%)	44.2	38.8	15.3	-8.8
Operating expenses	-37,973	-52,008	-60,673	-57,098
Operating profit	4,767	7,295	7,698	5,274
Other operating income				
EBITDA	4,767	7,295	7,698	5,274
growth (%)	49.8	53.0	5.5	-31.5
Depreciation	-265	-324	-367	-485
Other income	737	710	1,304	726
EBIT	5,239	7,682	8,635	5,515
Interest paid	-7	-117	-303	-241
PBT (before EoI)	5,232	7,565	8,332	5,274
Non-recurring items				(477)
Tax on EoI				
PBT (after EoI)	5,232	7,565	8,332	4,798
Tax (current + deferred)	-1,829	-2,648	-2,858	-1,728
Net profit	3,403	4,917	5,474	3,070
Adjusted net profit	3,403	4,917	5,474	3,546
growth (%)	55.6	44.5	11.3	-35.2
Prior period adjustments				
Minority interests				
Preference dividend				.
Net income	3,403	4,917	5,474	3,070

Cash Flow (Rs mn)	CY06	CY07	CY08	CY09
Pre-tax profit	5,232	7,565	8,332	4,798
Depreciation	198	176	-43	-145
Chg in working capital	-1,059	-2,164	-5,616	-616
Total tax paid	-1,748	-2,685	-2,948	-1,767
Other operating activities				
Cash flow from operations (a)	2,623	2,892	-275	2,270
Capital expenditure	-865	-1,437	-2,211	-916
Chg in investments	98	69	93	442
Other investing activities		-81	-4	132
Cash flow from investing (b)	-768	-1,449	-2,122	-342
Free cash flow (a+b)	1,856	1,443	-2,397	1,928
Equity raised/(repaid)		1	1	-2
Chg in minorities				
Debt raised/(repaid)	-12	-10	-5	0
Dividend (incl. tax)	-387	-470	-545	-545
Other financing activities				-2
Cash flow from financing (c)	-398	-479	-550	-550
Net chg in cash (a+b+c)	1,457	964	-2,947	1,378

Balance Sheet (Rs mn)	CY06	CY07	CY08	CY09
Current assets	27,967	41,107	46,998	47,493
Investments	774	705	611	169
Net fixed assets	3,318	4,579	6,833	7,895
Other non-current assets	166	261	459	1
Total assets	32,224	46,651	54,902	55,557
Current liabilities	19,919	29,993	33,215	31,320
Total Debt	15	6	0	
Other non-current liabilities	331	389	497	
Total liabilities	20,265	30,388	33,712	31,320
Share capital	424	424	424	424
Reserves & surplus	11,535	15,840	20,766	23,814
Less: Misc. expenditure				
Shareholders' funds	11,958	16,263	21,190	24,237
Minorities interests				
Total equity & liabilities	32,224	46,651	54,902	55,557

Key ratios	CY06	CY07	CY08	CY09
EPS (Rs)	16.1	23.2	25.8	16.7
EPS growth (%)	55.6	44.5	11.3	-35.2
EBITDA margin (%)	11.2	12.3	11.3	8.5
EBIT margin (%)	12.3	13.0	12.6	8.8
ROCE (%)	48.4	53.0	45.0	24.0
Net debt/Equity (%)	(45.6)	(39.5)	(16.4)	(21.6)

Valuations	CY06	CY07	CY08	CY09
PER (x)	47.4	32.8	29.4	45.5
PCE (x)	44.0	30.8	27.6	40.0
Price/Book (x)	13.5	9.9	7.6	6.7
Yield (%)	0.3	0.3	0.3	0.3
EV/Net sales (x)	3.6	2.6	2.3	2.5
EV/EBITDA (x)	32.7	21.2	20.5	29.6

Du Pont Analysis - ROE	CY06	CY07	CY08	CY09
Net margin (%)	8.0	8.3	8.0	5.7
Asset turnover (x)	1.5	1.5	1.3	1.1
Leverage factor (x)	2.7	2.8	2.7	2.4
Return on equity (%)	32.4	34.8	29.2	15.6

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Stock Ratings

BUY (B)	The stock's total return is expected to exceed 20% over the next 12 months.
ACCUMULATE (A)	The stock's total return is expected to be within 10-20% over the next 12 months.
HOLD (H)	The stock's total return is expected to be within0-10% over the next 12 months.
SELL (S)	The stock's is expected to give negative returns over the next 12 months.
NOT RATED (NR)	The analyst has no recommendation on the stock under review.

Industry Views

ATTRACTIVE (AT)	Fundamentals /Valuations of the sector is expected to be attractive over the next 12-18 months.
NEUTRAL (NL)	Fundamentals /Valuations of the sector are expected to neither improve nor deteriorate over the next 12-18 months.
CAUTIOUS (CS)	Fundamentals /Valuations of the sector is expected to deteriorate over the next 12-18 months.

Disclosure of Interest

1. The analysts who have prepared the report have in no way received or are expected to receive any compensation from the subject company.
2. The analysts do not hold any position in the subject company's stock, as on the date of release.
3. Neither the company nor an affiliate company of Systematix Shares & Stocks (I) Ltd. has received a mandate from the subject company.
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