

ABB INDIA

Back to basics: Tough times call for tough measures

India Equity Research | Engineering and Capital Goods

We recently met ABB India's (ABB) top management to understand key industry trends and business dynamics going ahead. While near-term outlook on the T&D equipment market is flattish, the company is focusing more on optimising product pull through by targeting large-value HVDC (High voltage direct current), FACT (Flexible alternating current transmission systems), metro projects, oil & gas projects and fertilisers. Maintain 'REDUCE' with a TP of INR440.

Maximising product pull through across projects

ABB is focusing on optimising product pull through in power and industrial projects in target market segments. The company, over the past one-two years, has been extremely selective in taking on projects. It is targeting a healthy 25-35% product pull through across power and industrial projects, which is a decent level to attain.

Exciting opportunities in railway, oil & gas, fertilisers

The company remains optimistic about fresh potential in the Dedicated Freight Corridor, metro rail, oil & gas and fertilisers in the coming years. With electrical distribution system in new plants accounting for 10-15% of total project cost, INR55-65bn worth of new business could accrue from new fertiliser capex alone.

T&D equipment market to hover around INR200-250bn

Led by a weak investment climate, especially from SEBs, private sector the overall T&D equipment market size has shrunk 40-45% from peak to INR200-250bn currently. This has led to average industry utilisation levels declining to 40-50% across segments for most equipment players. While ABB expects the market opportunity to improve over the long term, market size over one-two years is likely to remain at current level.

Outlook and valuations: Cautious; maintain 'REDUCE'

While ABB's product focus will boost overall profitability and cash flows, lower RoEs and expensive valuations will continue to remain key drags. We maintain 'REDUCE/Sector Underperformer' with a target price of INR440 as valuations are expensive at 45x and 35x CY13E and CY14E, respectively.

Financials

Year to December	CY11	CY12	CY13E	CY14E
Revenues (INR mn)	74,490	75,650	80,361	91,292
Rev. growth (%)	17.1	1.6	6.2	13.6
EBITDA (INR mn)	3,618	3,365	5,943	7,284
Net profit (INR mn)	1,845	1,374	2,921	3,672
EPS (INR)	8.7	6.5	13.8	17.3
EPS growth (%)	191.9	(25.5)	112.6	25.7
P/E (x)	70.4	94.6	44.5	35.4
ROAE (%)	7.4	5.4	10.7	12.2

EDELWEISS 4D RATINGS	
Absolute Rating	REDUCE
Rating Relative to Sector	Underperformer
Risk Rating Relative to Sector	Low
Sector Relative to Market	Underweight

MARKET DATA (R: ABB.BO, B: ABB IN)

CMP	: INR 612
Target Price	: INR 440
52-week range (INR)	: 830 / 468
Share in issue (mn)	: 211.9
M cap (INR bn/USD mn)	: 130 / 2,176
Avg. Daily Vol.BSE/NSE('000)	: 90.9

SHARE HOLDING PATTERN (%)

	Current	Q3FY13	Q2FY13
Promoters *	75.0	75.0	75.0
MF's, FI's & BK's	12.4	12.9	13.0
FII's	3.7	3.3	3.3
Others	8.9	8.7	8.7
* Promoters pledged shares (% of share in issue)	:	NIL	

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Capital Goods Index
1 month	(10.1)	(4.4)	6.0
3 months	25.3	2.8	(1.6)
12 months	(22.7)	13.5	(3.9)

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60:40 products: projects ratio to sustain

The proportion of products has risen in ABB's business mix over the past two-three years, led by expansion in medium voltage segment and new launches in the low voltage segment. Ergo, a lion's share of the company's order book (60% plus) comes from the products business, which used to be a share of projects business two-three years ago. ABB expects to sustain the current mix going ahead given its sharpening focus on this business, both in existing products and new launches.

Will target more HVDC jobs

ABB is looking to bid for more upcoming HVDC projects, while it is currently executing its first from PG&E. While the company works on the AC part, major value addition is done by parent on the DC side, which is a substantial scope of HVDC.

10 transmission projects on BOOT basis underway

There are 10 transmission projects on BOOT basis which are expected to come up over the next few years, ranging from USD100-500mn each. This is likely to throw open decent size of fresh potential for the transmission equipment industry.

Key segmental trends

Chart 1: Process automation

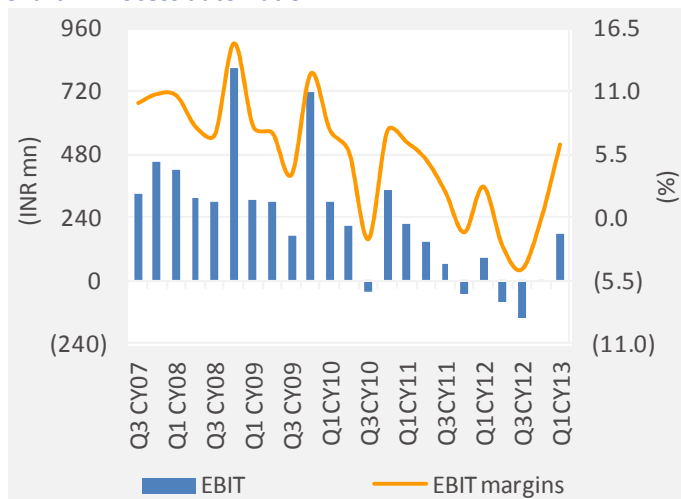


Chart 2: Automation products

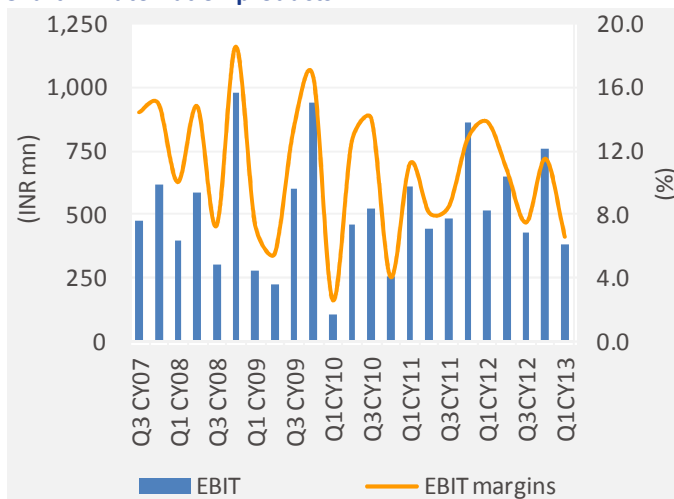


Chart 3: Power products

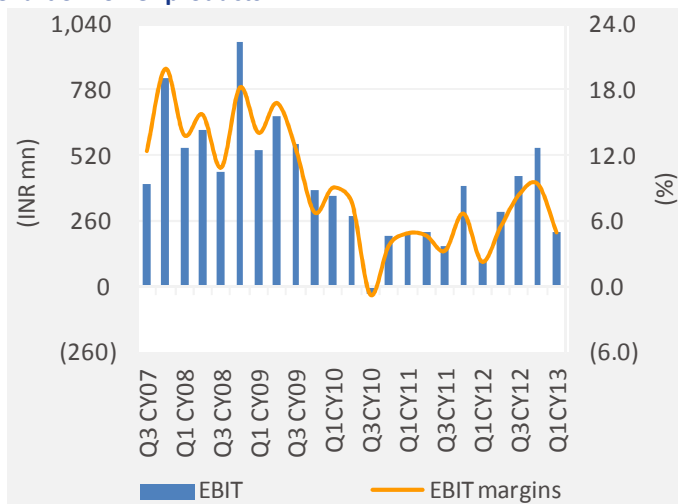
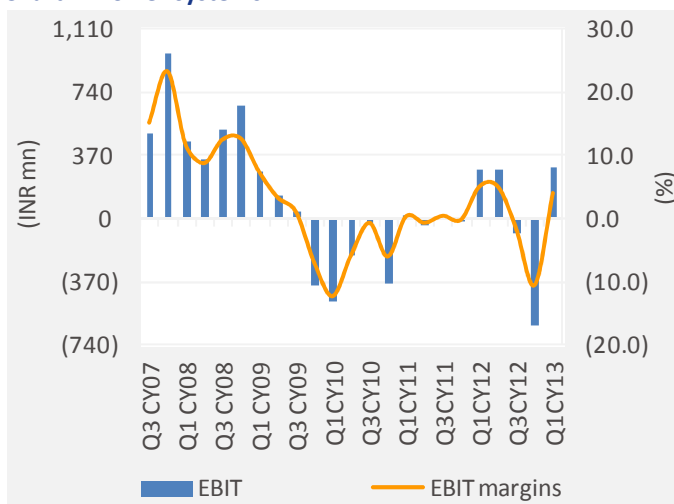


Chart 4: Power systems



Source: Company, Edelweiss research

Company Description

ABB, incorporated in December 1949 as Hindustan Electric Company, operates in two segments i.e. power technology and automation technology, and offers its services and products to the power transmission as well as other industries. Its power technology segment provides solutions for power transmission, power distribution, and control and protection systems for power plants. Products include transformers, switchgears, breakers, capacitors, power line carrier communication equipment, and relay control panels. Under the automation technology segment, it offers products, systems, software, and services for automation and optimization of discrete, process, and batch manufacturing operations, and related services. These technologies include measurement control, instrumentation, process analysis, drives and motors, power electronics, robots, and low-voltage products.

Investment Theme

ABB is likely to be the beneficiary of the government's focus on power capacity additions, prospects from UMPP expand projects, and renewed thrust in improving transmission and distribution infrastructure. New opportunities are also emerging in the field of 765 kV switchgear and transformer products as well as large-volume low-end products. Further, significant capacity additions in industries (steel and cement) and the service sector augur well for its automation segment.

Key Risks

Better than expected order intake could hit out topline estimates. Further, moderation of competitive intensity in the T&D segment could impact our margins estimates for the company.

Financial Statements

Key Assumptions					Income statement (INR mn)				
Year to December	CY11	CY12	CY13E	CY14E	Year to December	CY11	CY12	CY13E	CY14E
Macro					Income statement				
GDP(Y-o-Y %)	6.2	5.0	6.0	7.0	Income from operations	74,490	75,650	80,361	91,292
Inflation (Avg)	8.9	7.4	5.2	6.0	Direct costs	54,785	54,278	57,403	64,836
Repo rate (exit rate)	8.5	7.5	6.8	6.0	Employee costs	5,868	6,196	6,749	7,511
USD/INR (Avg)	48.0	54.5	58.0	56.0	Other Expenses	10,218	11,811	10,265	11,662
Company					Total operating expenses	70,872	72,285	74,417	84,008
Revenue growth (% yoy)					EBITDA	3,618	3,365	5,943	7,284
Power product	10.2	4.2	0.7	13.8	Depreciation & Amortization	795	941	1,048	1,166
Power System	29.3	(5.1)	0.8	14.7	EBIT	2,822	2,424	4,896	6,118
Process Automation	11.2	2.6	1.8	11.4	Other income	162	71	90	90
Discrete Automation	13.0	(1.3)	4.0	11.8	Interest expenses	307	432	626	727
Low voltage products	20.4	14.4	12.2	18.7	Profit before tax	2,677	2,062	4,360	5,481
Order inflow growth (%)					Provision for tax	832	688	1,439	1,809
Power product	41.9	(12.4)	-	10.0	Net profit	1,845	1,374	2,921	3,672
Power System	74.9	(45.4)	10.0	10.0	Shares outstanding (mn)	212	212	212	212
Process Automation	(25.3)	(8.0)	5.0	10.0	Diluted EPS (INR)	8.7	6.5	13.8	17.3
Discrete Automation	26.5	1.4	5.0	15.0	Dividend payout (%)	26.7	35.8	16.9	13.4
Low voltage products	21.8	22.2	10.0	15.0	Common size metrics				
Tax rate (%)	31.1	33.4	33.0	33.0	Year to December	CY11	CY12	CY13E	CY14E
Excise duty as a % of sales	4.0	5.7	4.0	4.0	Operating expenses	95.1	95.6	92.6	92.0
Total no. of employees	6,926	6,752	6,955	7,163	EBITDA margins	4.9	4.4	7.4	8.0
Employee cost per head(INR mn)	847,242	898,077	970,372	1,048,487	Net profit margins	2.5	1.8	3.6	4.0
Capex (INR mn)	3,481	1,242	2,000	2,000	Growth ratios (%)				
Depreciation as % of gross block	4.8	5.6	5.9	5.9	Year to December	CY11	CY12	CY13E	CY14E
					Revenues	17.1	1.6	6.2	13.6
					EBITDA	132.0	(7.0)	76.6	22.6
					Net profit	191.9	(25.5)	112.6	25.7

Engineering and Capital Goods

Balance sheet		(INR mn)			
As on 31st December	CY11	CY12	CY13E	CY14E	
Equity capital	424	424	424	424	
Reserves & surplus	24,921	25,557	27,985	31,165	
Shareholders funds	25,345	25,981	28,409	31,589	
Short term debt	-	3,277	3,277	3,277	
Long term debt	-	39	39	39	
Borrowings	-	3,316	3,316	3,316	
Sources of funds	25,345	29,297	31,725	34,905	
Gross block	10,303	10,781	11,822	12,744	
Depreciation	1,382	1,293	1,215	1,136	
Net block	839	1,169	1,169	1,169	
Capital work in progress	12,524	13,243	14,205	15,049	
Total fixed assets	13,363	14,412	15,374	16,218	
Non current investments	507	525	525	525	
Cash and equivalents	2,644	767	1,284	1,282	
Inventories	9,255	9,204	9,436	10,658	
Sundry debtors	30,825	32,728	35,609	40,711	
Loans and advances	6,876	8,085	8,125	8,413	
Total current assets (ex cash)	46,957	50,017	53,170	59,782	
Sundry creditors and others	35,179	32,939	37,116	41,388	
Provisions	2,331	2,465	492	492	
Total current liabilities &	37,509	35,404	37,608	41,881	
Net current assets (ex cash)	9,447	14,613	15,562	17,901	
Net Deferred tax	224	148	148	148	
Others	-	-	-	-	
Uses of funds	25,345	29,297	31,725	34,905	
Book value per share (INR)	119.6	122.5	134.0	149.0	

Free cash flow		(INR mn)			
Year to December	CY11	CY12	CY13E	CY14E	
Net profit	1,845	1,374	2,921	3,672	
Depreciation	795	941	1,048	1,166	
Deferred tax	(178)	-	-	-	
Others	506	(97)	626	727	
Gross cash flow	2,969	2,218	4,595	5,566	
Less: Changes in WC	1,788	2,720	949	2,339	
Operating cash flow	1,181	(502)	3,646	3,227	
Less: Capex	1,535	1,741	2,010	2,010	
Free cash flow	(355)	(2,243)	1,636	1,217	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted PE (X)		Price/BV (X)		ROAE (%)	
		CY13E	CY14E	CY13E	CY14E	CY13E	CY14E
ABB India	2,176	44.5	35.4	4.6	4.1	10.7	12.2
Crompton Greaves	940	14.0	10.2	1.5	14	11.0	14.3
Siemens	3,295	41.0	28.2	4.8	4.4	11.8	16.2
Median		28.3	35.4	4.4	4.1	11.4	14.3
AVERAGE		28.7	22.7	3.0	2.1	12.8	13.3

Source: Edelweiss research

Cash flow metrics					
Year to December	CY11	CY12	CY13E	CY14E	
Operating cash flow	1,181	(502)	3,646	3,227	
Investing cash flow	(3,610)	(3,398)	(2,010)	(2,010)	
Financing cash flow	(799)	2,106	(1,119)	(1,219)	
Net cash flow	(3,229)	(1,794)	518	(2)	
Capex	(1,535)	(1,741)	(2,010)	(2,010)	
Dividends paid	(493)	(739)	(492)	(492)	

Profitability & efficiency ratios

Year to December	CY11	CY12	CY13E	CY14E
ROAE (%)	7.4	5.4	10.7	12.2
ROACE (%)	11.4	8.9	16.0	18.4
Inventory day	54	62	59	57
Debtors days	147	153	155	153
Payable days	223	229	223	221
Cash conversion cycle (days)	(21)	(14)	(8)	(12)
Current ratio	1.3	1.4	1.4	1.4
Interest coverage	9.2	5.6	7.8	8.4

Operating ratios

Year to December	CY11	CY12	CY13E	CY14E
Total asset turnover	3.0	2.8	2.6	2.7
Fixed asset turnover	17.5	75.3	68.7	78.1
Equity turnover	3.0	2.9	3.0	3.0

Valuation parameters

Year to December	CY11	CY12	CY13E	CY14E
Diluted EPS (INR)	8.7	6.5	13.8	17.3
Y-o-Y growth (%)	191.9	(25.5)	112.6	25.7
CEPS (INR)	11.6	10.9	18.7	22.8
Diluted PE (x)	70.4	94.5	44.5	35.4
Price/BV (x)	5.1	5.0	4.6	4.1
EV/Sales (x)	1.7	1.7	1.6	1.4
EV/EBITDA (x)	35.2	39.3	22.2	18.1

Additional Data

Directors Data

Bazmi Husain	Managing Director	D E Udwadia	Non Executive & Independent Director
N S Raghavan	Non Executive & Independent Director	Naseer Munjee	Non Executive & Independent Director
Arun Kanti Dasgupta	Non Executive & Independent Director	Peter Leupp	Non Executive Director
Francis Duggan	Non Executive Director		

Auditors - SR Batliboi & Co.

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
Abb aseabrown bover	69.08	Life insurance corp	9.53
Abb norden holding a	5.92	Aberdeen	2.45
Reliance capital tru	0.65	Vanguard group inc	0.48
Blackstone asia advi	0.24	Idfc mutual fund	0.18
Uti asset management	0.08	Danske invest manage	0.05

**in last one year*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
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No Data Available

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
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No Data Available

**in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
ABB India	REDUCE	SU	L	Bajaj Electricals	HOLD	SP	M
BGR Energy	REDUCE	SU	M	Bharat Electronics	BUY	SO	H
Bharat Heavy Electricals	HOLD	SP	L	Crompton Greaves	HOLD	SP	M
Cummins India	BUY	SO	L	Havells India	BUY	SO	M
Jyoti Structures	HOLD	SP	M	Kalpataru Power	HOLD	SP	M
KEC International	BUY	SO	M	Larsen & Toubro	BUY	SO	M
Siemens	HOLD	SP	L	Sterlite Technologies	HOLD	SP	H
Techno Electric & Engineering	HOLD	SP	M	Thermax	REDUCE	SP	L
Voltamp Transformers	REDUCE	SU	M	Voltas	HOLD	SP	L

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

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Coverage group(s) of stocks by primary analyst(s): Engineering and Capital Goods

ABB India, BGR Energy, Bharat Electronics, Bharat Heavy Electricals, Bajaj Electricals, Crompton Greaves, Havells India, Jyoti Structures, KEC International, Cummins India, Kalpataru Power, Larsen & Toubro, Siemens, Sterlite Technologies, Techno Electric & Engineering, Thermax, Voltamp Transformers, Voltas

Recent Research

Date	Company	Title	Price (INR)	Recos
05-Jun-13	Cummins India	Positioned for a long haul; <i>Visit Note</i>	459	Buy
04-Jun-13	Blue Star	Not out of the woods yet; <i>Visit Note</i>	167	Not Rated
01-Jun-13	Crompton Greaves	Tread with caution; <i>Visit Note</i>	94	Hold

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	120	49	17	186
* - stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	118	56	12	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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