

Industrials
 Electrical Equipment
 Equity – India

Underweight

Target price (INR)	510.00
Share price (INR)	864.05
Forecast dividend yield (%)	0.3
Potential return (%)	-40.7

Note: Potential return equals the percentage difference between the current share price and the target price, plus the forecast dividend yield

Performance	1M	3M	12M
Absolute (%)	17.4	42.1	30.2
Relative ^A (%)	8.3	25.9	31.3

Index^A BOMBAY SE IDX

RIC	ABB.BO
Bloomberg	ABB IN
Market cap (USDm)	3,716
Market cap (INRm)	183,099
Enterprise value (INRm)	176,880
Free float (%)	16

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ABB India (ABB.BO)

UW: Recovery remains elusive; valuation premium unjustified

- ▶ **Q4 earnings miss but orders surprise positively; beat driven largely by the booking of old HVDC order**
- ▶ **Margin recovery remains elusive; negative surprises likely to continue as restructuring benefits appear backend loaded**
- ▶ **With further downside risk to earnings, valuation premium unjustified; reiterate UW with a TP of INR510**

Earnings miss but orders surprise positively: ABB reported another set of weak results missing our Q4 EPS estimate by c8% but consensus by c50%. Sales growth of c6% came in line with our expectations and was driven primarily by the Power business, which grew c13%. Industry growth disappointed, as large automation projects failed to materialise. While the total order intake of INR22bn surprised positively, the beat was largely driven by the booking of the 9-month old HVDC order worth INR5.6bn. Management noted that growth in base orders remains healthy but revival in project capex, particularly in the Industrial segment, may take some time. The order backlog was largely in line with our expectations and stood at INR91bn, on the back of which management expects strong (double-digit) sales growth in the next couple of quarters.

Visibility on margin recovery remains low: While margins improved somewhat q-o-q, they once again fell short of expectations. Management attributed weak profitability to lower volumes, high input costs, project delays and poor project mix. We note that ABB India's margins have remained depressed for two years now, more so than any of its competitors, and this may indicate poor project selection. In addition, restructuring benefits seem to be more backend-loaded as they have hardly provided the necessary impetus to the margins in last two years. Hence, while on a long term basis, ABB India may appear to be well placed to benefit from India's growth story, in the near term the outlook certainly remains weak, particularly as expectations of recovery remain too high in spite of estimate downgrades in the last 8 quarters. We currently forecast EBITDA margins to improve to c7.7% in CY12 and c9.1% in CY13; however, if the project mix remains suboptimal, future results may warrant further downgrades.

We trim our CY12/13e EPS by c3%/5%; maintain UW with TP of INR510: As Q4 results came only c8% below our forecasts and the order intake was ahead of our estimates, we are only marginally reducing our CY12/13e earnings. Consequently, we keep our TP of INR510 unchanged and reiterate UW on the stock as we believe ABB will most likely continue to miss expectations in the near term. In addition, the stock remains priced for perfection, trading at c51x CY12e (Dec YE) PE and c35x CY13e PE, factoring in a solid beat to our numbers, which appears unlikely. Hence, we would take profits at current levels. Our target price is derived from our preferred EVA valuation methodology and implies a 12 month forward target PE multiple of c21x on 24 month forward estimated EPS of INR24.5.

Financials & valuation

Financial statements

Year to	12/2011a	12/2012e	12/2013e	12/2014e
Profit & loss summary (INRm)				
Revenue	73,703	84,575	98,568	116,359
EBITDA	3,618	6,517	8,933	11,834
Depreciation & amortisation	-795	-1,015	-988	-960
Operating profit/EBIT	2,822	5,502	7,945	10,874
Net interest	-145	-105	-73	14
PBT	2,677	5,397	7,872	10,888
HSBC PBT	2,677	5,397	7,872	10,888
Taxation	-832	-1,835	-2,676	-3,702
Net profit	1,845	3,562	5,195	7,186
HSBC net profit	1,845	3,562	5,195	7,186

Cash flow summary (INRm)

Year to	12/2011a	12/2012e	12/2013e	12/2014e
Cash flow from operations	2,748	1,676	4,361	5,829
Capex	-5,081	-1,530	-1,030	-830
Cash flow from investment	-5,081	-1,530	-1,030	-830
Dividends	-493	-744	-620	-744
Change in net debt	3,103	598	-2,712	-4,255
FCF equity	-2,332	146	3,331	4,999

Balance sheet summary (INRm)

Year to	12/2011a	12/2012e	12/2013e	12/2014e
Intangible fixed assets	363	271	212	175
Tangible fixed assets	12,160	12,768	12,868	12,775
Current assets	49,600	58,572	70,028	85,403
Cash & others	6,310	5,712	8,424	12,679
Total assets	62,855	72,341	83,840	99,085
Operating liabilities	35,179	41,847	48,770	57,573
Gross debt	0	0	0	0
Net debt	-6,310	-5,712	-8,424	-12,679
Shareholders funds	25,345	28,163	32,739	39,181
Invested capital	35,221	40,790	45,423	51,131

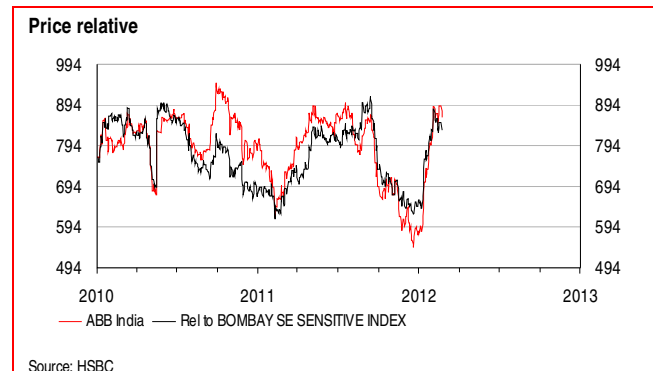
Ratio, growth and per share analysis

Year to	12/2011a	12/2012e	12/2013e	12/2014e
Y-o-y % change				
Revenue	17.2	14.8	16.5	18.0
EBITDA	44.4	80.1	37.1	32.5
Operating profit	41.9	94.9	44.4	36.9
PBT	167.1	101.6	45.9	38.3
HSBC EPS	50.1	93.0	45.9	38.3
Ratios (%)				
Revenue/IC (x)	2.1	2.1	2.2	2.3
ROIC	6.3	9.7	12.4	14.9
ROE	7.3	12.6	15.9	18.3
ROA	3.4	5.3	6.7	7.9
EBITDA margin	4.9	7.7	9.1	10.2
Operating profit margin	3.8	6.5	8.1	9.3
EBITDA/net interest (x)	24.9	62.2	121.9	
Net debt/equity	-24.9	-20.3	-25.7	-32.4
Net debt/EBITDA (x)	-1.7	-0.9	-0.9	-1.1
CF from operations/net debt				
Per share data (INR)				
EPS reported (fully diluted)	8.71	16.81	24.52	33.91
HSBC EPS (fully diluted)	8.71	16.81	24.52	33.91
DPS	3.00	2.50	3.00	3.50
Book value	119.60	132.90	154.49	184.90

Valuation data

Year to	12/2011a	12/2012e	12/2013e	12/2014e
EV/sales	2.4	2.1	1.8	1.5
EV/EBITDA	48.7	27.1	19.5	14.4
EV/IC	5.0	4.3	3.8	3.3
PE*	87.3	51.4	35.2	25.5
P/Book value	6.4	6.5	5.6	4.7
FCF yield (%)	-1.3	0.1	1.8	2.7
Dividend yield (%)	0.3	0.3	0.3	0.4

Note: * = Based on HSBC EPS (fully diluted)



Note: price at close of 22 Feb 2012

Quarterly Results Summary

ABB Standalone - Dec YE (INR m)

	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11a	Q4FY11e	BB Cons Q4FY11e	Act vs. HSBC	Act vs. Cons
Net Sales	20,506	17,813	16,930	17,263	21,696	21,723	22,873	-0.1%	-5.1%
EBITDA	327	1,016	855	666	1,080	1,292	1,485	-16.4%	-27.2%
Profit before tax	156	877	589	371	840	1,044	1,574	-19.5%	-46.6%
Net Income	68	595	387	222	641	697	886	-8.1%	-27.6%
EPS	0.3	2.8	1.8	1.0	3.0	3.3	5.9	-8.1%	-48.7%
Margins & Trend									
Sales growth	9%	22%	17%	29%	6%	6%	12%	-0.1%	-5.7%
EBITDA mgn	1.6%	5.7%	5.0%	3.9%	5.0%	5.9%	6.5%	(97)	(151)
PBT mgn	0.8%	4.9%	3.5%	2.1%	3.9%	4.8%	6.9%	(93)	(301)
NI mgn	0.3%	3.3%	2.3%	1.3%	3.0%	3.2%	3.9%	(26)	(92)

Source: Company data, HSBC estimates, Bloomberg consensus estimates

Segment Information

Segment sales	Q110	Q210	Q310	Q410	Q111	Q211	Q311	Q411
Power Systems	3,825	4,173	3,919	6,350	5,723	5,077	5,462	7,314
Power Products	4,318	4,441	3,992	5,404	4,400	4,688	4,975	5,952
Process Automation	2,866	2,259	2,180	4,582	3,298	2,938	2,781	4,255
Discrete Automation and Motion	3,960	3,649	3,445	4,875	4,174	4,211	4,344	5,271
Low Voltage Products	973	1,034	1,039	1,440	1,297	1,275	1,391	1,449
Unallocated/Intersegment	(1,190)	(925)	(1,086)	(1,930)	(932)	(1,063)	(1,517)	(2,243)
Total	14,752	14,631	13,490	20,720	17,960	17,125	17,435	21,999
Segment sales growth								
Power Systems	-14.5%	-10.1%	2.8%	48.9%	49.6%	21.7%	39.4%	15.2%
Power Products	1.4%	-11.5%	-15.7%	-8.8%	1.9%	5.6%	24.6%	10.1%
Process Automation	14.0%	-27.8%	-16.1%	-2.2%	15.1%	30.1%	27.5%	-7.1%
Discrete Automation and Motion	28.4%	14.7%	-0.4%	12.2%	5.4%	15.4%	26.1%	8.1%
Low Voltage Products	25.6%	25.7%	4.4%	16.8%	33.3%	23.3%	33.8%	0.7%
Total	4.9%	-3.4%	-8.2%	9.0%	21.7%	17.0%	29.2%	6.2%
Segment EBIT								
Power Systems	(485)	(212)	(28)	(381)	17	(35)	23	(14)
Power Products	359	284	(28)	204	214	220	164	399
Process Automation	303	208	(41)	346	217	150	64	(54)
Discrete Automation and Motion	106	461	484	271	509	320	459	779
Low Voltage Products	(7)	(3)	40	(12)	104	125	29	83
Unallocable	(155)	(140)	(175)	(224)	(144)	(125)	(298)	(223)
Total	121	598	253	204	917	656	442	969
Segment EBIT margin								
Power Systems	-12.7%	-5.1%	-0.7%	-6.0%	0.3%	-0.7%	0.4%	-0.2%
Power Products	8.3%	6.4%	-0.7%	3.8%	4.9%	4.7%	3.3%	6.7%
Process Automation	10.6%	9.2%	-1.9%	7.6%	6.6%	5.1%	2.3%	-1.3%
Automation Products	2.7%	12.6%	14.0%	5.6%	12.2%	7.6%	10.6%	14.8%
Low Voltage Products	-0.8%	-0.3%	3.9%	-0.8%	8.0%	9.8%	2.1%	5.7%
Total	0.8%	4.1%	1.9%	1.0%	5.1%	3.8%	2.5%	4.4%

Source: Company reports, HSBC

ABB Ltd - Dec YE (INR m)- Change in forecasts

	CY11	New Forecasts		Old Forecasts		Change in f/cs	
		CY12e	CY13e	CY12e	CY13e	CY12e	CY13e
Order Backlog	91,288	102,758	122,426	101,314	119,377	1.4%	2.6%
Net Sales	73,703	84,575	98,568	84,823	100,287	-0.3%	-1.7%
Clean EBITDA	3,618	6,517	8,933	6,489	9,175	0.4%	-2.6%
Reported EBITDA	3,618	6,517	8,933	6,489	9,175	0.4%	-2.6%
Clean EBIT	2,822	5,502	7,945	5,611	8,313	-2.0%	-4.4%
Reported EBIT	2,822	5,502	7,945	5,611	8,313	-2.0%	-4.4%
Net Financials	(145)	(105)	(73)	(64)	(12)		
Profit before tax	2,677	5,397	7,872	5,548	8,301	-2.7%	-5.2%
Income tax	(832)	(1,835)	(2,676)	(1,886)	(2,822)		
Extraordinary items	0	0	0	0	0		
Minorities	0	0	0	0	0		
Clean Net Income	1,845	3,562	5,195	3,662	5,478	-2.7%	-5.2%
Reported Net Income	1,845	3,562	5,195	3,662	5,478	-2.7%	-5.2%
Clean EPS	8.7	16.8	24.5	17.3	25.9	-2.7%	-5.2%
Reported EPS	8.7	16.8	24.5	17.3	25.9	-2.7%	-5.2%
DPS	3.0	2.5	3.0	2.5	3.0	0.0%	0.0%
Margins & Trend							
	CY11	CY12e	CY13e	CY12e	CY13e	CY12e	CY13e
Sales visibility (yrs)	1.2	1.2	1.2	1.2	1.2	1.7%	4.3%
Sales growth	17%	15%	17%	15%	18%	-0.3%	-1.7%
Clean EBITDA mgn	4.9%	7.7%	9.1%	7.7%	9.1%	0.1%	-0.1%
Reported EBITDA mgn	4.9%	7.7%	9.1%	7.7%	9.1%	0.1%	-0.1%
Clean EBIT mgn	3.8%	6.5%	8.1%	6.6%	8.3%	-0.1%	-0.2%
Reported EBIT mgn	3.8%	6.5%	8.1%	6.6%	8.3%	-0.1%	-0.2%
PBT mgn	3.6%	6.4%	8.0%	6.5%	8.3%	-0.2%	-0.3%
Clean NI mgn	2.5%	4.2%	5.3%	4.3%	5.5%	-0.1%	-0.2%

Source: Company Report, HSBC estimates

Risks and Valuation

Our target price of INR510 is derived from our preferred EVA valuation methodology, assuming a target sales growth of c9%, through-cycle operating return margin of c9.0% and WACC of c11.7% [all unchanged?]. Our target price implies that the stock should be trading at a 12-month forward PE of 21x on 24-month forward EPS of INR24.5.

Under our research model, for stocks without a volatility indicator, the Neutral band is 5 percentage points above and below the hurdle rate for Indian stocks of 11%. Our target price of INR510 implies a potential return of -40.7%, below the Neutral band of our model; therefore, we are reiterating our UW rating on ABB India stock. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated..

Risks

We highlight the key upside risks related to our investment case for ABB below:

- ▶ Significant pick-up in execution
- ▶ Better-than-expected improvement in margins
- ▶ Resurgence of large orders

Disclosure appendix

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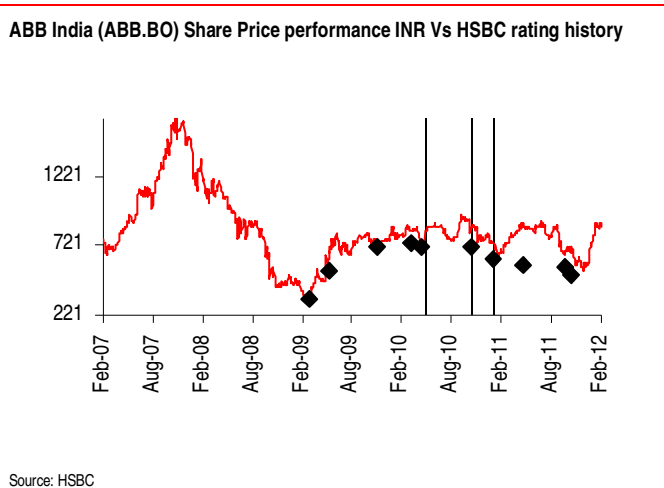
*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However, stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

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Overweight (Buy)	52%	(26% of these provided with Investment Banking Services)
Neutral (Hold)	35%	(22% of these provided with Investment Banking Services)
Underweight (Sell)	13%	(15% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities



Recommendation & price target history

From	To	Date
Underweight (V)	Restricted	17 May 2010
Restricted	Underweight (V)	04 November 2010
Underweight (V)	Underweight	25 January 2011
Target Price	Value	Date
Price 1	335.00	19 March 2009
Price 2	542.00	03 June 2009
Price 3	712.00	26 November 2009
Price 4	736.00	30 March 2010
Price 5	710.00	03 May 2010
Price 6	Restricted	17 May 2010
Price 7	Restricted	28 July 2010
Price 8	710.00	04 November 2010
Price 9	630.00	25 January 2011
Price 10	590.00	15 May 2011
Price 11	570.00	11 October 2011
Price 12	510.00	08 November 2011

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
ABB INDIA	ABB.BO	864.05	22-Feb-2012	11

Source: HSBC

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