## Q4CY11 Result Update

February 28, 2012

ABB is a global provider of power transmission and distribution (T&D) products and automation technologies to utility and industry customers. It is a 75% subsidiary of ABB, the Swiss-Swedish electrical engineering company. Its businesses are divided into five segments: Power products, Power Systems, Discrete Automation and Motion, Low Voltage Products and Process Automation.

ABB reported a decent quarter in terms of order inflows however margins (though improved) remained on the lower side. Orders booked during Q4CY11 have gone up 58.4% y-o-y to Rs 2,209 cr while order backlog stood at 9,128.8 cr (1.2x CY11 Net Sales). Operating margins have gone from 1.6% in Q4CY10 and 3.8% in Q3CY11 to 4.9% in Q4CY11. Net Sales is up 5.8% y-o-y and 25.7% q-o-q to Rs 2,169.9 cr. PAT has gone up almost 10x y-o-y and 3x q-o-q (albeit the low base) to Rs 64.1 cr.

### Key highlights of the results:

| Particulars (Rs cr) | Q4CY11 | Q4CY10 | % chg | Q3CY11 | % chg | CY11 | CY10 | % chg |
|---|---|---|---|---|---|---|---|---|
| Orders booked | 2209.0 | 1394.2 | 58.4% | 2492.6 | -11.4% | 8188.8 | 6349.6 | 29.0% |
| Order backlog | 9128.8 | 8436.2 | 8.2% | 9151.3 | -0.2% | 9128.8 | 8436.2 | 8.2% |
| Net Sales | 2169.6 | 2050.6 | 5.8% | 1726.3 | 25.7% | 7370.3 | 6287.1 | 17.2% |
| Other Operating Income | 30.2 | 21.4 | 41.5% | 17.2 | 75.4% | 78.7 | 72.2 | 9.0% |
| Total Income from operations | 2199.9 | 2072.0 | 6.2% | 1743.5 | 26.2% | 7449.0 | 6359.3 | 17.1% |
| Total Expenditure | 2091.8 | 2039.3 | 2.6% | 1676.9 | 24.7% | 7087.2 | 6203.4 | 14.2% |
| Raw Material | 1535.6 | 1595.3 | -3.7% | 1185.5 | 29.5% | 5158.4 | 4504.1 | 14.5% |
| Traded Goods | 99.7 | 78.2 | 27.5% | 69.8 | 43.0% | 320.2 | 298.1 | 7.4% |
| Employee cost | 154.7 | 126.9 | 21.9% | 160.1 | -3.4% | 586.8 | 490.1 | 19.7% |
| Other expenses | 301.9 | 238.9 | 26.4% | 261.5 | 15.4% | 1021.9 | 911.1 | 12.2% |
| EBIDTA | 108.0 | 32.7 | 230.6% | 66.6 | 62.1% | 361.8 | 156.0 | 131.9% |
| Depreciation | 12.5 | 14.8 | -16.1% | 26.3 | -52.6% | 79.5 | 51.7 | 54.0% |
| EBIT | 95.6 | 17.8 | 435.8% | 40.4 | 136.7% | 282.2 | 104.3 | 170.6% |
| Interest | 12.9 | 4.8 | 166.9% | 7.1 | 81.7% | 30.7 | 17.4 | 76.4% |
| Other Income | 1.4 | 2.6 | -47.9% | 3.8 | -64.2% | 16.2 | 13.3 | 21.6% |
| PBT | 84.0 | 15.6 | 438.9% | 37.1 | 126.8% | 267.7 | 100.2 | 167.1% |
| Tax | 19.9 | 8.81 | 125.9% | 14.9 | 33.6% | 83.2 | 37 | 124.9% |
| PAT | 64.1 | 6.8 | 845.7% | 22.2 | 189.5% | 184.5 | 63.2 | 191.8% |
| Equity | 42.4 | 42.4 | | 42.4 | | 42.4 | 42.4 | |
| Face Value | 2.0 | 2.0 | | 2.0 | | 2.0 | 2.0 | |
| EPS | 3.0 | 0.3 | 8.5 | 1.0 | 1.9 | 8.7 | 3.0 | 1.9 |
| OPM % | 4.9% | 1.6% | 3.3% | 3.8% | | 4.9% | 2.5% | |
| NPM % | 2.9% | 0.3% | | 1.3% | | 2.5% | 1.0% | |
| Tax rate | 23.7% | 56.5% | | 40.2% | | 31.1% | 36.9% | |

- Order inflows for the fourth quarter were up 58.4% y-o-y (led by ~Rs5.6 bn UHVDC transmission line order from the parent (22% of inflows)) and lower by 11.4% q-o-q to Rs 2,209 cr. The present order backlog is 1.2x company's CY11 Net Sales of Rs 7,370.3 cr. Large orders in CY11 include share of Agra-HVDC order (Rs.5.6bn), Isolux (Rs.8bn) and Bhilai Steel (Rs.3bn). Management stated that growth in base orders remains healthy but revival in project capex, particularly in the Industrial segment, could take some time.


(Source: Company, HDFC Sec)

- Net Sales grew by 5.8% y-o-y and 25.7% q-o-q to Rs 2,169.6 cr which is decent considering the degrowth witnessed by the company in the first half of CY11. Sequentially, all segments have registered robust growth with the highest growth coming in from the Process Automation (53%) and Power Systems (33.9%). Other operating income grew 75.4% q-o-q and 41.5% y-o-y to Rs 30.2 cr.

- Operating margins which had fallen to 3.8% in Q3CY11 have risen to 4.9% in Q4CY11 with lower employee cost and other expenses as a percentage cost to sales. Employee costs have come down to 7.1% from 9.3% while other expenses have come down to 13.9% from 15.1% sequentially. Margins have also improved considerably compared to margins in Q4CY10 (1.6%) when ABB was bogged down by higher raw material costs.

| Cost as a % of net sales | Q4CY11 | Q4CY10 | Q3CY11 | CY11 | CY10 |
|---|---|---|---|---|---|
| Raw Material | 70.8% | 77.8% | 68.7% | 70.0% | 71.6% |
| Traded Goods | 4.6% | 3.8% | 4.0% | 4.3% | 4.7% |
| Employee cost | 7.1% | 6.2% | 9.3% | 8.0% | 7.8% |
| Other expenses | 13.9% | 11.7% | 15.1% | 13.9% | 14.5% |

(**Source**: Company, HDFC Sec)

- Depreciation was lower by 16.1% y-o-y and 52.6% q-o-q to Rs 12.5 cr on account of change in accounting policy for amortization of goodwill on acquisition of business. During the quarter, the Company has revised its accounting policy for goodwill arising on acquisition of businesses effective 1st January, 2011, from amortisation to testing for Impairment annually. Management believes this change in accounting policy aligns with leading international practices and reflects enduring benefits to be derived from goodwill arising on acquisitions. Consequent to this change in accounting policy, the profit of the Company is higher by an amount of Rs 816.29 Lakhs for the current quarter as well as for the current year. In quarter ending 30th September, 2011 Rs 165.65 Lakhs was provided for amortisation of Goodwill. Interest costs have gone up substantially during the quarter and stood at Rs 12.9 cr, up from Rs 4.8 cr in Q4CY10 and Rs 7.1 cr in Q3CY11. PAT has gone up nearly 10 times y-o-y and 2 times q-o-q to Rs 64.1 cr albeit the lower base of Rs 6.8 cr in Q4CY10 and Rs 22.2 cr in Q3CY11. Exchange gain during the quarter was Rs 15 cr (Rs 8.5 cr in Q3CY11).

- For the full year 2011, Net Sales was up 17.1% to Rs 7,449 cr over last year. Operating margins improved to 4.9% from 2.5% with overall decline across all expenses. Interest and Depreciation costs were up 76.4% and 54% to Rs 79.5 cr and Rs 30.7 respectively. PAT has gone up significantly to Rs 184.5 cr from Rs 63.2 last year. Exchange gain in CY11 was Rs 25 cr (Loss in CY10 of Rs 94 cr).

- Inventories in CY11 stood at Rs 925.5 cr (Rs 697.8 cr in CY10) which is an increase of 9 days y-o-y to 62 days with ABB projecting to meet delivery obligations for the next two quarters. ABB remains debt free and has cash per share of Rs 62.

- Company has approved acquisition of Baldor Electric, Pune for Rs 33.9 cr which offers mechanical equipments along with motors and machines. This is expected to open new opportunities for ABB in areas like material handling. It has sales of Rs 30 cr in India. Mechanical equipment segment which constitutes 20% of Baldor's business offers products of conveyer systems and gear components. It has now become the wholly owned subsidiary of ABB effective from December 2011.

## Segmental Analysis

ABB's business has undergone a restructuring with the company reporting its results under 5 segments (previously 4 - Power systems, Power products, Process Automation and Automation products), namely, Power systems, Power products, Process Automation, Discrete Automation & Motion and Low voltage products.

## Power Systems:

Power Systems offers turnkey systems and services for power transmission and distribution grids, and for power plants. Substations and substation automation systems are key areas. Additional highlights include flexible alternating current transmission systems (FACTS), high-voltage direct current (HVDC) systems and network management systems. In power generation, Power Systems offers the instrumentation, control and electrification of power plants.

| Power systems | Q4CY11 | Q4CY10 | % chg | Q3CY11 | % chg | CY11 | CY10 | % chg |
|---|---|---|---|---|---|---|---|---|
| Revenue | 731.4 | 635.0 | 15.2% | 546.2 | 33.9% | 2362.4 | 1826.7 | 29.3% |
| PBIT | -1.4 | -38.1 | -96.4% | 2.3 | -158.8% | -83.1 | -110.5 | -24.8% |
| PBIT % | -0.2% | -6.0% | | 0.4% | | -3.5% | -6.0% | |
| Capital employed | 441.7 | 386.2 | 14.4% | 534.3 | -17.3% | 441.7 | 386.2 | 14.4% |

**(Source:** Company, HDFC Sec)

This segment reported growth of 15.2% y-o-y and 33.9% q-o-q in topline to Rs 731.4 cr. At the PBIT level, it again slipped into red in Q4CY11 (loss of Rs 1.4 cr) after reporting improvement in Q3CY11 (profit of Rs 2.3 cr). The segment performance has been affected from CY09 onwards with the company's exit from Rural electrification business. It has pending orders of Rs 25 cr which may get closed in coming few quarters.

## Power Products:

Power Products are the key components to transmit and distribute electricity. The division incorporates ABB's manufacturing network for transformers, switchgear, circuit breakers, cables and associated equipment. It also offers all the services needed to ensure products' performance and extend their lifespan.

| Power products | Q4CY11 | Q4CY10 | % chg | Q3CY11 | % chg | CY11 | CY10 | % chg |
|---|---|---|---|---|---|---|---|---|
| Revenue | 595.2 | 540.4 | 10.1% | 497.5 | 19.6% | 2000.8 | 1815.5 | 10.2% |
| PBIT | 39.9 | 20.4 | 95.7% | 16.5 | 142.6% | 99.8 | 81.9 | 21.9% |
| PBIT % | 6.7% | 3.8% | | 3.3% | | 5.0% | 4.5% | |
| Capital employed | 679.3 | 584.9 | 16.1% | 790.5 | -14.1% | 679.3 | 584.9 | 16.1% |

(**Source:** Company, HDFC Sec)

This segment posted a decent top-line growth of 10.1% y-o-y and 19.6% q-o-q to Rs 595.2 cr. PBIT margins have improved to 6.7% from 3.8% in Q4CY10 and 3.3% in Q3CY11. Severe competition in the T&D segment from domestic as well as Chinese and Korean players (esp. in switchgears) seems to be impacting ABB's power segment margins. Increasing number of utilities prefer to buy on turnkey basis from EPC contractors. Other than that, excess capacity for certain products have affected the price levels and in some cases clients have deferred taking deliveries of products.

## Process Automation:

ABB's Process Automation division delivers integrated automation solutions for control, plant optimization, and industry-specific application knowledge and services to help process industry customers worldwide improve their energy efficiency and meet their critical business needs in the areas of operational profitability, capital productivity, risk management and global responsibility. These industries include oil and gas, power, chemicals and pharmaceuticals, pulp and paper, metals, minerals, cement, marine and turbo charging. Key customer benefits include improved asset productivity and energy savings.

| Process Automation | Q4CY11 | Q4CY10 | % chg | Q3CY11 | % chg | CY11 | CY10 | % chg |
|---|---|---|---|---|---|---|---|---|
| Revenue | 425.5 | 458.2 | -7.1% | 278.1 | 53.0% | 1321.9 | 1188.7 | 11.2% |
| PBIT | -5.4 | 34.6 | -115.5% | 6.4 | -183.6% | 37.7 | 81.6 | -53.8% |
| PBIT % | -1.3% | 7.6% | | 2.3% | | 2.9% | 6.9% | |
| Capital employed | 360.4 | 295.8 | 21.8% | 397.6 | -9.4% | 360.4 | 295.9 | 21.8% |

(**Source:** Company, HDFC Sec)

Process automation segment recorded revenue of Rs 425.5 cr, down 7.1% y-o-y and up 53% q-o-q. PBIT loss stood at Rs 5.4 cr in Q4CY11 compared to PBIT profit of Rs 34.6 cr in Q4CY10 and profit of Rs 6.4 cr in Q3CY11. Customers are splitting the packages into smaller group of products limiting the opportunities for the segment in terms of volume and margin. Also, management indicated weak demand and high input costs as reasons for the decline. New project investments have been held back by customers as major industry segments continue to operate with a capacity surplus.

## Discrete Automation & Motion:

This division provides products, solutions and related services that increase industrial productivity and energy efficiency. Its motors, generators, drives, programmable logic controllers (PLCs), power electronics and robotics provide power, motion and control for a wide range of automation applications. The drives market in India is ~ 1500 cr in which ABB has a market share of more than 30%. Motor market is about Rs 3000 cr in which the company has a market share of ~20%.

| Discrete Automation& Motion | Q4CY11 | Q4CY10 | % chg | Q3CY11 | % chg | CY11 | CY10 | % chg |
|---|---|---|---|---|---|---|---|---|
| Revenue | 527.1 | 487.5 | 8.1% | 434.4 | 21.4% | 1799.3 | 1592.9 | 13.0% |
| PBIT | 77.9 | 27.1 | 187.4% | 45.9 | 69.7% | 206.6 | 132.1 | 56.4% |
| PBIT % | 14.8% | 5.6% | | 10.6% | | 11.5% | 8.3% | |
| Capital employed | 208.4 | 284.4 | -26.7% | 284.4 | -26.7% | 208.4 | 200.5 | 3.9% |

(**Source:** Company, HDFC Sec)

Revenues were up 8.1% y-o-y and 21.4% q-o-q to Rs 527.1. PBIT margins have gone up to 14.8% in Q4CY11 compared to 5.6% in Q4CY10 and 10.6% in Q3CY11.

## Low Voltage Products:

The low voltage products division manufacturers low voltage circuit breakers, switches, control products, wiring accessories, enclosures and cable systems to protect people, installations and electronic equipment from electrical overload. The division further makes KNX systems that integrate and automate a building's electrical installations, ventilation systems and security and data communication networks.

| Low Voltage Products | Q4CY11 | Q4CY10 | % chg | Q3CY11 | % chg | CY11 | CY10 | % chg |
|---|---|---|---|---|---|---|---|---|
| Revenue | 144.9 | 144.0 | 0.7% | 139.1 | 4.2% | 539.9 | 448.6 | 20.4% |
| PBIT | 8.3 | -1.2 | -788.3% | 2.9 | 184.8% | 34.1 | 1.8 | 1786.2% |
| PBIT % | 5.7% | -0.8% | | 2.1% | | 6.3% | 0.4% | |
| Capital employed | 201.4 | 125.7 | 60.2% | 210.3 | -4.2% | 201.4 | 125.7 | 60.2% |

**(Source:** Company, HDFC Sec)

The low voltage segment posted growth of 4.2% q-o-q and almost flattish y-o-y to Rs 144.9 cr. PBIT improved to Rs 8.3 cr from Rs 2.9 in Q3CY11 and a loss of Rs 1.2 cr in Q4CY10.

## Concerns

- Slowdown in industrial capex may put a dampener on company's growth in revenues and order book
- Volatility in raw material costs and execution delays impact operating margins adversely
- Execution risk
- Increasing competition from local & foreign players.
- Potential delay in power sector reforms/capex
- Exchange rate volatility risk

## Conclusion

ABB, the parent is a worldwide leader in power transmission and distribution and process automation space. ABB India is 75% subsidiary of ABB with focus on power T&D and automation space. Given that India's power capex is spread out and a multi-year theme, ABB is likely to sustain through in the long run with its strong balance sheet and technological leadership.

At present, the power theme is off-track with delays and postponements due to high cost of capital, inflation pressures, uncertain macro environment and competition pressures. ABB has to also to deal with prequalification norms relaxation by PGCIL to allow non-equipment manufacturers to participate in turnkey substation jobs. The competition in the T&D space is intensifying and hence it is a difficult operating environment for the company. Several EPC contractors have entered the T&D space and they are pulling down the prices. Chinese competition is continuing.

For CY11, ABB has reported some revival in revenues, profits and order inflows though low margins remain a concern. Over last year Net Sales were up 17.2% to Rs 7,370.3 cr, PAT more than doubled to Rs 184.5 cr (over a low base) while order inflows have gone up 29% to Rs 8,188.8 cr. Present Order backlog is 1.2x CY11 Net Sales. Operating margins have improved to 4.9% from 2.5% last year, staying however on the lower side. ABB's historical margins of 8-10% seem to be an uphill task for the company in the present scenario and may take some to achieve.

We are maintaining our CY12 estimates and expect margins to be at the lower end with weak profitability on orders booked in a difficult environment though the situation/performance could improve in second half of CY12. Margin recovery is the key which given the intensified competition, increasing pricing pressure and rising input costs is getting difficult for the company to attain at present. Order book of the company is healthy but the order mix is likely to keep margins on the lower side. With only Rs 25 cr of pending Rural electrification orders, its negative impact on margins is expected to subside in the coming quarters.

In our Q3CY11 Result Update dated November 14, 2011 we had stated that the stock could trade in the Rs 593 – Rs 745 (43x-54x CY12E EPS) band for the next quarter. Post the issue of the report, the stock made a low of Rs 541.1 on 20$^{th}$ December 2011 and a high of Rs 915 on 17$^{th}$ February 2012.

Most capital goods stocks, including some of ABB's closest peers, are trading at significant discount to their historical average PE band. Historical buyback price of Rs 900 and expectation of delisting is providing support to the stock price. We think that the stock could trade in the Rs 676 – Rs 856 (49x-62x CY12E EPS) band for the next quarter. The high P/E multiple are a factor of i) in anticipation of corporate action by the parent (buyback, delisting etc) ii) low floating stock iii) street discounting CY12 and CY13 numbers which it feels can be a great improvement over CY11 numbers.

## Financials

| Particulars (Rs in cr) | CY09 | CY10 | CY11 (E) | CY11(A) | CY12 (E) |
|---|---|---|---|---|---|
| Sales | 6237.2 | 6359.3 | 7758.3 | 7449.0 | 8611.3 |
| EBIDTA | 583 | 156 | 387.9 | 361.8 | 533.9 |
| EBIDTA (%) | 9.3% | 2.5% | 5.0% | 4.9% | 6.2% |
| PAT | 354.6 | 63.2 | 186.9 | 184.5 | 292.1 |
| PAT (%) | 5.7% | 1.0% | 2.4% | 2.5% | 3.4% |
| EPS | 16.7 | 3 | 8.8 | 8.7 | 13.8 |
| PE | 50.0 | 278.1 | 94.8 | 95.9 | 60.4 |

(*Quick Estimates, A-Actual, Source**:** Company, HDFC Sec)

Analyst: Siji A. Philip – Capital Goods, Power & Mid Caps
Email: siji.philip@hdfcsec.com

**RETAIL RESEARCH Tel: (022) 3075 3400 Fax: (022) 3075 3450**
**Corporate Office**
HDFC Securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066 Website: www.hdfcsec.com
Email: hdfcsecretailresearch@hdfcsec.com