



Q3CY11 Result Update

November 14, 2011

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.

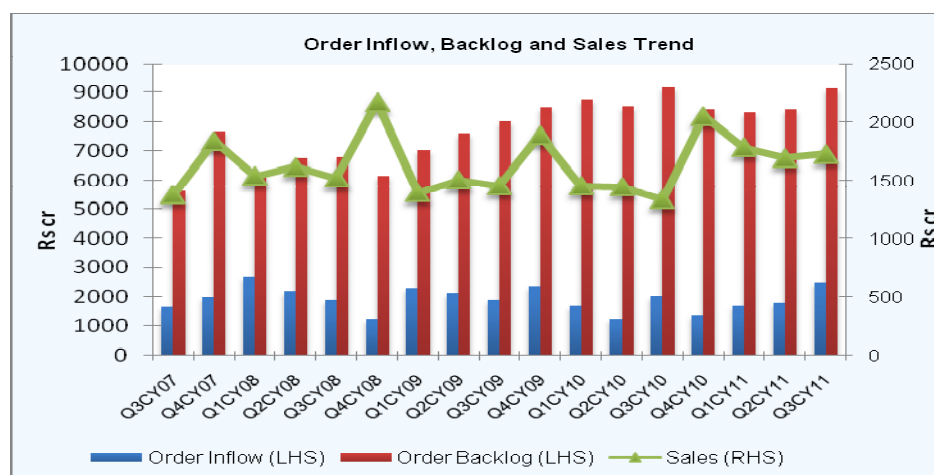
ABB reported yet another disappointing quarter in terms of operating margins which stood at 3.8% compared to 5% and 5.7% in the previous two quarters of the calendar year. However, there has been significant improvement in Net Sales by 29.4% to Rs 1,726.3 cr and in PAT by 92.4% to Rs 22.2 cr over corresponding quarter last year (albeit on a low base). Order inflows have grown by 22.7% y-o-y and 39.1% q-o-q to 2,493 cr. Order backlog stood at Rs 9,151 cr.

Key highlights of the results:

Particulars (Rs cr)	Q3CY11	Q3CY10	% chg	Q2CY11	% chg	9MCY11	9MCY10	% chg
Orders booked	2493	2032	22.7%	1792	39.1%	5980	4955	20.7%
Orders backlog	9151	9178	-0.3%	8415	8.7%	9151	9178	-0.3%
Net Sales	1726.3	1334.0	29.4%	1693.0	2.0%	5200.6	4236.5	22.8%
Other Operating Income	17.2	15.0	15.2%	19.5	-11.5%	48.5	50.8	-4.7%
Total Income from operations	1743.5	1349.0	29.2%	1712.5	1.8%	5249.1	4287.3	22.4%
Total Expenditure	1676.9	1314.5	27.6%	1627.0	3.1%	4995.3	4164.0	20.0%
Raw Material	1185.5	929.4	27.5%	1160.0	2.2%	3622.8	2908.7	24.5%
Traded Goods	69.8	81.2	-14.1%	71.9	-3.0%	220.5	219.9	0.3%
Employee cost	160.1	122.9	30.3%	146.7	9.1%	432.2	363.2	19.0%
Other expenses	261.5	181.1	44.4%	248.4	5.3%	719.9	672.2	7.1%
EBIDTA	66.6	34.5	93.3%	85.5	-22.1%	253.8	123.3	105.8%
Depreciation	26.3	12.6	108.7%	26.4	-0.7%	67.1	36.8	82.2%
EBIT	40.4	21.9	84.4%	59.1	-31.6%	186.7	86.5	115.8%
Interest	7.1	4.5	58.0%	6.7	6.9%	17.8	12.6	41.4%
Other Income	3.8	3.4	10.9%	6.5	-42.1%	14.8	10.7	38.3%
PBT	37.1	20.8	78.1%	58.9	-37.1%	183.7	84.7	117.1%
Tax	14.9	9.3	60.4%	20.2	-26.2%	63.3	28.2	124.5%
PAT	22.2	11.5	92.4%	38.7	-42.8%	120.4	56.5	113.3%
Equity	42.4	42.4		42.4		42.4	42.4	
Face Value	2	2		2		2	2	
EPS	1.0	0.5		1.8		5.7	2.7	
OPM %	3.8%	2.6%		5.0%		4.8%	2.9%	
NPM %	1.3%	0.9%		2.3%		2.3%	1.3%	

(Source: Company, HDFC Sec)

- Order inflows for the third quarter recorded a 22.7% growth y-o-y and 39.1% q-o-q to Rs 2,493 cr. These include Rs 820 cr from Isolux and Rs 330 cr for a high voltage substation package from Bhilai steel plant which helped register higher growth in order inflows. Base orders witnessed double digit growth during the quarter. ABB's order backlog remained stagnant y-o-y but registered a 8.7% growth sequentially to Rs 9,151 cr. ABB has yet to book the HVDC Agra order from PGCIL amounting to ~Rs 580 cr and is awaiting financial closure for the same which may happen in Q4CY11. The present order backlog is 1.3x company's trailing twelve months revenues of Rs 7,251.3 cr.



(Source: Company, HDFC Sec)

- Net Sales grew by 29.4% y-o-y and 2% q-o-q to Rs 1,726.3 cr which is steady considering the degrowth witnessed by the company in the previous quarters of CY11. All segments have registered more than 20% y-o-y increase in their top-line with the highest growth coming in from the Power Systems (39.4%) and Low voltage products (33.8%). Other operating income grew 15.2% y-o-y but fell 11.5% q-o-q to Rs 17.2 cr.
- OPMs which were expected to improve from 5% in Q2CY11 and 5.7% in Q1CY11 have further dipped to 3.8% in Q3CY11 mainly due to pricing pressures, exit cost from rural electrification and execution of low margin orders in the Low Voltage segment. Sequentially, employee costs have risen from 8.7% in Q2CY11 and 7% in Q1CY11 to 9.3% in Q3CY11 as a percentage cost to sales. Management expects employee cost to stabilize at 9% cost to sales. The operating margins over last year have however improved from 2.6%, an increase of 130 bps with less pressure on margins from traded goods as percentage cost to sales despite lower other operating income. Expenses in Q3CY11 include onetime stamp duties related expenses of Rs 24 cr.

Cost as a % of net sales	Q3CY11	Q3CY10	Q2CY11	9MCY11	9MCY10
Raw Material	68.7%	69.7%	68.5%	69.7%	68.7%
Traded Goods	4.0%	6.1%	4.2%	4.2%	5.2%
Employee cost	9.3%	9.2%	8.7%	8.3%	8.6%
Other expenses	15.1%	13.6%	14.7%	13.8%	15.9%

(Source: Company, HDFC Sec)

- Depreciation has more than doubled to Rs 26.3 cr, up from Rs 12.6 cr y-o-y owing to the Rs 300 cr capex executed by the company in the current year. Sequentially depreciation was almost flat. Interest costs were up 58% y-o-y and 6.9% q-o-q to Rs 7.1 cr. All segments are back in the black though Discrete Motion and Low Voltage Products witnessed some de-growth in profits. PAT was up 92.4% y-o-y but down 42.8% q-o-q to Rs 22.2cr (tax rate has gone up sequentially from 34.3% to 40.2%). Exchange gain during the quarter was Rs 8.5 cr vs loss of Rs 47.8 cr in Q3CY10.
- For the nine months ended half ended CY11, Net Sales was up 22.8% to Rs 5,200.6 cr over last year. Operating margins stood at 4.8% up from 2.9% last year with lower other expenses and traded goods as percentage cost to sales. As a result, PAT has more than doubled to Rs 120.4 cr from Rs 56.5 cr last year.
- Company has approved acquisition of Baldor Electric, Pune for Rs 35.7 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.
- Considering the demand environment across sectors, the power generation side has witnessed slowdown on account of fuel linkages, land acquisitions, funding etc. On the T&D side, a large number of tenders are expected from PGCIL and States. The Metro Rail Project is expected to provide demand in the Infrastructure segment. Across the Industry segment, demand is expected from cement and metals sectors once investments pick up since utilization levels have dipped below 80%. The textile sector is being helped by weaker rupee while there has been a pickup in the petrochemical space. Renewable, especially solar have shown good traction with policy push from the government.

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 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:

Power systems (Rs cr)	Q3CY11	Q3CY10	% chg	Q2CY11	% chg q-o-q	9MCY11	9MCY10	% chg
Revenue	546.2	391.9	39.4%	507.7	7.6%	1631.0	11191.7	-85.4%
PBIT	2.3	-2.8	-184.7%	-3.5	-166.6%	0.5	-72.4	-100.7%
PBIT %	0.4%	-0.7%		-0.7%		0.0%	-0.6%	
Capital employed	534.3	530.8	0.7%	466.4	14.6%	534.3	530.8	0.7%

(Source: Company, HDFC Sec)

This segment reported growth of 39.4% y-o-y and 7.6% q-o-q in top-line to Rs 546.2 cr. This division houses the Rs 506 cr Bangalore Metro Rail Project. At the PBIT level the segment was back in the black and posted a profit of Rs 2.3 cr against a loss of Rs 2.8 cr and Rs 3.5 cr posted in Q3CY10 and Q2CY11 respectively. The segment performance has been affected from CY09 onwards with the company's exit from Rural electrification business. It had pending rural orders of Rs 31 cr at the end of Q3CY11 which may get closed by Q1CY12.

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.

Particulars (Rs cr)	Q3CY11	Q3CY10	% chg	Q2CY11	% chg	9MCY11	9MCY10	% chg
Revenue	497.5	399.2	24.6%	468.8	6.1%	1405.6	1275.1	10.2%
PBIT	16.5	-2.9	NC	22.0	-25.3%	59.9	61.5	-2.5%
PBIT %	3.3%	-0.7%		4.7%		4.3%	4.8%	
Capital employed	790.5	645.9	22.4%	741.6	6.6%	790.5	645.9	22.4%

(Source: Company, HDFC Sec)

This segment posted a decent top-line growth of 24.6% y-o-y and 6.1% q-o-q to Rs 497.5 cr. PBIT margins have improved over last year and stood at 3.3% while sequentially it has come down 140 bps from 4.7% in Q2CY11. 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.

Particulars (Rs cr)	Q3CY11	Q3CY10	% chg	Q2CY11	% chg	9MCY11	9MCY10	% chg
Revenue	278.1	218.0	27.5%	293.8	-5.4%	896.4	730.5	22.7%
PBIT	6.4	-4.1	-258.3%	15.0	-57.1%	43.1	47.0	-8.4%
PBIT %	2.3%	-1.9%		5.1%		4.8%	6.4%	
Capital employed	397.6	302.4	31.5%	369.6	7.6%	397.6	302.4	31.5%

(Source: Company, HDFC Sec)

Process automation segment recorded revenues of Rs 278.1 cr, up 27.5% y-o-y and down 5.4% q-o-q. PBIT improved to Rs 6.4 cr from a loss of Rs 4.1 cr in corresponding quarter last year. Sequentially, profits have come down from Rs 15 cr posted in Q2CY11 on lower margins. Customers are splitting the packages into smaller group of products limiting the opportunities for the segment in terms of volume and margin.

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%.

Particulars (Rs cr)	Q3CY11	Q3CY10	% chg	Q2CY11	% chg	9MCY11	9MCY10	% chg
Revenue	434.4	344.5	26.1%	421.1	3.1%	1272.2	1105.4	15.1%
PBIT	45.9	48.4	-5.1%	32.0	43.2%	128.8	105.0	22.6%
PBIT %	10.6%	14.0%		7.6%		10.1%	9.5%	
Capital employed	284.4	200.4	41.9%	236.3	20.3%	284.4	200.4	41.9%

(Source: Company, HDFC Sec)

Revenues were up 26.1% y-o-y and 3.1% q-o-q to Rs 434.4 cr. PBIT margins have deteriorated to 10.6% from 14% in Q3CY10 but have improved from 7.6% posted in Q2CY11.

Low Voltage Products:

The low voltage products division manufactures 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.

Particulars (Rs cr)	Q3CY11	Q3CY10	% chg	Q2CY11	% chg	9MCY11	9MCY10	% chg
Revenue	139.1	103.9	33.8%	127.5	9.1%	394.9	304.6	29.7%
PBIT	2.9	4.0	-28.0%	12.6	-76.9%	25.9	3.0	759.8%
PBIT %	2.1%	3.9%		9.8%		6.6%	1.0%	
Capital employed	210.3	135.4	55.4%	150.0	40.2%	210.3	135.4	55.4%

(Source: Company, HDFC Sec)

Retail Research

The low voltage segment posted a 33.8% y-o-y and 9.1% q-o-q increase in its revenues. Margins have taken a hit with an erosion of 180 bps y-o-y and 780 bps q-o-q to 2.1% in Q3CY11. PBIT stood at Rs 2.9 crs, a drop of 28% over Q3CY10 and 76.9% over Q2CY11.

Concerns

- Slowdown in industrial capex may put a dampener on company growth
- 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 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.

ABB had shown a good revival at the beginning of the calendar year but couldn't follow through with a better performance in the subsequent quarters in CY11. Decline in operating margins sequentially is a major concern though the trend in Sales and Profits offer some respite. Another key positive has been the revival in order inflows to Rs 2,493 cr but this could be due to one off orders booked in the quarter. 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. Its order backlog at 1.3x trailing twelve month's sales has also become another stalemate for the company.

We are downward revising our CY11 estimates with lower operating margins and higher fixed costs given the weak operational performance in Q3CY11 while we expect ABB to post better sales growth in CY11. For CY12 we expect sales growth of 11% and slightly better operating margins of 6% with subsequent improvement expected in the coming years. 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 low visibility on margins in current order book put a dampener on the order growth of 23%.

In our Q3CY11 Result Update dated August 11, 2011 we had stated that the stock could trade in the Rs 731 – Rs 844 (58x-67x CY11E EPS) band for the next quarter. Post the issue of the report, the stock made a low of Rs 657 on 12th October 2011 and a high of Rs 879.8 on 15th September 2011.

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 593 – Rs 745 (43x-54x 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 (OE)	CY11 (RE)	CY12 (E)
Sales	6237.2	6359.3	7504.0	7758.3	8611.3
EBIDTA	583	156	450.2	387.9	533.9
EBIDTA (%)	9.3%	2.5%	6.0%	5.0%	6.2%
PAT	354.6	63.2	267.2	186.9	292.1
PAT (%)	5.7%	1.0%	3.6%	2.4%	3.4%
EPS	16.7	3	12.6	8.8	13.8
PE	41.7	234.2	55.4	79.2	50.7

(*Quick Estimates, RE-Revised Estimates, OE – Original estimate; Source: Company, HDFC Sec)



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