

ABB

ENGINEERING

HOLD

Target Price: Rs 1,400

Strong order inflow, outlook; in line Q1

ABB's Q1CY17 order inflow at Rs 23 bn increased 28% YoY, which was significantly better than estimate. Growth was broad-based: 5-fold rise in large orders (on a low base), short cycle base orders (up 17%), services (up 40%) and exports (up 120%). Order backlog at Rs 120 bn was up 54% YoY and 2% QoQ.

Revenue at Rs 22 bn (up 8% YoY) was in line with our/consensus expectations. **EBITDA margin** declined 80 bps YoY and missed estimate **impacted by expected credit loss (ECL) on transition to Ind AS** (our est. impact of ~200bps). ECL provisioning is expected to normalize over next few quarters. PAT at Rs 880 mn was slightly above our estimate on higher other income.

CMP : Rs 1,538
Potential Upside : -9%

MARKET DATA

No. of Shares : 212 mn
Free Float : 25%
Market Cap : Rs 326 bn
52-week High / Low : Rs 1,595 / Rs 950
Avg. Daily vol. (6mth) : 87,786 shares
Bloomberg Code : ABB IB Equity
Promoters Holding : 75%
FII / DII : 4% / 13%

Outlook positive: Management expects future growth to be driven by increased investments in domestic sectors such as T&D, renewables, railways, and Industrial automation, as well as rebound in exports.

Management optimism stems from increased investments in government sectors such as T&D, Railways and PSU Refiners. It also highlighted first signs of pick-up in private capex driven by Cement sector and continued traction in Renewables. However, it cautioned on pricing pressures in Renewables on falling tariffs which it plans to offset through higher volumes and cost rationalization.

Cutestimates, maintain TP; downgrade to HOLD on stock price appreciation: We cut our CY17 EPS to Rs 25 (Rs 26 earlier) and CY18 EPS to Rs 35 (Rs 40 earlier) to adjust for expected credit loss impact and increasing competitive pressure in renewables equipment market. However, we raise our target multiple to 40x (vs 35x earlier) to account for strong order inflow and improved outlook for T&D markets and private capex. Our TP stands at Rs 1,400 (40x CY18E).

Financial summary (Standalone)

| Y/E December | CY15 | CY16 | CY17E | CY18E |
|---------------------|--------|--------|--------|---------|
| Sales (Rs mn) | 80,152 | 85,156 | 95,828 | 115,472 |
| EBITDA (Rs mn) | 7,192 | 7,466 | 9,108 | 11,728 |
| Adj PAT (Rs mn) | 3,066 | 3,567 | 5,239 | 7,414 |
| Consensus EPS* (Rs) | - | - | 23.6 | 29.3 |
| EPS (Rs) | 14.5 | 16.8 | 24.7 | 35.0 |
| Change YoY (%) | 33.9 | 16.4 | 46.8 | 41.5 |
| P/E (x) | 106.3 | 91.3 | 62.2 | 44.0 |
| RoE (%) | 10.5 | 11.3 | 15.2 | 19.1 |
| EV/E (x) | 45.3 | 42.8 | 34.8 | 26.8 |
| DPS (Rs) | 4.5 | 4.8 | 8.2 | 11.7 |

Source: *Consensus broker estimates, Company, Axis Capital

Key drivers

| (Rs bn) | CY16 | CY17E | CY18E |
|---------------|------|-------|-------|
| Order Inflow | 125 | 101 | 117 |
| Order Backlog | 118 | 122 | 122 |
| Margin (%) | 8.6 | 9.4 | 10.0 |

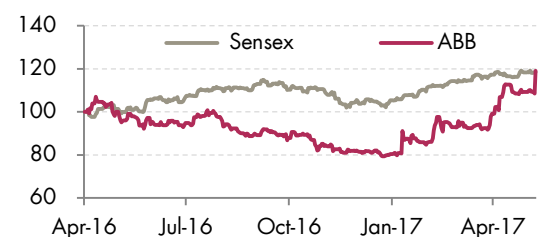
Price performance


Exhibit 1: Results update(Rs mn)

| | Quarter ended | | | | | 12 months ended | | |
|-------------------------------|---------------|---------------|------------|---------------|---------------|-----------------|---------------|-------------|
| | Mar-17 | Mar-16 | % Chg | Dec-16 | % Chg | CY17E | CY16 | % Chg |
| Total Income | 21,688 | 20,035 | 8.3 | 24,939 | (13.0) | 97,316 | 86,484 | 12.5 |
| EBITDA | 1,714 | 1,737 | (1.3) | 3,017 | (43.2) | 9,108 | 7,467 | 22.0 |
| Other income | 186 | 149 | 24.3 | 97 | 91.8 | 700 | 353 | 98.5 |
| PBIDT | 1,900 | 1,887 | 0.7 | 3,113 | (39.0) | 9,808 | 7,819 | 25.4 |
| Depreciation | 376 | 359 | 4.9 | 389 | (3.2) | 1,574 | 1,510 | 4.2 |
| Interest | 212 | 223 | (5.0) | 303 | (30.1) | 750 | 849 | (11.7) |
| PBT | 1,312 | 1,305 | 0.5 | 2,422 | (45.8) | 7,484 | 5,461 | 37.1 |
| Tax | 430 | 442 | (2.7) | 835 | (48.5) | 2,245 | 1,893 | 18.6 |
| Adjusted PAT | 882 | 863 | 2.2 | 1,587 | (44.4) | 5,239 | 3,568 | 46.8 |
| No. of shares (mn) | 212 | 212 | - | 212 | - | 212 | 212 | - |
| EBITDA margins (%) | 7.9 | 8.7 | - | 12.1 | - | 9.4 | 8.6 | - |
| PBIDT margins (%) | 8.8 | 9.4 | - | 12.5 | - | 10.1 | 9.0 | - |
| EPS - annualized (Rs.) | 16.6 | 16.3 | 2.2 | 29.9 | (44.4) | 24.7 | 16.8 | 46.8 |

Source: Company, Axis Capital

ABB's earnings have turned around, well ahead of peers – driven by renewables

- ◆ Earnings have posted CAGR of 25% over CY13-16, driven by closure of loss-making rural electrification jobs and exponential growth in renewables
- ◆ Renewables now constitute ~ 16% of sales and have grown 4-fold in the last 4 years. Within renewables, ABB addresses the most profitable value chain in both solar and wind. In Solar, ABB is market leader in Invertors (50% market share) and in wind it is leader in generators (>35% mkt share)
- ◆ Additionally, concentration on renewables helps in pushing its bread and butter products in T&D segment

New sectors like renewables, railways, industrial automation/ digitization, smart cities, etc. to take a lead over the conventional sectors in driving growth

- ◆ **Railways:** Now expanded the product portfolio, almost similar to Siemens. Product portfolio for locomotives include: turbochargers, transformers, convertors, etc. Besides this, ABB is present in signaling and has tied-up with GE and ALSTOM for component supplies to its diesel and electric locomotive space. Management commented that share of railways in the order inflow has increased to 5% (vs. 2% earlier)
- ◆ **Industrial automation** is usually first to turn around in the private capex cycle, as companies initially spend to cut energy and employee costs. ABB is also one of the leading manufacturers of industrial robots
- ◆ Management highlighted **transformation in energy** (smart grids, micro grids, remote monitoring, renewable energy storage), **robotics and digitization** (Industry 4.0), **transportation and infrastructure** (railways, metro, EV charging, electrical propulsion) as the key areas of future growth for the company

Geared for growth acceleration by right-sizing itself

- ◆ As the company waits for volumes in conventional sector to revive, it has lowered raw material cost to 65% of revenue from 77% historically
- ◆ Strong focus on exports (~16% of revenue vs. 8% in CY10). Company expects **significant growth in exports as ABB India is acting as the feeder factory** and has started export of new product lines in CY16

Financial summary (Standalone)

Profit & loss (Rs mn)

| Y/E December | CY15 | CY16 | CY17E | CY18E |
|-------------------------------|---------------|---------------|---------------|----------------|
| Net sales | 80,152 | 85,156 | 95,828 | 115,472 |
| Other operating income | 1,251 | 1,328 | 1,487 | 1,666 |
| Total operating income | 81,403 | 86,484 | 97,316 | 117,138 |
| Cost of goods sold | (53,646) | (56,897) | (64,086) | (77,869) |
| Gross profit | 27,757 | 29,587 | 33,230 | 39,270 |
| <i>Gross margin (%)</i> | <i>34.6</i> | <i>34.7</i> | <i>34.7</i> | <i>34.0</i> |
| Total operating expenses | (20,565) | (22,121) | (24,122) | (27,541) |
| EBITDA | 7,192 | 7,466 | 9,108 | 11,728 |
| <i>EBITDA margin (%)</i> | <i>9.0</i> | <i>8.8</i> | <i>9.5</i> | <i>10.2</i> |
| Depreciation | (1,598) | (1,510) | (1,574) | (1,737) |
| EBIT | 5,594 | 5,957 | 7,534 | 9,991 |
| Net interest | (912) | (849) | (750) | (200) |
| Other income | 130 | 353 | 700 | 800 |
| Profit before tax | 4,813 | 5,460 | 7,484 | 10,591 |
| Total taxation | (1,747) | (1,893) | (2,245) | (3,177) |
| <i>Tax rate (%)</i> | <i>36.3</i> | <i>34.7</i> | <i>30.0</i> | <i>30.0</i> |
| Profit after tax | 3,066 | 3,567 | 5,239 | 7,414 |
| Minorities | - | - | - | - |
| Profit/ Loss associate co(s) | - | - | - | - |
| Adjusted net profit | 3,066 | 3,567 | 5,239 | 7,414 |
| <i>Adj. PAT margin (%)</i> | <i>3.8</i> | <i>4.2</i> | <i>5.5</i> | <i>6.4</i> |
| Net non-recurring items | (67) | 195 | - | - |
| Reported net profit | 2,999 | 3,762 | 5,239 | 7,414 |

Balance sheet (Rs mn)

| Y/E December | CY15 | CY16 | CY17E | CY18E |
|-------------------------------|---------------|---------------|---------------|---------------|
| Paid-up capital | 424 | 424 | 424 | 424 |
| Reserves & surplus | 29,662 | 32,404 | 35,903 | 40,831 |
| Net worth | 30,086 | 32,828 | 36,327 | 41,255 |
| Borrowing | 6,000 | 6,000 | 6,000 | - |
| Other non-current liabilities | - | - | - | - |
| Total liabilities | 36,086 | 38,828 | 42,327 | 41,255 |
| Gross fixed assets | 20,267 | 21,142 | 23,819 | 25,819 |
| Less: Depreciation | (7,283) | (8,592) | (10,166) | (11,903) |
| Net fixed assets | 12,984 | 12,549 | 13,653 | 13,916 |
| Add: Capital WIP | 443 | 678 | - | - |
| Total fixed assets | 13,427 | 13,227 | 13,653 | 13,916 |
| Total Investment | 164 | 163 | 163 | 163 |
| Inventory | 9,396 | 9,403 | 10,502 | 12,655 |
| Debtors | 33,909 | 30,633 | 32,537 | 37,650 |
| Cash & bank | 5,736 | 11,892 | 14,394 | 11,225 |
| Loans & advances | 7,003 | 7,114 | 7,876 | 9,491 |
| Current liabilities | 38,003 | 38,461 | 41,783 | 49,690 |
| Net current assets | 22,005 | 24,655 | 27,727 | 26,392 |
| Other non-current assets | 490 | 784 | 784 | 784 |
| Total assets | 36,086 | 38,828 | 42,327 | 41,255 |

Source: Company, Axis Capital

Cash flow (Rs mn)

| Y/E December | CY15 | CY16 | CY17E | CY18E |
|----------------------------------|----------------|----------------|----------------|----------------|
| Profit before tax | 4,813 | 5,460 | 7,484 | 10,591 |
| Depreciation & Amortisation | 1,598 | 1,510 | 1,574 | 1,737 |
| <i>Chg in working capital</i> | <i>(1,330)</i> | <i>3,506</i> | <i>(570)</i> | <i>(1,834)</i> |
| Cash flow from operations | 4,178 | 9,627 | 6,993 | 7,517 |
| <i>Capital expenditure</i> | <i>(672)</i> | <i>(1,109)</i> | <i>(2,000)</i> | <i>(2,000)</i> |
| Cash flow from investing | (1,583) | (1,958) | (2,750) | (2,200) |
| <i>Equity raised/ (repaid)</i> | - | - | - | - |
| <i>Debt raised/ (repaid)</i> | <i>2,289</i> | - | - | <i>(6,000)</i> |
| <i>Dividend paid</i> | <i>(944)</i> | <i>(1,020)</i> | <i>(1,740)</i> | <i>(2,486)</i> |
| Cash flow from financing | 895 | (1,020) | (1,740) | (8,486) |
| Net chg in cash | 3,490 | 6,649 | 2,503 | (3,169) |

Key ratios

| Y/E December | CY15 | CY16 | CY17E | CY18E |
|----------------------------|-------------|-------------|-------------|-------------|
| OPERATIONAL | | | | |
| FDEPS (Rs) | 14.5 | 16.8 | 24.7 | 35.0 |
| CEPS (Rs) | 21.7 | 24.9 | 32.1 | 43.2 |
| DPS (Rs) | 4.5 | 4.8 | 8.2 | 11.7 |
| Dividend payout ratio (%) | 31.5 | 27.1 | 33.2 | 33.5 |
| GROWTH | | | | |
| Net sales (%) | 5.0 | 6.2 | 12.5 | 20.5 |
| EBITDA (%) | 28.6 | 3.8 | 22.0 | 28.8 |
| Adj net profit (%) | 33.9 | 16.4 | 46.8 | 41.5 |
| FDEPS (%) | 33.9 | 16.4 | 46.8 | 41.5 |
| PERFORMANCE | | | | |
| RoE (%) | 10.5 | 11.3 | 15.2 | 19.1 |
| RoCE (%) | 16.9 | 16.8 | 20.3 | 25.8 |
| EFFICIENCY | | | | |
| Asset turnover (x) | 2.7 | 3.0 | 3.5 | 4.0 |
| Sales/ total assets (x) | 1.1 | 1.1 | 1.2 | 1.3 |
| Working capital/ sales (x) | 0.2 | 0.2 | 0.1 | 0.1 |
| Receivable days | 154.4 | 131.3 | 123.9 | 119.0 |
| Inventory days | 46.2 | 43.4 | 43.5 | 43.8 |
| Payable days | 165.9 | 157.0 | 163.5 | 164.1 |
| FINANCIAL STABILITY | | | | |
| Total debt/ equity (x) | 0.2 | 0.2 | 0.2 | - |
| Net debt/ equity (x) | - | (0.2) | (0.2) | (0.3) |
| VALUATION | | | | |
| PE (x) | 106.3 | 91.3 | 62.2 | 44.0 |
| EV/ EBITDA (x) | 45.3 | 42.8 | 34.8 | 26.8 |
| EV/ Net sales (x) | 4.1 | 3.8 | 3.3 | 2.7 |
| PB (x) | 10.8 | 9.9 | 9.0 | 7.9 |
| Dividend yield (%) | 0.3 | 0.3 | 0.5 | 0.8 |
| Free cash flow yield (%) | - | - | - | - |

Source: Company, Axis Capital

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| Sr. No | Name | Designation | E-mail |
|--------|---------------|--------------------|---------------------------------|
| 1 | Akhand Singh | Research Analyst | akhand.singh@axissecurities.in |
| 2 | Poonam Darade | Research Associate | poonam.darade@axissecurities.in |

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|-----------------------|---|
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| HOLD | Between 10% and -10% |
| SELL | Less than -10% |

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