

SIEMENS

Prudent change in focus amid challenges

India Equity Research | Engineering and Capital Goods

At its recent analyst meet, Siemens management cited growth concerns across large projects such as steel and thermal power, but mentioned commercial factories/buildings, pharma, industrial steam turbines and mobility offer better prospects. FY19 growth for Siemens (+5.5% in base orders and 8.4% in revenue) – despite recent weakness – was led by the digital, services, and smart infra segments. Solid FCF (INR11.8bn at 108% of PAT) despite tighter liquidity reflects prudent business selection. We retain 'BUY/SO' on the stock with a TP of INR1,750 (45x March 2021E EPS) based on growth levers that offer scope for OPM expansion while sustaining the solid FCF track record. That said, in the wake of the stock's 35% rally since our upgrade (refer to [DIGITISATION: Opportunities amid disruption](#)) and persistent weakness in large projects, we are dropping Siemens as our sector top pick; we prefer L&T.

Prudent approach amid weak capex; focus on cash/OPM

Siemens notched up 8.4/12.1% revenue/EBIDTA growth in FY19 and robust FCF in the face of capex challenges across thermal and steel projects and tighter liquidity. The company's focus on efficiency/productivity-based products/solutions across sectors is helping it grow the product business recognising the manufacturing sector's inclination to incur higher opex than capex. Opex spend has slowed too and must be monitored.

Way forward and key value trigger

While capex momentum over coming quarters is likely to remain weak, we see management focus on cost control and cash flow, which coupled with larger solutions/product offerings across a wide range of clients will help deliver much better growth/cash flow than peers. While we expect mobility/digital factories and smart infra to drive long-term growth, there is reasonable scope for OPM expansion over two–three years given robust demand and continued focus on localisation. Besides, watch out for clarity regarding consolidation of the gas & power business.

Outlook and valuation: Resilient in tough times; maintain 'BUY'

Siemens has been the best sector performer over the past six months led by its strong operating performance, recent tax cuts, etc; however, current capex weakness is a key variable, limiting growth avenues. Maintain 'BUY/SP'.

Financials (Standalone)

(INR mn)

Year to Sept	FY18	FY19	FY20E	FY21E
Revenues	127,251	136,838	149,690	162,843
EBITDA	13,161	14,757	16,695	18,487
Adjusted Profit	8,939	10,869	13,285	14,675
Adjusted diluted EPS (INR)	25.1	30.5	37.3	41.2
Diluted P/E (x)	61.5	50.6	41.4	37.4
EV/EBITDA (x)	39.0	33.9	30.0	27.0
ROAE (%)	11.2	12.5	14.0	14.0

EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	Low
Sector Relative to Market	Overweight

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

CMP	: INR 1,543
Target Price	: INR 1,750
52-week range (INR)	: 1,717 / 900
Share in issue (mn)	: 356.1
M cap (INR bn/USD mn)	: 550 / 7,647
Avg. Daily Vol.BSE/NSE('000)	: 639.3

SHARE HOLDING PATTERN (%)

	Current	Q1FY20	Q4FY19
Promoters *	75.0	75.0	75.0
MF's, FI's & BK's	11.9	11.8	11.3
FII's	2.2	2.1	2.3
Others	10.9	11.1	11.4
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Capital Goods Index
1 month	8.4	7.0	3.3
3 months	43.3	7.9	6.1
12 months	75.1	12.4	1.5

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Analyst meet: Key takeaways

Macro / industry

- **Power generation**
 - Lack of opportunities in large thermal generation. Slowdown in T&D capex. A shift in orders from centre to states, which is driving orders in the lower kVA capacity (220/110/66/33kVa).
 - Demand for industrials steam turbines across sectors such as steel, cement and chemicals. This has not slowed down as companies continue to focus on reliability of power.
 - Transmission – Slowdown in ordering from central government (long-, high-range kva lines), scattered orders from states.
- **Mobility**
 - Large-ticket capex projects deferred or absent.
 - Railway continues to do well, despite limited orders in signaling and rolling stock.
 - Advanced security and energy efficiency solutions for buildings, hotels, convention centres, data centres, etc. This trend is expected to sustain in data centres and hospitality.
- **Power T&D**
 - Automotive, cement and steel continue to face stress.
 - Opex optimisation spend is slowing down. The focus on productivity benefits is seeing a slowdown as well. Companies are focusing on demand recovery, availability of funding.

Financials

- Book-to-bill at 1x. At peak, they were at 1.2–1.3x.
- New orders in digital industries grew 11%, gas & power 7% and smart infra 7%.
- A few large orders were refused as they did not meet the internal hurdle rates.
- One-time impact in Q4FY19 stemming from VRS, inventory provisioning cost, and forex loss (INR0.6bn).

Chart 1: Exports pick up key

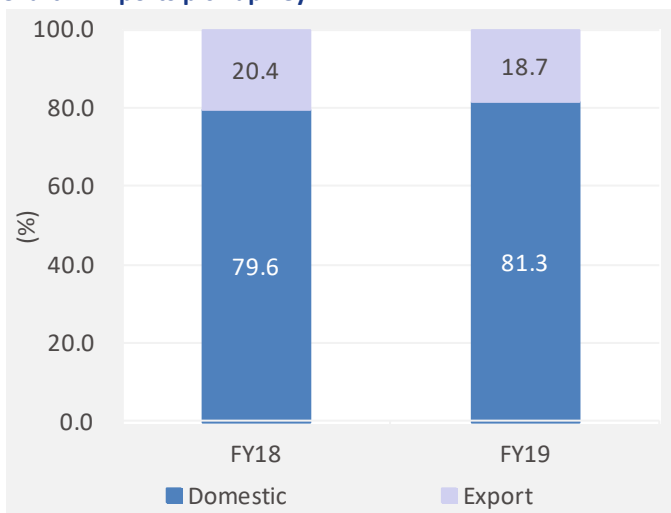
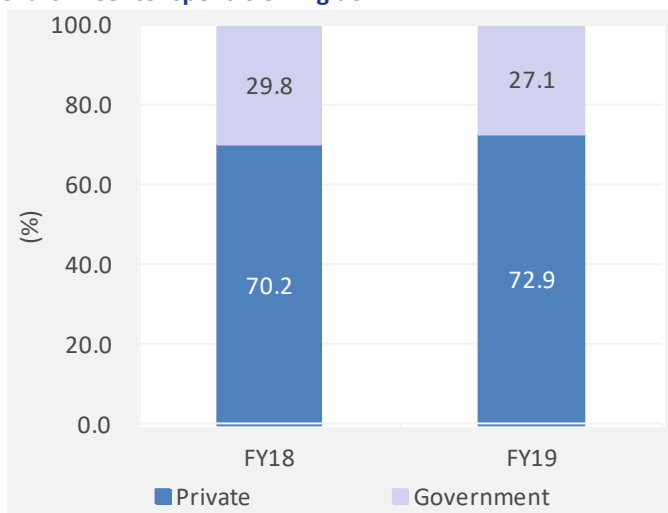


Chart 2: Center spend slowing down



Source: Company, Edelweiss research

Digitalisation gaining prominence

- Digitalisation continues to gain pace with 105 cases in India across 50-plus customers spread across 18 industry segments.
- Key benefits derived across clients in gas turbines, smart infra, automotive segment –
 - Energy savings of 25–30% and reduced maintenance requirements
 - Reduction in development time by ~10% and engineering time by ~15%

Commentary by segment**Gas & Power**

- Growth in services and small turbines offsets the decline in large projects.
- Order inflow grew from INR42.2bn in FY18 to INR45.1bn in FY19 (up 6.8%).

Smart Infrastructure

- Growth driven by hospitality, commercial offices and data centres. Slowdown in the utilities segment.
- Increasing competition/pricing pressure in the distribution business.
- Order inflow grew from INR36.5bn in FY18 to INR39.2bn in FY19 (up 7.4%).

Digital Industries

- Food & beverages and pharma are driving growth. Slowdown in the automotive segment.
- Order inflow grew from INR24.0bn in FY18 to INR26.5bn in FY19 (up 10.6%).

Portfolio business

- Order inflow grew from INR9.9bn in FY18 to INR13.7bn in FY19 (up 31.7%).
- INR1bn one-time costs of rationalisation and inventory provision. INR0.5bn pertains to inventory and INR0.5bn to retirement schemes. A large part of inventory provision was in Q4. Excluding this one-time cost, the segment reported a profit.

Table 1: Segmental revenue and EBIT margin snapshot

Standalone	Q4FY19	Q4FY18	Y-o-Y growth (%)	FY19	FY18	Y-o-Y growth (%)
Revenues (INR mn)						
Gas and Power	16,321	14,583	11.9	50,559	48,258	4.8
Smart Infra	10,996	12,111	(9.2)	37,950	37,962	(0.0)
Mobility	3,588	3,552	1.0	11,203	9,814	14.2
Digital Industries	7,189	6,923	3.8	26,874	23,699	13.4
Portfolio companies	3,945	3,354	17.6	12,042	9,335	29.0
Others	312	295	5.8	1,191	1,336	(10.9)
Total (ex- inter segmental)	42,351	40,818	3.8	139,819	130,404	7.2
EBIT (INR mn)						
Gas and Power	1,765	1,520	16.1	6,911	5,184	33.3
Smart Infra	1,028	853	20.5	3,516	3,024	16.3
Mobility	377	553	(31.8)	1,126	985	14.3
Digital Industries	561	443	26.6	1,648	1,521	8.3
Portfolio companies	(245)	211	(216.1)	(857)	118	(826.3)
Others	13	99	(86.9)	240	362	(33.7)
Total	3,499	3,679	(4.9)	12,584	11,194	12.4
EBIT margins (%)						
Gas and Power	10.8	10.4		13.7	10.7	
Smart Infra	9.3	7.0		9.3	8.0	
Mobility	10.5	15.6		10.1	10.0	
Digital Industries	7.8	6.4		6.1	6.4	
Portfolio companies	(6.2)	6.3		(7.1)	1.3	
Others	4.2	33.6		20.2	27.1	
Total	8.3	9.0		9.0	8.6	

Source: Company, Edelweiss research

Portfolio companies margins impacted by an INR1bn one-time rationalisation cost (inventory provisioning and retirement scheme)

Financial snapshot

(INR mn)

Year to September	Q4FY19	Q4FY18	% change	Q3FY19	% change	FY19	FY20E	FY21E
Net revenues	41,288	39,392	4.8	31,984	29.1	136,838	149,690	162,843
Raw material	29,475	26,889	9.6	20,901	41.0	93,230	101,065	109,780
Staff costs	3,440	3,637	(5.4)	3,973	(13.4)	16,036	17,283	18,642
Other expenses	4,317	4,680	(7.8)	3,573	20.8	12,815	14,647	15,934
Total expenditure	37,232	35,206	5.8	28,447	30.9	122,081	132,995	144,356
EBITDA	4,056	4,186	(3.1)	3,537	14.7	14,757	16,695	18,487
Depreciation	558	507	10.1	512	9.0	2,173	2,211	2,370
EBIT	3,498	3,679	(4.9)	3,025	15.6	12,584	14,484	16,118
Interest	86	51	68.6	2	NA	114	123	133
Other income	1,414	764	85.1	825	71.4	3,946	3,392	3,627
Add: Exceptional items								
Profit before tax	4,826	4,392	9.9	3,848	25.4	16,416	17,753	19,611
Tax	1,520	1,600	(5.0)	1,367	11.2	5,547	4,468	4,936
Reported net profit	3,306	2,792	18.4	2,481	33.3	10,869	13,285	14,675
Adjusted Profit	3,306	2,792	18.4	2,481	33.3	10,869	13,285	14,675
Equity capital(FV INR 2)	712	712		712		712	712	712
Diluted shares (mn)	356	356		356		356	356	356
Adjusted Diluted EPS	9.3	7.8	18.4	7.0	33.3	30.5	37.3	41.2
As % of net revenues								
Direct costs	71.4	68.3		65.3		68.1	67.5	67.4
Employee cost	8.3	9.2		12.4		11.7	11.5	11.4
Other operating expenses	14.6	17.4		17.1		9.4	9.8	9.8
EBITDA	9.8	10.6		11.1		10.8	11.2	11.4
Adjusted net profit	8.0	7.1		7.8		7.9	8.9	9.0
Tax rate	31.5	36.4		35.5		33.8	25.2	25.2

Company Description

Siemens India (SIEM) is a 75% subsidiary of Siemens AG, Germany, which has presence in more than 200 countries. SIEM offers diverse products and services solutions in power generation, transmission and distribution, automation and drives, industrial and digital solution. Siemens has 22 factories located across the country, eight Centres of Competence, 11 R&D centres and a nationwide sales and service network.

Investment Theme

Siemens (SIEM) is one of the most diversified industrial product/solutions companies in India with exposure to a wide range of industries including power, steel, cement, hydrocarbons, factories & building technologies, automation/digitalization, etc. Over the past three-four years, the company has simplified its business structure, apart from reducing operating margin volatility, which we believe is a significant departure from the past. Additionally, we expect it to significantly scale up in new areas like digital and factories & building technologies, which will boost growth and operating margin given the high growth potential and scope for value addition. The stock's re-rating will be a function of structural shift in revenue stream to more short-cycle/high-returns yielding businesses.

Key Risks

Slowdown in key infra verticals including T&D, transportation, hydrocarbon etc., could impact SIEM's overall business growth.

SIEM has reasonable exposure to export markets and hence a sustained slow down in key export markets, including the Middle East, could impact our growth estimates.

Parent's strategy has a direct bearing on SIEM's domestic business positioning. Hence, any significant decision w.r.t. business verticals could impact future growth potential and valuations.

Financial Statements (Standalone)

Key Assumptions

Year to September	FY18	FY19	FY20E	FY21E
Macro				
GDP(Y-o-Y %)	6.7	6.8	6.3	6.8
Inflation (Avg)	3.6	3.4	3.7	4.0
Repo rate (exit rate)	6.0	6.3	4.5	4.5
USD/INR (Avg)	64.5	70.0	71.0	71.0
Company				
Order inflow growth (%)	(6)	4	10	10
Dep. (% gross block)	5.9	6.0	6.0	6.1

Income statement

(INR mn)

Year to September	FY18	FY19	FY20E	FY21E
Income from operations	127,251	136,838	149,690	162,843
Direct costs	85,864	93,230	101,065	109,780
Employee costs	14,487	16,036	17,283	18,642
Other Expenses	13,739	12,815	14,647	15,934
Total operating expenses	114,090	122,081	132,995	144,356
EBITDA	13,161	14,757	16,695	18,487
Depreciation	1,967	2,173	2,211	2,370
EBIT	11,194	12,584	14,484	16,118
Less: Interest Expense	82	114	123	133
Add: Other income	2,800	3,946	3,392	3,627
Profit Before Tax	13,912	16,416	17,753	19,611
Less: Provision for Tax	4,973	5,547	4,468	4,936
Reported Profit	8,939	10,869	13,285	14,675
Adjusted Profit	8,939	10,869	13,285	14,675
Shares o /s (mn)	356	356	356	356
Basic EPS (INR)	25.1	30.5	37.3	41.2
Diluted shares o/s (mn)	356	356	356	356
Adjusted Diluted EPS	25.1	30.5	37.3	41.2
Adjusted Cash EPS	29.8	37.7	43.5	47.9
Dividend per share (DPS)	7.0	8.0	9.0	10.0
Dividend Payout Ratio(%)	33.4	31.4	28.9	29.1

Common size metrics

Year to September	FY18	FY19	FY20E	FY21E
Operating expenses	89.7	89.2	88.8	88.6
EBITDA margins	10.3	10.8	11.2	11.4
Net Profit margins	7.0	7.9	8.9	9.0

Growth ratios (%)

Year to September	FY18	FY19	FY20E	FY21E
Revenues	15.5	7.5	9.4	8.8
EBITDA	25.2	12.1	13.1	10.7
Adjusted Profit	27.1	21.6	22.2	10.5

Balance sheet		(INR mn)			
As on 30th September	FY18	FY19	FY20E	FY21E	
Share capital	712	712	712	712	
Reserves & Surplus	82,342	89,724	99,166	109,571	
Shareholders' funds	83,054	90,436	99,878	110,283	
Long Term Liabilities	2,292	2,771	2,771	2,771	
Sources of funds	82,681	90,797	100,239	110,644	
Gross Block	34,483	35,046	36,846	38,846	
Net Block	13,514	11,904	11,494	11,124	
Capital work in progress	624	583	583	583	
Total Fixed Assets	14,138	12,487	12,077	11,707	
Non current investments	550	550	550	550	
Cash and Equivalents	36,457	48,913	47,904	51,258	
Inventories	11,389	10,950	12,460	13,534	
Sundry Debtors	37,250	38,762	44,141	48,020	
Loans & Advances	40,043	38,032	41,835	46,019	
Current Assets (ex cash)	88,682	87,744	98,436	107,573	
Sundry creditors	48,280	49,797	49,173	50,410	
Provisions	8,866	9,100	9,555	10,033	
Total Current Liab	57,146	58,897	58,728	60,443	
Net Curr Assets-ex cash	31,536	28,847	39,708	47,130	
Net Deferred tax	(2,665)	(2,410)	(2,410)	(2,410)	
Uses of funds	82,681	90,797	100,239	110,644	
BVPS (INR)	233.2	254.0	280.5	309.7	

Free cash flow		(INR mn)			
Year to September	FY18	FY19	FY20E	FY21E	
Reported Profit	8,939	10,869	13,285	14,675	
Add: Depreciation	1,967	2,173	2,211	2,370	
Interest (Net of Tax)	53	75	92	100	
Others	(2,177)	(5,264)	(3,361)	(3,593)	
Less: Changes in WC	8,361	(4,452)	10,861	7,422	
Operating cash flow	421	12,305	1,366	6,129	
Less: Capex	2,137	563	1,800	2,000	
Free Cash Flow	(1,716)	11,742	(434)	4,129	

Cash flow metrics		FY18	FY19	FY20E	FY21E
Year to September					
Operating cash flow		421	12,305	1,366	6,129
Financing cash flow		(3,054)	(3,113)	(3,843)	(4,270)
Investing cash flow		(1,572)	(10,512)	1,469	1,494
Net cash Flow		(4,205)	(1,320)	(1,008)	3,353
Capex		(1,788)	(336)	(1,800)	(2,000)
Dividend paid		(3,054)	(3,113)	(3,843)	(4,270)

Profitability and efficiency ratios		FY18	FY19	FY20E	FY21E
Year to September					
ROAE (%)		11.2	12.5	14.0	14.0
ROACE (%)		17.5	19.1	18.8	18.8
Inventory Days		46	44	42	43
Debtors Days		103	101	101	103
Payable Days		196	192	179	166
Cash Conversion Cycle		(47)	(47)	(35)	(19)
Current Ratio		2.2	2.3	2.5	2.6
Interest Coverage Ratio		136.5	110.4	117.6	121.2

Operating ratios		FY18	FY19	FY20E	FY21E
Year to September					
Total Asset Turnover		1.6	1.6	1.6	1.5
Fixed Asset Turnover		9.5	10.8	12.8	14.4
Equity Turnover		1.6	1.6	1.6	1.5

Valuation parameters		FY18	FY19	FY20E	FY21E
Year to September					
Adj. Diluted EPS (INR)		25.1	30.5	37.3	41.2
Y-o-Y growth (%)		27.1	21.6	22.2	10.5
Adjusted Cash EPS (INR)		29.8	37.7	43.5	47.9
Diluted P/E (x)		61.5	50.6	41.4	37.4
P/B (x)		6.6	6.1	5.5	5.0
EV / Sales (x)		4.0	3.6	3.3	3.0
EV / EBITDA (x)		39.0	33.9	30.0	27.0
Dividend Yield (%)		0.5	0.5	0.6	0.6

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		P/B (X)		ROAE (%)	
		FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Siemens	7,647	41.4	37.4	5.5	5.0	14.0	14.0
ABB India	4,274	76.8	56.6	8.6	7.7	9.6	12.1
Median	-	59.1	47.0	7.0	6.3	11.8	13.0
AVERAGE	-	59.1	47.0	7.0	6.3	11.8	13.0

Source: Edelweiss research

Additional Data

Directors Data

Deepak S Parekh	Chairman	Sunil Mathur	Managing Director & CEO
Darius C Shroff	Director	Keki B. Dadiseth	Director
Yezdi H. Malegam	Director	Mehernosh B. Kapadia	Director
Josef Kaeser	Director	Cedrik Neike	Special Director
Mariel von Schumann	Director	Johannes Apitzsch	Director
Dr. Daniel Spindler	Executive Director and CFO		

Auditors - S R B C & Co. LLP

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
Siemens ag	71.7	Life insurance corp	4.49
Siemens metals tech	3.3	Reliance capital tru	2.38
Hdfc asset managemen	1.25	Vanguard group	0.86
Dsp blackrock invest	0.52	Norges bank	0.42
Uti asset management	0.37	Sundaram asset manag	0.22

**in last one year*

Bulk Deals

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

**in last one year*

Insider Trades

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

**in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
ABB India	HOLD	SP	M	Bharat Forge	REDUCE	SP	M
Bharat Heavy Electricals	REDUCE	SP	M	CG Power and Industrial Solutions	HOLD	SP	M
Cummins India	HOLD	SP	M	Engineers India Ltd	REDUCE	SU	M
Greaves Cotton	HOLD	SP	M	Kalpataru Power	BUY	SO	M
KEC International	BUY	SP	M	Larsen & Toubro	BUY	SO	M
Praj Industries	HOLD	None	None	Ramkrishna Forgings	BUY	SP	M
Siemens	BUY	SO	L	Techno Electric & Engineering	BUY	SP	M
Thermax	REDUCE	SP	L	Triveni Turbine	BUY	None	None
VA Tech Wabag	BUY	None	None				

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, Bharat Heavy Electricals, Bharat Forge, CG Power and Industrial Solutions, Engineers India Ltd, Greaves Cotton, KEC International, Cummins India, Kalpataru Power, Larsen & Toubro, Praj Industries, Ramkrishna Forgings, Siemens, Techno Electric & Engineering, Thermax, Triveni Turbine, VA Tech Wabag

Recent Research

Date	Company	Title	Price (INR)	Recos
14-Nov-19	Thermax	Big-project execution sustains revenue; soft H2 expected; <i>Result Update</i>	1,071	Reduce
13-Nov-19	Bharat Heavy Electricals	Sticky challenges stalling recovery; <i>Result Update</i>	55	Reduce
13-Nov-19	AIA Engineering	Muted sales volume; future ready; <i>Result Update</i>	1,699	Buy

Distribution of Ratings / Market Cap

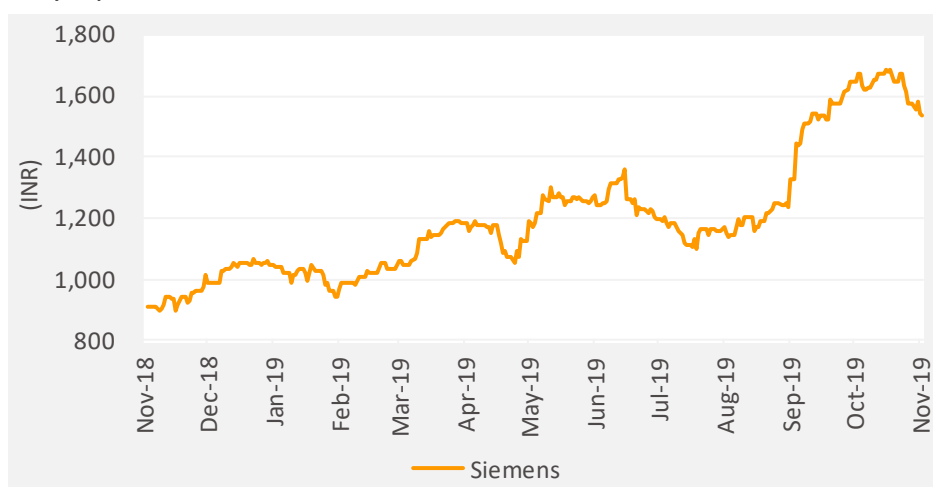
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

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

One year price chart



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