



RESULT UPDATE

ABB INDIA

Bucking the trend; cash flow focus yields impressive results

India Equity Research | Engineering and Capital Goods



ABB's in-line Q2CY18 results reaffirm our thesis of reasonable potential for operational improvement on the back of strong product focus. Key highlights: a) execution pickup led by traction in base business, HVDC order execution and strong opex demand from consumer industries; b) profitability, though improving gradually in our view, has sustained owing to product innovation and healthy demand in segments including railways and metro. We maintain 'BUY/SO' on ABB given potential for improvement in cash flow/profitability (five-year FCF/PAT in excess of 100%) driven by keen focus on product business, which should post 25% PAT CAGR and average FCF of INR5bn over the next two years. Our revised TP of INR1,550 (INR1,850 earlier) is based on the assigned P/E of 50x (down from 60x) in line with the reduction in sector multiple (maintaining the premium).

Maturing HVDC contract; profitability improving

Sustained HVDC execution momentum in Q2CY18 lifted the power grid segment revenue by 41% YoY. ABB's strategy of diversifying into new geographies and segments continues to yield benefits for the Robotics and Motion (RM) division, up 34% YoY. While higher import content impacted the Electric Products and RM segments, cost control and a better product mix improved the overall EBITDA margin by 60bps YoY.

Exports division drives order intake; inflow likely to be buoyant

ABB reported order intake growth of 7% YoY led by a 52/68% spurt in services/exports orders. Order book stood robust at INR107bn (post internal consolidation). Management reiterated its focus on changing trends across utilities – power, oil & gas, railways, etc – wherein ABB has been ahead of peers and near-term growth is likely to be driven by consumption-oriented sectors and large projects in infra.

Outlook and valuations: Growth potential; maintain 'BUY'

ABB's comprehensive product portfolio provides multiple-growth opportunities along with ongoing traction in railways and T&D, and government-push for EV and digitalisation. At CMP, the stock is trading at 47x/37x CY18/19E EPS. We maintain 'BUY/SO'.

EDELWEISS 4D RATINGS

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

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

CMP	: INR 1,158
Target Price	: INR 1,550
52-week range (INR)	: 1,749 / 1,123
Share in issue (mn)	: 211.9
M cap (INR bn/USD mn)	: 245 / 3,554
Avg. Daily Vol.BSE/NSE('000)	: 93.1

SHARE HOLDING PATTERN (%)

	Current	Q4FY18	Q3FY18
Promoters *	75.0	75.0	75.0
MF's, FI's & BK's	13.5	13.5	13.7
FII's	3.2	3.2	3.1
Others	8.2	8.2	8.2
* Promoters pledged shares (% of share in issue)	:	NIL	

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Capital Goods Index
1 month	(1.7)	1.1	(4.1)
3 months	(5.0)	3.9	(8.8)
12 months	(18.5)	10.6	(0.6)

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Financials

(INR mn)

Year to December	Q2CY18	Q2CY17	% Chg	Q1CY18	% Chg	CY17	CY18E	CY19E
Net revenues	27,127	22,237	22.0	25,255	7.4	90,873	102,741	115,949
EBITDA	1,959	1,473	33.0	1,890	3.7	7,361	8,875	10,481
Adjusted Profit	1,022	751	36.1	1,025	(0.3)	4,200	5,196	6,572
Adjusted Diluted EPS	4.8	3.5	36.1	4.8	(0.3)	19.8	24.5	31.0
Diluted P/E (x)						58.4	47.2	37.3
EV/EBITDA (x)						31.8	25.9	21.6
ROAE (%)						12.2	13.6	15.3

Q2CY18 conference call: Key takeaways

Key partnerships

- MoU signed with NITI Aayog to make India Artificial Intelligence-ready
- Partnerships with Cochin Shipyard and SCI for automation solutions
- Breakthrough traction motor order from rail transport company

Market overview

- Macros are not very strong in India; however, the micro environment is robust. The auto segment is doing very well.
- States, namely Karnataka, Maharashtra and Andhra Pradesh have rolled out their EV policies.
- Transmission — Digital substation, smart network to drive growth in transmission.
- Pickup in opex cycle in steel, cement and factories – largely with the objective of driving improvement in operational efficiency
- Transportation – airports, railways and metro rail (25 metro projects under planning and ordering).
- Smart Cities project status—Projects moving out of the design phase to execution.
- Data centers—Expansion of communication network and data privacy driving growth.
- Growth to be led by consumer-oriented sectors, wherein ABB will continue to focus in the near term. The industrial cycle should pick up once the NPA issue is resolved.

Segment

- Robotics and motions – ABB is diversifying into new segments and geographies.
- EP and RM have higher import content; hence it will be impacted by fluctuations in foreign currency.

Financial comment

Order inflow and order book

- Order intake growth led by a 52% increase in services and a 68% jump in exports orders.
- Order intake by segment: EP – INR7.13bn (+13% YoY); RM – INR6.33bn (+25% YoY); IA – INR4.13bn (+25% YoY); and PG – INR8.56bn (-5% YoY)
- Closing order book – Internal consolidation shrunk the closing book; no cancellations.
- Execution worth INR3bn pending in the RP contract.

Other comments

- Net working capital – up 23% YoY
- Cash balance – INR10bn (flat YoY)
- Negative impact of GST over
- Currency impact of INR100mn; hedging policy is minimizing the impact
- Some export markets performed better than India while others were lower.
- Services/exports contribute ~15% each to revenue

Financial snapshot

(INR mn)

Year to December	Q2CY18	Q2CY17	% change	Q1CY18	% change	YTD17	CY18E	CY19E
Net revenues	27,127	22,237	22.0	25,255	7.4	62,903	102,741	115,949
Staff costs	2,231	2,157	3.4	2,184	2.1	6,124	8,933	9,845
Direct costs	18,030	14,248	26.5	17,231	4.6	40,132	66,363	74,780
Other operating expenses	4,908	4,359	12.6	3,951	24.2	12,223	18,570	20,842
Total expenditure	25,168	20,764	21.2	23,365	7.7	58,479	93,866	105,467
EBITDA	1,959	1,473	33.0	1,890	3.7	4,424	8,875	10,481
Depreciation	356	383	(7.1)	356	0.0	1,148	1,643	1,717
EBIT	1,603	1,090	47.1	1,533	4.6	3,276	7,232	8,764
Interest	232	231	0.6	232	0.2	595	559	60
Other income	236	326	(27.7)	269	(12.5)	1,022	1,224	1,284
Add: Exceptional items								
Profit before tax	1,607	1,185	35.6	1,571	2.3	3,703	7,897	9,989
Tax	586	435	34.7	546	7.2	1,218	2,701	3,416
Reported net profit	1,022	751	36.1	1,025	(0.3)	2,484	5,196	6,572
Adjusted Profit	1,022	751	36.1	1,025	(0.3)	2,484	5,196	6,572
Equity capital(FV INR10)	424	424		424		424	424	424
Diluted shares (mn)	212	212		212		212	212	212
Adjusted Diluted EPS	4.8	3.5	36.1	4.8	(0.3)	11.7	24.5	31.0
As % of net revenues								
Direct costs	66.5	64.1		68.2		63.8	64.6	64.5
Employee cost	8.2	9.7		8.6		9.7	8.7	8.5
Other operating expenses	18.1	19.6		15.6		19.4	18.1	18.0
EBITDA	7.2	6.6		7.5		7.0	8.6	9.0
Reported net profit	3.8	3.4		4.1		3.9	5.1	5.7
Tax rate	36.4	36.7		34.8		32.9	34.2	34.2

Company Description

ABB, incorporated in December 1949 as Hindustan Electric Company, operates in two segments i.e. power technology and automation technology, and offers its services and products to the power transmission as well as other industries. Its power technology segment provides solutions for power transmission, power distribution, and control and protection systems for power plants. Products include transformers, switchgears, breakers, capacitors, power line carrier communication equipment, and relay control panels. Under the automation technology segment, it offers products, systems, software, and services for automation and optimization of discrete, process, and batch manufacturing operations, and related services. These technologies include measurement control, instrumentation, process analysis, drives and motors, power electronics, robots, and low-voltage products.

Investment Theme

ABB has strengthened its business portfolio with core focus on product innovations to expand its sectoral offerings. With pick up in power T&D, railways, oil & gas etc., we believe the company is well poised to see significant ramp up in utilisation levels, which will drive substantially boost profitability. We observe that ABB has one of the most comprehensive product portfolios across various industries versus peers, imparting it significant competitive advantage

Key Risks

Weak order intake could hit out top line estimates. Further, increasing competitive intensity in the T&D segment could impact our margins estimates for the company.

Financial Statements

Key Assumptions

Year to December	CY16	CY17	CY18E	CY19E
Macro				
GDP(Y-o-Y %)	7.1	6.5	7.1	7.6
Inflation (Avg)	4.5	3.6	4.5	5.0
Repo rate (exit rate)	6.3	6.0	6.0	6.5
USD/INR (Avg)	67.1	64.5	66.0	66.0
Company				
Industrial automation - Order inflow growth (%)	11.0	23.8	18.0	18.0
Revenue growth (% yoy)	14.6	2.1	8.2	12.9
Power Grid division	1.0	4.7	8.2	11.3
Electrification Products	39.9	2.9	8.2	14.2
Industrial automation	7.4	(4.3)	12.1	21.4
Robotics and Motion automation	(9.3)	0.9	5.7	7.7
Order inflow growth (%)	58	(24)	14	14
Power Grid division - Order inflow growth (%)	129.6	(49.7)	12.0	12.0
Electrification Products - Order inflow growth (%)	8.6	37.9	15.0	15.0
Robotics and Motion automation - Order inflow	4.4	(17.5)	12.0	12.0
Tax rate (%)	34.7	36.0	36.0	36.0
Dep. (% gross block)	8.5	10.2	10.3	10.0

Income statement

(INR mn)

Year to December	CY16	CY17	CY18E	CY19E
Income from operations	86,422	90,873	102,741	115,949
Direct costs	56,132	58,906	66,363	74,780
Employee costs	7,503	7,963	8,933	9,845
Other Expenses	15,842	16,644	18,570	20,842
Total operating expenses	79,477	83,513	93,866	105,467
EBITDA	6,945	7,361	8,875	10,481
Depreciation	1,510	1,580	1,643	1,717
EBIT	5,436	5,781	7,232	8,764
Less: Interest Expense	919	773	559	60
Add: Other income	1,216	1,210	1,224	1,284
Profit Before Tax	5,733	6,218	7,897	9,989
Less: Provision for Tax	1,988	2,018	2,701	3,416
Reported Profit	3,745	4,200	5,196	6,572
Adjusted Profit	3,745	4,200	5,196	6,572
Shares o/s (mn)	212	212	212	212
Adjusted Basic EPS	17.7	19.8	24.5	31.0
Diluted shares o/s (mn)	212	212	212	212
Adjusted Diluted EPS	17.7	19.8	24.5	31.0
Adjusted Cash EPS	24.8	27.3	32.3	39.1
Dividend per share (DPS)	4.1	4.3	4.5	4.7
Dividend Payout Ratio(%)	26.8	25.1	21.3	17.7

Common size metrics

Year to December	CY16	CY17	CY18E	CY19E
Operating expenses	92.0	91.9	91.4	91.0
EBITDA margins	8.0	8.1	8.6	9.0
Net Profit margins	4.3	4.6	5.1	5.7

Growth ratios (%)

Year to December	CY16	CY17	CY18E	CY19E
Revenues	6.2	5.2	13.1	12.9
EBITDA	(2.5)	6.0	20.6	18.1
Adjusted Profit	24.9	12.1	23.7	26.5

Engineering and Capital Goods

Balance sheet		(INR mn)			
As on 31st December	CY16	CY17	CY18E	CY19E	
Share capital	424	424	424	424	
Reserves & Surplus	32,443	35,645	39,734	45,143	
Shareholders' funds	32,867	36,069	40,157	45,567	
Long term borrowings	6,000	6,041	41	41	
Short term borrowings	-	-	-	-	
Total Borrowings	6,000	6,042	41	41	
Long Term Liabilities	560	465	465	465	
Def. Tax Liability (net)	(1,304)	(1,173)	(1,173)	(1,173)	
Sources of funds	38,124	41,403	39,491	44,900	
Gross Block	14,059	15,251	16,163	17,374	
Net Block	12,152	11,890	11,185	10,706	
Capital work in progress	678	1,165	1,265	1,365	
Intangible Assets	397	296	270	243	
Total Fixed Assets	13,227	13,351	12,720	12,314	
Non current investments	162	2	2	2	
Cash and Equivalents	11,892	17,621	15,691	18,889	
Inventories	9,403	11,536	12,727	14,341	
Sundry Debtors	29,707	27,878	31,971	36,081	
Loans & Advances	4,797	8,069	8,472	8,896	
Other Current Assets	6,820	9,251	8,326	8,742	
Current Assets (ex cash)	50,727	56,733	61,496	68,060	
Trade payable	34,860	43,160	47,272	51,219	
Other Current Liab	3,025	3,145	3,145	3,145	
Total Current Liab	37,885	46,305	50,418	54,364	
Net Curr Assets-ex cash	12,842	10,429	11,079	13,696	
Uses of funds	38,124	41,403	39,491	44,900	
BVPS (INR)	155.0	170.1	189.4	214.9	

Free cash flow		(INR mn)			
Year to December	CY16	CY17	CY18E	CY19E	
Reported Profit	3,745	4,200	5,196	6,572	
Add: Depreciation	1,510	1,580	1,643	1,717	
Interest (Net of Tax)	600	509	368	40	
Others	(49)	(456)	191	21	
Less: Changes in WC	(2,821)	(2,166)	650	2,617	
Operating cash flow	8,626	7,998	6,748	5,732	
Less: Capex	1,040	1,847	1,011	1,311	
Free Cash Flow	7,586	6,152	5,737	4,421	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		P/B (X)		ROAE (%)	
		CY18E	CY19E	CY18E	CY19E	CY18E	CY19E
ABB India	3,554	47.2	37.3	6.1	5.4	13.6	15.3
Siemens	4,870	34.0	27.4	3.8	3.4	11.6	13.1
Median	-	40.6	32.4	5.0	4.4	12.6	14.2
AVERAGE	-	40.6	32.4	5.0	4.4	12.6	14.2

Source: Edelweiss research

Cash flow metrics					
Year to December	CY16	CY17	CY18E	CY19E	
Operating cash flow	8,626	7,998	6,748	5,732	
Financing cash flow	(1,788)	(1,710)	(7,667)	(1,224)	
Investing cash flow	(681)	(3,287)	(1,011)	(1,311)	
Net cash Flow	6,156	3,001	(1,930)	3,198	
Capex	(1,040)	(1,847)	(1,011)	(1,311)	
Dividend paid	(944)	(1,020)	(1,108)	(1,163)	

Profitability and efficiency ratios

Year to December	CY16	CY17	CY18E	CY19E
ROAE (%)	11.9	12.2	13.6	15.3
ROACE (%)	17.7	17.3	20.5	23.4
Inventory Days	61	65	67	66
Debtors Days	134	116	106	107
Payable Days	223	242	249	240
Cash Conversion Cycle	(27)	(61)	(76)	(67)
Current Ratio	1.7	1.6	1.5	1.6
Gross Debt/EBITDA	0.9	0.8	-	-
Adjusted Debt/Equity	0.2	0.2	-	-
Net Debt/Equity	0.2	0.2	-	-
Interest Coverage Ratio	5.9	7.5	12.9	145.5

Operating ratios

Year to December	CY16	CY17	CY18E	CY19E
Total Asset Turnover	2.3	2.3	2.5	2.7
Fixed Asset Turnover	6.8	7.3	8.7	10.4
Equity Turnover	2.7	2.6	2.7	2.7

Valuation parameters

Year to December	CY16	CY17	CY18E	CY19E
Adj. Diluted EPS (INR)	17.7	19.8	24.5	31.0
Y-o-Y growth (%)	24.9	12.1	23.7	26.5
Adjusted Cash EPS (INR)	24.8	27.3	32.3	39.1
Diluted P/E (x)	65.5	58.4	47.2	37.3
P/B (x)	7.5	6.8	6.1	5.4
EV / Sales (x)	2.8	2.6	2.2	2.0
EV / EBITDA (x)	34.5	31.8	25.9	21.6
Dividend Yield (%)	0.4	0.4	0.4	0.4

Additional Data

Directors Data

Bazmi Husain	Managing Director	D E Udwadia	Non Executive & Independent Director
N S Raghavan	Non Executive & Independent Director	Naseer Munjee	Non Executive & Independent Director
Arun Kanti Dasgupta	Non Executive & Independent Director	Peter Leupp	Non Executive Director
Francis Duggan	Non Executive Director		

Auditors - BSR & Co LLP

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
Abb aseabrown bover	69.08	Life insurance corp	8.74
Abb norden holding a	5.92	Reliance capital tru	3.53
Hdfc asset managemen	1.36	Ac r shares infra b	1.28
Standard life aberde	1.04	Vanguard group	0.83
Sundaram asset manag	0.41	Blackstone asia advi	0.24

**in last one year*

Bulk Deals

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

**in last one year*

Insider Trades

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

**in last one year*

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

Recent Research

Date	Company	Title	Price (INR)	Recos
04-Jul-18	Engineering & Capital Goods	Healthy order books to spur execution; <i>Q1FY19 Result Preview</i>		
14-Jun-18	KEC International	New businesses to lead next leg of growth; <i>Visit Note</i>	370	Buy
31-May-18	CG Power and Industrial Solutions	Core in line; rising debt, loans to subsidiaries key concerns; <i>Result Update</i>	77	Hold

Distribution of Ratings / Market Cap

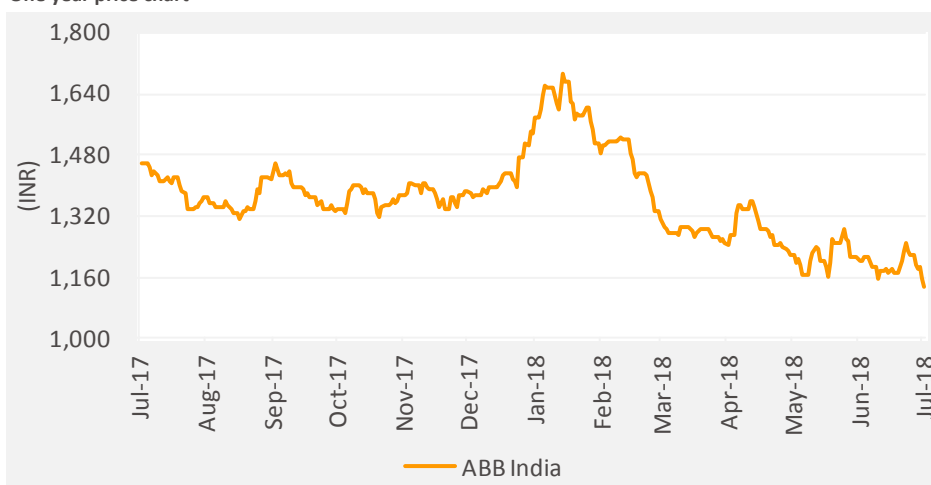
Edelweiss Research Coverage Universe

	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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