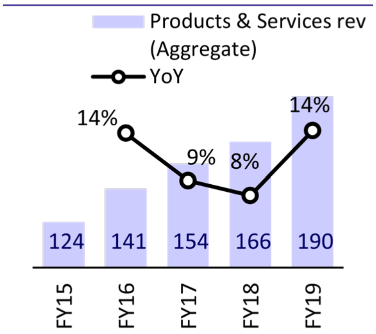
Capital Goods

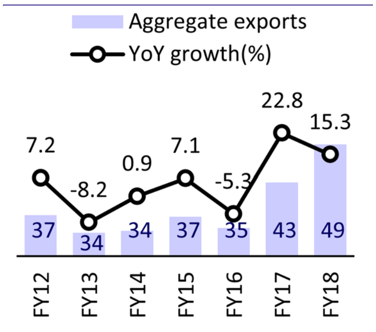
Digitalization/Automation + Exports + margin expansion: Strong tailwinds outweigh near term blip in order inflow

Order inflows/revenue growth to rebound sharply as economy recovers

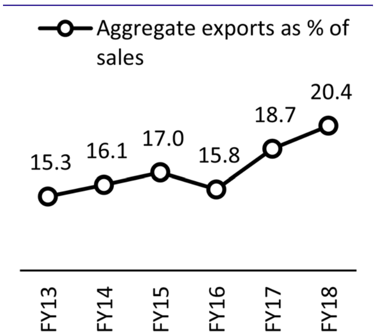
Products & services business has grown at 11% CAGR over FY15-19 at an aggregate basis (INRb)



Aggregate exports have risen at CAGR of 10% over FY15-18 (INRb)



Aggregate exports as % of sales has been on rise



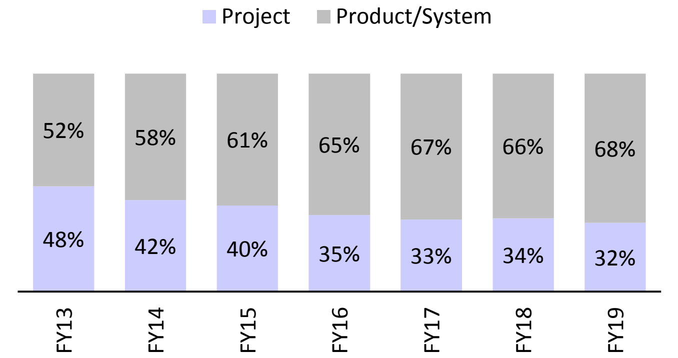
- **Attractive digitalization/automation opportunity:** The latest financial results of ABB, Siemens and Honeywell (not rated) reflect a slowdown in the opex spending-related businesses. Siemens' order inflow declined 14% YoY in 4QFY19 (year ending September), while ABB's order inflow growth decelerated to 5% YoY in 3QCY19 from 23% in the previous quarter. We attribute this to the economic slowdown, which has impacted the key end-markets of auto, food and beverages. However, the medium-term opex-related opportunities appear promising, given the faster adoption of such products & services and cost savings led by preventive maintenance for end-market players. Given the short cycle nature of such orders, inflows will bounce back sharply as the economy recovers, in our view.
- **Beneficiaries of rising exports:** Over the past five years or so, revenue growth has been supported by exports for multi-national engineering companies. **(a) ABB delivered a CAGR of 9.5% in exports (15% of CY18 revenue)** versus 7.1% in overall revenue. Importantly, this is primarily led by external exports (20% CAGR) rather than to related party (4.4% CAGR). **(b) Siemens' exports (21% of FY18 revenue)** CAGR was at 7.7% over FY13-18 v/s 1.7% in overall revenue. Again, exports growth was primarily led by external sales (10.7% CAGR) rather than to related party (5.9% CAGR). **(c) Honeywell's exports (46% of FY19 revenue)** CAGR was the highest at 17.6% over FY15-19 versus 6.8% in revenue. With the new corporate tax rates in place, MNC engineering companies are well placed to benefit from the increasing competitiveness of their Indian entities.
- **Scope of margin expansion, operating leverage to play out:** A comparison of the segmental margins for the Indian entities versus their global parents suggests ample room for margin expansion, despite taking into account the royalty/technical fees. Revenue growth, coupled with margin expansion, is likely to drive 20%+ earnings growth over the near-to-medium term.
- **Superior cash flow generation and strong balance sheet hard to ignore:** Despite the absence of capex cycle (in particular private capex), ABB, Siemens and Honeywell have delivered strong earnings growth, led by margin expansion. We like the strong cash flow generation potential of these businesses, along with the superior strength of the balance sheets and strong cash balances (for any potential inorganic opportunity). These engineering companies enjoy high barrier to entry, better pricing power due to access to global technologies and thus command high valuation premium.
- **Upgrading ABB to Buy; maintaining Buy on Siemens:** We upgrade ABB to Buy with a TP of INR1,660. The pending demerger of the Power Grid business (likely by Jun'20) has led to valuation correction. We maintain our **Buy** rating on Siemens as well with a TP of INR1,705. That said, we prefer ABB over Siemens. Honeywell is not rated.

Nilesh Bhaiya – Research Analyst (Nilesh.Bhaiya@MotilalOswal.com); +91 22 6129 1556
Pratik Singh – Research Analyst (Pratik.Singh@MotilalOswal.com) +91 22 6129 1543

Products & services driving revenue growth in absence of broad capex cycle

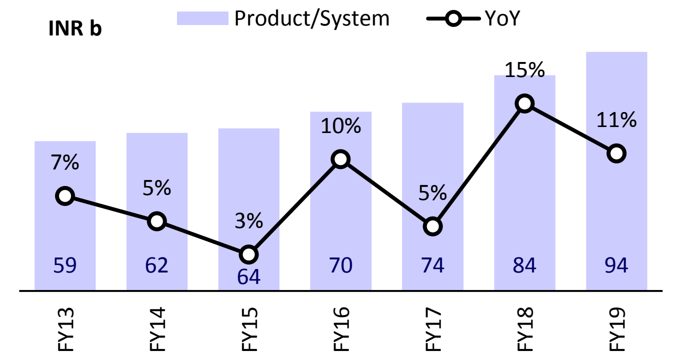
- **Products & services maintains double-digit growth rate:** Over the past five years, the products & services business for ABB, Siemens and Honeywell has delivered a CAGR of 10-13%, offsetting the weakness in the projects business. Products & services is expected to maintain this growth rate over the next 2-3 years.

Exhibit 1: SIEM: Revenue composition shifts from projects to products/services business



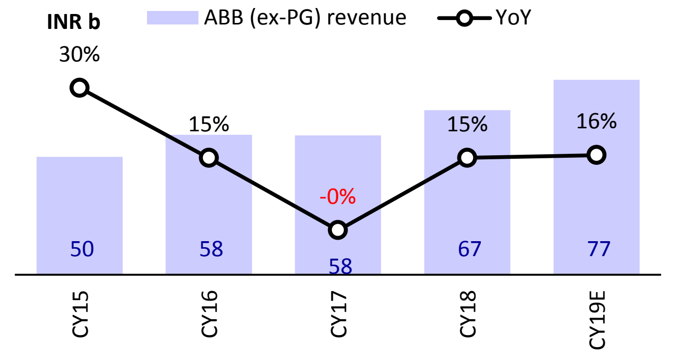
Source: MOFSL, Company

Exhibit 2: SIEM: Product/services CAGR of 10% over FY15-19 offsets muted growth in projects business



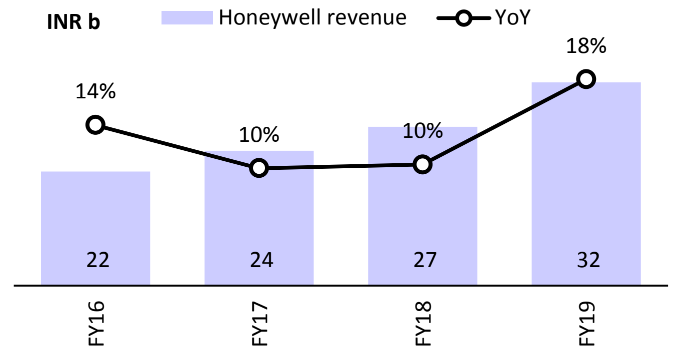
Source: MOFSL, Company

Exhibit 3: ABB: Ex-Power Grid business, ABB's revenue CAGR stands at 11% over CY15-19



Source: MOFSL, Company

Exhibit 4: Honeywell: Revenue of 13% CAGR over FY16-19



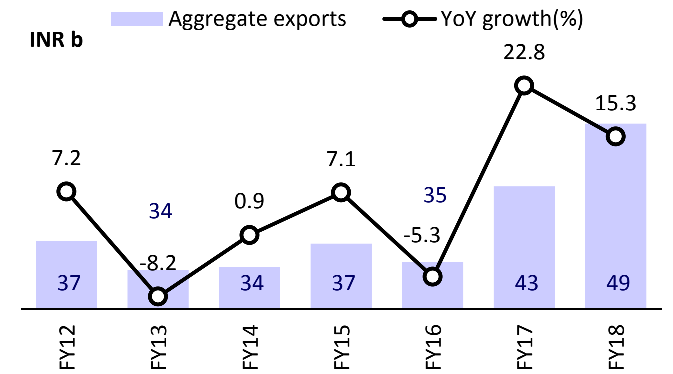
Source: MOFSL, Company

- **Only Siemens may have large exposure to capex cycle:** Post the demerger of the Power Grid business, ABB India will have ~93% of its business from products & services. Honeywell is anyways largely a products & services business. Thus, we believe that only Siemens will have a large proportion of the projects business (primarily gas & power and mobility segments).
- **Changing business models – order inflows to be volatile given short cycle nature:** With the declining proportion of the projects business, order inflow of such engineering companies is likely to remain volatile given ups and downs of the economic cycle. Volatility is likely to remain particularly high over the near term, given the sharp slowdown in India's economic growth. This in fact is reflected in the sharp decline in order inflow/revenue growth in the latest quarterly results. However, we believe that the rebound in order inflows/revenue growth will be sharper as the economy recovers. Over the medium-to-long term, strong growth in products & services will likely sustain, in our view.

Export-led growth evident across companies

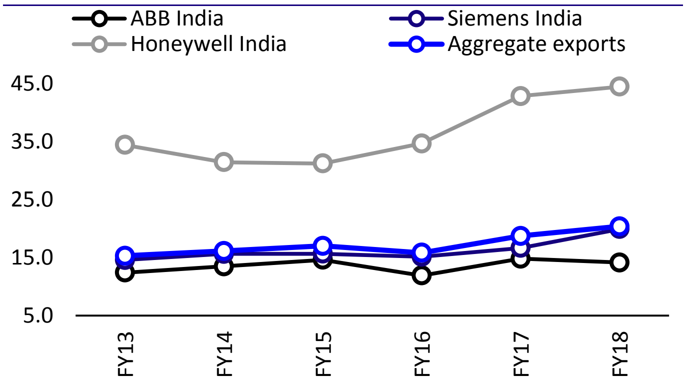
- **Rising exports augur well for the sector:** Exports have picked up sharply over the past three years and now contribute ~20% of aggregate revenue for the three companies. Honeywell has the highest export content at 46% of sales as of end-FY19. For ABB and Siemens, the contribution stands ~15% and ~20%, respectively.

Exhibit 5: Aggregate exports have been on the rise



Source: MOFSL, Company; Note: Above data is aggregate of Siemens, ABB and Honeywell normalized to same reporting period

Exhibit 6: Aggregate exports up to 20.4% of sales in FY18 from 15.3% in FY13

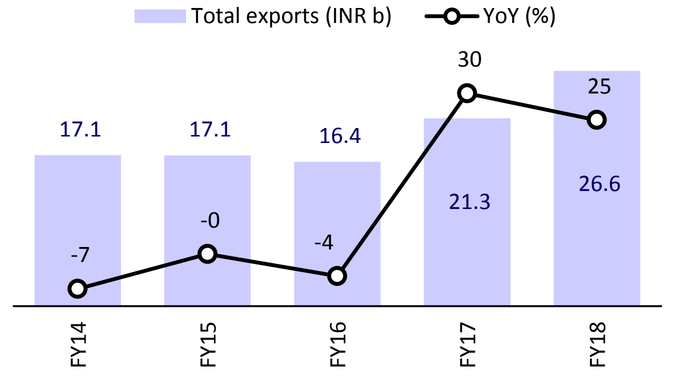


Source: MOFSL, Company

- **Corporate tax cuts augur well for exports growth:** The recent corporate tax cuts augur well for export growth for the Indian engineering companies, as the parent companies can increase utilization of Indian factories over their other factories. ABB India has communicated the use of Indian factories for exports to Bangladesh post the corporate tax cuts; it will likely increase exports to other countries as well.

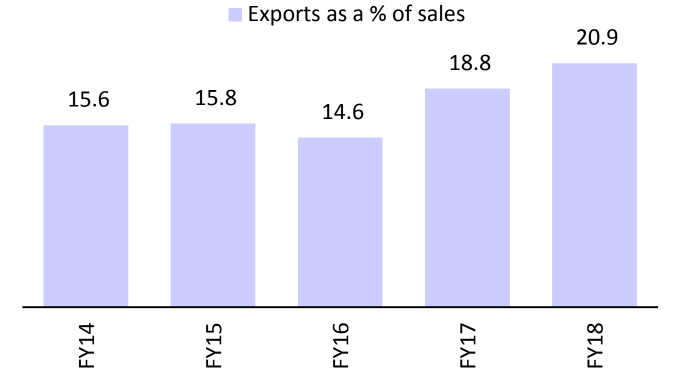
- **Export growth led by external sales rather than just to related parties:** MNCs can procure products & services from Indian entities and supply to end customer themselves or they can utilize Indian factories directly for customer needs. Our analysis of exports trends and related-party transactions suggests that exports growth is primarily led by external sales rather than to related parties. This augurs well for the future of Indian entities as it lays the path for using India as a manufacturing hub for global engineering companies, in our view.

Exhibit 7: SIEM: Exports have been on the rise over last two years



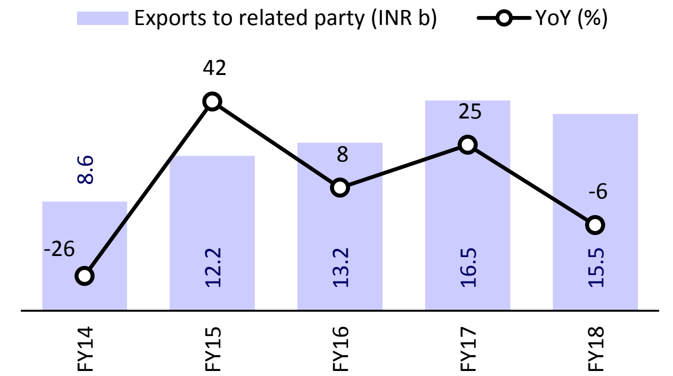
Source: MOFSL, Company

Exhibit 8: SIEM: Exports as % of sales reached 21% by end-FY18



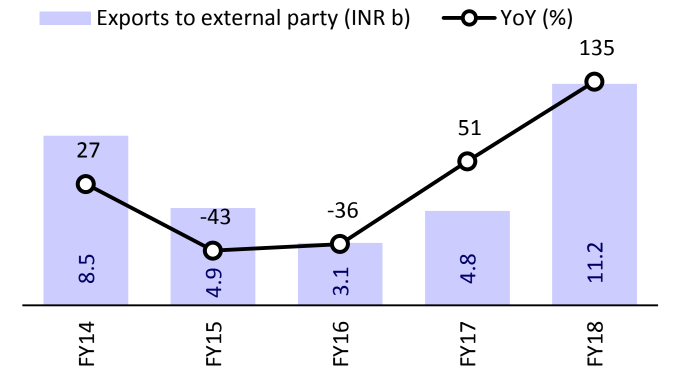
Source: MOFSL, Company

Exhibit 9: Siemens' exports to related party have been muted over past four years…



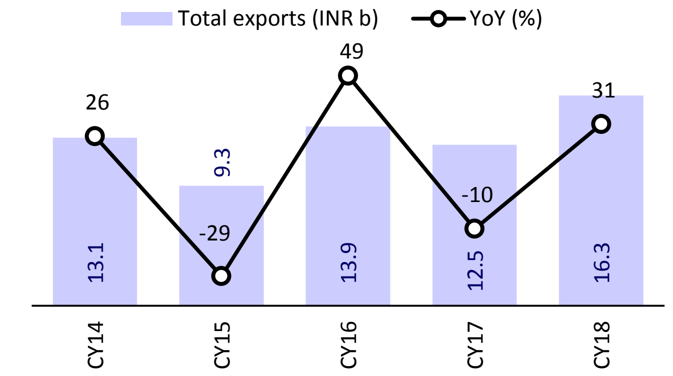
Source: MOFSL, Company

Exhibit 10: …however, exports to external party have jumped sharply over last two years



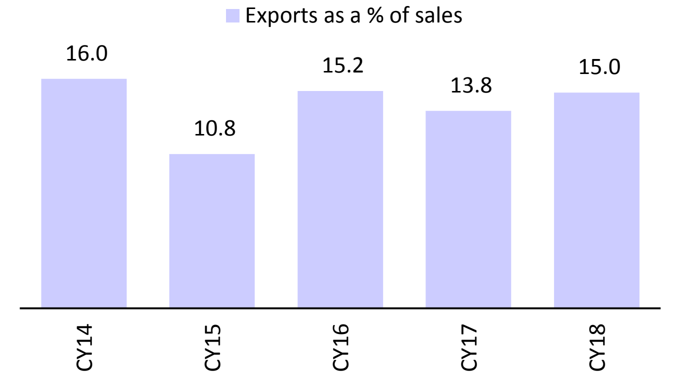
Source: MOFSL, Company

Exhibit 11: ABB India exports CAGR of 6% over CY15-19



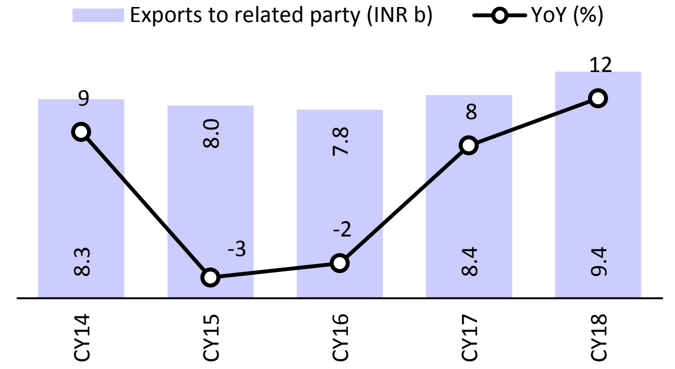
Source: MOFSL, Company

Exhibit 12: ABB India exports as % of sales up to 15% after a blip in CY15



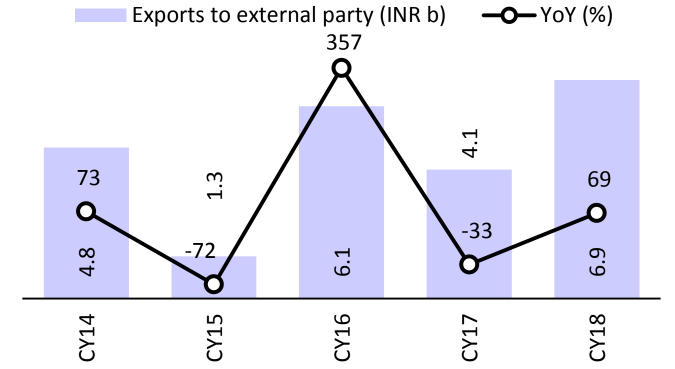
Source: MOFSL, Company

Exhibit 13: ABB India exports to related party



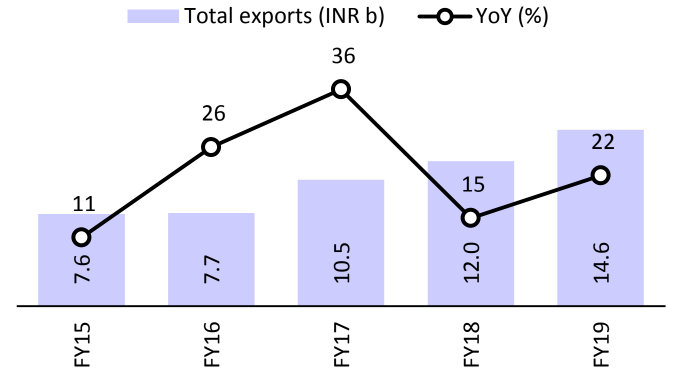
Source: MOFSL, Company

Exhibit 14: ABB India exports to external party



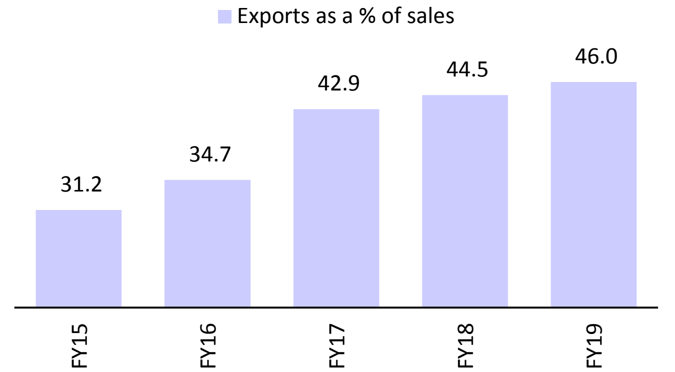
Source: MOFSL, Company

Exhibit 15: Honeywell India exports CAGR of 17.6% over FY15-19 – the best amongst three companies



Source: MOFSL, Company

Exhibit 16: Honeywell India's share of exports in total sales has steadily risen to 46% in FY19



Source: MOFSL, Company

Margins of Indian entities quite low compared to global parents

- **Indian entities make lower margins as services business is yet to scale up:** We performed a comparative analysis of Indian entities with their corresponding global parents. It suggests that in the growth businesses led by digitalization and automation, the Indian entities make quite low margins compared to parent company. This is because economies of scale are yet to kick in due to the nascent stage of the services business in India. We note that the Indian entities have been delivering margin expansion along with revenue growth in these segments. We expect the trend to continue over the next 2-3 years.

Exhibit 17: SIEM: Ample scope of margin improvement (%)

Segment	FY18	FY21E	Global margin	Comment
Gas & Power	13.7%	13.5%	8-12%	❖ In-line
Smart Infrastructure	9.3%	10.3%	10-15%	❖ Scope for margin improvement
Mobility	10.1%	10.1%	9-12%	❖ Scope for margin improvement
Digital Industries	6.1%	7.1%	17-23%	❖ Scope for margin improvement

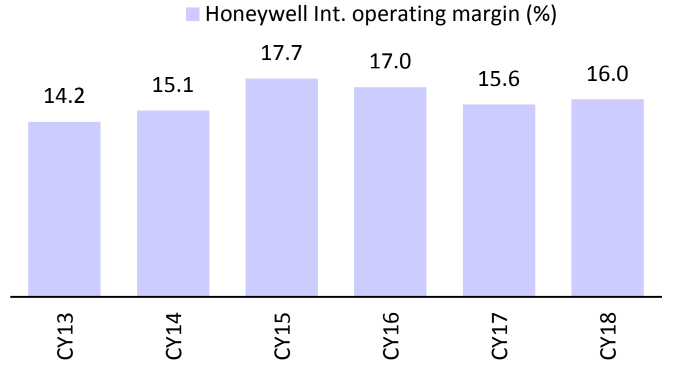
Source: MOFSL, Company

Exhibit 18: ABB India: Ample scope of margin improvement (%)

Segment	CY19E	CY21E	Global margin (CY18)	Comment
Electrification products	9.3%	10.1%	13.9%	❖ Scope for margin improvement
Industrial automation	10.0%	10.3%	13.8%	❖ Scope for margin improvement
Robotics and motion	9.5%	10.3%	15.8%	❖ Scope for margin improvement

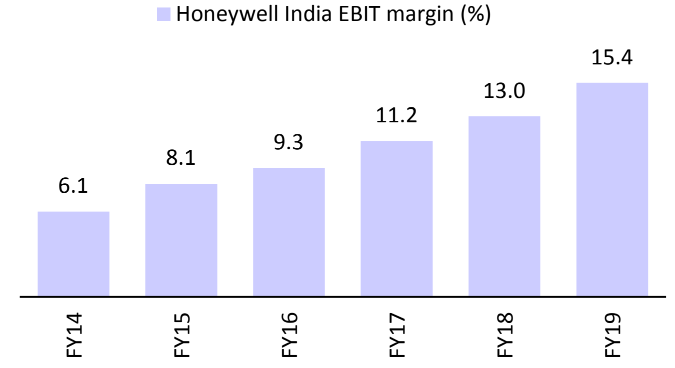
Source: MOFSL, Company

Exhibit 19: Global segment margin for Honeywell Int.



Source: MOFSL, Company

Exhibit 20: EBIT margin of Honeywell India

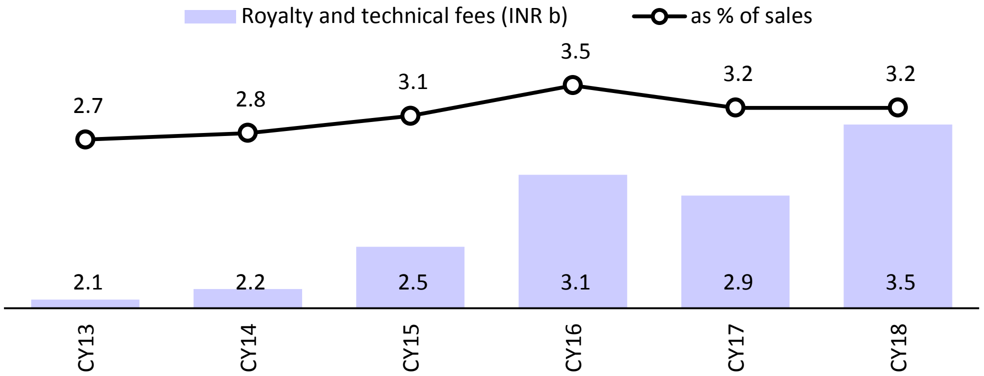


Source: MOFSL, Company

- **Expect Indian entities to make lower margins than parent companies owing to royalty/technical fees:** While there is ample room for margin expansion given the margin differential between the parent and Indian entities, we do consider the royalty/technical fee as a factor for the same. Thus, to the extent of such fees, the Indian entities are expected to have lower margins compared to their parent companies. Among the three companies, only ABB India has a defined royalty and technical policy in place. We believe that Siemens has a very low royalty payout (~1%) and thus it is not disclosed separately. Note that according to the regulations, the listed companies are required to obtain approval from the 'majority of minority' shareholders if the payment toward royalty & license fee exceeds 2% of consolidated revenue of the listed company.

- **ABB India:** According to the latest policy of ABB India, royalty and technical fee to parent has a cap at 4.2% of the total turnover of the company. In CY18, royalty payments from ABB India stood at 3.2% of sales.

Exhibit 21: ABB's royalty and technical fees trend

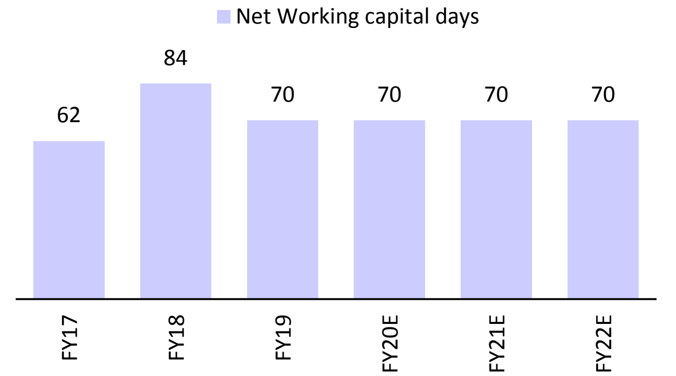


Source: MOFSL, Company

Superior balance sheet led by strong cash flow generation

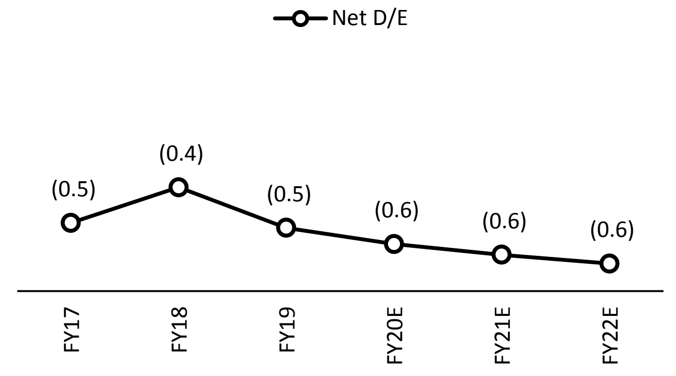
- **Net cash balance sheet provides comfort:** We derive comfort from the net cash balance sheet positions of engineering companies. With growth being driven by the products & services business, the balance sheets of these companies will continue strengthening further.
- **RoEs depressed owning to excess cash on balance sheet:** One key argument against the companies like Siemens and ABB is their low RoEs. However, we note that the reason of low RoEs is excess cash on their balance sheets. Companies have preferred higher cash balance for inorganic growth opportunities in niche technologies. However, these companies are yet to make any meaningful acquisitions.
- **Working capital cycle improving:** Siemens, ABB and Honeywell have witnessed an improvement in the working capital cycle over the past few years. We expect these companies to be prudent in working capital management.

Exhibit 22: SIEM: Working capital days expected to stabilize at 70 days from FY20



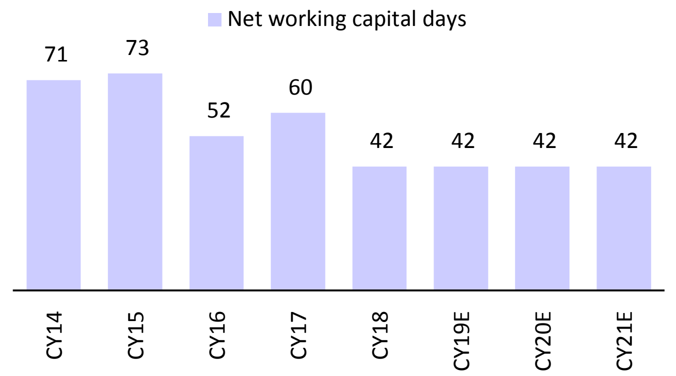
Source: MOFSL, Company

Exhibit 23: SIEM: Net D/E position expected to improve further owing to strong cash generation



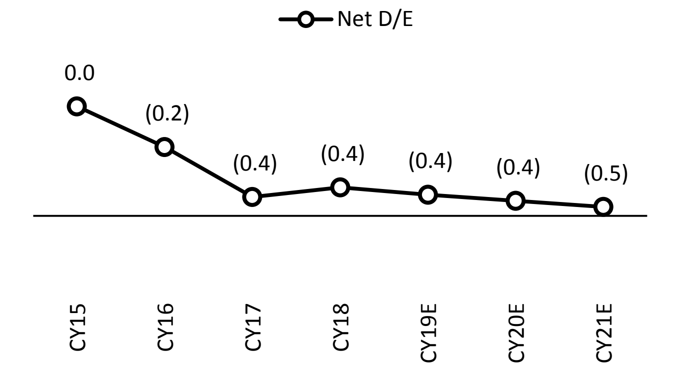
Source: MOFSL, Company

Exhibit 24: ABB India: Working capital days to be lower compared to historical levels post demerger of Power Grid business



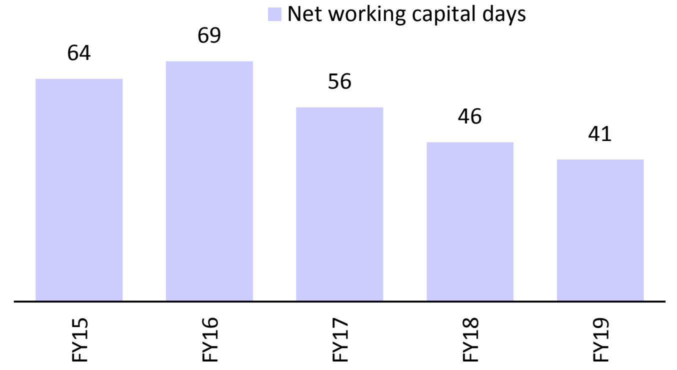
Source: MOFSL, Company

Exhibit 25: ABB India: Net D/E expected to improve further with ABB India remaining a net cash company



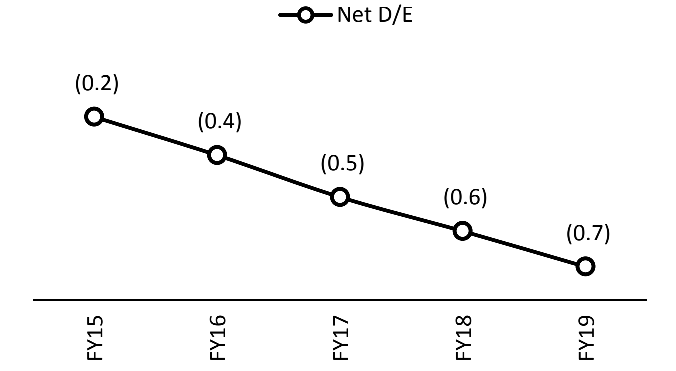
Source: MOFSL, Company

Exhibit 26: Honeywell India: Working capital days have improved significantly from FY16



Source: MOFSL, Company

Exhibit 27: Honeywell India: Net D/E has further improved owing to strong cash generation



Source: MOFSL, Company

Maintaining Buy on Siemens; upgrading ABB to Buy

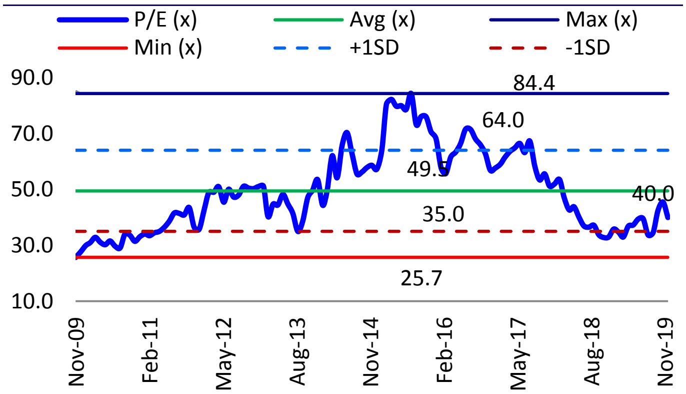
We upgrade ABB to Buy with a target price of INR1,660. Pending demerger of Power Grid business (likely by Jun'20) has led to valuation correction. Separately, we maintain our Buy rating on Siemens with a target price of INR1,705.

Exhibit 28: Valuation summary - Capital Goods

Company	Mkt Cap	CMP		PE (x)			RoE (%)			Net D/E		
name	(INR b)	(INR)	Rating	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
ABB	306	1,443	Buy	56.4	45.7	37.8	13.1	14.2	15.0	-0.4	-0.4	-0.4
Siemens	525	1,475	Buy	53.0	41.8	34.8	11.4	13.0	14.1	-0.5	-0.6	-0.6
Honeywell	232	26,240	NR	64.6	47.3	40.8	20.5	22.3	21.0	-0.7	-0.8	-0.8
Mkt Cap weighted average				**56.5**	**44.1**	**37.0**	**13.9**	**15.4**	**15.9**	**-0.5**	**-0.6**	**-0.6**

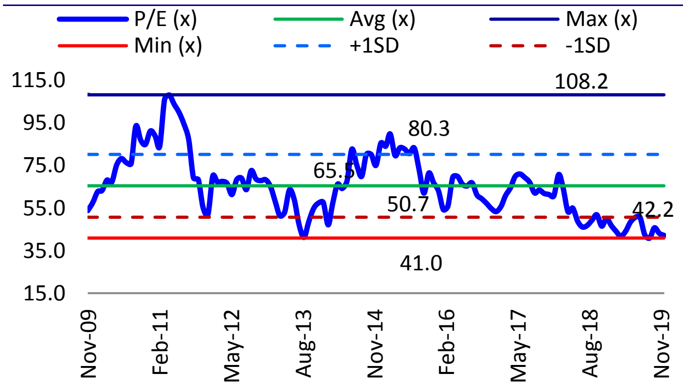
Source: MOFSL, Company; Note: Since all the three companies have different reporting period, we have normalized their ratios for easier comparison purpose

Exhibit 29: Siemens trades at 1Y P/E multiple of ~40x v/s long-term average of ~50x



Source: MOFSL, Company

Exhibit 30: ABB trades at 1Y fwd P/E multiple of ~42x v/s long-term average of ~65x



Source: MOFSL, Company

Siemens

BSE SENSEX	S&P CNX
40,794	12,056

SIEMENS

Stock Info

Bloomberg	SIEM IN
Equity Shares (m)	356
M.Cap.(INRb)/(USDb)	523.6 / 7.3
52-Week Range (INR)	1717 / 902
1, 6, 12 Rel. Per (%)	-13/13/47
12M Avg Val (INR M)	740
Free float (%)	25.0

Financials Snapshot (INR b)

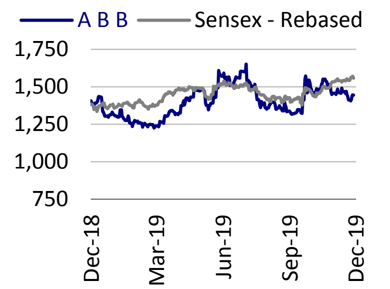
Y/E SEP	2019	2020E	2021E
Net Sales	136.8	147.9	165.7
EBITDA	14.8	17.0	19.1
PAT	10.9	14.2	16.0
EPS (INR)	30.5	40.0	44.9
Gr. (%)	21.6	31.0	12.2
BV/Sh (INR)	254.0	284.4	318.5
RoE (%)	12.0	14.1	14.1
RoCE (%)	12.4	14.5	14.5
P/E (x)	48.3	36.9	32.9
P/BV (x)	5.8	5.2	4.6

Shareholding pattern (%)

As On	Sep-19	Jun-19	Sep-18
Promoter	75.0	75.0	75.0
DII	11.9	11.8	9.6
FII	2.2	2.1	4.6
Others	10.9	11.1	10.8

FII Includes depository receipts

Stock Performance (1-year)



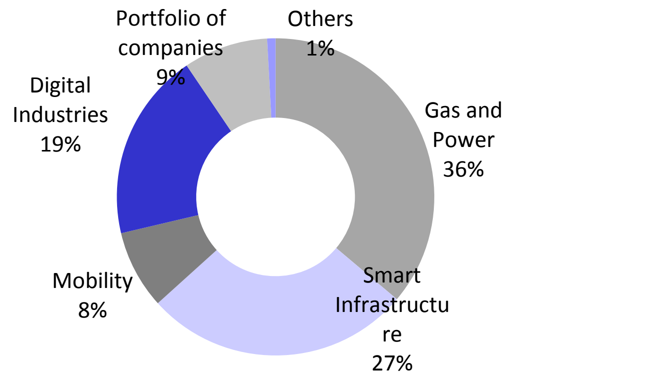
CMP: INR1,475 TP: INR1,705 (+16%) Buy

Margin expansion-led earnings growth

- **Multiple growth levers across industry segments:** The strong focus on products & services has helped Siemens to mitigate the slowdown in industrial capex, as it has been able to capitalize on opex-related spending. We expect the trend to continue, driving strong growth for its products business. Any revival in capex spending can further strengthen its revenue trajectory (not a base-case scenario for us and consensus).
- **Revenue CAGR (excl. Gas & Power) estimated at 14% over FY19-22 (year ending September):** We expect overall revenue growth to be driven by Smart Infrastructure and Digital Industries. However, the gas & power division (37% of revenue) is expected to be muted as the HVDC order is approaching completion and the outlook remains weak on power capex. Thus, we expect overall revenue CAGR of ~10% over FY19-21 but a pick up thereafter.
- **Margin expansion – a key driver of earnings:** We expect the EBIT margin to expand from 9.2% in FY19 to 10.1% in FY21, as the share of the products & services business increases further. We note that SIEM has steadily expanded its EBIT margin from 4.7% in FY14 to 9.2% in FY19. This is attributable to (a) the rising share of the products & services business, (b) the completion of loss-making/low-margin projects and (c) export incentives in the services business in the gas & power segment. A comparison of the segmental margins with the parent company suggests a further scope of margin expansion in products & services.
- **Look beyond near-term business weakness:** The recent weakness in new order inflows (down 14% YoY in 4QFY19) has cast some doubt over an otherwise strong structural story. We attribute this to the likely decline in the end market of the auto industry (where Siemens has high exposure) and slowing growth momentum in the F&B industry. Also, management let go of certain large-ticket size orders, especially in the mobility segment, on account of intense competition. Our revenue forecasts adequately capture the recent weakness in the ordering environment. However, we remain positive from the medium- to long-term perspective as we expect the company to be a key beneficiary of Industry 4.0 and the recent cut in the corporate tax rates.
- **Maintain Buy with TP of INR1,705:** We assign a TP of INR1,705 to the stock based on a target P/E multiple of 38x on Sep'21E EPS. We forecast earnings CAGR of 19.4% over FY19-22. Maintain **Buy**.

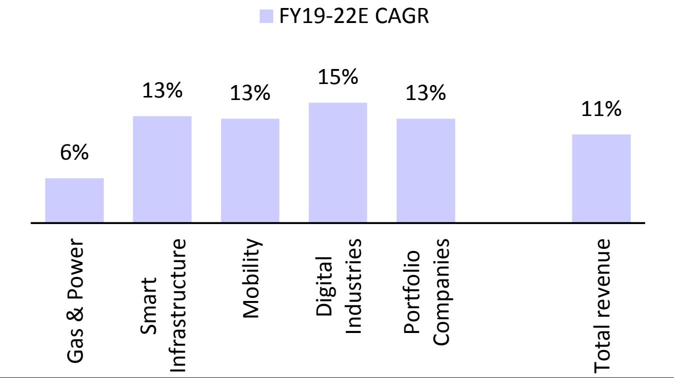
Story in charts

Exhibit 31: Revenue break-up (FY19) according to new segmentation



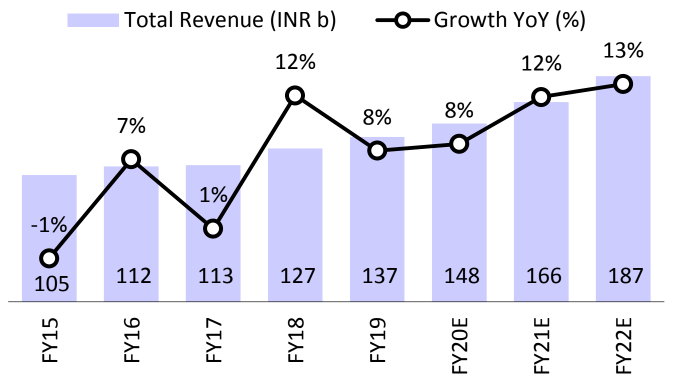
Source: MOFSL, Company

Exhibit 32: Revenue CAGR assumption across segments



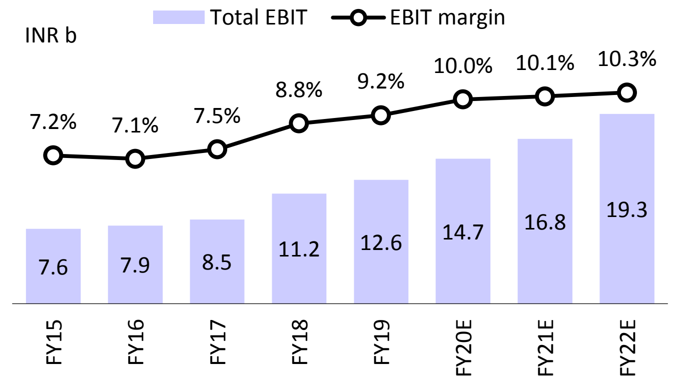
Source: MOFSL, Company

Exhibit 33: We forecast revenue CAGR of 11% over FY19-22



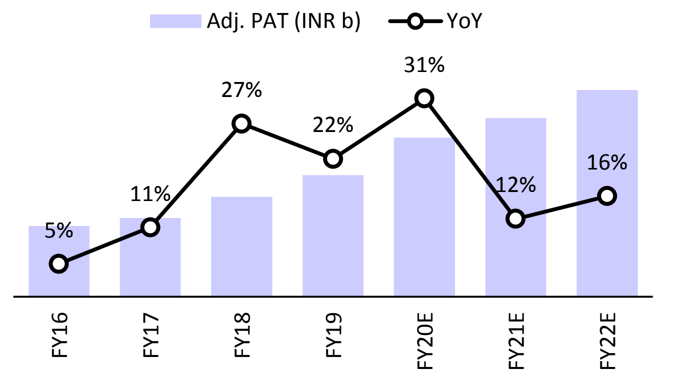
Source: MOFSL, Company

Exhibit 34: EBIT and EBIT margin trend



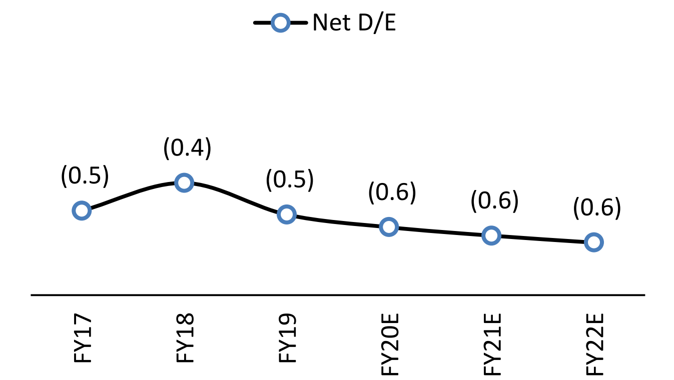
Source: MOFSL, Company

Exhibit 35: We forecast earnings CAGR of 19.4% over FY19-22, aided by tax rate cuts.



Source: MOFSL, Company

Exhibit 36: Siemens enjoys net cash balance sheet



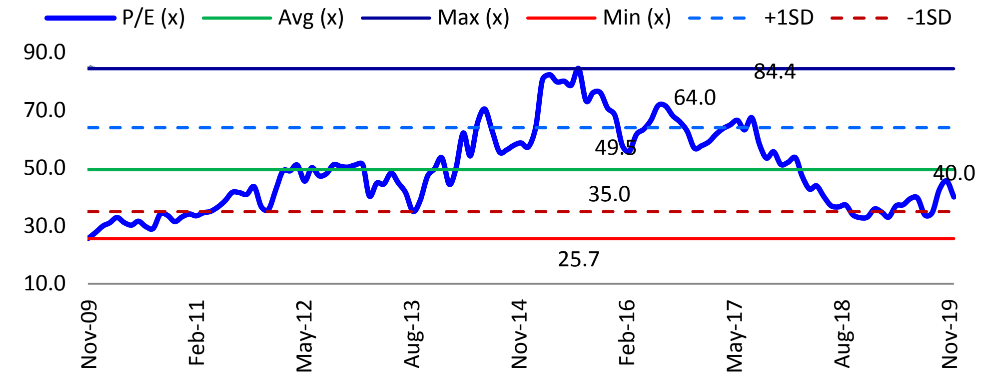
Source: MOFSL, Company

Exhibit 37: We assign TP of INR1,705 (target multiple of 38x Sep'21 EPS)

Valuation	Basis	Multiple	Sep'21 EPS	Value/share
Core business	Sep'21 PE	38.0	44.9	1,705
Total			**44.9**	**1,705**

Source: MOFSL, Company

Exhibit 38: Siemens trades at 1Y fwd P/E multiple of ~40x v/s long-term average of ~50x



Source: MOFSL

Financials and Valuations

Income Statement (Standalone)						(INR Million)
Y/E September	**2017**	**2018**	**2019**	**2020E**	**2021E**	**2022E**
Total Revenues	**1,10,148**	**1,27,251**	**1,36,838**	**1,47,927**	**1,65,671**	**1,87,334**
Change (%)	1.9	15.5	7.5	8.1	12.0	13.1
EBITDA	**10,512**	**13,161**	**14,757**	**16,999**	**19,122**	**21,786**
Change (%)	3	25	12	15	12	14
% of Total Rev.	9.5	10.3	10.8	11.5	11.5	11.6
Depreciation	1,967	1,967	2,173	2,259	2,368	2,477
Interest	77	82	114	114	114	114
Other Income	2,547	2,800	3,946	4,402	4,710	5,521
EO Items (net)	4,301	0	0	0	0	0
PBT	**15,317**	**13,912**	**16,416**	**19,029**	**21,350**	**24,715**
Tax	3,982	4,973	5,547	4,790	5,374	6,221
Rate (%)	26.0	35.7	33.8	25.2	25.2	25.2
PAT	**11,335**	**8,939**	**10,869**	**14,239**	**15,976**	**18,494**
Adjusted PAT	**7,034**	**8,939**	**10,869**	**14,239**	**15,976**	**18,494**
Change (%)	10.9	27.1	21.6	31.0	12.2	15.8

Balance Sheet (Standalone)						(INR Million)
Y/E September	**2017**	**2018**	**2019**	**2020E**	**2021E**	**2022E**
Share Capital	712	712	712	712	712	712
Reserves	76,335	82,342	89,724	1,00,546	1,12,688	1,26,744
Net Worth	**77,047**	**83,054**	**90,436**	**1,01,258**	**1,13,400**	**1,27,456**
Loans	0	0	0	0	0	0
Net Deferred Tax Liab	**-2,442**	**-2,665**	**-2,410**	**-2,410**	**-2,410**	**-2,410**
Capital Employed	**74,605**	**80,389**	**88,026**	**98,848**	**1,10,990**	**1,25,046**
Gross Fixed Assets	17,502	19,574	20,137	21,137	22,137	23,137
Less: Depreciation	4,158	6,060	8,233	10,492	12,859	15,337
Net Fixed Assets	**13,344**	**13,514**	**11,904**	**10,645**	**9,278**	**7,800**
Capital WIP	1,430	624	583	583	583	583
Investments	550	550	550	550	550	550
Curr. Assets	**1,13,465**	**1,25,139**	**1,36,657**	**1,53,735**	**1,75,242**	**2,00,537**
Inventory	10,165	11,389	10,950	11,837	13,257	14,991
Debtors	34,725	37,250	38,762	41,903	46,929	53,066
Cash & Bank Balance	40,713	36,457	48,913	58,880	69,009	80,414
Loans & Advances	6,216	8,733	8,513	9,203	10,307	11,654
Other Current assets	21,646	31,310	29,519	31,911	35,739	40,412
Current Liab. & Prov.	**54,184**	**59,438**	**61,668**	**66,665**	**74,662**	**84,425**
Creditors	26,556	30,303	32,907	35,574	39,841	45,050
Other Liabilities	17,377	18,123	17,025	18,405	20,612	23,308
Provisions	10,251	11,012	11,736	12,687	14,209	16,067
Net Current Assets	**59,281**	**65,701**	**74,989**	**87,069**	**1,00,580**	**1,16,113**
Application of Funds	**74,605**	**80,389**	**88,026**	**98,848**	**1,10,990**	**1,25,046**

E: MOFSL Estimates

Financials and Valuations

Ratios

Y/E September	2017	2018	2019	2020E	2021E	2022E
Basic (INR)						
EPS	**19.8**	**25.1**	**30.5**	**40.0**	**44.9**	**51.9**
Growth (%)	10.9	27.1	21.6	31.0	12.2	15.8
Cash EPS	25.3	30.6	36.6	46.3	51.5	58.9
Book Value	216.4	233.3	254.0	284.4	318.5	358.0
DPS	7.0	7.0	7.0	8.0	9.0	10.4
Payout (incl. Div. Tax.)	20.0	20.0	20.0	20.0	20.0	20.0
Valuation (x)						
P/E (Standalone)	49.9	39.3	48.3	36.9	32.9	28.4
Cash P/E	39.0	32.2	40.3	31.8	28.6	25.0
EV/EBITDA	29.5	23.9	32.3	27.4	23.9	20.4
EV/Sales	2.8	2.5	3.5	3.2	2.8	2.4
Price/Book Value	4.6	4.2	5.8	5.2	4.6	4.1
Dividend Yield (%)	0.7	0.7	0.5	0.5	0.6	0.7
Profitability Ratios (%)						
EBITDA Margin	9.5	10.3	10.8	11.5	11.5	11.6
Net Margin	6.4	7.0	7.9	9.6	9.6	9.9
RoE	9.1	10.8	12.0	14.1	14.1	14.5
RoCE	11.0	11.2	12.4	14.5	14.5	14.9
RoIC	23.3	20.8	27.7	36.5	40.3	44.6
Turnover Ratios						
Debtors (Days)	115	107	103	103	103	103
Inventory (Days)	34	33	29	29	29	29
Creditors. (Days)	88	87	88	88	88	88
Asset Turnover (x)	1.5	1.6	1.6	1.5	1.5	1.5
Leverage Ratio						
Net Debt/Equity (x)	(0.5)	(0.4)	(0.5)	(0.6)	(0.6)	(0.6)

Cash Flow Statement **(INR Million)**

Y/E September	2017	2018	2019	2020E	2021E	2022E
PBT before EO Items	**11,016**	**13,912**	**16,416**	**19,029**	**21,350**	**24,715**
Add : Depreciation	1,967	1,967	2,173	2,259	2,368	2,477
Interest	3	4	114	114	114	114
Less: Directtaxespaid	3,982	4,973	-6,130	-4,790	-5,374	-6,221
(Inc)/Dec in WC	-3,200	-10,676	4,452	-2,113	-3,381	-4,128
CF from Operations	**5,801**	**230**	**17,025**	**14,499**	**15,077**	**16,957**
EO Income	5,205	0	-1,338	0	0	0
CF from oper. Incl. EOitems	**11,006**	**230**	**15,687**	**14,499**	**15,077**	**16,957**
(Inc)/dec in FA	-2,863	-1,554	-336	-1,000	-1,000	-1,000
Free Cash Flow	**8,143**	**-1,324**	**15,351**	**13,499**	**14,077**	**15,957**
(Pur)/Sale of Investments	-0	0	235	0	0	0
CF from Investments	**-2,863**	**-1,554**	**-101**	**-1,000**	**-1,000**	**-1,000**
(Inc)/Dec in Networth	496	58	0	0	0	0
Inc/(Dec) in Debt	0	0	0	0	0	0
Less : Interest Paid	77	54	108	114	114	114
Dividend Paid	2,990	2,990	3,005	3,417	3,834	4,439
CF from Fin. Activity	**-2,572**	**-2,986**	**-3,113**	**-3,531**	**-3,948**	**-4,553**
Inc/Dec of Cash	5,571	-4,310	12,473	9,967	10,129	11,405
Add: Beginning Bal.	35,094	40,713	36,457	48,913	58,880	69,009
Closing Balance	**40,713**	**36,457**	**48,913**	**58,880**	**69,009**	**80,414**

E: MOFSL Estimates

ABB

BSE SENSEX	S&P CNX
40,794	12,056

CMP: INR1,443 **TP: INR1,660(+15%)** **Upgrade to Buy**

Demerger overhang provides entry point

Stock Info

Bloomberg	ABB IN
Equity Shares (m)	212
M.Cap.(INRb)/(USDb)	306.4 / 4.3
52-Week Range (INR)	1669 / 1210
1, 6, 12 Rel. Per (%)	-2/-11/-8
12M Avg Val (INR M)	178
Free float (%)	25.0

Financials Snapshot (INR b)

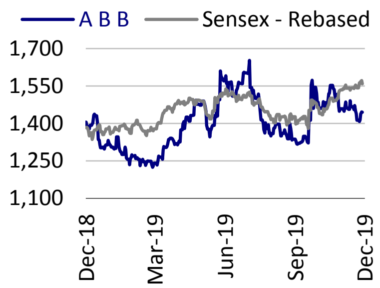
Y/E DEC	2019E	2020E	2021E
Net Sales	75.1	86.2	100.1
EBITDA	6.3	7.7	9.5
PAT	4.1	5.5	6.9
EPS (INR)	19.3	25.8	32.4
Gr. (%)	61.2	33.7	25.4
BV/Sh (INR)	214.4	244.6	280.5
RoE (%)	14.0	14.9	15.5
RoCE (%)	15.0	15.8	16.4
P/E (x)	74.9	56.0	44.7
P/BV (x)	6.8	5.9	5.2

Shareholding pattern (%)

As On	Sep-19	Jun-19	Sep-18
Promoter	75.0	75.0	75.0
DII	12.2	12.7	13.5
FII	3.4	3.5	3.2
Others	9.4	8.9	8.3

FII Includes depository receipts

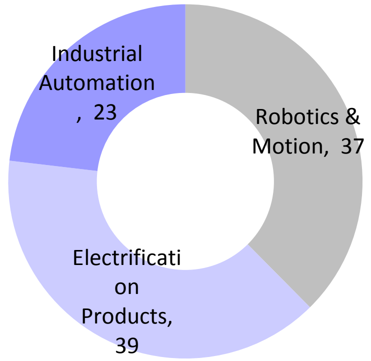
Stock Performance (1-year)



- **Post demerger, the residual business will be pure play on Industry 4.0:** Post the pending demerger of Power Grid business, ABB India's business will be largely products & services oriented with projects forming 7-8% of revenue. This makes it a pure play on the digitalization and automation theme. After coming in at 13% over CY15-18, residual business revenue CAGR is estimated at 14% over CY18-21.
- **Order inflows may be volatile due to short cycle nature of business:** Given the high component of products & services, the residual business will be short cycle in nature. Thus, order inflows may be volatile over the near term, especially given ups and downs of the economic cycle. For example, order inflows increased at just 5% YoY in 3QCY19 v/s 23% YoY in the preceding quarter. While the sharp slowdown in order inflow momentum may be attributed to the current economic slowdown, we believe that order inflows will bounce back sharply as the economy recovers.
- **Not just a capex play, beneficiary of consumption-led growth as well:** Historically, ABB has been a key beneficiary of the capex cycle. However, over the past few years, it has been realigning its business model toward the changing realities of industrialization. Thus, from primary a power sector dependent company, ABB India today caters to end markets across industries. Thus, we believe that the sensitivity of earnings to capex spending has reduced drastically. ABB is a beneficiary of consumption revival as well, especially in the end markets of auto, food and beverages.
- **Expect strong earnings momentum to continue:** Over FY13-18, ABB delivered an adj. PAT CAGR of ~20%. In 9MCY19, it delivered reported PAT growth of 22% YoY. However, in the continued business, the growth rate stands at 89.2%. We forecast residual business CAGR of 29.5% over CY19-21. Including the Power Grid business, the earnings CAGR stands at 22.9%.
- **Upgrading to Buy with a TP of INR1,660.** ABB's stock has rallied just 10% YTD v/s 40% for Siemens and 13% for Nifty 50 Index. We attribute this underperformance to the pending demerger of the Power Grid business (likely by Jun'20). ABB, along with Siemens, is one of the biggest beneficiaries of the corporate tax cut and also the likely beneficiary of the boost in the manufacturing sector in India. Exports as a percentage of revenue stand at ~15% and have grown 91% in 9MCY19 (CY18: 31%). We continue valuing its discontinued T&D business at a target multiple of 25x and current core business at 45x. However, we roll over our TP to Sep'21E EPS from Mar'21E. Thus, our TP increases to INR1,660. We **upgrade ABB to Buy** from Neutral.

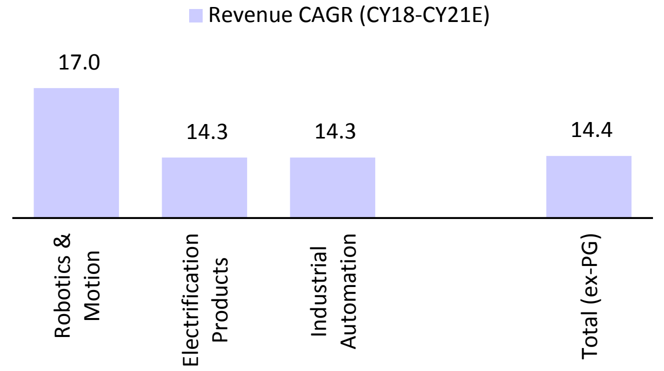
Story in charts

Exhibit 39: Revenue break-up (excl. PG)



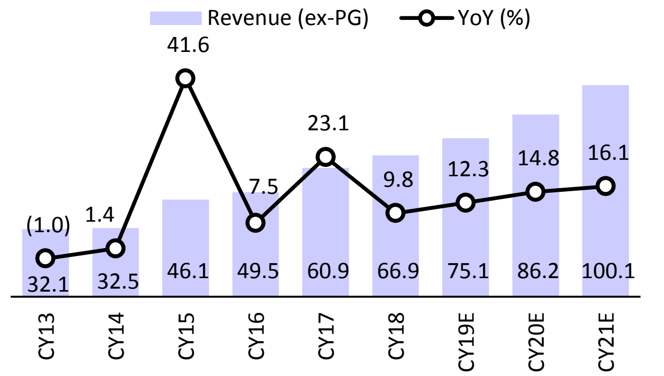
Source: MOFSL, Company

Exhibit 40: Revenue CAGR assumption in continued business



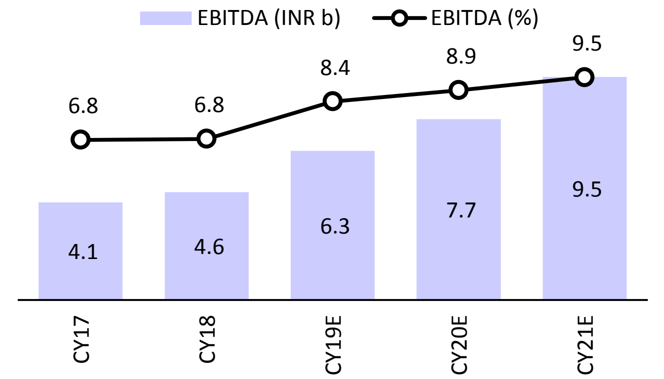
Source: MOFSL, Company

Exhibit 41: We forecast revenue CAGR of 14.4% in continued business over CY18-21



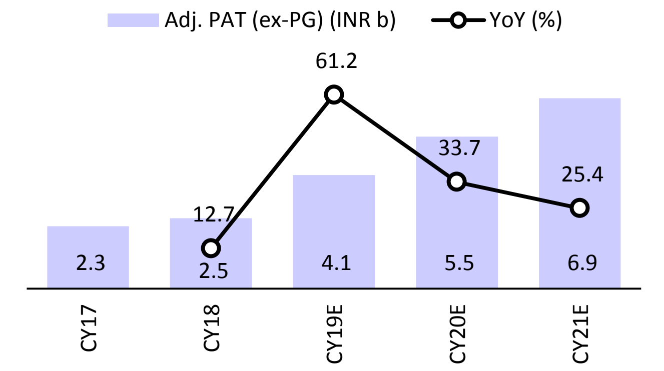
Source: MOFSL, Company

Exhibit 42: EBITDA and EBITDA margin in continued business; note that EBITDA margin for 9MCY19 has already expanded 220bp YoY



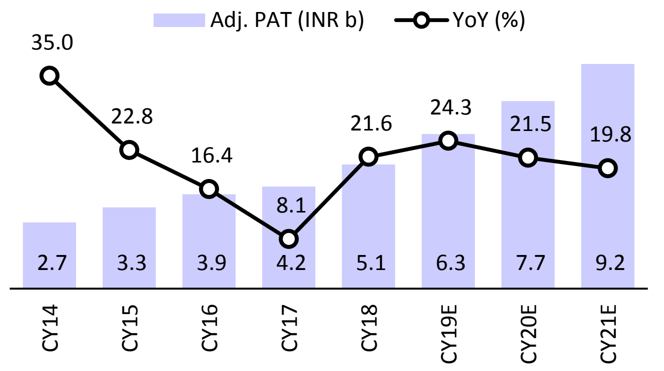
Source: MOFSL, Company

Exhibit 43: Expect adj. PAT (excl. PG) CAGR of 39.3% over CY18-21 (9MCY19: 89.2%)



Source: MOFSL, Company

Exhibit 44: Expect adj. PAT (incl. PG) CAGR of 21.8% over CY18-21 v/s 17% over CY14-18 as tax cuts help boost earnings



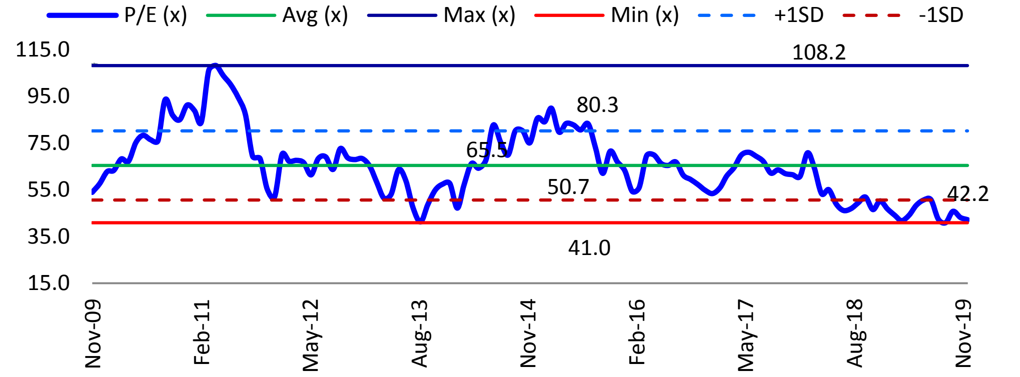
Source: MOFSL, Company

Exhibit 45: We value ABB at INR1,660/sh

Valuation	Basis	PE Multiple	Dec'20 EPS	Dec'21 EPS	Sep'21 EPS	Value/ share
ABB (ex-PG)	Sep'21 PE	45.0	25.8	32.4	30.8	1,384
PG	Sep'21 PE	25.0	10.6	11.2	11.0	276
Total		**39.7**	**36.4**	**43.6**	**41.8**	**1,660**

Source: MOFSL, Company

Exhibit 46: ABB trades at 1Y fwd P/E multiple of ~42x v/s long-term average of ~65x



Source: MOFSL

Financials and Valuations

Income Statement (INR Million)

Y/E December	2016	2017	2018	2019E	2020E	2021E
Net Sales	**86,422**	**60,937**	**66,901**	**75,099**	**86,223**	**1,00,133**
Change (%)	6.2	-29.5	9.8	12.3	14.8	16.1
EBITDA	**7,085**	**4,146**	**4,578**	**6,333**	**7,682**	**9,471**
% of Net Sales	8.2	6.8	6.8	8.4	8.9	9.5
Depreciation	1,510	1,012	928	930	1,008	1,086
Interest	919	572	539	200	200	200
Other Income	1,216	777	840	738	843	988
Extra-ordinary Items (net)	-140	1,945	2,567	2,253	2,239	2,375
PBT	**5,733**	**5,284**	**6,518**	**8,194**	**9,556**	**11,549**
Tax	1,988	1,084	1,410	1,845	1,842	2,309
Rate (%)	34.7	20.5	21.6	22.5	19.3	20.0
PAT (incl. PG)	**3,745**	**4,200**	**5,109**	**6,349**	**7,714**	**9,240**
Adjusted PAT	**3,885**	**2,255**	**2,542**	**4,096**	**5,475**	**6,865**
Change (%)	16.4	-41.9	12.7	61.2	33.7	25.4

Balance Sheet (INR Million)

Y/E December	2016	2017	2018	2019E	2020E	2021E
Share Capital	424	424	424	424	424	424
Reserves	32,443	35,645	39,649	45,015	51,415	59,008
Net Worth	**32,867**	**36,069**	**40,073**	**45,439**	**51,839**	**59,431**
Loans	6,000	41	20	20	20	20
Net Deffered Tax Liability	-1,304	-1,173	-1,150	-1,150	-1,150	-1,150
Capital Employed	**37,564**	**34,937**	**38,944**	**44,310**	**50,710**	**58,302**
Gross Fixed Assets	14,059	15,251	11,419	12,419	13,419	14,419
Less: Depreciation	1,510	3,064	2,488	3,418	4,425	5,511
Net Fixed Assets	**12,549**	**12,187**	**8,931**	**9,002**	**8,994**	**8,908**
Capital WIP	678	1,165	831	831	831	831
Investments	163	2,706	2	2	2	2
Curr. Assets	**62,618**	**71,650**	**58,628**	**67,532**	**78,837**	**92,637**
Inventory	9,403	11,536	9,279	10,415	11,958	13,887
Debtors	29,707	27,641	16,869	18,936	21,741	25,248
Cash & Bank Balance	11,892	14,917	14,751	16,858	19,758	23,473
Loans & Advances	413	462	263	295	338	393
Other current Assets	11,204	17,095	17,468	21,028	25,041	29,636
Current Liab. & Prov.	**38,445**	**52,770**	**29,448**	**33,056**	**37,953**	**44,076**
Creditors	21,573	27,131	18,745	21,042	24,159	28,056
Other Liabilities	13,326	22,067	8,046	9,032	10,370	12,043
Provisions	3,546	3,572	2,657	2,982	3,424	3,976
Net Current Assets	**24,174**	**18,880**	**29,180**	**34,476**	**40,884**	**48,561**
Application of Funds	**37,564**	**34,938**	**38,944**	**44,310**	**50,710**	**58,302**

E: MOFSL Estimates

Financials and Valuations

Ratios

Y/E December	2016	2017	2018	2019E	2020E	2021E
Basic (INR)						
EPS	**18.3**	**10.6**	**12.0**	**19.3**	**25.8**	**32.4**
Growth	16.4	-41.9	12.7	61.2	33.7	25.4
Cash EPS	25.5	15.4	16.4	23.7	30.6	37.5
Book Value	155.1	170.2	189.1	214.4	244.6	280.5
DPS	4.0	4.4	4.8	3.9	5.2	6.5
Payout (incl. Div.Tax)	21.8	41.3	40.0	20.0	20.0	20.0
Valuation (x)						
P/E	78.9	136.0	120.6	74.9	56.0	44.7
Cash P/E	56.8	93.8	88.4	61.0	47.3	38.6
EV/EBITDA	42.4	70.4	63.8	45.8	37.3	29.9
EV/Sales	3.5	4.8	4.4	3.9	3.3	2.8
Price/Book Value	9.3	8.5	7.7	6.7	5.9	5.2
Dividend Yield (%)	0.3	0.3	0.3	0.3	0.4	0.4
Profitability Ratios (%)						
RoE	11.8	11.6	12.7	14.0	14.9	15.5
RoCE	12.0	11.5	14.4	15.0	15.8	16.4
RoIC	14.9	17.6	21.3	24.9	26.2	27.6
Turnover Ratios						
Debtors (Days)	125	166	92	92	92	92
Inventory (Days)	40	69	51	51	51	51
Creditors. (Days)	91	163	102	102	102	102
Asset Turnover (x)	2.3	1.7	1.7	1.7	1.7	1.7
Leverage Ratio						
Net Debt/Equity (x)	-0.2	-0.4	-0.4	-0.4	-0.4	-0.4

Cash Flow Statement **(INR Million)**

Y/E December	2016	2017	2018	2019E	2020E	2021E
PBT before EO Items	**5,873**	**3,339**	**3,951**	**5,941**	**7,317**	**9,174**
Add : Depreciation	1,712	1,859	2,003	930	1,008	1,086
Interest	200	100	80	200	200	200
Less : Direct taxes paid	1,988	1,084	1,410	1,845	1,842	2,309
(Inc)/Dec in WC	3,986	8,319	-3,671	-935	-1,270	-1,587
CF from operations	**9,381**	**11,586**	**-202**	**4,291**	**5,414**	**6,563**
EO Income	0	0	0	0	0	0
CF from Oper. incl. EO Items	**9,262**	**9,507**	**10,246**	**4,291**	**5,414**	**6,563**
(Inc)/Dec in FA	-1,254	-1,137	2,662	-1,000	-1,000	-1,000
Free Cah Flow	**8,127**	**10,450**	**2,460**	**3,291**	**4,414**	**5,563**
(Pur)/Sale of Investments	1	-2,543	2,705	0	0	0
CF from investments	**-1,989**	**-1,939**	**-1,891**	**-1,000**	**-1,000**	**-1,000**
(Inc)/Dec in Net Worth	22	85	116	0	0	0
(Inc)/Dec in Debt	-371	-297	-237	0	0	0
Less : Interest Paid	200	100	80	-200	-200	-200
Dividend Paid	985	953	1,221	-983	-1,314	-1,648
CF from Fin. Activity	**-2,929**	**-3,714**	**-4,840**	**-1,183**	**-1,514**	**-1,848**
Inc/Dec of Cash	**6,155**	**4,894**	**9,454**	**2,107**	**2,899**	**3,715**
Add: Beginning Balance	5,736	11,892	14,917	14,751	16,858	19,758
Closing Balance	**11,892**	**14,917**	**14,751**	**16,858**	**19,758**	**23,473**

E: MOFSL Estimates

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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