

# MONTHLY MAG

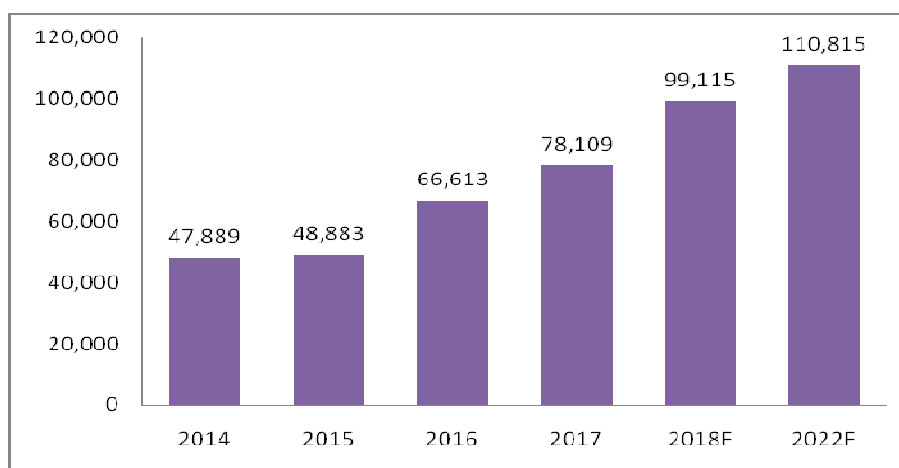
April 2019

- ✓ Sector of the month
- ✓ Picks of the month

**Sector of the Month (Capital Goods):**

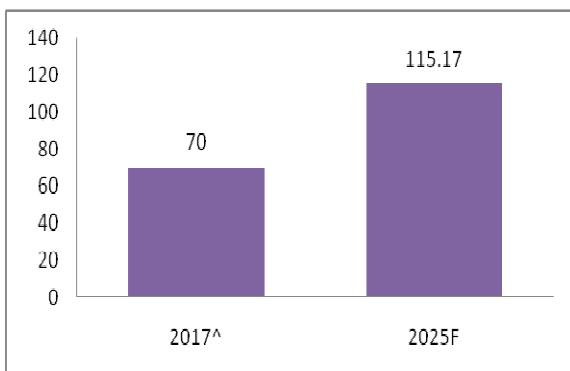
- As India has emerged as the world’s fastest-growing large economy, it’s no surprise that demand for capital goods has more than doubled in the past decade.
- Increasing industrialization and economic development drives growth in the capital goods market. Turnover of the capital goods industry is estimated to have reached US\$ 70.00 billion by 2017 and is forecasted to grow to US\$ 115.17 billion by 2025.
- Growth in the power industry is expected to drive growth in the electrical equipment industry. Electrical equipment market production is forecasted to reach Rs 500,000 crore (US\$ 100 billion) by 2022 from Rs175,000 crore (US\$ 27.3 billion) in 2017-18. The industry grew 19.1 percent year-on-year between Apr-Sep 2018.
- Engineering research and design segment revenues to increase four folds by 2020. ER&D revenues projected to reach US\$ 42 billion by FY22F from US\$ 28 billion in FY18.

**Construction equipment sales volume (in units)**

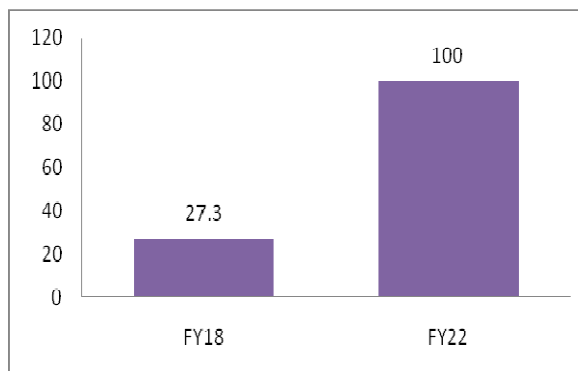


- Construction equipment sales in India increased from 47,889 in 2014 to 78,109 in 2017. Sales are forecasted to advance to 99,115 and 110,815 in 2018 and 2022, respectively. Construction equipment market projected to reach US\$ 7 billion by 2020 from US\$ 4.2 billion in 2017.

**Capital goods turnover (US\$ billion)**



**Electrical equipment production (US\$ billion)**



Source: Ace equity, CARE, IBEF

### Factors Driving Growth

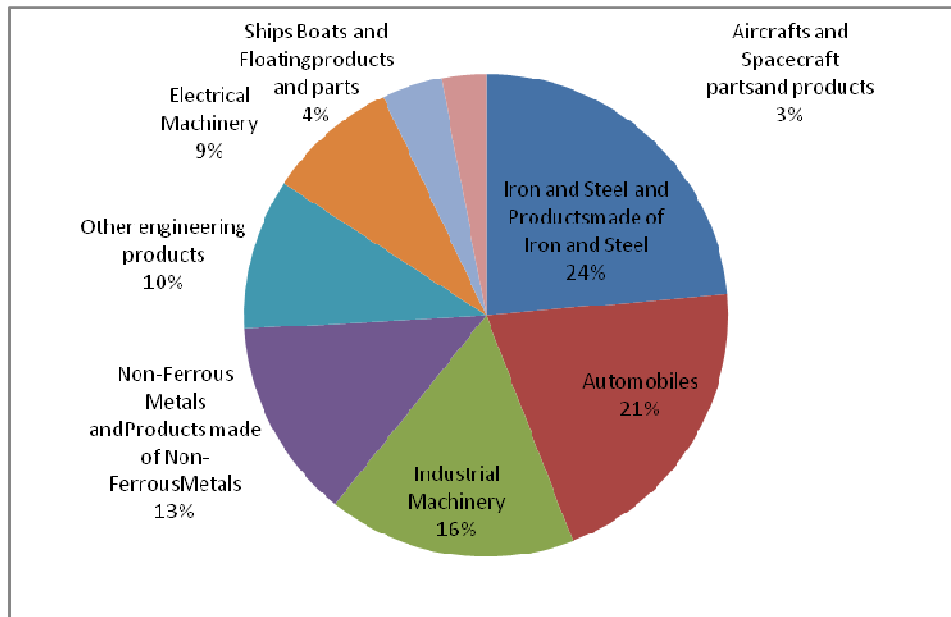
- India was the world's eighth largest consumer of machine tools globally, as of 2017.
- Capacity creation in sectors such as infrastructure, power, mining, oil and gas, refinery, steel, automotive and consumer durables is driving demand in the engineering sector. Rising demand for electrical and construction equipment to also drive the growth.
- Comparative advantage vis-à-vis peers in terms of manufacturing costs, market knowledge, technology and creativity leading to higher investments. Highly organised sector, dominated by large players employing over 4 million skilled and semi-skilled labour .
- Nuclear capacity expansion to provide significant business opportunities to the electrical machinery industry. Infrastructure investments are expected to increase to Rs 50.2 trillion (US\$ 778.90 billion) in FY18-22E<sup>^</sup>, which will provide a significant boost to demand for capital goods.
- De-licensed engineering sector; 100 per cent FDI permitted. Government of India has introduced the National Policy on Capital Goods 2016 which aims to treble production of capital goods and employment opportunities in the sector.
- India's energy requirement is expected to grow from 1,212.13 BU in FY18 to 1,566 BU in FY21 and further to 2,047 BU in 2026-27. The increase in installed power capacity is expected to boost demand for power generation and transmission equipment.
- Infrastructure investments in India increased from US\$ 369.28 million in 2008-12 to US\$ 577.19 million in 2013-17RE and are further expected to grow to US\$ 778.90 million. Government of India has also renewed its focus on development of infrastructure of the country. With development of infrastructure, demand for construction equipment and other machinery is expected to rise significantly.
- The general elections and political stability thereof. Despite the strong progress made in infrastructure building over the past years, the sector remains inadequate, especially in railways, water treatment and roads. India needs around a \$1 trillion infrastructure investment in next few years. However, funding remains a challenge. To attract foreign investment, India needs to ensure that its macro-economic picture remains stable..
- We note that certain macro indicators like credit growth (services) and IIP-based capital goods index have started showing traction. The IIP-based capital goods index was strong during the April-October period at 8.7 per cent compared with 0.7 per cent in the corresponding period of previous financial year. In our view, an improving business cycle should bode well for the capital goods sector.

Source: Ace equity, CARE, IBEF

**ROBUST GROWTH IN INDIA'S ENGINEERING EXPORTS OVER THE YEARS**

- Engineering exports include transport equipment, capital goods, other machinery/ equipment and light engineering products such as castings, forgings and fasteners. During FY08-FY18, engineering exports from India registered growth at a CAGR of 8.50 percent.
- Engineering exports from India grew 16.81 percent to US\$ 76,204.38 million in FY18 from US\$ 65,239.19 million in FY17. Exports grew 5.95 percent year-on-year to reach US\$ 59.13 billion during Apr-Dec 2018. Engineering exports are expected to reach US\$ 80 billion in FY19 on the back of healthy growth in key markets, including US and Europe.
- Engineering exports of India can be divided into eight major categories. Out of these eight categories, Iron and Steel and Products of Iron and Steel form a substantial share (23.59 per cent) of the total engineering exports. Automobiles (20.59 per cent) and Industrial Machinery (16.56 per cent) also contribute a major share of total exports.

**Engineering Export categories**



Source: Ace equity, CARE, IBEF

## Outlook

For a \$2 trillion economy, the country's capital-goods sector remains relatively underdeveloped, offering a significant business opportunity for both Indian and foreign original-equipment manufacturers (OEMs).

India's domestic capital-goods industry is weighed down by low investment in technology and talent. Most companies focus on low-value-add fabrication and assembly work, unable to move up the chain with their designs or technology. Value addition represents only about 22 percent of total output, or \$13 billion, and the capital-goods sector as a whole accounts for just 0.6 percent of India's GDP, compared with 4.1 percent for China, 3.4 percent for Germany, and 2.8 percent for South Korea (exhibit). The output of domestic capital-goods players grew by an average of 2 percent annually from 2010 to 2015, trailing the overall average of 7 percent annual economic growth.

Yet change may be on the horizon. Accelerated economic reforms have created new opportunities in the capital-goods sector, with new policies lowering barriers for domestic and foreign investment as well as for partnerships.

However, the sector is showing early signs of recovery. Gross fixed capital formation in terms of GDP at constant prices during Q2 of 2018-19 was estimated at 32.3 per cent compared with 30.8 per cent in Q2 of 2017-18.

Even industry capacity utilisation as reflected by RBI's survey has improved to 73.8 per cent in Q1FY19 from 71.2 per cent in Q1FY18. In the recently-concluded earnings season, capital goods majors like L& T, Siemens and ABB reported strong growth in order intake.

Capacity expenditure is resuming in consumer-oriented industries like FMCG, auto and tyres, though there has not been much movement in power generation, metals and refinery segments. So, while large-ticket investments are not happening yet, the positive takeaway is that smaller size capex has begun to come onstream.

Source: Ace equity, CARE, IBEF

## Pick of the Month (ABB Ltd.):

**CMP: 1408**

**Target: 1650**

ABB India, the ABB Group company was incorporated in India in 1949, it is leader in power automation technologies. These technologies enable industrial customers to improve their performance along with lower environment impact. Today, ABB employs over 10,000 people across more than 40 locations in Bangladesh, India and Sri Lanka. ABB has 12 manufacturing sites on the subcontinent and one of its seven corporate research centers around the world is based in India

**Divesting Power Grid; to focus on Industry 4.0 and profitability growth:** ABB Group will sell its Global Power Grid business to Hitachi, at an enterprise value of ~USD11bn. The deal has been valued at EV/EBITA of 11.2x. While ABB Group would initially retain 19.9% in the equity of the carved-out Power Grid business to ensure a seamless transition, the company has a pre-defined put option to exit the 19.9% share, at a fair market value with floor price at 90% of the agreed-upon EV, exercisable three years after the closing of the transaction. In the case of ABB India, the Power Grid segment contributes ~40% and ~30% of revenues and EBIT, respectively, unlike 28% and 21% for its parent ABB Group.

**Order inflows saw healthy growth; execution cycle shortens :** Order inflows grew by 17% YoY to INR19bn in 4Q18 and were up 16% YoY to INR 67.3bn in CY18. Order book was up 10% YoY to INR 42.3bn, 0.6x TTM sales, as separation of Power Grids division has led to a sharp decline in execution period. The book-to-bill ratio (order inflow/sales) becomes more relevant to monitor future performance, stood at 1.0x at end-CY18 vs 0.95x at end-CY17. Power-grids division reported 9% decline in order intake at INR 34bn .

**Financial performance:** A robust revenue growth can be attributed to healthy 31% YoY growth in Robotics & Motion to Rs7bn, 18% YoY growth in Electrification Products' business to Rs7.5bn and 10% YoY growth in Industrial Automation business to Rs5.1bn. Discontinued Power Grid business grew by 6% YoY to Rs11.6bn. ABB's EBITDA grew by 48% YoY to Rs2.2bn, while EBITDA margin expanded by 250bps YoY to 11% led by cost control and improved efficiencies. Margin of Robotics & Motion rose by 60bps to 10.7%. While PAT increased by 58% YoY to Rs1.3bn, PAT – including Power Grid rose by 15% YoY to Rs1.98bn.

**Valuation:** The stock is trading valuations is at Rs.71.1x FY18. We recommend **buy on ABB India Ltd.** with a price target of **Rs 1650**.

NSE / BSE Code	ABB
Sector	Capital Goods
Industry	Electric Equipment
Face value / Book Value (₹ per share)	2 / 189.1
Dividend yield (%)	0.3
52 H/L (Rs.)	1517 / 1123
Market Cap. (Rs. Cr)	295,824
Shares Outstanding (Cr)	211.9
NSE / BSE Code	176,280

	18-Dec	18-Sep	18-Jun	18-Mar
Net Sales	1,940	2,490	2,681	2,495
EBITDA	215	194	196	189
PAT	129	108	102	102
EBITDA %	11.1%	7.8%	7.3%	7.6%
PAT %	6.6%	4.4%	3.8%	4.1%

(In Rs. Cr)	Dec14	Dec15	Dec16	Dec17
Net Sales	77,333	81,403	86,422	90,873
Sales Growth	0.1%	5.3%	6.2%	5.2%
EBITDA	5,718	7,213	7,102	7,472
EBITDA Margin	7.4%	8.9%	8.2%	8.2%
PAT	2,285	2,999	3,745	4,200
NPM%	3.0%	3.7%	4.3%	4.6%
Adj. EPS (Rs.')	10.8	14.2	17.7	19.8

	Dec14	Dec15	Dec16	Dec17
P/E (x)	5.5	4.2	3.4	3.0
P/B (x)	0.4	0.4	0.4	0.3
EV/Sales(x)	0.2	0.2	0.1	0.1
EV/EBITDA(x)	2.2	1.8	1.8	1.7
ROCE(x)	14.7%	17.1%	18.2%	17.5%
ROE(x)	8.3%	10.3%	11.9%	12.2%

Source: Ace equity, CARE, IBEF

**Pick of the Month (Siemens Ltd.):**

**CMP: 1154**

**Target: 1430**

The Siemens Group in India has emerged as a leading inventor, innovator and implementer of leading-edge technology enabled solutions operating in the core business segments of Industry, Energy and Healthcare. The Group's business is represented by various companies that span across these various segments. Siemens brings to India state-of-the-art technology that adds value to customers through a combination of multiple high-end technologies for complete solutions. The Group has the competence and capability to integrate all products, systems and services. It caters to Industry needs across market segments by undertaking complete projects such as Hospitals, Airports and Industrial units.

**Siemens, SAS partner to deliver AI-embedded IoT Analytics for edge and cloud:** Siemens Digital Industries Software and SAS announced a new partnership that will help companies create new IoT edge and cloud-enabled solutions by applying SAS and open source streaming analytics through Siemens' MindSphere. Users will gain access to SAS advanced and predictive analytics in MindSphere, which can accelerate the adoption of machine learning (ML) and artificial intelligence (AI) in Internet of Things (IoT) environments.

**Healthy revenue and EBITDA growth:** The company's topline has grown by 15.7% on YoY basis to Rs. 2734.2 crs in Q3FY19 against Rs. 2363.2 crs in Q3FY18. The EBITDA notched 12.5% growth on YoY basis to Rs. 306.5 crs mainly due to decrease in services cost by 15.5% YoY to 592.5 which constitutes approx 20% on revenue.

**Order flow of large projects is yet to pick up:** Order inflow grew by 4%YoY to Rs33.9bn, base orders (order value <Rs1bn) was up by 16%YoY and large orders remain muted. Order book grew by 5%QoQ to Rs130bn (0.96x FY19E revenue). As per management, base order continues to report steady growth while order finalisation for large projects is yet to pick up. The factors like recent slowdown in orders from Powergrid Corporation of India, rapid change towards electrification in mobility segment are impacting order inflow.

**Valuation:** With above mentioned rationale, the current valuations is at 45.3x FY18. We recommend **buy on Siemens Ltd.** with a price target of **Rs 1430**.

NSE / BSE Code	SIEMENS
Sector	Capital Goods
Industry	Electric Equipment
Face value / Book Value (₹ per share)	2 / 239.6
Dividend yield (%)	0.6
52 H/L (Rs.)	1173 / 841
Market Cap. (Rs. Cr)	407,758
Shares Outstanding (Cr)	356.1
NSE / BSE Code	132,785

	18-Dec	18-Sept	18-June	18-Mar
Net Sales	2,807	3,939	3,073	3,283
EBITDA	307	419	302	323
PAT	228	279.2	204.4	219.7
EBITDA %	10.9%	10.6%	9.8%	9.8%
PAT %	8.1%	7.1%	6.7%	6.7%

(In Rs. Cr)	Sept-15	Sept-16	Sept-17	Sept-18
Net Sales	105,631	108,366	110,647	127,953
Sales Growth	-1.1%	2.6%	2.1%	15.6%
EBITDA	9,969	10,464	10,383	13,547
EBITDA Margin	9.4%	9.7%	9.4%	10.6%
PAT	11,744	29,137	11,366	9,012
NPM%	11.1%	26.9%	10.3%	7.0%
Adj. EPS (Rs. `)	33.0	81.9	31.9	25.3

	Sept-15	Sept-16	Sept-17	Sept-18
P/E (x)	33.7	14.06	31.99	30.5
P/B (x)	9.21	6.49	5.55	4.04
EV/Sales(x)	4.26	3.75	3.49	2.33
EV/EBITDA(x)	38.88	33.6	29	18.24
ROCE(x)	36.1	66.41	23.43	17.98
ROE(x)	24.74	48.88	15.68	11.27

Source: Ace equity, CARE, IBEF



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