NOMURA

Schneider Electric SCHN.PA SU FP

EQUITY: EUROPEAN CAPITAL GOODS

Initiated with Buy; TP EUR 80

Smart through and through

Global Markets Research

12 March 2015

Rating Remains	**Buy**
Target price Remains	EUR 80.00
Closing price 11 March 2015	EUR 72.35
Potential upside	+10.6%

We initiated coverage of Schneider Electric with a target price of EUR 80 and a Buy rating on 11 March 2015. We believe it is best positioned among the large industrials to benefit from the industrial internet with broad Smart sector exposure and strong established positions in automation markets.

- **Growth:** Regional growth is weighed to EM (44% of sales), a mixed blessing in the near term with China construction markets soft. Europe (27%) remains critical and early-cycle growth in industrial automation is offsetting medium-term utility weakness. In the US (25%), datacentre demand is improving, and O&G exposure is the lowest among large industrials.
- **Secular trends:** We regard Schneider's portfolio as well positioned to benefit from the industrial internet. It holds established positions across the industrial automation hierarchy and a strong history in automation and energy efficiency. This is complemented by its effort to digitise its supply chain and production system that began two years ago.
- **Profitability:** Schneider reiterated its 13-17% through-cycle EBITA margin targets at its recent CMD, with another EUR 1.5bn in support function costs (SFC) and productivity gains. The costs to achieve these are increasing, but the group's record is strong.
- **Sentiment:** Schneider underperformed the SXNP for much of the past three years, driven by investor disappointment on margins and potential large scale M&A. Management assurances at the CMD regarding M&A discipline and a EUR 1.0bn-1.5bn buy-back should have eased investor concerns.
- **Valuation:** Relative EV/EBIT and P/E is in line with history but long-term fundamentals are positive. Our above-consensus EPS forecasts suggest scope for multiple expansion remains as earnings momentum improves.
- Please see *Investing in industrials in the digital age* for full details.

Research analysts

European Capital Goods

Alexander Virgo - NIplc
alexander.virgo@nomura.com
+44 20 7102 5759

Maggie Paxton - NIplc
maggie.paxton@nomura.com
+44 20 7102 4397

Felix Wienen - NIplc
felix.wienen@nomura.com
+44 20 7102 5758

Sidharth Saboo
sidharth.saboo@nomura.com
+91 22 4053 3728

Industry specialist

Eve Raoul - NIplc
eve.raoul@nomura.com
+44 20 7103 9214

Year-end: Dec	2014		2015E		2016E		2017E
Currency (EUR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	24,939	27,473	27,473	28,614	28,614	29,763	29,763
Organic revenue growth (%)	1.4	2.7	2.7	4.2	4.2	4.0	4.0
Adj. EBITA (mn)	3,463	3,994	3,994	4,290	4,290	4,534	4,534
Adj. EBITA margin (%)	13.9	14.5	14.5	15.0	15.0	15.2	15.2
Adj. EPS	4.68	5.03	5.03	5.50	5.50	5.93	5.93
EV/sales (x)	1.77	N/A	1.73	N/A	1.62	N/A	1.50
Adj. EV/EBITA (x)	12.77	N/A	11.89	N/A	10.82	N/A	9.87
Adj. P/E (x)	13.55	N/A	14.27	N/A	13.03	N/A	12.10

Source: Company data, Nomura estimates

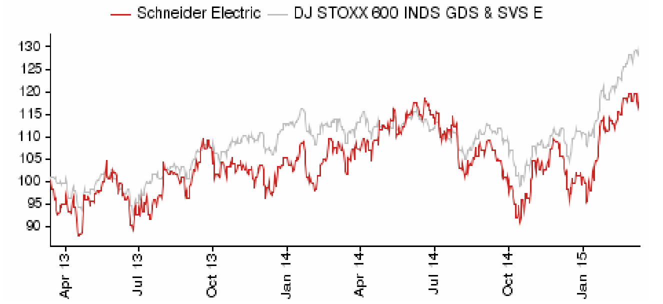
Key company data: See page 2 for company data and detailed price/index chart

Key data on Schneider Electric

Rating

Stock	Buy
Sector	Neutral

Relative performance chart



Source: Thomson Reuters, Nomura research

Performance

(%)	1m	3m	12m	YTD
Absolute	6.1	17.5	13.0	19.4
Relative to sector	-1.9	-3.3	-3.9	1.6

Enterprise value

Year-end: Dec	2014A	2015E	2016E	2017E
Avg/curr share price (EUR)	64.00	72.35	72.35	72.35
Avg shares outstanding (mn)	572.17	572.17	572.17	572.17
Market cap (EUR bn)	36.62	41.40	41.40	41.40
Net debt/(cash) (EUR bn)	4.98	3.49	2.39	0.73
Pension deficit (EUR bn)	2.20	2.20	2.20	2.20
Other EV adj (EUR bn)	0.42	0.42	0.42	0.42
Enterprise value (EUR bn)	44.22	47.50	46.41	44.74

Free float: 90.4%

Valuation

Year-end: Dec	2014A	2015E	2016E	2017E
P/E (x)	13.6	14.3	13.0	12.1
EV/revenue (x)	1.8	1.7	1.6	1.5
EV/EBITDA (x)	11.7	10.5	9.6	8.8
EV/EBIT (x)	13.8	12.6	11.4	10.4
EV/CE (x)	1.5	1.5	1.4	1.3
EV/EBITA (x)	12.8	11.9	10.8	9.9
FCF yield (%)	6.8	7.3	6.9	8.4
Dividend yield (%)	3.0	3.0	3.4	3.7

Growth (%)

Year-end: Dec	2014A	2015E	2016E	2017E
Revenue	6.3	10.2	4.2	4.0
EBITDA	(3.4)	19.2	7.1	5.6
EBIT	(6.8)	25.7	8.1	6.2
EPS	(3.2)	28.1	10.9	8.7
DPS	2.7	13.3	10.9	8.7

Margins & returns

Year-end: Dec	2014A	2015E	2016E	2017E
Gross margin (%)	37.7	37.8	38.3	38.5
EBITDA margin (%)	15.2	16.5	16.9	17.2
EBIT margin (%)	11.6	13.2	13.8	14.0
ROE (%)	13.7	13.7	14.0	14.1
ROCE (%)	11.6	12.8	13.1	13.2
ROCE/WACC (x)	1.3	1.5	1.5	1.5

Source: Company data, Nomura estimates; please see the appendix at the back of this report for more detailed financial statements.

Summary income statement (EUR mn)

Year-end: Dec	2014A	2015E	2016E	2017E
Revenue	24,939	27,473	28,614	29,763
COGS	(15,532)	(17,077)	(17,658)	(18,295)
Gross profit	9,407	10,395	10,957	11,469
Operating expenses	(5,614)	(5,876)	(6,116)	(6,357)
EBITDA	3,793	4,519	4,841	5,111
Depreciation & amortization	(897)	(880)	(906)	(933)
EBIT	2,896	3,639	3,935	4,179
Adj EBIT	3,204	3,774	4,070	4,314
Net interest expense	(467)	(273)	(260)	(246)
Pre-tax profit	2,429	3,366	3,675	3,933
Income tax	(551)	(772)	(808)	(826)
Minorities	(120)	(120)	(120)	(120)
Extraordinary items	0	0	0	0
Net income	1,941	2,490	2,761	3,002
Adj net income	2,702	2,901	3,176	3,420
EPS (EUR)	3.37	4.32	4.79	5.20
Adj EPS (EUR)	4.68	5.03	5.50	5.93
DPS (EUR)	1.92	2.18	2.41	2.62
Dividend payout ratio (%)	57.0	50.4	50.4	50.4

Summary cash flow statement (EUR mn)

Year-end: Dec	2014A	2015E	2016E	2017E
Net income	1,941	2,490	2,761	3,002
Depreciation & amortization	897	880	906	933
Change in working capital	(508)	(170)	(698)	(232)
Other non cash items	510	0	0	0
Cash flow from operations	2,840	3,199	2,970	3,702
Capital expenditure	(475)	(604)	(630)	(655)
Free cash flow	2,490	3,025	2,875	3,474
Net acquisitions	(2,490)	0	0	0
Net disposals	0	0	0	0
Cash flow from investing	(5,153)	(608)	(630)	(655)
Cash dividends received/(paid)	(1,095)	(1,099)	(1,245)	(1,381)
Share (buyback)/issuance	(134)	0	0	0
FX & others	(61)	0	0	0
Net cash in/(out)flow	(2,913)	1,492	1,096	1,667
Net cash/(debt)	(4,982)	(3,490)	(2,394)	(727)

Summary balance sheet (EUR mn)

Year-end: Dec	2014A	2015E	2016E	2017E
Fixed assets	2,751	2,915	3,078	3,241
Goodwill	16,733	16,293	15,853	15,413
Other intangible assets	5,061	5,061	5,061	5,061
Other fixed assets	0	0	0	0
Total fixed assets	27,721	27,445	27,168	26,891
Cash & equivalents	2,690	4,182	5,278	6,945
Inventories	3,027	3,434	3,777	3,929
Receivables	5,991	6,319	6,867	7,143
Other current assets	1,729	1,729	1,729	1,729
Total current assets	13,437	15,664	17,652	19,746
Total assets	41,158	43,110	44,820	46,637
Long term liabilities	9,779	9,775	9,775	9,775
Short term liabilities	11,228	11,792	11,986	12,182
Provisions	3,448	3,448	3,448	3,448
Other Liabilities	1,304	1,300	1,300	1,300
Minorities	419	419	419	419
Shareholders' equity	19,732	21,123	22,640	24,261
Total liabilities & equity	41,158	43,110	44,820	46,637

Financial ratios

Year-end: Dec	2014A	2015E	2016E	2017E
Interest cover (x)	11.1	14.6	16.5	18.4
Net debt/EBITDA (x)	1.9	1.3	1.0	0.6
Net debt/equity (%)	37.7	28.4	21.7	13.6

Source: Company data, Nomura estimates

Note: The following is reproduced from our report Investing in industrials in the digital age, priced as at close of 5 March 2015.

Schneider Electric BUY PRICE TARGET (EUR) 80

Market data (EURm)	2015E	2016E
Share price (EUR)	72	
NOSH	572	
Market capitalisation	41,099	41,099
Adj. net debt (inc pension	6,108	5,012
Enterprise value	47,206	46,110

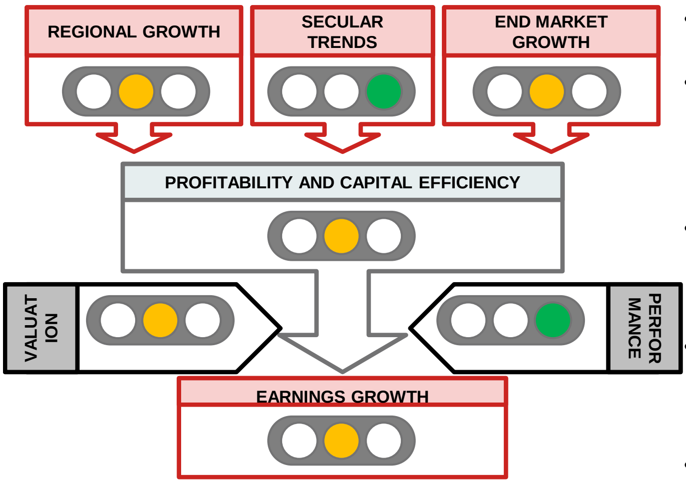
Share price as of 5th March, 2015

Multiples	2015E	2016E
EV/Sales	1.72	1.61
EV/EBITDA (clean)	10.1	9.3
EV/Nomura EBITA	11.8	10.7
EV/IC	1.7	1.7
P/E (reported)	16.5	14.9
P/E (Nomura)	14.2	12.9
Dividend yield	3.1%	3.4%
FCF yield	7.4%	7.0%

Headline data (EURm)	2013	2014	2015E	2016E	2017E
Sales	23,456	24,939	27,473	28,614	29,763
Gross profit	(14,550)	(15,532)	(17,077)	(17,658)	(18,295)
Nomura EBITA	3,427	3,463	3,994	4,290	4,534
EBIT (reported)	3,106	2,896	3,639	3,935	4,179
EPS (reported) (EUR)	3.5	3.4	4.3	4.8	5.2
EPS (Nomura) (EUR)	4.1	4.7	5.0	5.5	5.9
Reported sales growth	-2%	6%	10%	4%	4%
Organic sales growth	0%	1%	3%	4%	4%
Gross margin	38.0%	37.7%	37.8%	38.3%	38.5%
Nomura EBITA margin	14.6%	13.9%	14.5%	15.0%	15.2%
EPS growth (reported)	4%	-3%	28%	11%	9%
EPS growth (Nomura)	-11%	14%	7%	9%	8%
FCF conversion	111%	92%	104%	91%	102%
RoIC	12.1%	10.2%	11.5%	12.3%	13.1%

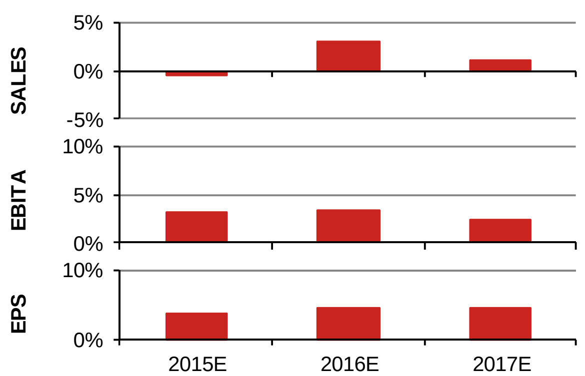
Source: Company data, Nomura estimates

Fig. 1: Schneider in the context of the sector framework



- We initiate coverage of **Schneider Electric** with a target price of **EUR 80** and a **Buy** rating.
- **Growth:** Largest EM exposure in the sector, but Europe still key especially for early-cycle business. Mixed end-market outlook with datacentre and construction demand improving offset by weak utility markets. Lower O&G exposure vs other large industrials.
- **Secular trends:** We regard Schneider Electric as the industrial for the industrial internet as it has strong established automation positions and broad-based exposure to Nomura Smart Sectors without ABB or Siemens's portfolio dilution.
- **Profitability:** Productivity is becoming more expensive, but the record of delivery is good and headroom for simplification and cost structure improvement remains despite investor scepticism.
- **Valuation:** Relative EV/EBIT and P/E is in line with historical levels (vs sector at premium). EUR 1.0bn-1.5bn buy-back and management assurances regarding M&A should assuage investor concerns. In-line EPS growth means outperformance is likely to be a slow burn, in our opinion.

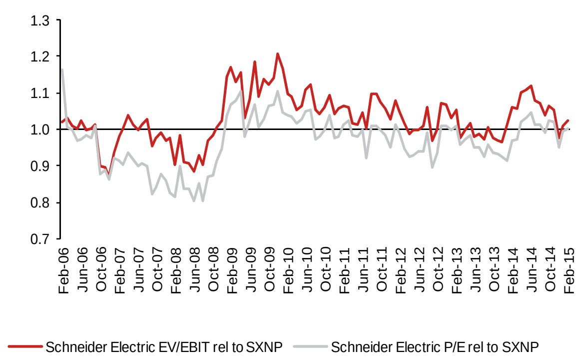
Fig. 2: Nomura estimates vs consensus estimates



Source: Bloomberg, Nomura estimates

Fig. 3: Relative valuation

12-month forward EV/EBITA and P/E relative to SXNP



Source: Bloomberg, Nomura research

Smart through and through

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- **Growth:** Regional growth is weighed to EM (44% of sales), a mixed blessing in the near term with China construction markets soft. Europe (27%) remains critical and early-cycle growth in industrial automation is offsetting medium-term utility weakness. In the US (25%), datacentre demand is improving, and O&G exposure is the lowest among large industrials.
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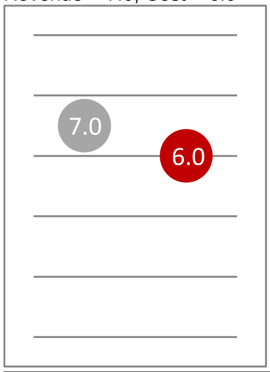
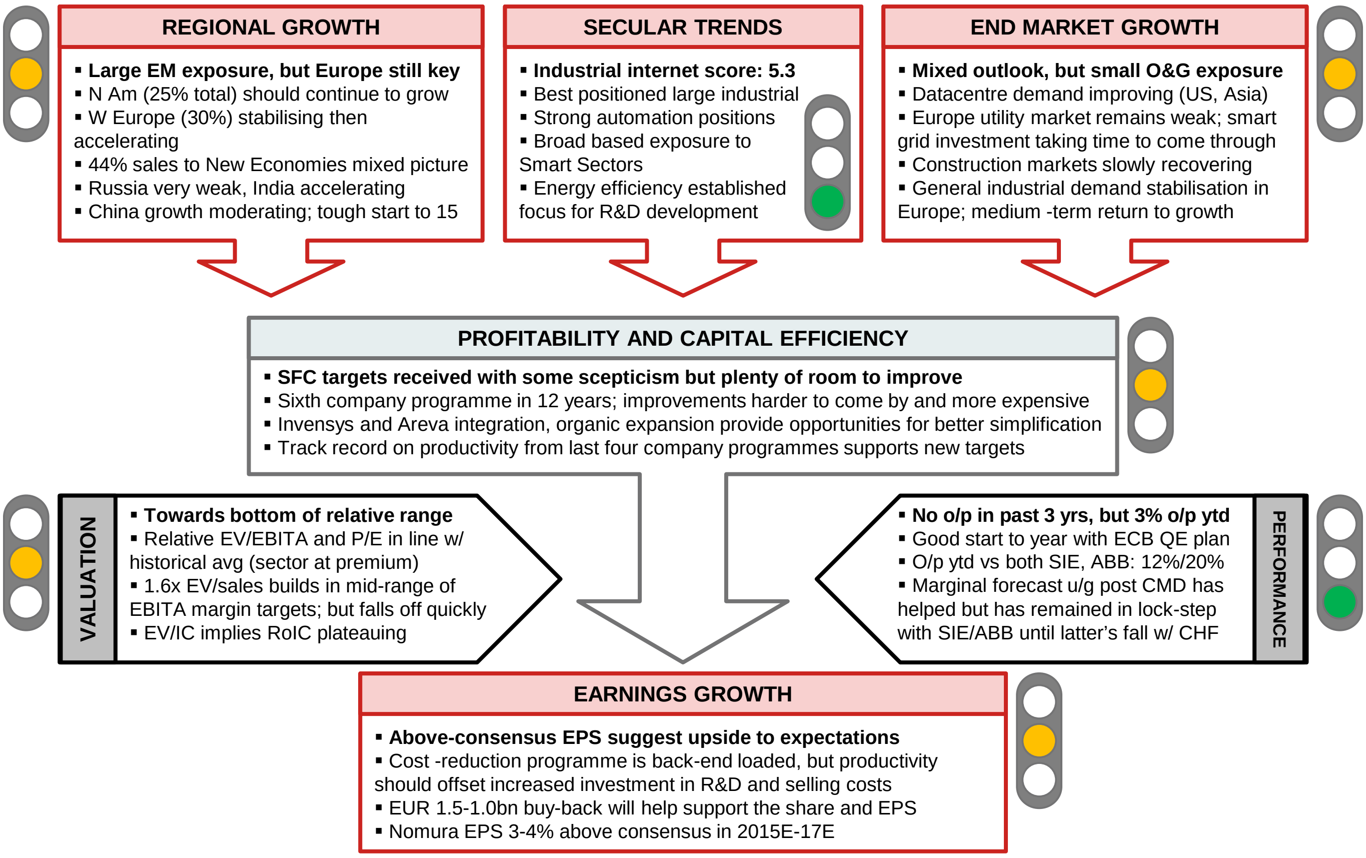
Fig. 4: Industrial internet score

Revenue = 7.0; Cost = 6.0



Source: Nomura research

Fig. 5: Schneider Electric in the context of the sector framework



Source: Nomura estimates

Best positioned large cap for industrial internet

We regard Schneider as the best way for large cap investors to gain access to the developing trends of the industrial internet. It has focused on improving connectivity since the launch of its appropriately-named Connect programme in 2012, while 2013 also saw the launch of its cloud-based supply chain optimisation programme. On both the revenue side, with smart grid, smart buildings, datacentres and leading automation and industrial software, as well as on the cost side, we believe Schneider Electric is also best able to capitalise on what will be the major secular trend for industrial companies over the next 5-10 years.

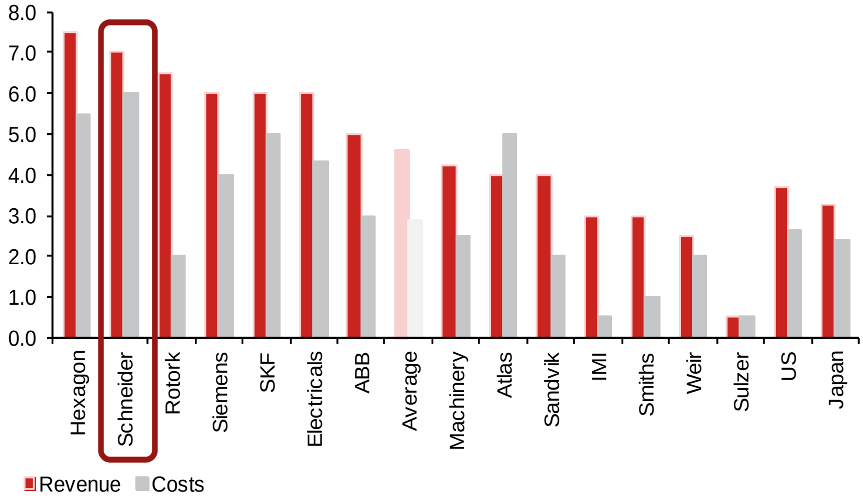
The industrial for the industrial internet

Notwithstanding Hexagon has a marginally better score, we regard Schneider Electric as the best positioned large-cap industrial for the industrial internet. Hexagon is another of our preferred names, but we consider Hexagon to be a much purer software stock, whereas Schneider still has a lot of the core product business that will be critical to bridging the gap between the field or factory floor and the management and operational software, just as it has been for the past 20-30 years of industrial automation development.

Schneider Electric scores considerably higher than most of the companies we have surveyed for industrial internet. From a revenue standpoint, it has the broadest exposure to the industrial internet, with all four divisions having considerable exposure to digital themes, whether it is the 'traditional' automation business in the industry business or the smart-grid capability in the infrastructure business. On the supply-chain side, it is making moves to optimise its own supply chain through the use of cloud technology, while IT's global leading UPS and cooling capabilities go right to the heart of the cloud 'supply chain'; without UPS and cooling systems, the datacentres that underpin the cloud would be unable to cope with the proliferation of the technology.

Fig. 6: Schneider Electric and Hexagon score equally well in aggregate in the Nomura Industrial Internet survey. Schneider Electric appears slightly more advanced in its supply chain, while Hexagon's industrial internet product portfolio appears more mature

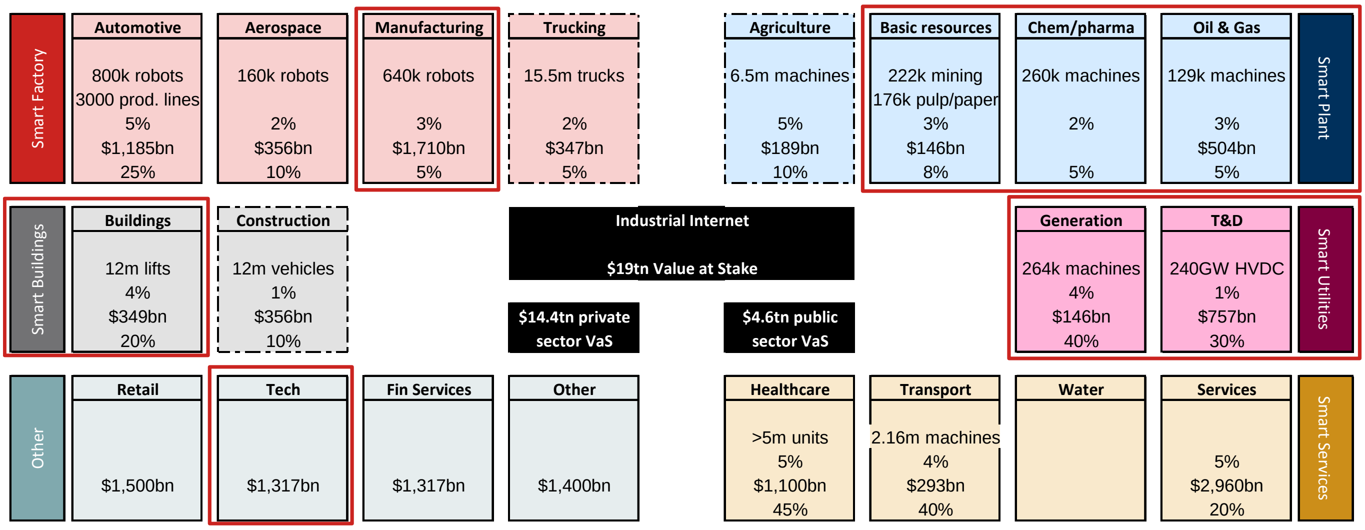
Revenue = score out of 10; Cost = score out of 10



Source: Nomura research

The breadth of Schneider Electric's portfolio means it has some exposure to all but one of the broader Nomura Smart Sectors, with the detailed exposure of its portfolio encompassing some USD 5trn in VaS in aggregate. Software is a growing proportion of the overall business and the company employs some 10,000 software and application engineers. Software is the 'enabling technology' for the industrial internet – only Siemens, GE and Honeywell among industrial companies have more software engineers than Schneider Electric. GE and Siemens are twice the size in personnel terms and Honeywell has a sizable avionics business.

Fig. 7: Schneider Electric's exposure to Nomura Smart sectors encompasses some USD 6trn in VaS

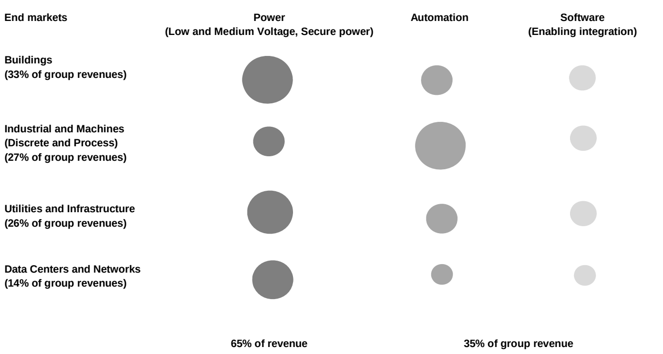


Source: Nomura research

Looking across the divisions, the greatest strength in automation terms lies in the legacy factory automation business in Industry, though this has now been well complemented by the addition of Invensys on the process automation side but the software business is relatively evenly distributed. Interestingly and perhaps surprisingly, the IT business has more power than automation and software business in relative terms. Intuitively one might think the datacentre business would have more associated automation and software, but ultimately the critical technology Schneider supplies into that market is uninterruptible power supplies (UPS) and cooling equipment. Both require automation and software, particularly in terms of optimising cooling systems, but the associated software requirement here is relatively limited compared with a petrochemical plant or an automotive factory.

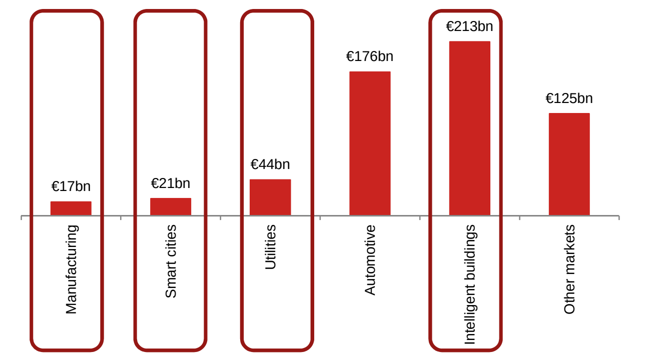
Further highlighting the appeal of the portfolio is the fact that the company forecasts that it will supply four of the top five end markets for IoT revenue by 2022, with those markets accounting for some EUR 295bn in revenue associated with the industrial internet.

Fig. 8: Schneider Electric portfolio strengths



Source: Company data

Fig. 9: IoT-based revenue by 2022 by sub-sector

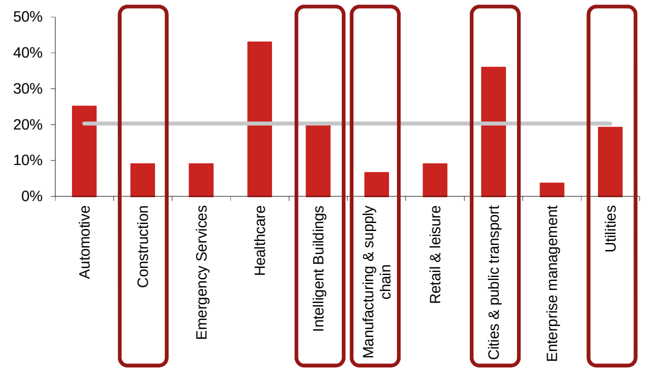


Source: Bosch ConnectedManufacturing White Paper, Sep 2014

Cutting the data another way and looking at the number of connected devices by 2022 shows that markets to which Schneider Electric is exposed should see significant growth in connected devices over the coming 5-7 years. The recent IoT World Forum hosted by Cisco in December 2014 showed that attendees expect energy, manufacturing and smart cities to be the fastest adopters of IoT technology. Arguably the entirety of Schneider Electric's business is geared to these three end markets in some form or other.

Fig. 10: Growth in connected devices by sector

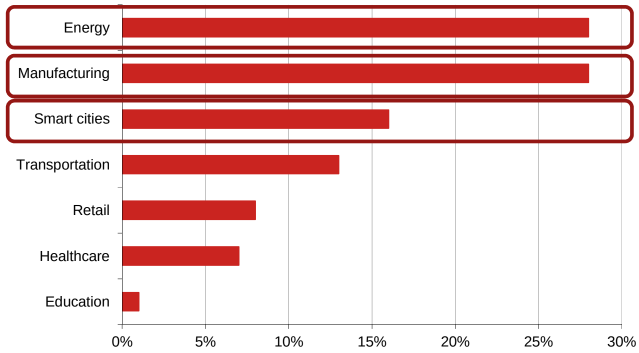
CAGR 2012-22E (%)



Source: Bosch ConnectedManufacturing White Paper, Sep 2014

Fig. 11: Which vertical is likely to adopt IoT faster?

IoT World Forum attendees were asked to choose one sector



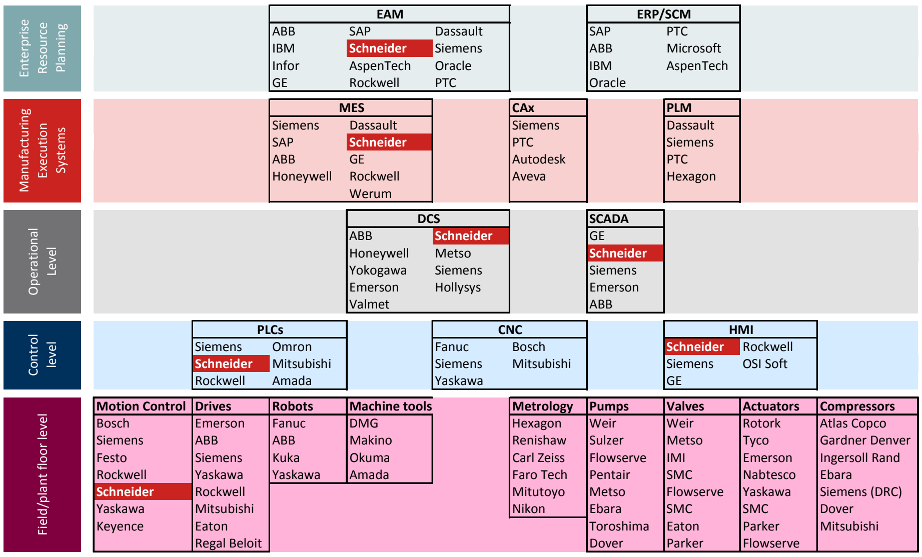
Source: IoT World Forum, December 2014

Established position at the heart of industrial automation

Schneider has been at the heart of the industrial automation hierarchy for many years, though until the acquisition of Invensys it was mostly focused on discrete automation. With the two businesses alongside each other, the combination has become one the most powerful and well-balanced automation companies in the sphere.

With automation and software capabilities at each level of the automation hierarchy and across both discrete and process automation, we believe the company is well positioned to be a driver of the evolution of the industrial automation into the industrial internet.

Fig. 12: Schneider Electric has capabilities across all strata of the industrial automation hierarchy



Source: Nomura research

Schneider Electric management defines its automation markets with slightly better refinement than we are afforded from an external perspective, at least for the time being. Hence its assertion that Schneider Electric is the global number two in process automation and number four in discrete automation. When we split the various participants across the end markets to which they are exposed, then the numbers come out slightly differently. Nonetheless, Schneider Electric is favourably positioned in the end markets it serves, particularly with the Invensys installed base on board as well.

Importantly, when we think of the exposures of its immediate peers and the broader sector coverage, the company's exposure to O&G end markets is lower than both ABB and Siemens, as well as lower than many of the more mechanical names we cover.

Schneider Electric's grid automation capabilities position it well in the power automation end market. The dominance Emerson appears to have in the process industry generally, but in O&G in particular, is brought into sharp focus when one considers the company has less than half the software engineers of its immediate peers such as Schneider Electric and Honeywell, and only marginally more than Hexagon, a company that is not much more than 10% of its size (by headcount).

Arguably the process automation market is growing more slowly than the discrete automation end markets, particularly as many of Schneider Electric's power automation business customers are European utilities whose purse strings are notoriously tight at the moment. Invensys' view of the broader process market was similar to the growth rates we show below, but there were expectations that niche software applications in power, refining and O&G end markets were likely to develop quicker. The latter is likely to see a mixed outlook for the time being, until the capex intentions of the international oil companies (IOCs) stabilise.

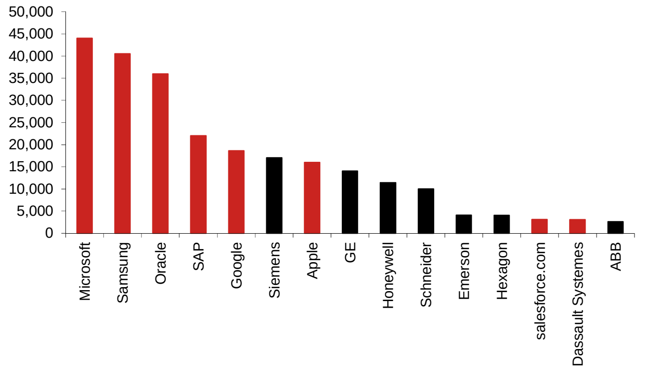
Fig. 13: Process automation end market: top 10 providers

2012-18E CAGR

Power		Gen Proc		Oil & gas		Petrochem	
EUR 32bn 3%		EUR 9bn 4%		EUR 25bn 6%		EUR 12bn 5%	
Siemens	5.0	Siemens	2.9	Emerson	3.9	Emerson	1.8
Schneider	**3.2**	ABB	2.5	ABB	2.4	Yokogawa	1.5
ABB	2.0	Emerson	1.5	Siemens	2.0	ABB	1.0
GE	1.3	**Schneider**	**0.9**	Rockwell	1.4	Siemens	1.0
SAP	1.0	SAP	0.4	GE	1.0	Honeywell	0.9
Emerson	1.0	Oracle	0.3	Honeywell	1.0	SAP	0.7
Bosch	0.6	Honeywell	0.2	SAP	1.0	GE	0.4
Oracle	0.5	Fanuc	0.2	Yokogawa	0.5	Oracle	0.3
Hexagon	0.4	Microsoft	0.1	**Schneider**	**0.5**	Bosch	0.2
Yokogawa	0.2			Bosch	0.4	Infor	0.2

Source: Company data, Nomura estimates

Fig. 14: Total software engineers…Siemens employs more than Apple



Source: Company data, Nomura research

Schneider Electric's legacy strength in automation has been in the discrete space, rather than process and this is apparent when looking at the top-10 providers across the hybrid and discrete end markets. Schneider Electric is stronger in the faster-growing markets on an underlying basis, with estimates from Schneider Electric and Hexagon, among others, suggesting that the software elements of these end markets are likely to grow 200-300bp faster than the underlying CAGRs we show here.

Fig. 15: Hybrid automation end markets: top 10 providers

2012-18E CAGR

Food & bev		Pulp & paper		Mining	
EUR 16bn 4%		EUR 3bn 3%		EUR 10bn 6%	
Siemens	1.9	ABB	0.86	ABB	3.6
Fanuc	0.9	Siemens	0.77	Siemens	1.4
ABB	0.7	Valmet	0.34	Rockwell	1.4
Schneider	**0.4**	Honeywell	0.26	SAP	0.9
Bosch	0.3	SAP	0.25	Bosch	0.6
Oracle	0.3	Bosch	0.11	**Schneider**	**0.4**
Microsoft	0.2	IBM	0.01	Oracle	0.3
Infor	0.2	Aveva	0.01	Honeywell	0.2
GE	0.1			Yaskawa	0.2
Dassault	0.1			Autodesk	0.1

Source: Company data, Nomura estimates

Fig. 16: Discrete automation end markets: top 10 providers

2012-18E CAGR

Aero		Gen Man		Auto	
EUR 4bn 3%		EUR 50bn 5%		EUR 11bn 3%	
Siemens	0.9	Siemens	4.0	Fanuc	1.5
GE	0.4	**Schneider**	**2.9**	Kuka	1.4
ABB	0.4	Emerson	2.6	Siemens	1.4
Dassault	0.3	SAP	2.3	Bosch	1.1
Bosch	0.3	Rockwell	2.2	ABB	1.0
Infor	0.3	Omron	2.2	Dassault	0.6
PTC	0.2	Bosch	2.2	Rockwell	0.6
Hexagon	0.2	ABB	1.9	SAP	0.5
SAP	0.2	Yaskawa	1.7	Infor	0.4
IBM	0.1	Fanuc	1.1	Yaskawa	0.4

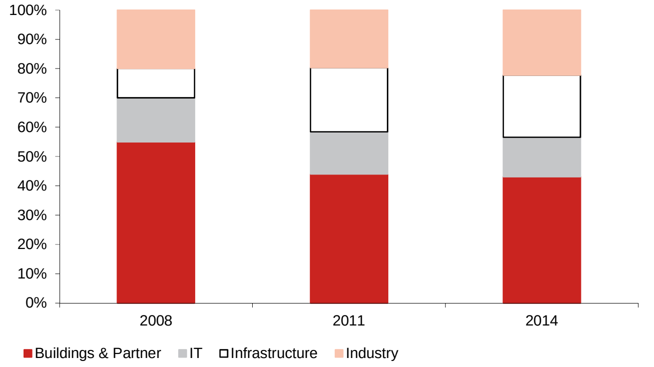
Source: Company data, Nomura estimates

End market and regional growth is balanced

Schneider Electric was one of the first large industrials to make a push to attack emerging economies in the early 2000s. The benefits of that strategy have manifested themselves in the evolution of the regional exposure – Asia accounts for 28% of group revenue (China alone is 13-14% of revenue) and the whole 'new economies' exposure has reached 44% (compared with 20% in 2001). The acquisitions of Areva (2010), Telvent (2011) and more recently Invensys (2014) have given the Schneider Electric portfolio more balance, and reduced dependence on the low-voltage business.

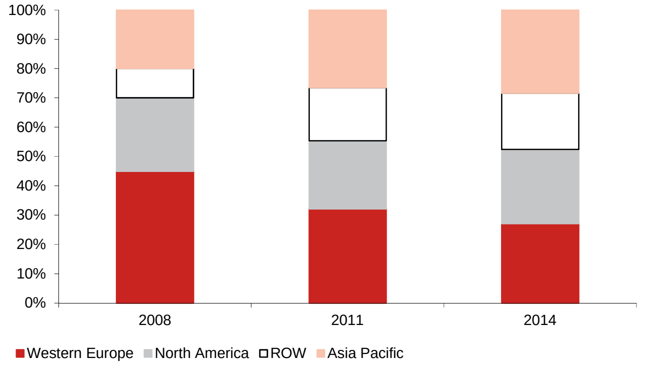
In some respects, the company has been a victim of its own success in balancing the portfolio, with 2H14 performance highlighting this. Mature economies grew faster in aggregate, on an organic basis, than new economies. Granted, organic growth for the former was 3%, compared with 2% in new economies, but worth noting as it highlights the benefits and disadvantages of diversification – lower volatility, but probably lower growth.

Fig. 17: Evolution of revenue by division



Source: Company data, Nomura research

Fig. 18: Evolution of revenue by region

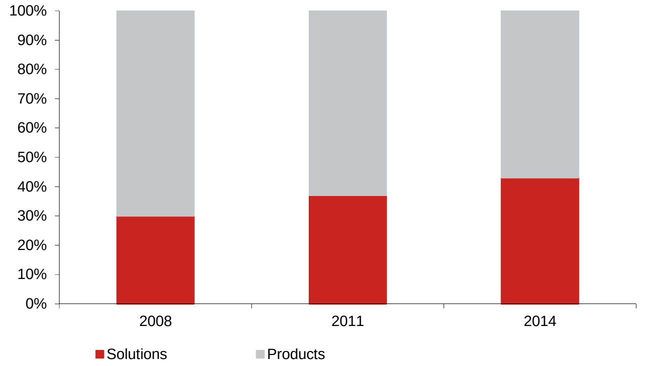


Source: Company data, Nomura research

At the same time as balancing the portfolio, Schneider Electric has been driving development in the business model to expand the solutions business. Its definition of solution encompasses automation and software and now accounts for some 43% of group revenue (compared with 30% in 2008). The ultimate target is for this figure to move above 50%.

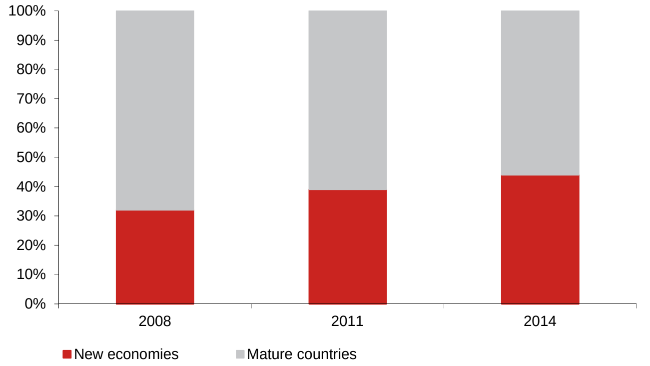
By division, the largest driver of the solutions business is infrastructure, for which 69% of divisional revenue is derived from solutions. The greatest potential is within 'Buildings & Partner', which derives only 27% of revenue from solutions, but industry's solutions business accounts for only 41% of revenue and may see stronger near-term improvement in the ratio given the focus of Schneider Electric's innovation efforts and the indications we saw above with respect to expected adoption rates.

Fig. 19: Development of solutions revenue



Source: Company data

Fig. 20: Development of new economies' revenue exposure



Source: Company data

Ultimately, if software can become a larger part of the mix, this ought to be margin-accretive; however, management has indicated that the solutions business as a whole remains dilutive to margins given the more comprehensive nature of the offering to customers. The software piece, we believe, makes a very strong gross contribution to the group, but is diluted by the continued drift in solutions and guidance has been that this is unlikely to improve much in the near term.

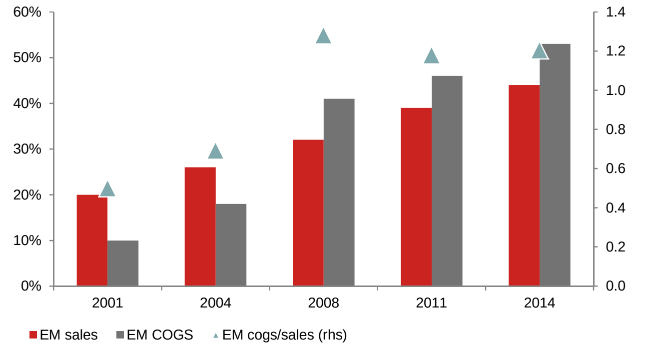
Room for improvement

Although not best-in-sector in terms of profitability, Schneider Electric's EBIT margins are better than its immediate peers (Siemens and ABB). Part of the reason for this is the flexibility it has managed to build into its cost base and the transition it has made in terms of manufacturing footprint. COGS for the group is now over 50% in new economies, some 10pp above the level of revenue derived from new economies, which implies there is an arbitrage for the lower cost of goods sold supporting revenue in mature markets.

Examination of the development of revenue, COGS and workforce in the business since 2006 shows favourable management. Schneider Electric states that 70% of COGS is variable and we can see that even the workforce was relatively flexible (the past three years have seen some 13-14% of headcount accounted for by temporary workers).

Fig. 21: Schneider Electric has shifted 53% of COGS to new economies, compared with 44% of revenue generated there

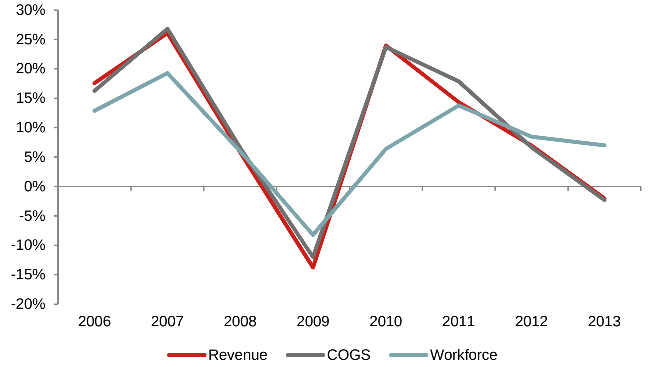
New economies' revenue and COGS as % of total (lhs) vs COGS/Sales (rhs)



Source: Company data, Nomura research

Fig. 22: Development of revenue, COGS and workforce through the cycle

Y-o-y change



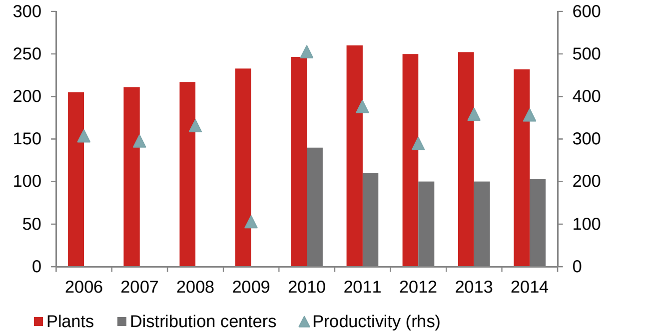
Source: Company data, Nomura research

Schneider Electric has also done a good job of managing the manufacturing footprint and distribution network, despite absorbing two major acquisitions in Areva and Invensys. Work within this development and the broader implementation of efficient manufacturing practices and a leaner supply chain have resulted in >EUR 300m in productivity benefits pa for much of the past 10 years.

We have aggregated the realised benefits of the past three productivity programmes implemented by Schneider Electric alongside the costs incurred to achieve them. One of the concerns we came away with from the recent CMD was the apparent diminishing returns on the cost invested in deriving productivity savings. This is apparent from our analysis, with the benefits from 'New2' nearly three times the cost to implement, whereas the new 'Schneider Electric is On' targets are less than two times the cost expected to implement.

Fig. 23: Evolution of Schneider Electric's manufacturing footprint

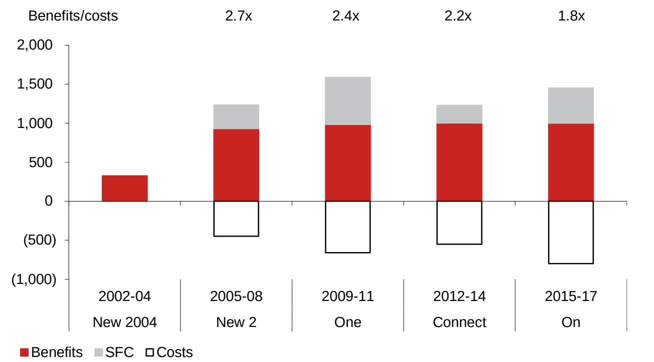
Plants and distribution centres (lhs) vs revenue generated per plant (EURk, rhs)



Source: Company data, Nomura research

Fig. 24: Productivity is becoming more costly to implement

EURm unless stated



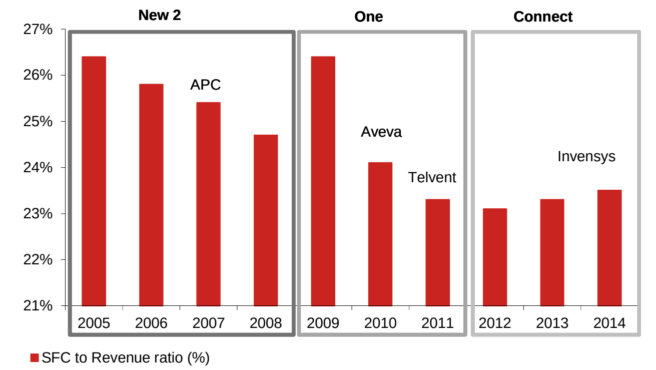
Source: Company data, Nomura research

An unsurprising conclusion perhaps, but one that investors will focus on as a negative sign for Schneider Electric. However, we do think it is worth bearing in mind that the acquisitions we mentioned above have come at times when SFC improvements have been moving in the right direction.

We were struck by several of the numbers presented at the CMD by Annette Clayton, the head of Schneider Electric's Tailored Supply Chain 2.0 programme. Ms Clayton pointed to 232 factories and 103 distribution centres as good examples of improvement to the manufacturing footprint. What received less attention were the SKU numbers (500,000) and the supplier numbers (45,000).

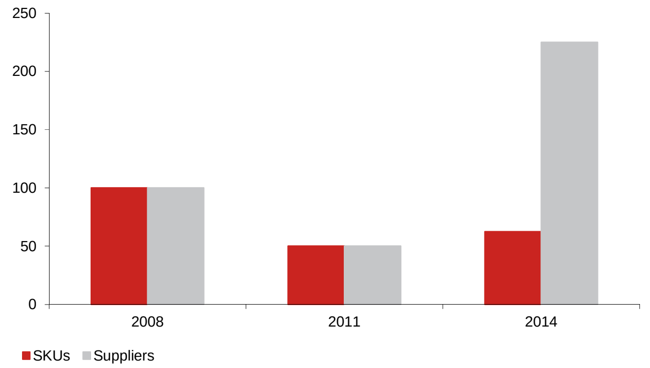
Compared with previous presentations of both supply-chain optimisation and reported numbers, these figures represent a significant 'complication' to the Schneider Electric simplification strategy. Explainable by the absorption of Telvent, Invensys and several smaller acquisitions, the 500,000 SKUs are 20% higher than the previously reported number of 400,000 (2011; itself 50% of the 2008 number of 800,000). The supplier number has grown significantly though – 20,000 suppliers were identified in 2008 with a target to halve this by the end of 2011. We cannot find an interim figure and the company will not confirm the details, but it shows that there is still considerable room for simplification of the supply chain to the benefit of lower SFCs.

Fig. 25: Several significant acquisitions have 'gotten in the way' of Schneider Electric's historical SFC reduction targets
SFC as % of sales



Source: Company data, Nomura research

Fig. 26: There remains decent headroom in terms of extracting benefits from simplification, particularly in the supply chain
SKUs and suppliers indexed to 2008



Source: Company data, Nomura research

Valuation: still scope for multiple expansion

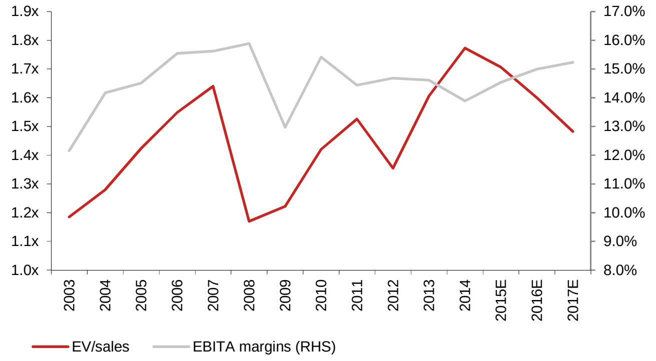
Valuation is generally in line with history, which suggests a relative discount given the sector is broadly trading several multiple turns above historical averages, which means scope for expansion given the sector is at a premium to history. Management is instigating a EUR 1.5bn-1.0bn buy-back and taking large acquisitions off the table (there is to be no equity issuance if it is buying back) should assuage concerns of a significant acquisition.

The recent move up in the share price (stock has outperformed SXNP by 2-3% year-to-date) and has had a strong run in absolute terms over the past two years) has driven the EV/sales up to 1.6x for 2016E, which implies the top end of the EBITA margin range management targets through the cycle (13-17%). Historically, the stock has seen EV/sales at a 'premium' compared with EBIT margins in periods of early-cycle strength.

Sentiment on the sell-side does not appear to have changed significantly over time, though there is a greater weighting of negative or on the side-lines, rather than positive on the stock.

Fig. 27: Current EV/sales in line with 2015E margins but drops off rapidly despite our expectations for margin improvement

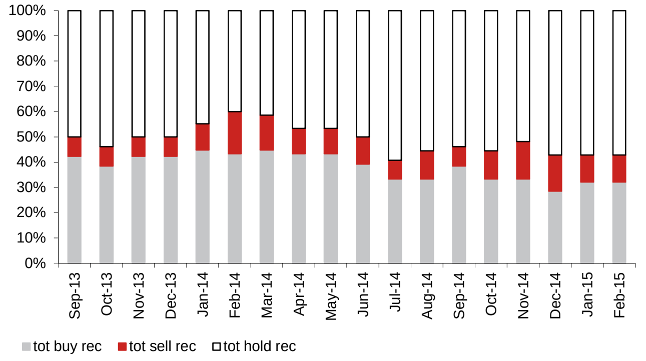
EV/sales (lhs) vs EBITA margins over time (rhs)



Source: Company data, Nomura estimates

Fig. 28: Sell-side sentiment remains neutral to indisposed to the stock

Sell-side rating development



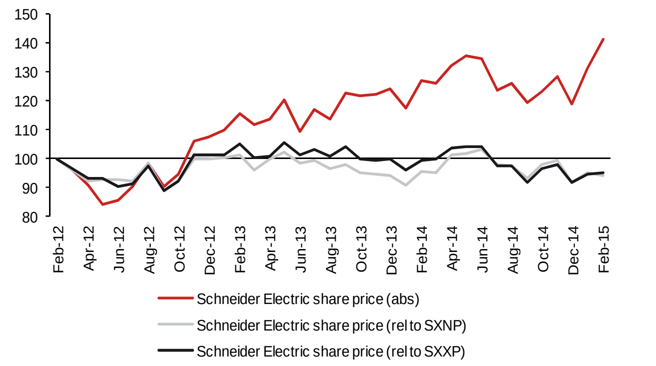
Source: Bloomberg, Nomura research

The stock has had a strong run over the past couple of years in absolute terms, though relative to the broader index and also its immediate electrical peers it has traded largely in line. Recently, Schneider Electric and Siemens have diverged from ABB, but this has largely been driven by the movements in the Swiss franc. In absolute terms, we can understand investor caution given the strength of Schneider Electric's stock, but on a relative basis the stock has not really outperformed.

Relative multiples are also only really in line with historical premiums to the sector, which given most of our coverage universe at the higher end of the quality spectrum trades at relative highs, suggests there is further room for Schneider Electric's relative valuation to expand.

Fig. 29: Schneider Electric's recent absolute share price has essentially just been in line with the sector

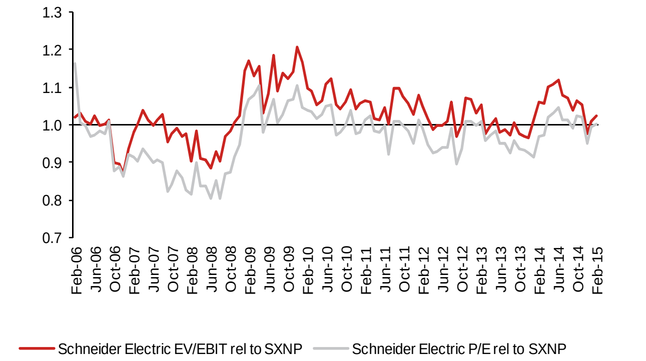
Indexed to 100 (January 2012)



Source: Bloomberg, Nomura research

Fig. 30: Relative valuation multiples are just in line with historical premiums to the broader sector, suggesting scope for expansion

One-year forward EV/EBIT and P/E relative to SXNP

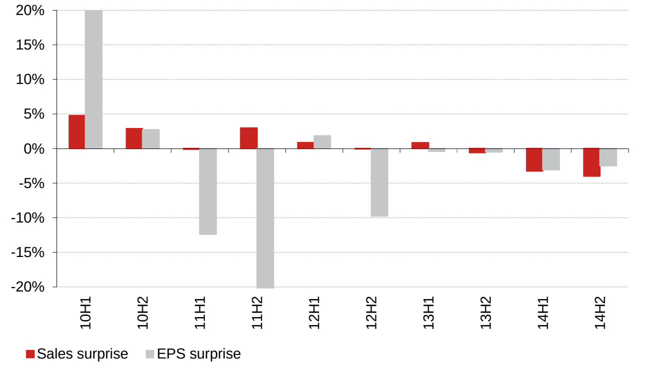


Source: Bloomberg, Nomura research

Schneider Electric has not seen the sort of one-off charges and project execution issues experienced by the other electrical companies or the significant end-market deterioration with which some of the mechanical companies have had to deal, but earnings disappointments have still weighed on the stock and sentiment in the past. We do not think expectations are particularly aggressive, which should reduce the risk of meaningful earnings disappointments, though we are cognisant of management commentary that FY15 has started tough in China and Invensys faces some tough comparables in the first half.

Fig. 31: Reporting period surprises have ameliorated but there is still vestigial caution among investors around Schneider Electric's margin targets

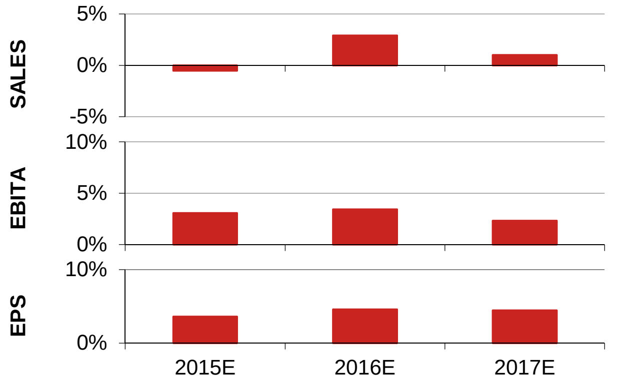
% beat or miss on sales and EPS



Source: Bloomberg, Nomura research

Fig. 32: We are 2-4% more optimistic than consensus across the portfolio

% difference vs consensus



Source: Bloomberg, Nomura estimates

Target price suggests 13% upside potential

We derive our target price using a blend of relative (multiples) and absolute (DCF, SOTP) valuations. We apply five-year average multiples as this is a fairer reflection of the current cost of capital, which we believe has inflated valuations across the board.

Fig. 33: Derivation of our Schneider Electric target price

EUR

Valuation method	2015E	Disc.	2017E	Assumptions
Sum of the parts	81	0.83	97	Peer trading multiples
DCF	95		112	10yr growth 5%, 16% avg margin, 9% WACC
EV/EBITA	70	0.83	84	5yrs avg 11x
P/E	71	0.83	85	5yrs avg 16x
Average	**80**		**95**	**Blended average**

Source: Nomura estimates

Our sum-of-the-parts valuation supports a share price of nearly EUR 100 based on 2017 estimates.

Fig. 34: Sum-of-the-parts suggests fair value could be closer to EUR 100

EUR m

2017E	Sales	EBITA		EV/ Sales	EV/ EBITA	EV	% of EV	EV/sh
Buildings & Partner	13,179	2,384	18.1%	2.4	13.0	30,993	53%	51.1
Infrastructure	6,012	657	10.9%	1.3	12.0	7,881	13%	13.0
Industry	6,571	1,351	20.6%	2.9	14.0	18,913	32%	31.2
IT	4,001	807	20.2%	2.4	12.0	9,683	16%	16.0
Group Holding		-665			12.8	-8,476	-14%	(14.0)
Total revenues	**29,763**	**4,534**	**15.2%**	**2.0**	**13.0**	**58,994**	100%	97.3
Net debt						3,345		
Other EV adjustments								
Market cap						**55,649**		
NOSH						572.2		
Fair value						**97.3**		

Source: Nomura estimates

Key risks to our investment case

Macro

- Further QE in Europe or significant changes in the oil price could change investor sentiment and expectations with respect to growth in Europe.
- Schneider Electric also the highest exposure to emerging markets in the sector, so any changes in underlying country-specific growth in the likes of China, Brazil, and India, among others, could affect our forecasts for growth at Schneider Electric.
- A change in geopolitical tensions or a major terrorist attack could seriously affect our investment thesis.

Micro

- **Growth:** Our basic thesis envisages continued weak growth in Europe for the next 12 months, as well as weak utility spending and concerns around the near- and medium-term outlook in O&G. Any further deterioration in either end market would likely be detrimental to our forecasts. We also envisage a slow but sustainable recovery in construction end markets, which ought to benefit Schneider Electric's Building & Partner business; if this fails to materialise our forecasts could be at risk.
- **Profitability:** Schneider Electric has launched a new strategy and plans to continue driving productivity and reduce SFCs, which we build into our forecasts. If management fails to deliver on the productivity or the SFC savings, then our margin expectations are likely to be at risk.
- **M&A:** Schneider Electric has made M&A a significant part of its strategy for the past decade and this has caused investors a considerable amount of concern. We get the impression that in the near term management is focused on integrating the Invensys deal and not on large scale M&A, particularly as it has instigated a buy-back of EUR 1.5bn-1.0bn, which ought to assuage investor concerns about being asked for more capital. However, given its record, we cannot rule out management considering a large deal if it believes it makes sense strategically and this represents potential downside risk to our rating.

Fiscal Headline Data (EURm)	2012	2013	2014	2015E	2016E	2017E
Sales	23,946	23,456	24,939	27,473	28,614	29,763
Gross profit	(14,889)	(14,550)	(15,532)	(17,077)	(17,658)	(18,295)
EBIT	2,866	3,106	2,896	3,639	3,935	4,179
PTP	2,461	2,623	2,429	3,366	3,675	3,933
Reported net income	1,840	1,933	1,941	2,490	2,761	3,002
EPS - Reported	3.36	3.48	3.37	4.32	4.79	5.20
DPS - Reported	1.87	1.87	1.92	2.18	2.41	2.62
EBITDA clean	3,854	4,029	4,101	4,654	4,976	5,246
Nomura EBITA	3,515	3,427	3,463	3,994	4,290	4,534
EBIT clean	3,040	3,209	3,204	3,774	4,070	4,314
Nomura Net Income	2,523	2,279	2,702	2,901	3,176	3,420
Nomura EPS	4.6	4.1	4.7	5.0	5.5	5.9

Source: Company data, Nomura estimates

Profit & Loss (EURm)	2012	2013	2014	2015E	2016E	2017E
Sales	**23,946**	**23,456**	**24,939**	**27,473**	**28,614**	**29,763**
COGS	(14,889)	(14,550)	(15,532)	(17,077)	(17,658)	(18,295)
Gross profit	**9,057**	**8,906**	**9,407**	**10,395**	**10,957**	**11,469**
Margin	37.8%	38.0%	37.7%	37.8%	38.3%	38.5%
SGA expenses	(5,542)	(5,479)	(5,944)	(6,401)	(6,667)	(6,935)
Other operating income/expenses	(649)	(321)	(567)	(355)	(355)	(355)
Reported EBIT	**2,866**	**3,106**	**2,896**	**3,639**	**3,935**	**4,179**
Margin	12.0%	13.2%	11.6%	13.2%	13.8%	14.0%
Nomura EBITA	**3,515**	**3,427**	**3,463**	**3,994**	**4,290**	**4,534**
Margin	14.7%	14.6%	13.9%	14.5%	15.0%	15.2%
Net Financial Items	(405)	(483)	(467)	(273)	(260)	(246)
Reported pre-tax income	**2,461**	**2,623**	**2,429**	**3,366**	**3,675**	**3,933**
Taxation	(568)	(665)	(551)	(772)	(808)	(826)
Minority interest	(87)	(77)	(120)	(120)	(120)	(120)
Associates/others	34	52	183	15	15	15
Reported net income	**1,840**	**1,933**	**1,941**	**2,490**	**2,761**	**3,002**
Reported EPS (dil.)	**3.4**	**3.5**	**3.4**	**4.3**	**4.8**	**5.2**

Source: Company data, Nomura estimates

Balance Sheet (EURm)	2012	2013	2014	2015E	2016E	2017E
Fixed assets	**22,622**	**22,171**	**27,721**	**27,445**	**27,168**	**26,891**
Intangibles assets	17,423	17,328	21,794	21,354	20,914	20,474
Tangible assets	2,622	2,595	2,751	2,915	3,078	3,241
Investments/associates	2,577	2,248	3,176	3,176	3,176	3,176
Current assets	**9,670**	**9,587**	**10,747**	**11,482**	**12,374**	**12,801**
Inventories	3,090	3,072	3,027	3,434	3,777	3,929
Trade debtors	5,289	5,123	5,991	6,319	6,867	7,143
Other current assets	1,291	1,392	1,729	1,729	1,729	1,729
Cash & securities	**3,744**	**5,591**	**2,690**	**4,182**	**5,278**	**6,945**
TOTAL ASSETS	**36,036**	**37,349**	**41,158**	**43,110**	**44,820**	**46,637**
Gross debt	**8,012**	**8,889**	**7,672**	**7,672**	**7,672**	**7,672**
Current liabilities	**7,238**	**7,421**	**8,583**	**9,147**	**9,341**	**9,537**
Trade creditors	4,190	3,791	4,106	4,670	4,864	5,060
Accrued and other liabilities	3,048	3,630	4,477	4,477	4,477	4,477
Provisions (l-term)	**2,761**	**2,312**	**3,448**	**3,448**	**3,448**	**3,448**
Post-employment benefits	1,976	1,485	2,199	2,199	2,199	2,199
Other provisions	785	827	1,249	1,249	1,249	1,249
Other non-current liabilities	1,209	1,134	1,304	1,300	1,300	1,300
Total Equity	**16,816**	**17,593**	**20,151**	**21,542**	**23,059**	**24,680**
Ordinary Shareholders Funds	16,642	17,211	19,732	21,123	22,640	24,261
Minorities	174	382	419	419	419	419
TOTAL EQUITY & LIABILITIES	**36,036**	**37,349**	**41,158**	**43,110**	**44,820**	**46,637**

Source: Company data, Nomura estimates

Cash Flow (EURm)	2012	2013	2014	2015E	2016E	2017E
Reported net income	1,840	1,933	1,941	2,490	2,761	3,002
D & A	814	820	897	880	906	933
Movement in working capital	550	(215)	(508)	(170)	(698)	(232)
Other items						
Operating Cash Flow	**2,516**	**3,019**	**2,840**	**3,199**	**2,970**	**3,702**
Capital expenditure	(472)	(473)	(475)	(604)	(630)	(655)
Fixed asset/ investment sales	(337)	(225)	(5,044)	0	0	0
Others investing items	278	(96)	366	(4)	0	0
Investing Activities	**(531)**	**(794)**	**(5,153)**	**(608)**	**(630)**	**(655)**
Change in debt	192	877	(1,217)	0	0	0
Shareholders' equity	(1,114)	(1,156)	617	(1,099)	(1,245)	(1,381)
Financing Activities	**(922)**	**(279)**	**(600)**	**(1,099)**	**(1,245)**	**(1,381)**
Inc (+)/dec(-) in cash	**1,063**	**1,946**	**(2,913)**	**1,492**	**1,096**	**1,667**

Source: Company data, Nomura estimates

Divisional Sales (EURm)	2012	2013	2014	2015E	2016E	2017E
Buildings & Partner	10,420	10,203	10,754	12,068	12,672	13,179
Infrastructure	5,366	5,727	5,277	5,723	5,837	6,012
Industry	4,483	4,084	5,551	6,018	6,258	6,571
IT	3,677	3,442	3,357	3,664	3,847	4,001
Total	**23,946**	**23,456**	**24,939**	**27,473**	**28,614**	**29,763**

Divisional growth	2012	2013	2014	2015E	2016E	2017E
Buildings & Partner	5.8%	-2.1%	5.4%	12.2%	5.0%	4.0%
Infrastructure	9.6%	6.7%	-7.9%	8.4%	2.0%	3.0%
Industry	1.8%	-8.9%	35.9%	8.4%	4.0%	5.0%
IT	13.6%	-6.4%	-2.5%	9.1%	5.0%	4.0%
Total	**7.0%**	**-2.0%**	**6.3%**	**10.2%**	**4.2%**	**4.0%**

Divisional EBITA clean	2012	2013	2014	2015E	2016E	2017E
Buildings & Partner	1,920	1,910	1,913	2,179	2,299	2,384
Infrastructure	575	560	454	539	592	657
Industry	823	833	1,023	1,179	1,272	1,351
IT	698	650	630	711	766	807
Group Holding	(501)	(526)	(557)	(614)	(639)	(665)
Total	**3,515**	**3,427**	**3,463**	**3,994**	**4,290**	**4,534**

Divisional Clean margins (%)	2012	2013	2014	2015E	2016E	2017E
Buildings & Partner	18.4%	18.7%	17.8%	18.1%	18.1%	18.1%
Infrastructure	10.7%	9.8%	8.6%	9.4%	10.1%	10.9%
Industry	18.4%	20.4%	18.4%	19.6%	20.3%	20.6%
IT	19.0%	18.9%	18.8%	19.4%	19.9%	20.2%
Total	**14.7%**	**14.6%**	**13.9%**	**14.5%**	**15.0%**	**15.2%**

Source: Company data, Nomura estimates

Schneider Electric BUY PRICE TARGET (EUR) 80

Market data (EURm)	2015E	2016E
Share price (EUR)	72	
NOSH	572	
Market capitalisation	41,099	41,099
Adj. net debt (inc pension	6,108	5,012
Enterprise value	47,206	46,110

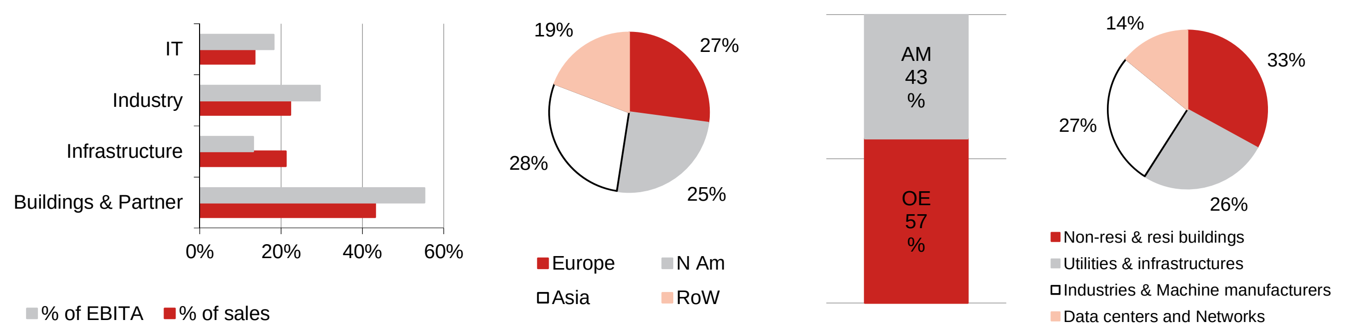
Share price as of 5th March, 2015

Multiples	2015E	2016E
EV/Sales	1.72	1.61
EV/EBITDA (clean)	10.1	9.3
EV/Nomura EBITA	11.8	10.7
EV/IC	1.7	1.7
P/E (reported)	16.5	14.9
P/E (Nomura)	14.2	12.9
Dividend yield	3.1%	3.4%
FCF yield	7.4%	7.0%

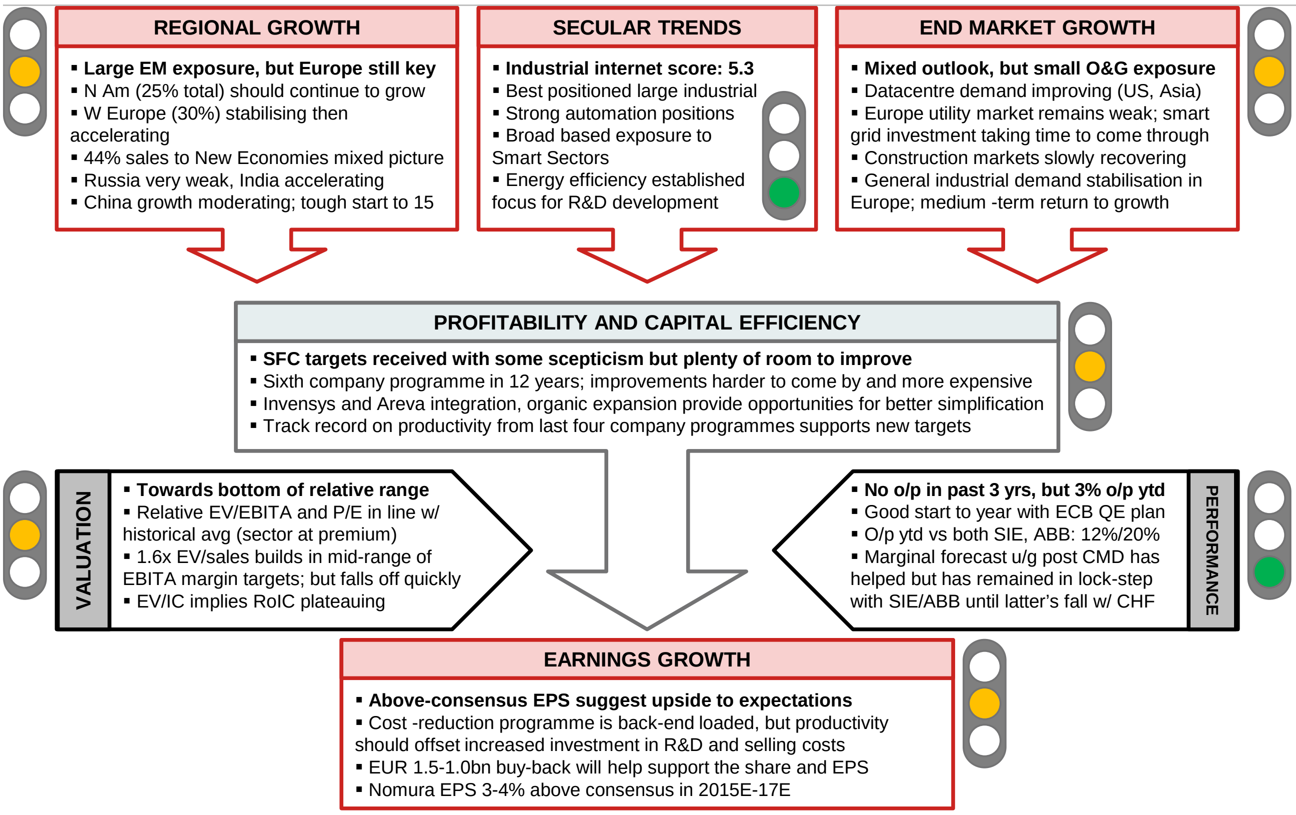
Headline data (EURm)	2013	2014	2015E	2016E	2017E
Sales	23,456	24,939	27,473	28,614	29,763
Gross profit	(14,550)	(15,532)	(17,077)	(17,658)	(18,295)
Nomura EBITA	3,427	3,463	3,994	4,290	4,534
EBIT (reported)	3,106	2,896	3,639	3,935	4,179
EPS (reported) (EUR)	3.5	3.4	4.3	4.8	5.2
EPS (Nomura) (EUR)	4.1	4.7	5.0	5.5	5.9
Reported sales growth	-2%	6%	10%	4%	4%
Organic sales growth	0%	1%	3%	4%	4%
Gross margin	38.0%	37.7%	37.8%	38.3%	38.5%
Nomura EBITA margin	14.6%	13.9%	14.5%	15.0%	15.2%
EPS growth (reported)	4%	-3%	28%	11%	9%
EPS growth (Nomura)	-11%	14%	7%	9%	8%
FCF conversion	111%	92%	104%	91%	102%
RoIC	12.1%	10.2%	11.5%	12.3%	13.1%

Source: Company data, Nomura estimates

Fig. 35: Divisional revenue and EBITA mix, regional exposure, OE/AM mix and end-market exposure



Source: Company data, based on 2014, Nomura research



Source: Nomura estimates

Appendix A-1

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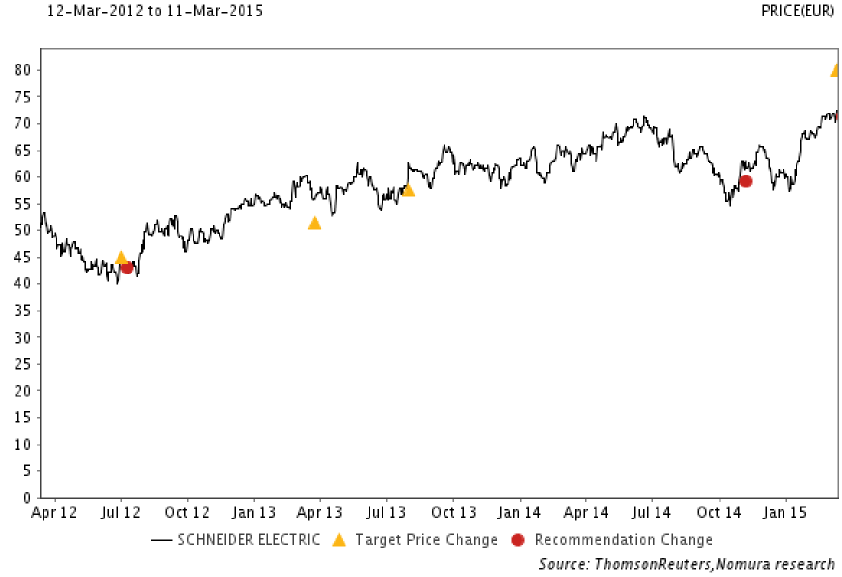
Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Schneider Electric	SU FP	EUR 72.35	11-Mar-2015	Buy	Neutral	

Schneider Electric (SU FP) **EUR 72.35 (11-Mar-2015)** Buy (Sector rating: Neutral)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
11-Mar-15	BUY		72.35
11-Mar-15		80.00	72.35
29-Oct-14	SUSPENDED		60.28
01-Aug-13		57.50	62.63
25-Mar-13		51.50	56.09
02-Jul-12	NEUTRAL		44.175
02-Jul-12		45.00	44.175

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We derive our target price of EUR 80 using a blend of relative (multiples) and absolute (DCF, SOTP) valuations. We look forward to 2017 and apply five-year average multiples (EV/EBITA of 11x to our 2017E adj. EBITA of EUR 4.5bn and P/E of 16x to our 2017E EPS of EUR 5.2) as this is a fairer reflection of the current cost of capital, which we believe has inflated valuations across the board. For our SOTP we apply a blend of peer group multiples. We discount our results back two years at a 10% cost of equity to derive a 12-month target price. For our DCF we use a WACC of 9% and terminal growth rate of 2% to derive a 12-month target price. The blended average supports our EUR 80 target price. The benchmark index for the stock is STOXX Europe 600 Industrial Goods and Services.

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