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ABB ABBN.VX ABBN VX

EQUITY: EUROPEAN CAPITAL GOODS

Initiated with Neutral; TP CHF 21

Downside revenue risks from O&G

Global Markets Research

12 March 2015

Rating Remains	Neutral
Target price Remains	CHF 21.00
Closing price 11 March 2015	CHF 20.37
Potential upside	+3.1%

We initiated coverage of ABB with a target price of CHF 21 and a Neutral rating on 11 March 2015

- **Growth:** With US and Asian revenue now 29% and 27% of total revenue, respectively, providing access to faster-growing regions for the near term, ABB's European exposure (34%) should support revenue growth in the medium term as the region's recovery gains momentum. O&G headwinds (>10% of sales) and continued weakness in power and mining markets drive our forecasts below consensus, suggesting downside risks remain despite ABB's backlog covering 67% of our 2015 revenue forecast and positive base order trends.
- **Secular trends:** ABB has been at the forefront of industrial software development for many years with global-leading positions in both process and factory automation. With the 'Next Level' strategy, management is formalising that software focus and ABB should be well positioned to develop the industrial internet revenue opportunity.
- **Profitability:** We believe investors should take heart from the Relentless Execution strand of Next Level. ABB has consistently delivered in the 3-5% target range on cost savings, EBITA focus (as opposed to EBITDA) is a cleaner measure and Power Systems appears to be under control.
- **Sentiment:** ABB has underperformed the sector and the broader market for the past three years and has been characterised by continual earnings disappointments. Working through legacy projects and driving better execution is positive for sentiment but improvements are still a long-term story and largely in consensus forecasts.
- **Valuation:** Execution issues and earnings disappointments have eroded the valuation premium ABB enjoyed in the previous cycle. 2015E EV/sales of 1.25x reflects expected margin development, although P/EG at 1x and mid-teens EPS growth is better than sector average.
- Please see *Investing in industrials in the digital age* for full details.

Year-end: Dec	2014	2015E		2016E		2017E	
Currency (USD)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	39,830	37,372	37,372	37,081	37,081	39,469	39,469
Organic revenue growth (%)	(2.0)	3.6	3.6	4.2	4.2	6.3	6.3
Adj. EBITA (mn)	4,848	4,893	4,893	5,259	5,259	5,670	5,670
Adj. EBITA margin (%)	12.2	13.1	13.1	14.2	14.2	14.4	14.4
Adj. EPS	1.34	1.49	1.49	1.64	1.64	1.78	1.78
EV/sales (x)	1.35	N/A	1.25	N/A	1.20	N/A	1.10
Adj. EV/EBITA (x)	11.95	N/A	10.35	N/A	9.18	N/A	8.33
Adj. P/E (x)	17.50	N/A	14.73	N/A	13.32	N/A	12.29

Source: Company data, Nomura estimates

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

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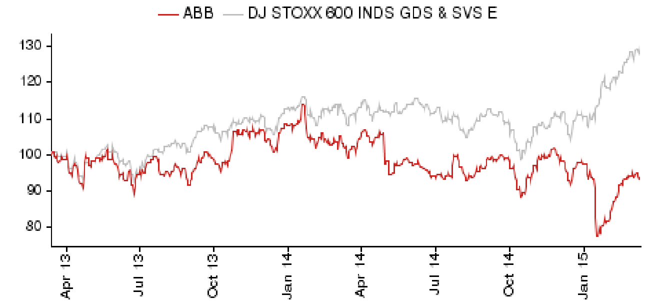
See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Key data on ABB

Rating

Stock	Neutral
Sector	Neutral

Relative performance chart



Source: Thomson Reuters, Nomura research

Performance

(%)	1m	3m	12m	YTD
Absolute	6.2	-1.1	-8.0	-3.6
Relative to sector	-1.8	-21.9	-24.9	-21.4

Enterprise value

Year-end: Dec	2014A	2015E	2016E	2017E
Avg/curr share price (CHF)	21.52	20.37	20.37	20.37
Avg shares outstanding (mn)	2,299.00	2,206.00	2,170.00	2,170.00
Market cap (CHF bn)	49.47	44.94	44.20	44.20
Net debt/(cash) (CHF bn)	0.92	(0.92)	(2.60)	(3.73)
Pension deficit (CHF bn)	2.38	2.42	2.42	2.42
Other EV adj (CHF bn)	0.54	0.63	0.72	0.82
Enterprise value (CHF bn)	53.31	47.06	44.74	43.71
Enterprise value (USD bn)	53.62	46.64	44.34	43.32

Free float: 91.0%

Valuation

Year-end: Dec	2014A	2015E	2016E	2017E
P/E (x)	17.5	14.7	13.3	12.3
EV/revenue (x)	1.3	1.2	1.2	1.1
EV/EBITDA (x)	9.8	8.4	7.5	6.8
EV/EBIT (x)	13.2	11.3	10.0	9.0
EV/CE (x)	2.0	1.7	1.5	1.4
EV/EBITA (x)	12.0	10.3	9.2	8.3
FCF yield (%)	7.7	7.7	7.7	7.2
Dividend yield (%)	3.3	3.7	3.9	4.1

Growth (%)

Year-end: Dec	2014A	2015E	2016E	2017E
Revenue	(4.8)	(6.2)	(0.8)	6.4
EBITDA	(3.9)	1.0	6.6	7.2
EBIT	(4.8)	1.8	8.6	8.9
EPS	(7.5)	12.6	12.0	9.7
DPS	(0.8)	4.2	4.9	4.7

Margins & returns

Year-end: Dec	2014A	2015E	2016E	2017E
Gross margin (%)	28.2	30.8	31.8	31.9
EBITDA margin (%)	13.8	14.8	15.9	16.0
EBIT margin (%)	10.5	11.4	12.5	12.7
ROE (%)	19.0	18.9	19.1	19.1
ROCE (%)	16.5	16.0	16.5	16.9
ROCE/WACC (x)	1.9	1.8	1.8	1.8

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

Summary income statement (USD mn)

Year-end: Dec	2014A	2015E	2016E	2017E
Revenue	39,830	37,372	37,081	39,469
COGS	(28,615)	(25,868)	(25,305)	(26,860)
Gross profit	11,215	11,504	11,776	12,609
Operating expenses	(5,732)	(5,968)	(5,876)	(6,286)
EBITDA	5,483	5,536	5,900	6,324
Depreciation & amortization	(1,305)	(1,282)	(1,280)	(1,292)
EBIT	4,178	4,254	4,620	5,031
Adj EBIT	4,394	4,469	4,835	5,246
Net interest expense	(282)	(272)	(228)	(211)
Pre-tax profit	3,896	3,982	4,392	4,821
Income tax	(1,202)	(1,075)	(1,186)	(1,302)
Minorities	(75)	(80)	(90)	(100)
Extraordinary items	0	0	0	0
Net income	2,594	2,827	3,116	3,419
Adj net income	3,090	3,294	3,582	3,886
EPS (USD)	1.13	1.28	1.43	1.57
Adj EPS (USD)	1.34	1.49	1.64	1.78
DPS (CHF)	0.78	0.81	0.85	0.89
Dividend payout ratio (%)	68.9	62.8	58.9	56.2

Summary cash flow statement (USD mn)

Year-end: Dec	2014A	2015E	2016E	2017E
Net income	2,594	2,827	3,116	3,419
Depreciation & amortization	1,305	1,282	1,280	1,292
Change in working capital	1,349	477	50	(719)
Other non cash items	0	0	0	0
Cash flow from operations	5,248	4,586	4,447	3,993
Capital expenditure	(1,026)	(1,115)	(1,113)	(1,129)
Free cash flow	4,174	3,733	3,688	3,424
Net acquisitions	(70)	0	0	0
Net disposals	1,108	0	0	0
Cash flow from investing	(248)	(1,115)	(1,113)	(1,129)
Cash dividends received/(paid)	(1,841)	(1,715)	(1,758)	(1,845)
Share (buyback)/issuance	(965)	0	0	0
FX & others	(278)	0	0	0
Net cash in/(out)flow	(319)	1,836	1,666	1,119
Net cash/(debt)	(923)	913	2,578	3,698

Summary balance sheet (USD mn)

Year-end: Dec	2014A	2015E	2016E	2017E
Fixed assets	5,652	5,485	5,318	5,155
Goodwill	10,053	10,053	10,053	10,053
Other intangible assets	2,702	2,702	2,702	2,702
Other fixed assets	1,485	1,485	1,485	1,485
Total fixed assets	19,892	19,725	19,558	19,395
Cash & equivalents	6,768	8,604	10,269	11,389
Inventories	5,376	5,419	5,377	5,723
Receivables	11,078	10,464	10,383	11,051
Other current assets	1,764	1,764	1,764	1,764
Total current assets	24,986	26,251	27,793	29,927
Total assets	44,878	45,976	47,351	49,322
Long term liabilities	12,483	12,483	12,483	12,483
Short term liabilities	15,580	15,487	15,413	15,709
Provisions	3,559	3,559	3,559	3,559
Other Liabilities	1,586	1,586	1,586	1,586
Minorities	546	626	716	816
Shareholders' equity	16,269	17,381	18,739	20,314
Total liabilities & equity	44,878	45,976	47,351	49,322

Financial ratios

Year-end: Dec	2014A	2015E	2016E	2017E
Interest cover (x)	15.6	16.4	21.2	24.9
Net debt/EBITDA (x)	0.7	0.4	0.1	(0.1)
Net debt/equity (%)	23.0	11.7	2.7	(2.3)

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.

ABB NEUTRAL PRICE TARGET (CHF) 21

Market data (USDm)	2015E	2016E
Share price (CHF)	21	
NOSH	2,206	
Market capitalisation	48,885	48,087
Adj. net debt (inc pension	2,107	532
Enterprise value	50,992	48,619

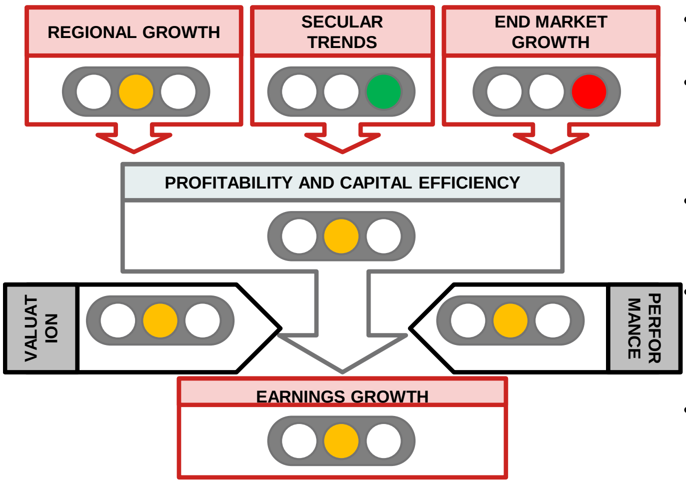
Share price as of 5th March, 2015

Multiples	2015E	2016E
EV/Sales	1.36	1.31
EV/EBITDA (clean)	8.9	8.0
EV/Nomura EBITA	10.4	9.2
EV/IC	2.3	2.2
P/E (reported)	17.3	15.4
P/E (Nomura)	14.8	13.4
Dividend yield	3.7%	3.9%
FCF yield	7.6%	7.7%

Headline data (USDm)	2013	2014	2015E	2016E	2017E
Sales	41,848	39,830	37,372	37,081	39,469
Gross profit	11,992	11,215	11,504	11,776	12,609
Nomura EBITA	5,493	4,848	4,893	5,259	5,670
EBIT (reported)	4,387	4,178	4,254	4,620	5,031
EPS (reported) (USD)	1.2	1.1	1.3	1.4	1.6
EPS (Nomura) (USD)	1.7	1.3	1.5	1.6	1.8
Reported sales growth	6%	-5%	-6%	-1%	6%
Organic sales growth	5%	-2%	4%	4%	6%
Gross margin	28.7%	28.2%	30.8%	31.8%	31.9%
Nomura EBITA margin	13.1%	12.2%	13.1%	14.2%	14.4%
EPS growth (reported)	4%	-8%	13%	12%	10%
EPS growth (Nomura)	13%	-19%	11%	10%	8%
FCF conversion	99%	135%	113%	103%	88%
RoIC	16.8%	14.9%	16.3%	17.7%	18.6%

Source: Company data, Nomura estimates

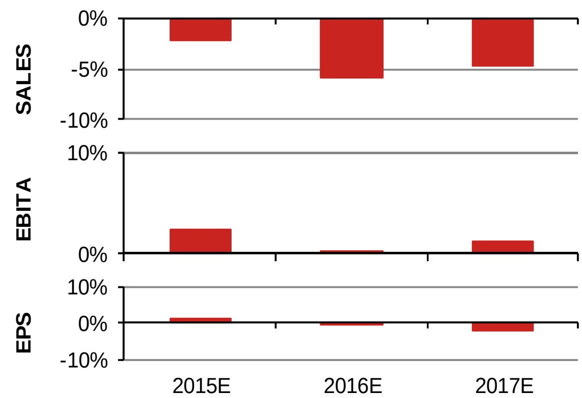
Fig. 1: ABB in the context of the sector framework



Source: Nomura research

- We initiate coverage of **ABB** with a target price of **CHF 21** and a **Neutral** rating.
- **Growth:** Underlying organic growth at bottom end of target range, but forex headwinds offset in 2015E/16E. Mining remains weak and O&G likely to deteriorate which could weigh on consensus revenue forecasts, particularly for 2016.
- **Secular trends:** Leading industrial software company with established market positions and smart product offerings already in the marketplace.
- **Profitability:** 3-5% cost saves offset price on annual basis and increasing software content should drive up gross margins. 2015 still transition year for Power Systems as it works through legacy contracts.
- **Valuation:** Despite valuation at discount relative to history and above-sector EPS growth (11% 2015E-17E), recent share price rally means this is priced in.

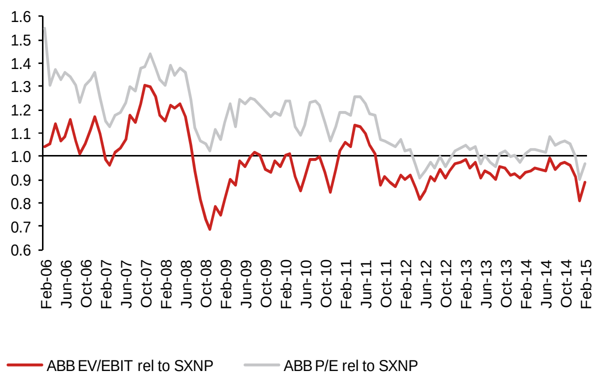
Fig. 2: Nomura estimates vs consensus estimates



Source: Bloomberg, Nomura estimates

Fig. 3: Relative valuation

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



Source: Bloomberg, Nomura research

Downside revenue risks from O&G

We initiate coverage of ABB with a target price of CHF 21 and a Neutral rating.

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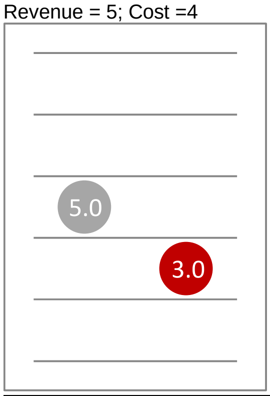
- **Sentiment:** ABB has underperformed the sector and the broader market for the past three years and has been characterised by continual earnings disappointments. Working through legacy projects and driving better execution is positive for sentiment but improvements are still a long-term story and largely in consensus forecasts.
- **Valuation:** Execution issues and earnings disappointments have eroded the valuation premium ABB enjoyed in the previous cycle. 2015E EV/sales of 1.4x reflects expected margin development, although P/EG at 1x and mid-teens EPS growth is better than sector average.

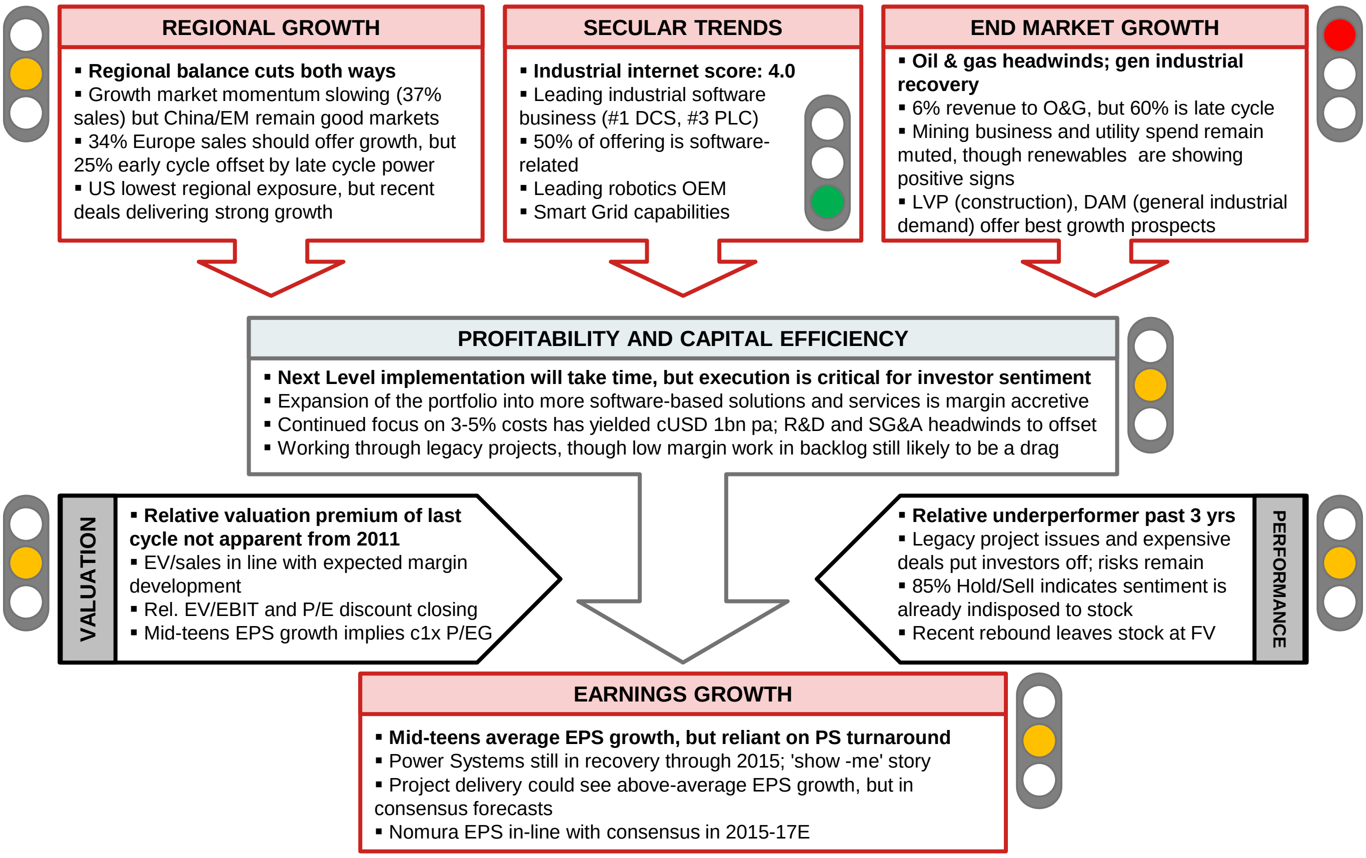
Fig. 4: Industrial Internet score

Revenue = 5; Cost =4



Source: Nomura research

Fig. 5: ABB in the context of the sector framework



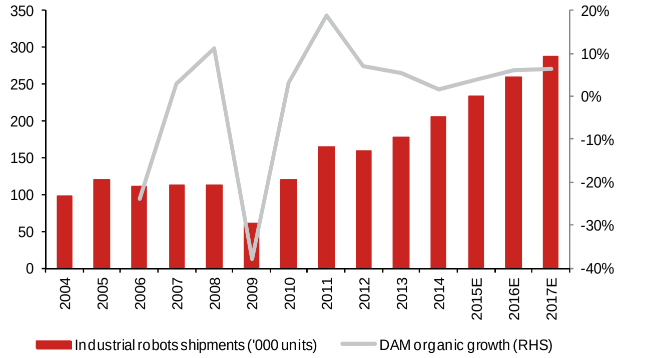
Source: Nomura estimates

Standing at the forefront of industrial software development

Since developing the world's first industrial robot in 1974, ABB has stood at the forefront of industrial robotics and software development. With leading global positions in process automation (global leader of distributed control systems (DCS)) and discrete automation (global leader of industrial motion motors and drives) as well as having delivered 250,000 robots, ABB is very well positioned to play a major role in the development and adoption of the industrial internet.

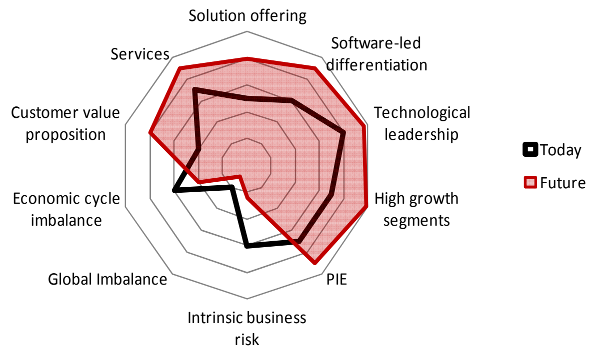
ABB already provides products, systems and software for automated process plants and factories. The Next Level strategy is positioning the company to expand into a closer and more symbiotic relationship with its customers offering software as a service (SaaS) and solutions focused on reducing through-life cost from product design to implementation.

Fig. 6: Robots vs DAM growth



Source: International Federation of Robotics, World Robotics 2014, company data, Nomura estimates

Fig. 7: Shifting the centre of gravity



Source: Company data, Nomura research

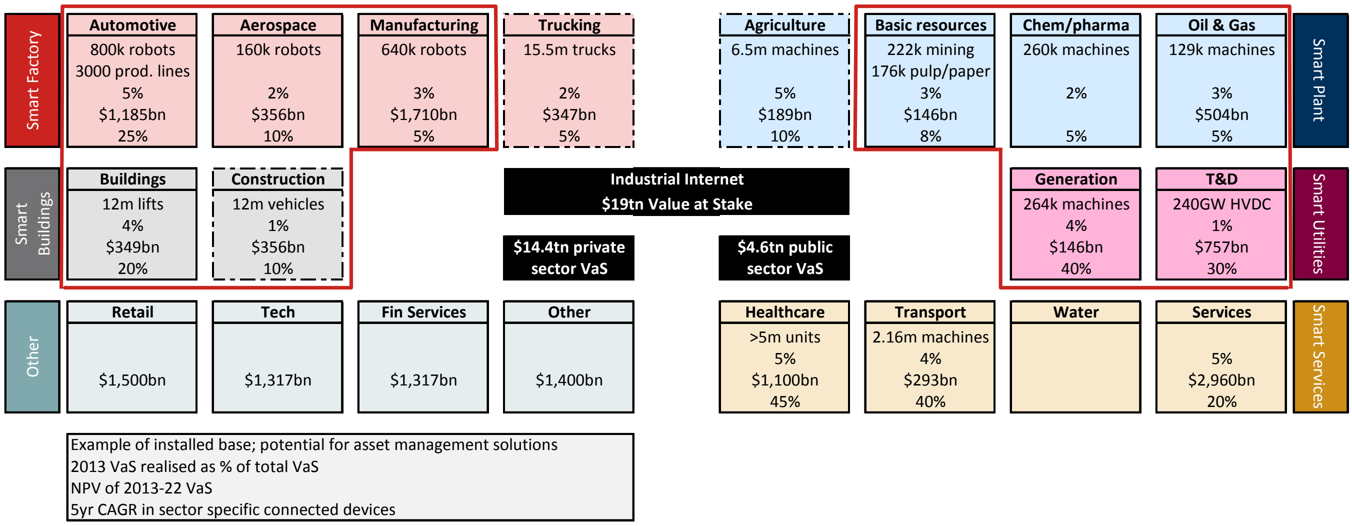
Sitting pretty at the top of Nomura Smart Sectors

ABB is well positioned at the top of several of the Nomura Smart Sectors, such as Smart Plant and Smart Utilities. With recent acquisitions, such as Ventyx in smart-grid applications, as well as long-established market positions in process automation with the 800xA DCS, ABB occupies a software development and integrator role that should position it well to take advantage of developments in the industrial internet.

Looking at ABB's overall exposure, we can see it participates in Smart Sectors accounting for 20% of the theoretical VaS in the industrial internet, with subsectors such as T&D and power generation expected to see CAGRs of 30-40% in sector-specific connected devices.

ABB's exposure to industrial automation is well publicised, with management presenting the portfolio as 60% automation, with software related to some 50% of the overall portfolio. Historically, ABB splits software revenue out explicitly, with the last published number being cUSD 1.6bn in 2012, or c4% of group sales that year. The reality is that ABB has automation products, software and systems across the industrial automation value chain, positioning it well to take advantage of developments in the industrial internet.

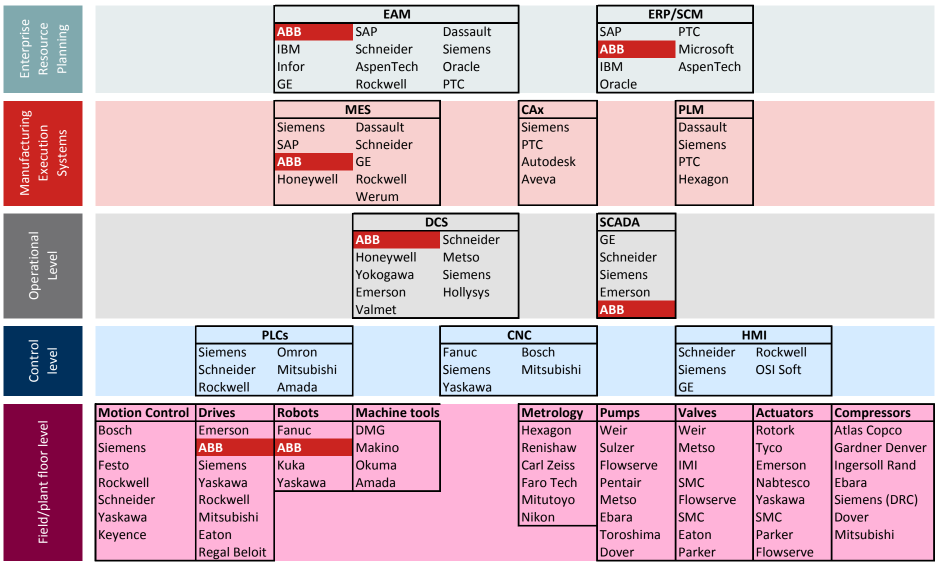
Fig. 8: ABB is present across many of our Smart Sectors, driven by strong legacy automation technology



Source: GE, Cisco, Bosch, Machina Research, Nomura estimates

Established positions in process automation control systems such as DCS and safety control and data acquisition (SCADA) systems place ABB towards the top of the plant or factory automation hierarchy, while the motors and drives it produces also give it exposure through the factory floor or field. Being present throughout the value chain should provide synergies and some advantage to ABB in developing more holistic solutions and ensuring greater connectivity between the various parts.

Fig. 9: ABB is positioned across most automation levels



Source: Company data, Nomura research

The breadth of ABB's product and software portfolio helps in its market positioning, placing the company at or near the top of most automation end markets. Historical strengths lie in the process automation end of the spectrum, where ABB is a strong number two or three manufacturer. Software and smart-grid capabilities in power systems underpin ABB's presence at the top of the power automation market, while the strength of its 800xA DCS is the driver for the company's position in O&G, petrochem and general process industries.

Fig. 10: ABB holds leading position in power, general process, O&G and petrochem

Power		Gen Proc		Oil & gas		Petrochem	
EUR 32bn		EUR 9bn		EUR 25bn		EUR 12bn	
3%		4%		6%		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 research

ABB's leading position in providing DCS for mining end markets puts it at the front of automated mining development, or Mining 2.0 as the company calls it. Despite remaining focused on capex constraints, miners are still considering investing in automated mining for the long-term savings inherent in being able to reduce operating costs in personnel and safety costs. Mining is one the lowest areas of penetration in the industrial sector, yet the mining sector is one of the key areas where adoption of the industrial internet is expected to take hold quickly and ABB Process Automation is well positioned to take advantage.

ABB's positioning in factory automation focuses on its robotics business and the drives and motors it supplies through its Discrete Automation and Motion (DAM) division. Robotics accounts for c20% of DAM divisional revenue; roughly half of the robotics business is automotive-driven, 30% or so is food & beverage and the balance is general manufacturing. Demand in China and Asia more broadly remains strong as wage inflation drives the need for automation. The rest of the division is relatively evenly split among the other discrete and hybrid end markets, with drives and motors being sold for mining equipment, pulp & paper equipment and the process industry.

Fig. 11: ABB leads in pulp & paper and mining

Food & bev		Pulp & paper		Mining	
EUR 16bn		EUR 3bn		EUR 10bn	
4%		3%		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 research

Fig. 12: Lower exposure to discrete end-markets

Aero		Gen Man		Auto	
EUR 4bn		EUR 50bn		EUR 11bn	
3%		5%		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 research

More generally, in the power segment, ABB's pioneering technology in HVDC applications and the Ventyx smart-grid software position it favourably to benefit from distributed power-generation and renewable power development. Fundamental changes in substation architecture driven by increased digitisation are met by ABB's USD 6bn in R&D focused on product innovation. The increased prevalence of the internet and the development of the industrial internet are likely to place further demands on electrical power requirements, while power security is likely to play an ever more important role, and thus provide opportunities for ABB.

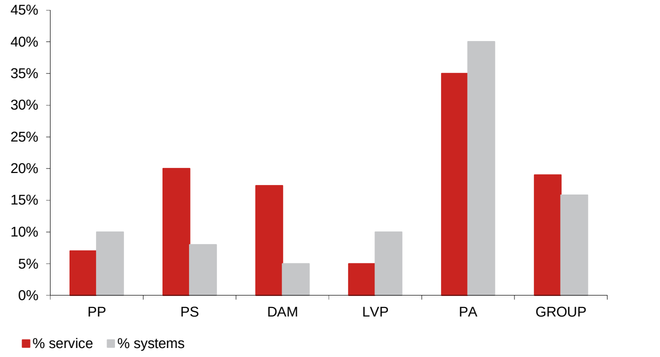
Growing service revenue has been difficult after a strong start

Service accounts for 18% of revenue, with software varying as a proportion of that, depending on which division (more in Process Automation and Power Systems). A key tenet of the Next Level strategy is to move this proportion overall for the group to 25% by 2020 through a combination of increased penetration (ABB believes it has mapped two-thirds of the USD 300bn product it has installed to date) and capturing a larger share of the customer wallet in its chosen end markets.

Service growth in the early part of the decade appears to have been easier for ABB to come by, presumably as accessing the low-hanging fruit in the installed base was a relatively easy win. Service declined by only 5% in the GFC (compared with a 15% decline in product revenue), providing some resilience for revenue and profitability of the group as a whole. As with many industrial companies, ABB was able to pick up momentum strongly again post the GFC, but then has seen a marked slowdown as the mining industry has shrunk over the past couple of years and economic growth more generally has been anaemic.

Fig. 13: Divisional service and systems exposure varies, but service has reached c20% of sales for the group overall

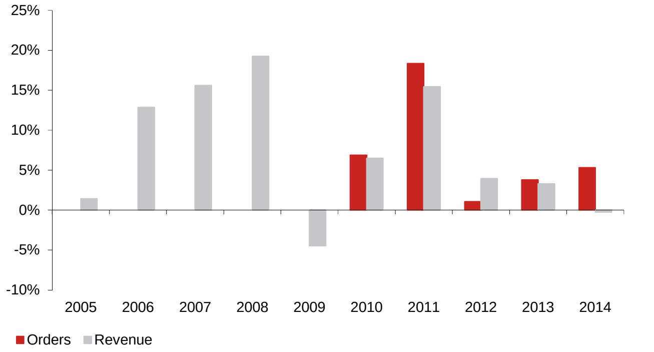
Service and systems revenue as proportion of total, 2014 (ex. Baldor and T&B)



Source: Company data, Nomura estimates

Fig. 14: Growth in service revenue was strong in the early part of the decade and post-GFC, but has slowed since

Y-o-y growth in service revenue and orders

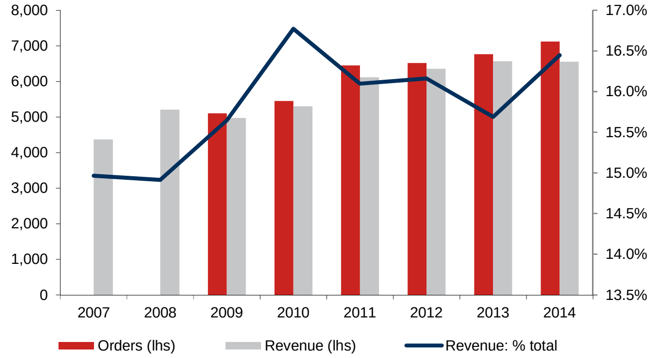


Source: Company data, Nomura research

Although we are proponents of the development of the service business within ABB, growth appears to have slowed in the past couple of years. Both the two big deals in the past five years (Baldor and Thomas & Betts) had low service businesses, so the original 2010/11 targets to increase installed base penetration and raise the service business to 25% of revenue remain in place. Adjusting for Baldor and Thomas & Betts makes a c300bp difference to the proportion of revenues derived from service (16.4% including; 19% excluding), and the proportion of orders from service in 2014 (19%) gives an indication that the service focus is beginning to pay off.

Fig. 15: Service as a proportion of the overall revenue and order intake has grown to c16.5% of total sales

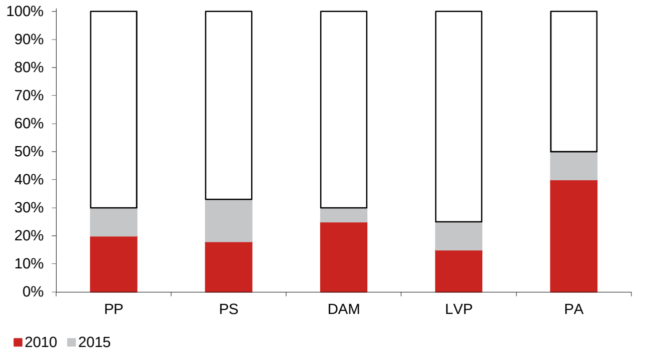
Service revenue and orders (CHFm, lhs) vs revenue as % of sales (rhs)



Source: Company data, Nomura research

Fig. 16: Previous targets were for service to be 25% of sales by 2015; we suspect it has been harder than expected to penetrate the installed base, while M&A has been dilutive

Penetration of the installed base (100%); 2010 vs targeted penetration for 2015



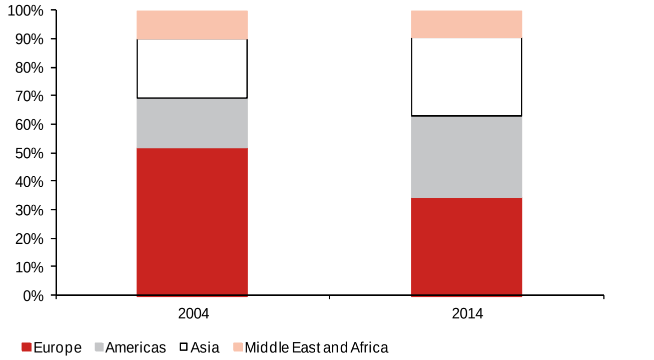
Source: Company data, Nomura estimates

Regional balance cuts both ways

ABB has shifted its regional exposure over the past 10 years through a combination of organic initiatives and M&A. The result is a group with regional revenue exposure that is well balanced across geographies and should provide exposure to continued strength in the US, improving momentum in Europe and some insulation against continued moderation in China. The acquisitions of Baldor and Thomas & Betts have also shifted the balance of the portfolio away from being overly exposed to late-cycle, big-ticket business. Acquiring the motors and low-voltage businesses in the US has helped geographically, but also given ABB access to a less lumpy revenue stream.

Fig. 17: ABB's regional revenue mix has become much more balanced over the past decade, positioning it to benefit as the different growth rates shift over 2015-17E

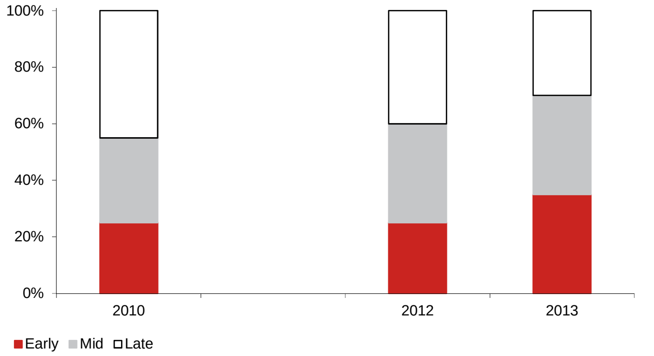
Regional revenue mix based on 2004 and 2014 revenues



Source: Company data, Nomura research

Fig. 18: ABB's recent (and much maligned) M&A has given it better cyclical balance, reducing the late-cycle exposure and increasing early-cycle exposure

Revenue mix by cycle exposure

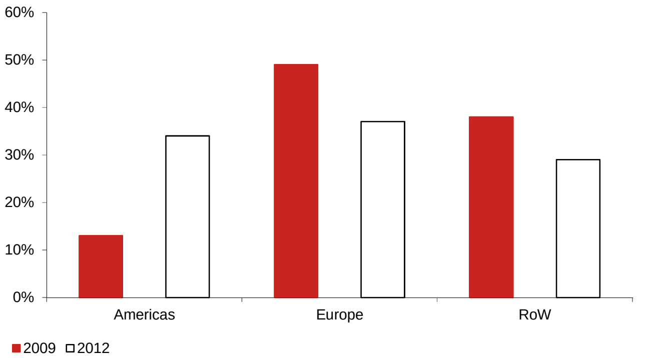


Source: Company data, Nomura research

Both acquisitions have helped in increasing ABB's exposure to North American markets, as shown by the strong organic growth in the Americas for both DAM and LVP in 2014, particularly in the second half.

Fig. 19: As well as increasing early-cycle exposure, the acquisition of Baldor improved the regional balance in DAM

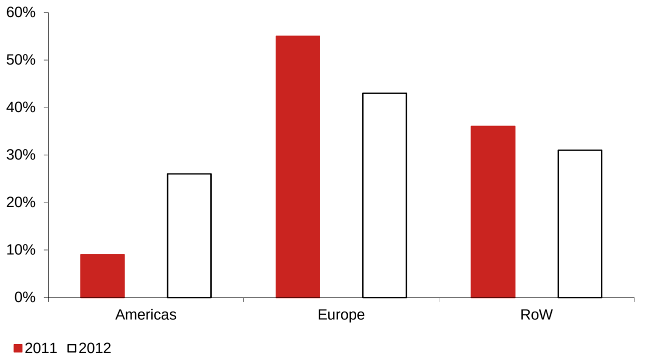
Revenue by region, 2009 vs 2012



Source: Company data, Nomura research

Fig. 20: Similarly, the acquisition of Thomas & Betts addressed the regional revenue imbalance in LVP

Revenue by region, 2011 vs 2012

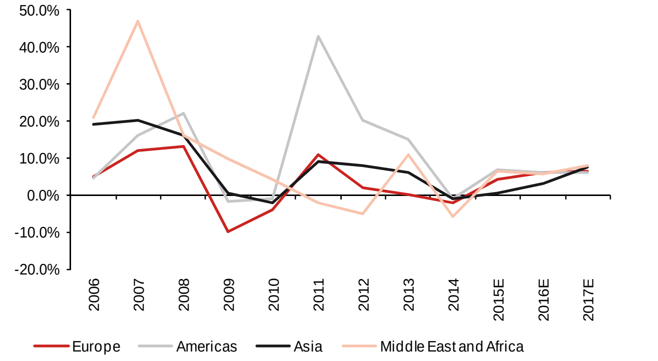


Source: Company data, Nomura research

Having said that, balanced regional exposure does cut both ways. ABB's reduced European exposure compared with the previous cycle dilutes the impact of accelerating growth in the bloc, while the third of its revenue exposed to Asia continues to see moderating growth in China. Our forecasts assume mid-single-digit organic growth in most regions, but the slowdown of Asia and the acceleration of Europe serve to drive convergence of global growth for ABB on that mid-single-digit level. There is less of a disparity among regional rates of growth than there was in previous cycles. Looking to the order book, given we do not forecast big, one-off orders, the expected growth rates look much less volatile as they essentially reflect just the base order growth.

Fig. 21: Regional revenue growth reflects the convergence of global growth as different regions speed up and others slow down

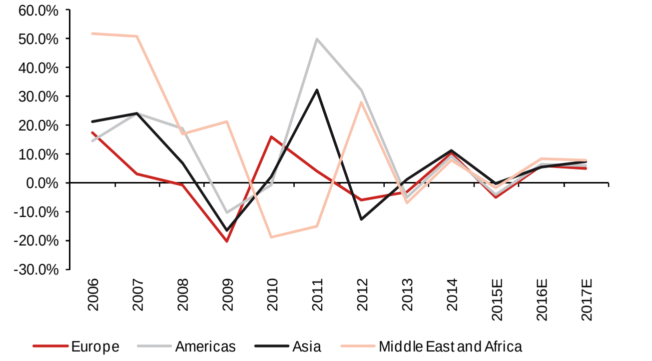
Y-o-y organic revenue growth by region



Source: Company data, Nomura estimates

Fig. 22: Lumpy orders generate high cyclicality in the regional order intake; forecasts reflect only base order development, so the volatility decreases

Y-o-y organic order growth by region

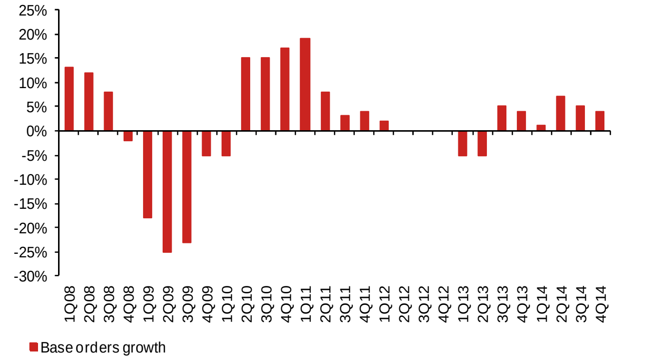


Source: Company data, Nomura estimates

That base order growth has been trending nicely positively for the past six quarters. Although growth is not strong, it is positive, and underlying positive developments in the base order data should be taken as encouraging. Rolling 12-month book-to-bill suggests the group enters 2015 with a decent amount of visibility, though 4Q book-to-bill of 0.91 for the group as a whole does give us pause for thought. The backlog of USD 25bn is c67% of our 2015 revenue forecast, which does not differ significantly from the average of the past five years (68%).

Fig. 23: Base orders have shown a positive organic development for the past six quarters, though the trend has been decelerating

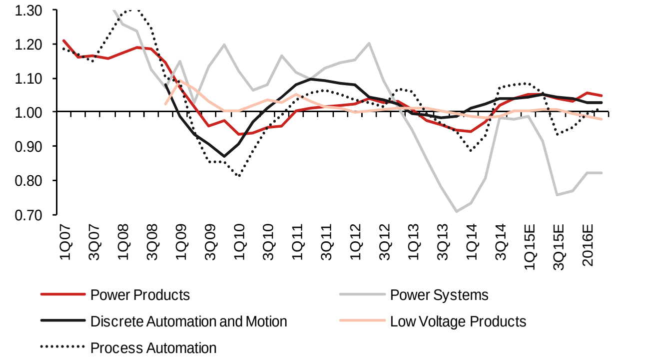
Y-o-y organic order growth (base orders only)



Source: Company data, Nomura research

Fig. 24: The rolling 12-m B2B suggests ABB enters 2015 with decent visibility, but O&G weighs on orders in 2015, dragging B2B down towards the end of the year

12 month rolling book-to-bill (B2B) by division



Source: Company data, Nomura estimates

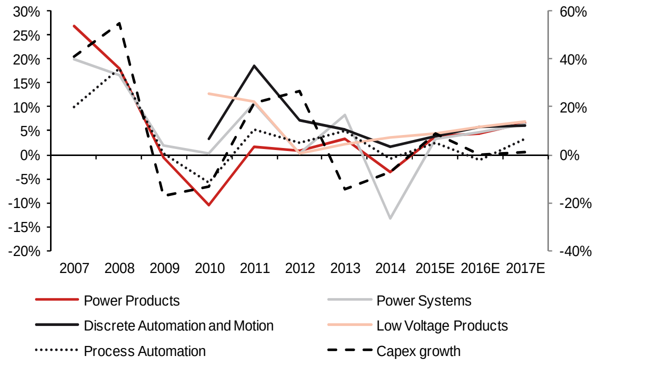
O&G provides headwinds and downside risk to revenue expectations

ABB has had relatively consistent divisional reporting in place for a number of years now and as such the market is familiar with many of the trends affecting each division. The later cycle nature of the process and power businesses is apparent in comparing their organic revenue growth with the development of capex growth from our proprietary capex analysis. The broader themes around power, mining and general industrial production have not significantly changed as we enter 2015 compared with where expectations were for much of 2014. Power demand remains muted except for renewables (primarily wind), the much-expected reinvestment in smart grid is slow to come through in demand and the mining industry capex recovery has been pushed back another year. However, the end market that has changed, and changed materially for the worse, is O&G.

However, it is ABB's later cycle exposure that provides it with some insulation to near-term declines in O&G, which we do not expect to manifest themselves in numbers until 2016. Nevertheless, the order intake in O&G will probably be affected this year, particularly around the upstream exposure.

Fig. 25: Comparing divisional organic growth to the Nomura end-market capex growth highlights the late-cycle nature of the Power and Process Automation divisions

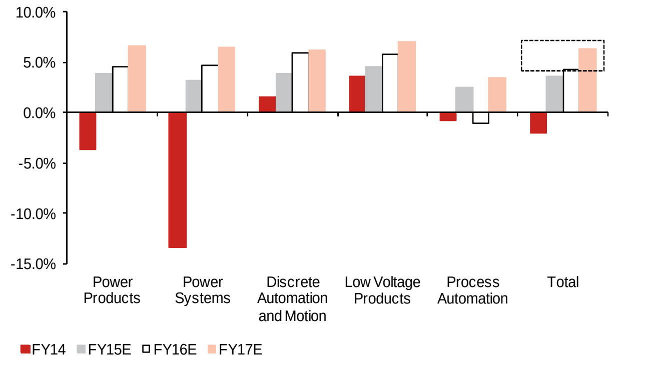
Y-o-y divisional growth vs Nomura end-market capex growth (rhs)



Source: Company data, Nomura estimates

Fig. 26: Despite the headwinds from O&G, decent order intake in FY14 underpins revenue development in most divisions; late-cycle growth supports 5% in 2017E

Y-o-y organic revenue growth by division

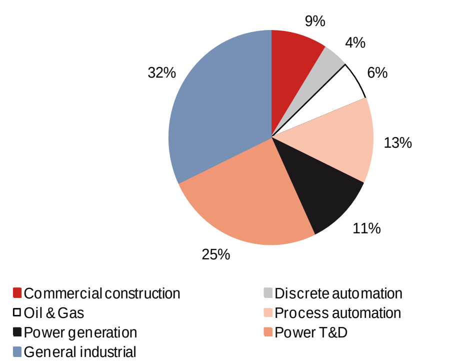


Source: Company data, Nomura estimates

ABB very helpfully detailed its O&G exposure at the FY14 results, identifying c6% of the portfolio as exposed to upstream markets. This is where the most immediate and painful hit is likely to come with E&P company capex budgets being cut by 30-50%, but we think there will be pain across the industry and the supply chain with mid- and downstream sectors just seeing a delayed effect. Helpfully, ABB has shown that some 55% of its exposure is driven by customer opex as opposed to capex budgets, which means that there is some mitigation to the substantial declines in spending in the headlines, but it is clear from the recent results that equipment and systems suppliers throughout the O&G supply chain are receiving requests for price concessions and are likely to see projects delayed, if not outright cancelled, even those in relatively advanced stages.

Fig. 27: ABB estimates direct O&G exposure to be 6% of revenue, with end-market exposure dominated by power markets both generation and T&D

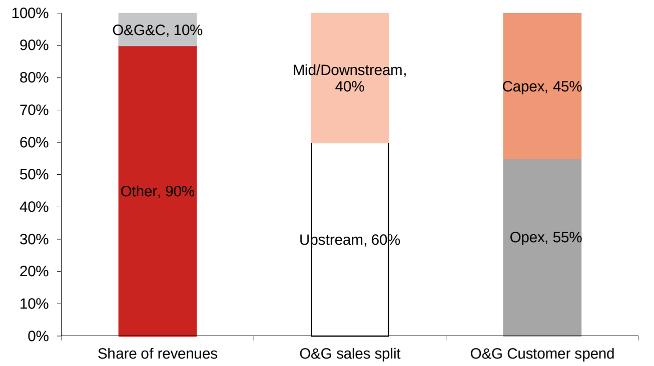
2014 revenue split by end market



Source: Company data, Nomura research

Fig. 28: Management broke out O&G exposure in more detail, emphasising the downstream and opex parts of the revenue base as areas of potential upside

2014 revenue exposure to oil, gas and chemical industries

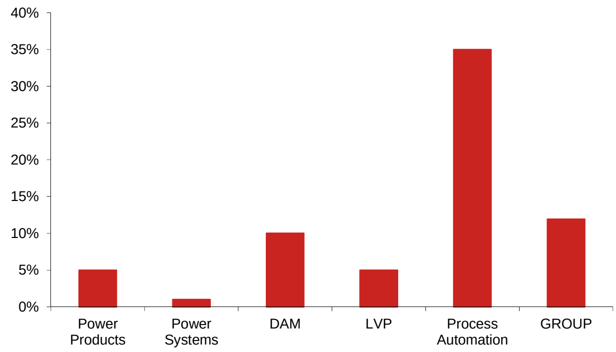


Source: Company data, Nomura research

We estimate the indirect exposure to the O&G industry at ABB is about 12%, though even this does not take account of additional indirect benefits that may have come through improved North American construction markets as a result of the strength of unconventional oil investment (eg, additional infrastructure in the Bakken). Broad O&G consensus capex forecasts are not supportive of the outlook for ABB, but the issue will be one of timing. Our research colleagues covering the chemical industry have pointed out that, while the chemical companies are enjoying the improvement to their own cost structure and profitability, they do not appear to be imminently considering further expansion.

Fig. 29: We estimate the total O&G exposure is closer to 12% for ABB group, but includes mid- and downstream

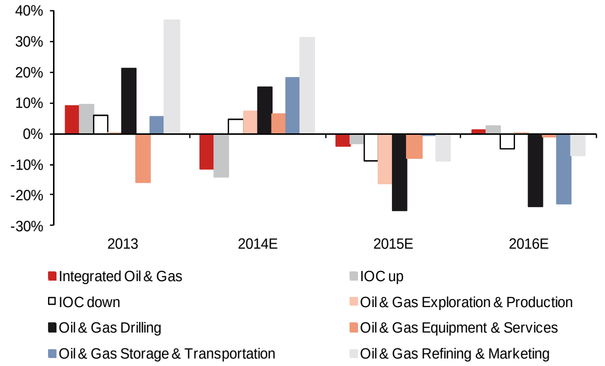
O&G revenue exposure by division and group; 2014



Source: Company data, Nomura estimates

Fig. 30: O&G capex forecasts are not supportive of positive end-market outlook for ABB, even in mid- and downstream

Y-o-y capex growth by O&G sub-sector

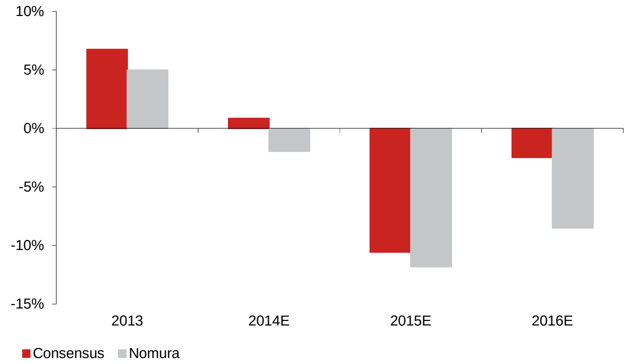


Source: Bloomberg, Nomura research

Overall our Nomura research O&G industry capex forecasts across the board are more bearish than consensus, whether for upstream or downstream, suggesting that we remain in the early stages of a reset in expectations. Going back to our comments on regional exposure, ABB's balance here may provide some additional mitigation, with much of the pain in the near term at least likely to happen in North America. Having said that, Weir recently commented that it has received requests for price concessions internationally, and even in the Middle East, as much as it has in the US, which suggests that the industry overall is looking to address an inflated cost structure.

Fig. 31: Our OFS research colleagues are more bearish than consensus on capex development

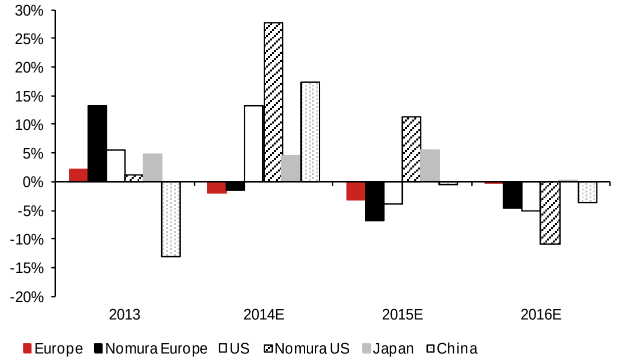
Y-o-y O&G capex growth



Source: Bloomberg, Nomura research

Fig. 32: ABB's regional exposure may provide some mitigation, given the biggest cuts are likely in the US

Y-o-y O&G capex growth



Source: Bloomberg, Nomura research

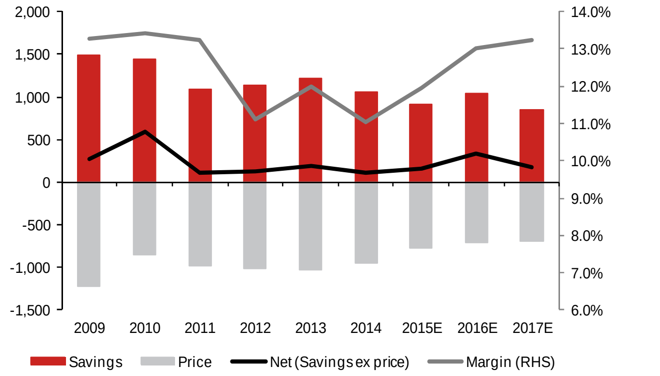
Moving beyond project execution issues

ABB has, rightly, been the subject of investor concern with respect to the long-term profitability of some of its businesses, particularly in the power end of the portfolio. Although the Power Products (PP) division has seen margins deteriorate from high-teen levels, the real culprit here is Power Systems (PS), which has seriously under-delivered for two of the past three years. Much of the underperformance relates to large, turnkey projects where ABB has acted as the overall contractor for delivering the project and has undertaken this task with weak risk management, weak pricing and weak execution.

In fairness to the company, though, despite a difficult pricing environment in many of its divisions, it has managed to drive net positive savings vs price since 2009 and we expect this to continue. We assume pricing deteriorates in 2016/17 as the current weak oil price environment will be unlikely to manifest in revenue until then. If management can cut out the PS execution issues, then the drag on group margins should lift and, with the benefit of productivity offsetting price headwinds, mid-single-digit organic growth in the balance of the business should see overall margins edge up to within target ranges for the rest of the divisions.

Fig. 33: ABB has consistently delivered net positive benefits despite serious price headwinds in competitive product areas, which underpins our forecasts

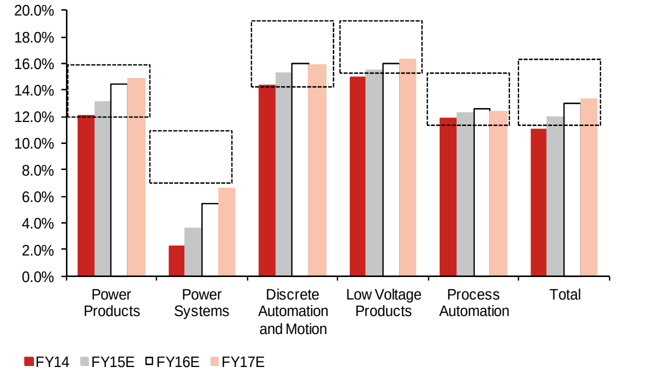
Cost savings and price vs margin



Source: Company data, Nomura estimates

Fig. 34: We assume all divisions apart from PS manage to achieve margins inside the target ranges over 2015-17

Divisional margin vs target ranges



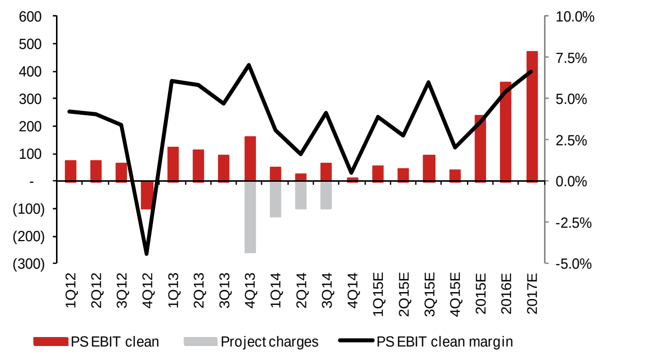
Source: Company data, Nomura estimates

At PS, the business remains in transition, with margin improvement likely this year, but the real improvement towards target margin range is likely in 2016. The lumpy nature of the project business and already low profitability means 2015 is likely to continue to see sub-par margins in PS, but management believes that it now has sufficient handle on the business to be confident in achieving target margins in 2016. With a firm grip on the execution side, management has also stated that it is not including the platform in the project bid anymore, which should help reduce the ultimate risk for ABB. Pricing for the industry appears to have improved somewhat as all participants have had their fingers burned, so competitive discipline should also help margins recover. With less project work, the business may well end up being smaller, but profitability should improve and the risks decline.

For the group as a whole, the aggregate EBIT bridge shows the benefits, or arguably necessity, of a successful productivity programme, with cost saves offsetting pricing. Underlying volume development contributes above half of the overall incremental in the forecast period, but the real kicker is whether management can deliver the productivity savings to offset pricing headwinds and any cost inflation. History provides decent evidence that it can do that, if it can ensure the project business remains under control.

Fig. 35: Lack of charges as legacy project execution issues are addressed should allow the margins to improve but the ramp in margins is steep and well above historical delivery

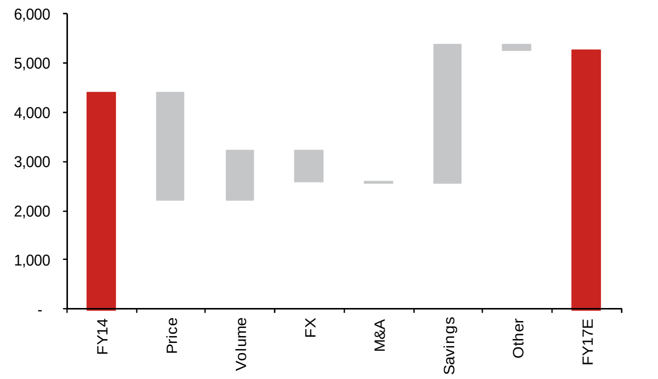
PS margin development



Source: Company data, Nomura estimates

Fig. 36: Cost savings and price remain the largest components of the aggregate group EBIT bridge, which means it comes down to whether management can deliver

Group EBIT bridge (CHFm)



Source: Company data, Nomura estimates

SG&A costs have remained largely flat relative to sales (ex-R&D and D&A), which is a positive given the acquisitions and additional investments in selling personnel and IT (particularly in the past couple of years; selling expenses increased 5% in 2013 on an underlying basis and 9%, excluding Thomas & Betts, in 2012 owing to investment in personnel). The benefits of this investment should begin to manifest themselves in improved organic growth. Disaggregating the impact of an improvement in net promotor score (NPS) on the base order growth is difficult, but the trends are encouraging, while the increase in R&D should also support further improvement in organic growth in our forecast period.

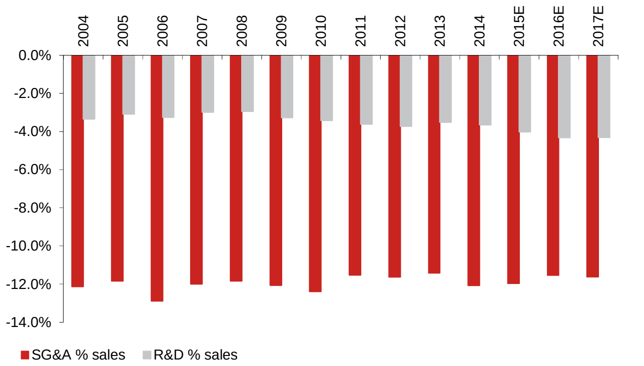
Fig. 37: Although difficult to disaggregate, the improvement in Net Promoter Score should have had a positive impact on the base order intake

NPS over time vs base order growth

Source: Company data, Nomura estimates

Fig. 38: SG&A costs have remained stable relative to sales over time, despite the business doubling sales

SG&A and R&D as a % of sales (SG&A adjusted for R&D and D&A)

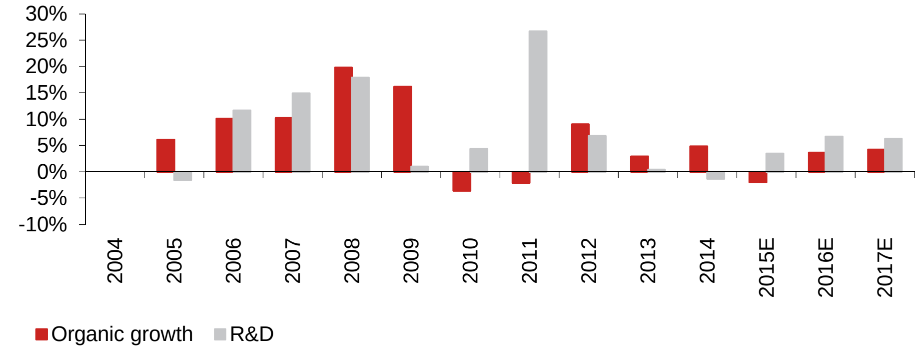


Source: Company data, Nomura estimates

ABB has cautioned that continued R&D investment is required as part of the Next Level strategy and therefore we build continued growth in R&D into our forecasts, expecting the expense grows to 4.3% of 2016E/17E sales. Encouragingly, if we look historically at the growth in R&D spending and organic growth, the latter tends to improve after an increase in the former, giving us some confidence that our low-growth assumptions are supported by new product innovation.

Fig. 39: Comparing R&D growth with organic growth shows the latter tends to improve following an increase in the former

Y-o-y change



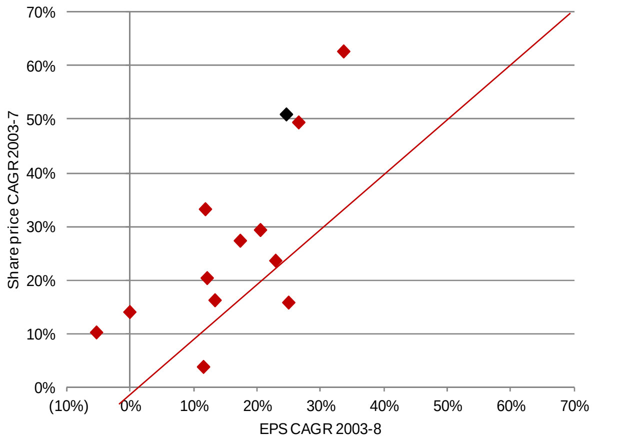
Source: Company data, Nomura estimates

Valuation premium has disappeared

Our standard EPS growth vs share price performance charts are particularly instructive for ABB, with strong growth in 2003-08 supporting strong share price performance, and lack of EPS growth in 2010-14 driving little share price performance.

Fig. 40: Share price performance and EPS growth in the past cycle

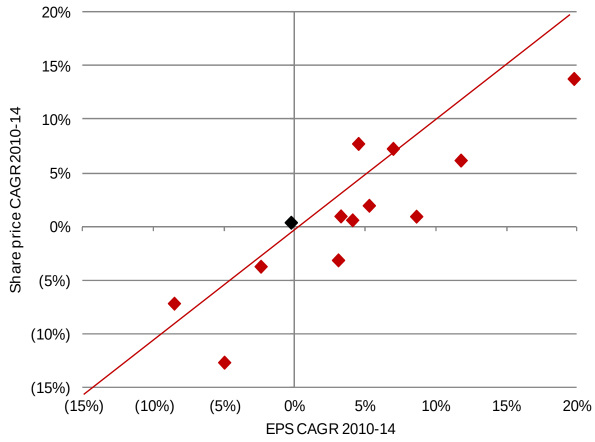
Share price growth vs EPS growth



Source: Company data, Nomura research

Fig. 41: Share price performance and EPS growth in the current cycle

Share price growth vs EPS growth

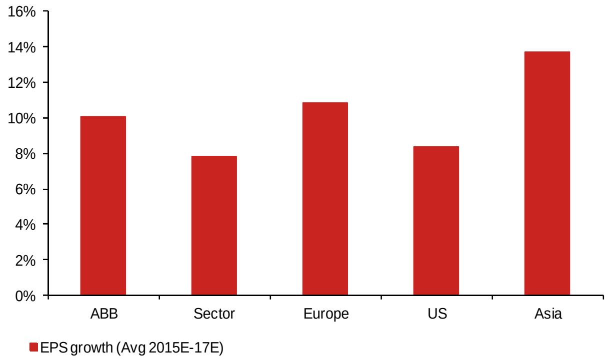


Source: Company data, Nomura research

As such, a low EPS base in 2014 means ABB's EPS growth over 2015-17E could be among the best in the sector we cover. However, compared with a broader European peer group it appears more in line, which means outperformance relative to the broader SXNP may be less well supported. Nevertheless, on a stand-alone basis, the strong EPS growth and deterioration in forward P/E multiples means ABB is one of the few of our coverage companies to enjoy a P/EG ratio of 1x, which represents good value compared with the broader sector both within Europe and elsewhere.

Fig. 42: A low base in 2014 drives EPS growth above the sector average, which should drive a reversal in fortunes for the share price performance

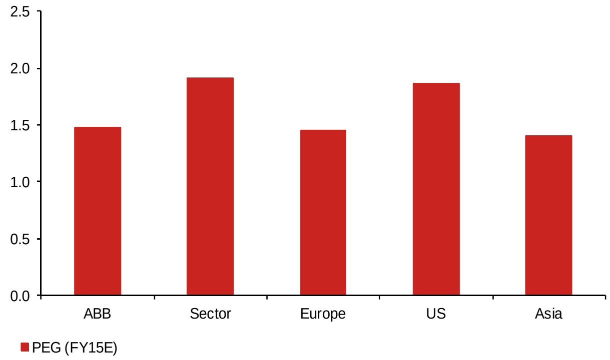
Average EPS growth 2015-17E



Source: Bloomberg, Nomura estimates

Fig. 43: Strong EPS growth and a relative P/E at cyclical lows vs the sector means ABB's P/EG ratio is well below the sector average

P/EG ratio

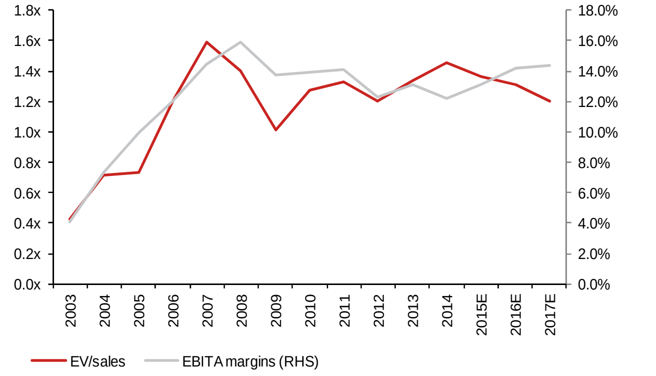


Source: Bloomberg, Nomura estimates

Looking at EV/sales multiples compared with EBITA margins suggests the market is pricing a lack of margin improvement. We have demonstrated above that we believe there may be some improvement, conditional on the improvement in the PS division, which suggests the current valuation is building in little in the way of upside. The balance of sentiment has become marginally more negative in recent months, with more of our peers recommending selling the stock.

Fig. 44: EV/sales reflects the market's caution regarding the EBITA margin development

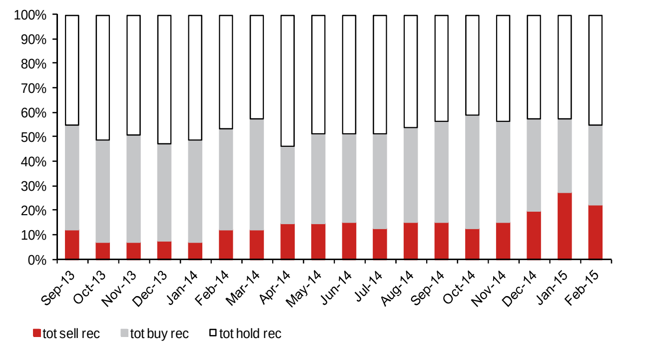
EV/sales (lhs) vs EBITA margins over time (rhs)



Source: Company data, Nomura research

Fig. 45: Sell-side ratings have evolved over the past 18 months but sentiment towards ABB remains neutral

Bloomberg ratings history

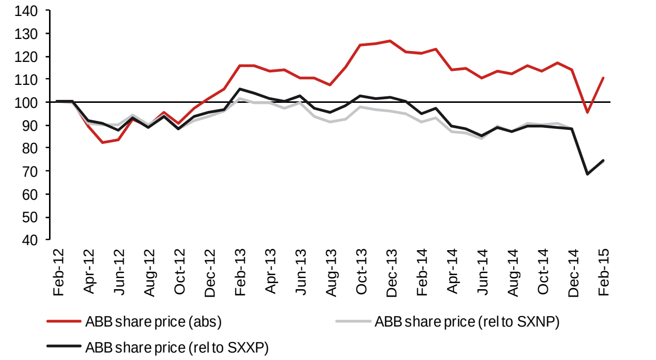


Source: Bloomberg, Nomura research

Concerns around M&A integration and execution issues in the backlog led to a preponderance of earnings disappointments over the past three years. This has led to underperformance relative to the broader sector for the past three years and the recent development of the oil price has further dampened performance.

Fig. 46: Concerns around M&A integration, project execution and earnings disappointments have weighed on the stock, compounded by the removal of the CHF peg

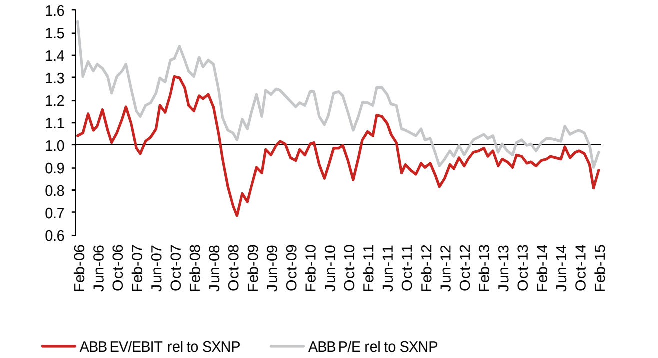
Share price development indexed to 100, Jan 2012=100



Source: Bloomberg, Nomura research

Fig. 47: Relative valuation is at cyclical lows; although the stock has rallied in the last month, it will take time to recover prior cycle premium

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

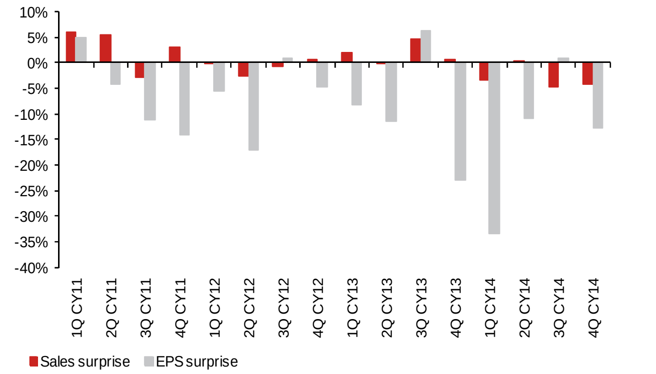


Source: Bloomberg, Nomura research

It has also further eroded ABB's relative valuation, with the stock now trading at cyclical lows on a relative EV/EBITA and P/E basis.

Fig. 48: Earnings disappointments have been predominant for several years; turning this around should drive better share price performance

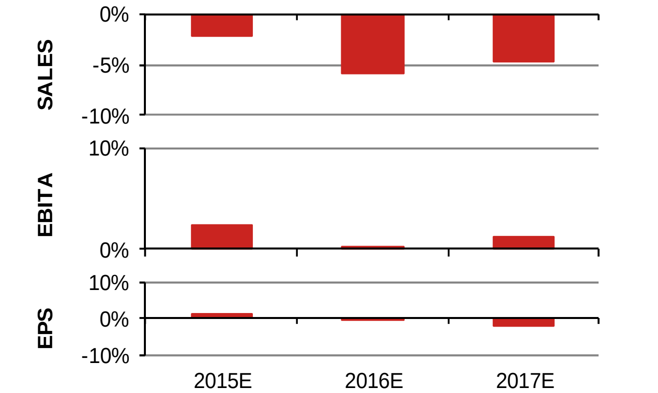
% beat or miss on sales and EPS



Source: Bloomberg, Nomura research

Fig. 49: Our cautious growth outlook drives revenue forecasts below consensus, but we see margin improvement driving EBITA/EPS in line with consensus

% difference vs consensus



Source: Bloomberg, Nomura estimates

Our forecasts relative to consensus paint a mixed picture. We are cautious on top-line development, driven by continued weakness in power and mining markets and medium-term deterioration in ABB's O&G exposure. However, we are optimistic on profitability. We do believe in the Relentless Execution element of the ABB 'Next Level' plan, which is why our EBIT margin expectations are in line with consensus. Improved project execution in PS and continued delivery of productivity should go some way to mitigating what we see as downside risks in revenue expectations.

Target price suggests stock at fair value

We derive our target price of CHF 21 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. 50: Derivation of our ABB target price

CHF

Valuation method	2015E	Disc.	2017E	Assumptions
Sum of the parts	25	0.83	31	Peer trading multiples
DCF	23		27	10yr growth 5%, 14% avg margin, 9% WACC
EV/EBIT	22	0.83	27	5yr avg 11x
P/E	21	0.83	26	5yr avg 14x
Average (USD)	**23**		**27**	**Blended average**
Average (CHF)	**21**		**25**	

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.
- ABB also has high exposure to emerging markets, so any changes in underlying country-specific growth in the likes of China, Brazil, and India, among others, could affect our forecasts for growth.
- 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. Should QE or low oil prices prove a catalyst for European growth to pick up earlier than we thought, then it could have a meaningful positive impact on our forecasts for ABB's organic growth. Similarly, if our cautious view of the development of O&G industry spending over the coming 1-2 years proves unfounded, then ABB's growth would not face the headwinds we build into our forecasts.
- **Profitability:** We expect a pickup in R&D investment and continued price competition to provide a headwind for profitability at ABB. ABB has been able to consistently offset price erosion with cost savings, but these productivity measures are likely to become more difficult to realise. Failure by management to offset price headwinds would be detrimental to margins. In addition, any resurgence of the execution issues ABB has seen in the past in delivering large projects would also add to negative investor sentiment and weigh on earnings expectations
- **M&A:** Although unlikely to be imminent given the previous management team spent a considerable amount of money on M&A, we cannot rule out the return of M&A to the ABB investment thesis. The usual risks associated with significant M&A could affect our neutral investment thesis to either upside or downside, depending on the quality and/or price of any deal.

Fiscal Headline Data	2012	2013	2014	2015E	2016E	2017E
Sales	39,336	41,848	39,830	37,372	37,081	39,469
Gross profit	11,378	11,992	11,215	11,504	11,776	12,609
EBIT	4,058	4,387	4,178	4,254	4,620	5,031
PTP	3,838	4,066	3,896	3,982	4,392	4,821
Reported net income	2,704	2,787	2,594	2,827	3,116	3,419
EPS - Reported	1.18	1.23	1.13	1.28	1.43	1.57
DPS - Reported	0.74	0.78	0.78	0.81	0.85	0.89
EBITDA clean	5,555	6,335	5,699	5,751	6,115	6,539
Nomura EBITA	4,822	5,493	4,848	4,893	5,259	5,670
EBIT clean	4,373	5,017	4,394	4,469	4,835	5,246
Nomura Net Income	3,353	3,820	3,090	3,294	3,582	3,886
Nomura EPS	1.46	1.66	1.34	1.49	1.64	1.78

Source: Company data, Nomura estimates

Profit & Loss	2012	2013	2014	2015E	2016E	2017E
Sales	**39,336**	**41,848**	**39,830**	**37,372**	**37,081**	**39,469**
COGS	(27,958)	(29,856)	(28,615)	(25,868)	(25,305)	(26,860)
Gross profit	**11,378**	**11,992**	**11,215**	**11,504**	**11,776**	**12,609**
Margin	28.9%	28.7%	28.2%	30.8%	31.8%	31.9%
SGA expenses	(7,220)	(7,564)	(7,566)	(7,250)	(7,157)	(7,578)
Other operating income/expenses	(100)	(41)	529	0	0	0
Reported EBIT	**4,058**	**4,387**	**4,178**	**4,254**	**4,620**	**5,031**
Margin	10.3%	10.5%	10.5%	11.4%	12.5%	12.7%
Nomura EBITA	**4,822**	**5,493**	**4,848**	**4,893**	**5,259**	**5,670**
Margin	12.3%	13.1%	12.2%	13.1%	14.2%	14.4%
Net Financial Items	(220)	(321)	(282)	(272)	(228)	(211)
Reported pre-tax income	**3,838**	**4,066**	**3,896**	**3,982**	**4,392**	**4,821**
Taxation	(1,030)	(1,122)	(1,202)	(1,075)	(1,186)	(1,302)
Minority interest	(108)	(116)	(75)	(80)	(90)	(100)
Associates/others	4	(41)	(25)	0	0	0
Reported net income	**2,704**	**2,787**	**2,594**	**2,827**	**3,116**	**3,419**
Reported EPS (dil.)	**1.18**	**1.23**	**1.13**	**1.28**	**1.43**	**1.57**

Source: Company data, Nomura estimates

Balance Sheet	2012	2013	2014	2015E	2016E	2017E
Fixed assets	**21,068**	**21,639**	**19,892**	**19,725**	**19,558**	**19,395**
Intangibles assets	13,727	13,967	12,755	12,755	12,755	12,755
Tangible assets	5,947	6,254	5,652	5,485	5,318	5,155
Investments/associates	1,394	1,418	1,485	1,485	1,485	1,485
Current assets	**19,521**	**19,940**	**18,218**	**17,647**	**17,523**	**18,538**
Inventories	6,182	6,004	5,376	5,419	5,377	5,723
Trade debtors	11,575	12,146	11,078	10,464	10,383	11,051
Other current assets	1,764	1,790	1,764	1,764	1,764	1,764
Cash & securities	**8,481**	**6,485**	**6,768**	**8,604**	**10,269**	**11,389**
Total assets	**49,070**	**48,064**	**44,878**	**45,976**	**47,351**	**49,322**
Gross debt	**10,071**	**8,023**	**7,691**	**7,691**	**7,691**	**7,691**
Current liabilities	**16,437**	**16,222**	**15,227**	**15,134**	**15,060**	**15,356**
Trade creditors	4,992	5,112	4,765	4,672	4,598	4,894
Accrued and other liabilities	7,961	7,670	7,383	7,383	7,383	7,383
Other current liabilities (ex-debt)	3,484	3,440	3,079	3,079	3,079	3,079
Provisions (l-term)	**3,550**	**2,904**	**3,559**	**3,559**	**3,559**	**3,559**
Post-employment benefits	2,290	1,639	2,394	2,394	2,394	2,394
Other provisions	1,260	1,265	1,165	1,165	1,165	1,165
Other non-current liabilities	1,566	1,707	1,586	1,586	1,586	1,586
Total Equity	**17,446**	**19,208**	**16,815**	**18,007**	**19,455**	**21,130**
Ordinary Shareholders Funds	16,906	18,678	16,269	17,381	18,739	20,314
Minorities	540	530	546	626	716	816
Total Equity and Liabilities	**49,070**	**48,064**	**44,878**	**45,976**	**47,351**	**49,322**

Source: Company data, Nomura estimates

Cash Flow	2012	2013	2014	2015E	2016E	2017E
Reported net income	2,704	2,787	2,594	2,827	3,116	3,419
D & A	1,182	1,318	1,305	1,282	1,280	1,292
Movement in working capital	(1,044)	(273)	1,349	477	50	(719)
Other items						
Operating Cash Flow	**2,842**	**3,832**	**5,248**	**4,586**	**4,447**	**3,993**
Capital expenditure	(1,293)	(1,106)	(1,026)	(1,115)	(1,113)	(1,129)
Fixed asset/ investment sales	(5,119)	(759)	1,535	0	0	0
Others investing items	1,057	(13)	(757)	0	0	0
Investing Activities	**(5,355)**	**(1,878)**	**(248)**	**(1,115)**	**(1,113)**	**(1,129)**
Change in debt	6,075	(2,048)	(332)	0	0	0
Shareholders' equity	(1,594)	(1,025)	(4,987)	(1,635)	(1,668)	(1,745)
Financing Activities	**4,481**	**(3,073)**	**(5,319)**	**(1,635)**	**(1,668)**	**(1,745)**
Inc (+)/dec(-) in cash	**1,968**	**(1,119)**	**(319)**	**1,836**	**1,666**	**1,119**

Source: Company data, Nomura estimates

Divisional Sales	2012	2013	2014	2015E	2016E	2017E
Power Products	10,717	11,032	10,333	9,975	9,975	10,627
Power Systems	7,852	8,375	7,020	6,700	6,693	7,124
Discrete Automotion and Motion	9,405	9,915	10,142	9,636	9,747	10,355
Low Voltage Products	6,638	7,729	7,532	7,018	7,073	7,565
Process Automation	8,156	8,497	7,948	7,244	6,818	7,049
Corporate and Other	(3,432)	(3,700)	(3,145)	(3,200)	(3,225)	(3,250)
Total revenue	**39,336**	**41,848**	**39,830**	**37,372**	**37,081**	**39,469**

Divisional EBIT clean	2012	2013	2014	2015E	2016E	2017E
Power Products	1,376	1,414	1,252	1,309	1,441	1,576
Power Systems	116	496	156	239	363	469
Discrete Automotion and Motion	1,472	1,498	1,451	1,467	1,557	1,648
Low Voltage Products	969	1,145	1,128	1,086	1,131	1,232
Process Automation	921	1,009	941	889	861	870
Corporate and Other	(481)	(545)	(534)	(521)	(517)	(548)
Total revenue	**4,373**	**5,017**	**4,394**	**4,469**	**4,835**	**5,246**

Divisional Clean margins (%)	2012	2013	2014	2015E	2016E	2017E
Power Products	12.8%	12.8%	12.1%	13.1%	14.4%	14.8%
Power Systems	1.5%	5.9%	2.2%	3.6%	5.4%	6.6%
Discrete Automotion and Motion	15.7%	15.1%	14.3%	15.2%	16.0%	15.9%
Low Voltage Products	14.6%	14.8%	15.0%	15.5%	16.0%	16.3%
Process Automation	11.3%	11.9%	11.8%	12.3%	12.6%	12.3%
Total revenue	**11.1%**	**12.0%**	**11.0%**	**12.0%**	**13.0%**	**13.3%**

Source: Company data, Nomura estimates

ABB			NEUTRAL	PRICE TARGET (CHF)				21

Market data (USDm)	2015E	2016E
Share price (CHF)	21	
NOSH	2,206	
Market capitalisation	48,885	48,087
Adj. net debt (inc pension	2,107	532
Enterprise value	50,992	48,619

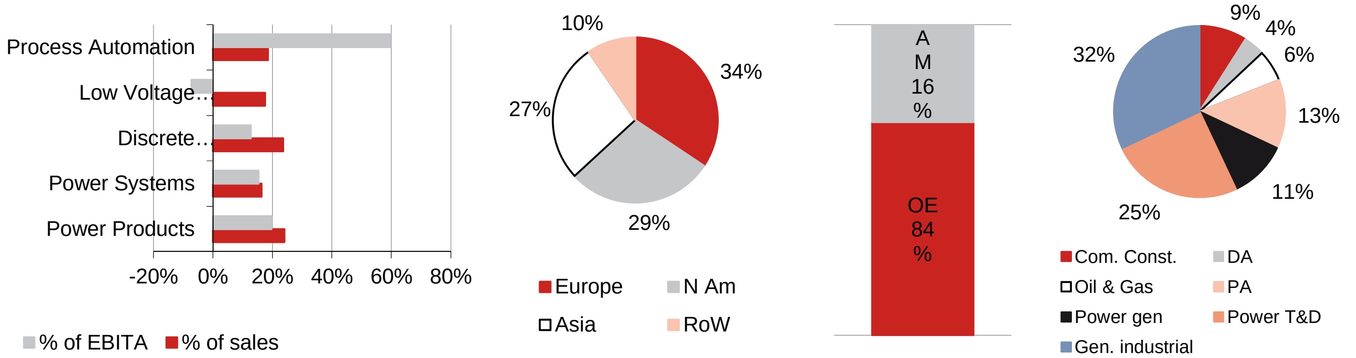
Share price as of 5th March, 2015

Multiples	2015E	2016E
EV/Sales	1.36	1.31
EV/EBITDA (clean)	8.9	8.0
EV/Nomura EBITA	10.4	9.2
EV/IC	2.3	2.2
P/E (reported)	17.3	15.4
P/E (Nomura)	14.8	13.4
Dividend yield	3.7%	3.9%
FCF yield	7.6%	7.7%

Headline data (USDm)	2013	2014	2015E	2016E	2017E
Sales	41,848	39,830	37,372	37,081	39,469
Gross profit	11,992	11,215	11,504	11,776	12,609
Nomura EBITA	5,493	4,848	4,893	5,259	5,670
EBIT (reported)	4,387	4,178	4,254	4,620	5,031
EPS (reported) (USD)	1.2	1.1	1.3	1.4	1.6
EPS (Nomura) (USD)	1.7	1.3	1.5	1.6	1.8
Reported sales growth	6%	-5%	-6%	-1%	6%
Organic sales growth	5%	-2%	4%	4%	6%
Gross margin	28.7%	28.2%	30.8%	31.8%	31.9%
Nomura EBITA margin	13.1%	12.2%	13.1%	14.2%	14.4%
EPS growth (reported)	4%	-8%	13%	12%	10%
EPS growth (Nomura)	13%	-19%	11%	10%	8%
FCF conversion	99%	135%	113%	103%	88%
RoIC	16.8%	14.9%	16.3%	17.7%	18.6%

Source: Company data, Nomura estimates

Fig. 51: Divisional revenue and EBITA mix, regional exposure, OE/AM mix and end-market exposure



Source: Company data, based on 2014, Nomura research

REGIONAL GROWTH

- **Regional balance cuts both ways**
- Growth market momentum slowing (37% sales) but China/EM remain good markets
- 34% Europe sales should offer growth, but 25% early cycle offset by late cycle power
- US lowest regional exposure, but recent deals delivering strong growth

SECULAR TRENDS

- **Industrial internet score: 4.0**
- Leading industrial software business (#1 DCS, #3 PLC)
- 50% of offering is software-related
- Leading robotics OEM
- Smart Grid capabilities

END MARKET GROWTH

- **Oil & gas headwinds; gen industrial recovery**
- 6% revenue to O&G, but 60% is late cycle
- Mining business and utility spend remain muted, though renewables are showing positive signs
- LVP (construction), DAM (general industrial demand) offer best growth prospects

PROFITABILITY AND CAPITAL EFFICIENCY

- **Next Level implementation will take time, but execution is critical for investor sentiment**
- Expansion of the portfolio into more software-based solutions and services is margin accretive
- Continued focus on 3-5% costs has yielded cUSD 1bn pa; R&D and SG&A headwinds to offset
- Working through legacy projects, though low margin work in backlog still likely to be a drag

VALUATION

- **Relative valuation premium of last cycle not apparent from 2011**
- EV/sales in line with expected margin development
- Rel. EV/EBIT and P/E discount closing
- Mid-teens EPS growth implies c1x P/EG

PERFORMANCE

- **Relative underperformer past 3 yrs**
- Legacy project issues and expensive deals put investors off; risks remain
- 85% Hold/Sell indicates sentiment is already indisposed to stock
- Recent rebound leaves stock at FV

EARNINGS GROWTH

- **Mid-teens average EPS growth, but reliant on PS turnaround**
- Power Systems still in recovery through 2015; 'show -me' story
- Project delivery could see above-average EPS growth, but in consensus forecasts
- Nomura EPS in-line with consensus in 2015-17E

Source: Nomura estimates

Appendix A-1

Analyst Certification

We, Alexander Virgo, Maggie Paxton, Felix Wienen and Sidharth Saboo, hereby certify (1) that the views expressed in this Research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of our compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

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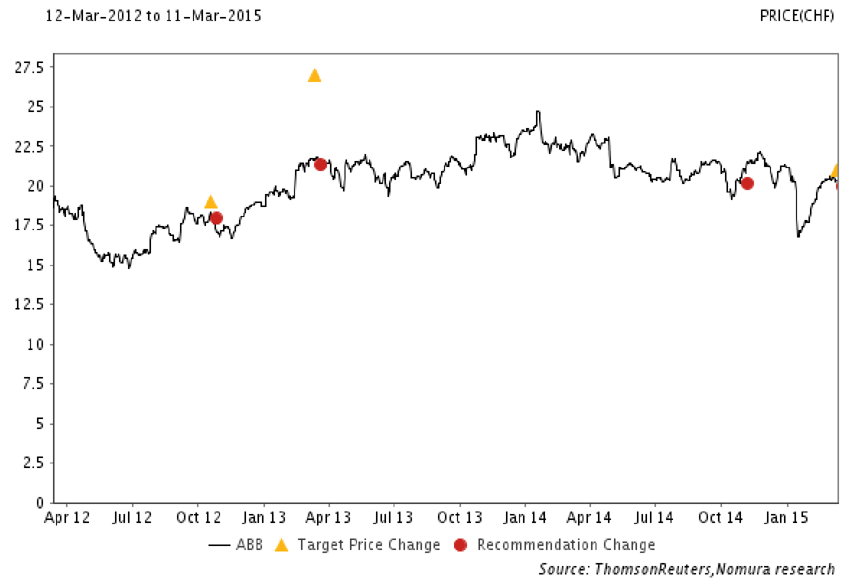
Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
ABB	ABBN VX	CHF 20.37	11-Mar-2015	Neutral	Neutral	A6

A6 The Nomura Group expects to receive or intends to seek compensation for investment banking services from the issuer in the next three months.

ABB (ABBN VX) **CHF 20.37 (11-Mar-2015)** Neutral (Sector rating: Neutral)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
11-Mar-15	NEUTRAL		20.37
11-Mar-15		21.00	20.37
29-Oct-14	SUSPENDED		20.54
13-Mar-13	BUY		21.69
13-Mar-13		27.00	21.69
18-Oct-12	NEUTRAL		18.31
18-Oct-12		19.00	18.31

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

Valuation Methodology We derive our target price of CHF 21 using a blend of relative (multiples) and absolute (DCF, SOTP) valuations. We look forward to 2017 and apply five-year average multiples (EV/EBIT of 11x to our 2017E adj. EBIT of USD 5.2bn and P/E of 14x to our 2017E adj. EPS of USD 1.8) 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 premium 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 CHF 21 price target. The benchmark index for the stock is STOXX Europe 600 Industrial Goods and Services.

Risks that may impede the achievement of the target price Macro risks: ABB has high exposure to emerging markets, so underlying growth rate changes in China, Brazil, and India could affect our forecasts. Significant changes to the oil price or further QE in Europe also poses risks to our assumptions. Micro risks: We expect a pickup in R&D investment and continued price competition to provide a headwind for profitability at ABB. Failure by management to offset price headwinds through cost savings would be detrimental to margins. In addition, any resurgence of the execution issues ABB has seen in the past in delivering large projects would also add to negative investor sentiment and weigh on earnings expectations. Any significant M&A could affect our neutral investment thesis to either upside or downside, depending on the quality and/or price of any deal.

Important Disclosures

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The distribution of all ratings published by Nomura Global Equity Research is as follows:
49% have been assigned a Buy rating which, for purposes of mandatory disclosures, are classified as a Buy rating; 43% of companies with this rating are investment banking clients of the Nomura Group*.
43% have been assigned a Neutral rating which, for purposes of mandatory disclosures, is classified as a Hold rating; 54% of companies with this rating are investment banking clients of the Nomura Group*.
8% have been assigned a Reduce rating which, for purposes of mandatory disclosures, are classified as a Sell rating; 26% of companies with this rating are investment banking clients of the Nomura Group*.
As at 31 December 2014. **The Nomura Group as defined in the Disclaimer section at the end of this report.*

Explanation of Nomura's equity research rating system in Europe, Middle East and Africa, US and Latin America, and Japan and Asia ex-Japan from 21 October 2013

The rating system is a relative system, indicating expected performance against a specific benchmark identified for each individual stock, subject to limited management discretion. An analyst's target price is an assessment of the current intrinsic fair value of the stock based on an appropriate valuation methodology determined by the analyst. Valuation methodologies include, but are not limited to, discounted cash flow analysis, expected return on equity and multiple analysis. Analysts may also indicate expected absolute upside/downside relative to the stated target price, defined as (target price - current price)/current price.

STOCKS

A rating of **'Buy'**, indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months. A rating of **'Neutral'**, indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months. A rating of **'Reduce'**, indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months. A rating of **'Suspended'**, indicates that the rating, target price and estimates have been suspended temporarily to comply with applicable regulations and/or firm policies. Securities and/or companies that are labelled as **'Not rated'** or shown as **'No rating'** are not in regular research coverage. Investors should not expect continuing or additional information from Nomura relating to such securities and/or companies. Benchmarks are as follows: **United States/Europe/Asia ex-Japan**: please see valuation methodologies for explanations of relevant benchmarks for stocks, which can be accessed at: http://go.nomuranow.com/research/globalresearchportal/pages/disclosures/disclosures.aspx; **Global Emerging Markets (ex-Asia)**: MSCI Emerging Markets ex-Asia, unless otherwise stated in the valuation methodology; **Japan:** Russell/Nomura Large Cap.

SECTORS

A **'Bullish'** stance, indicates that the analyst expects the sector to outperform the Benchmark during the next 12 months. A **'Neutral'** stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next 12 months. A **'Bearish'** stance, indicates that the analyst expects the sector to underperform the Benchmark during the next 12 months. Sectors that are labelled as **'Not rated'** or shown as **'N/A'** are not assigned ratings. Benchmarks are as follows: **United States:** S&P 500; **Europe:** Dow Jones STOXX 600; **Global Emerging Markets (ex-Asia):** MSCI Emerging Markets ex-Asia. **Japan/Asia ex-Japan:** Sector ratings are not assigned.

Explanation of Nomura's equity research rating system in Japan and Asia ex-Japan prior to 21 October 2013

STOCKS

Stock recommendations are based on absolute valuation upside (downside), which is defined as (Target Price - Current Price) / Current Price, subject to limited management discretion. In most cases, the Target Price will equal the analyst's 12-month intrinsic valuation of the stock, based on an appropriate valuation methodology such as discounted cash flow, multiple analysis, etc. A **'Buy'** recommendation indicates that potential upside is 15% or more. A **'Neutral'** recommendation indicates that potential upside is less than 15% or downside is less than 5%. A **'Reduce'** recommendation indicates that potential downside is 5% or more. A rating of **'Suspended'** indicates that the rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the subject company. Securities and/or companies that are labelled as **'Not rated'** or shown as **'No rating'** are not in regular research coverage of the Nomura entity identified in the top banner. Investors should not expect continuing or additional information from Nomura relating to such securities and/or companies.

SECTORS

A **'Bullish'** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a positive absolute recommendation. A **'Neutral'** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a neutral absolute recommendation. A **'Bearish'** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a negative absolute recommendation.

Target Price

A Target Price, if discussed, reflects in part the analyst's estimates for the company's earnings. The achievement of any target price may be impeded by general market and macroeconomic trends, and by other risks related to the company or the market, and may not occur if the company's earnings differ from estimates.

Disclaimers

performance. Moreover, simulations are based on models and simplifying assumptions which may oversimplify and not reflect the future distribution of returns.
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