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CAPITAL GOODS

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A rising tide…

- **Buoyant commentary from global capital goods players is likely to rub off on Indian companies via potentially higher sourcing**
- **Supply chain situation and government stimulus are key variables being closely tracked by global companies**
- **We remain positive on India's capital goods sector amid a capex-heavy domestic budget and global optimism; prefer LT, SIEM and AIAE**

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Global players upbeat: Global capital goods companies across the board exhibited optimism about growth and profitability in their December quarter commentary, citing the normalisation of ordering patterns as a positive factor along with the expected abatement of inflation in the latter half of H2CY23. This is reflected in the healthy growth guidance of multinationals Honeywell/Cummins/ABB/Siemens at 2-5%/ 12-17%/5%+/7-10% for the forthcoming year. Additionally, supply chain constraints appear to be easing, with Honeywell noting that the semiconductor industry is exhibiting significant improvement and expected to return to normal by CY23-end.

Positive readthrough for most Indian companies: Honeywell Inc's positive outlook on the normalisation of semiconductor supply suggests favourable prospects for the capital goods industry as a whole. Additionally, Siemens AG's upward revision of its forecasts for the digital industries and smart infrastructure businesses points to rising demand traction. Similarly, the ABB Group may benefit from increased outsourcing, particularly in software, as a means of optimising costs in India.

Cummins India has, however, cautioned that it is already struggling with component shortages – a predicament that may worsen for the Cummins Group as China opens up. Similarly, Hitachi's India arm is currently facing the impact of chip shortages, although it believes the situation will improve within the next one or two quarters.

Supply chain and economic stimulus key variables: The prevailing uncertainty in China along with the possibility of government intervention remains a primary headwind for most global capital goods majors. However, following the relaxation of strict lockdown measures, economic activity in China is expected to improve, leading to a decline in operational disruptions. This apart, companies are also monitoring potential stimulus measures by governments that may benefit the global economy.

Retain positive sector outlook: We remain positive on the Indian capital goods sector, buoyed by visibility from the government's capex-heavy budget and the likelihood of gradual margin improvement as supply bottlenecks ease. We retain our bullish view on **LT** (BUY, TP Rs 2,440), **SIEM** (BUY, TP Rs 3,800) and **AIAE** (BUY, Rs 3,300).

Recommendation snapshot

Ticker	Price	Target	Rating
ABB IN	3,311	3,220	HOLD
AIAE IN	2,707	3,300	BUY
KECI IN	463	500	HOLD
KKC IN	1,603	1,600	HOLD
LT IN	2,115	2,440	BUY
POWERIND IN	3,320	3,500	BUY
SIEM IN	3,257	3,800	BUY
TMX IN	2,196	2,200	HOLD

Price & Target in Rupees | Price as of 1 Mar 2023

Global commentary upbeat

ABB Global: Q4CY22 earnings call highlights

- **Outlook:** ABB Group's management does not anticipate any major decline in demand during CY23 despite the prevailing high inflation rates. However, growth in order inflows during H1CY23 is expected to be adversely affected by a higher base of the previous year and normalisation of customer ordering patterns

- **CY23 guidance:** Management is confident of delivering comparable revenue growth of over 5% in CY23, with 75% of the order backlog expected to be executed. Even if the market were to remain soft, EBITDA margin is guided to be at least 15% (CY22: 15.3%).

- **Orders:** Order inflows held strong in the Americas during the Dec'22 quarter, up 15% YoY, while growth was slow in Europe (-5% YoY) and EMEA (-2% YoY). In Europe, Germany remained a drag (-15% YoY) as the residential building market softened. In Asia, China weighed on growth as the Covid situation worsened. Momentum in the company's China motion business continued, while other businesses declined. Order inflows for the India arm increased 22% YoY during the quarter.

- **E-mobility business:** In line with its commitment to list the E-mobility business, ABB has raised CHF525mn for the same, in addition to the CHF200mn raised in November of this year. This would be deployed to pursue organic and inorganic growth through investments in hardware and software. As of Q1CY23, the E-mobility business was moved out of the electrification division.

- **Return ratios:** ROCE remained strong at 16.5% for the quarter. For CY23, management expects a ~130bps negative impact from the 19.9% ownership interest in Hitachi Energy which will be reversed in CY23.

Siemens Global: Q1FY23 earnings call highlights

- **Q1 performance:** The Siemens Group reported sequential growth in Q1FY23 (Y/E Sep) orders, reaching EUR 22.6bn, exceeding the revenue in all its industrial businesses. One of the key objectives of the company has been to shorten delivery times, which it believes supported the strong revenue growth of 8% YoY to over EUR 18bn. Growth was primarily driven by the Digital Industries and Smart Infrastructure businesses, each contributing 15% YoY growth.

  The company is gradually releasing targeted opex and capex investments as market opportunities are attractive and demand patterns favourable. However, management remains cautious on investments and ensures that forecast scenarios are constantly realigned to the latest developments.

- **Guidance:** After a successful start to FY23, the Siemens Group raised its guidance and now expects comparable revenue growth of 7-10% for the year, which represents an increase of 100bps over its earlier outlook. Additionally, management anticipates a book-to-bill ratio above 1x, which demonstrates a strong order pipeline and positive customer demand.

In the first quarter, **Digital Industries** achieved strong momentum, which the company expects will continue through the year. As a result, management raised revenue growth guidance for the business by 200bps to 12-15% for FY23. Profit guidance at the lower end was also upped by 1ppt to 20-22%. The company anticipates that Digital Industries will achieve revenue growth and profit margin towards the upper end of the new guidance corridors in the second quarter.

For **Smart Infrastructure**, management has raised its guidance for revenue growth by 100bps to 9-12% and has lifted profit guidance by 50bps to 13.5-14.5%. Looking ahead to the second quarter, the company expects that the comparable revenue growth rates will be within the upgraded full-year growth guidance, strongly supported by the order backlog. Moreover, it anticipates that the second quarter margin will be in the raised margin corridor as well.

Digital Industries outlook: The Digital Industries business has experienced sustained and strong demand in the company's core end markets, resulting in order growth. This is a positive indicator of the overall investment sentiment, not only in discrete industries such as automotive, machine building, and aerospace, but also in hybrid verticals such as food, beverage and pharma.

The return of orders in discrete automation from previously high levels and process automation remaining close to the prior year's level is a reflection of the current state of the industry. The modest increase in software is promising, especially with significant deals in the PLM (Product Lifecycle Management) business, indicating a trend towards digitalisation and automation in the industry.

- **Supply chain:** Recent developments in the supply chain have been encouraging, with the easing of constraints providing a more stable operating environment and enabling high utilisation. However, the company believes there remains a need for caution and continued vigilance to mitigate potential disruptions that may arise from component availability and increased infection rates in China following the recent Chinese New Year travels.

Cummins Inc: Q4CY22 earnings call highlights

- **Outlook:** Cummins Inc has unveiled its organic growth strategy, which includes introduction of the industry's inaugural integrated, fuel-agnostic internal combustion powertrain platforms. Additionally, the company has made notable progress in the advancement of its electrolyser technology and opportunities for producing green hydrogen. Although there has been a decrease in demand in China, management indicated that demand for its products remains robust across key markets and regions, culminating in substantial fourth-quarter revenues.

- **India:** In India, the company has projected a 1% increase in total revenue for CY23. Industry-wide demand for trucks is predicted to remain either steady or increase by up to 5% for the year. Additionally, the company expects its key high-horsepower markets worldwide to continue to perform well in CY23. However, sales of mining engines are projected to decline by 5% or rise by 5% based on the trajectory of commodity prices and improvements in the supply chain.

- **Guidance:** Cummins Inc is predicting a noteworthy surge in total revenues, ranging from 12% to 17%, in CY23 as compared to the previous year, and EBITDA to be at 14.5-15.2% of sales. The company expects growth to be driven by several factors, including a full year of sales from Meritor, sustained robustness in the North American truck market, increased demand in the power generation sector, pick-up in overall pricing, and gradual improvement in the on-highway markets in China.
- **Headwinds:** The primary area of uncertainty for the company lies in China, where management projects a gradual recovery throughout CY23, subject to Covid waves and the possibility of government intervention in the economy. However, with the relaxation of strict lockdown measures in December, the company expects to see a boost in economic activity and a decrease in operational disruptions. Nonetheless, it will continue to closely monitor the situation in China and any potential stimulus measures that may impact the economy.

Honeywell Inc: Q4CY22 earnings call highlights

- **Outlook:** Honeywell Inc had a record US$ 30bn order backlog in Q4CY22 (+7% YoY), signalling a robust first quarter. Management indicated that prevailing macroeconomic uncertainty is causing some hesitation among customers in the short-cycle businesses of SPS (Safety and Productivity Solutions) and HBT (Honeywell Building Technologies). However, with a gradual improvement in the supply chain, it believes a better balance between volumes and prices would drive topline growth in CY23. On the cost front, the company anticipates a decrease in raw material inflation but believes it will still remain high.
- **CY23 guidance:** For CY23, Honeywell Inc projects sales ranging from US$ 36bn to US$ 37bn, equating to an organic growth sales range of 2% to 5% for the year. The focus will be on maintaining pricing strategies to counteract the effects of cost inflation and to attain a better balance between volume and price contributions. In line with the previous year, H1CY23 is expected to be slower as supply chains gradually improve and potential drawbacks from China's zero-Covid reversal may be most prominent in the first quarter. Despite this, the company is optimistic that reopening will drive demand growth as the year progresses, leading to a strong second half in China.
- **Supply chain:** Management stated that supply chain constraints are gradually easing, with the semiconductor industry exhibiting significant improvement and expected to return to a normal state by the year-end.
- **India business:** In Building Technologies, management is aware of the overall economic landscape and anticipates that private investments in non-residential construction will continue to be affected by rising financing costs. Nevertheless, it indicated that the division successfully amassed a robust order backlog in CY22, partially due to the supply chain environment, providing stable sales visibility and a cushion for CY23.

  The Safety and Productivity Solutions business is expected to be the most affected by macroeconomic conditions in CY23. The reduced investment in new warehouse capacity by Intelligrated will continue to hinder near-term prospects in the long-cycle projects business, with management anticipating a low point in demand this year before growth returns in CY24.

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BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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