

Market's turnaround will be reflected in ABB

By Sunil Vidyarthi



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Nothing catches investors' attention more than a good kick in the wallet. It is one thing to speculate on whether the market is going up or down and another to be long in a dropping market. Analysis has begun and will continue until there is stability, meaning cessation of the carnage, which should last at least a month for the bloodletting to be of any value to the patient. A quick in and out will mean we have to face the music another day.

It started with China's one-day descent, which is still up nine per cent this year. People were talking about a bubble, so the government was quite worried and did some tough talking to make its presence felt. But worse for the bears was former Fed Chairman Alan Greenspan's speech. The R-word, coming from Greenspan, still has great power. The 1996 irrational-exuberance speech also had a quick market impact, although that turned out to be a warning shot that was four years too early.

And of course, there is no question now that the multi-year U.S. housing boom is over. Shares of subprime lenders such as New Century Financial Corp. and Nova Star have crashed in the past month. Higher up on the lending food chain, British-based banking giant HSBC Holdings PLC recently admitted it's feeling pain. And many major U.S. banks are quietly increasing their loan-loss reserves, worrying about a spillover, which could even reach across our borders.

Worry of all worries

Finally, the worry of all worries are corporate profits; first- and second-quarter earnings for U.S. companies are expected to grow by less than five per cent, year over year. The last time that kind of decline happened was April, 2000, a month after the start of the bear market and 11 months before the economy fell into recession.

The correction was rather sudden as this February was one of the best for mutual funds in Canada, further affirming that individual investors are sitting on mounting cash. Year-end U.S. Federal Reserve data showed just under \$5 trillion is

stockpiled in savings and money-market accounts and retail certificates of deposit, a record stash.

Much of the stock invested has gone into foreign equities. According to fund-flow tracker TrimTabs Investment Research, last year saw U.S. funds draw just \$20 billion in inflows, compared with nearly \$150 billion dedicated to hot foreign investments. After last week's action, that may be changing soon as global money may look to the U.S. for safety.

U.S. stocks are trading at 17 times earnings — roughly what they changed hands for in 1995. Hopefully, you have not forgotten the near triple-digit Nasdaq price-to-earnings ratio in 2000, the last time we faced a climate with frothy stocks and slowing profit pictures.

My intention is not to frighten by bringing back memories of 2000. On the contrary, I want to point out that we have come a long way from the Internet-bubble days when stocks could do no wrong if they had technology in their name. Most of those, like Microsoft, Cisco and GE, have yet to scale back their old highs.

It has been a different kind of a bubble if you insist on calling this one of those in the U.S. Yes, some material stocks, particularly juniors (gold and uranium this year, copper and zinc earlier) have gone up multifold in the last 52 weeks. They are still trading at a reasonable P/E ratio and this happens every time there is a semblance of a gold rush.

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The old-style technology stocks, ones that deal with engineering, construction and robotics, have prospered since the debacle of 2000. Engineering companies like SNC in Canada and Ingersoll Rand or Siemens on the NYSE are near their all-time highs. Some of these like **ABB Ltd.** (ABB- NYSE, \$16.02, 203-750-7743, www.abb.com), while on a positive trend, are still far from their highs and give us hope there is still considerable room for improvement in the stock markets.

ABB is particularly interesting as it is a global corporation with contracts and operations in parts of the world where there is a need for tremendous construction as in the Middle East, India and China. Think of it as a European version of SNC.

ABB provides power and automation technologies to utility and industry customers worldwide. It produces and sells transformers, power systems, switchgear, breakers, capacitors, and cables for high- and medium-voltage applications.

The Automation Technologies division provides products, systems, software, and services for the automation of industrial and commercial processes. The division also provides robots and robot cells, which include standardized and tailored systems for discrete applications, such as painting, picking, packing, palletizing, welding and assembly.

The company is in a turnaround mode and the stock shot up more than 50 per cent since September of last year. In the current correction, shares are down over 15 per cent from a high of \$19.25, nearly at the level back in 2000.

Then, the bottom fell out as it failed in an expansion strategy and faced costly asbestos-related lawsuits in the United States, bringing the stock down to pretty close to one dollar. It is now undoing much of its sins and is expected to gain cash in the months ahead from the pending sale of oil and gas unit Lummus Global. The company has already sold stakes in two non-core power projects for US\$490 million earlier this year.

Part of the recent decline is because the stock went up too high too fast. The results are, however, still great. The company reported its

fourth-quarter recently when net profit almost doubled on continued cost-cutting and buoyant markets in Europe and Asia.

"Our order backlog has grown significantly, and improved business execution is allowing us to capture more of that growth in our bottom line," said Chief Executive Fred Kindle. "We are heading into 2007 in a strong position."

The company is doubling its dividend to US\$0.19 per share. Its fourth-quarter sales were US\$7.19 billion, 21 percent higher than the US\$5.92 billion posted a year ago. Orders, which indicate future revenue and profit momentum, increased 36 per cent to US\$7.48 billion from US\$5.5 billion.

For the full year, its net income rose 89 percent to US\$1.39 billion from US\$735 million in 2005. The company said it is benefiting from strong demand for technology to increase power-grid reliability, industrial productivity and energy efficiency. The results allowed ABB to cut down its debt and further strengthen its balance sheet. At the end of 2006, cash flow from operations already doubled to US\$2 billion.

The stock is trading at 15 times next year's earnings, has a forecast growth rate of 18 per cent and delivers a return-on-equity of 30 per cent. Barring a global recession, this is one to bet on for a turnaround in the stock market and another way to play the nuclear market. Oh, and I didn't mention that it is one of the key nuclear energy contractors in the world.

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