



Industrial Companies



FINANCIALEDGE

Key Sectors

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AUTOS



**AEROSPACE &
DEFENSE**



**EQUIPMENT
MANUFACTURERS**



AUTOS



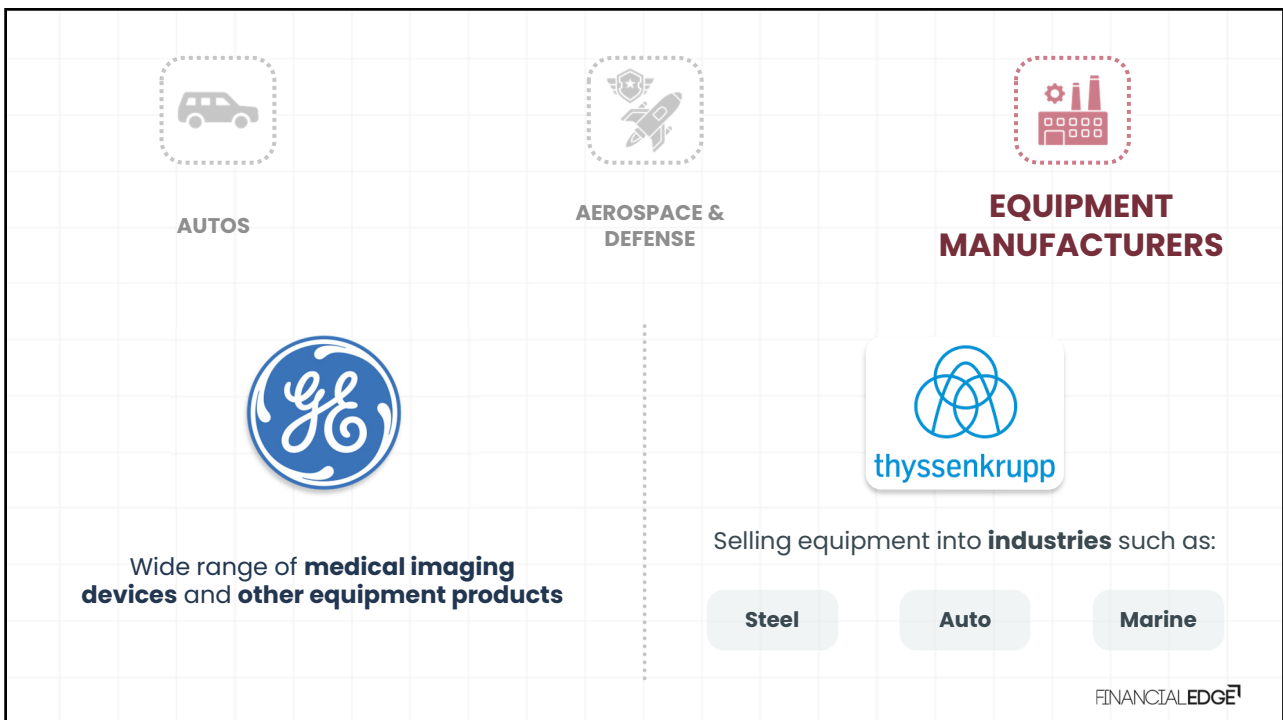
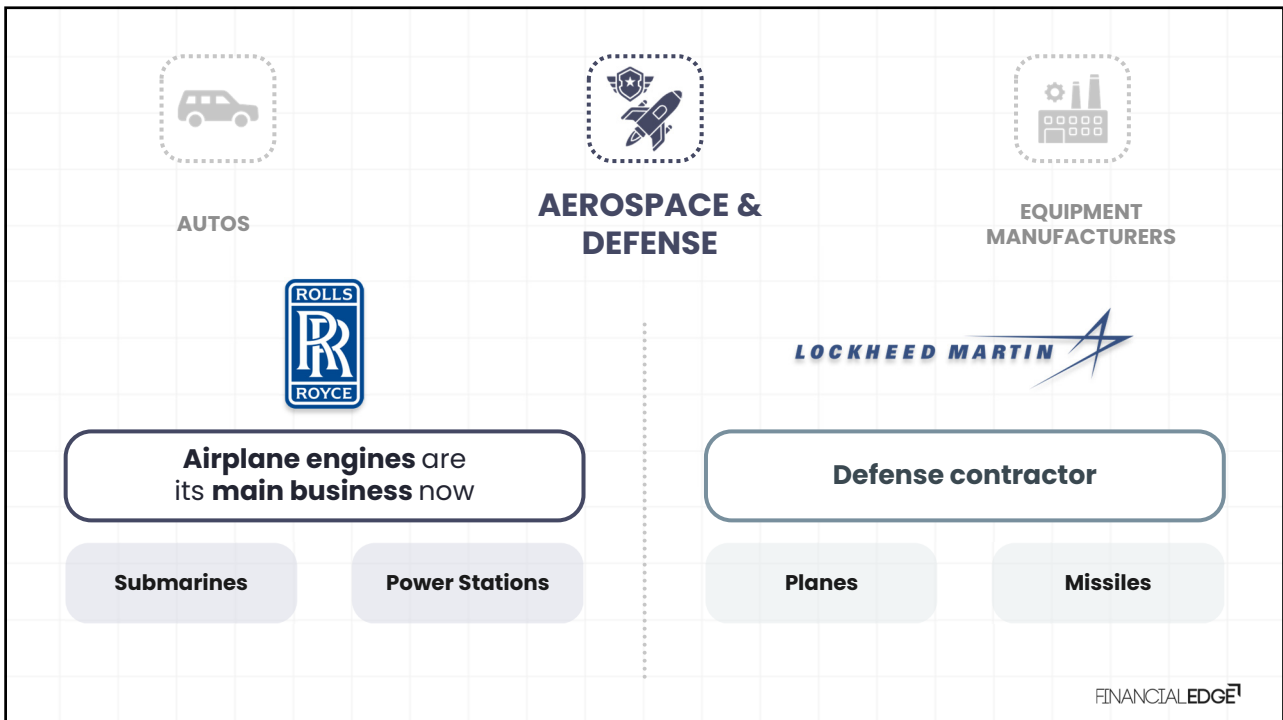
**AEROSPACE &
DEFENSE**



**EQUIPMENT
MANUFACTURERS**



Visible in many **people's day-to day lives**





AUTOS



**AEROSPACE &
DEFENSE**



**EQUIPMENT
MANUFACTURERS**

What Makes them Special?

LONG CYCLE VS SHORT CYCLE

R&D SPEND

CUSTOMER FINANCING

PENSION LIABILITIES

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LONG CYCLE VS SHORT CYCLE

LONG CYCLE

Businesses which have **contracts** that take **longer** than a **quarter to deliver**

LOCKHEED MARTIN

F-35 stealth fighter

12-18 months to build

Long cycle contract

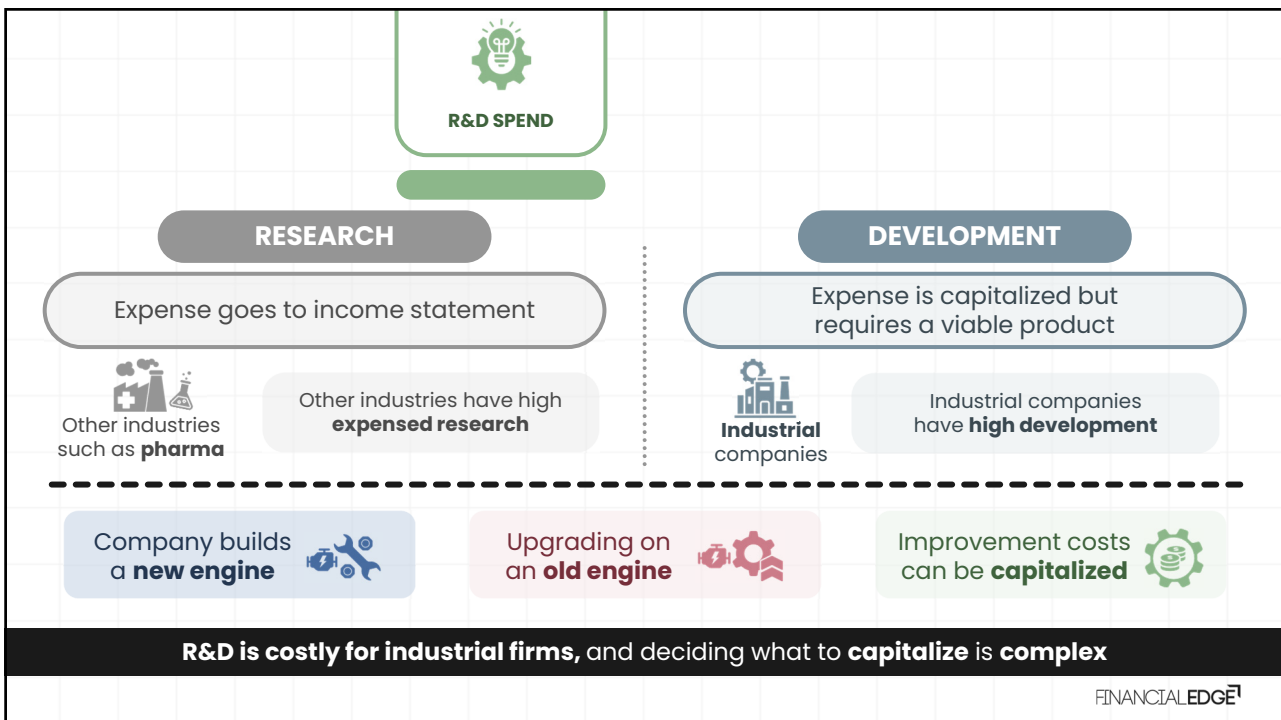
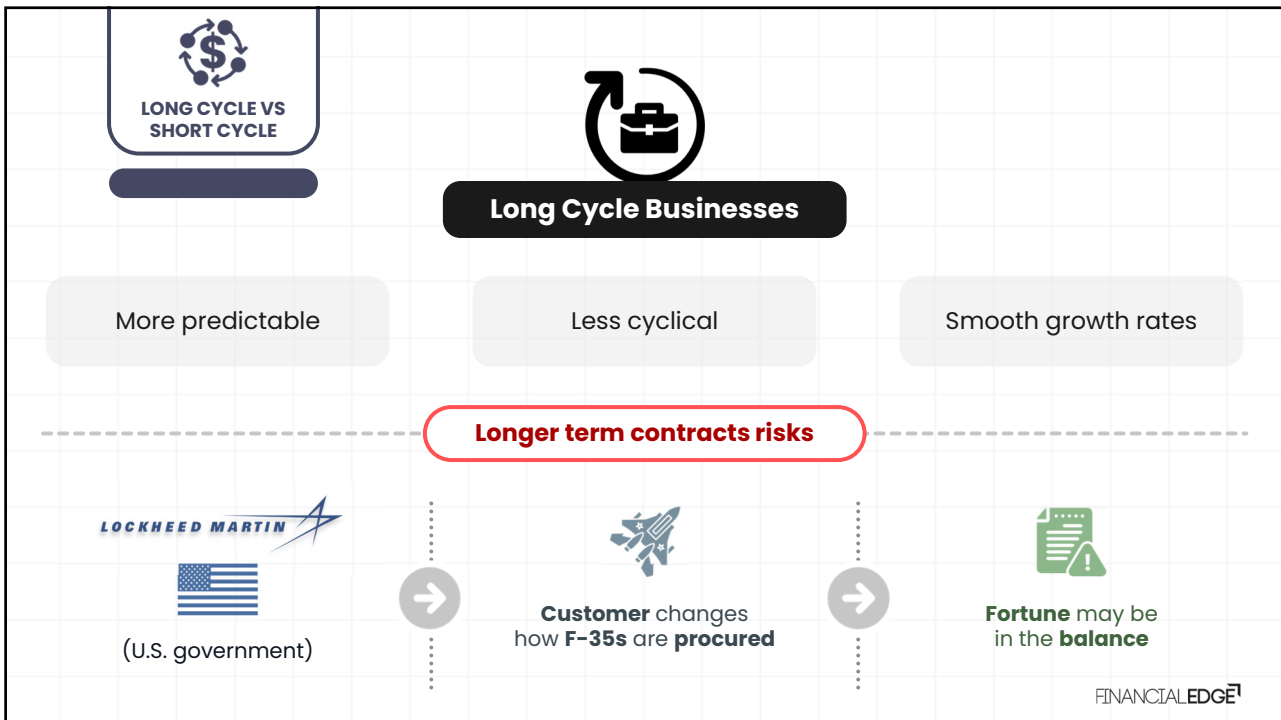
KION GROUP

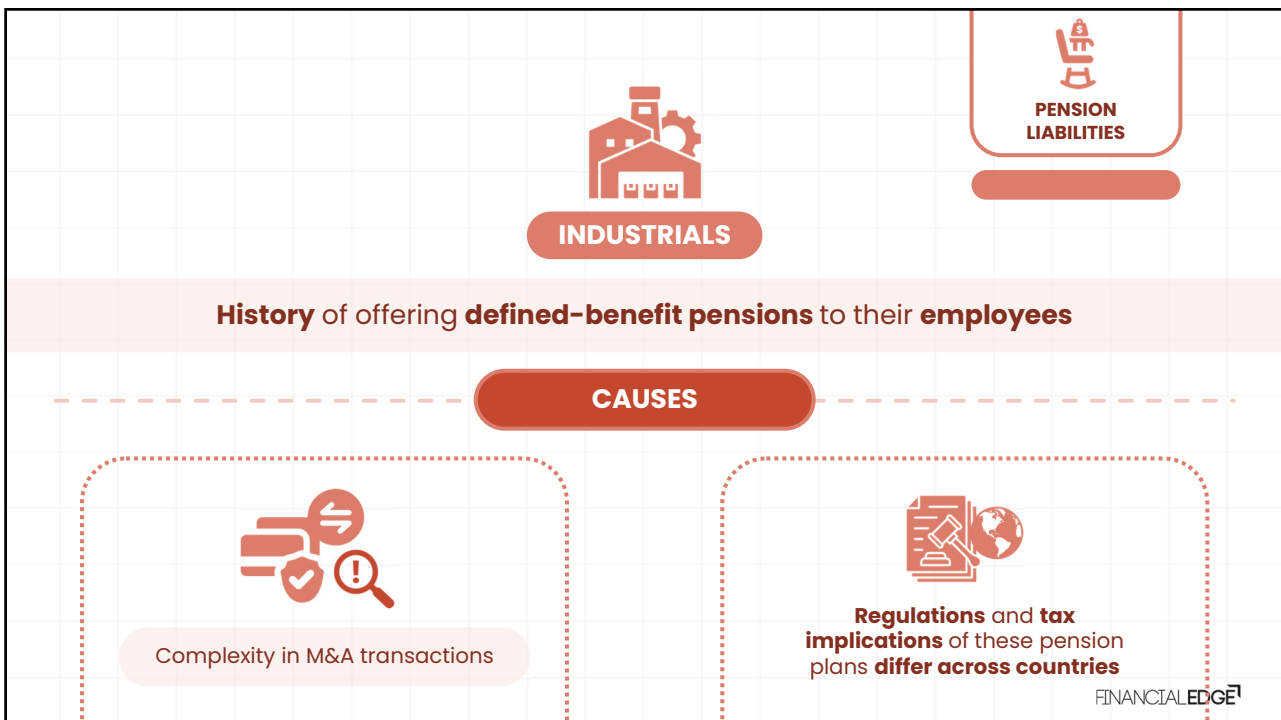
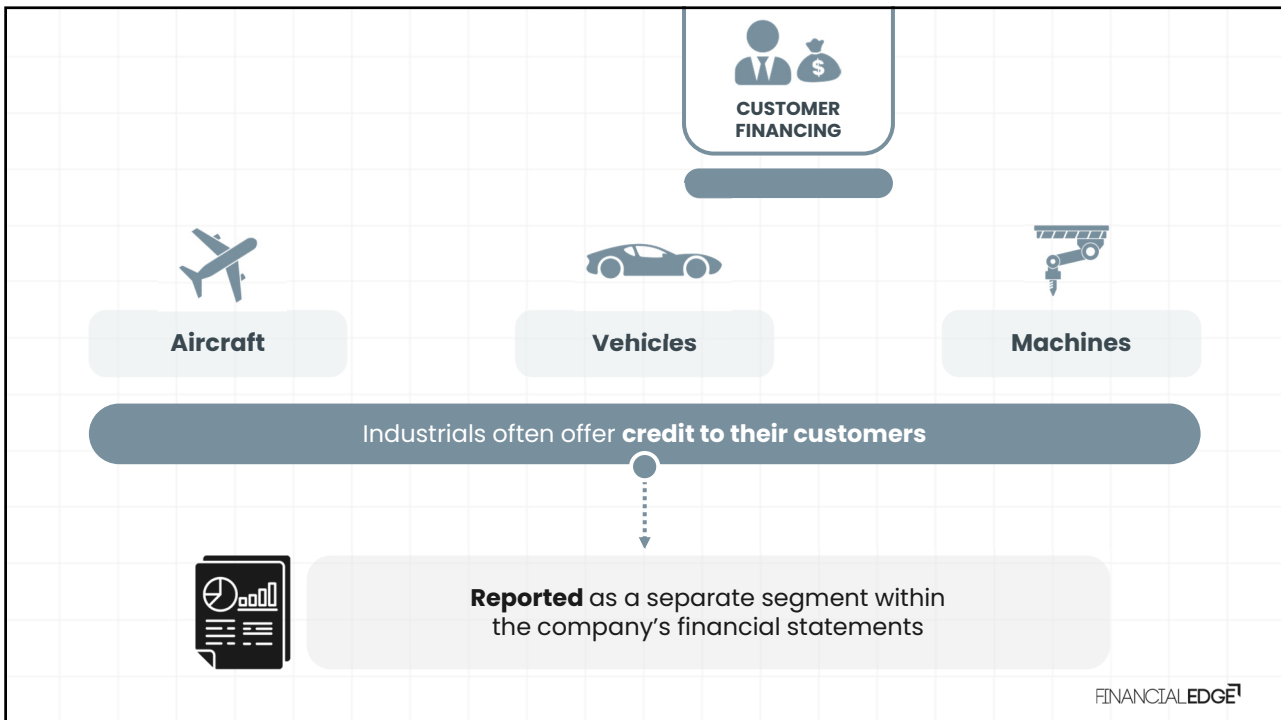
Forklift truck

A few days or weeks to build

Short cycle contract

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Order Backlog



Industrials Sector Companies
have **extensive backlogs**



Significant Time Lag



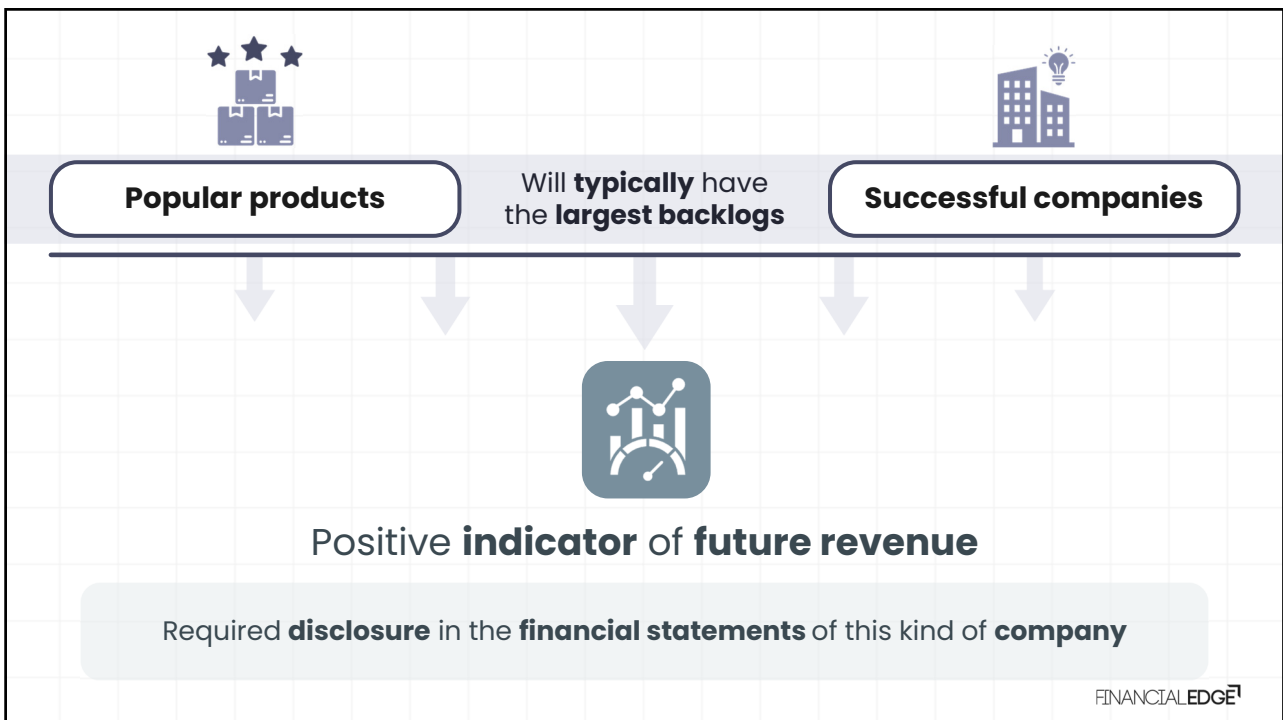
Customer placing an order



Final product being delivered

High levels of orders are placed

Customers often **all order** at the **same time of the year**



The backlog is made up of:



The backlog is not deferred revenue


Industrial takes an order

Added to the **backlog**

No cash is taken at that point



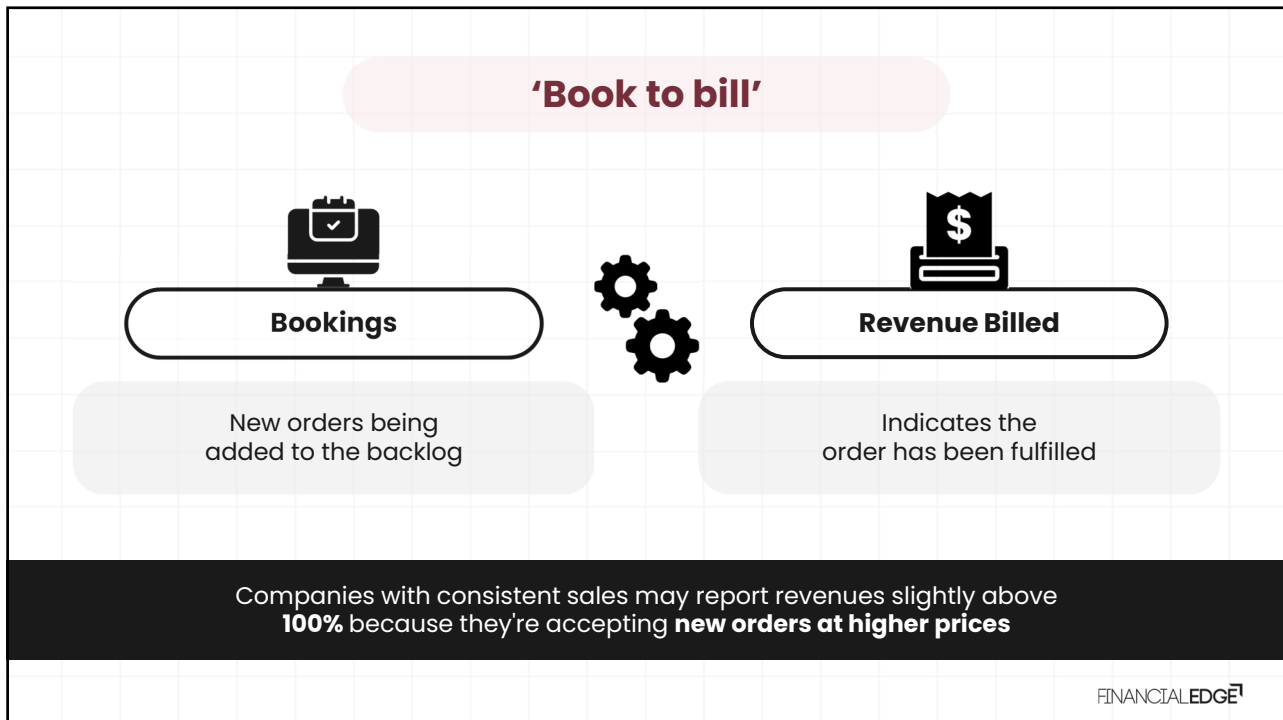
As product are delivered by the industrial company



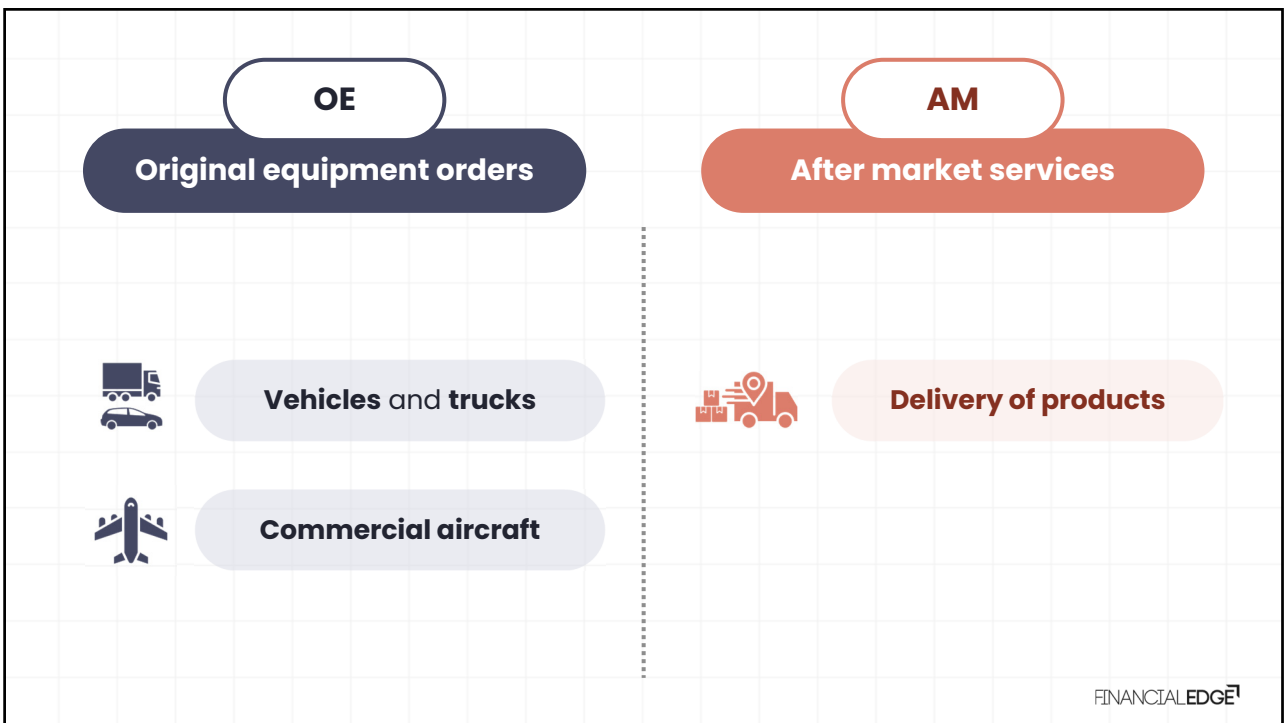
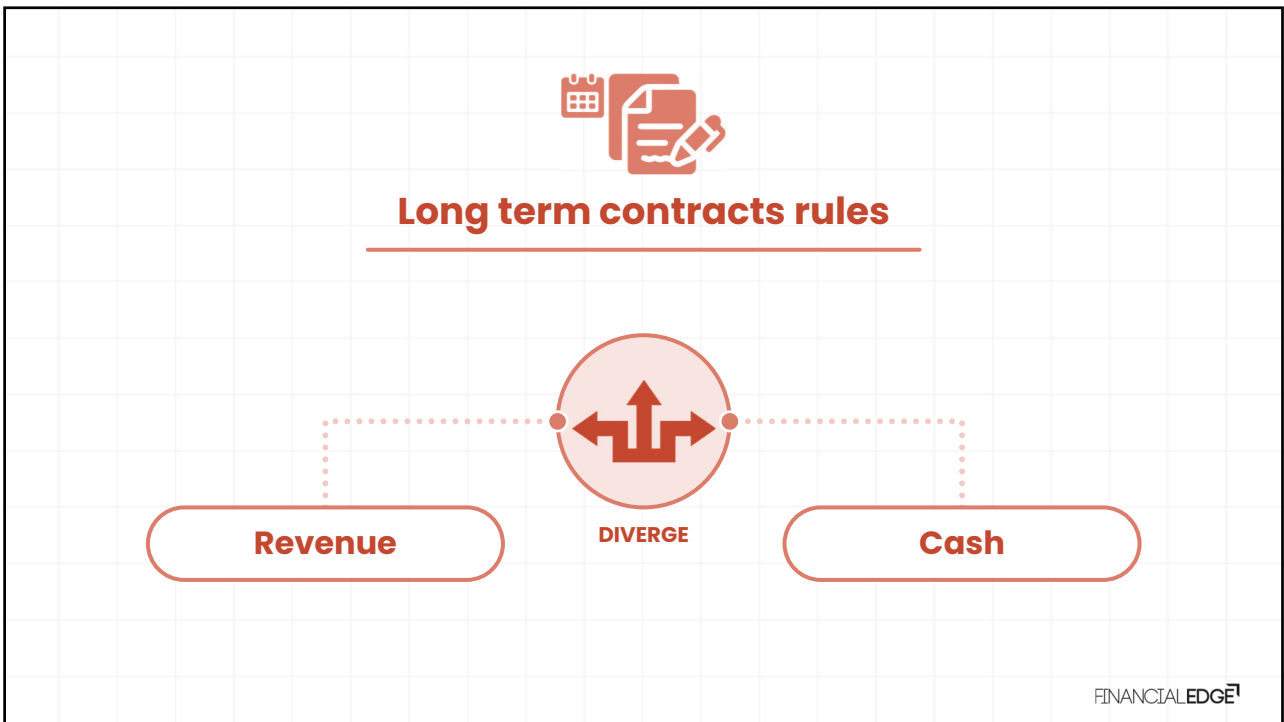
Recognize revenue in their income statement

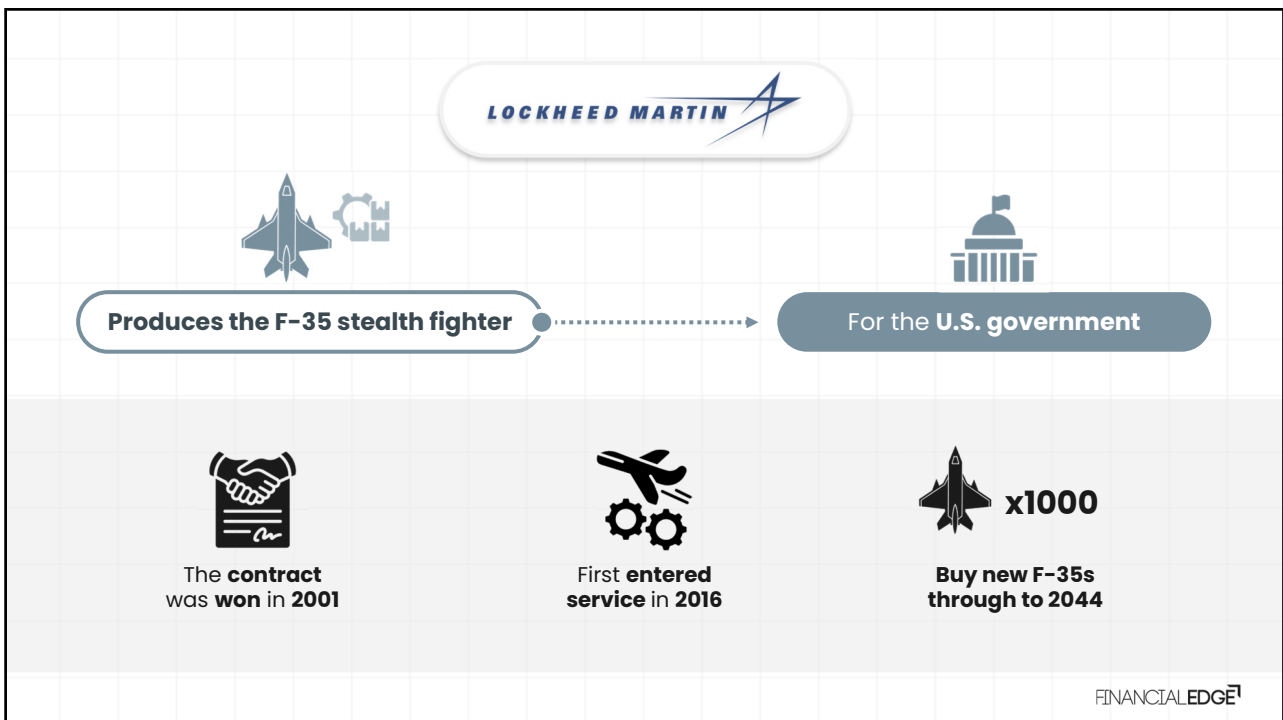
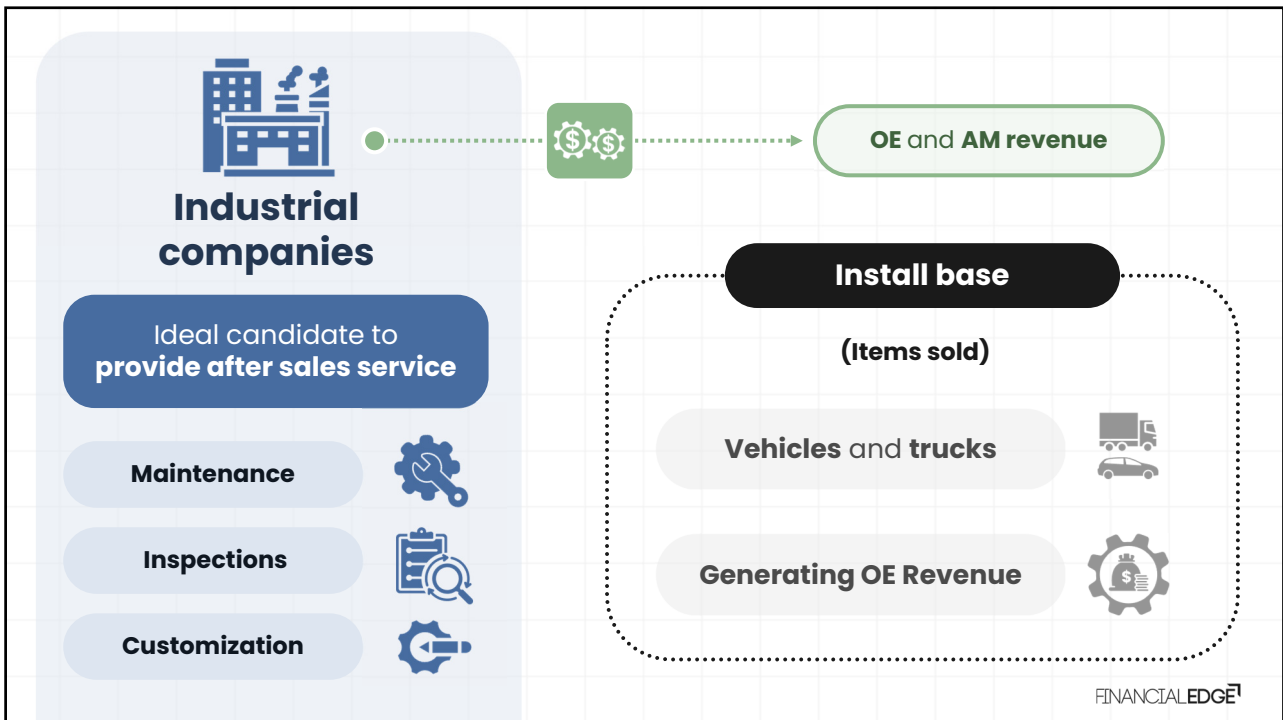


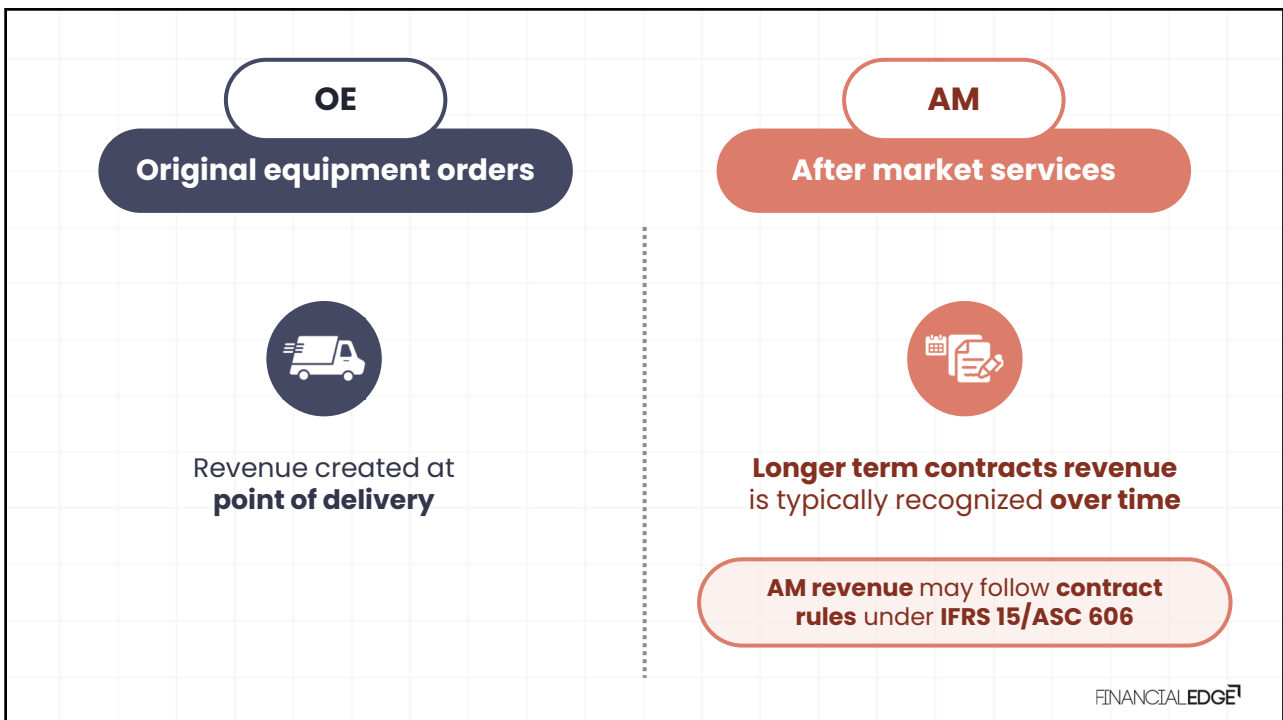
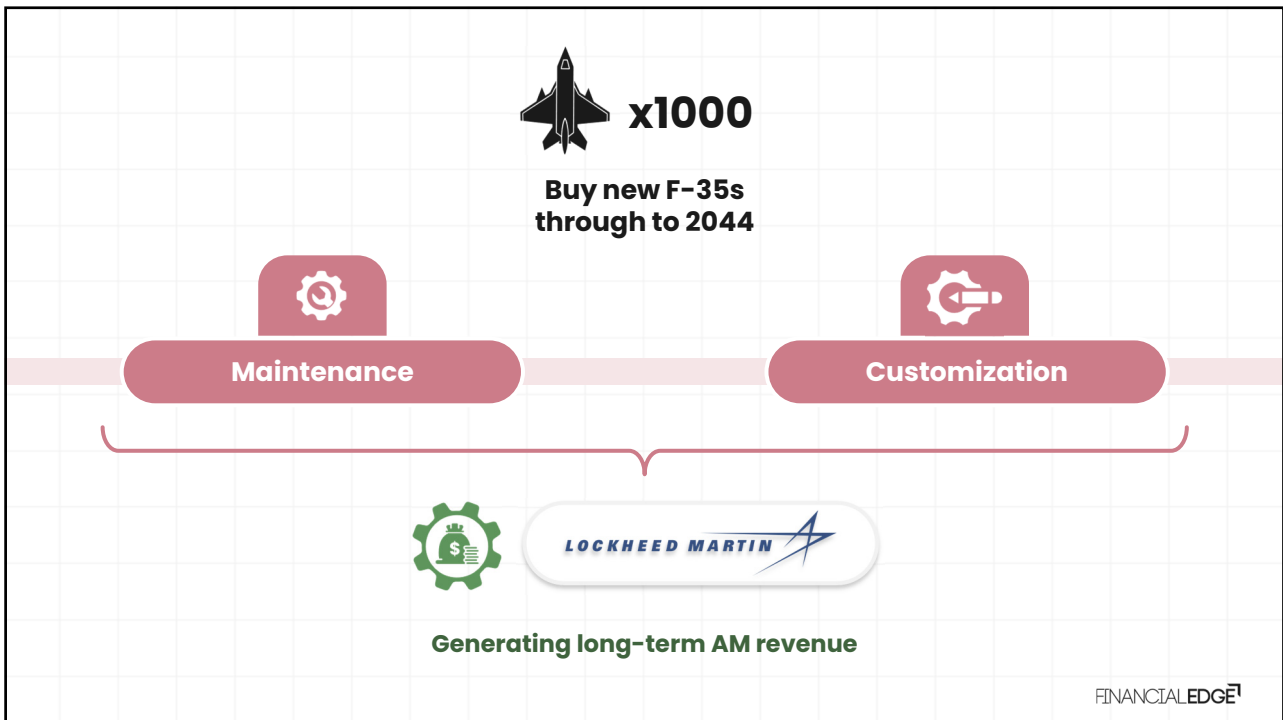
Removed from the backlog



Revenue Recognition under IFRS 15/ASC 606

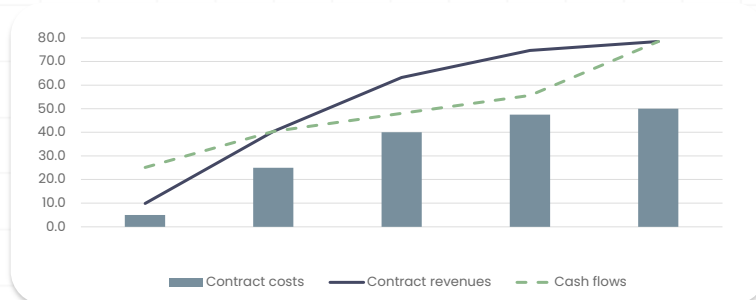






Revenue Recognition on Long Term Contracts

Company making aircraft on a long-term contract



Cost to cost
(Sometimes called percentage of completion)



Cashflows

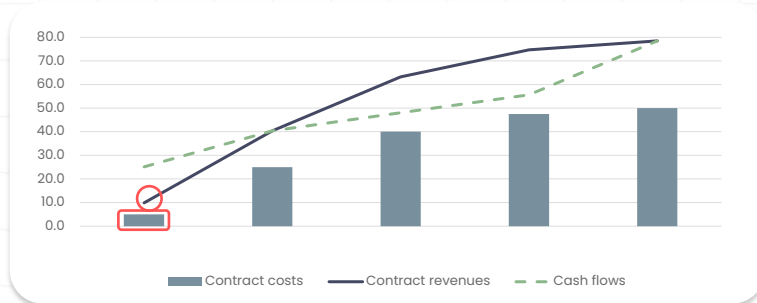


Costs



Revenues

Company making aircraft on a long-term contract



Recognize revenue in proportion to the **costs that it incurs**

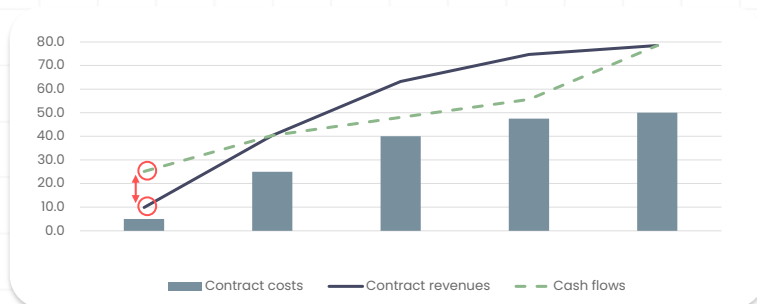


Very low cost



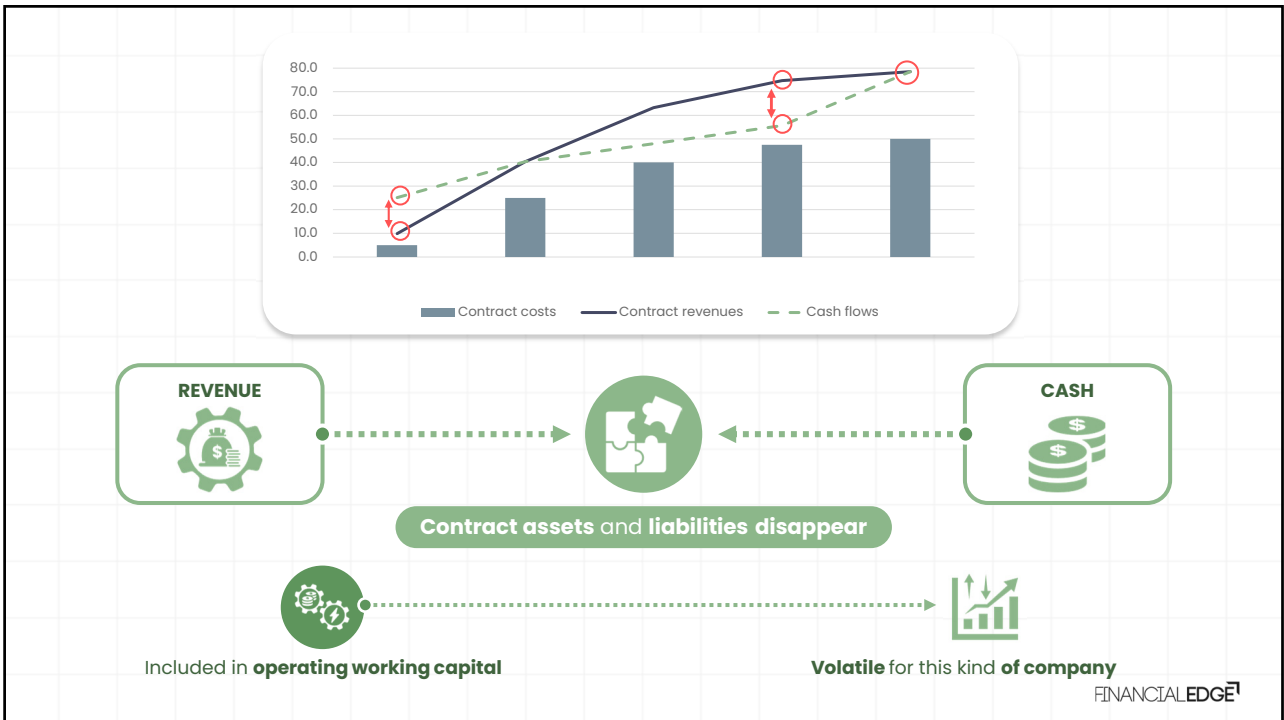
Low levels of revenue are recognized

Company making aircraft on a long-term contract



Customer has **committed to paying** a relatively **high early-stage payment**





Industrial R&D Spend



Industrials use **R&D** to **improve design of products**

In **IFRS-adopting countries** like those in **Europe**:



R&D have potentially **high capitalization rates**

R&D in **industrials** is often **fine-tuning existing products**

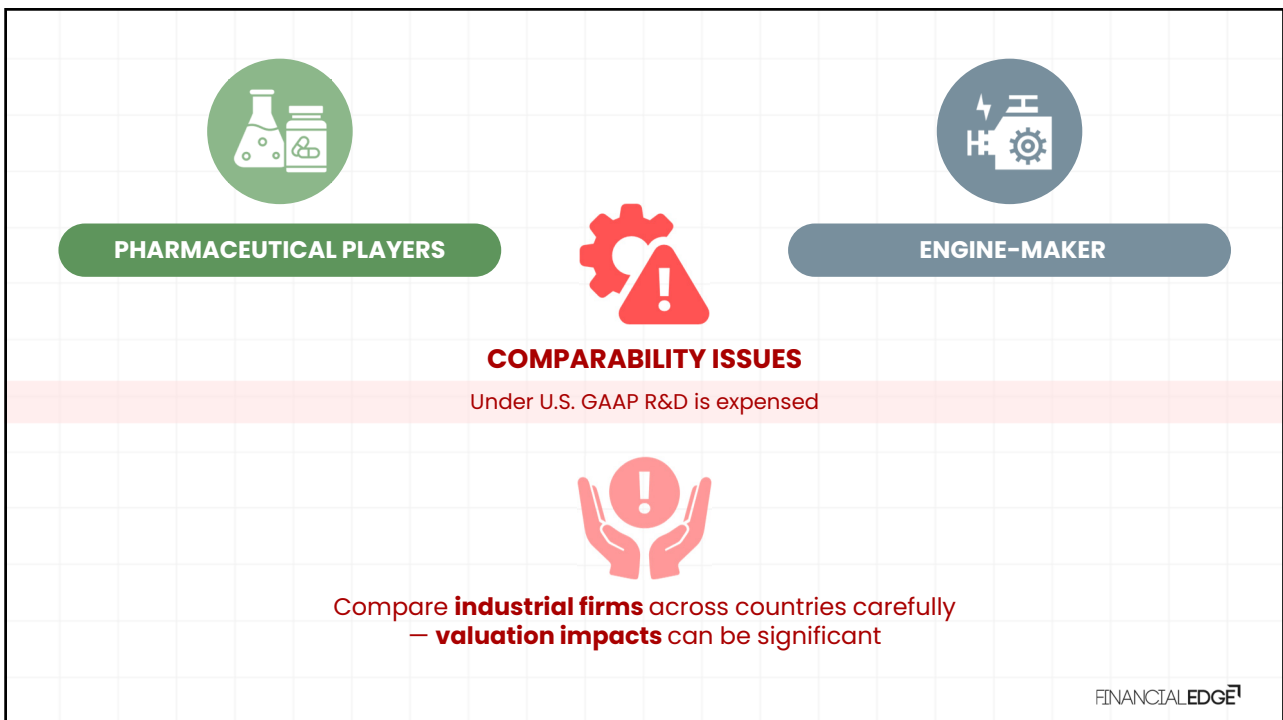
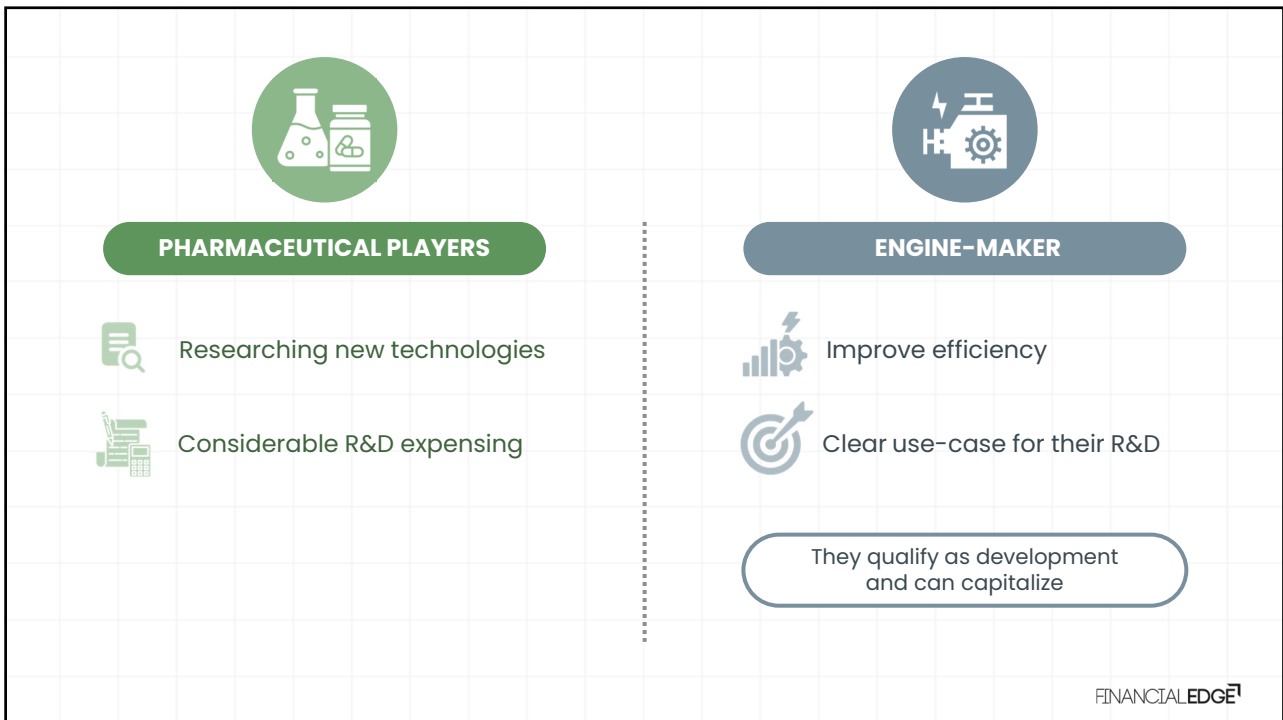
Life sciences



VS



Industrials



Customer Financing

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Industrials companies **offer finance regularly** to their **customers**



**FINANCIAL
REPORTING**

BALANCE SHEET

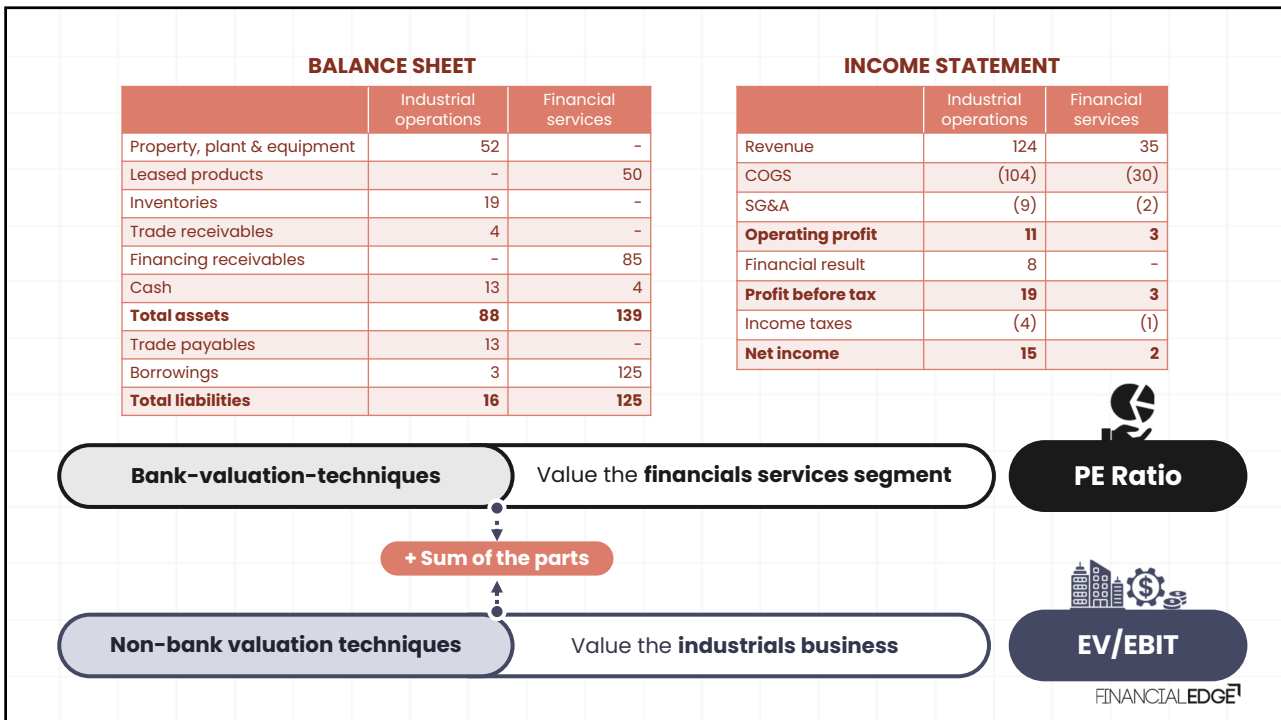
	Industrial operations	Financial services
Property, plant & equipment	52	-
Leased products	-	50
Inventories	19	-
Trade receivables	4	-
Financing receivables	-	85
Cash	13	4
Total assets	88	139
Trade payables	13	-
Borrowings	3	125
Total liabilities	16	125

INCOME STATEMENT

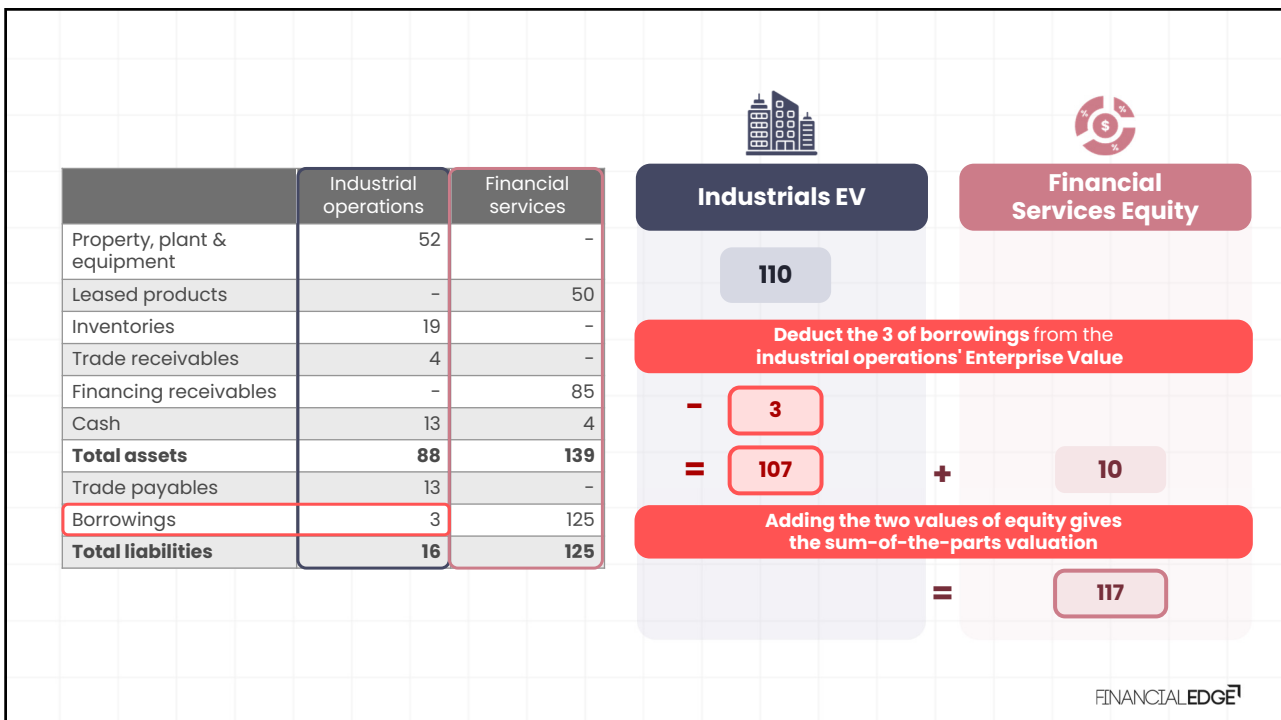
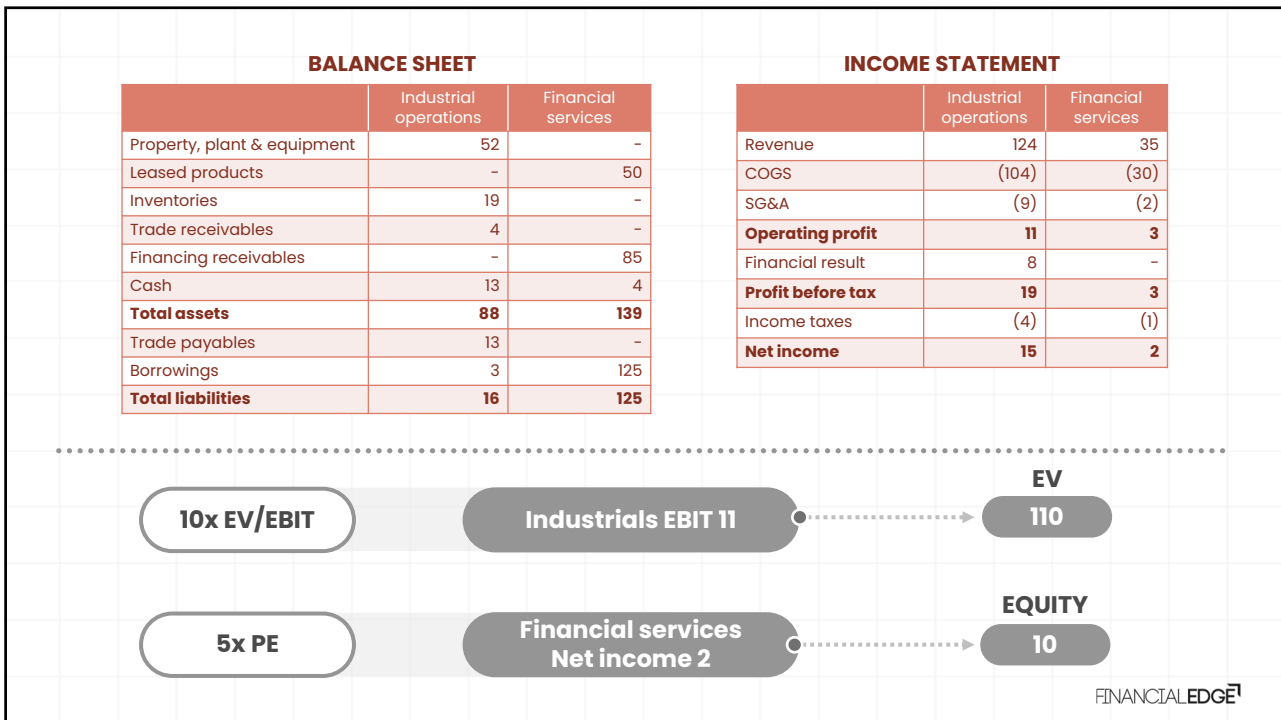
	Industrial operations	Financial services
Revenue	124	35
COGS	(104)	(30)
SG&A	(9)	(2)
Operating profit	11	3
Financial result	8	-
Profit before tax	19	3
Income taxes	(4)	(1)
Net income	15	2

Analyze this part of the **business** as if it were **bank**

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Customer Financing – Sum-of-the-Parts



Pension and OPEB liabilities

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Benefits pensions can be significant in **industrials**



Pay out an **agreed amount**
yearly on **retirement**



Pension plans are usually
required to have **assets** set
aside to **covers these**
future pension liabilities

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If assets **aren't sufficient** to cover the **pension plans liabilities**, the **pension plan is in deficit**



Need to be **shown** in the **sponsoring company balance sheet**

Treated as **debt-like** for valuation purposes



Sponsoring company will most likely have to **pay money** to the **pension plan**

To cover the **deficit in the future**



Assets

Exceed



Liabilities



SURPLUS

Surplus is usually **inaccessible**, so it's **excluded from valuation**

**UNDERFUNDED PLAN****UNFUNDED PLAN**

These **pension plans** don't need **pre-funding**

No plan assets – all deficit

Certain countries, most notably **Germany**, permit **pension funds** to **operate in this manner**



Understanding the Financial Statements

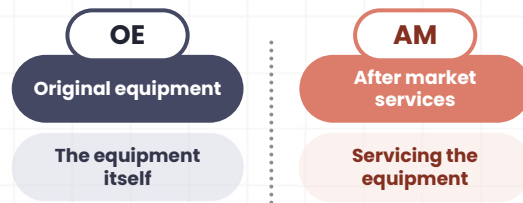
Extracts from ABB Income Statement

Amounts in \$m	2018	2017
Sales of products	22,366	20,438
Sales of services and other	5,296	4,758
Total revenues	27,662	25,196
Cost of sales of products	15,961	14,485
Cost of services and other	3,157	2,865
Gross profit	8,544	7,846
Selling, general and admin	5,295	4,765
Non-order related R&D expenses	1,147	1,013
Other income	124	162
Income from operations	2,226	2,230
Net finance expense	107	128
Income before tax	2,119	2,102
Income taxes	544	583
Income after tax	1,575	1,519



Swedish-Swiss multinational electrical engineering corporation

Sales will be split into:



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The backlog and the book-to-fill can help to analyze the split



Costs may be linked to sales through contract accounting



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If the **product is long cycle**

Running **cost-to-cost systems**



R&D will be significant

Capitalization matters
for comparison

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Understanding the Financial Statements – PT2

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Extracts from ABB balance Sheet

Amounts in \$m	2018	2017
Cash and marketable securities	4,157	5,609
Receivables	6,386	5,861
Contract assets	1,082	1,141
Inventories	4,284	3,737
Other current assets	792	744
PP&E	4,133	3,804
Goodwill and other intangibles	13,371	11,961
Deferred tax assets	1,006	1,212
Other non-current assets	639	786
Assets held for sale	8,591	8,603
Total assets	44,441	43,458
Accounts payable	4,424	3,736
Contract liabilities	1,707	1,792
Provisions for warranties	948	909
Other current liabilities	5,152	4,786
Short and long term debt	8,618	7,408
Pension and other employee benefits	1,828	1,589
Other non-current liabilities	2,616	2,899
Liabilities held for sale	4,614	4,990
Total liabilities	29,907	28,109



Working Capital

Regular receivables



Inventories



Payables



Contract assets and liabilities



May be highly volatile due to differences in **cost-to-cost systems** and **cashflows**

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Assets

Capitalized R&D

Create much **higher intangibles** in companies



Pensions and OPEBs

Create **debt-like items** in valuation



Need to really **understand the footnotes**

Analyzing Industrial Companies

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Industrial companies



Measured using many of the **same metrics as other companies**



Revenue Growth



Profit Margins



Returns

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Industrial Analyst

Forward-looking revenue analysis



Order backlog



Book-to-bill ratios

Returns

Analyze depreciation as part of margins, using an EBITA margin for example

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Valuation



PE (Price-to-Earnings) and sum of the parts valuation is important

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