



Overview & Investment Thesis:

- ABB is a leading global engineering firm, specialized in power and automation technologies. The company founding dates back to 1883, when Asea AB of Sweden was created to excel in the "generation and application of electric power", and 1891, when Brown Boveri & Cie was initiated to manufacture motors and generators. The two companies merged in 1988 to form Asea Brown Boveri, which changed its name to ABB in 1996. The company was a dual listed company until 1999 and it has been since its formation a key player in the electric infrastructure industry.
- ABB is ideally positioned to take advantage of the capital investment growth trends in electrical infrastructure (transmission and distribution) in both developed world (due to equipment obsolescence, the need to connect the renewable energy generation sites to the grid and to manage the power flows and facilitate smart consumption) and developing world (mainly driven by increased consumption).
- ABB is the technological leader in designing and delivering large scale transmission projects all over the world. Arguably, ABB leads Siemens by developing unique competencies in setting up high (and ultra high) voltage direct current (U-HVDC) transmission lines which are capable of transferring safely, power with minimum losses over hundreds and even thousands of kilometers from the generation sites to the consumption centers
- The company's optimum portfolio of businesses allows it to take advantage of growth trends in the power supply and power consumption sectors, while at the same time provides a balanced earnings stream throughout the economic cycle. Its early to mid cycle businesses, such as power products, low voltage products and discrete automation and motion are complementary to its long cycle businesses such as process automation and power systems, ensuring a reduced earnings volatility in any economic environment.
- Good geographic diversification with excellent exposure to key growth emerging markets. The company derives about 50% of its business from emerging markets. ABB has been present in China for more than 100 years and is currently employing over 15,000 people in about 30 locations in the country.
- The company's management has a strategic approach to growth (recent acquisition focused on increasing the company's already world class capabilities in smart grids design and operation by adding a leading utility IT provider) while maintaining a prudent approach (pulled out of the bidding process for Chohride against Emerson in order to avoid overpaying for assets) and focusing on shareholders return.
- ABB's strong cash flow generating ability, together with a persistent approach to cost cutting and disciplined mergers and acquisitions lead to an outstanding balance sheet, allowing the company significant financial flexibility.
- In an attempt to reduce the need for additional power generation capacity and limit the impact on the environment, governments and companies alike are looking for increased energy efficiency and industrial productivity. At the Transmission & Distribution level the focus is on improving the network efficiency through better power control (driven by the 'digitalization' of the electrical power), while at the industry level the focus is on improving and automating the production processes as well as on improving the performance of the end products which account for most of the power consumption. ABB is driving the progress in network efficiency by delivering equipment and software responsible for the power control and power quality, while it is one of the main providers of automations solutions and products for a broad array of industrial users.
- Economies of scale and scope: As power transmission and distribution becomes 'smarter', a lot of automation technologies become applicable to it and the two areas, power and automation are converging. A company with ABB's footprint and R&D commitments is poised to make the most of this trend, while a new entrant would face significant challenges.

Business Description:

The current organizational structure incorporates five operational divisions and a corporate division. Two of the divisions are involved in power technologies. The Power Products division is responsible for manufacturing high and medium voltage equipment such as breakers, switchgear, distribution automation, transformers and insulation. The Power Systems division is providing complete electrical infrastructure solutions such as grid systems, network management, power generation systems and integration and substations. The automation technology is present in three of the ABB divisions and this area has recently suffered a slight organizational change. The Low Voltage products, formerly known as Automation Products, are products used in the final distribution of power such as breakers, switches, enclosures and wiring accessories. The Discrete Automation and Motion division, built around the former Robotics division, also includes programmable logic controllers (PLC), motors and drives. The Process Automation division supplies turn-key automation solutions for a varied array of end markets including oil, gas and petrochemicals, marines and cranes, minerals, metals and pulp and paper. The company is headquartered in Zurich, Switzerland, and employs 116,000 people.

Industry Growth Drivers/Trends:

- One of the avenues of growth in the transmission and distribution (T&D) industry is the addition of new infrastructure in areas where the power consumption is expected to grow, primarily in the emerging growth countries. Some estimates put the requirement for T&D expenditure in China at more than \$700bn from now until 2020. Similarly, obsolete equipment has to be upgraded or replaced throughout the developed countries, with US in particular being in dire need for an update of its electrical grid. It is estimated that the replacement of old equipment and the upgrade to 'smart grid' in the US is an enterprise worth more than \$600bn. ABB carries a strong portfolio for greenfield and upgrades for infrastructure, industry and utilities.
- The climate change concerns pushed for an increased focus on power generation from renewable sources. One of the main challenges in taking advantage of renewable energy sources is the complexity that such power sources introduce in the system. Most renewables have uncertain power output depending on the availability of the energy source (solar, wind, biomass, etc.) and are often located in remote locations. The industry's answer to the challenge is developing technology in high efficiency power grids (usually based on high voltage direct current), automation of the grids as well as providing service and software for grid management. ABB is the leader in developing the above technologies.

Competitive Advantages:

- ABB has a rich history and unmatched expertise in large T&D projects, evidenced by the award of a project in China to transmit power from the dam at Xiangjiaba to Shanghai over a distance of 2,000km.
- The company's global footprint allows it to leverage its research and development capabilities; the company has actually increased its R&D spend during the downturn.
- A balanced portfolio including early, mid and late cycle businesses provides stability and better financial flexibility over the more cyclical competitors.

Competitors:

- **Transmission:** Siemens, Areva (now part of Alstom/Schneider)
- **Distribution:** Schneider, Legrand, Siemens
- **Industrial Automation:** Siemens, Rockwell, Mitsubishi, Schneider, Emerson, Honeywell

Barriers to Entry:

- Technological advances: ABB has built its considerable technological base over a period of more than 100 years and currently holds patents and has a technological edge in many of the areas it operates.
- Track record: Governments and utilities would be reluctant to award a newcomer a strategic project which involves significant capital commitments and is needed to operate safely and efficiently over long periods of time.

Customers:

- ABB has a diversified customer base, with some business concentration at regional/local levels (i.e. utilities), but no single major customer at the group level.
- ABB's most important end-markets are: utilities, automotive, construction, OEM, general industry, chemicals and oil and gas.
- ABB's most important markets by geography are: China, US, Middle East, Germany, India, Brazil and Russia.



Officers and Directors:

Leadership team: Hubertus von Grunberg, 67, Non-Executive Independent Chairman of the Board; Joe Hogan, 53, Chief Executive Officer; Michel Demare, 53, Chief Financial Officer, Head – Global Markets; Peter Leupp, 59, Power Systems Division; Ulrich Spiesshofer, 46, Head – Corporate Development

Corporate Governance:

- **7 member board** – are independent and the functions of chairman and managing director are separated.
- The company scores at the top of the scale (8.5) in the Governance Metrics International (GMI) Overall Global rating and also above average in the Institutional Shareholder Services Corporate Governance Quotient (ISS CGQ) Index (62.7) and ISS CGQ Industry (65.8).
- ABB is targeting a 2.5% energy use reduction annually at all manufacturing sites over 2010-2011.
- ABB is a member of the Dow Jones Sustainability Index (DJSI) World and DJSI Europe.
- The company as a group has issued a sustainability report since 1998 and the reports are audited by independent consulting firms. In reporting its sustainability metrics, the company follows the Global Reporting Initiative guidelines.
- The compensation of the 10 members of the executive committee amounted to 0.8% of the group's operating profit.

Ownership:

Insiders own less than 0.01% of outstanding shares.

Notable holders include: BlackRock 3.1%, Credit Suisse Asset Management 1.5%, UBS 1.1%, Harbor Capital 1%, Swedbank 1%, Vanguard 0.9%.

Capital Allocation/Uses:

- ABB strong cash flow generation capabilities are evidenced by an operating cash flow compound annual growth rate of over 40% over the 2005-2009 period.
- At the end of the first half of 2010 the company held \$5.9bn in net cash.
- The company is pursuing organic growth and it expensed \$1bn on capital expenditure projects in 2009, forecasting an \$800mm (or about 115% of the depreciation) spend for the 2010 fiscal year. Priority is given to emerging markets (Poland, India, etc.) and strategic products.
- The company spent relatively little on acquisitions in the 2007 to 2009 period, ramping up purchases in 2010 by acquiring Ventyx, a leading utility software provider, for roughly \$1bn and increasing its stake in the publicly listed ABB India for a similar consideration.
- The company is following a progressive dividend policy, with the 2009 dividend 6% higher than in 2008, yielding about 2.4% at CHF0.51/share.
- The company is committed to its 'A' credit rating, upgraded during the fiscal 2010.

Business Segments:

Business Mix	Revenues (%)		Operating Profit (%)	
	2008	2009	2008	2009
Power Products	28.3	29.5	37.9	48.3
Automation Products	26.1	24.9	34.5	32.6
Process Automation	21.7	22.5	16.7	16.8
Power Systems	19.2	20.0	10.7	9.5
Robotics	4.6	3.0	0.2	-7.3

Financial Statement Summary: (USD MM, years ended Dec 31)

Income Statement	2005	2006	2007	2008	2009
Total Revenue	22,442	24,412	29,183	34,912	31,795
Normalized EBIT	2,375	3,281	4,582	6,536	4,711
Net Income, continuing ops	1,014	1,736	3,415	3,403	3,203
Fully Diluted EPS, continuing ops	0.44	0.71	1.37	1.37	1.30
ROE	13.30%	25.30%	32.71%	37.32%	26.74%
Balance Sheet					
Net Debt	849	-1,057	-4,844	-4,831	-6,536
Common Equity	3,483	6,038	10,957	11,158	13,790
Net Debt: Common Equity	24.38%				
Operating Cash Flow	1,021	1,943	3,093	3,984	4,027

Key Profitability Ratios and Figures:

Y/E December 31	2007	2008	2009
Operating Margin	15.7%	18.7%	14.8%
Interest Coverage	14.8x	12.2x	33.4x
Return on Equity, continuing ops	32.71%	37.32%	26.74%
S&P Credit Rating	A-	A-	A-

Sourced from Thomson Reuters, Company Filings, PIC.

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Portland Investment Counsel Inc.

1375 Kerns Road • Suite 100 • Burlington, Ontario L7P 4V7 • Tel: 1-888-710-4242 • Fax: 1-866-722-4242

www.portlandic.com • info@portlandic.com