ABB and GE Industrial Services merger: a $2.6bn deal to revamp GE division

General Electric Company (NYSE:GE) – market cap as of 06/10/2017: $211.2bn
ABB Ltd (SWX: ABBN) – market cap as of 06/10/2017: $53.3bn

Introduction

On September 25, 2017, ABB announced the acquisition of GE Industrial Solutions for a cash consideration of $2.6bn.

The transaction is a further move in an industry stepping towards consolidation. ABB, in particular, is looking to strengthen its competitive positioning, betting on revamping the GE division, while making the most of the well-known GE brand. As the market is growing competitive, the transaction will also enable ABB to remark its position as a comprehensive servicer, with a wide portfolio of products and services, which is a remarkable differentiating factor with respect to smaller and less relevant players.

About General Electric Company

General Electric Company is an American industrial conglomerate founded in 1892 and based in Boston, boasting a market capitalization of $211.167bn as of October 5, 2017. In 2016 it reported Total Revenues of $120.27bn, EBITDA of $17.14bn (14.3% margin) and Net Income of $8.83bn (7.3% margin). Its reported Net Debt is of $120.18bn (7.0x EBITDA), resulting in Enterprise Value equal to $336.18bn.

It operates as an infrastructure and technology company worldwide through a wide variety of business segments. (1) The Power segment provides steam power, water treatment, gas engines and nuclear plants with maintenance, services and upgrade solutions; (2) The Renewable Energy segment provides onshore and offshore wind turbine platforms hardware and software, together with hydropower solutions, products and services; (3) The Oil & Gas segment provides subsea drilling and production systems, equipment for floating production systems, compressors, turbines, turboexpanders and auxiliary equipment; (4) The Aviation segment designs and produces commercial and military aircraft engines, digital components, electric and mechanic aircraft systems, together with aftermarket assistance and services; (5) The Healthcare segment offers imaging and clinical systems, products for drug discovery biopharmaceutical manufacturing and cellular technologies; (6) The Transportation segment provides freight, passenger and rail support and advisory services, together with parts, integrated software solutions, data analytics, stationary power diesel engines and motors as well as overhaul, repair and upgrade services; (7) The Electric Connections & Lighting segment offers industrial, grid, power conversion, automation and control, lighting and current solutions; (9) The Capital segment provides industrial and energy financial services, commercial aircraft leasing, financing and consulting services.

The target company of the M&A transaction is General Electric Industrial Systems, an Atlanta-based subsidiary of General Electric Company, belonging to the Electric Connections & Lightning segment. Its operations are divided among 3 main segments. The Critical Power segment manufactures and sells automatic transfer switches, critical power distribution systems, DC power systems, and switchgears. The Motor & Lighting Control segment offers contractors, drives, overload relays, starters and terminal blocks. Finally, the Protection and Distribution segment produces circuit breakers, generators' accessories, motor control centers, power equipment buildings, switchboards and transformers. The company covers 8 industries: Commercial, Data Centers, Healthcare, Industrial, Mining, Oil & Gas, Residential and Telecom.

GE Industrial Solution can boast 29 manufacturing facilities, 15 distribution centers, 13 service centers and 9 R&D centers around the globe. It now employs around 13,500 people worldwide, with a turnover of c. $2.7bn in

2016 and a pre-tax profit of c. $160m (5.93% margin). Within the Energy Connections & Lighting segment, which started 130 years ago when Thomas Edison patented the first circuit breaker, the Industrial Solution unit accounts for 22% of the Total Segment Revenues, which were c. $15.1bn in 2016.

About ABB Group

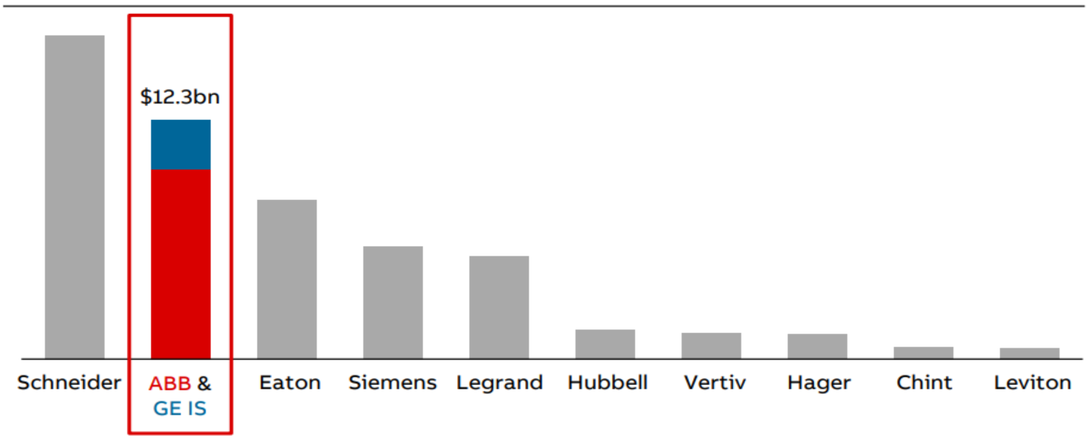
ABB is a Switzerland-based company founded in 1883 with a market capitalization of CHF52.21bn ($53.34bn) as of October 5, 2017. As of FY2016, it reported Total Revenues of $33.82bn, EBITDA of $4.46bn (13.2% margin) and Net Income of $1.89bn (5.6% margin). Its reported Net Debt is of $1.89bn (0.43x EBITDA), resulting in Enterprise Value equal to $55.72bn.

Its operations are divided in 3 main segments. (1) The Utilities segment manufactures and sells electrification, robotics and motion, power grid and industrial automation products for utilities, transportation, infrastructure and industrial customers worldwide. The company also provides modular substation packages, distribution automation products, circuit breakers, measuring and sensing devices, wiring accessories, enclosures and cabling systems, low and medium-voltage switchgears, installation materials for building, data centers and for the rail, wind, solar, food and beverage, marine, and oil & gas industries. (2) The Industry segment offers motors, generators, variable speed drives, solar inverters, wind converters, electric vehicle fast charging infrastructure solutions and components. In addition, the company develops and sells control and plant optimization systems, automation products and solutions, and industry-specific application services for the oil & gas, metals, minerals, marine, chemical, pharmaceutical and power industries. (3) The Transportation & Infrastructure segment manufactures and sells energy efficient solutions, particularly in data centers, rail and electric mobility. It continued its collaboration with Stadler Rail to deliver its newest traction equipment for reliable and energy-efficient trains and has received an order to provide additional fast chargers for hybrid electric buses in the city of Luxembourg.

The company also has a strategic collaboration with IBM to develop industrial artificial intelligence solutions.

Industry Overview

The electrification and electric equipment manufacturing sectors are very fragmented ones, where many different players supply a wide array of products to several target markets, which are mainly represented by industry, transport and infrastructure customers. As of today, based on the global electrification business volumes, there are two major players: the French Schneider, that leads the $32bn market for electrification globally, and ABB which, as a consequence of the GE IS acquisition, will strengthen its number two position, pushing for the slot number 1. Other smaller incumbents are represented by Eaton, Siemens AG and Legrand.



According to ABB's CEO Ulrich Spiesshofer, the most attractive electrification market is the North American one, as it is growing by more than 32% at a yearly rate due to the rising demand in sectors like data centers and EP charging, as well as energy efficiency and classic industrial electrification. In this specific market however, Eaton and the newly created ABB&GE IS are the only two players which are able to supply a complete portfolio of electrification products ranging from MV and LV (medium and long voltage) protection and control, to building products, solar inverters and EV chargers. Smaller players instead are more focused on the production and supply of singular product categories.

For what concerns the current global trends, over the last years, demand for electricity consumption has been growing faster than overall energy demand, as more people gain access to electricity. Firstly, urbanization is playing a pivotal role in fueling this demand: cities today are the home to 50% of the world's population and they account for 75% of global energy consumption. Moreover, they are now growing and by 2050 they are expected to house an additional of 2.5bn electricity-consuming people. Secondly, figures in the transport and infrastructure markets have been positive too: the accelerating take-up of electric vehicles, the increasing demand for building automation solutions, as well as solutions involving energy efficiency for rail transport are significant contributors. On the contrary, the marine sector, except for cruise ships, still suffers from a sharp decline in demand for electricity mainly because of the subdued oil and gas sector. Concerning the sector of utilities, new capacity is being added in emerging markets, while the aging power infrastructure is being upgraded in mature markets and renewable energy is being integrated globally.

This final significant shift in the electricity value chain (i.e. the growth in renewable power generation) represents a great opportunity for those companies that will be able to deliver intelligent solutions for further services and product development, in order to contribute towards efficiency and sustainability improvements in every market.

Deal Structure

The bidding process saw also the participation of Schneider and of 4 private equity firms: KKR, Clayton, Dubilier & Rice, Warburg Pincus and Onex Corporation.

The deal was eventually announced on September 25, 2017 and, according to the agreed-upon terms, it provides for the integration of General Electric Industrial Solutions into the ABB's Electrification Products (EP) division, with the preservation of the current management team. The consideration for General Electric Company is of $2.6bn in cash in exchange for 100% of the shares of the target company. The deal is subject to customary regulatory clearances and it is expected to close in the first half of 2018.

Deal Rationale

GE's Industrial Solutions will be integrated into ABB's Electrification Products Division in a further attempt to strengthen ABB's worldwide portfolio and rekindle growth after wrapping up a four-year restructuring plan during which it regrouped operations. The deal would provide access to GE's already established electrical installations unit and its solid customer base in the North American market, which remains to this day ABB's largest foothold.

Following last year's acquisition of Bernecker & Rainer, an Austrian specialist in Computer Systems, the purchase of GE's Industrial Solutions unit marks another acquisition oriented towards enhancing growth externally. GE's strong presence in North America also confers ABB with an opportunity to close the gap with its main competitor and U.S. market leader Schneider Electric, which is itself awaiting completion of a $1.25bn deal to purchase rival Asco Power.

The deal, financed entirely with cash, is expected to be EPS accretive by year one, and while integration costs are poised at $400m, analysts remain confident in the announced of $200m annual cost synergies which aim to be realized within a five-year time span. On the revenues side, the deal marks a bet on ABB's behalf to be able to restore GE IS's performance and bring it in line with industry peers. Currently, GE IS's lackluster margins sit at 6% (EBITA/Sales), which are well below industry benchmarks and ABB's target corridor of 15-20%, and represent a good opportunity for a successful turnaround.

Complementarities in the product offerings of the two companies will also create value. Moreover, ABB's innovative technologies and digital offerings will find a good fit with GE's market access and experienced sales force. On a further note, the deal comes paired with a long term right to use the recognized GE brand and an agreement concerning a supply side partnership with GE. Both agreements come in to sweeten the somewhat hefty $2.6bn price tag for GE's underperforming unit.

Market Reaction

On the day of the official announcement, shares of ABB closed largely unchanged, while shares in GE rose by 0.5%. The imperceptibility of the market reaction was due to the fact that information regarding the sale of the Industrial Solutions unit was largely public by the time the official announcement broke out, and the market had already priced accordingly.

Since August 24, when rumors of a definitive interest on behalf of ABB and of a second round of negotiations came out, ABB's share price has risen by 6.7%. Because of the acquisition, ABB has decided to halt its share buyback program. Surprisingly, this has not upset markets, further leading to the hypothesis that the acquisition has been very well accepted by investors.

Advisors

Credit Suisse and Dyal Co, a boutique owned by former Goldman Sachs banker Gordon Dyal, acted as financial advisors to ABB. On the sell-side, GE advisors were not disclosed.