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the official newsletter of sigma investment counselors July 2006

The Game Is On

As the global marketplace continues to evolve and consolidate, we believe it is crucial and necessary from an investment perspective to focus on those companies that are winning on the international battlefield. In this report, we are introducing to our clients and readers a Zurich, Switzerland based company that has, in our opinion, positioned itself to be a leader in the infrastructure build-out and revitalization that is occurring all over the globe. The intent is to provide a brief investment summary of a company and not a full research report. Importantly, depending on the objectives of our clients, the company highlighted may or may not be utilized in all portfolios. As we stated in a previous Sigma Summaries, we hope to use this forum in the future to be informative and provide a glimpse of the many investment ideas that come into our viewfinder.

Roger N. Steed
Chief Investment Officer

ABB: A Revitalized Power and Automation Company

The "game is definitely on" across all governments, corporate boardrooms and municipalities to improve their cost competitiveness in order to foster future growth as well as rehabilitate capital-starved infrastructure assets. A multitude of factors including rising energy costs, global competition and the emerging growth from the BRIC countries (Brazil, Russia, India & China) have accelerated the demand to build and revamp critical infrastructure assets such as electric and water utility grids as well as automation technology solutions for commercial and industrial companies. **ABB** finds itself right in the middle of this long-term demand surge.

The **ABB Group** was formed in 1988, when the Swedish Asea and the Swiss BBC Brown Boveri merged under the name **ABB**. Asea's history dates back to 1883. BBC Brown Boveri was founded in 1891. The company is a leader in power and automation technologies that enable utility and industry customers to improve performance with reduced environmental impact.

Our investment thesis for **ABB** common shares is centered on two significant trends currently taking place. First, the company is coming out of a major turnaround effort in 2003 and 2004 and has shown improving operating performance over the last eighteen months that we believe will continue far into the future. Second, the company is very well positioned for the global demand and revitalization of infrastructure assets that will be necessary to ensure reliable power and automation that both emerging and maturing economies will need to provide for their growing populations.

The company made significant strides in 2004 to establish a new corporate structure that allows it to compete more effectively in the new world order. Like many European based companies, **ABB** has revered global relationships from decades and decades of spadework but had a bureaucratic and cumbersome business model that couldn't produce best of breed financial returns. The numerous changes put in place by the Board of Directors now positions the company to go toe-to-toe with the very best engineering companies and win large, profitable infrastructure contracts.

In September 2005, the company unveiled new business targets for the overall group and their five divisions for the years 2005-2009. The strategy emphasizes improved business execution and a balanced approach to value creation, including focus on growth, operating margin, use of capital and cash generation. If the first quarter of 2006 is a good indication, **ABB** is on a path to meet and exceed the 2009-targeted metrics.

The company had a very strong start to 2006 reflected through numerous data points including continued strong organic growth in orders (+21% in local currencies) and revenues (+13% in local currencies). EBIT (Earnings before interest and taxes) grew 30% to $509 million and EBIT margin increased to 9.4%, up from last year's first quarter due to improved volumes, operational efficiency, factory loading, project selection and execution.

In addition, part of the new corporate strategy has been to reduce total debt and improve cash flow. The company reduced its gearing (total debt divided by the sum of total debt plus stockholders' equity, including minority interest) to 50% in the first quarter of 2006 from 86% in 2002. Cash flow from operating activities was up $249 million in the first quarter from last year. Moody's and Standard & Poor's upgraded the company's debt in April 2006 to investment grade due to improved financial results. Finally, the Board of Directors proposed a dividend of 0.12 Swiss Francs per share, in February 2006. It is the first time **ABB** has paid a dividend since 2001.

The company's products and business applications apply to a wide spectrum of customers across the world. The company has five divisions including power products, power systems, automation products, process automation and robotics. The company is the leader in supplying key components to transmit and distribute electricity. They also provide process automation technology with integrated solutions for control and plant optimization, and have established the world's largest installed base of industrial robots for the automotive, foundry, packaging, material handling and consumer industries.

Speaking to the company's strength in grid reliability, **ABB** won a noteworthy $220 million deal in November 2005 linking six Gulf States including Saudi Arabia, Kuwait, Qatar and the United Arab Emirates (UAE). The company will contribute six turnkey 400-kilovolt (kV) substations, including gas insulated switchgear (GIS), circuit breakers, transformers and shunt reactors as the main components. **This contract was the biggest power transmission project to be announced anywhere in the world in 2005.**

Another great contract win and a likely sign of the future is in the oil and gas industry. **ABB** systems for enterprise-wide Supervisory Control and Data Acquisition (SCADA) won a $95 million contract in January 2006 from India's largest integrated oil and gas company, ONGC Limited. The new system will monitor, control and manage vital information from ONGC's production and drilling facilities, linking oil basins, processing plants and other assets to the corporate data center. It is designed to support the company's geographically dispersed production and drilling facilities, both onshore and offshore, with "anytime-anywhere" data access to enable faster decision-making and response.

India will be an important revenue and profitability center for the company far into the future. On the demand side, the company has significant opportunities from the changing income distribution profile toward a more robust middle class. **The rising income throughout the economy is driving increased demand for power plants and super transformers as illustrated by the expected 25% growth over the next six years from electrifying Indian villages that currently do not have electricity.** On the supply side, the company has been establishing manufacturing plants across India that will provide power technology products for customers in Europe, China and the United States.

Looking at **ABB's** position in China, the company has more than 30 manufacturing plants, and 8,500 skilled employees. **China represented 11% of world sales in 2005 and has grown over 30% since 2000. With 10% plus annual growth in power consumption, China is planning the world's first "super grid." Looking to 2020, China is planning to build 144 HVDC power plants.** In 2006, the company announced it would relocate their global robotics headquarters to Shanghai.

Along with the positive demand trends that are developing, we realize that the company must address ethical and safety issues that arose in the past. We believe management understands that proper business conduct is the hallmark of a sound organization and have instituted new mechanisms to educate and train employees in correct behavior and to take action to punish violations.

Taking everything we have outlined and researched into account, the company has demonstrated a great deal of progress toward becoming a top-tier global engineering company. While not yet at the growth and profitability level of a company like Emerson Electric, we believe we are in the very early innings of a long-term growth and profitability drive.

Roger N. Steed
Chief Investment Officer

The Economic and Market Environment

In Sum: A generally improving economic and securities market environment appears to have stalled of late, due mainly to geopolitical concerns. Past crises have been resolved and so too will the current challenges notwithstanding the unnerving nature of the hostilities. Global economic growth probably will be tempered but monetary policy should become a bit less restrictive too, setting the stage for an eventual turnabout for global equities, rewarding rational investors. Bond interest rates are compensating investors for the attendant level of inflation which will not accelerate markedly from current levels.

Geo-political: Since the end of June, the geo-political environment has deteriorated markedly. Continued armed conflict between Israel and Hamas and Hizbollah has left the entire Mideast a smoldering cauldron. Given the high concentration of oil reserves in this region, energy prices have begun to surge again. At the same time, North Korea recently fired several missiles in the direction of Japan and the United States as a reminder that the country continues to seek bilateral talks with the United States regarding security guarantees and economic assistance. Finally, Iran has rejected a unanimous United Nations nuclear weapons containment recommendation.

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Economic: Higher oil prices and interest rates have served to dampen both consumer as well as investor sentiment. The July University of Michigan Consumer Sentiment Index fell to 83 versus 84.9 in June while stock markets the world over have gyrated with a negative bias. Former Fed Chief Alan Greenspan articulated his assessment of events in recent testimony to the US Senate Foreign Relations Committee, commenting that "The US especially, has been able to absorb the huge implicit tax of rising oil prices so far. However, recent data indicate we may finally be experiencing some impact." Developing countries would be similarly impacted barring a reversal of energy prices.

Monetary: The Federal Reserve Board raised the fed funds rate again at the end of June to its highest level since January of 2001. Given the surge again in global energy prices, and the expected dampening effect on global consumers, it would appear that the Fed will be reluctant to raise rates again when it meets in August.

Fiscal Policy: The 2006 fiscal federal budget deficit was revised downward by the Bush Administration to $296 billion in early July versus a February estimated shortfall of $423 billion. With a paucity of good news coming out of Washington of late, this is clearly a positive development.

Equity markets: Stock markets the globe over have fallen in unison since early May, with an acceleration following the heightened tensions in the mid-east. Regardless of the emotional lure of following the herds liquidating equities, history has proven time and again that the best investment opportunities take place during periods of tumult, when good investment values are abundant.

Fixed income markets: Bond rates appear at present to be adequately rewarding investors for the attendant inflationary risks.

As of July 17, 2006

Please remember to contact Sigma Investment Counselors if there are any changes in your financial situation or investment objectives.