

25 April 2014 | 7 pages

Machinery
Western Europe | Sweden

Volvo AB (VOLVb.ST)

Results: EPS Momentum Turning, DM To Offset LATAM Weakness

■ **Citi's Take** — Volvo delivered a solid set of results, in our view; a 2% beat on clean EBIT, following six big earnings misses in a row (20% miss on average). Truck order intake a bit light though, in line with Citi, but 4.6% below SME consensus, driven by weakness in Brazil, with orders now down 30% yoy, similar to what we have seen at other truck peers. A strong momentum in Europe, with orders 15% ahead of our forecast could not offset this weakness and Volvo is now guiding down on Brazil, seeing the truck market falling 13% yoy vs flat previously and our current -6% forecast. We would expect FY14-15 consensus EPS flat to slightly down on these numbers, but still representing a big turn in EPS momentum for Volvo. While orders are softer on the back of Brazil and guidance is cut, this follows recent negative newsflow on the economy and a more difficult environment to get truck financing through as well as other truck peers already reporting weaker orders. Key bull points still: 1) strong momentum in DM, 2) solid margin now with most of the easy cost savings still ahead of us, and 3) re-rating potential towards 0.9x 2015 EV/Sales, when investors will gradually believe that the 9% margin is not a peak margin but the new through the cycle margin for Volvo.

■ **DM Momentum to Offset LATAM Weakness** – The new guidance for North America was in line with our expectations, now seeing growth of +10% vs +5% previously. The guide for Europe was kept unchanged, which was expected by us; a flat market, but we think Volvo will continue to take market share as we go through the year (Volvo currently has a record market share in Europe). We think it is encouraging to see Renault orders recovering strongly already this quarter (up 50% sequentially, we had expected a recovery from 2Q14 onwards). Whilst Brazil is a high margin region, DM EBIT is >50% of group and volumes are only now recovering from a low base.

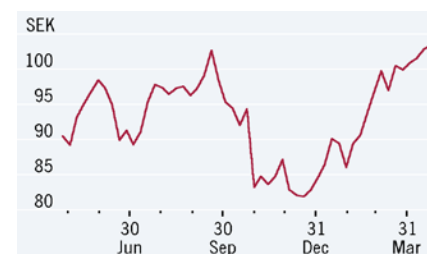
■ **The numbers** – Volvo reports Truck orders of 55,146 units vs SME cons at 57,784 (4.6% miss), deliveries of 47,845 vs cons at 46,852 units (3% ahead), sales of SKr 65.646m vs cons at SKr 65.653m (in line), clean EBIT of SKr 2,588m vs cons SKr 2,540m (2% ahead); a 3.9% margin vs 3.9% consensus (4% 4Q13, 0.8% 1Q13). Volvo reports a slight miss on Truck margin (25bps vs cons, 50bps ahead of Citi), offset by better margin in CE (50bps ahead of cons, 130bps ahead of Citi), but no drama.

■ **Cash Flow** – Weaker cash flow on inventory buildup with a SKr 9bn outflow vs 7.6bn outflow last year. The bears will fret about over-production, but this is build up on the back of stronger than expected demand into 2Q14. If this was a patchy Truck and CE cycle we would be concerned, but this is not our base case.

■ **Implications** — Solid set of results; we reiterate our Buy recommendation.

Buy	1
Price (24 Apr 14)	SKr103.40
Target price	SKr117.00
Expected share price return	13.2%
Expected dividend yield	2.9%
Expected total return	16.1%
Market Cap	SKr220,387M
	US\$33,525M

Price Performance (RIC: VOLVb.ST, BB: VOLVB SS)



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Volvo AB

Valuation

Our target price of SKr 117 is a blend of three valuation methodologies, on our 2015 forecasts: 1) EV/Sales of 0.9x (SKr 127), matching our 9% EBIT margin, 2) average EV/EBIT of 9.2x (109 SKr), and 3) a DCF fair value of SKr 117 per share (WACC of 8.5% and terminal growth rate of 2.5%).

Risks

Downside risks to our recommendation and target price include: 1) slow recovery in European truck markets beyond the hangover from the pre-buy (switch from Euro 5 to Euro 6), 2) pricing risks on Euro 6 series, and 3) slower execution of Volvo's cost savings.

Appendix A-1

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Ratings and Target Price History Fundamental Research

Analyst: Klas Bergelind
Covered since February 24 2014



	Date	Rating	Target Price	Closing Price
1	28-Apr-11	3H	*110.00	115.90
2	1-Sep-11	*2H	*80.00	79.35
3	29-Sep-11	2H	*78.00	71.05
4	4-Oct-11	2H	*71.00	64.95

* Indicates change

	Date	Rating	Target Price	Closing Price
5	7-Oct-11	Stock rating system changed		
6	8-Oct-11	*2	71.00	73.30
7	13-Oct-11	2	*78.00	73.30
8	28-Oct-11	2	*85.00	86.60

	Date	Rating	Target Price	Closing Price
9	9-Jul-13	2	*87.00	89.15
10	24-Feb-14	*1	*117.00	98.55

Rating/target price changes above reflect Eastern Standard Time

Volvo AB (VOLVb.ST)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Klas Bergelind

Covered since February 24 2014



Date	Rating	Target Price	Closing Price
[1] 20-May-11	*ADD LP	-	114.70

* Indicates change

Date	Rating	Target Price	Closing Price
[2] 13-Jan-12	*REM LP	-	82.40

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Data current as of 31 Mar 2014

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% of companies in each rating category that are investment banking clients

12 Month Rating			Relative Rating		
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49%	40%	12%	1%	98%	1%
55%	53%	45%	58%	53%	42%

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