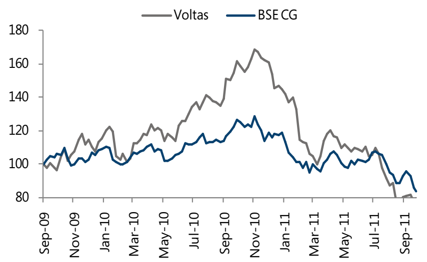
Visit Note

Accumulate

Reco	Maintain
CMP	₹ 119.5
Target Price	₹ 125.9
Upside Potential	5.4%

Price Performance

52 wk Hi/Lo	122/114
All time Hi/Lo	267/268
6 mnth Average Vol	971983
Stock Beta	0.85



Valuation

	FY11	FY12P	FY13P
P/E (x)	12.5	11.7	10.0
P/BV (x)	2.9	2.4	2.0
RONW (%)	25.9	22.5	21.9
ROCE (%)	21.9	16.5	16.5

Peer Valuation (FY13)

	Bluestar	Avg
PE	10.0	10.0
EV/EBIDTA	4.5	6.2

Equity Data

Market Cap. (₹ bln)	39
Face value (₹)	1
No of shares o/s (mln)	330

	Jun10	Jun11	Δ%
Promoters	30.48	30.55	0.22
FII's	8.14	18.42	126.2
DII's	36.88	29.80	-19.19
Public	24.50	21.23	-13.34

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Voltas

Still feeling the heat

In our recent meeting with Voltas, its management threw light on weak sentiments prevailing across its targeted geographies and maintained cautious outlook for FY12. The uncertain outlook is a result of thinning order inflow and near term pressure on margins.

EMPS segment to be impacted by sluggish order inflow and margin pressure

Voltas' prime segment- EMPS is sitting on an order book of ₹ 45bln with a visibility of another 1.5 years. Voltas has been asked to expedite work on two major projects in Qatar as they are slated to be complete by middle of the next year. As a result, Voltas may have additional cost escalation in these projects thereby impacting the margins of the company. Moreover, Voltas is bidding for new projects (overseas) at a margin of 5-5.5% as compared to 7-7.5% earlier. However, the company hopes to have a sustainable margin of 7% in the EMPS segment for the next 2-3 years going forward.

Domestic business – mixed outlook

In the domestic business major orders include Chennai and Kolkata airport, Chennai Metro rail and F1 order in Noida and few hospital orders. Recently won Chennai metro rail is worth ₹ 1.96bln and expected to kick start in FY13. The company is optimistic of order growth in domestic markets; although delays in finalization of orders and increasing receivables are the prevailing concerns. On the other hand, the company is looking to grow its water treatment business through technological acquisition and regional expansion. Rohini Electricals is also expected to break even in FY12 as the management hopes to do away with the loss making orders.

UCP segment- threat from new entrants, margin under pressure

In Q1FY12 the entire AC industry de grew by 15% vs 4% de growth in Voltas' sales due to early monsoon; indicating Voltas still held on to its market share. However, the management does not rule out threat to its realization given the entry of several new players such as Daikin and Panasonic. The company may also have to resort to discounts in order to clean up its old inventory. Although, we expect the company to have a decent volume growth as the AC market still remains under penetrated.

Outlook and Valuation

Voltas has de rated owing to its unsatisfactory performance over last couple of quarters coupled with margin and growth concerns across all its segments. We foresee Voltas to overcome the execution issues as the two Qatar projects are delivered and pressure may ease on margins when Rohini Electricals breaks even by year end. Voltas trades at 11.7xFY12P and 10xFY13P EPS at a significant discount to its historical average of 20. We, therefore, maintain Accumulate with a PT of ₹ 125.9.

Summary Financials

₹ in Mln	FY10	FY11	FY12P	FY13P
Net Sales	47748	51914	54723	61882
OPBDIT	4769	4554	4348	5147
Net Profit	3560	3171	3390	3964
EPS	10.8	9.6	10.3	12.0
Networth	10851	13617	16577	19660
Debt	352	1381	1483	1533
Fixed Assets	2262	2458	2585	2564
Net Current Assets	5774	9077	11750	14617

Electro-mechanical Projects & Services (EMPS)– order inflow slowing down, margin under pressure

Voltas' EMPS segments' order book currently stands at ₹ 45bln of which ₹ 26bln is in the international market while the domestic order book is at ₹ 19bln. The total execution period of the order book is 14-15 months.

In the International market 95% of the order book is from Qatar and Abu Dhabi with Qatar forming major part and the rest is from Singapore. In Qatar, the company is executing two large sized MEP contracts- Barwa housing project and Sidra Medical Research Center. On the execution front, Voltas has been facing issues with respect to labor deployment and design changes in the two projects; which led to cost escalation. However, the company is confident of getting compensated for the variation when the project is fully executed and bills are settled with the client.

- **Opportunities aplenty in Middle East but order awards have slowed down**
  Although investments in Qatar, Abu Dhabi and Bahrain are on the cards, order finalization is taking time due to weak global sentiments. Order inflow has slowed down as the pie of projects awards has shrunk leading to margin pressure. For recent orders, the company has bid at a margin of just 5-5.5% as compared to 7% earlier and therefore expects margin pressure to remain for next couple of years unless the inflows pick up and competition subsides. The company has observed that off late, standards rather than specialized and challenging jobs are being awarded. These standard jobs can be done by small contactors as well. Thus, it has become challenging for large players such as Arabtec, Voltas, DSI and ETA of Ascon group to bag orders without sacrificing their margins. Although no new player has entered the MEP space in the targeted geographies of Voltas.

- **Domestic business too growing at a slow pace**
  In the domestic business major orders include Chennai and Kolkata airport, Chennai Metro rail and F1 order Noida and few hospital orders. Recently won Chennai metro rail is worth ₹ 1.96bln and expected to kick start in FY13. The company is optimistic of order growth in domestic markets; although delays in finalization of orders and increasing receivables are the prevailing concerns in domestic markets.

  The company is also seeing opportunity in its water treatment business. The segment has an order book of ₹ 2bln. Voltas is looking at a technological partner in order to climb up the value chain and offer membrane technology. Voltas also plans to expand its water treatment business across India (currently it has major hold in East particularly Kolkata) and penetrate international market subsequently.

- **Rohini Electricals shall break even in FY12**
  Rohini has ₹ 2.25bln order book of which, ₹ 1bln orders have healthy margins, while the rest of the legacy orders carry nil to negative margins. Voltas has downsized staff in Rohini and has completely taken over the operations under its purview. The management expects Rohini to break even this year as compared to ₹ 350mln loss incurred in FY11.

Engineering Products and Services- Sale of MHE business, expects moderate growth in commission business

Voltas has transferred its Materials Handling business to a joint venture company (JVC) – Voltas Materials Handling Private Limited. Majority of the equity share capital of the JVC is held by Linde Material Handling Asia Pacific Pte Limited, Singapore, an affiliate of KION Group with 26% stake withheld by Voltas. Voltas has entered into a supply agreement with the JVC for forklifts and warehousing equipment at cost and has also granted license to the JVC for use of 'Voltas' brand for forklifts and warehousing equipments. On an average MHE division's contribution to the EPS segment was over 25% in the past couple of years. From FY12 onwards, there will be no impact of revenues from MHE on Voltas' sales.

Textile business in FY11 performed above expectations with a growth of over 50% in order booking for spinning machinery, despite the suspension of TUF scheme from July 2010. The mining and construction sectors also showed sustained growth in demand for various categories of equipments, driven by the many mining and infrastructure projects. Although the company expects the stupendous growth to pause a bit, pending orders booked for textile spinning machinery is large and the company will reap the benefits by execution of these orders over the coming years. The company also expects orders for mining equipment for coal and iron ore projects, as well as many service contracts for maintenance and other services.

Unitary Cooling Products (UCP) - expect market growth to decline in FY12, increased competition to impact margins

Voltas has cut down its yearly guidance of 1.2mln units of ACs sales to 1mln units given the subdued performance in Q1FY12 caused by early monsoon and aggressive pricing and launch of entry level ACs by players such as Panasonic and Daikin. However, 1mln units indicate over 30% volume growth over last year. Although realization might drop going forward as the company is sitting on sufficient inventory and may have to resort to off-season discounts in next couple of quarters.

Exhibit 1: Segment wise performance

Particulars (₹ in mln)	FY08	FY09	FY10	FY11	Q1FY12
A. Electro-mechanical Projects & Services					
Revenue	17449	27668	31134	30411	6,769
y-o-y growth	*21%*	*59%*	*13%*	*-2%*	*-2%*
PBIT	1170	2134	3091	2393	310
PBIT Margin (%)	6.7	7.7	9.9	7.9	4.6
B. Engineering Products & Services					
Revenue	5535	5422	4680	5638	973
y-o-y growth	*33%*	*-2%*	*-14%*	*20%*	*-19%*
PBIT	1136	627	768	1031	170
PBIT Margin (%)	20.5	11.6	16.4	18.3	17.5
C. Unitary Cooling Products for Comfort & Commercial Use					
Revenue	8259	9222.80	11387	15608	5625
y-o-y growth	*39%*	*12%*	*23%*	*37%*	*-4%*
PBIT	553	550	1203	1599	636
PBIT Margin (%)	6.7	6	10.6	10.2	11.3
D. Others					
Revenue	895	1039	391	126	98
PBIT	102	90.2	71.8	15.9	18.9
PBIT Margin (%)	11.4	8.7	18.4	12.6	19.3
Revenue Contribution					
A. Electro-mechanical Projects & Services	54%	64%	65%	59%	50%
B. Engineering Products & Services	17%	13%	10%	11%	7%
C. Unitary Cooling Products for Comfort & Commercial Use	26%	21%	24%	30%	42%
D. Others	3%	2%	0.8%	0.2%	0.7%

Source: MSFL Research

Outlook and Valuation

Voltas has de rated owing to its unsatisfactory performance over last couple of quarters and margin and growth concerns across all its segments. We foresee Voltas to overcome the execution issues as the two Qatar projects are delivered and pressure may ease on margins when Rohini breaks even by year end. Voltas trades at 11.7xFY12P and 10xFY13P EPS at a significant discount to its historical average of 20. We, therefore, maintain Accumulate with a PT of ₹ 125.9.

Financial Summary

Profit & Loss

Particulars (₹ in mln)	2009	2010	2011	2012P	2013P
Total Income	**43617**	**47748**	**51914**	**54723**	**61882**
Total Expenditure	40428	42979	47360	50375	56734
EBITDA	**3189**	**4769**	**4554**	**4348**	**5147**
EBITDA Margin (%)	7.3	10.0	8.8	7.9	8.3
Depreciation	210	214	210	223	249
EBIT	2980	4555	4344	4125	4899
Interest	(24)	98	165	264	268
Operating Profit	3004	4456	4178	3861	4630
Other Income	452	612	664	698	733
Extraordinary Item	261	250	402	815	0
PBT	**3717**	**5318**	**5245**	**5782**	**5814**
Tax	1172	1472	1729	1908	1919
PAT	2545	3846	3516	3874	3896
Adj. PAT	2284	3595	3114	3328	3896
Minority interest	(31)	(36)	57	62	69
Adj. Net profit	**2253**	**3560**	**3171**	**3390**	**3964**
PAT Margin (%)	5.2	7.5	6.1	6.2	6.4
Adj EPS	6.8	10.8	9.6	10.3	12.0
Sales Growth (%)	35.6	9.5	8.7	5.4	13.1
EBITDA Growth (%)	20.1	49.5	-4.5	-4.5	18.4
PAT Growth (%)	27.9	58.0	-10.9	6.9	16.9

Balance Sheet

Particulars (₹ in mln)	2009	2010	2011	2012P	2013P
Sources of Funds					
Share Capital	331	331	331	331	331
Reserves & Surplus	7567	10521	13286	16247	19329
Networth	**7897**	**10851**	**13617**	**16577**	**19660**
Secured Loans	1688	306	1280	1381	1431
Unsecured Loans	127	45	101	101	101
Total Loans	**1814**	**352**	**1381**	**1483**	**1533**
TOTAL	**9871**	**11343**	**15234**	**18295**	**21428**
Application of Funds					
Net Fixed Assets	**2280**	**2262**	**2458**	**2585**	**2564**
Investment	1562	2339	2613	2875	3162
Current Assets	27489	28249	35310	41440	49377
Current Liabilities	22360	22475	26232	29690	34761
Net Current Assets	**5129**	**5774**	**9077**	**11750**	**14617**
Deferred Tax Asset (Net)	224	203	170	170	170
TOTAL	**9871**	**11343**	**15234**	**18295**	**21428**

Cash Flow

Particulars (₹ in mln)	2009	2010	2011	2012P	2013P
Internal accruals	2670	3921	1847	4097	4144
(Inc)/Dec in Net Current	(1760)	(348)	(3320)	(861)	2767
Other adjustments	63	(509)	1866	-	-
Cash flow from Operations	**973**	**3065**	**392**	**3236**	**6911**
Inc/(Dec) in Debt	577	(1463)	1030	101	50
Inc/(Dec) in Equity	0	(0)	(0)	(0)	0
Dividend & Tax	(520)	(615)	(768)	(976)	(881)
Other adjustments	(111)	(99)	(166)	-	-
Cash flow from Financing	**(53)**	**(2177)**	**96**	**(874)**	**(831)**
Fixed Asset formation	(367)	33	(3)	(350)	(228)
Inc/(Dec) in Investment	1076	(775)	(21997)	(261)	(287)
Minority interest	-	(36)	-	62	68
Other adjustments	(60)	13	21712	-	-
Cash flow from Investment	**649**	**(764)**	**(288)**	**(549)**	**(447)**
Net Change in Cash	**1569**	**124**	**200**	**1812**	**5633**

Ratio

Valuation Ratio	2009	2010	2011	2012P	2013P
P/E	17.5	11.1	12.5	11.7	10.0
P/BV	5.0	3.6	2.9	2.4	2.0
EV/EBIDTA	11.5	7.4	7.9	7.9	5.6
EV/Sales	0.8	0.7	0.7	0.6	0.5
Dividend Yield (%)	1.3%	1.7%	1.7%	2.1%	1.9%
EPS	6.8	10.8	9.6	10.3	12.0
DPS	1.6	2.0	2.0	2.5	2.3
Book Value	24	33	41	50	59
ROE (%)	33.0%	38.0%	25.9%	22.5%	21.9%
ROCE (%)	24.9%	31.1%	21.9%	16.5%	16.5%
Solvency Ratio (x)					
Debt/Equity	0.2	0.0	0.1	0.1	0.1
Debt/EBIDTA	0.6	0.1	0.3	0.3	0.3
Turnover Ratio (x)					
Fixed Asset Turnover	5.3	4.5	3.9	3.3	3.1
Assets Turnover	6.4	5.1	4.2	3.6	3.4
Current Ratio	1.2	1.3	1.3	1.4	1.4
Inventory (days)	74	68	52	58	57
Debtors (days)	64	75	77	87	87
Creditors (days)	90	104	102	110	107

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Key ratings:

Rating	Expected Return
Buy	> 15%
Accumulate	5 to 15%
Hold	-5 to 5%
Sell	< -5%
Not Rated	-

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