

## Company Flash

14 May 2007 | 6 pages

# Voltas (VOLT.BO)

## Sell: Other Income + Lower Taxes Boost Recurring PAT Growth

- Revenues up 40% YoY...** — Voltas reported Q407 revenues of Rs7.2bn, up 40%YoY and 4% ahead of our expectations. Electromechanical and engineering divisions grew by 50%YoY and 52%YoY, respectively. Unitary products division grew 11%YoY in Q407.
- ...but margins decline 105bps** — Voltas Q407 reported EBITDA margins of 4.8%, down 105bps YoY due to higher material costs. While Electromechanical and unitary products EBIT margins improved by 85bps and 465bps, respectively, engineering services margins declined by 344bps in Q407.
- Other income, low taxes boost recurring PAT** — Voltas reported Q407 recurring PAT at Rs544mn, up 133%YoY and 169% ahead of expectations. This was primarily driven by other income of Rs243mn (up 170% YoY) and a low tax rate of 9% (vs. 36% in Q406 and 33% in 9mFY07).
- Extraordinary income of Rs655mn bolsters reported PAT** — Voltas Q407 reported PAT was Rs1.2bn, up 405%YoY buoyed by extraordinary income of Rs655mn. Voltas booked profit of Rs780mn from sale of its subsidiary Simtools Ltd to Lodha developers.
- Order backlog up 19%YoY** – Voltas FY07 end order backlog was Rs24bn, up 19%YoY. Electromechanical division order book at Rs22bn was up 18%YoY.
- Maintain Sell, Medium Risk** — We await further details from the management in its conference call to be held on 15 May. Maintain Sell (3M).

<b>Sell/Medium Risk</b>	<b>3M</b>
Price (14 May 07)	Rs94.70
Target price	Rs73.00
Expected share price return	-22.9%
Expected dividend yield	0.7%
<b>Expected total return</b>	<b>-22.2%</b>
Market Cap	Rs31,335M US\$769M

### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2005A	454	1.37	55.7	69.1	16.2	23.7	0.5
2006A	967	2.92	113.1	32.4	13.0	44.5	0.6
2007E	842	2.55	-12.9	37.2	10.4	31.0	0.7
2008E	1,209	3.65	43.6	25.9	8.0	34.9	0.8
2009E	1,657	5.01	37.1	18.9	6.0	36.2	1.0

Source: Powered by dataCentral

See Appendix A-1 for Analyst Certification and important disclosures.

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Figure 1. Voltas Q407 results (Rsmn)

	Q406	Q407	% Change	Q407E Comments
Net Sales	5,139	7,214	40%	6,908 Marginally ahead of expectations
(Increase)/Decrease in Stock in Trade	371	618	67%	
Consumption of raw materials	(4,210)	(6,153)	46%	(5,155)
as a % of sales	75%	77%	3%	75% Higher than expected
Staff costs	(506)	(628)	24%	(740)
as a % of sales	10%	9%		11% Lower than expected
Other expenditure	(494)	(705)	43%	(711)
as a % of sales	10%	10%	2%	10%
Total Expenditure	(4,838)	(6,867)	42%	(6,606)
<b>EBITDA</b>	<b>301</b>	<b>347</b>	<b>15%</b>	<b>303</b>
<b>EBITDA margin%</b>	<b>5.9%</b>	<b>4.8%</b>	<b>(105)</b>	<b>4.4% Marginally ahead of expectations</b>
Change bp				
Depreciation	(36)	(30)	-17%	(38) Lower than expected
<b>EBIT</b>	<b>264</b>	<b>317</b>	<b>20%</b>	<b>265</b>
<b>EBIT margin%</b>	<b>5%</b>	<b>4%</b>	<b>-15%</b>	<b>4%</b>
Interest	13	37	186%	85 Lower than expected
Other Income	90	243	170%	(49) Higher than expected
<b>PBT</b>	<b>367</b>	<b>596</b>	<b>62%</b>	<b>301</b>
Tax	(134)	(52)	-62%	(99) Tax rate lower than expected
Effective tax rate %	36%	9%	-76%	33%
<b>Recurring PAT</b>	<b>233</b>	<b>544</b>	<b>133%</b>	<b>203</b> Higher than expected due to high other income and low taxes
<b>Recurring PAT margin%</b>	<b>5%</b>	<b>8%</b>	<b>66%</b>	<b>3%</b>
Growth %				
Exceptional	4	655		23 Sale of Investment in Subsidiary
<b>Reported PAT</b>	<b>237</b>	<b>1,199</b>	<b>405%</b>	<b>226</b>

Source: Citigroup Investment Research

## Voltas

### Company description

Voltas, a Tata group company, is a leading player in India's Heating, Ventilation and Air Conditioning (HVAC) market, having a ~28% market share in electro-mechanical projects. The company offers engineering solutions for a wide spectrum of industries in areas such as HVAC, refrigeration, electro-mechanical projects, textile machinery, machine tools, mining and construction equipment, materials-handling vehicles, water management, building management systems, indoor air quality and chemicals.

## Investment thesis

We rate Voltas Sell/Medium Risk with a target price of Rs73. While Voltas is well positioned to benefit from a construction boom in airports, malls, multiplexes and offices in India, we believe that the market is building in too many expectations (despite an EPS CAGR of 40% over FY07E-09E) and that, at current valuations, the downside risk to the stock is high. Slower-than-expected revenue growth for FY07, pressure on EBITDA margins and ongoing losses in the Unitary Products Division could subdue investor sentiment.

## Valuation

Our target price for Voltas of Rs73 is set at 20x FY08E FD EPS and is supported by our forecasts for its earnings and RoE. At 20x FY08E, Voltas would trade at a ~19% premium to International HVAC companies, which we believe is justified given an earnings CAGR of 40% over FY07E-09E, compared with 10% for the international companies, ROEs that are double those of many International companies. At 20x FY08E, Voltas would trade at a discount to power equipment stocks like BHEL but at a slight premium to our target multiple of 19x for a second-tier construction company such as Nagarjuna. While we note that the revenue visibility for Voltas (~2 years) is much less than for construction companies (~3-4 years), its ROEs and free cash flow are much higher. It is also pertinent that Voltas' ROEs are on an unlevered balance sheet (debt/equity ratio: ~0.3).

## Risks

We rate Voltas as Medium Risk. The rating differs from the High Risk rating assigned by our quantitative risk-rating system, which tracks 260-day historical share price volatility. We believe that our risk rating reflects the earnings visibility of over a year for Voltas and its dominant market position in the HVAC market. Key downside risks include: Continuing losses at the Unitary Products Division, international projects risks, termination of principal-agent relationships, increasing competition in domestic and international markets, manpower shortages and material prices. Key upside risks: Stronger-than-expected order inflows, a better-than-expected turnaround at the unitary products division, and major changes announced by the company post its strategic review.

## Appendix A-1

### Analyst Certification

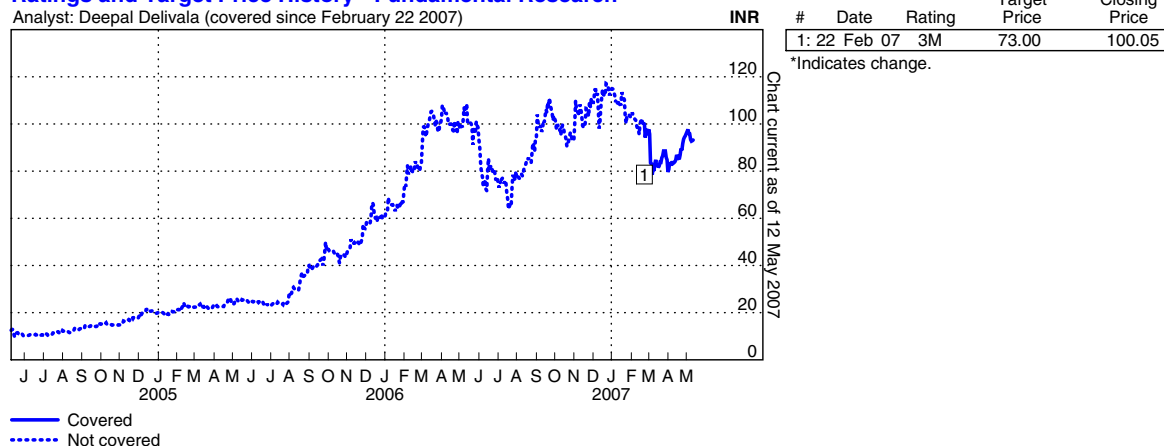
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Analyst: Deepal Delivala (covered since February 22 2007)



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