

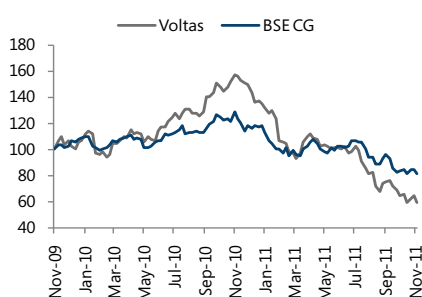
Result Update - Q2FY12

Hold

| | |
|--------------------|------------|
| Reco | Downgraded |
| CMP | ₹ 95.5 |
| Target Price | ₹ 90.5 |
| Downside Potential | 5.2% |

Price Performance

| | |
|--------------------|---------|
| 52 wk Hi/Lo | 262/94 |
| All time Hi/Lo | 268/2 |
| 6 mnth Average Vol | 1066858 |
| Stock Beta | 0.91 |



Valuation

| | FY11 | FY12P | FY13P |
|----------|------|-------|-------|
| P/E (x) | 10.0 | 14.3 | 10.6 |
| P/BV (x) | 2.3 | 2.0 | 1.7 |
| RONW (%) | 25.9 | 15.1 | 17.6 |
| ROCE (%) | 21.9 | 9.5 | 11.7 |

Peer Valuation (FY13P)

| | Voltas | Blue Star |
|------|--------|-----------|
| P/E | 10.6 | 10.0 |
| P/BV | 1.7 | 4.5 |

Equity Data

| | |
|------------------------|-----|
| Market Cap. (₹ bln) | 32 |
| Face value (₹) | 1 |
| No of shares o/s (mln) | 331 |

| | Sep'10 | Sep'11 | %Δ |
|-----------|--------|--------|--------|
| Promoters | 30.53 | 30.53 | 0.00 |
| DFI's | 33.83 | 31.23 | -7.68 |
| FII's | 11.25 | 17.61 | 56.53 |
| Public | 24.39 | 20.63 | -15.42 |

Khadija Bohra

khadija.bohra@msflibg.in
(+ 91 22 30947130)

November 14, 2011

Voltas Ltd.

Still feeling the heat

Voltas' poor performance continued this quarter as well, as the sales grew moderately by 5% to ₹ 11bln in Q2FY12. The major disappointment was on the EBITDA front which declined 75% y-o-y to ₹ 273mln from ₹ 1.1bln. Consequently EBITDA margin dipped to 2.4%. The adjusted net profit declined by about 77% y-o-y to ₹ 169mln.

Dismal performance of Electro-mechanical Projects & Services (EMPS) on margin front

EMPS segment did well on execution front with sales growing by 8% y-o-y after a tepid growth since four to five quarters. This indicates speeding up of two slow moving Qatar projects- Sidra medical research centre and Barwa housing project. Hence, substantial cost overruns have led to a sharp decline in margin from 8.2% to just 0.65%.

EPS segment has decent quarter; while UCP segment disappoints

EPS segment's sales declined 5% y-o-y to ₹ 1.2bln. However, excluding sales of material handling business from last year, sales for the EPS segment on comparative basis has grown over 20% y-o-y. EBIT margins for EPS segment declined to 14.8% vs 20.9% in Q2FY11. UCP's sales also declined by 7.5% y-o-y to ₹ 2.11bln. Significant impact of unfavorable weather conditions and increased completion led to volume decline of 18% y-o-y. However, with aggressive advertising and strong brand name Voltas performed better than the industry where volumes decreased by 50% on an average. Voltas compensated lower AC sales with strong sales push across water coolers and other commercial refrigeration products. Voltas maintained its price levels despite highly competitive environment; which resulted in a sales decline of just 7%.

Order book declines 10% y-o-y to ₹ 44.6bln

The order backlog for EMPS segment declined 10% y-o-y to ₹ 44.6bln. International order book stands at ₹ 26.4bln (down 23% y-o-y); while the domestic order book is at ₹ 18.1bln (up 17.7% y-o-y). Order inflow for Q2FY12 was approximately ₹ 6bln. This is exclusive of a large retail project in Abu Dhabi worth ₹ 5bln; for which Voltas secured an LOI at the beginning of the third quarter.

Outlook and Valuation

Voltas is likely to underperform for next couple of quarters given the continuous cost over runs in EMPS and margin pressure across its segments as there is no sign of a sustained improvement. Although most of the concerns have been priced in and the stock has de rated significantly, we cannot rule out more such negative surprises on margin front till the company executes two Qatar projects and volumes improve in the UCP segment. We have revised our sales and earnings estimates downward to factor in the sharp margin erosion of H1FY12. Voltas currently trades at 14.3x FY12P and 10.6x FY13P. Therefore, we downgrade our rating from Accumulate to Hold with a TP of ₹ 90.5. Acceptance of cost overrun claims on Qatar Projects and Rohini Electrical's turnaround are the key reasons for our cautiously optimistic outlook on Voltas.

Summary Financials

| ₹ in Mln | FY10 | FY11 | FY12P | FY13P |
|--------------------|-------|-------|-------|-------|
| Total Income | 47748 | 51914 | 54230 | 58653 |
| OPBDIT | 4769 | 4554 | 2606 | 3628 |
| Adj. Net Profit | 3560 | 3171 | 2216 | 2992 |
| Adj EPS | 10.8 | 9.6 | 6.7 | 9.0 |
| Networth | 10851 | 13617 | 15797 | 18159 |
| Debt | 352 | 1381 | 2133 | 2133 |
| Fixed Assets | 2262 | 2458 | 2405 | 2285 |
| Net Current Assets | 5774 | 9077 | 11801 | 13995 |

Exhibit 1: Q2FY12 Highlights

| (in ₹ mln) | Q2FY12 | Q2FY11 | Y-o-Y | Q1FY12 | Q-o-Q |
|---|--------------|--------------|-------------|--------------|-------------|
| Total Income | 11019 | 10651 | 5% | 13484 | -18% |
| Raw material cost | 8499 | 7279 | 17% | 9688 | -12% |
| Staff cost | 1483 | 1268 | 17% | 1467 | 1% |
| Other expenditure | 961 | 1029 | -7% | 1240 | -23% |
| OPBDIT | 273 | 1075 | -75% | 1089 | -75% |
| OPBDIT margin (%) | 2.5 | 10.1 | | 8.1 | |
| Depreciation | 89 | 53 | 66% | 103 | -14% |
| Interest cost | 71 | 37 | 90% | 85 | -17% |
| Other Income | 224 | 193 | 16% | 188 | 19% |
| Extra ordinary items | 250 | 178 | 41% | 815 | -69% |
| PBT | 587 | 1356 | -57% | 1904 | -69% |
| Tax | 177 | 453 | -61% | 582 | -70% |
| PAT | 410 | 902 | -55% | 1323 | -69% |
| Adjusted Net Profit (excluding extra ordinary items) | 169 | 746 | -77% | 752 | -78% |
| EPS | 0.5 | 2.3 | | 2.3 | |

Source: Company

Key Result Highlights

- Voltas' sales for Q2FY12 grew by 5% to ₹ 11.0bln in Q2FY12 as against ₹ 10.7bln in Q2FY11. The growth was driven by Electro-mechanical Projects & Services (EMPS) segment which contributed around 70% to the total sales. EMPS' sales grew by 8% to ₹ 7.6bln. EMPS segment's growth is driven by improved execution on its two projects in Qatar- Barwa housing project and Sidra Medical Research Center.
- EPS segment degrew by 5% y-o-y to ₹ 1.2bln. However, in view of transfer of Materials Handling business, the segment's sales for the current quarter are not comparable with the corresponding quarter of last year. Adjusting the sales of MHE division for Q2FY11; EPS segment's sales have grown by over 20% y-o-y. Textile Machinery business has performed better than the corresponding period in the previous year.
- Unitary Cooling Product (UCP) segment's revenue also declined by 7.5% y-o-y to ₹ 2.11bln. The entire air conditioning industry is witnessing drop in volumes due to unfavorable weather conditions (mild summer); which is compounded by a general slowdown in the economy and inflation costs coupled with high interest rates.
- Voltas' AC sales by volume have declined but lesser than that of the industry. The company has managed to compensate the lower AC sales with strong sales push across water coolers and other commercial refrigeration products. Therefore, the company managed to contain volume shortfall to 18%. Voltas' strong brand name has helped the company to maintain its price levels despite highly competitive environment; which resulted in a revenue decline of just 7%.
- EBITDA for Q2FY12 dipped by 75% to ₹ 273mln as compared to ₹ 1.1bln in Q2FY12. Consequently margin declined by over 760bps to 2.4% vs 10.1% in Q2FY11. Off late, two above mentioned projects in Qatar have gathered momentum and have led to rushed clearance of design drawings and hence execution has become little complicated. Therefore, substantial cost overruns have led to such a sharp decline in margin. The margin drop was further aggravated by EBIT margin decline in UCP segment from 12.3% to 2.9% due to increase in fixed cost owing to lower volumes.

- Margin in EPS segment declined from 14.8% vs 20.9% last year. EPS segment's results have been under pressure in the Mining and Construction equipment business primarily due to tough business conditions. Recurring PAT for the company (excluding onetime profit of sales of properties) declined by 77% y-o-y to ₹ 169mln as compared to ₹ 746mln last year.

Exhibit 2: Segmental Analysis

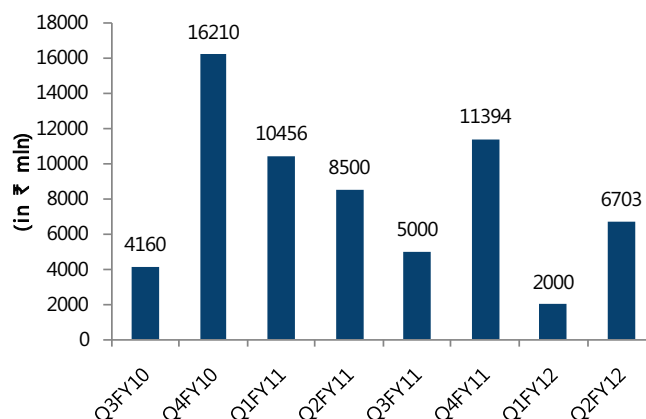
| (in ₹ mln) | Q2FY12 | Q2FY11 | Y-o-Y | Q1FY12 | Q-o-Q |
|---|--------|--------|--------|--------|--------|
| Electro-mechanical Projects & Services | | | | | |
| Revenue | 7623 | 7066 | 7.9% | 6769 | 12.6% |
| PBIT | 50 | 580 | -91.4% | 310 | -83.9% |
| PBIT Margin (%) | 0.65 | 8.2 | | 4.6 | |
| Engineering Products & Services | | | | | |
| Revenue | 1202 | 1267 | -5.1% | 973 | 23.6% |
| PBIT | 178 | 264 | -32.7% | 170 | 4.5% |
| PBIT Margin (%) | 14.8 | 20.9 | | 17.5 | |
| Unitary Cooling Products | | | | | |
| Revenue | 2110 | 2281 | -7.5% | 5625 | -62.5% |
| PBIT | 61 | 280 | -78.1% | 636 | -90.4% |
| PBIT Margin (%) | 2.9 | 12.3 | | 11.3 | |
| Revenue Mix | | | | | |
| Electro-mechanical Projects & Services | 69% | 66% | | 50% | |
| Engineering Products & Services | 11% | 12% | | 7% | |
| Unitary Cooling Products | 19% | 21% | | 42% | |
| Others | 1% | 0% | | 1% | |

Source: Company

Unexecuted order book declines 10.3% y-o-y to ₹ 44.6bln

The order backlog for EMPS segment stands at ₹ 44.6bln as against ₹ 49.8bln in Q2FY11. The international order book stands at ₹ 26.4bln (down 23% y-o-y); while the domestic order book is at ₹ 18.1bln (up 17.7% y-o-y). Order inflow for Q2FY12 was approximately ₹ 6.7bln. The company also secured an LOI for a large retail project in Abu Dhabi worth ₹ 5bln at the beginning of the third quarter.

Exhibit 3: Quarterly Order Inflow



Source: Company, MSFL Research

Change in estimates

Poor performance of Voltas on margin front in H1FY12 warrants revision in estimates. In the revised estimates we have built in the weakest margins ever for Voltas and feel that things shall improve going forward.

Exhibit 4: Revised Estimates

| (in ₹ mln) | FY12 | | | FY13 | | | Rationale |
|--------------|-------|-------|-------|-------|-------|-------|---|
| | New | Old | % chg | New | Old | % chg | |
| Total Income | 54230 | 54723 | -1% | 58653 | 61882 | -5% | Change in order inflow assumptions will result in lower sales |
| EBITDA | 2606 | 4348 | -40% | 3628 | 5147 | -30% | Competition and weak economic outlook will keep margin under pressure |
| Net Profit | 2216 | 3390 | -35% | 2992 | 3964 | -25% | |

Source: MSFL Research

Outlook

- In the EMPS segment, Voltas has received some domestic orders in the health sector apart from a breakthrough order from GNFC for industrial refrigeration systems. In the International markets, though, the major challenge relates to intense competition which has resulted in the compression of bidding margins. Therefore, company is likely to bid at 5% margins for the upcoming projects and improve upon internal efficiency to increase its margins. The company sees opportunities to be emerging in UAE (realty sector), Abu Dhabi (airports), and KSA (built environment and urban infrastructure such as King Abdullah Sports City).
- In the EPS segment, the company currently has a healthy order book although the pace of replacement demand has slowed down due to significant profitability concerns in the user industry. There has been few consolidations globally- Bucyrus and Letourneau (Voltas' erstwhile principals) being taken over by Caterpillar and Joy respectively. Voltas already competes with the aforementioned acquirers' well established Indian distributors but the competition may intensify further following the consolidation.
- Competition is intensifying in the UCP segment, owing to the opportunity that it offers presently. In Q2FY11; players such as Daikin, Panasonic and Hitachi have cut their prices by 40%, 15% and 10% respectively. Moreover industry still has high inventory levels which can lead to weak margins as other small players may resort to higher discounting to dispose off the stock.

Cost overhang may subside in FY13 post completion of two Qatar projects

Voltas' Barua Project which is originally valued at ₹ 5bln is 90% complete and is expected to complete by March 2012. Sidar Medical centre project (worth ₹ 9bln) is 60% complete and is expected to be fully complete by June 2012. Timely completion of these projects may prevent any additional cost overrun and improve margins post H2FY12. Moreover, acceptance of claims of cost over runs by the customers shall provide some solace to the depleting performance of EMPS.

Valuation

Voltas has corrected sharply over last few quarters due to weak performance across segments. Currently it trades at 14.3x FY12P and 10.6x FY13P; at a steep discount to its historical average of 20. Although most of the concerns seem to be factored in; expectations of more negative surprises on margin front and volumes in the UCP shall hamper the stock performance over a short to medium term. We, therefore downgrade the stock from Accumulate to Hold with a PT of ₹ 91 (10x FY13P).

Financial Summary

Profit & Loss

| Particulars (₹ in mln) | 2009 | 2010 | 2011 | 2012P | 2013P |
|------------------------|--------------|--------------|--------------|--------------|--------------|
| Total Income | 43617 | 47748 | 51914 | 54230 | 58653 |
| Total Expenditure | 40428 | 42979 | 47360 | 51624 | 55025 |
| EBITDA | 3189 | 4769 | 4554 | 2606 | 3628 |
| EBITDA Margin (%) | 7.3 | 10.0 | 8.8 | 4.8 | 6.2 |
| Depreciation | 210 | 214 | 210 | 238 | 245 |
| EBIT | 2980 | 4555 | 4344 | 2368 | 3383 |
| Interest | (24) | 98 | 165 | 326 | 388 |
| Operating Profit | 3004 | 4456 | 4178 | 2042 | 2995 |
| Other Income | 452 | 612 | 664 | 764 | 917 |
| Extraordinary Item | 261 | 250 | 402 | 815 | 0 |
| PBT | 3717 | 5318 | 5245 | 4029 | 4363 |
| Tax | 1172 | 1472 | 1729 | 1330 | 1440 |
| PAT | 2545 | 3846 | 3516 | 2699 | 2923 |
| Adj. PAT | 2284 | 3595 | 3114 | 2154 | 2923 |
| Minority interest | (31) | (36) | 57 | 62 | 69 |
| Adj. Net profit | 2253 | 3560 | 3171 | 2216 | 2992 |
| PAT Margin (%) | 5.2 | 7.5 | 6.1 | 4.1 | 5.1 |
| Adj EPS | 6.8 | 10.8 | 9.6 | 6.7 | 9.0 |
| Sales Growth (%) | 35.6 | 9.5 | 8.7 | 4.5 | 8.2 |
| EBITDA Growth (%) | 20.1 | 49.5 | -4.5 | -42.8 | 39.2 |
| Net profit Growth (%) | 27.9 | 58.0 | -10.9 | -30.1 | 35.0 |

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 | 15467 | 17828 |
| Networth | 7897 | 10851 | 13617 | 15797 | 18159 |
| Secured Loans | 1688 | 306 | 1280 | 2031 | 2031 |
| Unsecured Loans | 127 | 45 | 101 | 101 | 101 |
| Total Loans | 1814 | 352 | 1381 | 2133 | 2133 |
| TOTAL | 9871 | 11343 | 15234 | 18165 | 20527 |

Application of Funds

| | | | | | |
|---------------------------|-------------|--------------|--------------|--------------|--------------|
| Net Fixed Assets | 2280 | 2262 | 2458 | 2405 | 2285 |
| Investment | 1562 | 2339 | 2613 | 2875 | 3162 |
| Current Assets | 27489 | 28249 | 35310 | 39382 | 44668 |
| Current Liabilities | 22360 | 22475 | 26232 | 27582 | 30674 |
| Net Current Assets | 5129 | 5774 | 9077 | 11801 | 13995 |
| Deferred Tax Asset (Net) | 224 | 203 | 170 | 170 | 170 |
| TOTAL | 9871 | 11343 | 15234 | 18165 | 20527 |

Cash Flow

| Particulars (₹ in mln) | 2009 | 2010 | 2011 | 2012P | 2013P |
|----------------------------------|-------------|---------------|--------------|--------------|--------------|
| Internal accruals | 2670 | 3921 | 1847 | 2938 | 3168 |
| (Inc)/Dec in Net Current Assets | (1760) | (348) | (3320) | (3065) | 2160 |
| Other adjustments | 63 | (509) | 1866 | - | - |
| Cash flow from Operations | 973 | 3065 | 392 | (127) | 5328 |
| Inc/(Dec) in Debt | 577 | (1463) | 1030 | 751 | - |
| Inc/(Dec) in Equity | - | - | - | - | - |
| Dividend & Tax | (520) | (615) | (768) | (582) | (630) |
| Other adjustments | (111) | (99) | (166) | - | - |
| Cash flow from Financing | (53) | (2177) | 96 | 170 | (630) |
| Fixed Asset formation | (367) | 33 | (3) | (185) | (125) |
| 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) | (384) | (344) |
| Net Change in Cash | 1569 | 124 | 200 | (341) | 4354 |

Ratio

| Valuation Ratio | 2009 | 2010 | 2011 | 2012P | 2013P |
|--------------------|------|------|------|-------|-------|
| P/E | 14.0 | 8.9 | 10.0 | 14.3 | 10.6 |
| P/BV | 4.0 | 2.9 | 2.3 | 2.0 | 1.7 |
| EV/EBIDTA | 9.0 | 5.7 | 6.1 | 11.2 | 6.8 |
| EV/Sales | 0.7 | 0.6 | 0.5 | 0.5 | 0.4 |
| Dividend Yield (%) | 1.7 | 2.1 | 2.1 | 1.6 | 1.7 |
| EPS | 6.8 | 10.8 | 9.6 | 6.7 | 9.0 |
| DPS | 1.6 | 2.0 | 2.0 | 1.5 | 1.6 |
| Book Value | 24 | 33 | 41 | 48 | 55 |
| ROE | 33.0 | 38.0 | 25.9 | 15.1 | 17.6 |
| ROCE | 24.9 | 31.1 | 21.9 | 9.5 | 11.7 |

Solvency Ratio (x)

| | | | | | |
|-------------|-----|-----|-----|-----|-----|
| Debt/Equity | 0.2 | 0.0 | 0.1 | 0.1 | 0.1 |
| Debt/EBIDTA | 0.6 | 0.1 | 0.3 | 0.8 | 0.6 |

Turnover Ratio (x)

| | | | | | |
|----------------------|-----|-----|-----|-----|-----|
| Asset Turnover | 5.3 | 4.5 | 3.9 | 3.2 | 3.0 |
| Fixed Asset Turnover | 6.4 | 5.1 | 4.2 | 3.7 | 3.5 |
| Current Ratio | 1.2 | 1.3 | 1.3 | 1.4 | 1.5 |
| Inventory (days) | 74 | 68 | 52 | 60 | 60 |
| Debtors (days) | 64 | 75 | 77 | 87 | 89 |
| Creditors (days) | 90 | 104 | 102 | 104 | 102 |

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Key ratings:

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

Marwadi Shares & Finance Limited

Institutional Business Group, MSFL

@p-sec, 306, Gresham Assurance House
 132, Mint Road, Fort, Mumbai – 400 001
 Tel : + 91 22 30947100 / 102 Fax : +91 22 2269 0478

Registered Office

Marwadi Financial Plaza, Nava Mava Main Road,
 Off 150 FT. Ring Road, Rajkot,- 360 005
 Tel : + 91 281 2481313 / 3011000