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PINC RESEARCH

VOLTAS

SELL
CMP Rs120
TP Rs91

VISIT UPDATE

More stress to come...!!!

29 Sept. 2011

We recently met with the management of Voltas. The management expects its near term profitability to be impacted on account of cost overrun in some of the overseas projects, unfavourable weather conditions impacting the growth of the cooling products and lack of orders on account of poor sentiments. We reduce our target multiple from 13x to 10x and downgrade the stock to SELL with a reduced target price of Rs91 (10xFY13E) from Rs131 earlier.

MEP division facing severe headwinds

The size of the Middle East market is shrinking on account of weak sentiments. This has led to increased competition and pricing pressure. In order to address the concern of slowdown in order inflows, management has strategically decided to bid for new orders (overseas) @ 4-5% (earlier 7-8%) PBIT margins.

Voltas has been asked to put the Sidra Medical centre and Barwa City projects in Qatar on fast track and accomplish them as per the terms and conditions of the customer at any cost. We believe this would put severe pressure on the profitability of the division.

Domestically, there is lack of orders, competition is increasing and hence margins are expected to be under pressure. Rohini Electricals is expected to break even (at PBIT level) in FY12.

Unitary Cooling Division witnessing slowdown

Due to unfavourable weather conditions, there is a huge pile up of inventory in the industry. This has forced the players to offer freebies and discounts to liquidate the inventory. Resultantly increased competition would put pressure on margins. Management expects margins in the range of 8-8.5% in this division going forward.

VALUATIONS AND RECOMMENDATION

Factoring in the above concerns we believe next few quarters would be very stressful for Voltas. We have reduced our earning estimates by 15% for FY12 and 10% for FY13. Considering steep fall in profitability and return ratios, near term concerns of cost overrun on account of execution of Qatar projects, increased competition putting pressure on margins on new orders and weak sentiments, we reduce our target multiple from 13x to 10x and downgrade the stock to SELL with a reduced target price of Rs91 (10xFY13E) from Rs131 earlier.

KEY FINANCIALS (CONSOLIDATED) (Rs mn)

	FY09	FY10	FY11	FY12E	FY13E
Net Sales	43,617	47,748	51,914	49,312	54,398
YoY Gr. (%)	35.6	9.5	8.7	(5.0)	10.3
Op. Profits	3,189	4,769	4,554	3,250	3,948
OPM (%)	7.3	10.0	8.8	6.6	7.3
Adj. Net Profits	2,335	3,628	3,303	2,448	3,013
YoY Gr. (%)	25.4	55.4	(9.0)	(25.9)	23.1
KEY RATIOS					
Dil. EPS (Rs)	7.1	11.0	10.0	7.4	9.1
ROCE (%)	44.6	49.5	38.0	22.6	24.0
ROE (%)	34.2	38.7	27.0	16.6	17.8
PER (x)	17.0	10.9	12.0	16.2	13.2
EV/ Net Sales (x)	0.8	0.7	0.7	0.8	0.7
EV/ EBDITA (x)	9.7	6.6	6.9	9.2	7.5

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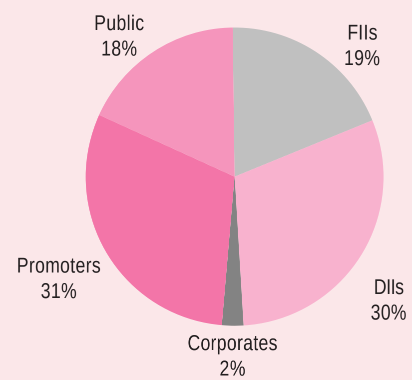
SHAREHOLDING PATTERN



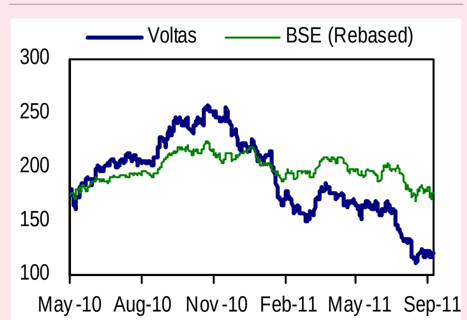
STOCK DATA

Market Cap	Rs39.7bn.
Book Value per share	Rs41.2
Eq Shares O/S (F.V. Rs1)	330.7mn.
Free Float	69.4%
Avg Traded Value (6 mnths)	Rs189mn
52 week High/Low	Rs263/109
Bloomberg Code	VOLT IN
Reuters Code	VOLT.BO

PERFORMANCE (%)

	1M	3M	12M
Absolute	5.3	(25.5)	(51.2)
Relative	15.2	(16.2)	(40.4)

RELATIVE PERFORMANCE



MEP division facing severe headwinds

In the Middle East, there is slowdown in order inflows on account of weak global sentiments. However, management doesn't expect a recession as there is no dearth of money since crude oil price is ruling above $100/barrel for a fairly long time. As per the management, till 2010 end all the countries in the Middle East were investing in their economy especially in iconic structures to make a statement to the outside world about the strength of their economy. However, since the beginning of 2011, on account of weak sentiments across the globe, they have adopted a wait and watch policy. These countries have started investing very selectively with more focus on necessity (where size of the opportunity is less) than discretionary. Usually, iconic structures (discretionary in nature) are challenging projects which enable the contractors to earn better margins.

Increased competition leading to pricing pressure

The pie has not been increasing (rather decreasing) leading to stiff competition. Some marginal players and new entrants have started under-cutting thus exerting pressure on the margins. Management shared that players who get disqualified in the technical bidding round are allowed to make a price bid and then qualified players (like Voltas) are asked to match their (disqualified players') bid, which is generally lower, in order to bag the contract.

In the last few months Voltas has not won any major overseas contracts as it was bidding @7% PBIT margin. In order to address the slowdown in order inflows, management has strategically decided to bid @4-5% margins. We believe this would enable the company to bag good amount of orders albeit at the cost of profitability.

Projects in Qatar creating a mess

Voltas has been asked to put the Sidra Medical centre and Barwa City project on fast track and accomplish it as per the terms and conditions of the customer and within stipulated time period irrespective of the amount of resources required. This has led to huge cost overrun for the company. However, it makes a business sense for Voltas to accomplish the Qatar orders as per the specification of the customer at whatever cost, as it would place the company in a better position to garner a larger share of business in the upcoming 2021 FIFA world cup to be held in Qatar.

Meanwhile, we believe this would put huge pressure on the profitability of division in the near term. Management agreed that they might loose money in these projects. Any claim for the cost overrun would be presented only after the full accomplishment of the project (expected to get accomplished in the middle of next year) and acceptance of the claim depends on the customer's discretion. We believe, till then, company would have to make provision for the same exerting pressure on margins.

Domestic business also facing slowdown, Rohini to break even

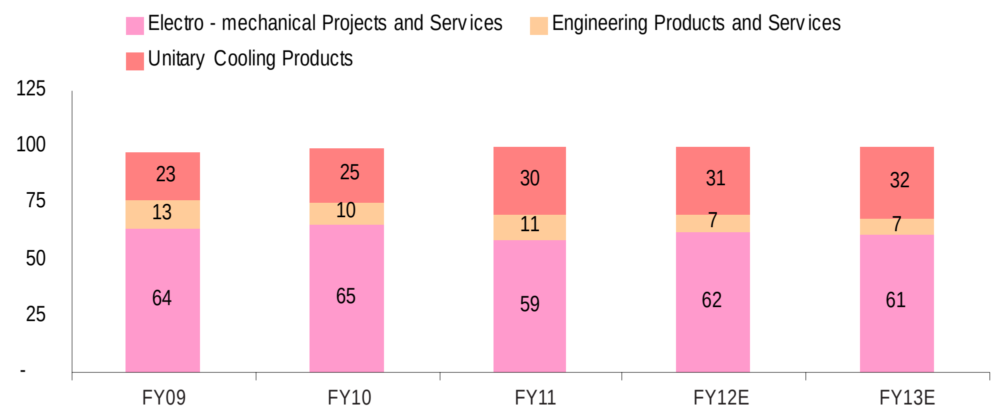
Domestic business is plagued with high interest rates, delay in finalisation of orders, increased working capital requirement and overall slowdown in industrial capex. This has led to lower order inflows and increased competition. On the positive side, Rohini Electricals is expected to achieve break even (PBIT level) in FY12 and new orders are coming at reasonable margins. Domestic order book stands at Rs19bn out of which Rohini accounts for Rs2.25bn. Management would buy out the remaining stake (~17%) in the company by the end of this fiscal at no further cost.

Voltas has recently ventured into water treatment business where margins are expected to be lower initially. Management sees good opportunities in this segment and expects margins to be in line with overall project level margins in the longer term. The current order book stands at Rs2bn. The company is looking out for inorganic growth in this space.

Unitary Cooling Products facing slowdown

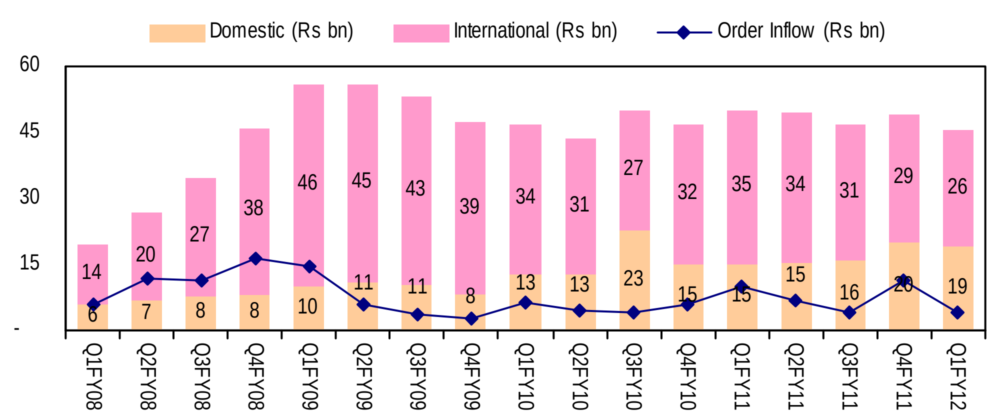
Due to unfavourable weather conditions, there is huge pile up of inventory in the industry. This has forced the players to offer freebies and discounts to liquidate the inventory. In order to maintain the market share, Voltas might also resort to such measures. This would result in increased competition and hence would put pressure on margins. Q4FY12 would be the key quarter to watch out as early summers might arrest the decline in sales volume. Management expects margins in the range of 8-8.5% in this division going forward. We project sales to decline by 5% in FY12.

Revenue Mix (%)



Source: Company, PINC Research

Consolidated Order Book (Rs bn)



Source: Company & PINC Research

VALUATION AND RECOMMENDATION

Factoring in the above concerns we believe next few quarters would be very stressful for Voltas in terms of top line and bottom line growth. For FY12, at PBIT level, we are factoring in negative margin in the Qatar projects and 8% margin in other overseas projects. In domestic business, we expect break-even in Rohini Electricals and 8% margin in other projects. With new orders coming at low margins we believe going forward margins are going to tend lower. Delay in payments, increase in inventory and lack of orders reducing the advances would result into marginal increase in working capital requirement.

Voltas would continue to focus on cash flows and is expected to remain debt free (net) in the near future. Considering the steep fall in profitability and return ratios, near term concerns of cost overrun on account of execution of Qatar projects, increased competition putting pressure on margins on new orders and weak sentiments, we reduce our target multiple from 13x to 10x and downgrade the stock to SELL with a reduced target price of Rs91 (10xFY13E) from Rs131 earlier.

Change In estimates

	Previous		Revised		Change (%)	
	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E
Revenue	54,598	57,570	49,312	54,398	(10)	(6)
EBIDTA	4,669	5,188	4,047	4,713	(13)	(9)
Adj. PAT	2,878	3,325	2,449	2,997	(15)	(10)

Source: PINC Research

Consolidated

Year Ended March (Figures in Rs mn)

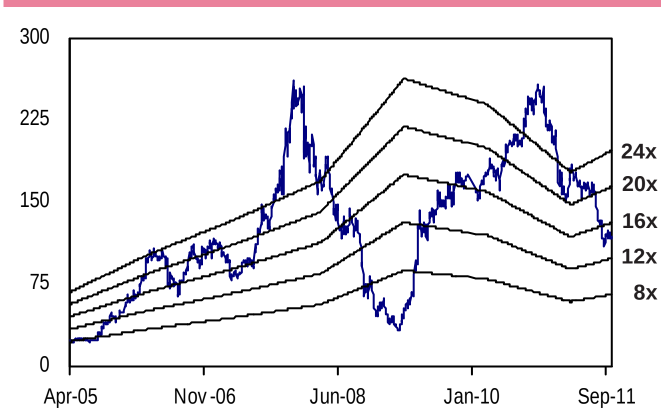
Income Statement	FY09	FY10	FY11	FY12E	FY13E
Net Sales	43,617	47,748	51,914	49,312	54,398
Growth (%)	*35.6*	*9.5*	*8.7*	*(5.0)*	*10.3*
Operating Profit	3,189	4,769	4,554	3,250	3,948
Other income	604	612	664	780	897
EBITDA	3,793	5,380	5,218	4,030	4,844
Growth (%)	*27.6*	*41.8*	*(3.0)*	*(22.8)*	*20.2*
Depreciation	210	214	210	297	327
EBIT	3,584	5,166	5,008	3,734	4,518
Interest paid	128	98	165	185	150
PBT (before E/o items)	3,456	5,068	4,843	3,549	4,368
Tax provision	1,172	1,472	1,729	1,353	1,354
E/o Income / (loss)	261	250	402	815	-
Net Profit	2,514	3,809	3,573	3,010	3,013
Adjusted net profit	2,335	3,628	3,303	2,448	3,013
Growth (%)	*25.4*	*55.4*	*(9.0)*	*(25.9)*	*23.1*
Basic EPS (Rs)	7.6	11.5	10.8	7.4	9.1
Adj Dil EPS (Rs)	7.1	11.0	10.0	7.4	9.1
Diluted EPS Growth (%)	*25.4*	*55.4*	*(9.0)*	*(25.9)*	*23.1*

Cash Flow Statement	FY09	FY10	FY11	FY12E	FY13E
Pre-tax profit	3,717	5,318	5,245	4,363	4,368
Depreciation	210	214	210	297	327
Total tax paid	(1,048)	(1,611)	(1,879)	(1,353)	(1,354)
Chg in working capital	(1,954)	(258)	(3,320)	(2,889)	(185)
Other items	65	(604)	137	(595)	(855)
Cash from oper. (a)	990	3,059	392	(176)	2,300
Capital expenditure	(902)	33	(3)	(500)	(500)
Chg in investments	1,076	(1,011)	(271)	(58)	(150)
Other items	475	213	(14)	780	897
Cash flow from inv. (b)	649	(764)	(288)	221	247
Free cash flow (a+b)	1,639	2,295	104	45	2,547
Equity raised/ (repaid)	-	-	-	-	-
Debt raised/ (repaid)	577	(1,561)	1,030	419	(300)
Interest Paid	(128)	(615)	(165)	(185)	(41)
Dividend (incl. tax)	(520)	-	(768)	(774)	(774)
Other items	-	-	-	-	-
Cash flow from fin. (c)	(71)	(2,177)	96	(540)	(1,115)
Net chg in cash (a+b+c)	1,569	118	200	(495)	1,432

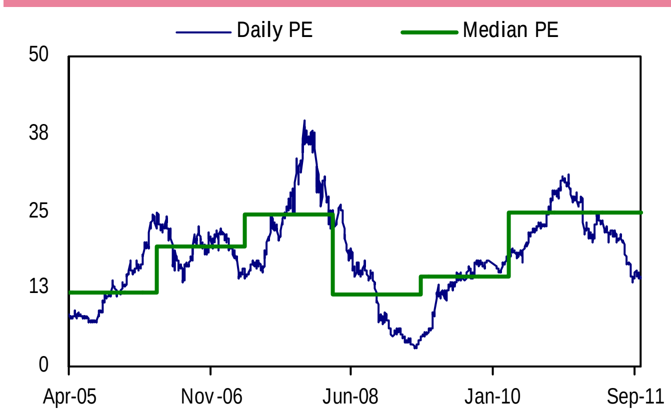
Balance Sheet	FY09	FY10	FY11	FY12E	FY13E
Equity Share Capital	331	331	331	331	331
Reserves & surplus	7,567	10,521	13,286	15,522	17,761
Shareholders' funds	7,897	10,852	13,617	15,853	18,092
Total Debt	1,814	352	1,381	1,800	1,500
Minority interest	159	139	218	219	220
Capital Employed	9,871	11,342	15,216	17,872	19,812
Net fixed Assets	2,955	3,026	3,373	3,577	3,750
Cash & Cash Eq.	5,755	6,719	7,236	6,607	7,342
Net other current assets	558	1,085	4,097	7,131	8,152
Investments	378	309	357	405	415
Net Deferred tax asset	224	202	152	152	152
Total Assets	9,871	11,342	15,216	17,872	19,812

Key Ratios	FY09	FY10	FY11	FY12E	FY13E
OPM (%)	7.3	10.0	8.8	6.6	7.3
Net margin (%)	5.4	7.6	6.4	5.0	5.5
Dividend yield (%)	1.3	1.7	1.7	1.7	1.7
Net debt/ Equity (x)	0.2	0.0	0.1	0.1	0.1
Net working capital (days)	44.6	43.3	33.9	56.4	57.8
Asset turnover (x)	4.4	4.2	3.4	2.8	2.7
ROCE (%)	44.6	49.5	38.0	22.6	24.0
RoE (%)	34.2	38.7	27.0	16.6	17.8
EV/Net sales (x)	0.8	0.7	0.7	0.8	0.7
EV/EBITDA (x)	9.7	6.6	6.9	9.2	7.5
PER (x)	17.0	10.9	12.0	16.2	13.2
Price/Book (x)	5.0	3.7	2.9	2.5	2.2

P/E Band



Median PE v/s Daily PE



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