Voltas Ltd

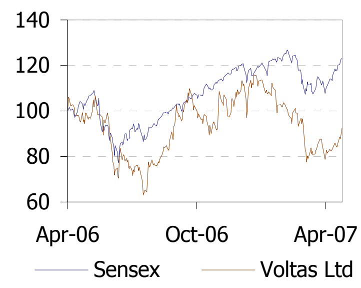
Analyst: **Bhavin Vithlani**
Email: bhavin@enam.com
Tel: 9122 6754 7634

Associate: **Shreya Doshi**
Email: shreya@enam.com
Tel: 9122 6754 7646

Associate: **Akshen Thakkar**
Email: akshen.thakkar@enam.com
Tel: 9122 6754 7507

Not- rated

Relative Performance



Source: Bloomberg, ENAM Research

Stock data

No. of shares	: 331mn
Market cap	: Rs 31bn
52 week high/low	: Rs 121/ Rs 64
Avg. daily vol. (6mth)	: 2mn shares
Bloomberg code	: VOLT IN
Reuters code	: VOLT .BO

Shareholding (%)		Mar-07	QoQ chg
Promoters	:	27.3	0.0
FIIs	:	28.7	1.2
MFs / UTI	:	6.8	(2.2)
Banks / FIs	:	13.0	(0.2)
Others	:	24.3	1.2

DOMESTIC MARKET TO DRIVE GROWTH

We met the management of Voltas to apprise ourselves with the company's future strategy and business prospects. Voltas aims to be an Rs 100bn company by 2012. It plans over 30% organic growth in current businesses and the balance through an inorganic route – primarily by pursuing opportunities in cold storage and water treatment sectors.

Electromechanical: Increasing the addressable pie

Driven by the retail, IT and entertainment boom in the domestic market, coupled with the Middle-East realty boom, Voltas' MEP revenues have grown at a 24% CAGR over FY04-06 and currently form 55% of revenues. Voltas' strategy to upgrade its HVAC projects to MEP projects is likely to increase its addressable market two-fold in the domestic market and also improve profitability. We estimate a 35% CAGR in its MEP revenues over FY07-09E.

Engineering products: Best placed

Voltas' engineering product's agency business is well placed to ride the capex upsurge in the textile sector as well as the strong demand momentum from construction and mining equipments. The division continues to be Voltas' cream business with RoI in excess of 100%.

Unitary products: Turning around

Voltas has exited the loss making refrigeration business, closed the Hyderabad unit and shifted manufacturing to a tax-free zone in Uttaranchal, in an effort to turnaround the division. These efforts have started bearing fruits, as the division turned PBIT positive in 9MFY07.

Outlook

Given the strong macro tailwinds, we believe that 30% topline growth is likely to be achieved over FY07-09E. Further, cold chain infrastructure and water treatment plants are likely to be long-term growth drivers. However, rising competitive intensity and ability to manage large projects profitably are key challenges. At CMP (95), the stock trades at 30.1x FY08E earnings of Rs 3.2.

Financial summary (Consolidated)

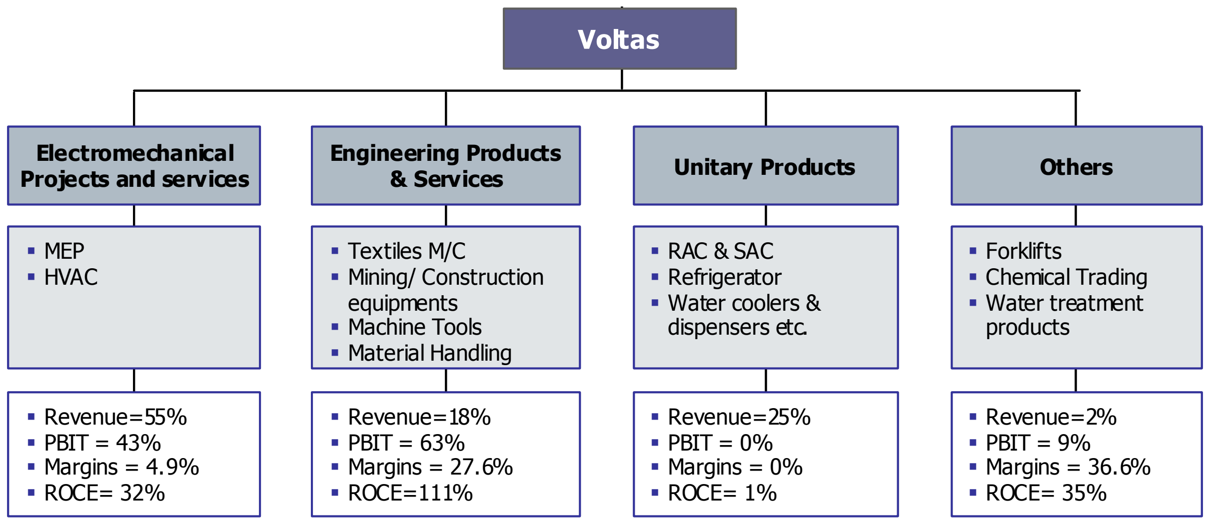
Y/E Mar	Sales (Rs mn)	PAT (Rs mn)	Consensus EPS* (Rs.)	EPS (Rs.)	Change YoY (%)	P/E (x)	RoE (%)	RoCE (%)	EV/EBIDTA (x)	DPS (Rs.)
2006	19,544	856	-	2.6	130	38.6	34.8	32.3	29.1	0.6
2007E	23,929	913	3.3	2.8	7	30.7	29.9	36.1	23.8	0.9
2008E	30,392	1,075	4.4	3.2	18	29.2	28.7	36.7	18.4	1.0
2009E	41,741	1,823	5.6	5.5	70	17.2	38.8	51.1	10.6	1.6

Source: *Consensus broker estimates, Company, ENAM estimates

Business Overview

Voltas is a leading air-conditioning and engineering solutions provider in India. Voltas caters to wide array of industries offering engineering solutions such as heating, ventilation and air-conditioning (HVAC), refrigeration, mechanical, electrical and plumbing (MEP), textile machinery, machine tools, mining and construction equipment, materials handling, water management, indoor air quality and chemicals. Voltas operates in four basic segments viz. electro-mechanical projects and services, engineering products and services, unitary cooling products and others.

Voltas business model



Source:, Enam Research

Electromechanical projects and services

Voltas undertakes HVAC related projects on an EPC basis for sectors such as retail, IT/ITES, airport, etc. Voltas acts as a contractor, whereby the client supplies design & engineering and large part of the equipments are bought out. The major components involved in an HVAC project are chillers, air handling systems, compressors, control systems, etc. Of these products, Voltas has manufacturing capability for chillers, while rest is outsourced. Ability to offer EPC solutions is Voltas' key differentiator.

Over the period, Voltas has expanded his scope of work in a project from HVAC to mechanical, electrical and plumbing (MEP). A MEP project involves centralized a/c ducting, electrical wiring and plumbing. Voltas' scope of work in an HVAC project would be 8-10% of the project cost, but inclusive of MEP, it would increase to 15-20% of the of the total project cost. The average project execution cycle is generally 12 months for a domestic project and 24 months for international projects. The average project size in the domestic market is ~Rs 600mn, whereas it is ~Rs 3bn in the international market. This is because most of the domestic projects are only HVAC. Hence, Voltas is planning to upgrade them to MEP projects in the domestic market so as to capture a larger share of the pie.

Key growth drivers - IT/ITES, retail and hospitality sectors

The domestic market for Heating, Ventilation, Air Conditioning and Refrigeration (HVACR) is buoyant, and is growing at over 20%, currently driven by strong growth in IT, retail and entertainment. Voltas' order intake in the domestic market has grown higher than the industry growth rate at ~50% in FY06. Also, Voltas has secured all the major airport projects, namely Calicut, Kochi, Delhi, Mumbai, Chennai, Pune and the greenfield Hyderabad International Airport.

Electromechanical projects: Key domestic growth drivers

Sectors	Potential demand over next five years	Comment
Retail	90bn	KSA Technopak estimates that the organized retail sector in India to grow a 25-30% CAGR to reach USD 24bn by 2010. Assuming ~200mn sq ft of retail space addition and Rs 450psf for electromechanical jobs.
IT/ITES	112 bn	According to a Nasscom-McKinsey report, the Indian IT and BPO industry employed over a million employees in FY05 and is expected to grow at 30% over the next 3-5 years. This implies that over two million professionals will be added requiring nearly 250mn sq ft of space (@ 125 sqft/person) and Rs 450psf for electromechanical jobs.
Hospitality	14bn	Multiplex cinemas have ballooned over the last few years. Multiplex majors like INOX, Adlabs, PVR etc are now moving into Tier-II cities. It is expected that the number of multiplex screens will grow at a CAGR of over 60% to reach 1,000 by FY2008. About 30mn sq ft of space is expected to be added in the hospitality sector.
Total	**215 bn**	**Overall incremental market opportunity over the next five years**

Source: Company, Enam research

Middle East Demand

Middle East is on the cusp of an unprecedented reality boom. "Petro Dollars" from the last few years of soaring crude prices are pouring in and fueling investments in many Middle Eastern countries. It is estimated that the total value of projects planned in the UAE – starting in 2005 and continuing for the next 10 years – will amount to ~USD 61bn. The Qatar Airport (world's largest), to be built at Doha at a cost of USD 5bn, is an example of the scale and magnitude of the investments to come. Voltas being a qualified and experienced MEP player would be a big beneficiary of this boom. Voltas has an excellent track record and has executed various projects in over 30 countries worldwide. The Middle East has contributed 27.2% of revenues in FY06, up from 16.4% in FY05.

Driven by strong growth in its addressable markets, we expect the revenues of this division to grow at a 35 % CAGR over FY07-09E.

Engineering products and services

Voltas' engineering products and services division is a trading business. It supplies engineering and capital equipment such as Mining & Construction equipment, Textile Equipments, Material Handling Equipments & Machine tools to various segments. Being an agency business, it has low capital intensity and strong free cash generation. The division is currently riding the strong growth in infrastructure, mining and textile sectors.

Engineering Products and Services Business

Category	Principals	Growth rate
Textile Machinery	Lakshmi Machine Works; Terrot, Germany; Heliot, France	30%
CNC Machines	Mitsubishi, Japan; SIP, Switzerland; HTT, Switzerland; Muller, Germany	35%
Mining & Construction	P&H (UK/USA); Terex, USA; Terex, Germany; Le Tourneau, Australia; Toyo, Japan	35%
Materials Handling Business	Terex, UK; Terex, UK; Gencor, UK; Hyundai, Korea; Dressta, USA	25%

Source: Company, Enam Research

Textile Machinery Business

Voltas is sole selling agency of Lakshmi Machine Works' (LMW) spinning machines for western India. Its agreement with LMW has been recently extended till 2010. Further, apart from spinning machinery, it imports weaving and carding from Terrot and Heliot. In the recent union budget, the Textile Upgradation Fund (TUFS) was extended till 2012, which augurs well for Voltas' textile machinery business. On back of strong growth in textile along with TUFS extension, we expect the segment to report 30% CAGR over 2007-09.

Mining and Construction Business

Under this segment Voltas supplies various mining & construction equipments of Terex, Hyundai and Dressta. The mining sector in India is on an investment upswing driven by power (coal) and steel (iron ore) industries. Further, strong growth in the infrastructure sector is driving demand for construction equipments. We expect this segment to grow at a 35% CAGR over FY2006-09E.

Materials Handling Business

This division is engaged in the manufacture and marketing of forklift trucks used in material handling and marketing of warehousing equipment for BT, Sweden; PPM, France; and Lodigie, Germany. Also, it is one of India's leading suppliers of machine tools such as CNC machining centers, grinding machines, gear-cutting machines etc and has the agencies of leading players such as Mitsubishi, SIP, and LMW. The division's growth thus hinges on industrial capex, which is expected to grow at a CAGR of 27% over FY06-11E. We expect this segment to grow at a 25% CAGR over FY2007-09E.

Unitary cooling division

Voltas is a leading enterprise in the cooling appliance business in India. It produces a variety of cooling appliances like window and split air conditioners, water coolers, freezers, bottle coolers and commercial refrigerators.

Although this division top-line growth has been outperforming the industry, high competitive intensity especially in the AC market, has resulted in losses at EBITDA levels. Voltas has exited the loss making refrigeration business, closed the Hyderabad unit and shifted manufacturing to a tax free zone in Uttaranchal, in an effort to turnaround the division. These efforts have started bearing fruits, as the division turned PBIT positive in 9MFY07.

The strategy is to concentrate on the institutional side i.e. the B2B business (now around 50% of segment sales) and hence on the water cooler and the commercial refrigeration segments.

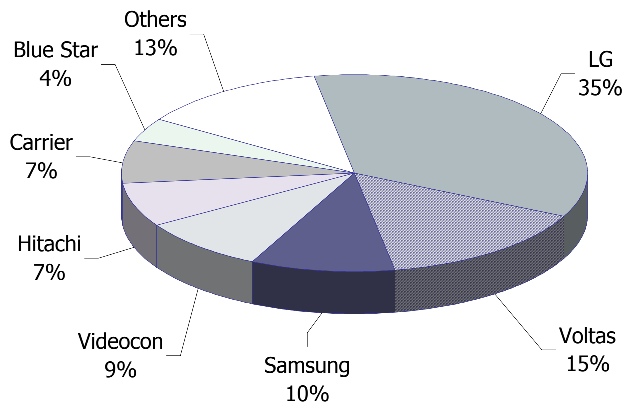
Industry outlook:

Room ACs: Room AC is a Rs 32bn market and is growing by 25% driven by higher income level, increasing affordability and rising aspiration levels. Voltas the second largest player with 15% market share has been a major beneficiary. Split AC contributes ~45% of Voltas' sales and has been growing at a robust pace at 73% (FY06) compared to 26% (FY06) for window ACs.

Water coolers: The robust growth in the services like retail, call centers, cyber cafes etc, has brushed off on the water cooler market, which has grown at 20%. Voltas is the market leader in this segment.

Commercial refrigeration: This market will be largely driven by investment in cold storage infrastructure. (Refer *Long Term Growth Drivers overleaf)*

AC Market Share



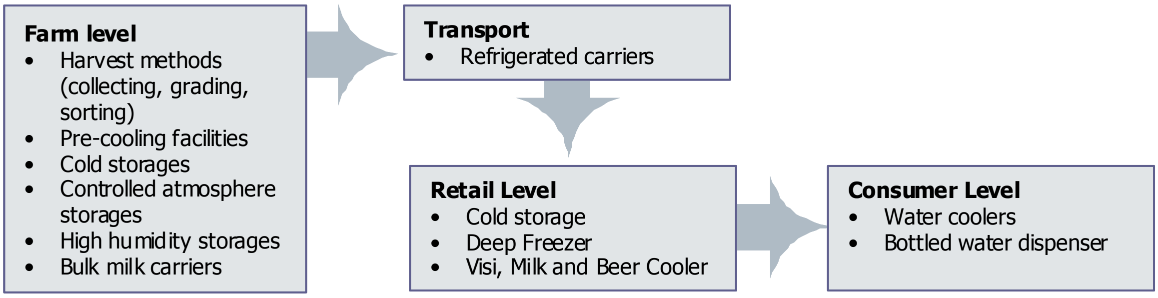
Source:, Company, Crisinfac

LONG TERM GROWTH DRIVERS:

The Cold Storage Opportunity

Voltas sees a big opportunity in the development of cold storage infrastructure. Close to Rs 500bn worth of perishable food items are wasted annually, due to a lack of cold storage facilities. With bigger players like RIL, Bharti and ITC entering the agricultural space, we believe that the domestic demand for cold storage equipments such as pre-coolers, bulk cold storage, transport, refrigeration and perishable cargo complexes will grow exponentially.

The cold storage value chain



Source:, Enam Research

Currently Voltas and Thermax are the only players with the technology for absorption chillers used in cold storage applications. These chillers run on ammonia instead of the traditional electricity. Chillers are a USD 600mn industry globally and in Japan, South Korea and China and they cater to more than 70% of large refrigeration needs. India is still at a nascent stage, accounting for just ~2-3% of world demand. Voltas, with its ability to execute projects on an EPC basis is well placed to capitalize on the cold storage opportunity. It has already secured an order of Rs 150mn from Adani Agri-Fresh, for refrigeration systems for their cold storage facilities with controlled atmosphere technology. We believe that this area would be a key long-term growth driver for Voltas.

Water Treatment Plants

Voltas is establishing itself as a turnkey service provider for turnkey pumping projects, water, effluent and sewage treatment and water pollution control projects. Voltas had bagged a large order worth about Rs 3.5bn for the Changi Water Reclamation Plant in Singapore. This project will give Voltas a pre-qualification to bid for similar projects coming up in the Middle East and India.

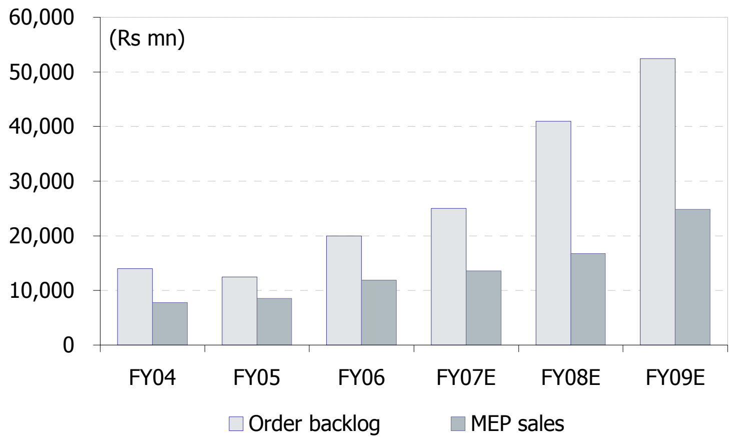
Considering that ~Rs 80bn worth of water supply and sanitation projects *(Source: World Bank website)* will be funded by the World Bank over the net five years in India alone, the water treatment market is likely to witness strong momentum in the coming years. Voltas is likely to adopt the inorganic growth route in this area to capitalize on the opportunity.

FINANCIAL EVALUATION:

Robust Order Book

Voltas' order book, at end December 2006, stood at Rs 2.4bn (up 30% from Rs 1.85bn in March 06). The order book which is only for the Electromechanical projects and services division is 1.8x FY07E MEP revenues. The domestic order book is Rs 6bn with the execution cycle of ~12 months and the international order book is Rs 1.8bn which has an execution cycle is ~18-24months. With a 35% CAGR in MEP revenues driven by the robust order book coupled with over 30% growth in its Engineering products and services business and 25% CAGR in unitary cooling products, we expect Voltas' revenues to grow at 32% CAGR over FY07-09E.

MEP division: Order backlog to sales



Source: Enam Research

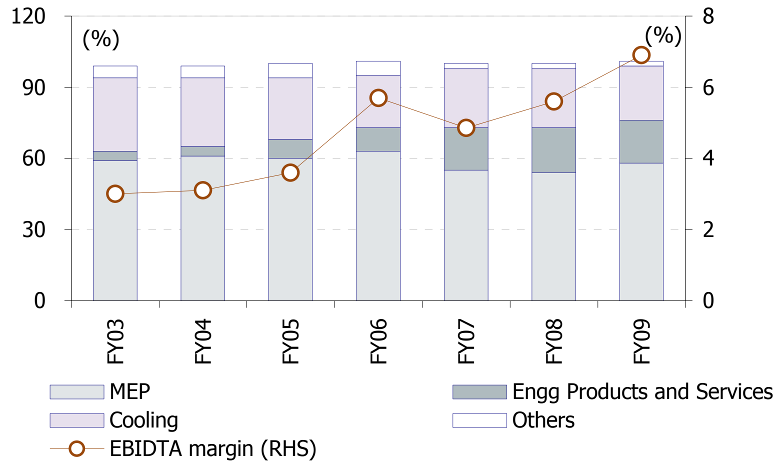
Profitability to improve gradually

Voltas expects that as it increasingly converts its HVAC projects to MEP projects, its business mix will gradually become favorable. Further, with certain internal streamlining measures and cost reduction efforts, Voltas believes that it can reach a sustainable net profit margin level of 10% over the next 3-4 years, vs. current levels of 4%. However, given the company's business dynamics, we believe that a 4-5% is a sustainable net margin level.

While its EBIDTA margin in FY06 expanded by 210 bps to 5.7%, it contracted in 9MFY07 by 130 bps to 4.4%. This was mainly due to some international projects where costs have been incurred but the revenue had not been recognized, as these projects had not reached the threshold level of execution. Going forward the EBIDTA margins should stabilize with the above projects getting executed and we estimate and OPM of 4.8% in FY07.

While the overall OPM will be a function of the business mix, we estimate EBIDTA margin to improve by 30-50bps on account of the company's cost reduction efforts. Overall, we estimate a 210bps OPM expansion over FY07-09E.

EBIDTA margin and sales mix over FY07-09E



Source: Company, Enam estimates

Healthy return ratios and cash flows

Return ratios have improved significantly in FY06 to over 30% vs. below 20% earlier owing to a substantial increase in contribution from the asset-light agency business (18% of sales in FY07E vs 10% in FY06). Further, operating cash flows have also turned positive in FY06. We expect the return ratios to expand going forward on the back of increasing contribution from high ROI MEP and agency business. Strong 32% revenue CAGR coupled with ongoing restructuring efforts will ensure better asset utilization. Also, except for the unitary cooling products, the working capital cycle for the company is negative. Hence, the return ratios and cash flows are likely to further improve over the medium term.

Outlook and Valuations

Given the strong macro tailwinds, we believe that 30% topline growth is likely to be achieved over the FY07-09E. Further, cold chain infrastructure and water treatment plants are likely to be long-term growth drivers. However, the rising competitive intensity and ability to manage large projects profitably are key challenges. At CMP (95), the stock trades at 30.1x FY08E earnings of Rs 3.2.

Company Financials

Income statement

(Rs mn)

Y/E Mar	2006	2007E	2008E	2009E
Net sales	**19,544**	**23,929**	**30,392**	**41,741**
Other operating income	0	0	0	0
Total income	**19,544**	**23,929**	**30,392**	**41,741**
Cost of goods sold	16,607	20,539	25,936	35,391
Contribution (%)	15	14	15	15
Advt/Sales/Distrn O/H	1,816	2,230	2,749	3,451
Operating Profit	**1,121**	**1,160**	**1,707**	**2,899**
Other income	164	411	220	235
PBIDT	**1,285**	**1,571**	**1,927**	**3,135**
Depreciation	141	143	227	275
Interest	64	54	72	72
Other pretax	0	0	0	0
Pre-tax profit	**1,080**	**1,374**	**1,629**	**2,788**
Tax provision	224	460	554	965
(-) Minority Interests	0	0	0	0
Associates	0	0	0	0
Adjusted PAT	**856**	**913**	**1,075**	**1,823**
E/o income / (Expense)	(119)	99	0	0
Reported PAT	**737**	**1,012**	**1,075**	**1,823**

Key ratios

(%)

Y/E Mar	2006	2007E	2008E	2009E
Sales growth	**32.3**	**22.4**	**27.0**	**37.3**
OPM	**5.7**	**4.8**	**5.6**	**6.9**
Oper. profit growth	110.0	3.4	47.2	69.8
COGS / Net sales	85.0	85.8	85.3	84.8
Overheads/Net sales	9.3	9.3	9.0	8.3
Depreciation / G. block	4.5	4.5	5.2	5.7
Effective interest rate	6.0	6.0	8.0	8.0
Net wkg.cap / Net sales	0.0	0.0	0.0	0.0
Net sales / Gr block (x)	6.5	7.5	8.0	9.1
Incremental RoCE	210.8	5.9	41.9	200.5
RoCE	**32.3**	**36.1**	**36.7**	**51.1**
Debt / equity (x)	0.3	0.3	0.2	0.2
Effective tax rate	20.7	33.5	34.0	34.6
RoE	**34.8**	**29.9**	**28.7**	**38.8**
Payout ratio (Div/NP)	27.0	29.4	30.8	29.0
EPS (Rs.)	**2.6**	**2.8**	**3.2**	**5.5**
EPS Growth	130.0	6.7	17.6	69.6
CEPS (Rs.)	3.0	3.2	3.9	6.3
DPS (Rs.)	**0.6**	**0.9**	**1.0**	**1.6**

Balance sheet

(Rs mn)

Y/E Mar	2006	2007E	2008E	2009E
Total assets	**3,617**	**4,290**	**4,988**	**6,207**
Gross block	3,163	3,177	4,377	4,777
Net fixed assets	1,521	1,392	2,366	2,491
CWIP	114	600	100	0
Investments	461	461	461	461
Wkg. cap. (excl cash)	(33)	234	868	1,413
Cash / Bank balance	1,298	1,346	936	1,586
Others/Def tax assets	256	256	256	256
Capital employed	**3,617**	**4,290**	**4,988**	**6,207**
Equity capital	331	331	331	331
Reserves	2,386	3,059	3,756	4,976
Borrowings	901	901	901	901
Others	0	0	0	0

Cash-flow

(Rs mn)

Y/E Mar	2006	2007E	2008E	2009E
Sources	**250**	**816**	**925**	**1,495**
Cash profit	952	1,056	1,302	2,098
(-) Dividends	226	339	377	603
Retained earnings	726	717	925	1,495
Issue of equity	0	(207)	0	0
Borrowings	(364)	0	0	0
Others	(112)	306	0	0
Applications	**250**	**816**	**925**	**1,495**
Capital expenditure	663	500	700	300
Investments	156	0	0	0
Net current assets	(248)	267	634	545
Change in cash	(321)	49	(410)	650

Source: Company, ENAM Research

ENAM Securities Pvt Ltd.

109-112, Dalamal Tower, Free Press Journal Marg, Nariman Point, Mumbai - 400 021, India.
Tel:- Board +91-22 6754 7500; **Dealing** +91-22 2280 0167
Fax:- Research +91-22 6754 7579; **Dealing** +91-22 6754 7575