# Voltas

**Initial Opinion** BUY

Equity | India | Engineering & Construction
05 June 2009

Bank of America Merrill Lynch

RESEARCH

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# Coolest one; new Buy

## Initiating with Buy and Rs185 PO based on 16xFY11E

We initiate on Voltas, the second largest air-conditioning & engg co in India (70% of sales) and Middle East (30% of sales), with a Buy. We expect it to be a key gainer of (1) thrust on infra in India; & (2) rise in oil price that could drive up capex in Middle East. Voltas FY10E PE has doubled to 16x since 15 May09 led by (1) new govt (2) 20% oil price rise & (3) new orders. We expect the 16xPE to be sustained due to expected 30%+ ROE and 25%+ EPS growth, hence have based our PO at 16xFY11E.

## Market size attractive; lead indicators showing uptrend

We expect market size for MEP (air-conditioning, electrification, plumbing etc), engg equipment and room AC in India to double in next five years, driven by India's thrust on infra and 7%+GDP growth. We expect Middle East MEP market, which is US$5bn+ in size to grow 10% pa driven by US$60/bbl+ oil price. Uptrend is evident from new order wins, rising order execution and declining inventory.

## FY09-12E EPS CAGR at 26%; 31% higher than consensus

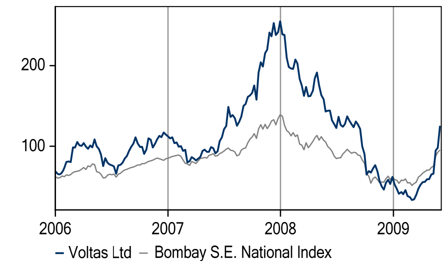
We expect profit to grow 22% in FY10E and 38% in FY11E. Order backlog of 1.9x FY09 sales for MEP key for FY10E. Expect stronger growth in FY11 to be driven by (1) 56% rise in new orders; and (2) 80bp increase in EBITDA margin driven by change in sales mix to favor more profitable mining and construction equipment sales. MEP, room AC and engg equipment contributed 60%, 21% and 19% of Voltas FY09 operating profit, respectively.

## New initiatives + acquisitions could yield further upside

Recent initiatives could yield further upside. These are (1) expansion of presence in MEP work in industrial units like power plants following acquisition of 51% stake in Rs2bn Rohini Electrical last year and (2) entry into water treatment biz where it recently won order worth Rs500mn in India. It has surplus for acquisitions.

### Stock Data

| | |
|---|---|
| Price | Rs126.30 |
| Price Objective | Rs185.00 |
| Date Established | 5-Jun-2009 |
| Investment Opinion | C-1-7 |
| Volatility Risk | HIGH |
| 52-Week Range | Rs31.10-Rs151.50 |
| Mrkt Val / Shares Out (mn) | US$885 / 330.7 |
| Average Daily Volume | 5,029,234 |
| ML Symbol / Exchange | VTSJF / NSI |
| Bloomberg / Reuters | VOLT IN / VOLT.NS |
| ROE (2010E) | 31.7% |
| Net Dbt to Eqty (Mar-2009A) | -26.1% |
| Est. 5-Yr EPS / DPS Growth | 20.0% / 20.0% |
| Free Float | 72.3% |




### Estimates (Mar)

| (Rs) | 2008A | 2009A | 2010E | 2011E | 2012E |
|---|---|---|---|---|---|
| Net Income (Adjusted - mn) | 2,076 | 2,282 | 2,742 | 3,795 | 4,527 |
| EPS | 5.62 | 7.60 | 8.28 | 11.47 | 13.68 |
| EPS Change (YoY) | 46.4% | 35.4% | 9.0% | 38.4% | 19.3% |
| Dividend / Share | 1.35 | 1.60 | 2.00 | 2.50 | 3.50 |
| Free Cash Flow / Share | 10.55 | 1.82 | 10.03 | 9.20 | 9.93 |

### Valuation (Mar)

| | 2008A | 2009A | 2010E | 2011E | 2012E |
|---|---|---|---|---|---|
| P/E | 22.49x | 16.61x | 15.25x | 11.01x | 9.23x |
| Dividend Yield | 1.07% | 1.27% | 1.58% | 1.98% | 2.77% |
| EV / EBITDA* | 15.29x | 13.61x | 11.22x | 8.13x | 6.71x |
| Free Cash Flow Yield* | 8.35% | 1.44% | 7.94% | 7.28% | 7.86% |

* For full definitions of *iQmethod* SM measures, see page 17.

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# *iQprofile* SM Voltas

| Key Income Statement Data (Mar) | 2008A | 2009A | 2010E | 2011E | 2012E |
|---|---|---|---|---|---|
| (Rs Millions) | | | | | |
| Sales | 32,029 | 43,259 | 51,257 | 62,936 | 74,620 |
| Gross Profit | 8,645 | 11,574 | 13,429 | 16,993 | 20,147 |
| Sell General & Admin Expense | (2,996) | (4,656) | (4,888) | (5,866) | (6,746) |
| Operating Profit | 2,353 | 2,621 | 3,212 | 4,510 | 5,498 |
| Net Interest & Other Income | 717 | 835 | 880 | 1,070 | 1,160 |
| Associates | 0 | (3) | 0 | 0 | 0 |
| Pretax Income | 3,069 | 3,453 | 4,092 | 5,580 | 6,658 |
| Tax (expense) / Benefit | (993) | (1,172) | (1,350) | (1,786) | (2,131) |
| Net Income (Adjusted) | 2,076 | 2,282 | 2,742 | 3,795 | 4,527 |
| Average Fully Diluted Shares Outstanding | 331 | 331 | 331 | 331 | 331 |
| **Key Cash Flow Statement Data** | | | | | |
| Net Income | 2,075 | 2,253 | 2,740 | 3,792 | 4,524 |
| Depreciation & Amortization | 167 | 210 | 220 | 230 | 240 |
| Change in Working Capital | 1,713 | (1,623) | 956 | (380) | (479) |
| Deferred Taxation Charge | NA | NA | NA | NA | NA |
| Other Adjustments, Net | (2) | 261 | 0 | 0 | 0 |
| Cash Flow from Operations | 3,952 | 1,101 | 3,916 | 3,642 | 4,285 |
| Capital Expenditure | (464) | (500) | (600) | (600) | (1,000) |
| (Acquisition) / Disposal of Investments | 0 | 0 | 0 | 0 | 0 |
| Other Cash Inflow / (Outflow) | NA | NA | NA | NA | NA |
| Cash Flow from Investing | (464) | (500) | (600) | (600) | (1,000) |
| Shares Issue / (Repurchase) | 0 | 0 | 0 | 0 | 0 |
| Cost of Dividends Paid | (447) | (622) | (777) | (971) | (1,360) |
| Cash Flow from Financing | (447) | (622) | (777) | (971) | (1,360) |
| Free Cash Flow | 3,488 | 601 | 3,316 | 3,042 | 3,285 |
| Net Debt | (2,264) | (2,000) | (3,250) | (3,250) | (4,250) |
| Change in Net Debt | NA | NA | NA | NA | NA |
| **Key Balance Sheet Data** | | | | | |
| Property, Plant & Equipment | 1,898 | 2,189 | 2,569 | 2,939 | 3,699 |
| Other Non-Current Assets | 2,775 | 3,018 | 4,307 | 6,378 | 7,303 |
| Trade Receivables | 5,703 | 8,296 | 9,128 | 11,208 | 13,289 |
| Cash & Equivalents | 3,002 | 3,500 | 4,000 | 4,000 | 5,000 |
| Other Current Assets | 32,682 | 45,629 | 53,364 | 65,522 | 77,687 |
| Total Assets | 46,059 | 62,633 | 73,368 | 90,047 | 106,977 |
| Long-Term Debt | 737 | 1,500 | 750 | 750 | 750 |
| Other Non-Current Liabilities | 0 | 0 | 0 | 0 | 0 |
| Short-Term Debt | NA | NA | NA | NA | NA |
| Other Current Liabilities | 39,544 | 53,463 | 62,985 | 76,844 | 90,610 |
| Total Liabilities | 40,281 | 54,963 | 63,735 | 77,594 | 91,360 |
| Total Equity | 5,778 | 7,670 | 9,632 | 12,453 | 15,617 |
| Total Equity & Liabilities | 46,059 | 62,633 | 73,368 | 90,047 | 106,977 |
| ***iQmethod* SM - Bus Performance*** | | | | | |
| Return On Capital Employed | 26.8% | 22.1% | 22.0% | 26.0% | 25.3% |
| Return On Equity | 41.5% | 34.0% | 31.7% | 34.4% | 32.3% |
| Operating Margin | 7.3% | 6.1% | 6.3% | 7.2% | 7.4% |
| EBITDA Margin | 7.9% | 6.5% | 6.7% | 7.5% | 7.7% |
| ***iQmethod* SM - Quality of Earnings*** | | | | | |
| Cash Realization Ratio | 1.9x | 0.5x | 1.4x | 1.0x | 0.9x |
| Asset Replacement Ratio | 2.8x | 2.4x | 2.7x | 2.6x | 4.2x |
| Tax Rate (Reported) | 32.4% | 33.9% | 33.0% | 32.0% | 32.0% |
| Net Debt-to-Equity Ratio | -39.2% | -26.1% | -33.7% | -26.1% | -27.2% |
| Interest Cover | 26.2x | 23.9x | 26.8x | 34.7x | 39.3x |
| **Key Metrics** | | | | | |

* For full definitions of *iQmethod* SM measures, see page 17.

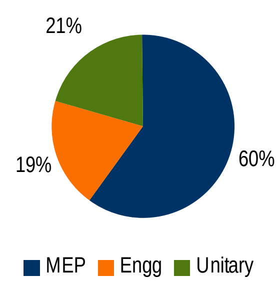
## Company Description

Voltas, a Tata Group company, is Indias leading air-conditioning & engineering services co. It also ranks as 2nd MEP contractor in the middle east. Voltas is a well known brand for aircondioners in India for over 50 years. Projects including airconditioning, electricfication and plumbing contributes to 60% of profit. Mining, construction, material handling and textile machine contributes to 19% of profits. Room air conditioners, freezers and water cooler contribute to remaining 21% of profit.

## Investment Thesis

Voltas as a leading supplier of building solutions in India and Middle East is a key beneficiary of rising investment cycle driven by low interest rate and rising oil price. Additional growth drivers are (1) recent acquisition of Rohini Electricals gives it stronger presence in industrial construction and (2) increase in stake to 100% in Saudi Arabia subsidiary. Voltas also has significant scope of margin expansion due to favourable change in business mix.

## Chart 1: Voltas – Segmentwise profit mix

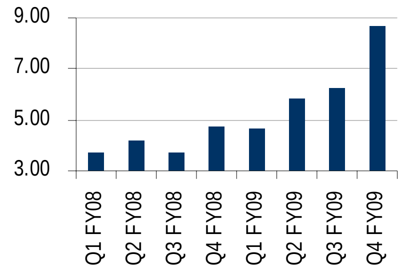



Source: Company

## Stock Data

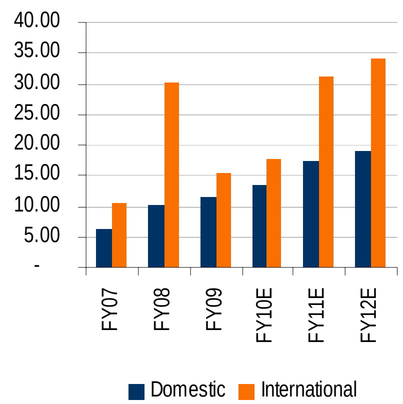
| | |
|---|---|
| Price to Book Value | 4.3x |

Chart 2: MEP revenue Rsbn, on upswing indicates low risk of order cancellation & delay




Source: Company

Chart 3: Order inflow rise from FY11E (Rsbn)




Source: Company, Banc of America Securities - Merrill Lynch

# Investment thesis

Voltas is the second largest air-conditioning & engineering services co in India (70% of sales, 35% market share) and Middle East (30% of sales).

We are initiating coverage on Voltas with a Buy rating and PO of Rs185 owing to:

(1) EPS growth of 22% in FY10E and 38% in FY11E.

(2) ROE of 30%+, which is higher than 22%+ for peers

(3) Success in new business initiatives which could boost longer term outlook

### Earnings expectation driven by eco rebound in India and Middle East

Voltas's business is highly leveraged to capex growth in India and Middle East. Voltas's key market segments typically grow at three times the rate of GDP growth. Our expectation for strong earnings growth is linked to an expected rebound in the India and Middle East economies driven by rising capex. We now expect (1) Stable govt in India since May09 to drive faster growth (Indranil Sengupta, 1 June 2009) and (2) Higher oil revenue from rising prices to boost the Middle East (GCC Strategy, Jun 09).

### Stock has re-rated in last fortnight on uptrend in lead indicators

Voltas FY10E PE has re-rated from 8x to 16x since 15 May 2009 driven by:

1. Upgrade in GDP growth expectation following the formation of a new govt.
2. Rising order execution and rising oil prices to above US$60/bbl that has led to reduced risk of cancellation of orders worth Rs38bn from the Middle East (80% of total order).
3. News of new order wins worth Rs5bn in the last week of May09 after a gap of almost six months has acted as a lead indicator of rising order cycle.
4. 20% reduction in inventory of room-air conditioners and industrial machinery has raised the hope of rising demand.

### Stock could continue to trade at least at current levels

Voltas is trading at 15.2x FY10E EPS, and is at 60% discount to its peak PE during last five years. It is also trading at a 20% discount to peers despite having higher ROE and stronger growth prospects. We think that Voltas's recent re-rating is based entirely on early indications of demand recovery. We expect the stock to continue to trade at least at current levels because of the following.

1. BAS-ML oil price forecast at US$60+ for the next year is favourable.
2. The new govt is to include a further fiscal stimulus package in the Jul09 budget for the infra, mining and textile industries, which could drive new orders.
3. Voltas has guided that it will be able to bring down inventory and receivables to normal levels by end 2009.

### Success in new business could drive structural re-rating

Voltas could see additional upside from new initiatives including: (1) expansion of presence in electrical work in industrial units like power plants following the acquisition of a 51% stake in Rohini Electrical which had revenues of over Rs 2bn last year (2) entry into the water treatment business following a recent Rs500mn order win in India from a cross section of industries and (3) proposed entry into Libya and Morocco in the next two years.

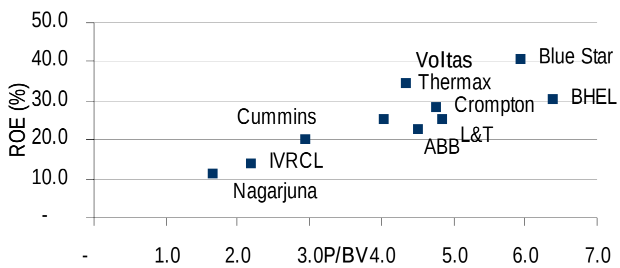
## Voltas PO based on 16x FY11E EPS

Our PO of Rs185 for Voltas is based on 16x FY11E EPS of Rs11.47/sh. Our target PE is roughly in line with the current FY10E PE of the stock and is a 20% discount to the peer average (Table 1). At 16x PE, the stock woud trade at a 60% discount to the company's peak PE reached during 2007, when the oil price was above US$100/bbl and India's GDP was growing at 9%+. We believe that our PO based on 16x FY11 PE is justifiable for to the following reasons.

- Since 2005, Voltas has predominantly traded above 15x one year forward PE
- Voltas has predominantly traded at a premium relative to sector (Chart 6) since 2005 owing to high ROE (Chart 4) and higher growth prospects. Both these factors are still in favour of Voltas (Table 1)
- Voltas's closest competitor Bluestar (not rated) is also trading at a PE of 16x FY10E (as per consensus), which is in line with our PO basis.

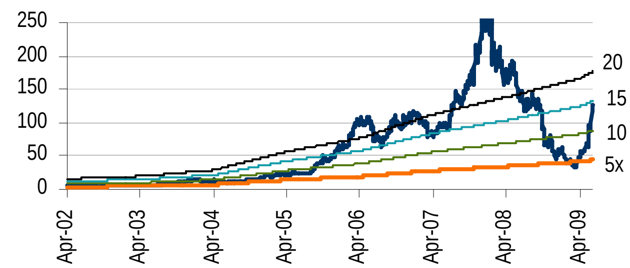
We have based our PO on a PE multiple as (1) Voltas is a growth stock and (2) PE is our preferred valuation metric for the engineering and construction sector.

Chart 4: Comparison of ROE vs PB – FY10



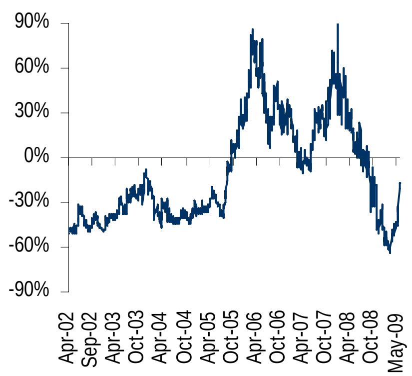

Source: Bloomberg

Chart 5: Voltas PE band chart




Source: Company, Banc of America Securities - Merrill Lynch, Bloomberg

Chart 6: Voltas PE vs sector – prem /disc (%)




Source: Bloomberg, Banc of America Securities - Merrill Lynch

### Voltas valuation is strongly influenced by order book quality

Voltas has traded in a wide valuation range in absolute as well as relative to peers. The key drivers of the company's valuation in the past has been:

(1) **New order inflow**. In FY06 Voltas PE was re-rated from 10x to 30x and its premium to the sector increased to 90% driven by a 65% increase in order inflow. Again in FY08 Voltas PE increased from 15x to 40x as Voltas reported a record 137% increase in new orders predominantly from the Middle East. In FY07 the stock de-rated by 40% due to lack of growth in new order inflow. Also 33% decline new order in FY09 contributed significantly to an over 85% de-rating of the stock during FY09.

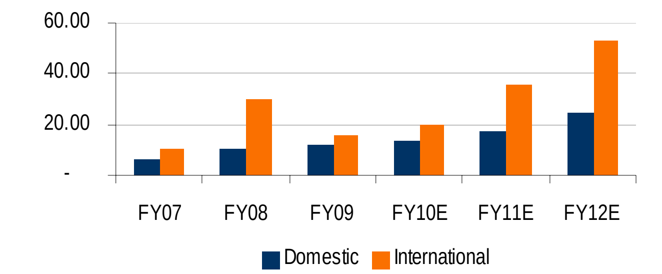
(2) **Quality of order book**. Increased risk of order cancellation in FY09 was a key driver of the over 85% PE de-rating in FY09. Fear over the viability of commercial real estate, and likely funding gaps for projects like airports etc were the key reasons for increase in risk perception over quality of order book.

### Rise in new orders going forward should support valuation

We believe that Voltas could continue to trade at least at the current level owing to:

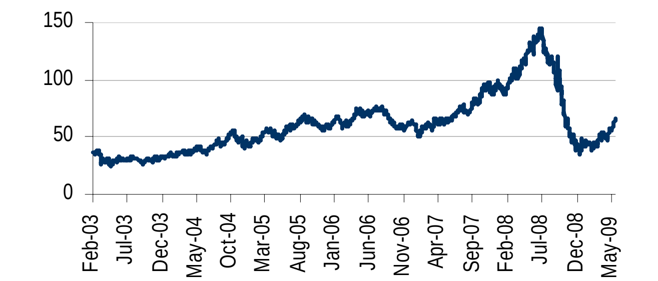
- Rising earnings visibility and new order inflow in India and the Middle East owing to an economic rebound. We expect new orders to rise 15% and 56% in FY10 and FY11, respectively.
- Timely execution of execution of the existing order backlog is also likely to support valuation and drive earnings growth in FY10E.
- Sustained ROE of 30%+ compared to avg. ROE of 22% for peers.

Chart 7: Expect new order inflow to rise




Source: Company, Banc of America Securities - Merrill Lynch, Bloomberg

Chart 8: Crude oil price bottoming out (US$/bbl)




Source: Company, Banc of America Securities - Merrill Lynch

Table 1: Peer comparison

| Company name | ML ticker | BAS-ML Rating | Local Price | Market Cap (US$ mn) | P/E (x) FY 09E | P/E (x) FY 10E | P/E (x) FY 11E | P/B FY 09E | P/B FY 10E | P/B FY 11E | EV/EBITDA FY 09E | EV/EBITDA FY 10E | EV/EBITDA FY 11E | ROE FY 09E | ROE FY 10E | ROE FY 11E | Year End |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Voltas | VTSJF | C-1-7 | 126.4 | 889.0 | 18.3 | 15.2 | 11.0 | 5.4 | 4.3 | 3.4 | 10.2 | 6.9 | 5.3 | 31.7 | 34.4 | 32.3 | Mar |
| India - Engineering & Construction | | | | | | | | | | | | | | | | | |
| ABB | ABVFF | C-3-7 | 675 | 2,780 | 25.9 | 21.9 | 18.2 | 5.5 | 4.5 | 3.7 | 15.3 | 13.0 | 10.8 | 23.6 | 22.7 | 22.4 | Dec |
| BHEL | BHHEF | C-1-7 | 2,135 | 21,659 | 28.2 | 23.3 | 18.7 | 8.1 | 6.4 | 5.0 | 17.7 | 15.2 | 11.7 | 31.3 | 30.7 | 30.2 | Mar |
| L&T | LTOUF | C-1-7 | 1,405 | 16,743 | 26.5 | 21.0 | 17.6 | 5.9 | 4.8 | 4.0 | 20.2 | 15.7 | 13.2 | 25.1 | 25.2 | 24.8 | Mar |
| IVRCL | IIFRF | C-1-7 | 338 | 934 | 21.1 | 16.6 | 12.8 | 2.5 | 2.2 | 1.9 | 13.5 | 10.3 | 8.7 | 12.5 | 14.0 | 15.8 | Mar |
| Nagarjuna Construction | NGRJF | C-1-7 | 131 | 703 | 19.5 | 15.4 | 13.2 | 1.8 | 1.7 | 1.5 | 11.6 | 9.4 | 8.2 | 9.4 | 11.3 | 12.0 | Mar |
| Thermax | | No-Rating | 390 | 989 | 17.3 | 16.8 | 15.6 | 5.2 | 4.0 | 3.5 | 10.2 | 9.9 | 8.6 | 31.3 | 25.0 | 24.0 | Mar |
| Blue Star | | No-Rating | 305 | 772 | 18.2 | 16.0 | 13.0 | 8.4 | 5.9 | 4.5 | 15.1 | 13.1 | 10.9 | 52.2 | 40.6 | 38.0 | Mar |
| Crompton | | No-Rating | 290 | 735 | 20.7 | 17.8 | 15.3 | 6.1 | 4.8 | 3.8 | 4.0 | 3.3 | 2.6 | 33.7 | 28.5 | 24.9 | Mar |
| Cummins | | No-Rating | 260 | 659 | 14.5 | 15.4 | 13.0 | 3.8 | 2.9 | 2.5 | 1.0 | 1.0 | 0.8 | 28.4 | 20.2 | 23.2 | Mar |
| India Average E&C | | | | | 22.4 | 19.3 | 15.3 | 5.2 | 4.1 | 3.4 | 12.9 | 10.5 | 8.4 | 26.5 | 23.3 | 23.9 | |
| India mid-cap E&C avg | | | | | 19.6 | 17.1 | 14.4 | 4.8 | 3.7 | 3.1 | 10.1 | 8.5 | 7.2 | 27.3 | 23.2 | 22.9 | |

Source: Banc of America Securities - Merrill Lynch, Bloomberg

### Our earnings estimates are ahead of consensus

Our estimates for FY10 and FY11 are 9% and 31% higher than consensus, respectively. Our expectation for higher growth is because we assume: (1) higher order inflow growth driven by a stronger economy and (2) higher margins for subsidiaries and lesser FX loss that impacted FY09 EPS.

Table 2: BAS-MLe EPS ahead of consensus

| | FY 09 | FY 10E | FY 11E |
|---|---|---|---|
| BAS-Mle | 6.9 | 8.3 | 11.5 |
| Consensus | 6.9 | 7.6 | 8.7 |
| % diff | 0.0% | 9.1% | 31.4% |

Source: Banc of America Securities - Merrill Lynch, Bloomberg

### DCF based fair value higher than our PO

Our DCF based fair value for Voltas is Rs197/sh, which is higher than our PO of Rs185. For the purpose of DCF we have assumed a WACC of 13.5% and 5% terminal growth rate.

Table 3: Voltas – DCF Valuation

| | | FY09 | FY10E | FY11E | FY12E |
|---|---|---|---|---|---|
| NOPLAT | | 1,731.8 | 2,069.9 | 3,041.9 | 3,988.9 |
| Depreciation | | 210 | 220 | 230 | 240 |
| CAPEX | | (500) | (600) | (600) | (1,000) |
| Net change in working capital | | (1,623) | 968 | (407) | (640) |
| Free cash flow | | (181) | 2,658 | 2,265 | 2,588 |
| NPV of Free Cash | 5,953 | | | | |
| NPV of terminal Value | 31,975 | | | | |
| Voltas - DCF Value | | | | | |
| Enterprise Value (Rs Mn) | 69,903 | | | | |
| Net Debt | 4,829 | | | | |
| Market Cap | 65,074 | | | | |
| No of share outstanding | 331 | | | | |
| Fair Value (Rs/share) | 197 | | | | |

Source: Banc of America Securities - Merrill Lynch

## Key risk is prolonged economic downturn

The key risk to our rating for Voltas would be a prolonged economic downturn considering its growth is leveraged 3x to GDP growth. The company's valuation has remained extremely volatile despite the company delivering at least 20%+ net profit growth since FY04. We think the key reason for this volatility is the company's exposure to the building and construction sector, which is highly leveraged to macro factors like interest rate and oil price. The company's trough valuation is 5x, which is 60% below current levels. Key factors, which could lead to a de-rating, are:

- Sharp decline in oil price below our expectation of US$60/bbl+ could hurt new order inflow from the Middle East and impact earnings.
- Sustained slowdown in commercial real estate including shopping malls, IT/ITES company office and SEZ, could hurt new order inflow
- Sharp appreciation of the rupee could hurt the company's export profitability.
- Likely increase in competition in sales and distribution of industrial machinery for which Voltas acts as a sales agent could hurt profitability.
- Increased imports of room air conditioners to India from China could hurt market share and profit margin of Voltas.

# Bull & bear case

| ML ticker - VTSJF Buy (C-1-7) Current price Rs126.30 | Bull case | Bear case | Merrill Lynch view |
|---|---|---|---|
| Middle East Mkt | ■ Countries in Middle East contribute to 80% of Voltas order book. Rise in oil price to US$60/bbl, which is the breakeven price for govt budget, has increased project visibility and increased prospects for new investment. | ■ Although oil price has risen from a low of US$35 to US$60/bbl, it is still significantly below the avg price of US$95/bbl in 2008, the year in which Voltas got 90% of its current order backlog. Hence, the risk of order cancellation is fairly high. | ■ We see little risk of order cancellation as 50% of Voltas's projects are from Qatar, whose GDP is growing at 5%+ driven by sustained demand for gas.<br>■ Remaining 50% of orders are from Abu Dhabi which has govt backing. |
| Real Estate | ■ Demand for room AC as well as central AC is extremely good in times of rising real estate construction including shopping malls, office complexes, hospitals etc. Sharp decline in borrowing cost as well as real estate price has increased affordability and could lead to a robust rise in real estate construction. | ■ Real estate including residential and commercial segments are in excess supply and could take time to recover.<br>■ Real estate companies are saddled with excess borrowings and will take time to restructure balance sheets. | ■ We are not assuming a significant increase in real estate construction.<br>■ We expect Voltas to gain from building of airport, hospitals and power plants. |
| Govt thrust | ■ Govt thrust to boosting the economy through higher investment could increase investment in a new airport, metro railway, power plants, and textile mills which are key segments for Voltas. | ■ Rising fiscal deficit could hold back govt spending | ■ We expect govt spending to accelerate despite the rising fiscal deficit. |

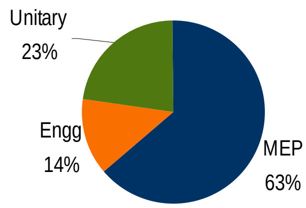
Source: Banc of America Securities-Merrill Lynch

# A leading engineering company

Voltas Limited incorporated in 1954 is a leading engineering company in India and is part of the Tata group. The total promoter stake of the Tata group in Voltas is 27.7%, of which Tata Sons owns 23.8%.

Voltas has three distinct lines of business:

Chart 9: Voltas FY09 operating revenue mix




Source: Company

**Segment 1 – MEP construction- (63% of revenue & 60% of profit in FY09)**
Construction projects including central air-conditioning, electrification, plumbing work etc (MEP) for all types of buildings as well as industrial units is the largest and the fastest growing business segment for Voltas. In FY09 Voltas derived 63% of its revenue and 60% of operating profit from MEP. Voltas is the second largest MEP contractor in India with around 35% market share. The company was also recognised as the second most prolific MEP contractor in Gulf in Nov 2008. Voltas MEP revenue has grown at a 31% CAGR over FY06-09.

**Segment 2 – Unitary Cooling system - (21% of revenue & profit in FY09)**
Room air conditioners, water coolers etc for residential and commercial use, forms the second largest business segment and is linked to rising consumer affluence in India. Voltas is the second largest player with a 16.5% market share and achieved 25% revenue CAGR in this segment in FY06-09

**Segment 3 – Engg Products - (12.5% of revenue & 19% of profit in FY09)**
Engg products is the third largest segment of Voltas in terms of profit and is the most cyclical component. This business comprises manufacturing and servicing of engineering equipment including (1) materials handling equipment (2) mining & construction equipment and (3) textile equipment. Voltas has dominant share in products like forklift and textile equipment. Engg products revenue has grown at 29% CAGR in FY06-09. This segment, however, is currently in decline.

## Earnings growth outlook robust

We expect Voltas's revenue to grow at 22% in FY10E and 38% in FY11E. Key drivers of growth are:.

(1) Execution of Rs48bn order backlog for MEP by Sep2010 at 1.9x FY09 sales expected to drive FY10 EPS growth.

(2) Likely reversal of provisions for doubtful accounts worth Rs300mn made during FY09, absence of one-time losses including Rs80mn from closure of Dadra plant and reversal of a loss making situation by a Saudi subsidiary expected to boost FY10E growth.

(3) Increased new MEP orders by 15% and 56% in FY10E and FY11E, respectively, expected to drive FY11E growth

(4) We expect stronger EPS growth in FY11E to be driven by turnaround in demand for mining, construction and textile machinery.

(5) Likely rise in contribution from the profitable industrial machinery segment is expected to expand EBITDA margin from 6.7% in FY09 to 7.5% in FY11E. This is also the key reason for our expectation for stronger growth.

Table 4: Voltas - Key assumption and forecasts

| Year End (Sep), Rs Mn | 2008A | 2009A | 2010E | 2011E | 2012E |
|---|---|---|---|---|---|
| Revenue | 32,029 | 43,259 | 51,257 | 62,936 | 74,620 |
| % Change | 26.8% | 35.1% | 18.5% | 22.8% | 18.6% |
| EBITDA Margin | 7.9% | 6.5% | 6.7% | 7.5% | 7.7% |
| Other Income | 806 | 945 | 1,000 | 1,200 | 1,300 |
| EPS | 5.62 | 6.90 | 8.29 | 11.47 | 13.69 |
| EPS growth | 46.3% | 22.8% | 20.2% | 38.4% | 19.3% |
| Key Segmental Revenue Mix | | | | | |
| MEP | 51.0% | 58.9% | 67.5% | 68.7% | 68.7% |
| Engg | 17.3% | 12.5% | 11.6% | 12.3% | 13.5% |
| Unitary | 25.6% | 21.1% | 20.0% | 18.2% | 17.2% |
| Opening Orderbacklog for MEP | 22,000 | 46,000 | 47,600 | 44,109 | 49,308 |
| Ratio of order backlog/sales | 1.35 | 1.81 | 1.38 | 1.02 | 0.96 |
| % Change in Key segmental revenue | | | | | |
| MEP | 21% | 56% | 36% | 25% | 18% |
| Engg | 33% | -2% | 10% | 30% | 30% |
| Unitary | 37% | 12% | 12% | 12% | 12% |
| Segmental contribution to total EBIT | | | | | |
| MEP | 42% | 60% | 66% | 62% | 58% |
| Engg | 39% | 19% | 15% | 22% | 27% |
| Unitary | 19% | 21% | 19% | 16% | 14% |

Source: Banc of America Securities - Merrill Lynch

### Balance sheet and cash flow remains strong

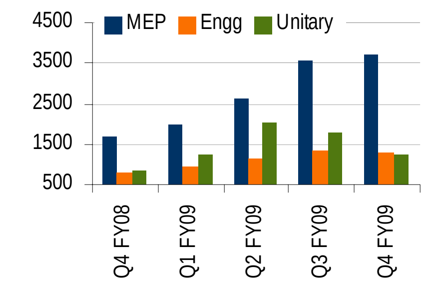
Voltas has consistently delivered strong cashflow for the last couple of years and has managed with very low operating capital. Cashflow declined in FY09 due to the sharp economic downturn and consequent increase in inventory and receivables. However, there are signs of improvement as the company has reported a sequential decline in capital employed in the quarter ending Mar09. Voltas has very high ROE and ROCE essentially due to a high asset turnover ratio and consistent focus on keeping low working capital. We expect Voltas to maintain its high ROCE and ROE.

Table 5: Summary - cash flow statement and return ratio

| | FY 08 | FY 09 | FY 10E | FY 11E | FY 12E |
|---|---|---|---|---|---|
| Profit before tax | 3,069 | 3,453 | 4,092 | 5,580 | 6,658 |
| Depreciation | 167 | 210 | 220 | 230 | 240 |
| Tax paid | (904) | (1,172) | (1,350) | (1,786) | (2,131) |
| Gross cash flow | 2,333 | 2,491 | 2,962 | 4,025 | 4,767 |
| Capital expenditure | (464) | (500) | (600) | (600) | (1,000) |
| Net change in investments | - | - | - | - | - |
| Change in working capital | 1,713 | (1,623) | 956 | (380) | (479) |
| Other operating expenditure | (93) | 232 | (2) | (2) | (4) |
| Dividend paid | (447) | (622) | (777) | (971) | (1,360) |
| Equity capital raised | - | - | - | - | - |
| Net cash flow | 3,041 | (21) | 2,539 | 2,071 | 1,925 |
| Net cash/(debt) at year end | 4,850 | 4,829 | 7,368 | 9,439 | 11,364 |
| | | | | | |
| Net Debt/Equity | (0.84) | (0.63) | (0.76) | (0.76) | (0.73) |
| EBIT/Net Operating capital employed | 319% | 99% | 155% | 160% | 135% |
| ROE | 37% | 34% | 32% | 34% | 32% |

Source: Company, Banc of America Securities - Merrill Lynch

Chart 10: Segmental capital employed trend




Source: Company

**Inventory reduction in Q4FY09 is encouraging**

Voltas has successfully reduced its inventory in Unitary cooling products by 30% q-o-q in Mar09Q. The company saw a marginal reduction in inventory of engineering and construction equipment in Q4FY09 after three consecutive quarters of increase. Voltas has seen an increase in receivables in domestic MEP business in Q4FY09. It also provided Rs300mn for a receivable in its international business. The company has seen higher cashflow in international business than operating profit while it is the reverse in its domestic business. Overall working the capital situation is getting better and is quite encouraging.

## (1) MEP construction, the key growth driver

We expect MEP segment to be the key growth driver of Voltas in FY09-12E, with a revenue CAGR of 26% compared to overall revenue CAGR of 20%. More importantly we expect MEP to grow at 36% in FY10E and drive overall revenue growth of 18.5% in FY10E. Key growth driver are as follows:

4. Execution of Rs48bn order backlog by Sep 2010. Current order backlog is 1.9x FY09 revenue of project's division of Voltas.

5. Around 15% and 56% rise in new order in FY10/11E, respectively. Voltas order inflow rose 145% during FY07-09 vs FY04-06.

6. Within project business, domestic market contributed 40% of FY09 sales and Middle East contributed 60% of sales. We expect domestic projects to grow at 22% CAGR with stronger growth from FY11. We expect international projects to grow at 29% CAGR with 50% growth in FY10E, given strong order backlog

Table 6: MEP Profit CAGR for FY09-12E - 29%

| | FY 08 | FY 09 | FY 10E | FY 11E | FY 12E |
|---|---|---|---|---|---|
| Order backlog (Rs bn) | 46.0 | 47.6 | 44.1 | 49.3 | 51.4 |
| Domestic | 8.0 | 9.4 | 10.9 | 13.5 | 14.2 |
| International | 38.0 | 38.2 | 33.2 | 35.8 | 37.2 |
| Order Inflow (Rs bn) | 40.32 | 27.06 | 31.12 | 48.47 | 53.31 |
| Domestic | 10.30 | 11.59 | 13.33 | 17.33 | 19.07 |
| International | 30.02 | 15.47 | 17.79 | 31.13 | 34.25 |
| Order Inflow y-o-y | 137% | -33% | 15% | 56% | 10% |
| Domestic | 63% | 13% | 15% | 30% | 10% |
| International | 182% | -48% | 15% | 75% | 10% |
| Total revenue (Rs Mn) | 16,320 | 25,464 | 34,615 | 43,268 | 51,230 |
| y-o-y growth | 56% | 36% | 25% | 18% | 0% |
| Domestic Revenue | 8,296 | 10,234 | 11,769 | 14,711 | 18,389 |
| y-o-y growth | 42% | 23% | 15% | 25% | 25% |
| International revenue | 8,024 | 15,230 | 22,846 | 28,557 | 32,841 |
| y-o-y growth | 5% | 90% | 50% | 25% | 15% |
| EBIT (Rs Mn) | 1,218 | 1,934 | 2,631 | 3,288 | 3,893 |
| EBIT Margin | 7.5% | 7.6% | 7.6% | 7.6% | 7.6% |
| EBIT y-o-y growth | 72% | 59% | 36% | 25% | 18% |

Source: Company, Banc of America Securities - Merrill Lynch

**Rs47.6bn order backlog key to FY10E growth**

Voltas ended year FY09 with an order backlog of Rs47.6bn, which is 1.9x FY09 sales, scheduled to be executed by Sep 2010. Voltas order backlog comprises Rs9.4bn in orders from India i.e 20% of total order. The remain 80% of the order backlog is equally split between Qatar and Abu Dhabi.

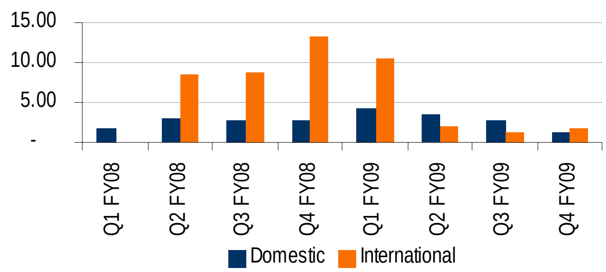
We don't expect Voltas to be affected by order cancellation or delays as there are strong signs of economic recovery in India, Abu Dhabi and Qatar. In our view, easier availability of credit and fiscal stimulus have addressed concerns over contracts in India and a rise in oil price to above US$60/bbl has addressed concerns over projects in Mid East

### New order inflow key to FY11/12E growth

We expect new order inflow to pick up momentum from H2FY10E. Key drivers:

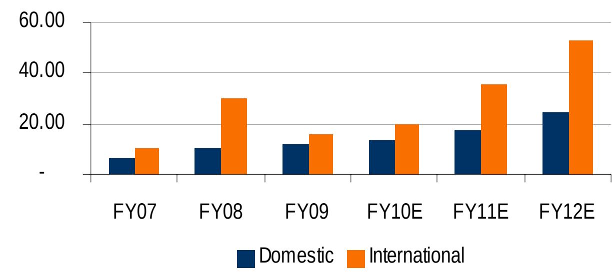
- India comprises 40% of Voltas MEP revenue. A stable govt in India since May09 should drive faster growth (Indranil Sengupta, 1 June 2009). Voltas is already seeing an increase in new enquiries. It landed a Rs3bn order for the airport upgrades in Kolkata and Chennai in May09.
- Voltas derived 60% of its MEP revenue from the Middle East in FY09. A rise in oil price to above US$60/bbl has boosted the outlook for the Middle East economies. (GCC Strategy, 1 June 09). We now expect non-oil growth of GCC region to rise from 2.9% in 2009 to 3.7% in 2010. Strong growth of 17% in cement sales in Jan-Mar09 in the Middle East by Lafarge indicates that construction is gaining momentum. Voltas could be a key beneficiary of rising capex in GCC.

Chart 11: Sharp decline in new order in since Jun 2008



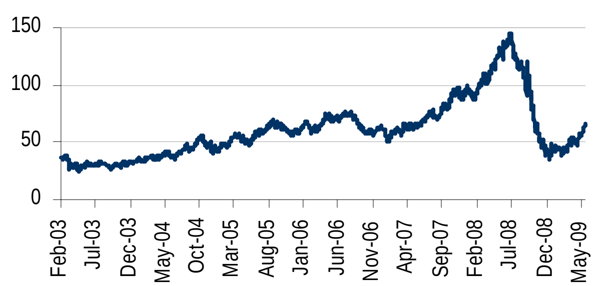

Source: Company

Chart 12: Cyclical recovery in new order likely in H2 FY10E



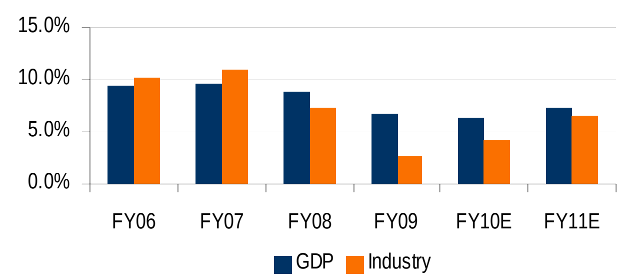

Source: Company, Banc of America Securities - Merrill Lynch

Chart 13: Oil price bottoming out




Source: Bloomberg

Chart 14: Indian economy to bottom out by end 2009




Source: Banc of America Securities - Merrill Lynch

### Voltas well positioned to capitalize MEP opportunity in India

Voltas is the second largest MEP contractor in India with about 35% market share, and is a close competitor to market leader Bluestar, which has about 38% share. India contributes 40% of Voltas MEP revenue. We expect MEP revenue from India to grow at 22% CAHR going forward. Key drivers are as follows.

- **Market size expected to jump three fold.** According to market leader Bluestar, India's market size for no-residential air-conditioning is likely to increase 3 fold to about Rs376bn in the next five years compared to the past five years. There is equal potential for building electrification and MEP offerings. The key growth drivers of domestic business in the near future are likely to be (1) Healthcare (2) Metro rail (3) airports (4) Telecom (5) commonwealth games and (5) the power sector. Nearly 40% of potential demand from retail, IT/ITES and SEZ sector could take time to be realized given the current economic downturn.

- **Service offering increased.** Voltas is likely to benefit from increasing emphasis on MEP projects instead of only air-conditioning. Increase in suffering has helped expand the target market by nearly three fold. Till about three years Voltas was working only in the central air-conditioning space. In the last three years Voltas has steadily expanded its service offering from only air-conditioning and is increasingly targeting electrification, water treatment, plumbing work, fire security etc.

- **Target market increased.** Voltas has also expanded its presence from MEP projects for buildings to Industrial units like power plants etc. The company expanded its presence by acquiring a 51% stake in Rohini Electrical for Rs620mn, with the option to increase its stake to 100% in Aug 2008. Industrial MEP could be a fast growth area for Voltas witnessed by the fact that Rohini's turnover grew 90% to Rs2.3bn in FY09.

- **Threat of competition relatively benign.** Only three players dominate India's MEP market, which includes Bluestar with 38% share and Voltas with about 35% share. Carrier, a subsidiary of United Technologies has about 10% share. ETA is the latest entrant to have increased competitive pressure and raised concerns by winning the Delhi Airport contract. However, despite this Voltas and Bluestar are enjoying over 70% ROCE in the business. Track record and local presence are key success factors of MEP business, which is why local players typically dominate the MEP market.

Table 7: India - Air-conditioning Opportunities (non-Residential) over next 5 years (cumulative)

| Segment | Size/Total investment value | TR of aircondition (TR Mn | Value of airconditioning Rs bn |
|---|---|---|---|
| IT/ITES | 300mn sq ft | 1.2 | 48.0 |
| Telecom | 370,000 cells | 0.5 | 22.0 |
| Pharma | Inv Rs 300bn | 0.4 | 25.0 |
| Bio-Tech | Inv Rs 125 bn | 0.15 | 6.0 |
| Healthcare | Inv Rs 1800bn | 0.4 | 20.0 |
| Electronic hardware | Inv Rs 465bn | 0.4 | 20.0 |
| Hospitality | 140 luxury hotels + Restaurants | 0.2 | 10.0 |
| Airports | Inv of Rs 243bn | 1.2 | 30.0 |
| Metro | Inv of Rs 667 bn | 0.4 | 20.0 |
| Retail | Inv of Rs800bn | 2.5 | 100.0 |
| SEZ | Inv of Rs3500bn | 1.5 | 75.0 |
| Total | | | 376.0 |

Source: Blue star ppt on 25 Feb2008

### International MEP business has robust outlook

Voltas derives 60% of its MEP revenue from outside India, predominantly from Abu Dhabi and Qatar. The company was adjudged second most prolific MEP contractor in 2008. During FY06-09 international MEP grew at a 68% CAGR. We expect international MEP to grow at a 29% CAGR in FY09-12E, with FY10E growing at 50%. Key drivers of growth are:

- **Huge market size.** Voltas had a turnover of around US$250mn in FY09 from Middle East, which is extremely small relative to an estimated cumulative capex of over US$50bn in MEP to be incurred in Middle East in next 10 years. Key driver of growth is the Middle East countries' goal to diversify their economy away from predominantly oil. Hydrocarbons account for 32% of GDP, 74% of total exports and 84% of budget revenues. According to GCC Strategy, 1 June 09) the recent rise in oil to above us$60/bbl has brightened the outlook for pickup in Middle East economies as well as their ability to increase capex.
- **Expansion of presence.** We expect the company to benefit from expanded market presence in terms of higher target market and achieve revenue diversification. Voltas currently has all its Middle East orders concentrated in Abu Dhabi and Qatar. The company has recently increased its stake in its Saudi Arabia subsidiary to 100% and plans to enter Morocco and Libya.
- **Strong competitive advantage.** Voltas Limited has a strong track record in the Middle East and in South East Asia and during the last 2 years. We expect the company to benefit from its recent recognition as $2^{nd}$ most prolific MEP contractor in the Middle East.

Table 8: Major upcoming projects in Saudi Arabia

| Project type | Value US$ Mn | Start time | Finish time | Current Status |
|---|---|---|---|---|
| King Abdullah Economic city | 50,000 | Q2 2006 | Q1 2020 | 1st phase by end 2009 |
| Port of King Abdullah Economic city | 500 | Q4 2009 | Q1 2015 | Design |
| Sudair City development | 40,000 | Q1 2010 | Q1 2015 | Design |
| Souk Ukaz City | 500 | Q1 2010 | Q1 2015 | Concept |
| Taif Domestic Airport Development | 5,000 | Q1 2010 | Q1 2014 | Concept |

Source: www.constructionweekonline.com

## (2) Unitary cooling products

We expect Unitary cooling product segment, which contributes to 21% of sales and profit, to grow at a 12% CAGR in FY09-12E. Room air conditioners contribute to about 70% of this division sale. Water cooler, commercial refrigeration etc contributes the remaining 30% of sales. Key drivers of growth are

- Steady industry growth rate of 12-15%, albeit lower than 21% growth witnessed in the last five years. We expect industry to grow at least 12-15% driven by falling prices, lower ownership costs due to more efficient machines and improved availability of electricity.
- We expect stable market share for Voltas compared to the 200bp increase seen in last three years driven by competing products and increase in distribution network. Voltas can offer competitive products in terms of cost owing to its policy of sourcing from either its in-house factory or externally depending on cost. The company also has a very low cost manufacturing facility in the tax free zone of Pantnagar, which can break even at around 20% capacity utilization. The factory, set up at a cost of Rs500mn, has capacity to produce 250,000 units of AC and has only 22 permanent employees.
- We also expect Voltas to maintain its EBIT margin at around 7.4%. The company's policy of avoiding dealers who ask for a high dealer margin is key to our assumption of a stable margin.

Table 9: Unitary cooling to have steady growth

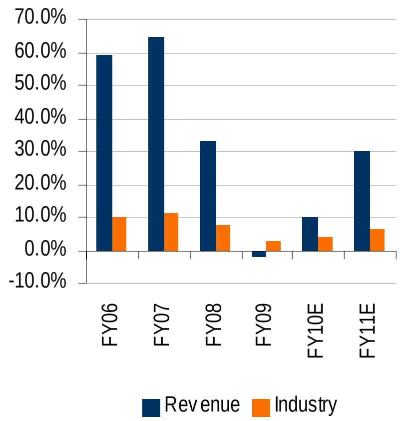
| | FY 08 | FY 09 | FY 10E | FY 11E | FY 12E |
|---|---|---|---|---|---|
| Revenue growth | 37% | 12% | 12% | 12% | 12% |
| EBIT Margin | 6.6% | 7.4% | 7.4% | 7.4% | 7.4% |
| No of AC sold | 333,000 | 359,269 | 411,683 | 464,339 | 523,985 |
| AC sales growth | 41% | 8% | 15% | 13% | 13% |
| Mkt Share | 16% | 16% | 17% | 17% | 17% |

Source: Company, Banc of America Securities - Merrill Lynch

## (3) Engineering Products and Services Segment

Cyclical downturn in the economy has hit the engineering product segment of Voltas quite hard. In FY09, revenue of this segment declined 2% and EBIT declined by 45%. We believe that worst is over for this segment as is evident from (1) decline in inventory by Rs50mn in Jan-Mar09 after three successive quarters of rise and (2) new order win worth Rs2bn for mining equipment from Hindusthan Zinc in Jun09 and (3) Likelihood of fiscal stimulus for the ailing textile industry as has been indicated by the new government.

Chart 15: Engg segment Vs India industrial gth




Source: Company, Banc of America Securities - Merrill Lynch

We expect revenue from this segment to rise 10% and EBIT to rise 14% in FY10E. We expect the segment to report stronger growth from FY11 along with the expected increase in industrial growth rate. Key driver of stronger earnings growth in this segment in FY11E and FY12E apart from rising industrial growth rate are:

- Mining and construction equipment likely to see stronger growth from FY11 driven by stimulus to construction from the recently elected government. We expect coal mining to rise 8-10% in FY11 and FY12 driven by an increase in coal based electricity generation capacity. This is much higher than growth of only 2-3% in FY09 and FY10. Improved availability of bank financing is also expected to be a key driver of mining and construction equipment as these products are mostly leased.
- We expect textile machinery sales to rise by 10% in FY11E and FY12E on base effect, cyclical up tick and new govt policy.
- Increase in demand for material handling equipment along with revival of exports following two years of sharp decline to kick in from FY11E.
- Rise in profitability driven by higher sales growth relative to cost, and improvement in revenue mix in favor of agency business.

Table 10: Engg segment - worst is over

| | FY 08 | FY 09 | FY 10E | FY 11E | FY 12E |
|---|---|---|---|---|---|
| Segmental revenue Growth (%) | | | | | |
| Material Handling Equipments (MHE) | 17% | 10% | 12% | 22% | 22% |
| Mining & Construction Equipment | 70% | -10% | 10% | 40% | 40% |
| Textile Machinery | 15% | -10% | -10% | 10% | 10% |
| Others | -40% | -10% | 15% | 25% | 4% |
| Total Engg product service | 33% | -2% | 10% | 30% | 30% |
| Agency Biz/Total Engg segment sales | 29% | 29% | 28% | 29% | 30% |
| EBIT Margin of Engg Segment | 21% | 12% | 12% | 14% | 18% |
| EBIT margin of agency biz | 30% | 25% | 25% | 25% | 25% |
| EBIT margin of mfg biz | 17% | 6% | 7% | 10% | 15% |

Source: Company, Banc of America Securities - Merrill Lynch

## Price objective basis & risk

### Voltas (VTSJF)

Our PO of Rs185/sh is based on a PER of 16x FY11E EPS of Rs11.47, which is 60% below the company's peak PE and a 15% discount to the average PE of Indian engineering and construction companies. Voltas has historically traded in a band of 60% premium/discount to the average PER of engineering cos with an average of 11% dscount since 2002 to date. Order inflow is the key catalyst for the stock valuation. A favourable change in business outlook for Voltas driven by low interest rates, rising infrastructure investment and rising oil price that would boost middle east economies will likely help re-rate the stock significantly from current levels. We have valued the company at a discount to the sector as well as peak PE, however, as we are still only in the early stages of a growth cycle.

The risks we see for the company are lack of new order wins owing to (1) extended phase slow economy growth (2) increase in competition and (3) sharp decline in oil price that could hit the middle east economies adversely.

## Analyst Certification

I, Sanjaya Satapathy, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

## Special Disclosures

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## India - General Coverage Cluster

| Investment rating | Company | ML ticker | Bloomberg symbol | Analyst |
|---|---|---|---|---|
| BUY | | | | |
| | Balrampur Chini | BMPRF | BRCM IN | Sanjaya Satapathy |
| | Chambal Fertilisers & Chemicals | CHBZF | CHMB IN | Prasad Deshmukh |
| | Exide Indus Ltd | XEDRF | CHLR IN | Sanjaya Satapathy |
| | Jain Irrigation Systems Ltd | JNIDF | JI IN | Prasad Deshmukh |
| | Motherson Sumi | XMSUF | MSS IN | Sanjaya Satapathy |
| | Renuka Sugars | SRNKF | SHRS IN | Sanjaya Satapathy |
| | Tata Chemicals Ltd | TTCXF | TTCH IN | Prasad Deshmukh |
| | Triveni Engg | TVIEF | TRE IN | Sanjaya Satapathy |
| | Voltas | VTSJF | VOLT IN | Sanjaya Satapathy |
| NEUTRAL | | | | |
| | Aditya Birla Nu | ADYAF | ABNL IN | Reena Verma Bhasin, CFA |
| | Indiabulls Real Estate Ltd | IBELF | IBREL IN | Gagan Agarwal |
| | UltraTech Cemen | XDJNF | UTCEM IN | Reena Verma Bhasin, CFA |
| UNDERPERFORM | | | | |
| | ABG Shipyard | ABSHF | ABGS IN | Sanjaya Satapathy |
| | Ambuja Cements | AMBUF | ACEM IN | Reena Verma Bhasin, CFA |
| | APIL | ANSFF | APIL IN | Gagan Agarwal |
| | Assoc. Cement | ADCLF | ACC IN | Reena Verma Bhasin, CFA |
| | Bajaj Hindusthan | BJJHF | BJH IN | Sanjaya Satapathy |
| | DLF Limited | XVDUF | DLFU IN | Vandana Luthra |
| | Grasim | GRSJF | GRASIM IN | Reena Verma Bhasin, CFA |
| | Grasim -G | GRSJY | GRAS LX | Reena Verma Bhasin, CFA |
| | HDIL | XGHSF | HDIL IN | Gagan Agarwal |
| | India Cements | INIAF | ICEM IN | Reena Verma Bhasin, CFA |
| | India Cements -G | IAMZY | ICEM LX | Reena Verma Bhasin, CFA |
| | Nagarjuna Fertilizers & Chemicals Ltd | NFACF | NFCL IN | Prasad Deshmukh |
| | Omaxe Limited | XOMXF | OAXE IN | Gagan Agarwal |
| | Puravankara Projects Ltd | XPJVF | PVKP IN | Gagan Agarwal |
| | Shree Cements | SREEF | SRCM IN | Reena Verma Bhasin, CFA |
| | Unitech Ltd | UTKIF | UT IN | Gagan Agarwal |

## *iQmethod* SM Measures Definitions

| Business Performance | Numerator | Denominator |
|---|---|---|
| Return On Capital Employed | NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization | Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization |
| Return On Equity | Net Income | Shareholders' Equity |
| Operating Margin | Operating Profit | Sales |
| Earnings Growth | Expected 5-Year CAGR From Latest Actual | N/A |
| Free Cash Flow | Cash Flow From Operations – Total Capex | N/A |
| **Quality of Earnings** | | |
| Cash Realization Ratio | Cash Flow From Operations | Net Income |
| Asset Replacement Ratio | Capex | Depreciation |
| Tax Rate | Tax Charge | Pre-Tax Income |
| Net Debt-To-Equity Ratio | Net Debt = Total Debt, Less Cash & Equivalents | Total Equity |
| Interest Cover | EBIT | Interest Expense |
| **Valuation Toolkit** | | |
| Price / Earnings Ratio | Current Share Price | Diluted Earnings Per Share (Basis As Specified) |
| Price / Book Value | Current Share Price | Shareholders' Equity / Current Basic Shares |
| Dividend Yield | Annualised Declared Cash Dividend | Current Share Price |
| Free Cash Flow Yield | Cash Flow From Operations – Total Capex | Market Cap. = Current Share Price * Current Basic Shares |
| Enterprise Value / Sales | EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities | Sales |
| EV / EBITDA | Enterprise Value | Basic EBIT + Depreciation + Amortization |

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Investment Rating Distribution: Engineering & Construction Group (as of 01 Apr 2009)

| Coverage Universe | Count | Percent | Inv. Banking Relationships* | Count | Percent |
|---|---|---|---|---|---|
| Buy | 18 | 58.06% | Buy | 6 | 42.86% |
| Neutral | 5 | 16.13% | Neutral | 2 | 40.00% |
| Sell | 8 | 25.81% | Sell | 4 | 50.00% |

Investment Rating Distribution: Global Group (as of 01 Apr 2009)

| Coverage Universe | Count | Percent | Inv. Banking Relationships* | Count | Percent |
|---|---|---|---|---|---|
| Buy | 1243 | 38.21% | Buy | 520 | 46.39% |
| Neutral | 841 | 25.85% | Neutral | 349 | 47.04% |
| Sell | 1169 | 35.94% | Sell | 388 | 36.30% |

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

FUNDAMENTAL EQUITY OPINION KEY: Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. *VOLATILITY RISK RATINGS*, indicators of potential price fluctuation, are: A - Low, B - Medium and C - High. *INVESTMENT RATINGS* reflect the analyst's assessment of a stock's: (i) absolute total return potential and (ii) attractiveness for investment relative to other stocks within its *Coverage Cluster* (defined below). There are three investment ratings: 1 - Buy stocks are expected to have a total return of at least 10% and are the most attractive stocks in the coverage cluster; 2 - Neutral stocks are expected to remain flat or increase in value and are less attractive than Buy rated stocks and 3 - Underperform stocks are the least attractive stocks in a coverage cluster. Analysts assign investment ratings considering, among other things, the 0-12 month total return expectation for a stock and the firm's guidelines for ratings dispersions (shown in the table below). The current price objective for a stock should be referenced to better understand the total return expectation at any given time. The price objective reflects the analyst's view of the potential price appreciation (depreciation).

| Investment rating | Total return expectation (within 12-month period of date of initial rating) | Ratings dispersion guidelines for coverage cluster* |
|---|---|---|
| Buy | ≥ 10% | ≤ 70% |
| Neutral | ≥ 0% | ≤ 30% |
| Underperform | N/A | ≥ 20% |

* Ratings dispersions may vary from time to time where BAS-ML Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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