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BUY

Voltas Ltd

October 23, 2007

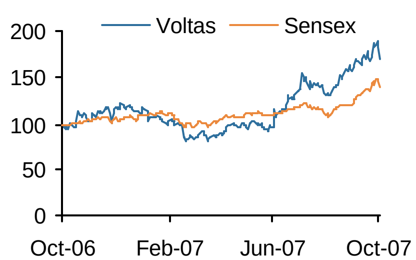
Sector: Engineering

Sensex:	17,614
CMP (Rs):	158
Target price (Rs):	190
Upside (%):	20
52 Week h/l (Rs):	187/75
Market cap (Rscr) :	5,225
6m Avg vol BSE&NSE ('000Nos):	2,781
No of o/s shares (mn):	33.1
FV (Rs):	1
Bloomberg code:	VOLT IN
Reuters code:	VOLT.BO
BSE code:	500575
NSE code:	VOLTAS

Shareholding pattern

September 2007	(%)
Promoters	27.3
FIIs	26.6
Indian institutions	18.9
Non promoter corp hold	5.2
Public & others	22.0

Share price trend



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Robust order backlog provides strong visibility

Voltas has a total order book of Rs20bn for its electro-mechanical division which would ensure healthy revenue growth for next two years. We expect electro-mechanical division revenues to witness 38% CAGR over FY07-09E driven by higher infrastructure spending in Middle East and boom in retail, IT and entertainment sector in domestic market.

Rising industrial capex

High capacity utilization across sectors, on the back of soaring domestic and international demand, has triggered capex frenzy across sectors. We find Voltas to be well equipped with having presence in mining, machine tools, spinning machines and construction equipment.

Margin sustainability will be a key

Although there has been structural margin expansion especially in unitary cooling business, Voltas in the past has witnessed volatility in operating margins. Any disappointments in maintaining margins will hurt investor sentiment on stock. We expect operating margins to stabilize around 7.1% in FY09E.

Earnings CAGR of 41.2% over FY07-09E

We expect Voltas to witness 41.2% CAGR in earnings over FY07-09E driven by robust revenue growth across all the business segments. Restructuring in unitary division as well as targeting larger projects size in electro-mechanical segment will lead to improvement in operating margins by 200bps over next two years.

Valuations justified

Voltas remains one of our preferred plays in the engineering sector with strong visibility, rising industrial capex, healthy return ratios and improving margins. At CMP of Rs158 the stock trades at 19.8x FY09E EPS and 16.1x FY09E EV/EBIDTA. We believe that earnings CAGR of 41% over FY07-09E justify current multiples at which it trades. We recommend a BUY with target price of Rs190, representing an upside of 20% from the current levels.

Valuation summary

Rs (mn)	FY06 (12)	FY07 (12)	FY08E (12)	FY09E (12)
Revenues	19,544	25,267	32,928	44,598
yoy growth (%)	32.3	29.3	30.3	35.4
Operating profit	1,118	1,280	2,272	3,166
OPM(%)	5.7	5.1	6.9	7.1
PAT	999	1,321	1,823	2,633
yoy growth (%)	4.9	32.2	38.0	44.4
EPS (Rs)	3.0	4.0	5.5	8.0
P/E (x)	52.3	39.6	28.7	19.8
P/BV (x)	19.3	12.3	9.2	6.8
EV/EBIDTA (x)	46.4	40.4	22.8	16.1
ROE (%)	40.7	38.0	36.9	39.6
ROCE (%)	29.5	26.6	37.8	42.2

Source: Company, India Infoline Research

Investment rationale

Electro mechanical segment –Revenue CAGR of 38% over FY07-09E

↗ Healthy order book position

Voltas current order backlog of Rs20bn as on June 2007, which translates to 1.5x FY07 electro-mechanical revenues would be executed over next two years. Out of the above, the domestic order book is around Rs7bn executed within 9-12 months while the remaining orders of Rs13bn are from international operations having an average execution cycle of 24 months. We expect order intake to remain strong driven by significant investments in service industry including sectors such as BPO, IT, banking, retailing and entertainment.

↗ Implementing international model to domestic market

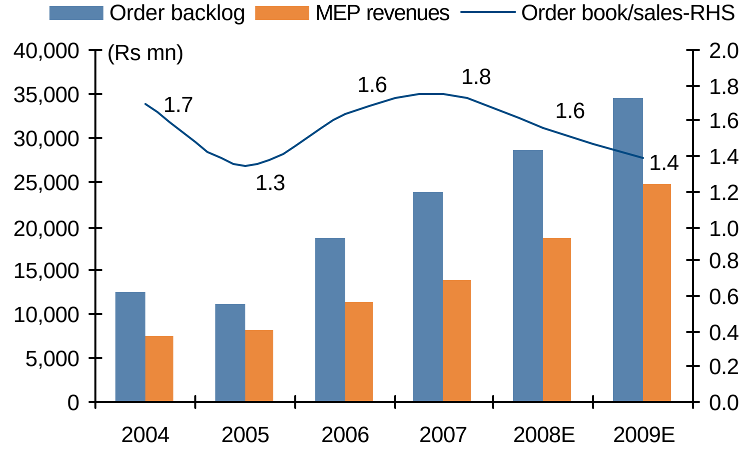
The Company's AC&R business has widened its scope of operations beyond heating, ventilation and air-conditioning (HVAC), to include mechanical electrical and plumbing (MEP) i.e. building management systems, public health engineering, process refrigeration, power management, indoor air quality, fire safety, security and multiple other utilities specially in international segment.

The company's scope of work in HVAC will be 10-12% of project cost while in MEP (which include HVAC) involve 30-35% of project cost. By bringing its international expertise and experience, Voltas will be able to capture larger share of pie in domestic market. We expect Voltas domestic business to witness 50% CAGR in revenues over next two years as compared to industry growth of 20-25%.

↗ Petro-Dollars driven construction boom to drive export segment

Voltas with an impressive track record of having executed contracts in 30 countries is an established MEP contractor in Middle East and part of South East Asia. The business potential of the amusement, leisure and entertainment industries in the Middle East is pegged above US$ 10 billion, excluding the land and the construction costs which experts are expecting to witness 27% CAGR for the next five years.The Middle East has contributed 26.3% of Voltas revenues in FY07, up from 20% in FY05. We expect Voltas export segment to witness 25% CAGR in revenues over next two years driven by Petro Dollar surplus realty boom.

Electromechanical segment: - Order book/sales



Source: Company, India Infoline Research

Engineering products and services (EPS) segment –Revenue CAGR of 35% over FY07-09E

↗ Strong capex cycle to drive segment revenues

Voltas engineering products and services division is a trading business where it markets products of its principals besides its own manufactured forklift trucks. It supplies engineering and capital equipment such as mining and construction equipment, textile equipments, machine tools to various segments. We expect Voltas to immensely benefit with impressive clients and growing manufacturing capex. This segment was most profitable business in FY07 due to less capital intensity and contributed 17% of revenues and 59% of EBIT.

↗ Operating margins to decline gradually

Material handling, construction and mining equipment accounts for about 70% of segment's revenue, while textile machinery accounts for the balance. Voltas enjoys around 20-22% operating margin in material handling segment where it sells its own manufactured forklifts and cranes. But it enjoys higher operating margins for its agency business i.e. commission income where it markets products of its principal. We expect EBIT margins to decline marginally due to following reasons;

- The share of material handling revenues to go up due to increased industrial capex taking place in India.
- Rising rupee to slower growth in textile equipment business as well as higher interest rate might affect order inflows for forklifts.

Consequently, we expect EBIT margins to decline marginally from 23.2% in FY07 to around ~21-22% in FY09.

EPS segment

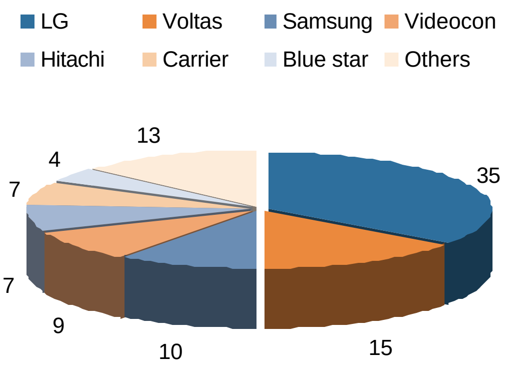
Segment	Principals	Products	Key attributes
Textile machinery	Lakshmi Machine Works, Terrot, Ebratech, Kuber, Dilo	Spinning,Knitting Weaving	Leader in spinning machinery and accessories with market share of more than 60%
Machine tools	Mitsubishi Heavy Industries, Fanuc, LMW, Weingartner, HTT, Tomos	CNC machines, Grinding machines, Gear cutting machines	One of leading machine tool suppliers in India
Mining and construction	Terex,Powerscreen,Kobelco,Dressta	Hydraulic Excavators, Dump trucks, Crushers, Loaders	Market leader in mobile crushers
Materials handling	BT,PPM,Lodigie	Forklift trucks, Container handling equipment	Largest manufacturers of forklift trucks with market share of more than 36%

Source: Company, India Infoline Research

Unitary Division –Revenue CAGR of 28% over FY07-09E

Voltas unitary division consists of room air conditioner, water coolers, water dispensers and commercial refrigerator. Higher disposable income, rising aspirations and low penetration have led to higher growth of AC industry. Voltas, the second largest player in AC segment with market share of 15% would be a major beneficiary. The water cooler and commercial refrigerators is also expected to witness strong growth driven by huge investment in retail, call centers and cold storage infrastructure. The segment contributed 25% of revenues and 6% of EBIT in FY07.

AC market share (%)



Source: Company, India Infoline Research

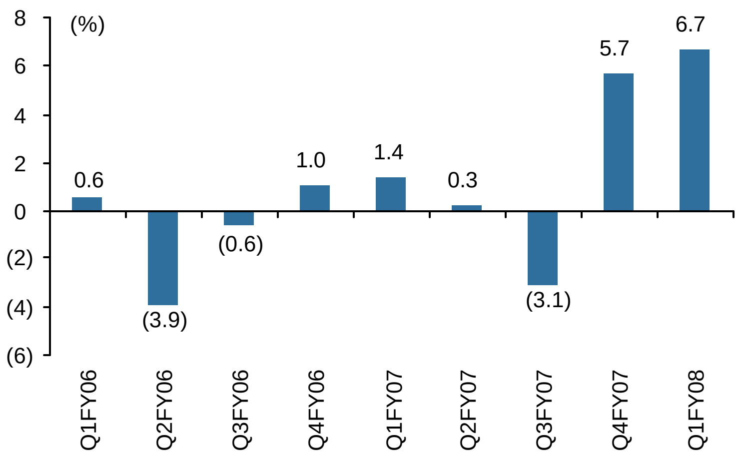
Restructuring in Unitary division

Traditionally, unitary segment has been a laggard but it has witnessed a sharp increase in EBIT margins since last two quarters (Q4FY08-5.7%, Q1FY08-6.7%) due to following reasons:

- Shifting of manufacturing facility from Hyderabad unit to Pantnagar unit where company will enjoy excise benefits.
- Increased prices for certain products as well as focus on B2B clients where margins are higher.
- Better product mix in terms of split air conditioners over window air conditioners where margins are higher.

We feel the above changes as structural and expect strong revenue as well as operating growth. Going forward, we expect EBIT margins to stabilize around 4-4.5% in FY08 as Q2 and Q3 are weak quarters for unitary division.

Quarterly EBIT margin trend in Unitary Division



Source: Company, India Infoline Research

New initiatives to enhance growth

Voltas is executing its first water treatment plant project in Singapore worth Rs3.5bn, which will help to pre-qualify for other such projects in Middle East and India. Voltas is likely to go for inorganic growth route for technological tie-up as it foresees huge opportunity in this segment. The company is also foraying into cold chain storage infrastructure in order to tap the opportunity of growing organized retail market. Both these initiatives will enhance growth in the long term.

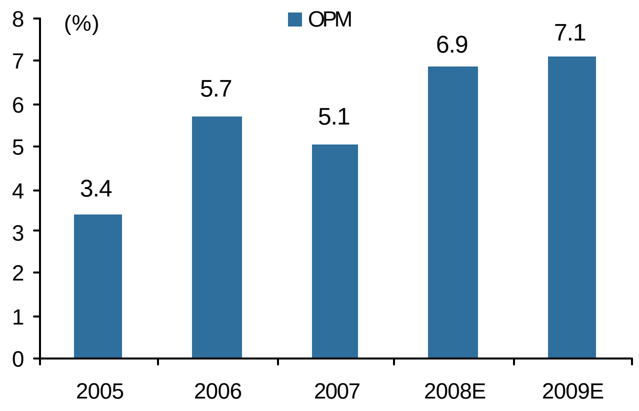
Wage cost remains concern

Since Voltas international EMPS operations are expanding on a huge scale, maintaining wage cost under control would be a key challenge. Also scarcity of skilled labor remains a key concern which restricts company to grow beyond 35-40% in topline. We expect Voltas staff cost to remain at current level of 10% in FY09E due to restructuring (VRS offered to employees) done in unitary division.

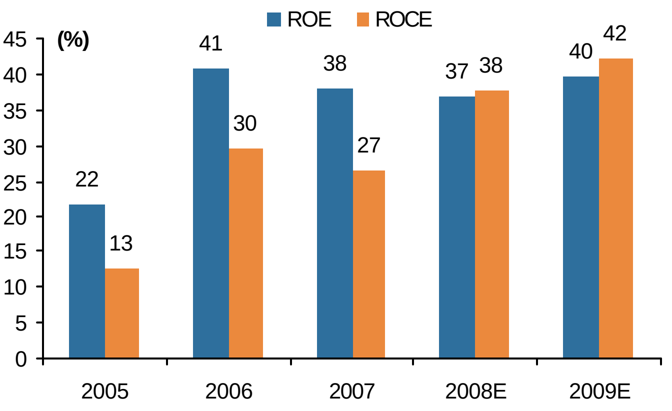
Operating margins to improve further

Although margin expansion in unitary division will be sustainable, we expect competition in this segment to continue and margin to get stabilized at 4-4.5%. Also any cost overruns in EPMS will affect margins and might prove a dampener for the stock. We expect operating margins to improve mainly on account of restructuring in unitary division and increased order intake of larger size. As a result of this, we expect operating margins to improve by 200bps from current level of 5.1%, which is in line with consensus estimates.

Trends in operating margins



Healthy return ratios (%)

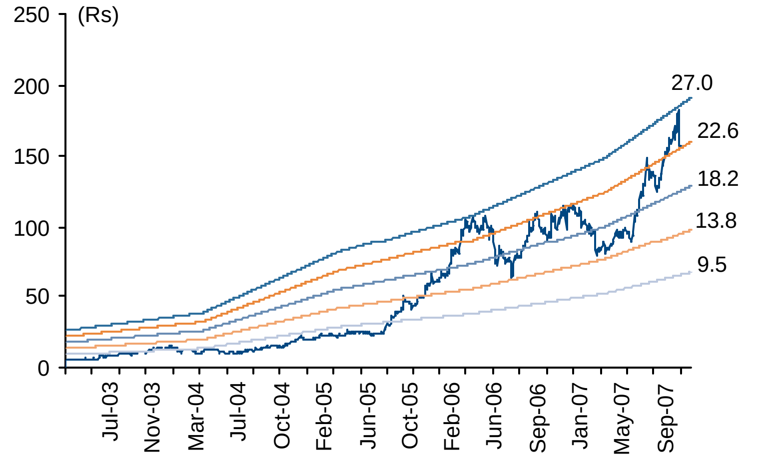


Source: Company, India Infoline Research

Valuations justified

We expect Voltas to witness 41.2% earnings CAGR over FY07-09E driven by robust revenue growth across all business segments and improvement in margins. Moreover, at the CMP of Rs158, the stock is trading at 19.8x FY09E EPS and 16.1x of FY09E EV/EBIDTA which looks attractive given growth of more than 30% in business over next four- five years. We recommend a BUY with target price of Rs190, representing an upside of 20% from the current levels.

1-year forward PE chart



Source: Bloomberg, India Infoline Research

Company background

Management Profile

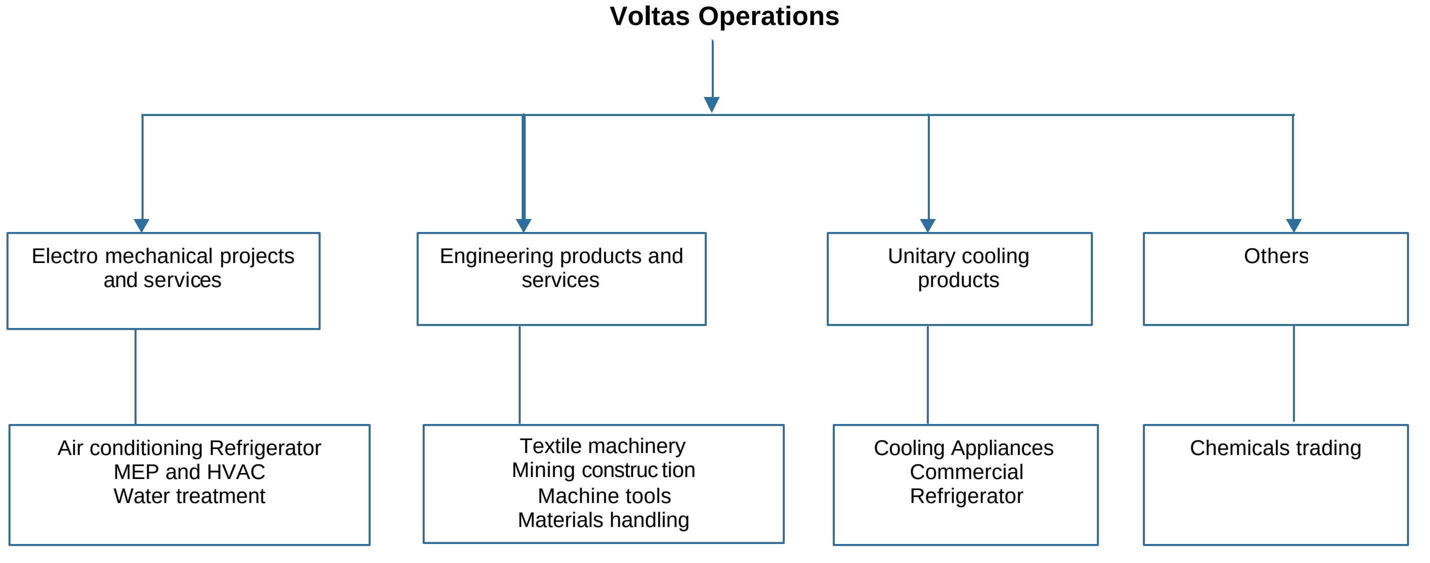
Name	Designation
Ishaat Hussain	Chairman
A Soni	Managing Director
N M Munjee	Director
N J Jhaveri	Director
S D Kulkarni	Director

Voltas Limited offers engineering solutions for a wide spectrum of industries in areas such as heating, ventilation and air conditioning, refrigeration, electro-mechanical projects, textile machinery, machine tools, mining and construction equipment, materials handling, water management, building management systems, indoor air quality and chemicals.

The Company's strengths lie principally in

- The design and manufacture of industrial equipment
- Management and execution of air conditioning and public works projects
- Sourcing, installation and servicing of technology-based systems
- Representation of global technology leaders, serving diverse industrial sectors and applications.

Voltas operations



Source: Company

Financials

Income statement

Period to (Rs mn)	FY06 (12)	FY07 (12)	FY08E (12)	FY09E (12)
Net sales	19,544	25,267	32,928	44,598
Operating expenses	18,427	23,988	30,656	41,432
Operating profit	1,118	1,280	2,272	3,166
Other income	252	514	659	981
PBIDT	977	1,124	2,118	3,005
Interest	6	(90)	56	56
Depreciation	141	156	154	162
Profit before tax(PBT)	1,222	1,728	2,721	3,930
Tax	224	407	898	1,297
Profit after tax (PAT)	999	1,321	1,823	2,633

Balance sheet

Period to (Rs mn)	FY06 (12)	FY07 (12)	FY08E (12)	FY09E (12)
Sources				
Equity share capital	331	331	331	331
Reserves	2,383	3,907	5,323	7,311
Net worth	2,714	4,237	5,654	7,642
Minority interest	3	4	4	4
Loan funds	901	1,116	750	750
Net Def tax liabilities	(256)	(279)	(279)	(279)
Total	**3,361**	**5,079**	**6,129**	**8,118**
Uses				
Gross block	3,163	2,851	3,001	3,151
Accd Depreciation	1,642	1,379	1,532	1,694
Net block	1,521	1,473	1,469	1,457
Capital WIP	114	128	128	128
Total fixed assets	1,635	1,601	1,597	1,586
Investments	461	1,248	1,248	1,248
Total current assets	10,122	13,482	16,433	23,318
Total current liabilities	8,858	11,252	13,149	18,034
Net working capital	1,264	2,230	3,284	5,284
Total	**3,361**	**5,079**	**6,129**	**8,118**

Key ratios

Period to	FY06 (12)	FY07 (12)	FY08E (12)	FY09E (12)
Per share ratios (Rs)				
EPS	3.0	4.0	5.5	8.0
Div per share	0.6	1.0	1.1	1.6
Book value per share	8.2	12.8	17.1	23.1
Valuation ratios(x)				
P/E	52.3	39.6	28.7	19.8
P/BV	19.3	12.3	9.2	6.8
EV/Sales	2.7	2.0	1.6	1.1
EV/EBIDTA	46.4	40.4	22.8	16.1
Profitability ratios (%)				
OPM	5.7	5.1	6.9	7.1
PAT	4.9	5.1	5.4	5.7
ROCE	29.5	26.6	37.8	42.2
RONW	40.7	38.0	36.9	39.6
Liquidity ratios				
Debtors days	78.5	67.1	67.0	67.0
Inventory days	54.2	60.0	60.0	60.0
Creditors days	89.3	77.1	74.0	74.0
Leverage ratios				
Debt/Total equity	0.3	0.3	0.1	0.1
Component ratios (as % of net sales)				
Cost of sales	74.6	74.3	73.5	73.5
Employee cost	9.8	10.3	9.6	9.9
Other expenditure	10.4	10.3	10.0	9.5
Total operating expenses	94.8	94.9	93.1	92.9

Cash flow statement

Period to (Rs mn)	FY06 (12)	FY07 (12)	FY08E (12)	FY09E (12)
Operating cash flow	555	1,253	2030	2795
Add/less wking cap changes	62	(1,187)	(1,524)	(1,235)
Net operating cash flow	618	65	505	1,559
Investing cash flow	(350)	457	(150)	(150)
Financing cash flow	(588)	(143)	(825)	(645)
Net increase in cash	(321)	379	(470)	765
Cash at start of the year	1618	1298	1677	1207
Cash at end of the year	1,298	1,677	1,207	1,971

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