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Rating	Reduce
Price	Rs95
Target Price	Rs86
Implied Upside	-9.5%
Sensex	17,193

(Prices as on November 11, 2011)
Trading data

Market Cap. (Rs bn)	38.0
Shares o/s (m)	330.7
3M Avg. Daily value (Rs m)	172

Major shareholders

Promoters	30.53%
Foreign	17.61%
Domestic Inst.	31.24%
Public & Other	20.62%

Stock Performance

(%)	1M	6M	12M
Absolute	(5.5)	(44.0)	(62.3)
Relative	(9.4)	(36.9)	(44.7)

Price Performance (RIC: VOLT.BO, BB: VOLT IN)



Source: Bloomberg

■ **Margins nosedive:** Voltas reported sales of Rs11bn, ahead of our estimate of Rs10.2bn, on account of higher-than-expected sales in the MEP segment (up 8% YoY to Rs7.6bn). However, sales for the EPS and UCP segment were 5% and 7.5%, respectively. Sales for the UCP segment were significantly impacted due to unfavourable weather and general economic downturn caused by soaring inflation and high interest rates. EBITDA margin was down 930bps YoY to 0.7%. EBIT margin was severely impacted in both, MEP (down 750bps to 0.7%) and UCP segment (down 940bps to 2.9%). Margins for the MEP segment were impacted by cost overrun in two major Qatar projects due to squeezed timeline on those projects. Margins for the UCP segment were impacted due to lower volumes, higher ad spend and increased raw material prices. Adj. PAT was down 71% YoY to Rs228m.

■ **Increased competitive intensity changing margin profile:** Voltas highlighted that lack of orders in the international market has led to severe competitive intensity, forcing it to lower its bidding margin to ~5% (from ~8%) to improve its chances of winning orders. It also highlighted that in the UCP segment, the number of players has increased significantly and many of the newer players have become aggressive which could lead to margin profile of the business coming to sub 9% levels.

■ **Valuation and Outlook:** The stock is trading at 15.5x FY12E earnings. We believe that Voltas will continue to face headwinds in the MEP and UCP segment, both on volume and margin front. This will continue to put pressure on working capital and balance sheet, restricting valuation. We maintain our 'Reduce' rating on the stock.

Key financials (Y/e March)	2010	2011	2012E	2013E
Revenues (Rs m)	48,058	51,768	52,152	57,629
Growth (%)	11.1	7.7	0.7	10.5
EBITDA (Rs m)	4,591	4,408	2,380	3,465
PAT (Rs m)	3,595	3,114	2,029	2,842
EPS (Rs)	10.9	9.4	6.1	8.6
Growth (%)	57.4	(13.4)	(34.8)	39.6
Net DPS (Rs)	2.7	2.5	1.5	2.1

Source: Company Data; PL Research

Profitability & Valuation	2010	2011	2012E	2013E
EBITDA margin (%)	9.6	8.5	4.6	6.0
RoE (%)	38.3	25.5	13.9	17.7
RoCE (%)	34.5	24.3	13.5	16.4
EV / sales (x)	0.6	0.5	0.6	0.5
EV / EBITDA (x)	5.9	6.3	12.5	8.1
PE (x)	8.8	10.1	15.5	11.1
P / BV (x)	2.9	2.3	2.0	1.9
Net dividend yield (%)	2.8	2.6	1.6	2.3

Source: Company Data; PL Research

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Exhibit 1: Q2FY12 Result Overview (Rs m)

Y/e March	Q2FY12	Q2Y11	YoY gr. (%)	Q1FY12	H1FY12	H1FY11	YoY gr. (%)
Net Sales	11,019	10,636	3.6	13,458	24,477	24,667	(0.8)
Expenditure							
Raw Material	8,479	7,279	16.5	9,688	18,167	17,386	4.5
<i>% of Net Sales</i>	<i>76.9</i>	<i>68.4</i>		<i>72.0</i>	<i>74.2</i>	<i>70.5</i>	
Personnel Cost	1,483	1,268	17.0	1,467	2,950	2,615	12.8
<i>% of Net Sales</i>	<i>13.5</i>	<i>11.9</i>		<i>10.9</i>	<i>12.1</i>	<i>10.6</i>	
Others	981	1,029	(4.7)	1,240	2,221	2,383	(6.8)
<i>% of Net Sales</i>	<i>8.9</i>	<i>9.7</i>		<i>9.2</i>	<i>9.1</i>	<i>9.7</i>	
Total Expenditure	10,943	9,576	14.3	12,395	23,339	22,383	4.3
EBITDA	76	1,060	(92.8)	1,062	1,138	2,284	(50.2)
<i>Margin (%)</i>	<i>0.7</i>	<i>10.0</i>		<i>7.9</i>	<i>4.7</i>	<i>9.3</i>	
Other income	421	209	101.9	215	636	461	37.8
Depreciation	89	53	66.5	103	192	104	85.4
EBIT	408	1,215	(66.4)	1,174	1,582	2,642	(40.1)
Interest	71	37	90.6	85	156	90	73.0
PBT	337	1,178	(71.4)	1,089	1,427	2,552	(44.1)
Total Taxes	176	453	(61.1)	582	758	882	(14.1)
<i>ETR (%)</i>	<i>52.3</i>	<i>38.5</i>		<i>53.4</i>	<i>53.1</i>	<i>34.6</i>	
Adjusted PAT	228	799	(71.5)	735	962	1,732	(44.5)
Reported PAT	411	902	(54.5)	1,323	1,733	1,847	(6.2)

Source: Company Data, PL Research

Exhibit 2: Segmental Break-up (Rs m)

Y/e March	Q2FY12	Q2FY11	YoY gr. (%)	Q1FY11	H1FY12	H1FY11	YoY gr. (%)
Revenue							
Electro-mechanical projects & services	7,623	7,066	7.9	7,066	14,392	13,991	2.9
<i>% of total Revenue</i>	<i>69.2</i>	<i>66.4</i>		<i>66.4</i>	<i>58.8</i>	<i>56.7</i>	
Engineering products & services	1,202	1,267	(5.1)	1,267	2,175	2,470	(12.0)
<i>% of total Revenue</i>	<i>10.9</i>	<i>11.9</i>		<i>11.9</i>	<i>8.9</i>	<i>10.0</i>	
Unitary Cooling products	2,110	2,281	(7.5)	2,281	7,735	8,149	(5.1)
<i>% of total Revenue</i>	<i>19.1</i>	<i>21.4</i>		<i>21.4</i>	<i>31.6</i>	<i>33.0</i>	
Total	11,019	10,637	3.6	10,637	24,477	24,668	(0.8)
EBIT							
Electro-mechanical projects & services	50	580	(91.4)	580	360	1,165	(69.1)
<i>% of total EBITDA</i>	<i>65.5%</i>	<i>54.7%</i>		<i>54.7%</i>	<i>33.9%</i>	<i>110.0%</i>	
Engineering products & services	178	264	(32.7)	264	348	540	(35.6)
<i>% of total EBITDA</i>	<i>233.9%</i>	<i>24.9%</i>		<i>24.9%</i>	<i>32.8%</i>	<i>51.0%</i>	
Unitary Cooling products	61	280	(78.1)	280	698	828	(15.7)
<i>% of total EBITDA</i>	<i>80.8%</i>	<i>26.5%</i>		<i>26.5%</i>	<i>65.8%</i>	<i>78.1%</i>	
Total	282	1,125	(74.9)	1,125	1,417	2,534	(44.1)
EBIT Margin (%)							
Electro-mechanical projects & services	0.7	8.2		8.2	2.5	8.3	
Engineering products & services	14.8	20.9		20.9	16.0	21.9	
Unitary Cooling products	2.9	12.3		12.3	9.0	10.2	
Total	2.6	10.6		10.6	5.8	10.3	

Source: Company Data, PL Research

Exhibit 3: Balance Sheet (Rs m)

Balance Sheet (Rs mn)	6MFY12	6MFY11	FY11
Shareholder's Funds			
Capital	331	331	331
Reserves & Surplus	15,055	12,345	13,286
Minority Interest	155	52	218
Loan Funds	2,857	883	1,381
Deferred tax Liability	18	16	18
Total	18,415	13,627	15,233
Fixed Assets			
Fixed Assets	2,377	2,387	2,458
Goodwill on consolidation	894	881	916
Investments	2,655	1,396	2,613
Deferred tax assets	237	228	170
Current assets, Loans and advances			
Inventories	8,098	7,296	8,224
Sundry Debtors	13,030	10,096	11,704
Cash and bank balances	3,333	5,503	4,980
Other current assets	7,101	5,947	7,961
Loans & Advances	2,661	2,062	2,440
Less: Current Liabilities			
Liabilities	19,900	20,273	21,137
Provisions	2,071	1,896	5,095
Net Current Assets	12,252	8,735	9,077
Total	18,415	13,627	15,233
Net NW Ex cash	8,919	3,231	4,097

The Net working capital % sale increased to 36% from 13% YoY

The Major reasons for steep increase in wc were lack of advance due to few new orders, difficulty in collecting due and increased inventory levels

Source: Company Data, PL Research

Other Highlights

Electro-mechanical Projects & Services (MEP)

- Current total order book for the segment stood at of Rs44.6bn. Domestic order book (including Water Management & Rohini) stood at Rs18.1bn, up 18% YoY and international order book stood at Rs26.4bn. Voltas highlighted that it has recently secured the LOI for a large retail project in Abu Dhabi of around Rs5bn and also secured orders worth Rs3.25bn in Saudi JV. Segment received fresh orders worth Rs8.2bn in H1FY12 v/s Rs15.2bn in H1FY11.
- It highlighted that in International markets, the major challenge relates to intense competition (resulting in the compression of bidding margins), apart from slow decision-making and conscious postponement of awarding contracts. While there is a definite slowdown in the international projects business, the more promising opportunities are within countries like Saudi Arabia, Qatar, and Oman, given their surplus oil and gas revenues.
- International profitability continues to be adversely impacted by rising input costs, restrictive visa conditions and setbacks in cash flows amplified by higher capital engagement. Two large projects in Qatar, whose margins are squeezed by the tightening of completion time lines, are expected to be completed by June 2012. Post which, the company will submit variation claims till the time the margins are likely to be under pressure on account of these projects.
- In the Water Management business, the order book shows an increase of 44% compared to the same period last year. The standalone order book of Rohini Industrial Electricals amounts to Rs2.6bn, 13% increase over the last year. However, Rohini continues to be in red due to the slow progress of some old jobs, including a high value rural electrification job.

Unitary Cooling Products for Comfort and Commercial Use

- Sales volume across the Room AC Industry in India has declined significantly in the second quarter. The downturn is firmly attributable to the significant impact of unfavourable weather duly compounded by the general economic downturn caused by soaring inflation and high interest rates.
- Voltas AC sale by volume has also declined, but lesser than that of the industry. It partly compensated the AC downturn by a strong sales push across water coolers and other commercial refrigeration products. The company saw volume dip of 18% in the unitary cooling business.
- Voltas has been able to sustain its number 2 position in the AC market, with a share of 17.6% as at the end of the quarter
- It highlighted that the AC industry is facing turmoil with increasing fragmentation and aggressive play by leading Japanese competitors with deep pockets. These new players in the last six months have exponentially increased their advertising spends and have significantly reduced unit prices.
- It has forced Voltas to up its advertising spend despite weak volumes. Voltas has concentrated on expanding its distribution reach and network into Tier II and Tier III towns.
- It also highlighted that high levels of inventory across the industry is a cause of worry and could lead to some players with cash constraints discounting their products prices.



Income Statement (Rs m)

Y/e March	2010	2011	2012E	2013E
Net Revenue	48,058	51,768	52,152	57,629
Raw Material Expenses	32,992	36,808	37,028	40,917
Gross Profit	15,066	14,961	15,124	16,713
Employee Cost	5,357	5,563	5,893	7,088
Other Expenses	5,118	4,990	6,851	6,159
EBITDA	4,591	4,408	2,380	3,465
Depr. & Amortization	214	210	354	375
Net Interest	98	165	312	270
Other Income	789	810	1,144	1,183
Profit before Tax	5,067	4,843	2,858	4,003
Total Tax	1,472	1,729	829	1,161
Profit after Tax	3,595	3,114	2,029	2,842
Ex-Od items / Min. Int.	—	—	—	—
Adj. PAT	3,595	3,114	2,029	2,842
Avg. Shares O/S (m)	330.7	330.7	330.7	331.7
EPS (Rs.)	10.9	9.4	6.1	8.6

Cash Flow Abstract (Rs m)

Y/e March	2010	2011	2012E	2013E
C/F from Operations	3,065	392	(939)	3,373
C/F from Investing	(765)	(288)	71	(500)
C/F from Financing	(2,176)	96	(207)	(1,102)
Inc. / Dec. in Cash	125	200	(1,075)	1,771
Opening Cash	4,571	4,694	4,980	3,905
Closing Cash	4,689	4,980	3,905	5,676
FCFF	3,380	(208)	(1,235)	3,884
FCFE	1,917	821	(537)	3,884

Key Financial Metrics

Y/e March	2010	2011	2012E	2013E
Growth				
Revenue (%)	11.1	7.7	0.7	10.5
EBITDA (%)	62.2	(4.0)	(46.0)	45.6
PAT (%)	57.4	(13.4)	(34.8)	40.0
EPS (%)	57.4	(13.4)	(34.8)	39.6
Profitability				
EBITDA Margin (%)	9.6	8.5	4.6	6.0
PAT Margin (%)	7.5	6.0	3.9	4.9
RoCE (%)	34.5	24.3	13.5	16.4
RoE (%)	38.3	25.5	13.9	17.7
Balance Sheet				
Net Debt : Equity	(0.4)	(0.3)	(0.1)	(0.2)
Net Wrkng Cap. (days)	(55)	(46)	(30)	(33)
Valuation				
PER (x)	8.8	10.1	15.5	11.1
P / B (x)	2.9	2.3	2.0	1.9
EV / EBITDA (x)	5.9	6.3	12.5	8.1
EV / Sales (x)	0.6	0.5	0.6	0.5
Earnings Quality				
Eff. Tax Rate	29.1	35.7	29.0	29.0
Other Inc / PBT	15.6	16.7	40.0	29.6
Eff. Depr. Rate (%)	5.5	4.8	7.0	7.0
FCFE / PAT	53.3	26.4	(26.4)	136.7

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

Y/e March	2010	2011	2012E	2013E
Shareholder's Funds	10,852	13,617	15,662	16,518
Total Debt	352	1,381	2,080	2,080
Other Liabilities	139	218	240	264
Total Liabilities	11,342	15,216	17,982	18,862
Net Fixed Assets	2,262	2,458	2,754	2,678
Goodwill	764	916	874	—
Investments	2,339	2,613	2,993	3,193
Net Current Assets	5,773	9,077	10,970	11,774
<i>Cash & Equivalents</i>	<i>4,689</i>	<i>4,980</i>	<i>3,905</i>	<i>5,676</i>
<i>Other Current Assets</i>	<i>23,561</i>	<i>30,329</i>	<i>30,452</i>	<i>31,612</i>
<i>Current Liabilities</i>	<i>22,477</i>	<i>26,232</i>	<i>23,386</i>	<i>25,515</i>
Other Assets	204	153	392	1,217
Total Assets	11,342	15,216	17,982	18,862

Quarterly Financials (Rs m)

Y/e March	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Net Revenue	10,393	16,708	13,458	11,019
EBITDA	763	1,361	1,062	76
<i>% of revenue</i>	<i>7.3</i>	<i>8.1</i>	<i>7.9</i>	<i>0.7</i>
Depr. & Amortization	54	53	103	89
Net Interest	34	42	85	71
Other Income	161	188	215	421
Profit before Tax	1,021	1,524	1,904	587
Total Tax	302	544	582	176
Profit after Tax	792	980	1,318	402
Adj. PAT	886	980	735	228

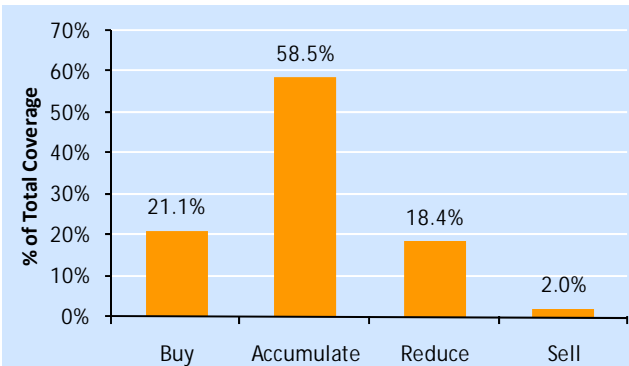
Source: Company Data, PL Research.

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Rating Distribution of Research Coverage



PL's Recommendation Nomenclature

BUY	: Over 15% Outperformance to Sensex over 12-months	Accumulate	: Outperformance to Sensex over 12-months
Reduce	: Underperformance to Sensex over 12-months	Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month	Trading Sell	: Over 10% absolute decline in 1-month
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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