India Equities
Airconditioning

Quarterly Update

Voltas Limited

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CMP	**Rs 212**
Target Price	**Rs 243**
Investment horizon	12 months
Sensex	17,868
Nifty	5,368

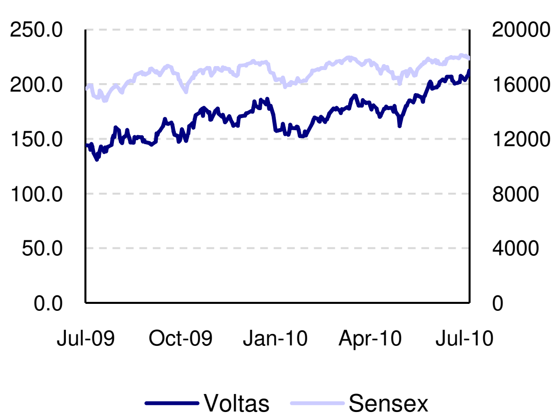
Stock Details

BSE Code	500575
NSE Code	VOLTAS
Reuters Code	VOLT.BO
Bloomberg Code	VOLT IN
Market Cap (Rs cr)	7,029.6
Beta	1.05
52 W High / Low (Rs)	215.5 / 128.0
Avg Daily Volume	3,34,926
Face Value (Rs)	1.00

Shareholding Pattern (%)

Promoters	30.48
MF/Banks/Indian FIs	36.88
FII / NRIs / OCBs	11.90
Indian Public	20.74

Price Chart



Performance Highlights

Order inflow of Rs 1,000cr during Q1FY2011; outlook positive: Voltas' carry forward order book for Q1FY2011 stood at Rs 5,006cr, representing a yoy growth of 7.3%. The order inflow of Rs 1,000cr during the quarter looks promising with Rs 407cr of domestic and Rs 600cr of international orders. The domestic order book stands at 1,500cr. The international order book contributed 70% to the total order book and stood at Rs 3,506cr. The management continues to focus on the Mechanical, electrical & plumbing (MEP), water management businesses in the domestic market. In the international market, foray into new regions like Oman, Qatar, Saudi Arabia and Singapore is expected to improve future order inflow.

Margins likely to moderate in FY2011: During FY2010, the company earned extraordinarily high margins in the Electro-Mechanical Projects and Services segment (which contributed ~65% of total sales and 60% of EBIDTA in FY2010) due to benign commodity prices, completion of large projects in the international market and settlement of claims on certain projects. However, going forward, the segment's operating margin may come down in FY2011. Also, high inflation and increase in interest rates may affect demand and impact profitability.

Valuation: We have used Relative Valuation based on average of EV/EBIDTA and Price/Earnings (P/E) ratios. The stock is currently trading at EV/EBIDTA of 12.4xFY2011E and P/E of 17.3xFY2011E earnings. The sales are expected to grow on the back of improved order inflow with foray into new international territories and a positive domestic growth scenario. **We recommend Hold on the stock with a target price of Rs 243.**

Exhibit 1: Quarterly Analysis — Rs cr

Particulars	**Q1FY2011**	**Q1FY2010**	***YoY(%)***	**Q4FY2010**	***QoQ(%)***
Revenue	1,408.3	1,249.8	*12.7*	1,480.6	*(4.9)*
Other Income	20.0	13.5	*48.1*	17.9	*11.7*
Total Income	1,428.4	1,263.3	*13.1*	1,498.5	*(4.7)*
Total Expenditure	1,280.7	1,139.3	*12.4*	1,330.7	*(3.8)*
EBIDTA	127.6	110.5	*15.5*	149.9	*(14.9)*
EBIDTA Margin (%)	*9.1*	*8.8*	-	*10.1*	-
Depreciation	5.0	4.9	*1.8*	5.4	*(7.6)*
EBIT	142.6	119.1	*19.8*	162.5	*(12.2)*
Interest	5.3	3.6	*45.6*	2.6	*102.7*
Profit before Exceptional Items and Tax	137.4	115.5	*19.0*	159.9	*(14.1)*
Exceptional Items	(0.7)	2.8	*(126.4)*	12.9	*(105.7)*
Profit before Tax	136.6	118.3	*15.5*	172.7	*(20.9)*
Tax	42.9	38.7	*11.0*	35.9	*19.6*
Net Profit	93.7	79.6	*17.7*	136.9	*(31.5)*
PAT Margin (%)	*6.7*	*6.4*	-	*9.2*	-
EPS	2.8	2.4	-	4.1	-

Source: Company data, Parsoli Research

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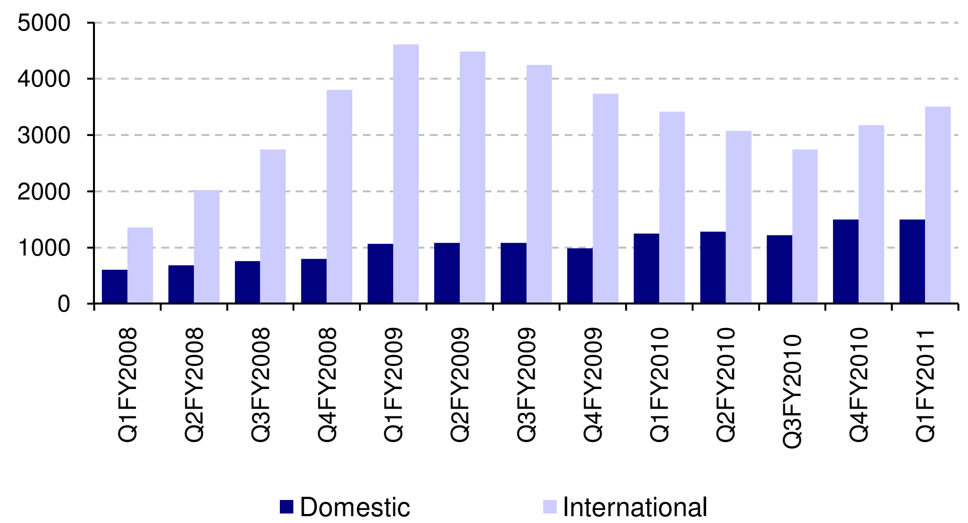
Key Updates

Order book grows 7.3% yoy as order inflow improves

Voltas' consolidated carry forward order book stood at Rs 5,006cr in Q1FY2011, up 7.3% yoy from Rs 4,666cr in Q1FY2010 with the order inflow at around Rs 1,000cr

The consolidated carry forward order book of Voltas increased by 7.3% yoy to Rs 5,006cr in Q1FY2011 as compared to Rs 4,666cr in Q1FY2010. While the domestic order book contributed approximately Rs 1,500cr (30.0% of the total order book), the international order book stood at Rs 3,506cr (70.0% of the total order book). During the quarter, the company's total order inflow stood at around Rs 1,000cr. Voltas' international business bagged four new orders worth Rs 407cr which included a project in Singapore for Metro tunnel ventilation. The management indicated that the project is a challenging one and has opened up more opportunities for the company in India, Middle East and South East Asian markets (like Hong Kong) where plans are being drawn for expanding the metro and railway network. The domestic market saw an order inflow of nearly Rs 600cr and the company's continued focus on MEP and water management businesses has contributed to the order book.

Exhibit 2: Order Book Growth **Rs cr**



Source: Company data, Parsoli Research

The order inflow is expected to improve on the back of upbeat domestic scenario and expansion of international operations to cover new markets

The management believes that the company is well-placed for the next two years in terms of size of the order book. The growth in order inflow during the quarter is a positive sign for the company. The order enquiries in the domestic market are picking up and the order execution cycle is also improving and currently stands at 1 year. The company's domestic business continues to grow and the large investments in the infrastructure sector would drive future order inflow. The international market continues to remain competitive, though the company is selective in choosing orders. The company has expanded its international operations to include new territories like Oman, Qatar and Saudi Arabia. During the quarter, Voltas signed a new joint venture (JV) with Mustafa Sultan Group in Oman which is expected to garner a good share of new orders coming up in Oman. The operations in Saudi Arabia are progressing well and the company would soon start bidding for new projects there. The execution cycle for the international market stands at around 2-2.5 years since design-based projects lead to a waiting period as they go under execution only after approval of work designs.

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The rise in COGS (as % of sales) was offset by decline in employee expenses and other expenditure

Total revenues up 12.7% yoy; margins show slight improvement

The overall revenues for Q1FY2011 grew by 12.7% yoy to Rs 1,408.3cr from Rs 1,249.8cr in Q1FY2010. The EBIDTA improved by 15.5% yoy to Rs 127.6cr in Q1FY2011 on account of a yoy decline in total expenditure (as % of sales). The EBIDTA margin, therefore, improved by 22bps yoy to 9.1% as compared to 8.8% in Q1FY2010. The net profit for the quarter was up 17.7% yoy to Rs 93.7cr and the PAT margin slightly improved to 6.7% from 6.4% in Q1FY2010.

Exhibit 3: Cost Analysis **% of sales**

	Q1FY2011	Q1FY2010	*bps change yoy*	Q4FY2010	*bps change qoq*
COGS	71.8	68.6	*315*	70.7	*106*
Employee Expenses	9.6	10.5	*(90)*	8.8	*73*
Other Expenditure	9.6	12.1	*(247)*	10.3	*(73)*
Total Expenditure	90.9	91.2	*(22)*	89.9	*107*

Source: Company data, Parsoli Research

The rise in COGS was on account of higher cost incurred in inventory procurement to meet demand in the Unitary Cooling Products segment

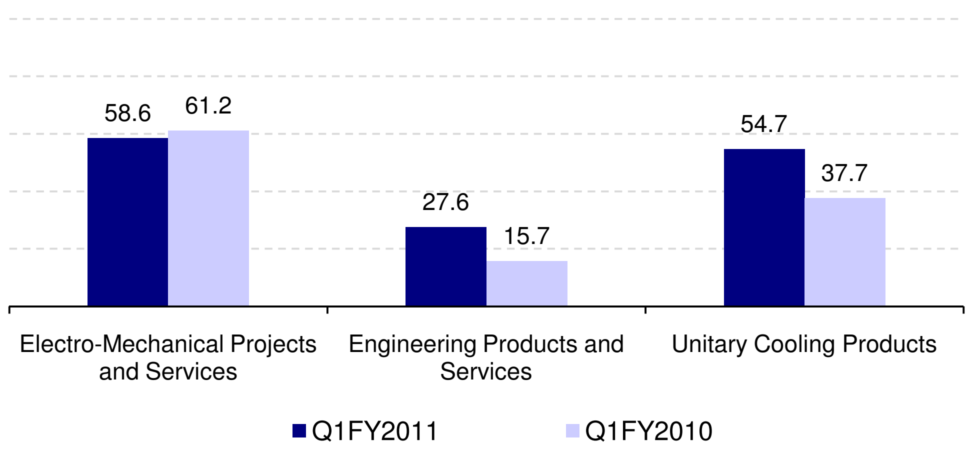
The COGS (as % of sales) increased by 315bps yoy and 106bps qoq to 71.8% in Q1FY2011. This was primarily due to an increase in expenditure on purchase of traded goods (which is part of COGS) as the company had to procure inventory at expensive rates in order to meet demand in the Unitary Cooling Products segment. The increase was offset by a 90bps yoy decline in employee expenses and 247bps yoy decline in other expenditure.

Segment Performance

Revenue and Operating Profit

The operating profit in the Electro-Mechanical Projects and Services segment was marginally lower due to slower project implementation

Exhibit 4: Segment Analysis - Operating Profit **Rs cr**



Source: Company data, Parsoli Research

During Q1FY2011, the *Electro-Mechanical Projects and Services* segment contributed 49.3% of net sales and 41.6% of operating profit. The segment revenues were marginally lower by 1.1% yoy to Rs 692.6cr due to slower project implementation by some clients. The operating profit for the segment, therefore, declined by 4.2% yoy to Rs 58.6cr.

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During Q4FY2010, the Engineering Products and Services segment's profits were up 75.2% yoy

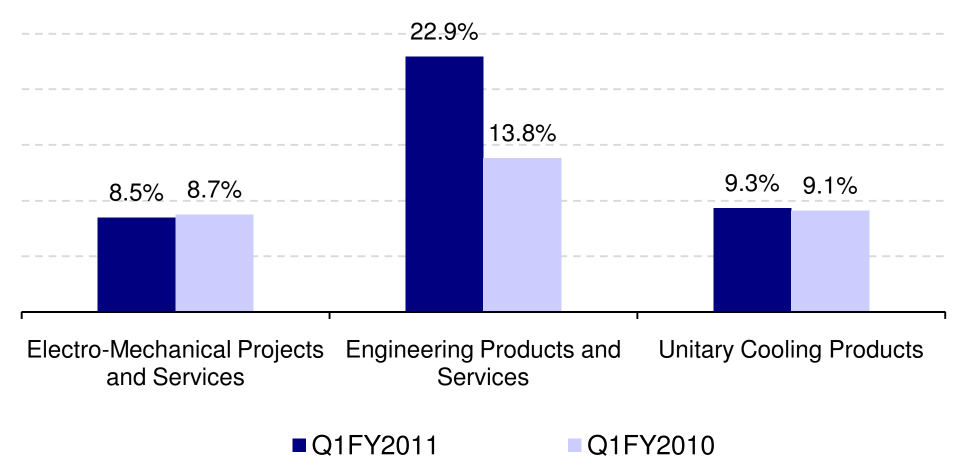
The *Engineering Products and Services* segment's revenues grew by 5.6% yoy to Rs 120.3cr in Q1FY2011. The segment's operating profit rose sharply by 75.2% yoy from Rs 15.7cr in Q1FY2010 to Rs 27.6cr in Q1FY2011. During FY2010, the segment was impacted with the sales going down by 13.7% yoy. Due to the low base effect and a revival in the businesses under the segment, the Q1FY2011 results showed improvement. The Textile Machinery business performed well during the quarter. The exchange rate also remained stable which led to growth in exports and profitability for the textile mills. There has been an improvement in new order inquiries and the order flow has also picked up. The Material Handling business growth has been slow till now but recent trends give positive indication. The company is planning to launch new products in the Forklift segment to improve sales. The Mining and Construction business performed very well during the quarter due to delivery of high value equipment yielding commissions, increased mining activity and higher revenues on spare parts.

The Unitary Cooling Products segment revenues were up 41.3% yoy and profits were up 45.0% yoy on the back of strong demand during the summer season

The *Unitary Cooling Products* segment revenues showed a robust growth of 41.3% yoy during the quarter. The revenues increased to Rs 586.8cr in Q1FY2011 on account of higher sales of airconditioners and commercial coolers. The volume growth in airconditioners was in excess of 60% during the quarter due to the increased demand during summer season. The operating profit was up 45.0% yoy to Rs 54.7cr from Rs 37.7cr in Q1FY2010. The operating profit was negatively impacted due to exchange losses (of Rs 4cr) and procurement of inventories at relatively higher prices at a short notice to avoid stock-out situation.

Operating Profit Margin

Exhibit 5: Segment Analysis - Operating Margin



Source: Company data, Parsoli Research

The Electro-Mechanical Projects and Services segment's margins may get impacted in FY2010

During Q1FY2011, the *Electro-Mechanical Projects and Services* segment margin declined by 28bps yoy. Overall, going forward, the segment margins could get affected as the very large margins of FY2010 arose due to specific situations including low commodity prices, completion of some large projects in the international business, settlement of claims on the projects completed earlier and on cancelled orders. The *Engineering Products and Services* segment margins improved from 13.8% in Q1FY2010 to 22.9% in Q1FY2011. The margins are, however, expected to moderate over time. The *Unitary Cooling Products* segment saw its margins improving by 24bps yoy to 9.3% during the quarter. However, the margins got affected as the company, in order to meet increased demand, had to procure inventories at relatively high prices to meet increased demand.

Valuation

We expect the company's revenues to grow at a CAGR of 14.6% during FY2010-12 to touch Rs 6,307.8cr by FY2012

We expect Voltas' revenues to increase at a CAGR of 14.6% (FY2010-12) to touch Rs 6,307.8cr by FY2012. The company is focusing on areas like Metro, airports (new construction and renovation) and segments including MEP and water management in the domestic market. In the international market, Voltas has expanded operations to cover new territories like Oman, Qatar, Saudi Arabia and Singapore. Voltas has a diversified portfolio which led to growth for the company even during slowdown. Going forward, we expect the order inflow to improve further as the company starts operations in new markets like Saudi Arabia and Oman. The growth scenario seems to be improving though the management has indicated that it is watchful on inflation and interest rates, where an increase is likely to dampen the demand. We maintain a cautious optimism on the company and expect moderate growth in FY2011.

Relative Valuation

We recommend Hold on the stock with a target price of Rs 243

Voltas currently trades at an EV/EBIDTA multiple of 12.4xFY2011E and 10.2xFY2012E. The current industry average stands at 16.6x. The company has reduced its debt and the current debt-equity ratio is 0.02:1. We believe that the EBIDTA margin would be slightly down in the *Electro-Mechanical Projects and Services* segment in FY2011 which contributed almost two-third of sales in FY2010. For valuing the stock, we have discounted the peer group average by 14.5% and assigned a multiple of 14.5. Using this target multiple on our FY2011 EBIDTA estimates of Rs 511.9cr, we arrive at a target price of Rs 246 per share.

When considering the P/E multiple, the stock currently trades at 17.3xFY2011E and 15.3xFY2012E earnings. We expect the EPS to grow at a CAGR of 9.2% (FY2010-12) to touch Rs 13.9 in FY2012. The peer group average stands at 23.6x. We have discounted the peer group average by 21.1% and assigned a multiple of 19.5 to value the stock. Employing this target multiple on our FY2011 EPS estimates of Rs 12.3, we arrive at a target price of Rs 240 per share.

We recommend Hold on the stock with a target price of Rs 243 and a potential upside of 14.2%.

Exhibit 6: Valuation

Pricing Methodologies	Weight Assigned	Target Price
Target price using EV/EBIDTA approach	50.0%	245.7
Target price using P/E approach	50.0%	239.6
Weighted average target price (Rs)		242.6
Current Market Price (CMP)		212.5
Upside from current levels (%)		14.2

Source: Company data, Parsoli Research

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Financial Statements

Exhibit 7: Profit & Loss Statement					**Rs cr**
	FY2008	**FY2009**	**FY2010**	**FY2011E**	**FY2012E**
Net Sales	3,202.9	4,325.9	4,805.9	5,445.9	6,307.8
% chg	*26.8*	*35.1*	*11.1*	*13.3*	*15.8*
Total Expenditure	2,949.9	4,042.8	4,346.7	4,934.0	5,727.5
% chg	*23.0*	*37.0*	*7.5*	*13.5*	*16.1*
EBIDTA	253.1	283.1	459.2	511.9	580.3
Margin (%)	*7.9*	*6.5*	*9.6*	*9.4*	*9.2*
Other Income	48.3	96.2	78.9	81.7	94.6
Depreciation & Amortisation	16.7	21.0	21.4	23.2	25.5
Interest	9.0	12.8	9.8	6.3	10.0
PBT	307.3	371.7	531.8	589.1	664.5
Margin (%)	*9.6*	*8.6*	*11.1*	*10.8*	*10.5*
Total Tax	99.7	117.2	147.2	182.6	206.0
(% of PBT)	*32.4*	*31.5*	*27.7*	*31.0*	*31.0*
PAT	207.6	254.5	384.6	406.5	458.5
% chg	*2.9*	*22.6*	*51.1*	*5.7*	*12.8*
Margin (%)	*6.5*	*5.9*	*8.0*	*7.5*	*7.3*

Source: Company data, Parsoli Research

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