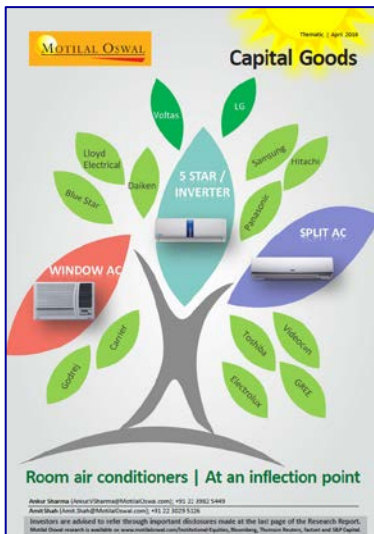


# Room Air Conditioners

Please refer our detailed report dated April 2016



## Big shift to inverter air conditioners likely in CY17

### LG taking the lead; warning bells for Voltas

We spoke with a few distributors/dealers of room air conditioners (ACs) across manufacturers to get an update on new model introductions planned for the upcoming summer season. Our key takeaways:

- **LG driving shift to inverter air conditioners:** We gather that LG, the number-2 player in ACs, with 18-20% share, has decided to stop production of fixed-speed ACs and completely shift to inverter ACs. It has aggressively priced its 1-ton inverter AC at INR31,000 and its 1.5-ton inverter AC at INR35,000. In 2016, the prices for these products were INR8,000-10,000 higher, implying ~20% price cuts. This brings the prices of inverter ACs in line with those of fixed-speed ACs, which were priced at INR30,000 for a 3-star, 1-ton variant and INR33,000 for a 3-star, 1.5-ton variant in CY16. Blue Star and Carrier to are also likely to focus on marketing inverter ACs in CY17. Being the market leader, Voltas also needs to aggressively scale up its presence in inverter ACs (5-7% of sales currently), as we expect a sharper than earlier shift in the industry from fixed-speed to inverter ACs in CY17. Inverter ACs currently account for ~10% of the industry sales.
- **Prices of fixed-speed air conditioners likely to decline in CY17:** Sales/prices of fixed-speed ACs are likely to decline. We expect a sharp fall in the sale of 5-star fixed-speed ACs (20% of the market), as LG's 3-star inverter ACs would be available at similar price points. Also, 3-star fixed-speed ACs would witness price declines, as 3-star inverter ACs of superior efficiency would be available at their current prices. Aggressive pricing of inverter AC models is likely to negatively impact the margins of incumbents, namely Voltas, Blue Star and Hitachi.
- **Warning bells for Voltas:** Relative to Hitachi and Blue Star, Voltas is weak in inverter ACs. Only 5-7% of Voltas' sales are from inverter ACs. It has not focused very aggressively on this segment. While it had started advertising inverter ACs in 2016 (advertising campaign in CY16 summer was '**Run two ACs at the cost of one**'), the share of inverter ACs in its overall sales is smaller than peers.
- **Valuation and view – downgrading Voltas to Neutral:** In the near term, LG's exit from fixed-speed ACs might imply some market share gains for Voltas, as price-conscious customers would prefer to buy fixed-speed ACs, likely to be priced below INR30,000. However, over the medium to long term, Voltas will need to aggressively scale up its share in inverter ACs, given the quicker than expected industry shift. Historically, the Japanese brands (Daikin, Mitsubishi and Hitachi) have dominated the inverter AC market in India. The strong run-up in Voltas' stock price over the past month leads us to revise our recommendation from Buy to Neutral; our target price of INR385 implies limited upside.

**Ankur Sharma** (Ankur.VSharma@MotilalOswal.com); +91 22 3982 5449

**Amit Shah** (Amit.Shah@MotilalOswal.com); +91 22 3029 5126

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**Exhibit 1: Split (fixed-speed) air conditioner energy ratings**

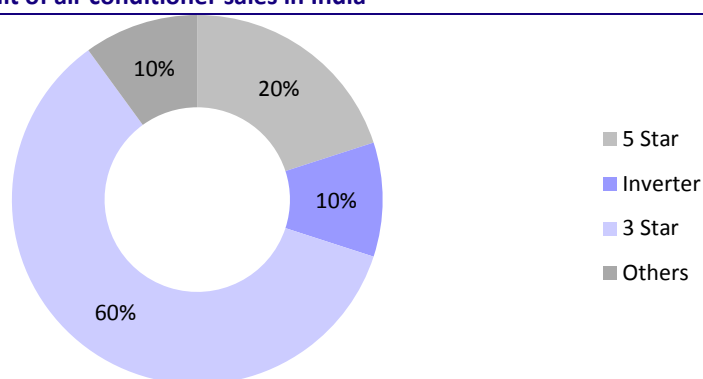
Description Star Level	Energy Efficiency Ratios (Watt)	
	Minimum	Maximum
1 Star *	2.7	2.89
2 Star **	2.9	3.09
3 Star **	3.1	3.29
4 Star ****	3.3	3.49
5 Star *****	3.5	

Source: BEE, MOSL

**Exhibit 2: Inverter air conditioner energy ratings**

Description Star Level	ISEER	
	Minimum	Maximum
1 Star *	3.1	3.29
2 Star **	3.3	3.49
3 Star **	3.5	3.99
4 Star ****	4.0	4.49
5 Star *****	4.5	

Source: BEE, MOSL

**Exhibit 3: Rating-wise split of air conditioner sales in India**

Source: Industry, MOSL

**Exhibit 4: Player-wise sales of inverter air conditioners**

Description	% of total
Industry	10%
Daikin	32-35%
Blue Star	13-14%
Voltas	5-7%
Lloyd	5%
Hitachi	40%

Source: Industry, MOSL

## Voltas: Financials and Valuations

Income Statement							(INR Million)
Y/E March	2014	2015	2016	2017E	2018E	2019E	
<b>Total Revenues</b>	<b>52,660</b>	<b>51,831</b>	<b>58,574</b>	<b>58,907</b>	<b>65,627</b>	<b>73,908</b>	
Change (%)	(4.8)	-2	13	1	11	13	
Raw Materials	38,543	35,974	41,260	41,275	46,823	52,990	
Staff Cost	5,947	5,899	6,699	6,442	6,732	7,035	
Other Expenses	5,515	5,857	6,246	6,459	6,767	7,090	
<b>EBITDA</b>	<b>2,656</b>	<b>4,100</b>	<b>4,369</b>	<b>4,732</b>	<b>5,305</b>	<b>6,794</b>	
% of Total Revenues	5.0	7.9	7.5	8.0	8.1	9.2	
Other Income	1,002	1,087	1,176	1,569	1,778	1,922	
Depreciation	248	280	278	320	333	346	
Interest	225	233	153	186	185	175	
Exceptional Items	215	462	407	0	0	0	
<b>PBT</b>	<b>3,399</b>	<b>5,136</b>	<b>5,114</b>	<b>5,795</b>	<b>6,565</b>	<b>8,195</b>	
Tax	941	1,276	1,761	1,813	1,838	2,295	
Rate (%)	27.7	25	34	31	28	28	
<b>Adjusted PAT</b>	<b>2,458</b>	<b>3,860</b>	<b>3,449</b>	<b>3,923</b>	<b>4,667</b>	<b>5,841</b>	
Extra-ordinary Income (net)	-	0	0	0	0	0	
<b>Reported PAT</b>	<b>2,458</b>	<b>3,860</b>	<b>3,856</b>	<b>3,923</b>	<b>4,667</b>	<b>5,841</b>	
Change (%)	18.7	57	0	2	19	25	
<b>Adj. Consolidated PAT</b>	<b>2,238</b>	<b>3,381</b>	<b>3,856</b>	<b>3,903</b>	<b>4,647</b>	<b>5,821</b>	
Change (%)	14.5	51	14	1	19	25	

Balance Sheet							(INR Million)
Y/E March	2014	2015	2016	2017E	2018E	2019E	
Share Capital	331	331	331	331	331	331	
Reserves	17,862	20,690	23,621	26,406	29,722	33,876	
<b>Net Worth</b>	<b>18,193</b>	<b>21,021</b>	<b>23,952</b>	<b>26,737</b>	<b>30,053</b>	<b>34,206</b>	
<b>Minority Intetest</b>	<b>138</b>	<b>161</b>	<b>258</b>	<b>258</b>	<b>258</b>	<b>258</b>	
Loans	2,629	1,217	2,600	3,100	3,600	4,100	
Deferred Tax Liability	(239)	(349)	(511)	(511)	(511)	(511)	
<b>Capital Employed</b>	<b>20,721</b>	<b>22,049</b>	<b>26,299</b>	<b>29,584</b>	<b>33,400</b>	<b>38,054</b>	
Gross Fixed Assets	4,198	4,114	5,105	5,318	5,531	5,744	
Less: Depreciation	2,113	2,223	2,894	3,214	3,546	3,892	
<b>Net Fixed Assets</b>	<b>2,086</b>	<b>1,891</b>	<b>2,211</b>	<b>2,104</b>	<b>1,984</b>	<b>1,851</b>	
Capital WIP	18	44	13	13	13	13	
Investments	7,320	10,939	15,258	15,258	15,258	15,258	
Goodwill	798	798	723	723	723	723	
<b>Curr. Assets</b>	<b>36,974</b>	<b>34,844</b>	<b>37,255</b>	<b>41,618</b>	<b>48,163</b>	<b>56,128</b>	
Inventory	9,010	8,671	8,928	8,978	10,002	11,265	
Debtors	22,039	21,051	13,066	13,140	14,639	16,486	
Cash & Bank Balance	2,818	2,516	1,971	6,133	8,630	11,606	
Loans & Advances	3,108	2,606	2,856	2,872	3,200	3,603	
<b>Current Liab. &amp; Prov.</b>	<b>26,476</b>	<b>26,466</b>	<b>29,160</b>	<b>30,051</b>	<b>32,580</b>	<b>35,679</b>	
Creditors	16,267	15,414	17,451	16,744	17,755	18,983	
Other Liabilities	10,208	11,051	11,709	13,307	14,825	16,696	
<b>Net Current Assets</b>	<b>10,499</b>	<b>8,378</b>	<b>8,095</b>	<b>11,567</b>	<b>15,583</b>	<b>20,449</b>	
<b>Application of Funds</b>	<b>20,721</b>	<b>22,050</b>	<b>26,299</b>	<b>29,665</b>	<b>33,560</b>	<b>38,294</b>	

E: MOSL Estimates

## Voltas: Financials and Valuations

### Ratios

Y/E March	2014	2015	2016	2017E	2018E	2019E
<b>Basic (INR)</b>	<b>6.8</b>	<b>10.2</b>	<b>11.7</b>	<b>11.8</b>	<b>14.0</b>	<b>17.6</b>
<b>Adj EPS</b>	<b>7.4</b>	<b>10.2</b>	<b>11.7</b>	<b>11.8</b>	<b>14.0</b>	<b>17.6</b>
Cash EPS	7.5	11.1	12.5	12.8	15.1	18.6
Book Value	55.0	63.6	72.4	80.8	90.8	103.4
DPS	1.9	2.3	2.6	2.9	3.5	4.3
Payout (incl. Div. Tax.)	29.2	23.3	28.6	28.6	28.6	28.6
<b>Valuation (x)</b>						
P/E	23.8	22.6	32.6	28.8	24.2	19.3
Cash P/E	34.2	20.9	30.2	26.6	22.6	18.2
EV/EBITDA	20.0	18.3	25.9	23.1	20.3	15.5
EV/Sales	1.0	1.5	1.9	1.9	1.6	1.4
Price/Book Value	2.9	3.6	4.7	4.2	3.7	3.3
Dividend Yield (%)	1.1	1.0	0.8	0.9	1.0	1.3
<b>Profitability Ratios (%)</b>						
RoE	13.0	17.2	15.3	15.4	16.4	18.1
RoCE	12.0	16.6	14.8	14.6	15.3	16.7
RoIC	15.0	28.1	30.4	33.1	38.2	42.7
<b>Turnover Ratios</b>						
Debtors (Days)	153	148.2	81.4	81.4	81.4	81.4
Inventory (Days)	62	61.1	55.6	55.6	55.6	55.6
Creditors. (Days)	164	161.4	108.7	103.7	98.7	93.7
Asset Turnover (x)	2.5	2.4	2.2	2.0	2.0	1.9
<b>Leverage Ratio</b>						
Debt/Equity (x)	0.1	0.1	0.1	0.1	0.1	0.1

### Cash Flow Statement

Y/E March	2014	2015	2016	2017E	2018E	2019E
<b>PBT before EO Items</b>	<b>3,399</b>	<b>5,136</b>	<b>5,114</b>	<b>5,795</b>	<b>6,565</b>	<b>8,195</b>
Add : Depreciation	248	280	278	320	333	346
Interest	225	233	-	-	-	-
Less : Direct Taxes Paid	(941)	(1,276)	(1,599)	(1,813)	(1,838)	(2,295)
(Inc)/Dec in WC	98	1,425	(262)	690	(1,519)	(1,890)
<b>CF from Operations</b>	<b>3,030</b>	<b>5,798</b>	<b>3,530</b>	<b>4,993</b>	<b>3,541</b>	<b>4,357</b>
(Inc)/Dec in FA	462	58	(213)	(213)	(213)	(213)
<b>Free Cash Flow</b>	<b>3,492</b>	<b>5,856</b>	<b>3,317</b>	<b>4,780</b>	<b>3,328</b>	<b>4,144</b>
Investment in liquid assets	(3,247)	(3,619)	(4,320)	-	-	-
<b>CF from Investments</b>	<b>(2,785)</b>	<b>(3,561)</b>	<b>(4,533)</b>	<b>(213)</b>	<b>(213)</b>	<b>(213)</b>
(Inc)/Dec in Debt	17	(1,412)	1,383	500	500	500
Less : Interest Paid	(225)	(233)	-	-	-	-
Dividend Paid	(716)	(894)	(988)	(1,118)	(1,331)	(1,667)
<b>CF from Fin. Activity</b>	<b>(925)</b>	<b>(2,539)</b>	<b>395</b>	<b>(618)</b>	<b>(831)</b>	<b>(1,167)</b>
<b>Inc/Dec of Cash</b>	<b>(679)</b>	<b>(302)</b>	<b>(607)</b>	<b>4,162</b>	<b>2,497</b>	<b>2,976</b>
Add: Beginning Balance	3,497	2,818	2,516	1,971	6,133	8,630
<b>Closing Balance</b>	<b>2,818</b>	<b>2,516</b>	<b>1,865</b>	<b>6,133</b>	<b>8,630</b>	<b>11,606</b>

E: MOSL Estimates

NOTES

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#### Kadambari Balachandran

Email : [kadambari.balachandran@motilalosal.com](mailto:kadambari.balachandran@motilalosal.com)

Contact : (+65) 68189233 / 65249115

Office Address : 21 (Suite 31), 16 Collyer Quay, Singapore 04931



## Motilal Oswal Securities Ltd

Motilal Oswal Tower, Level 9, Sayani Road, Prabhadevi, Mumbai 400 025

Phone: +91 22 3982 5500 E-mail: [reports@motilalosal.com](mailto:reports@motilalosal.com)