

Voltas

16 June 2016

Reuters: VOLT.BO; Bloomberg: VOLT IN

We had a meeting with the management of Voltas recently to get the latest business update. Following are the key takeaways:

Unitary cooling products (UCP) segment outlook

1QFY16 trend: While the management expects 1QFY16 performance to be better on YoY basis, the uptick in its largest market of North India is lower than expected. The industry witnessed strong growth momentum in AC (air-conditioner) sales during April 2016, but the growth intensity reduced in May 2016 and first two weeks of June 2016.

EESL's plan to distribute inverter ACs: As per media reports, EESL (Energy Efficiency Services Ltd) plans to foray into the distribution of ACs. The management is quite optimistic and feels it will be a good development for the AC industry. The focus of EESL is to save energy by promoting energy-efficient products and hence it intends to distribute only inverter ACs of 3-star and 5-star categories. Currently, inverter ACs account for only 10% of industry volume, while in case of Voltas it is even lower at 5%. The management feels that EESL can provide the required push to significantly increase the penetration of inverter ACs. While the trade terms of EESL are yet to be announced, the management expects EESL to work with at least five to seven leading AC vendors. Whether EESL leads to significant dilution in pricing/margin for the AC industry will be keenly monitored.

AC industry's outlook and Voltas strategy: The current domestic industry size of ACs is 4mn units, with a very low penetration level of around 5%. The management feels the industry can grow exponentially with better availability of power as 70%-75% of the AC industry's sales take place in only 20-25 cities of India. Voltas remains the market leader in India with a market share of 21% driven by factors such as strong brand pull, superior product quality, wider availability through a large dealer network, consumer trust and a strong track record. Voltas believes it has scope for further market share improvement in all four regions of India, provided the competition remains rational. Retail penetration of Voltas remains strong with 12,000 touch-points nationally, with North India accounting for the largest share. Institutional sales do not account for more than 10% of revenues, with limited direct exposure to the realty sector. Voltas does not intend to expand its scope of manufacturing (currently it imports indoor units and compressors while it makes outdoor units) and prefers the assembly model. Its AC plant is likely to lose excise duty benefit in two years and by then it hopes the GST will get implemented.

ACCUMULATE

Sector: Capital Goods

CMP: Rs325

Target Price: Rs322

Downside: 1%

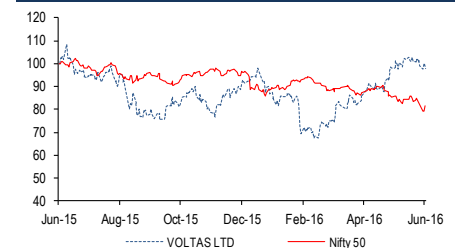
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Key Data

Current Shares O/S (mn)	330.9
Mkt Cap (Rsbn/US\$bn)	107/1.6
52 Wk H / L (Rs)	360/211
Daily Vol. (3M NSE Avg.)	1,869,971

One -Year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
Voltas	(0.6)	5.5	(2.3)
Nifty Index	3.6	5.0	1.2

Source: Bloomberg

Y/E March (Rsmn) (consolidated)	FY14	FY15	FY16	FY17E	FY18E
Net revenues	52,660	51,831	58,574	62,706	69,850
EBITDA	2,656	4,100	4,369	4,852	5,845
Adjusted net profit	2,238	3,349	3,404	4,025	4,839
Adjusted EPS (Rs)	6.8	10.1	10.3	12.2	14.6
EPS growth (%)	14.4	49.6	1.6	18.3	20.2
EBITDA margin (%)	5.0	7.9	7.5	7.7	8.4
PER (x)	48.0	32.1	31.6	26.7	22.2
P/BV (x)	5.9	5.1	4.5	4.0	3.5
EV/EBITDA (x)	40.4	25.9	24.7	22.1	17.9
Dividend yield (%)	0.6	0.7	0.8	0.9	1.0
RoCE (%)	12.1	17.6	16.6	16.2	18.1
RoIC (%)	21.7	38.7	44.2	42.9	45.5

Source: Company, Nirmal Bang Institutional Equities Research

Sustainable margin profile in UCP segment

Voltas posted a strong EBIT margin of 13.2% in FY16, although down 70bps YoY on a high base. It gave EBIT margin guidance of 12%-13% for FY17 during the 4QFY16 conference call, as the year started with a strong summer season. While there are many variables affecting the margin profile including commodity prices, currency movement (import content is high at 50%), competitive intensity, seasonality in demand and high advertising expenditure (at 4% to 6% of sales for Voltas), the management feels that over the next five years the sustainable operating margin profile will be 10%-11%. Further, Voltas is also prudent in making a provision for warranty at the time of sale of the AC itself and also in reporting advertisement expenses as a part of business expenses, which certain other players may not be following, and hence on a like-to-like basis Voltas has a 4%-5% higher margin than its peers. (Some players classify advertisement expenditure as a part of other unallocable expenses, thereby inflating their AC segment's margin in segmental reporting).

Air-cooler business update

Voltas launched air-coolers in Delhi and Punjab last year and completed one year of operations in air-cooler sales in three states. In a few other states (like Gujarat, Madhya Pradesh and parts of North and Central India), it has completed five to six months and sold 70,000 units of air-coolers in FY16 with the average selling price being Rs6,000 to Rs7,000. After a few months, Voltas will undertake a review to analyse its performance and decide the future course of action. Voltas currently has 11 models of air-coolers and has added 200 exclusive touch-points for air-cooler sales. The air-cooler industry size currently is 5mn units, of which only 30% is catered to by the organised segment. Voltas aims to be among Top-2 players in the air-cooler segment over the next three years.

Electro-mechanical projects segment (EMPS) outlook

International projects update

International EMPS business continues to remain challenging with limited tenders in the pipeline, and Voltas continues to remain cautious in bidding because of adverse tender conditions. International EMPS order book stood at Rs19bn as of end-FY16 (48% of total order book), constituting Rs3bn projects from Singapore (won in 1QFY16) and Rs16bn projects from the Middle East (of which, Rs6.2bn projects were won in 4QFY16 and Rs1.6bn were won in 9MFY16, while the balance Rs8.2bn is the unexecuted portion of orders won prior to FY16). The Middle East exposure is primarily in Qatar, UAE, Oman and Bahrain while key sectors are hotels, offices, malls and tunnel ventilation. The execution cycle for international projects is 18 to 24 months while Voltas wants to restrict itself to average ticket size per project of Rs1bn-Rs5bn. The pipeline for upcoming tenders is limited as MEP tenders for Dubai Expo and Qatar football stadiums are still awaited. Recently, Larsen & Toubro won an EPC contract to build a greenfield football stadium in Qatar, but civil works are likely to take around 12 months and hence tenders for MEP works of such stadiums are expected only three to four quarters down the line. Voltas continues to remain very cautious in bidding for new projects as certain contracts carry unfavourable terms. Voltas is unwilling to take any "design and build" type of contracts because of their undefined scope while it is also not interested in undertaking high value iconic projects. For large value projects, Voltas will opt for the joint venture route with clearly defined scope of work. Voltas has set up three internal risk evaluation committees to decide whether to bid for international contracts.

Domestic projects update

The current tender pipeline in the domestic market is low. Rural electrification (RE) is progressing well, but MEP orders from other large infrastructure projects like metro rail, airport and smart city have not fructified. Along with RE, government-sponsored projects like buildings for IIMs, IITs and hospitals form a large part of the order book of Voltas. In RE, the payment cycle is good while project certification speed has improved and therefore Voltas intends to focus more on RE, especially in Madhya Pradesh. Its domestic EMPS order book stood at Rs20bn as of end-FY16 (52% of total order book) constituting sectors such as RE (Rs2bn), water (Rs2bn), convention centre at Bandra-Kurla Complex in Mumbai (Rs2.2bn) and metro rail (Rs6bn) while the rest is scattered across various industries. While many large infrastructure projects are planned (like metro rail in Mumbai, Ahmedabad, Jaipur and Lucknow as well as many greenfield and brownfield airports), the management does not expect any significant revival in order finalisation over the next two years because of lack of tender pipeline visibility.

Revenue growth and margin outlook for EMPS

FY16 witnessed a strong 23% YoY rise in EMPS revenues to Rs27.2bn, primarily owing to the pick-up in execution of new projects in Qatar. On this high base, the management expects EMPS segment to post flat-to-low single digit revenue growth in FY17. While EMPS orders are taken at the bidding-level margin of 4%-5%, time overrun because of delay on the part of customers to execute and commission their projects leads to a margin of only 1%-2% on closure of the projects. Even in FY17, the management does not expect a significant increase in EMPS margins (EBIT margin was 1.4% in FY16).

Outlook and valuation

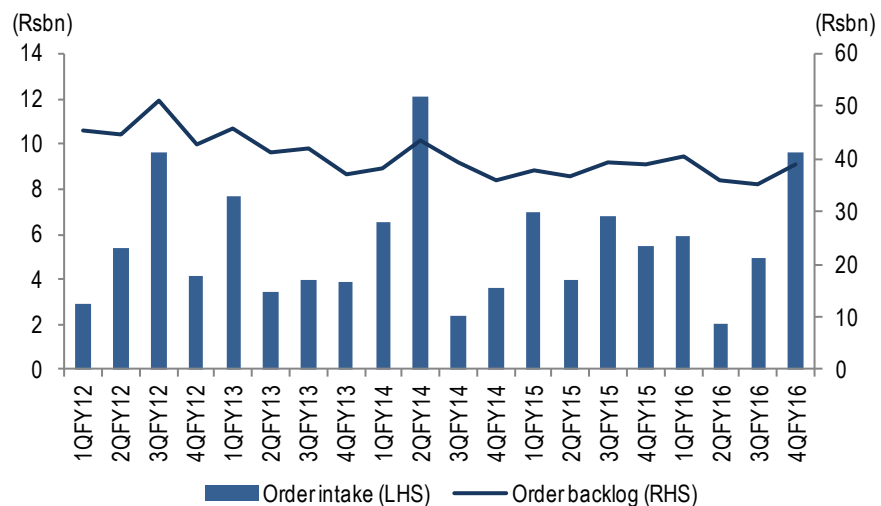
We expect Voltas to post a 19% adjusted earnings CAGR over FY16-FY18E along with a free cash flow generation of Rs6bn. Capex-light balance sheet remains strong with low leverage and high return ratios (RoCE/RoIC of 18%/45%, respectively, in FY18E) and low ex-cash net working capital requirement (8.4% in FY16 versus 9.6% in FY15). We have valued Voltas at 22x FY18E earnings, translating to a target price of Rs322. However, post 33% run-up over the past three months, the stock is fairly priced and hence we have retained Accumulate rating on it.

Exhibit 1: Segment-wise snapshot

Y/E March	4QFY15	3QFY16	4QFY16	YoY (%)	QoQ (%)	FY15	FY16	YoY (%)
Revenues (Rsmn)								
Electro-mechanical projects	5,997	7,219	8,186	36.5	13.4	22,085	27,172	23.0
Engineering products	811	1,114	927	14.3	(16.8)	3,601	3,702	2.8
Unitary cooling products	7,807	4,345	8,591	10.0	97.7	25,105	25,566	1.8
Revenue mix (%)								
Electro-mechanical projects	41.0	56.9	46.2	-	-	43.5	48.1	-
Engineering products	5.5	8.8	5.2	-	-	7.1	6.6	-
Unitary cooling products	53.4	34.3	48.5	-	-	49.4	45.3	-
EBIT (Rsmn)								
Electro-mechanical projects	43	(86)	278	541.5	NA	228	374	64.1
Engineering products	287	247	302	5.3	22.4	1,081	1,127	4.3
Unitary cooling products	1,391	505	1,391	-	175.6	3,491	3,382	(3.1)
EBIT margin (%)								
Electro-mechanical projects	0.7	(1.2)	3.4	-	-	1.0	1.4	-
Engineering products	35.4	22.1	32.6	-	-	30.0	30.5	-
Unitary cooling products	17.8	11.6	16.2	-	-	13.9	13.2	-

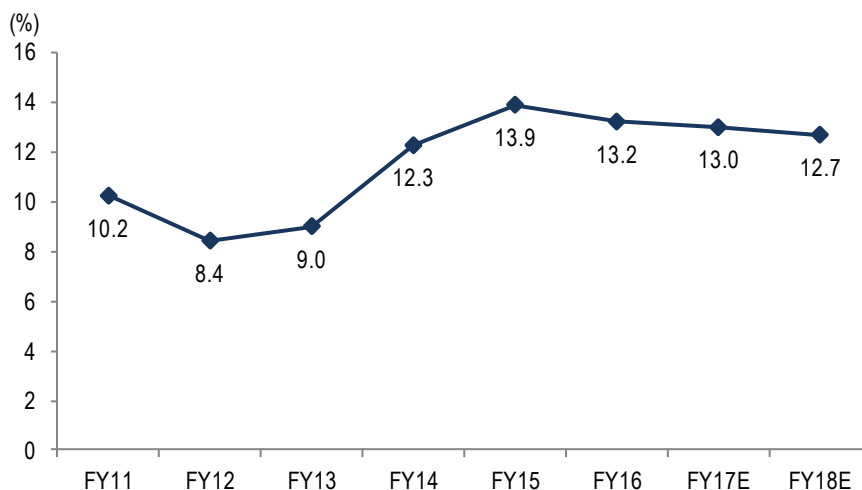
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: EMPS – trend in order inflow and backlog



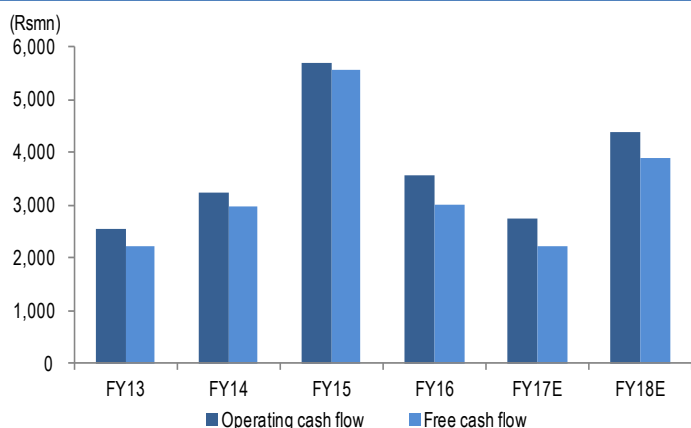
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: UCP – trend in EBIT margin profile



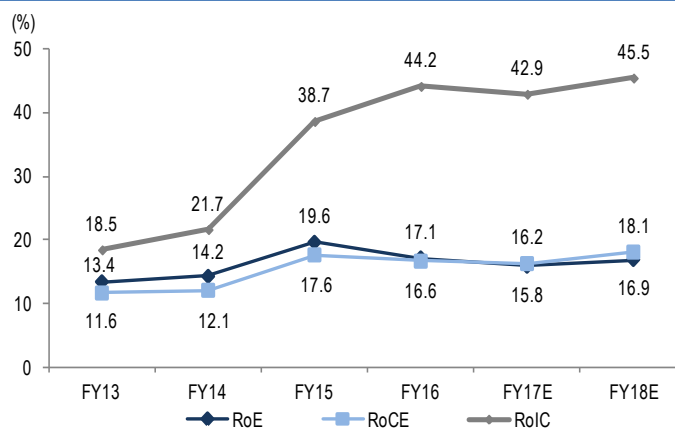
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Trend in cash flow position



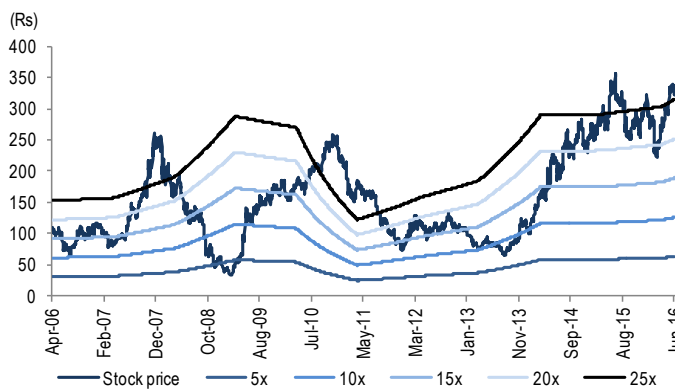
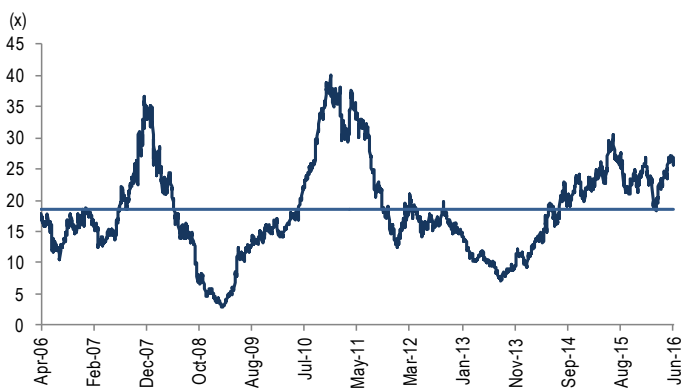
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Trend in return ratios



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: P/E charts



Source: BSE, Nirmal Bang Institutional Equities Research

Financial statements (consolidated)
Exhibit 7: Income statement

Y/E March (Rsmn)	FY14	FY15	FY16	FY17E	FY18E
Net sales	52,660	51,831	58,574	62,706	69,850
% growth	(4.8)	(1.6)	13.0	7.1	11.4
Raw material costs	38,543	35,975	41,260	43,831	48,336
Staff costs	5,947	5,899	6,699	7,274	8,103
Other overheads	5,515	5,857	6,246	6,749	7,566
Total expenditure	50,005	47,731	54,205	57,854	64,005
EBITDA	2,656	4,100	4,369	4,852	5,845
% growth	11.6	54.4	6.6	11.0	20.5
EBITDA margin (%)	5.0	7.9	7.5	7.7	8.4
Other income	1,002	1,087	1,176	1,232	1,343
Interest costs	225	233	153	180	124
Depreciation	248	280	278	314	343
Profit before tax	3,184	4,675	5,114	5,590	6,721
Tax	941	1,276	1,600	1,565	1,882
Net profit	2,243	3,398	3,515	4,025	4,839
Minority interest	5	50	111	-	-
Extra-ordinary items	216	462	407	-	-
Reported net profit	2,454	3,811	3,810	4,025	4,839
Adjusted net profit	2,238	3,349	3,404	4,025	4,839
Adjusted PAT margin (%)	4.2	6.5	5.8	6.4	6.9
Adjusted EPS (Rs)	6.8	10.1	10.3	12.2	14.6
% growth	14.4	49.6	1.6	18.3	20.2

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: Balance sheet

Y/E March (Rsmn)	FY14	FY15	FY16	FY17E	FY18E
Share capital	331	331	331	331	331
Reserves	17,862	20,690	23,621	26,562	30,086
Net worth	18,193	21,021	23,952	26,893	30,417
Minority interest	138	161	258	258	258
Short-term loans	2,575	1,170	2,599	1,899	1,199
Long-term loans	54	47	-	-	-
Total loans	2,629	1,217	2,599	1,899	1,199
Total liabilities	20,960	22,398	26,810	29,051	31,874
Gross block	4,592	4,549	5,161	5,661	6,161
Depreciation	2,507	2,659	2,937	3,251	3,594
Net block	2,086	1,891	2,224	2,410	2,567
Capital work-in-progress	18	44	-	-	-
Goodwill	798	798	723	723	723
Investments	7,320	10,939	15,257	15,257	15,257
Inventories	9,010	8,671	8,927	9,304	10,350
Debtors	13,352	13,386	13,066	13,789	15,253
Cash	2,818	2,516	1,971	2,237	3,979
Loans and advances	3,108	2,606	2,856	3,335	3,645
Other current assets	8,687	7,665	10,435	10,915	11,599
Total current assets	36,975	34,844	37,255	39,581	44,826
Creditors	16,267	15,414	17,451	17,135	18,812
Other current liabilities & provisions	10,208	11,051	11,709	12,296	13,198
Total current liabilities	26,476	26,466	29,160	29,431	32,010
Net current assets	10,499	8,378	8,095	10,150	12,816
Deferred tax asset (net)	239	349	511	511	511
Total assets	20,960	22,398	26,810	29,051	31,874

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Cash flow

Y/E March (Rsmn)	FY14	FY15	FY16	FY17E	FY18E
EBIT	2,408	3,820	4,091	4,538	5,502
(Inc.)/dec. in working capital	513	1,820	(262)	(1,789)	(924)
Cash flow from operations	2,921	5,639	3,829	2,749	4,578
Other income	1,002	1,087	1,176	1,232	1,343
Depreciation	248	280	278	314	343
Tax paid (-)	(941)	(1,276)	(1,600)	(1,565)	(1,882)
Minority interest (-)	(5)	(50)	(111)	-	-
Net cash from operations	3,225	5,681	3,572	2,730	4,382
Capital expenditure (-)	(242)	(112)	(567)	(500)	(500)
Net cash after capex	2,984	5,569	3,005	2,230	3,882
Interest paid (-)	(225)	(233)	(153)	(180)	(124)
Dividends paid (-)	(716)	(980)	(1,006)	(1,084)	(1,316)
Inc./(dec.) in short-term borrowing	23	(1,405)	1,430	(700)	(700)
Inc./(dec.) in long-term borrowing	(6)	(7)	(47)	-	-
Inc./(dec.) in total borrowings	17	(1,412)	1,383	(700)	(700)
(Inc.)/dec. in investments	(3,247)	(3,618)	(4,319)	-	-
Minority interest	20	22	98	-	-
Cash from financial activities	(4,152)	(6,221)	(3,997)	(1,964)	(2,140)
Others	488	350	447	-	-
Opening cash balance	3,498	2,818	2,516	1,971	2,237
Closing cash balance	2,818	2,516	1,971	2,237	3,979
Change in cash balance	(680)	(302)	(545)	266	1,742

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: Key ratios

Y/E March	FY14	FY15	FY16	FY17E	FY18E
Per share (Rs)					
Adjusted EPS	6.8	10.1	10.3	12.2	14.6
Book value	55.0	63.6	72.4	81.3	92.0
Valuation (x)					
P/E	48.0	32.1	31.6	26.7	22.2
P/BV	5.9	5.1	4.5	4.0	3.5
EV/EBITDA	40.4	25.9	24.7	22.1	17.9
EV/sales	2.0	2.0	1.8	1.7	1.5
Return ratios (%)					
RoCE	12.1	17.6	16.6	16.2	18.1
RoE	14.2	19.6	17.1	15.8	16.9
RoIC	21.7	38.7	44.2	42.9	45.5
Profitability ratios (%)					
EBITDA margin	5.0	7.9	7.5	7.7	8.4
EBIT margin	4.6	7.4	7.0	7.2	7.9
PAT margin	4.2	6.5	5.8	6.4	6.9
Turnover ratios					
Total asset turnover ratio (x)	2.6	2.4	2.4	2.2	2.3
Debtor days	93	94	82	83	84
Inventory days	65	62	55	56	57
Creditor days	158	161	145	147	149
Solvency ratios (x)					
Debt-equity	0.14	0.06	0.11	0.07	0.04

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
23 October 2013	Buy	85	108
7 November 2013	Buy	91	108
13 November 2013	Buy	88	108
26 November 2013	Buy	93	108
5 February 2014	Buy	108	140
5 June 2014	Hold	205	223
10 July 2014	Accumulate	200	223
18 August 2014	Accumulate	221	253
9 October 2014	Accumulate	238	253
18 November 2014	Buy	279	326
9 January 2015	Buy	244	326
16 February 2015	Buy	256	322
15 April 2015	Buy	303	322
26 May 2015	Accumulate	325	343
8 July 2015	Accumulate	319	343
17 August 2015	Accumulate	315	320
12 October 2015	Accumulate	277	320
10 November 2015	Accumulate	276	309
8 January 2016	Accumulate	297	309
16 February 2016	Buy	238	301
12 April 2016	Buy	278	301
20 May 2016	Accumulate	323	322
16 June 2016	Accumulate	325	322

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Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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