Voltas Ltd

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Voltas Ltd (Voltas), air-conditioning and engineering company, engaged in the field of air conditioning and refrigeration. It is also in the business of electro-mechanical projects as engineering, procurement and construction (EPC) contractor both in domestic and international geographies (Middle East and Singapore). Voltas is also in the business of engineering product services for mining, water management and treatment, construction equipment and textile industry.

Investment Rationale

Aims to further improve its market share in UCP segment in order to sustain its leadership position: Voltas continued to deliver strong performance in the AC business, which accounts for ~43% of the total sales, despite intense competition and subdued customer sentiments. For the second year in row, Voltas maintained its dominant market position in the UCP business with 21% market share at the end of March 2015. Strong sales growth of 22% YoY in the UCP segment and 100 bps YoY improvement in margins at 17.8% in FY15 due to improving margin realization, better product mix and cost efficiency drove the overall growth in the company's operating performance. Thus, we believe that strong brand call, increasing reach and new product launches helped Voltas build competitive advantage over its peers.

Betting big on UCP segment: The company is betting big on its UCP segment and aims to expand further by entering into air cooler industry. We believe that the company's dominant position in ac market and rising focus towards high margin domestic orders in EMPS business should enhance revenue growth in the following years to come.

High margin domestic orders in EMPS segment to boost margins in the upcoming years: The company's EMPS segment, which accounts ~49% of the total sales made a smart recovery in FY15. Order book from the segment rose by 8% YoY to Rs. 39 billion in Q4FY15. Going forward, the company is expected to bid for new orders, with focus on higher margin domestic orders at a threshold margin of 5%, which we believe is likely to boost the overall margin for Voltas. We expect the EMPS segment revenues to grow at a CAGR of ~3% during FY15-17E, with the strategy to focus on profitability by bidding for small size, high margin projects and their timely execution.

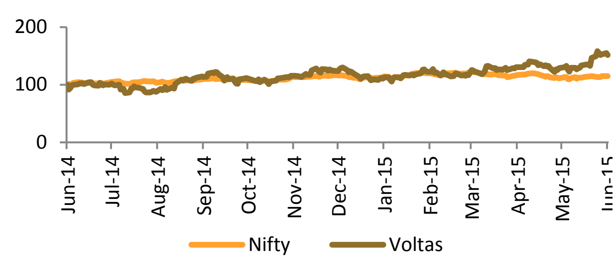
Market Data

Rating	**BUY**
CMP (Rs.)	306
Target (Rs.)	**348**
Potential Upside	~14%
Duration	Long Term
Face Value (Rs.)	1.0
52 week H/L (Rs.)	359.9/185.6
Adj. all time High (Rs.)	359.9
Decline from 52WH (%)	15.0
Rise from 52WL (%)	64.9
Beta	1.2
Mkt. Cap (Rs. mn)	101,209
Enterprise Value (Rs. mn)	100,070

Fiscal Year Ended

Y/E	FY14A	FY15A	FY16E	FY17E
Revenue (Rs. mn)	52,660	51,831	57,006	65,528
Net profit (Rs. mn)	2,454	3,843	4,348	5,280
EPS (Rs.)	7.4	11.6	13.1	16.0
P/E (x)	41.3	26.3	23.3	19.2
P/BV (x)	5.6	4.8	4.4	4.1
ROE (%)	13.5	18.3	18.9	21.2

One year Price Chart



Shareholding Pattern	Jun-15	Mar-15	Chg.
Promoters	30.3	30.3	0.0
FII	21.5	21.6	(0.1)
DII	27.3	27.0	0.3
Others	20.8	21.1	(0.3)

Well-poised to maintain its leadership position

Strong brand recognition coupled with wide network of over 6,500 dealers in India helped Voltas to improve its market share (in ACs) from 14% in FY10 to ~21% in FY15.

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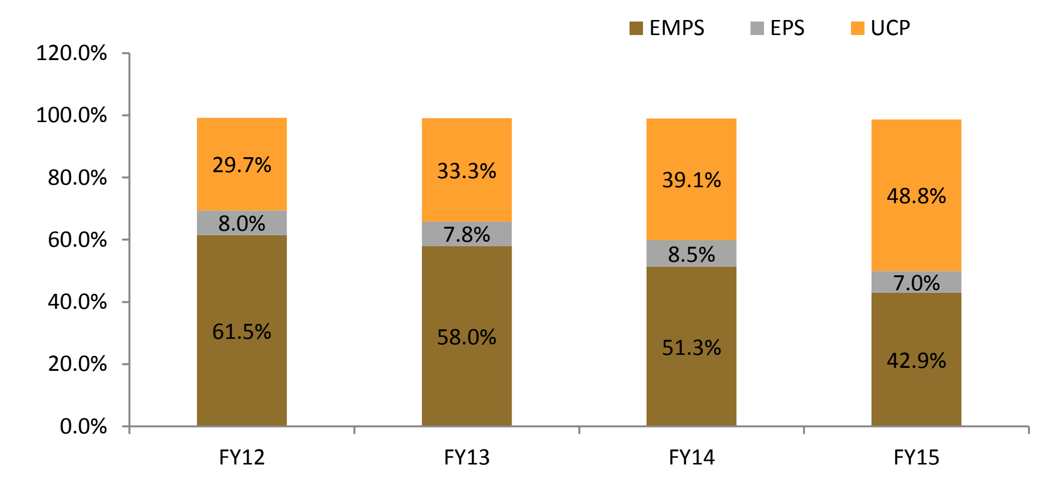
Despite strong competition, Voltas succeed in maintaining leadership position in the Unitary Cooling Products (UCP) business for the second consecutive year with a market share of 21% in FY15. Voltas' UCP division comprises air conditioners (windows ac and split ac), deep freezers, chest coolers, visi coolers, water coolers, and water dispensers. Primarily, Voltas is an assembler and not a manufacturer of ACs as it outsources various accessories of ACs (like compressors) and assembles at its Pantnagar plant (Uttarakhand). Voltas follows an asset light model for its UCP division wherein it has an assembling capacity of 770,000 units in Uttarakhand. The segment contributes ~39% to the consolidated top-line and recorded sales CAGR of ~16% in the last five years. Within UCP division, the room air conditioners (RAC) segment contributes 75% to UCP segment revenue, while ~25% revenue comes from institutional cooling products. We remained upbeat on the growth prospects of the company's UCP division, with expectation of 12-15% sustainable margins in this segment going ahead.

Strong brand recognition coupled with wide network of over 6,500 dealers in India helped Voltas to improve its market share (in ACs) from 14% in FY10 to ~21% in FY15. Given the relatively stable margin and healthy operating cash flow, the company's UCP segment helped in enhancing the company's earnings visibility by maintaining lower working capital requirement in the segment. We believe that the company's approach of introducing new products (such as all-weather AC, inverter AC) has helped Voltas to expand its market share by ~700 bps over the last five years. Besides, big MNCs such as Samsung and LG have stopped window AC sales, while Voltas is still continuing with window AC (considered for low price point buyers), is helping Voltas garnering additional market share.

Segmental revenue mix trend



The company has accomplished major MEP/HVAC&R projects. These projects include Burj Khalifa (Dubai), Ferrari Experience (Abu Dhabi) and Barwa City Qatar.

Revival in EMPS business to support earnings visibility

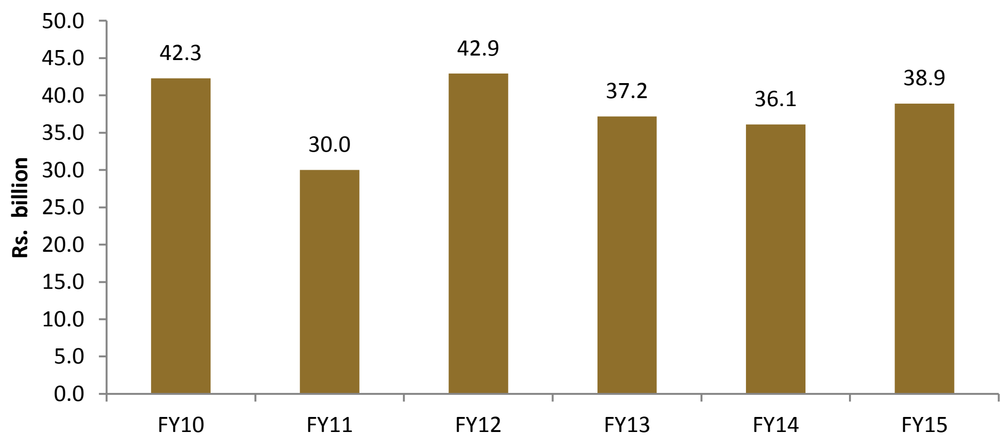
Electromechanical project & services (EMPS) business (contributes ~49% to the company's revenue) provides heat ventilation air conditioning & refrigeration (HVAC&R) services to medium to large office buildings, retail outlets or for industrial projects (such as installation of AC systems in power plants), wherein humidity and temperature must be closely regulated. But gradually over the years, Voltas has extended its scope of work from only an HVAC&R player to mechanical, electrical & public health (MEP) projects. With its strategic partner in Dubai, Abu Dhabi, Qatar, Jeddah, Bahrain, and Singapore, the company has accomplished major MEP/HVAC&R projects. These projects include Burj Khalifa (Dubai), Ferrari Experience (Abu Dhabi) and Barwa City Qatar.

During Q4FY15, the EMPS segment underperformed due to delay in execution of projects, rising competition and slow project awarding activity in India and Middle East countries. The company has now shifted its focus on smaller and medium sized projects, which it can execute timely and enhance profitably, instead of taking up large projects due to tough commercial conditions in Qatar.

With Rs. 5.8 billion order inflow, the total order book of the company in EMPS segment rose by ~8% YoY to Rs. 38.9 billion in Q4FY15, which includes Rs. 20.2 billion order from the domestic market. Voltas continued to focus more on the domestic business as the proportion of domestic orders in the total order rose from 45.5% in FY12 to 52% in FY15. We believe that the change in the order book mix is likely to recover the EBIT losses from international business during downturns. Further, revival in investment and the government of India (GoI)'s focus on large infrastructure projects like new airports, modernisation of railway stations, upcoming metro projects is likely to generate demand and help the company in bidding for strong order book in future.

We expect the EMPS segment revenues to grow at a CAGR of ~3% during FY15-17E, with the strategy to focus on profitability by bidding for small size, high margin projects and their timely execution.

EMPS segment's order book trend



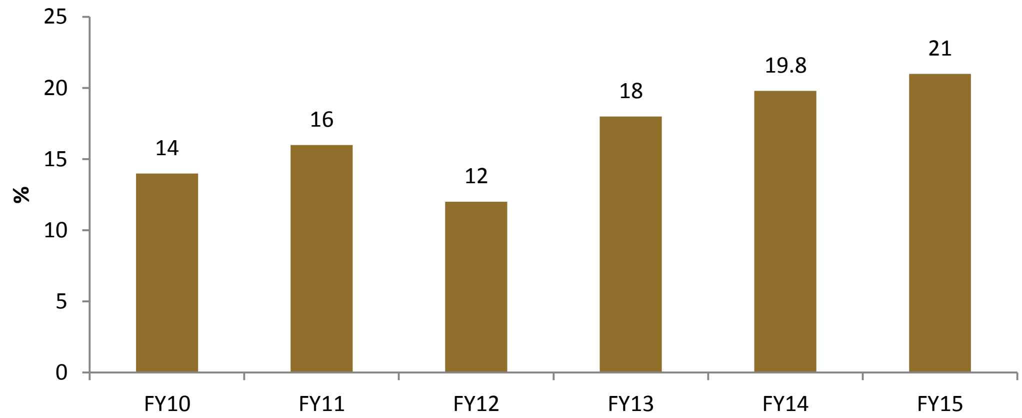
Leveraging its cooling expertise, the company forayed into the Rs. 2,000 crore air-coolers industry in India. The size of Air cooler market is around 50 lakhs units per year of which only 30% comes from organized sector. Therefore, there is immense opportunity in this space.

New launches & entry into air cooler business to further extend its cooling expertise

In order to stay competitive in the market, recently, Voltas has introduced its new range of 'All-Weather Smart' ACs, with a number of distinctive features including: smart inverter technology, which saves up-to 63% power; a smart (android-based) mobile application that provides direct AC control from one's handset; and smart sense technology, which can detect the ambient temperature and weather, and recommend the best AC settings. With these new launches, the company now offers a strong product line-up of 78 variants of split ACs, including the inverter range, through more than 10,000 retail outlets nationwide. With the launch of All-Weather Smart' AC line, the company is expected to maintain its strong brand equity growth momentum and sustain its market supremacy.

Further, leveraging its cooling expertise, the company forayed into the Rs. 2,000 crore air-coolers industry in India. The size of Air cooler market is around 50 lakhs units per year of which only 30% comes from organized sector. Therefore, there is immense opportunity in this space. With the launch of Voltas Fresh-Air Coolers, the company aim to bridge the wide gap between fans and ACs, and be among the top three brands in air coolers within the next 3 years. The Fresh-Air Cooler range comes with attractive features such as exclusive honeycomb cooling pads, carbonised dust filters, and powerful air throw. Thus, we believe that Voltas' entry into air-coolers, where it will leverage on its existing AC distribution strength, provides a strong growth avenue. The company is betting big on the air-collar segment and has set an ambitious target of becoming among the top three players in the segment with target revenue of Rs. 1.5 billion in the next 3 years.

Voltas' market share trend in domestic AC industry



Untapped cooling market to provide huge business opportunity

Despite of rising desires, the majority of Indian homes remain untouched by air conditioning, as the overall AC penetration in India remained at ~4%, which is significantly lower than other developing countries. We believe that out of the total ~330 million Indian households, ~66% own fans. Only ~4% of the total households own air conditioners while 8% own coolers. Over the last five years, the room air conditioners (RAC) industry grew at a CAGR of ~13%.

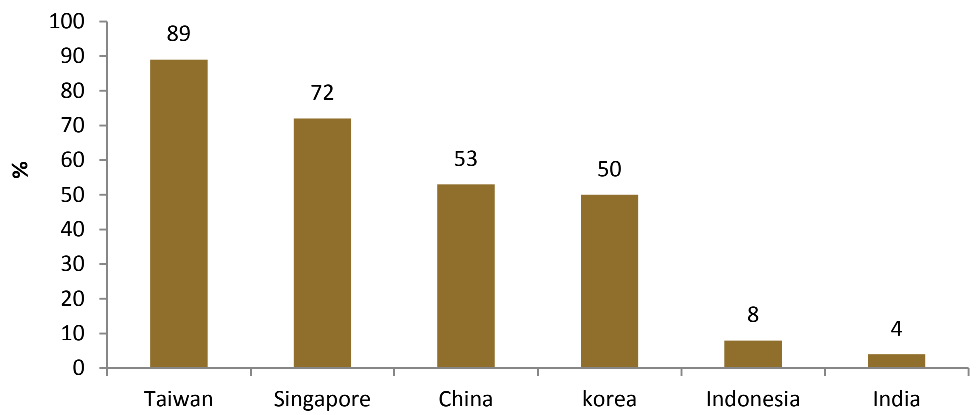
Owing rising preference for air coolers specifically in rural India (due to price difference of products and electricity consumption), the company plans to enter in to air-cooler industry.

We believe that owing to low penetration levels, easy availability of finance options coupled with a progressive shift in consumers' perception of air conditioners from that of a luxury to a necessity would help in driving demand for ac in India.

In the last three years, the Indian AC market struggled on account of a tough economic environment, higher inflation and interest rate, adverse currency movement, rising competition and execution of Bureau of Energy Efficiency (BEE) January 2014 obliging an upward rating revision in energy efficiency, resulting in an additional increase in prices for the same star rating.

But from long term perspective, we believe that owing to low penetration levels, easy availability of finance options coupled with a progressive shift in consumers' perception of air conditioners from that of a luxury to a necessity would help in driving demand for AC in India, which in turn would boost the volume growth from UCP segment. Moreover, an entry into air cooler industry will further consolidate its position in cooling market.

India is having low AC penetration level as compared to other developing nations



Mixed set of numbers in Q4FY15

In Q4FY15, the company's EBITDA rose by 35.7% YoY to Rs. 1.4 billion on account of recovery in project business and ~1000 bps YoY decline in raw material cost during the quarter.

Voltas witnessed mixed set of numbers in Q4FY15, with muted net sales growth of 1.9% YoY to Rs. 14.9 billion mainly due to 13% YoY and ~18% YoY decline in revenue from electro-mechanical projects (EMPS) and engineering product (EPS) segment, respectively. However, ~19% YoY revenue growth from unitary cooling products (UCP) segment supported the overall revenue growth of the company, driven by ~14% YoY growth in volume of cooling products. Notwithstanding the muted revenue growth, the company's EBITDA grew impressively by 35.7% YoY to Rs. 1.4 billion on account of recovery in project business and ~1,000 bps YoY decline in raw material cost during the quarter. As a result, EBITDA margin of the company rose significantly by ~239 bps YoY & ~355 bps QoQ to 9.6% in Q4FY15. The company's project business made recovery, while reported an EBIT of Rs. 0.04 billion against EBIT loss of Rs. 0.14 billion in Q4FY14. In line with robust growth in EBITDA, net profit of the company surged by ~18% YoY to Rs. 1.18 billion further supported by ~227 bps YoY decline in tax outgo, which offset ~2% YoY decline in other income and ~18% rise in depreciation charges.

For FY15, the company's revenue declined by 1.6% YoY at Rs. 51.8 billion. EBITDA for the year grew by 54.4% YoY. The EBITDA margin came in at 7.9% compared to 5.0% in FY14, mainly on account of improved performance from UCP and EPS segment and recovery in EMPS segment. Further, with 8.5% YoY increase in other income despite of 12.9% higher depreciation charges, net profit of the company grew by 57% YoY at Rs. 3.9 billion in FY15. With a recovery in the EMPS margin (as new orders commands margin of ~5%) coupled with strong margin of UCP segment and EPS segment, respectively, we expect net profit to grow at a CAGR of 29% in FY14-17E.

Balance Sheet (Consolidated)

Y/E(Rs. mn)	FY14A	FY15A	FY16E	FY17E
Share Capital	331	331	331	331
Reserve and surplus	17,862	20,690	22,618	24,616
Net Worth	18,193	21,021	22,948	24,947
Minority interest	138	161	193	227
Long term borrowings	54	47	45	42
Other liabilities	299	202	196	200
Long-term provisions	902	1,079	1,133	1,189
Current Liability	27,850	26,355	28,324	31,948
Total Liabilities	**47,436**	**48,864**	**52,838**	**58,553**
Fixed assets	2,103	1,935	1,954	1,974
Investment	1,393	6,269	6,833	7,448
Goodwill	798	798	798	798
Loans & adv	1,233	1,093	1,148	1,285
Deferred tax assets (net)	239	349	356	375
Other assets	1,524	1,053	1,158	1,262
Current Assets	40,146	37,368	40,591	45,411
Total Assets	**47,436**	**48,864**	**52,838**	**58,553**

Profit & Loss Account (Consolidated)

Y/E (Rs. mn)	FY14A	FY15A	FY16E	FY17E
Total revenue	52,660	51,831	57,006	65,528
Operating Expenses	50,004	47,731	51,876	58,713
EBITDA	2,656	4,100	5,131	6,815
Other Income	1,002	1,087	1,250	1,375
Depreciation	248	280	314	361
EBIT	3,409	4,907	6,067	7,829
Interest	225	233	244	256
Exceptional items	215	462	0	0
PBT	3,399	5,137	5,823	7,573
Tax	941	1,276	1,456	2,272
Share of associates' profit	0	16	16	16
Minority interest	(5)	(33)	(35)	(37)
Net Profit	**2,454**	**3,843**	**4,348**	**5,280**

Key Ratios (Consolidated)

Y/E	FY14A	FY15A	FY16E	FY17E
EBITDA Margin (%)	5.0	7.9	9.0	10.4
EBIT Margin (%)	6.5	9.5	10.6	11.9
Reported NPM (%)	4.6	7.3	7.5	7.9
ROCE (%)	17.4	21.8	24.7	29.4
ROE (%)	13.5	18.3	18.9	21.2
EPS (₹)	7.4	11.6	13.1	16.0
P/E (x)	41.3	26.3	23.3	19.2
BVPS(₹)	55.0	63.6	69.4	75.4
P/BVPS (x)	5.6	4.8	4.4	4.1
EV/Net Sales (x)	1.9	1.9	1.8	1.5
EV/EBITDA (x)	38.1	24.4	19.5	14.7

Valuation and view

With improving market share in Indian AC industry, we believe that Voltas is the best proxy to play the growth in the AC industry. Improving margin and focus on high margin domestic orders in the EMPS business segment of the company will further support earnings. We believe that with new launches across the UCP segment and entry into air cooler industry, the company is expected to perform well in the coming quarters. Considering the strong performance of the UCP business and recovery in the EMPS segment, we remain positive on the stock.

At the current market price (CMP) of Rs. 306, the stock trades at an EV/EBITDA of 19.5x FY16E and 14.7x FY17E. We recommend 'BUY' with a target price of Rs. 348, which implies a potential upside of ~14% to the CMP from 12 months perspective.

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