RESULT UPDATE

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VOLTAS
(Rs.94, FY08 18x, HOLD)

Voltas' second quarter earnings have been marred by higher tax charges and lower profitability on international projects. Notwithstanding this, its projects business continues to grow robustly with order backlog of Rs.18.3 bn. However, valuations are not cheap at 25.4x FY07 earnings. Given these factors, we revise our rating to a **HOLD.**

Summary table

(Rs mn)	FY06	FY07E	FY08E
Sales	18531	24133	30052
Growth %	32.1	31.7	20.0
EBITDA	1110	1714	2448
EBITDA margin %	6.0	7.1	8.1
Net profit (adjusted)	1069	1232	1736
Net cash (debt)	-646	-1608	-605
EPS (Rs)	3.2	3.7	5.3
Growth %	135.0	15.2	40.8
CEPS	3.3	4.2	5.7
DPS (Rs)	0.3	3.4	3.4
ROE %	44	50	61
ROCE %	43	60	78
EV/Sales (x)	1.7	1.3	1.1
EV/EBITDA (x)	28.8	19.2	13.0
P/E (x)	32.4	25.4	18.0
P/Cash Earnings	29.1	22.7	16.5
P/BV (x)	13.0	12.4	10.0

Source: Company & Kotak Securities - Private Client Research

Quarterly performance

Year	200609	200509	% change
SalesTurnover	**5298.8**	**4673**	**13.4**
Other income	152.8	54	182.4
Operating Expenditure	**5097.5**	**4405**	**15.7**
RM costs	3972.6	3618.2	9.8
Staff costs	580.2	402	44.4
Other costs	544.7	386	41.3
Operating profit	**201.3**	**267.2**	**-24.7**
Interest	15.6	2.1	642.9
Gross Profit	**339**	**319**	**6.0**
Depreciation	28.3	28	1.1
PBT	**310**	**291**	**6.5**
Tax	61	24	151.4
Adjusted PAT	249.1	266.9	-6.7
extraordinary items	0.9	-78	-101.1
Reported PAT	250	189	32.6
OPM%	3.8%	5.7%	-33.6
Tax rate %	20%	8%	136.0

Source: Company

- Net sales for the quarter increased by 13% to Rs.5.30 bn. Revenue growth was moderated due to marginal decline in international projects business, wherein a couple of large projects are still in the design stage and hence revenue booking has been sluggish. However, since the projects business, by itself, results in lumpiness in revenues, we expect the coming quarters to see a substantial growth in revenue recognition.
- Moreover, sluggish growth in the projects business is in line with management guidance and hence was in line with our expectations.
- Growth in the engineering services business has been on the back of huge demand from the textile machinery (Voltas is a exclusive marketing agent for LMW) and materials handling sectors.
- EBITDA margins dipped by 180 basis points from 5.7% to 3.8%. Margin expansion has been muted due to lower profitability in international operations.

Revenue Growth

	Yoy growth
Electromechanical projects	-3%
Engineering Services	80%
Unitary cooling	38%
Others	-17%
Total	14%

Source: Company

Segment Margins (%)

	Q2 FY07	Q2 FY06
Electromechanical projects	2.5%	6.2%
Engineering agency and products	25.5%	22.6%
Unitary cooling	0.3%	-3.9%
others	36.3%	45.1%

Source: Company

- Also, operating margins have been pulled down by rise in employee costs. During the year, the company has been very aggressive on manpower addition front (Currently the key constraint for engineering companies). It has added 1,400 employees in the last six months in its overseas operations. This has resulted in a 44% rise in staff costs. In our view, this might impact short-term margins, but on a longer-term basis the company is now well positioned to exploit the opportunities in Middle East markets.
- Order book is strong at Rs.18 bn but has remained flat on a sequential basis.

Earnings Outlook and Valuation

We are maintaining our earnings estimates for the company. We expect substantial improvement in revenues as well as profitability of the unitary cooling division, which has been bleeding for some time. Earnings are expected to grow at a CAGR of 34% over FY06-08.

We maintain HOLD on the stock with a target price of Rs 110.

On the back of very impressive earnings growth in FY06, Voltas has witnessed a significant re-rating. At our forecast EPS of Rs. 3.7 and Rs. 5.3, the stock is trading at 25.4x and 18x, respectively.

Valuations are not cheap. We maintain HOLD on the stock with a target price of Rs 110.