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Private Limited+

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Stock Rating
Equal-weight

Industry View
In-Line

Voltas Limited

Margins Bounce Back, but Valuations Look Demanding

What's Changed

Price Target	Rs114.00 to Rs135.00
F2008e EPS	From Rs3.94 to Rs5.24
F2009e EPS	From Rs5.17 to Rs6.92

Conclusion: Voltas reported strong F1Q08 results, underpinning positive momentum in the overall business dynamics and the possibility of operating margin expansion. However, valuations look expensive, and any slowdown in margin expansion may be negative for the stock.

What's New: Voltas reported F1Q08 standalone revenue of Rs8.2 bn (up 41% YoY) and earnings (excluding exceptional items) of Rs469 mn (up 116% YoY). The company recorded its highest-ever quarterly EBITDA margin of 8.2%, an expansion of over 360 bps YoY. The margin expansion was due to strong performance in the electro-mechanical and unitary cooling segments.

Key Negatives: The key negative, in our mind, is volatility in operating margins. Our F2008 EBITDA margin estimate of 6.7% assumes strong profitability in both the electro-mechanical and unitary cooling businesses. However, any decline in operating margins in these segments would be a dampener for the stock.

Implications: The stock is trading at 27.8x our F2008 earnings estimate and 21x our F2009E. We believe these valuations look demanding, given the quarterly volatility in operating margins. We maintain our Equal-weight rating on the stock but increase our price target to Rs135.

Key Ratios and Statistics

Reuters: VOLT.BO Bloomberg: VOLT IN

India Industrials

Price target	Rs135.00
Shr price, close (Jul 23, 2007)	Rs145.75
Mkt cap, curr (mn)	US\$1,200
52-Week Range	Rs151.40-64.62
Sh out, basic, curr (mn)	330.9

Fiscal Year (Mar)	2006	2007	2008e	2009e
ModelWare EPS (Rs)*	2.81	3.18	5.24	6.92
Prior ModelWare EPS (Rs)	2.81	2.77	3.94	5.17
Revenue, net (Rs mn)	19,544	25,267	34,283	44,012
ModelWare net inc (Rs mn)	929	1,051	1,735	2,291
P/E	35.8	26.7	27.8	21.1
P/BV	12.3	6.6	8.7	6.7
EV/EBITDA	28.4	19.6	19.5	14.4
Div yld (%)	0.6	1.2	1.0	1.4

* = Please see explanation of Morgan Stanley ModelWare later in this note.
e = Morgan Stanley Research estimates

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Financial Summary

Income Statement

	F2005	F2006	F2007	F2008E	F2009E
Gross Revenue	15,508	20,227	25,983	35,164	45,027
Excise duty	737	683	716	881	1,015
Net Revenue	14,771	19,544	25,267	34,283	44,012
Employee costs	1,546	1,925	2,596	3,600	4,621
Cost of sales and services	10,881	14,571	18,782	25,198	32,239
Other expenses	1,812	1,931	2,610	3,189	4,094
Total operating expenses	14,239	18,427	23,988	31,987	40,954
EBITDA	532	1,118	1,280	2,297	3,058
Depreciation	133	141	156	168	177
EBIT	399	977	1,124	2,129	2,882
Interest cost	87	64	99	109	109
Other income	222	242	481	612	700
PBT	534	1,154	1,506	2,631	3,473
Tax expense	82	224	454	894	1,180
PAT	452	929	1,052	1,737	2,292
Minority Interest	0	0	(2)	(2)	(2)
Equity share in affiliates	-	-	0	0	0
Profit after MI and affiliates	452	929	1,051	1,735	2,291
Exceptional items	70	(193)	965	53	-
PAT after exceptional items	523	737	2,016	1,788	2,291
EPS (Rs)	1.37	2.81	3.18	5.24	6.92
DPS (Rs)	0.50	0.60	1.00	1.50	2.00

Balance Sheet

	F2005	F2006	F2007	F2008E	F2009E
Liabilities					
Share Capital	331	331	331	331	331
Reserves and Surplus	1,865	2,383	3,907	5,199	6,828
Total Shareholders Funds	2,195	2,714	4,237	5,529	7,158
Loan Funds	1,265	901	1,116	1,116	1,116
Minority Interest	2	3	4	6	8
TOTAL LIABILITIES	3,463	3,617	5,358	6,651	8,282
Assets					
Gross Fixed Assets	2,864	3,163	2,851	3,401	3,551
Accumulated Depreciation	1,823	1,642	1,379	1,547	1,724
Net Block	1,041	1,521	1,473	1,854	1,828
Capital Work-in-Progress	72	114	128	150	150
Net Fixed Assets	1,113	1,635	1,601	2,004	1,978
Investments	297	286	293	293	293
Deferred Tax Assets	212	256	279	279	279
Current Assets	7,800	8,824	11,805	16,196	19,648
Cash and Cash Equivalents	1,627	1,473	2,631	3,068	3,687
Less: Current Liabilities	7,586	8,858	11,252	15,190	17,603
Net Current Assets	1,842	1,440	3,184	4,075	5,732
TOTAL ASSETS	3,463	3,617	5,358	6,651	8,282

Cash Flow

	F2005	F2006	F2007	F2008E	F2009E
PAT	452	929	1,051	1,735	2,291
Depreciation	133	141	156	168	177
Exceptional items	70	(193)	965	53	0
Change in working capital	1	248	(586)	(453)	(1,040)
Cash Flow From Operations	656	1,125	1,585	1,503	1,428
Capex	246	(663)	(122)	(572)	(150)
Purchase and Sale of investments	28	11	(8)	0	0
Cash Flow From Investing Activities	274	(652)	(129)	(572)	(150)
Inc/(Dec) in Borrowings	236	(364)	215	0	0
Dividend paid	(165)	(199)	(331)	(496)	(662)
Others	(419)	(64)	(182)	2	2
Cash Flow From Financing Activities	(349)	(627)	(298)	(495)	(660)
Change in cash and cash equiv	581	(154)	1,158	437	618
Opening cash and cash equiv	1,046	1,627	1,473	2,631	3,068
Closing cash and cash equiv	1,627	1,473	2,631	3,068	3,687

Ratio Analysis

	F2005	F2006	F2007	F2008E	F2009E
Growth (%)					
Revenues	8.6%	32.3%	29.3%	35.7%	28.4%
EBITDA	28.1%	110.2%	14.5%	79.5%	33.2%
EBIT	56.1%	144.7%	15.1%	89.4%	35.4%
EBT	43.9%	116.1%	30.5%	74.7%	32.0%
Net Profit	56.3%	105.4%	13.1%	65.2%	32.0%
EPS	56.3%	105.4%	13.1%	65.2%	32.0%
Margins (%)					
EBITDA	3.6%	5.7%	5.1%	6.7%	6.9%
EBIT	2.7%	5.0%	4.4%	6.2%	6.5%
EBT	3.6%	5.9%	6.0%	7.7%	7.9%
Net Profit	3.1%	4.8%	4.2%	5.1%	5.2%
Return (%)					
ROE	20.8%	37.9%	30.2%	35.5%	36.1%
ROCE	12.0%	27.6%	25.0%	35.4%	38.6%
ROA	4.3%	7.9%	7.2%	9.0%	9.6%
Gearing					
Debt/Equity	58%	33%	26%	20%	16%
Net Debt/Equity	NC	NC	NC	NC	NC
Valuations					
EV/EBITDA	90.0	42.6	36.5	20.1	14.9
P/E	106.6	51.9	45.9	27.8	21.1
P/BV	22.0	17.8	11.4	8.7	6.7
Dividend Yield (%)	0.3%	0.4%	0.7%	1.0%	1.4%
Turnover (days)					
Inventory	73	73	81	81	81
Debtors	94	76	65	65	65
Creditors	108	89	77	77	77

E= Morgan Stanley Research estimates; NC = Net Cash
Source: Company data, Morgan Stanley Research

Margins Bounce Back, but Valuations Look Demanding

Summary & Conclusions

Voltas reported strong F1Q08 results on the back of strong revenue growth in all segments and significant operating margin expansion in the electro-mechanical and unitary cooling businesses.

We understand that F2008 operating margins could be 6.5% for the electro-mechanical business and 4-4.5% for the unitary cooling business. However, the company has witnessed substantial quarterly volatility in operating margins in the past, which has been negative for the stock. We believe that any letdown on the margin expansion front going forward could dampen the stock's performance.

We forecast compound annual revenue growth of 32% between F2007 and F2009 and an earnings CAGR of 48% during the same period. The stock is trading at 27.8x F2008E and 21x F2009E earnings, which is expensive, in our view. We maintain our Equal-weight rating on the stock.

Huge margin expansion in F1Q08

Voltas reported F1Q08 standalone revenue of Rs8.2 bn (up 41% YoY) and earnings (excluding exceptional items) of Rs469 mn (up 116% YoY).

The electro-mechanical business grew 49% YoY and made an operating margin of 7.5% in F1Q08 (after adjusting for one-time income of Rs67 million received from the full and final settlement of the Queen Mary project). We believe this strong performance was due to increased billings in the international electro-mechanical business. At the end of June, the order book in this segment stood at Rs20 billion, of which the international order book was Rs13 bn.

Revenues of the unitary cooling business grew by 29% YoY, as this is seasonally the strongest quarter. The key highlight, however, was the 6.7% operating margin, which we understand was largely due to better product mix, increase in prices, and indirect tax benefits from the Pantnagar facility.

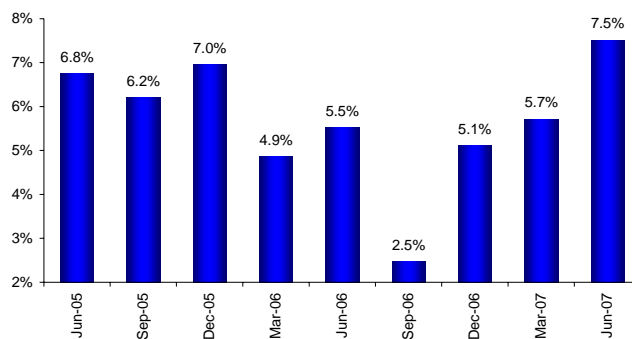
The engineering agency business grew 43% YoY but saw a 200 bps decline in operating margins, due to higher volumes in material handling equipment, which has lower margins.

Electro-mechanical business bounces back

Since the beginning of F2007, Voltas has commenced work on two significant projects in the Middle East – Bahrain City Centre and the Burj Tower, Dubai – with an aggregate order size of over Rs8.75 bn. We understand that these projects were in the initial stages of designing and mobilization in F2007, and hence, the company was unable to recognize profits on the same. Accordingly, operating margins in the electro-mechanical segment declined from 6.2% in F2006 to 5.2% in F2007. However, we believe that some of the profits for work executed in F2007 were booked in F1Q08, which resulted in the operating margin's moving up to 7.5% (Exhibit 1). The company believes that operating margins in this segment should be about 6.5% for F2008.

Exhibit 1

Electro-mechanical Segmental Margins Trend Up



Source: Company data, Morgan Stanley Research

Revenue growth in the electro-mechanical segment will likely be strong, with an order book position of Rs20 bn at the end of June. In the domestic business, Voltas achieved revenue growth of 48% in F2007, and we expect this to remain strong going forward as the company executes various airport and retail projects. In the international business, Voltas is pursuing opportunities in Qatar, UAE, Abu Dhabi, Bahrain, and Saudi Arabia. We understand that the company is now looking for bigger projects with an order size of Rs7.5 bn.

On the margin front, the company expects to expand margins through a combination of the following:

- better project mix;
- centralizing design work in Mumbai and sourcing operations in Dubai;
- entering new geographies such as Saudi Arabia.

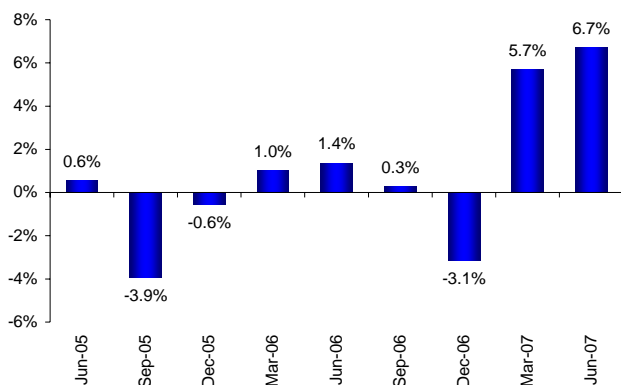
Is profitability in the unitary cooling business sustainable?

Operating margins in the unitary cooling business have been volatile in the past, due to intense competition in the market, which limited increases in selling prices while input costs rose. In the past two quarters, however, this segment has shown healthy margins on the back of better product mix, increased selling prices, indirect tax benefits from the Pantnagar facility, and more sales to institutional consumers. We believe that the company has increased the share of split air-conditioners versus that of window air-conditioners, since the former are more profitable. In F2007, the company witnessed 50%+ volume growth in split air-conditioners as against 15% volume growth in window air-conditioners.

We understand that this segment will continue to show strong revenue growth, and the company is confident of achieving an operating margin of 4-4.5% in F2008.

Exhibit 2

Unitary Cooling Margins Have Been Volatile



Source: Company data, Morgan Stanley Research

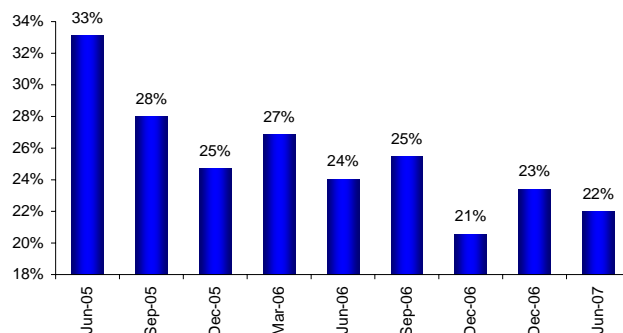
Engineering Agency business sees gradual decline in margins

Material handling and construction & mining equipment account for about 70% of the segment's revenue, while textile machinery accounts for the balance. In material handling, the company manufactures its own forklift trucks and cranes, on which it makes an operating margin of about 20%. We

understand that as the share of revenue from material handling equipment has been rising, operating margins in this segment have been trending closer to 20% from 33% two years back.

Exhibit 3

Gradual Decline in Operating Margins



Source: Company data, Morgan Stanley Research

Valuations

We have revised our F2008 and F2009 EPS estimates upwards by about 33% and 34%, respectively, largely to adjust for F2007 actual results and strong margin expansion in F1Q08. We have also increased our target price from Rs114 to Rs135 to adjust for the increase in earnings. Our methodology for arriving at our target price is unchanged — we continue to use a residual income model. Our assumptions for cost of equity and the residual income model are in Exhibits 4-6.

Key downside risks to achieving our price target are losses in the unitary cooling product business and significant cost overruns in the electro-mechanical project business. Upside risks include a sustained turnaround in the unitary cooling

Company Description

Voltas offers engineering solutions for a wide range of industries including heating, ventilation and air conditioning, refrigeration, electro-mechanical projects, textile machinery, machine tools, mining and construction equipment, materials handling, water management, building management systems, indoor air quality and chemicals.

India Industrials

Industry View: In-Line

Positive trends in the IT/BPO, retail, entertainment and healthcare segments will drive industry growth, but margin pressures keep us In-Line.

MSCI Country: India

Asia Strategist's Recommended Weight: 2.2%
MSCI Asia/Pac All Country Ex Jp Weight: 6.7%

product business and improving margins in the electro-mechanical business.

Exhibit 4

Residual Income: Assumptions

Beta	1.05
Risk free rate	8.00%
Market premium	5.00%
Cost of equity	13.3%
Terminal growth rate	5.0%

Source: Bloomberg, Morgan Stanley Research

Exhibit 5

Residual Income: Key Operational Parameters

	F2010	F2011-14	F2015-2020
Total revenue CAGR (%)	27%	21%	16%
EBITDA Margin (at end) (%)	7.2%	7.2%	5.7%
Capital expenditure (Rs mn/ Per Annum)		150	150
Tax rate (%)	33.99%	33.99%	33.99%
Dividend payout (%)	28%	30%	30%

Source: Morgan Stanley Research

Exhibit 6

Voltas: Residual Income Model

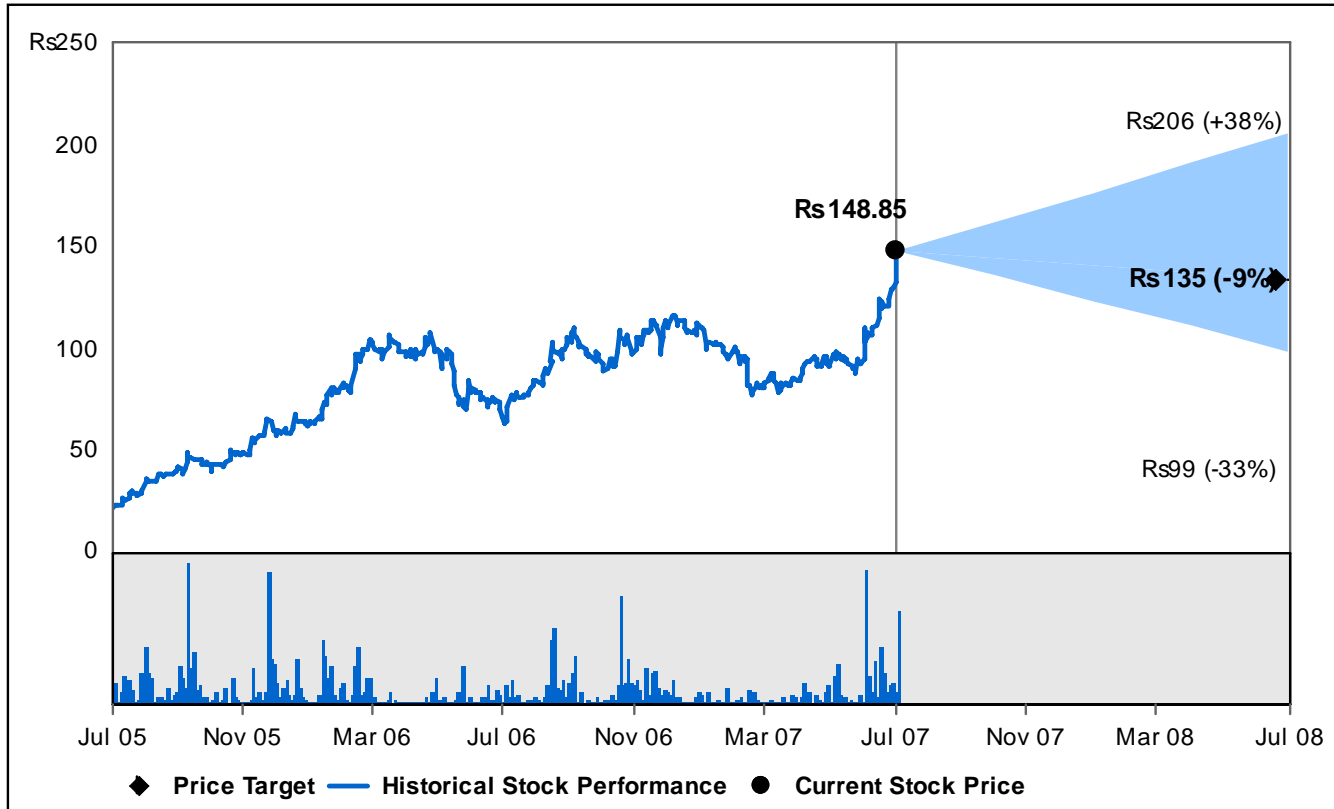
Rs Mn	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Shareholders Funds	5,529	7,158	9,333	11,944	15,181	19,057	23,691	28,947	34,892	41,630
Net Revenue	34,283	44,012	56,109	69,796	86,845	103,274	122,868	142,386	165,132	191,651
<i>YoY Growth</i>	36%	28%	27%	24%	24%	19%	19%	16%	16%	16%
EBITDA	2,297	3,058	4,039	5,025	6,252	7,435	8,845	9,894	11,062	12,360
<i>EBITDA margin</i>	6.7%	6.9%	7.2%	7.2%	7.2%	7.2%	7.2%	6.9%	6.7%	6.4%
Depreciation	168	177	186	189	196	204	211	219	226	234
Interest expense	109	109	109	106	104	101	98	95	92	92
Other Income	612	700	805	924	1,055	1,260	1,494	1,797	2,125	2,549
Tax	894	1,180	1,546	1,922	2,382	2,852	3,409	3,867	4,374	4,957
<i>Tax rate</i>	34.0%	34.0%	34.0%	34.0%	34.0%	34.0%	34.0%	34.0%	34.0%	34.0%
Net Profit	1,737	2,292	3,003	3,732	4,626	5,538	6,621	7,510	8,494	9,626
<i>Return on Equity</i>	41.0%	41.4%	41.9%	40.0%	38.7%	36.5%	34.7%	31.7%	29.3%	27.6%
Residual Income	1,174	1,558	2,053	2,494	3,042	3,525	4,095	4,370	4,658	5,001

Beginning Equity Capital	5,529
PV of Forecast Period	19,970
PV of Continuing Value	17,738
Equity Value	43,237
No. of Shares (mn)	330.9
Projected Share Price(Rs)	131
12 month Forward Target Price(Rs)	135

E = Morgan Stanley Research estimates
Source: Morgan Stanley Research

Exhibit 7

Risk-Reward Analysis



Share price as of July 20, 2007

Key Assumptions

Fair Value (Rs)	Case	Parameters	
206	Bull Case	Revenue CAGR (F2009-F2020)	19%
		Earnings CAGR (F2009-F2020)	22%
		EBITDA Margin at 2014	9.0%
135	Base Case	Revenue CAGR (F2009-F2020)	19%
		Earnings CAGR (F2009-F2020)	18%
		EBITDA Margin at 2014	7.2%
99	Bear Case	Revenue CAGR (F2009-F2020)	18%
		Earnings CAGR (F2009-F2020)	16%
		EBITDA Margin at 2014	6.2%

Source: FactSet, Morgan Stanley Research estimates

Exhibit 8

Voltas: Standalone Quarterly Results

Rs mn	Dec-06	YoY (%)	Mar-07	YoY (%)	Jun-07	YoY (%)
Gross Sales	5,809	30%	7,300	38%	8,270	38%
Excise Duty	-119	1%	-86	-48%	-88	-54%
Net Sales	5,689	31%	7,214	40%	8,182	41%
(Increase) / Decrease in Stock in Trade	-4	-97%	-618	67%	1	-96%
Consumption of Raw Materials	4,224	26%	6,153	46%	6,115	40%
Staff Cost	638	38%	628	24%	629	14%
Other Expenditure	557	34%	705	43%	769	27%
Expenditure	5,414	32%	6,867	42%	7,514	36%
EBITDA	275	8%	347	15%	668	153%
<i>EBITDA margin (%)</i>	4.8%	-99 bps	4.8%	-105 bps	8.2%	362 bps
Depreciation	29	33%	30	-17%	32	-12%
EBIT	246	6%	317	20%	637	179%
<i>EBIT margin (%)</i>	4.3%	-100 bps	4.4%	-76 bps	7.8%	385 bps
Other Income	85	79%	123	36%	85	-18%
Interest	14	-11%	-37	186%	7	158%
Profit before Tax	317	20%	476	30%	715	118%
Tax	136	269%	52	-62%	246	121%
<i>Tax rate (%)</i>	42.8%	2888 bps	10.8%	-2564 bps	34.4%	56 bps
Profit after Tax	181	-20%	424	82%	469	116%
<i>PAT Margin (%)</i>	3.2%	-203 bps	5.9%	134 bps	5.7%	199 bps
Extraordinary Items	13	-111%	775	19,265%	53	
Reported Net Profit	194	71%	1,199	405%	522	140%


Source: Company data, Morgan Stanley Research

Exhibit 9

Segment Operating Margins

	Jun-06	YoY %	Sep-06	YoY %	Dec-06	YoY %	Mar-07	YoY %	Jun-07	YoY %
Electro-mechanical projects and services	5.5%	-124 bps	2.5%	-373 bps	5.1%	-185 bps	5.7%	85 bps	7.5%	200 bps
Engineering Products and Services	24.0%	-907 bps	25.5%	-256 bps	20.6%	-415 bps	23.4%	-344 bps	22.0%	-203 bps
Unitary Cooling products	1.4%	83 bps	0.3%	420 bps	-3.1%	-257 bps	5.7%	465 bps	6.7%	533 bps
Other businesses	6.7%	-1739 bps	36.3%	1656 bps	34.5%	1521 bps	-121.9%	-13451 bps	15.9%	922 bps
Total Segmental Margins (%)	6.3%	-88 bps	7.1%	-46 bps	7.7%	-127 bps	7.7%	21 bps	9.3%	306 bps

Source: Company data, Morgan Stanley Research

	<p>Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations. For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.</p>
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(as of June 30, 2007)

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	892	39%	316	43%	35%
Equal-weight/Hold	1017	45%	320	44%	31%
Underweight/Sell	356	16%	94	13%	26%
Total	2,265		730		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.

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Overweight (O or Over) - The stock's total return is expected to exceed the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

Equal-weight (E or Equal) - The stock's total return is expected to be in line with the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

Underweight (U or Under) - The stock's total return is expected to be below the total return of the relevant country MSCI Index, on a risk-adjusted basis, over the next 12-18 months.

More volatile (V) - We estimate that this stock has more than a 25% chance of a price move (up or down) of more than 25% in a month, based on a quantitative assessment of historical data, or in the analyst's view, it is likely to become materially more volatile over the next 1-12 months compared with the past three years. Stocks with less than one year of trading history are automatically rated as more volatile (unless otherwise noted). We note that securities that we do not currently consider "more volatile" can still perform in that manner.

Unless otherwise specified, the time frame for price targets included in this report is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

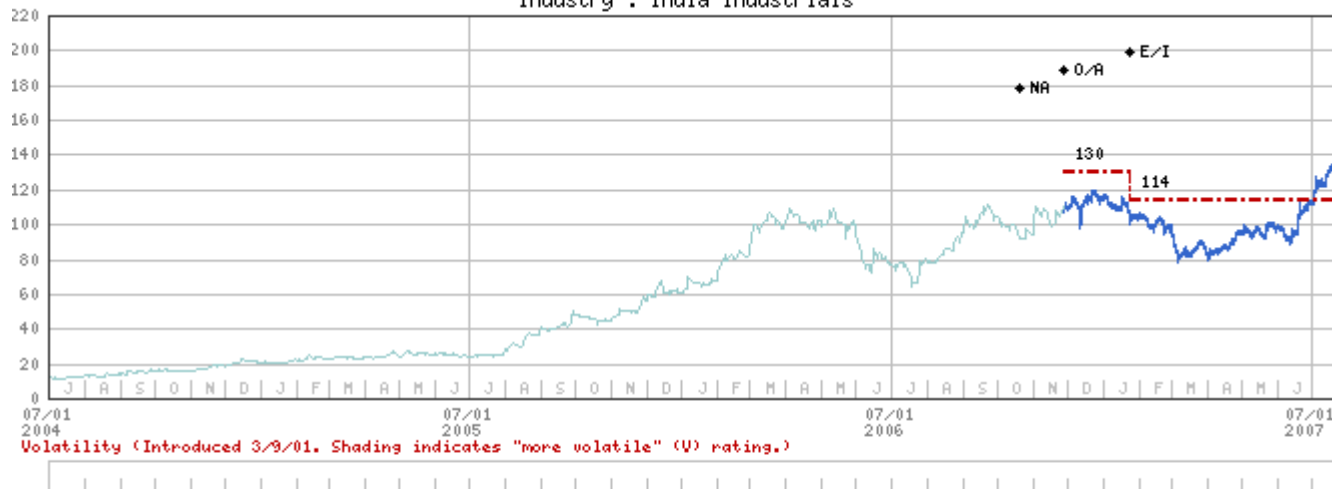
Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

Stock price charts and rating histories for companies discussed in this report are available at www.morganstanley.com/companycharts or from your local investment representative. You may also request this information by writing to Morgan Stanley at 1585 Broadway, (Attention: Equity Research Management), New York, NY, 10036 USA.

July 24, 2007
 Voltas Limited

Stock Price, Price Target and Rating History (See Rating Definitions)

Voltas Limited (VOLT.BO) - As of 7/23/07 in INR
 Industry : India Industrials



Stock Rating History: 10/20/06 : NA; 11/28/06 : O/A; 1/24/07 : E/I
 Price Target History: 11/28/06 : 130; 1/24/07 : 114

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
 Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) ■
 Stock Ratings abbreviated as below (Effective 3/18/02, ratings appear as Stock Ratings/Industry View) ♦
 Stock Ratings as of 3/18/02: Overweight (O) Equal-weight (E) Underweight (U) More Volatile (V) No Rating Available (NAU)
 Stock Ratings prior to 3/18/02: Strong Buy (SB) Outperform (OP) Neutral (N) Underperform (UP) No Rating Available (NAU)
 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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Voltas Limited

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Industry Coverage:India Industrials

Company (Ticker)	Rating (as of)	Price (07/23/2007)
Parag Gupta Voltas Limited (VOLT.BO)	E (01/24/2007)	Rs145.75

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