

Business Outlook – March 2011

Voltas, though divided into three segments, has multiple business opportunities within each segment and is therefore in a position to benefit at each position of Economic cycles. When some of the businesses come under pressure, others pick up, thereby softening the overall impact. Similarly, the geographical spread covering India, several countries in the Middle East and South East Asia also insures against any significant events in one country significantly impacting the overall Voltas story.

At present, it is a mixed bag for the Company. While some of the businesses and India story seems to be working very well, several other factors are having a negative impact on the performance. The details of these are provided hereunder.

SEGMENT A - Electro-mechanical Projects & Services (EMPS)

DOMESTIC :

Over the last few years, Voltas has increased the number of industrial verticals that it can service and has also expanded the basket of services. Therefore it is today capable of addressing many more opportunities compared to what it could 2-3 years back. While earlier Voltas could provide HVAC services to built environment, today it provides MEP services including HVAC, Electrical, Public Health/Plumbing, Building Management (BMS), Fire Fighting, Security Systems, Ozone air purification, Water pumping, Water and Sewage treatment and purification and various other services to built environment (hotels, commercial complexes, Special economic zones, IT infrastructure, etc). Infrastructure (airports, metro rail systems, tunnel ventilation, Hospitals, etc.) and industries (steel plants, balance of power in Power plants, Textile Mills, Sugar factories, etc).

Water business, which is presently small, has been ramping up quite speedily and has potential to become a major contributor to the Company's revenues and profits in the years to come. This business caters to the needs of various industries apart from Government and Municipal Water Departments.

During the current year, the enlarged services and client base have resulted in level of enquiries and order booking being much larger than in the previous year. In the third quarter, the order booking increased about 40% over the same quarter last year if one exceptionally large rural electrification order is excluded from last year's order booking. The level of pending inquiries is also encouraging. Inquiries and orders on hand include several jobs in infrastructure and industrial space.

The Order book of Rs. 1600 crores announced at the end of December 2011 is adequate to cover the whole of 2011-12.

The change in business profile has resulted in our being sub-contractor to the turn-key-main-contractors. This results in a longer chain for submission of bills and claims and their approval as also the flow of money. This has resulted in the receivable cycle getting elongated, and therefore, higher working capital.

In the recent past, there has been some negativity in business sentiment, further compounded by a drop in IIP numbers for Capital Goods Industry. However, there are several counter balancing positives as well, eg. clearance of several industrial and infrastructure projects by Environment Ministry, recently tendered road construction projects seeking much lower Government assistance compared to the expectations, budget sops given to Cold Chain and other infrastructure development project financing, etc.

In view of the positives mentioned above, we are quite hopeful that the encouraging trend seen in the previous 9 months will continue and there will be adequate opportunities for future growth of the Company.

INTERNATIONAL :

There has been some concern about disturbances in several Middle Eastern and North African countries in the recent past affecting our business in that region. We would like to clarify that we are not present in any of the countries that have been affected by the disturbances and that a large project that we had in Bahrain also has been completed. The general expectation is that Abu Dhabi and Qatar, where we have most of our international business, are unlikely to be impacted by these disturbances in view of the relatively small population, high per capita income and general well-being of the citizens of these countries. Our order book of Rs. 3100 crores as on 31-Dec-2010 consists of a little less than 10% from Singapore and the balance is divided between Abu Dhabi and Qatar. Some of the new territories we are looking at could be a little more sensitive to the events. However, such disturbances, if at all they happen, are expected to remain localized in small parts of the country and not impact overall market conditions.

These events have also not affected the pace of execution of our ongoing projects. Infact we are under pressure to expedite execution of our earlier slow-moving projects in Qatar.

We believe that the higher oil prices resulting from the unrest in some countries will put more resources at the command of the Governments of our target countries and there should be more investments going forward and therefore larger MEP opportunities. Some of the Governments have announced several packages of benefits for the people of their countries and it is expected that they will be under pressure to supplement these with higher investment in upgradation of their infrastructure. This coupled with larger opportunities that are likely to arise out of FIFA 2022 and trans-GCC metro network should throw up much larger business opportunities for Voltas in the medium-to-long term.

The expected opportunities arising from the above and the larger geographical spread due to the recent JVs should also provide added impetus to our business growth. We are now present in UAE, Qatar, Saudi Arabia, Oman, Bahrain, Singapore and Hong Kong.

As on 31-Dec-2010 we had an order book of Rs.3,100 crs in the international market. Normally, when the order book gets executed, the resultant revenues are much higher due to variations and claims. The order book of Rs.3,100 crores should therefore result in much higher revenue and be sufficient to cover revenue requirements of 18 to 24 months from January 2011, providing for reasonable growth over the current year's revenues.

The competitive situation in the Middle East market continues, but may subside over the next 6-8 months once the competitors have adequate order book. In view of this, we feel that towards the latter part of 2011-12, we should have a healthier inflow of new orders. In the interim, we are hopeful of booking more orders that will provide full visibility for revenues of 2012-13 (full cover for 2011-12 being available even now).

However, margins in the near term may remain under pressure due to the overall market conditions. As indicated in the past, the normal margins at the time of booking orders (for both Domestic and International business) range between 5-7%. Depending on opportunities for more efficient designing, higher bargaining power or more effective utilization of other resources, the margins can be improved in some of the projects thereby improving overall blended margins.

We are optimistic about getting back to the earlier growth rates in this business in the medium to long term.

ROHINI INDUSTRIAL ELECTRICALS:

As per the arrangements agreed with the promoters of the Company at the time of acquisition, the promoters were given operational freedom for a period up to 31st March 2011 and Voltas had appointed its CFO, statutory auditors and internal auditors.

Since the first acquisition of shareholding in the Company, we had seen that the margins on projects at the time of financial closure were generally be higher by 4.5% compared to the margins accounted under Percentage Completion Method (PCM). However, towards the end of the second quarter, we discovered that in certain large projects being closed, there were significant negative deviations in the margins from the PCM margins.

Arising from this Voltas management started reviewing margins in various projects and before the announcement of results, margin of several large projects were reviewed and the correction made in the results for that quarter which resulted in an EBIT loss of Rs. 14 Crores. During the 3rd quarter this review was extended to the remaining projects (the total number of projects under execution was about 90) and the correction required from this were accounted in the 3rd quarter, with a further loss of Rs. 9 crores. The total cumulative EBIT loss for the 9 months period amounted to Rs.21 crores. Most of the underperforming projects are likely to be completed by 31st March 2011 and therefore there will be some further operational loss in the fourth quarter as well.

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The Company also wishes to ensure that all the items of assets and liabilities appearing on the Balance Sheet of Rohini are validated and any adjustment required is carried out in the results for the quarter so that we have a clean slate at the start of the new financial year. Accordingly, further losses may have to be provided for in the 4th quarter. The operating management expects that in the year 2011-12 there will be a near break-even. In view of all of the above the segmented revenues and profits for this segment will remain under pressure in the 4th quarter of the current year and the year 2011-12 will be a year of consolidation.

The Company has so far paid Rs.105 Cr for acquiring 83% Shareholding of Rohini and it is expected that in the worst case scenario the balance shareholding could be acquired at zero value. This has resulted in significant goodwill which will need to be tested for impairment based on future earnings. There could therefore be some impact in the exceptional items.

SEGMENT B - Engineering Products & Services (EPS)

Materials Handling (MH)

The Company has just announced the formation of a JV with Kion group for developing MH business, which was a very small part of the overall revenue and profits of the Company as also of the segment. Several actions and formalities with regard to this JV need to be completed and it is expected that this would take approximately 2-3 months. Therefore, the 4th quarter of 2010-11 as also the 1st quarter of 2011-12 will continue to have revenues and profits flowing from this business in the segment results. The volumes in MH business have been improving well and this trend is expected to continue, going forward. However, following the formation of the JV, only the results may flow into the Company's overall results as a minority share of JV. The Company will continue to manufacture Forklift Trucks under a supply contract from the JV, which is presently for a period of five years.

MINING

In the Mining business Order booking has been progressing well in comparison to the last year and the operations and maintenance contract in Mozambique is stabilizing. The new Order booking would have been even better but for the slow down in iron ore mining due to various factors. The Company is also looking at opportunities in adjacent areas like coal washeries, mineral beneficiation etc. to cover a larger opportunity in the same manner as increase in service portfolio in Electro Mechanical Projects. Part of the Mining business of Terex was earlier sold to Bucyrus of USA and in the recent past Bucyrus has been taken over by Caterpillar, who already have two agents in India. Considering that despite its existing domestic business Bucyrus had not only continued its business with Voltas but had also extended the relationship it is quite possible that a similar situation may prevail with Caterpillar as well and it could become an opportunity for bigger things. However, this will become clearer over the next few months. The Company is also looking at more opportunities for its operations and maintenance business in Mozambique as also other African countries that have large mining operations and this could also become a global operation as has been the case with EMP.

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TMD

Order booking has been very good during the current year and execution of orders has also been taking place based on the order book. In the earlier upswing in the industrial cycles of the business the demand had come from exports, which are susceptible to changes in exchange rates. We understand that the current high demand emanates from domestic demand for yarn and garments and therefore should be more sustainable. It is very encouraging that the upswing in demand is despite the negative factors mentioned by us in earlier notes and concalls, such as closure of mills in Tirupur due to environmental reasons, high cotton prices and suspension of TUF (TUF is likely to end March 2012).

Overall we expect the Engineering Products and Services Business to continue to do well in the current quarter as well as over the next few years.

SEGMENT C - Unitary Cooling Products for Comfort and Commercial Use

Volumes in this business have been growing rapidly, subject to some variations due to climatic conditions from time to time. There are many factors working in favour of high demand viz. better and more reliable availability of power, high per capita disposable income, improved lifestyles and aspirations (most cars being sold in India now have ACs), increasing heat levels in summer, reduced cost of running the ACs and relatively low unit value of ACs (many models of mobile phones cost more than ACs). In view of these factors we believe that this business can grow at least 20-25% year on year. Voltas has grown at a pace faster than the market over the last few years and despite some of the small players becoming more aggressive and changing their business philosophies, we should be able to sustain this growth since Voltas is considered to be a pioneer and expert in cooling.

In the past we have been able to pass on the increase in cost of manufacture to the customers and if the demand levels are sustained, we should be able to continue doing so in the future, thereby sustaining satisfactory margins.

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