VOLTAS LIMITED
A TATA Enterprise

ANALYSIS OF RESULTS FOR THE QUARTER ENDED 30th SEPTEMBER 2011

Voltas entered the 2nd quarter of 2011-12 in the wake of a very challenging and uncertain economic environment, both domestic and international. The global economic crisis continued to cast its shadow on all facets of business, supply, currency and competition. In the domestic arena as well, high interest rates and inflation are resulting in the deferment of capital investment and general economic slowdown indicative of an across-the-board negative sentiment. General consumer austerity was reflected in sedate festival sales of unitary cooling products, unfortunately exacerbated by a mild summer. Against this difficult backdrop, the company contained its top-line shortfall and managed its bottom-line to deliver an EBITA margin of 4.5 %.

The Turnover of the Company on a consolidated basis was Rs. 1102 crs, 3% above the comparable quarter in the previous year. Consolidated Profit before Interest and Exceptional items declined to Rs. 41 crs against Rs. 121 crs reported last year. The Company earned Rs. 1.27 per share as compared to Rs. 2.79 per share in the previous year.

A snapshot of the highlights and the results for both the quarter and the half year at Consolidated level are given below :-

	Q2		H1	
	CY	PY	CY	PY
Increase in TO	3%	-2%	-1%	7%
EBITDA Margin	4.5%	12.2%	7.3%	11.8%
Increase in Profit before Excep. Items	-71%	-12%	-44%	3%
Increase in PBT	-57%	2%	-9%	8%
Increase in PAT	-55%	-2%	-6%	7%
Taxation as percentage of PBT	30%	33%	30%	32%
Positive EVA	2%	17%	2%	17%
EPS (Rs.)	1.27	2.79	5.25	5.61
Return on Net Worth (w/o Excep. Items)	5%	24%	9%	27%
Debt / Equity ratio	0.19	0.07	0.19	0.07

The Voltas Balance Sheet continues to remain strong with Shareholders' equity at Rs. 1539 crs against Rs. 1268 crs for the comparable period last year. The increase in Debt Equity Ratio to 0.19 indicates higher borrowings of Rs. 197 crs, mainly from Overseas operations. The Company's liquidity position is comfortable with cash and bank balances at approx. Rs. 333 crs and liquid investments aggregating Rs. 212 crs against Rs. 96 crs as at end of September last year.

Consolidated Segment results for the Quarter:

Segment Reporting	Q2 Sep-11	Q2 Sep-10	% Growth over Pr. Yr
1. Revenue			
Segment A : Eng. Projects	762	707	8%
Segment B : Eng. Products	120	127	-5%
Segment C : Unitary Cooling	211	228	-8%
Others	9	3	235%
Net Revenue from Operations	1102	1064	4%
2. Segment Results			
Segment A : Eng. Projects	5	58	-91%
Segment B : Eng. Products	18	26	-33%
Segment C : Unitary Cooling	6	29	-79%
Others	(1)	1	-227%
Total	28	114	-75%
3. Capital Employed			
Segment A : Eng. Projects	712	238	
Segment B : Eng. Products	101	98	
Segment C : Unitary Cooling	341	251	
Others	14	8	

We present below our detailed comments on the performance and future outlook of the various business segments that we operate in.

Segment A - Electro-mechanical Projects & Services

Lower volumes of business available in the Company's established geographies has resulted in a much more intensified competition amongst players. Nevertheless, Consolidated Turnover of the Electro-mechanical Segment for Q1 at Rs 762 crs, was higher by 8% over the comparable quarter in the previous year.

International profitability continues to be adversely impacted by rising input costs, restrictive visa conditions, and setbacks in cash flows amplified by higher capital engagement. This is especially evident in certain large iconic projects in Qatar whose margins are also being squeezed by the tightening of completion time lines. The faster tempo of execution including the complexity of sequential design and build projects has led to some unbudgeted cost overruns. While these are being contained to the extent possible, there is a probability that higher costs will continue to impact us over the next few quarters.

Our consolidated International projects order book stands at Rs 2642 crores. This does not however, take into account additional revenues from variations and claims arising in the course of ongoing projects, which are customarily settled after completion. We would also mention that we have recently secured the LOI for a large retail project in Abu Dhabi of around Rs. 500 crs.

Coming on the back of a number of prestigious MEP industry awards bagged last year in UAE, we are happy to report a further significant achievement of now winning the 'MEP Contractor of the Year' award in Qatar. This should position us rather well to capitalize on the emerging opportunities as FIFA infrastructure preparations, including the metro rail and several other Government led projects begin to crystallize.

The consolidated order book situation in the **Domestic** projects business (including Water Management & Rohini) has been consistently healthy, and the carry-forward position has risen from Rs.1545 crs to Rs.1819 crs, an increase of 18%. Notwithstanding the difficult environment, the domestic electro-mechanical business has seen success in obtaining some good orders in the health sector apart from a breakthrough order from GNFC for industrial refrigeration systems. Product sales price realization has shown improvement on the back of an upward price correction. Greater momentum in AMC and integrated technical services businesses was also evidenced.

The company has received much appreciation for its outstanding contribution to the timely completion and delivery of HVAC, Electrical and Plumbing systems for the recently opened and internationally acclaimed Formula 1 (F1) Circuit in Greater Noida.

In the Water Management business, the order book shows an increase of 44% compared to the same period last year. Importantly, this excludes a sizeable order of approx. Rs. 165 crores from Tata Steel, bid and successfully won against formidable competition in Q3. At the same time, the business is growing its technological capabilities and has obtained its first order for electrolysis-based water treatment plants. The business is quite clearly stepping up the tempo whilst investing in the development of trained resources and ramping up its execution capability.

The stand-alone order book of Rohini Industrial Electricals amounts to Rs. 260 crs, a 13% increase over last year. However, profitability fell short of expectation being impacted by the slow progress of some old jobs including a high value rural electrification job. At the same time, the high quantum of receivables amidst prolonged payment cycles is posing a challenge – this is being addressed with the formation of specific teams charged with the responsibility of collecting old outstandings. A dedicated team has also been focusing on business development which should hopefully result in a higher order book for Rohini as the quarters progress. Systems and operational processes are also increasingly now getting integrated with those of Voltas.

Forward Outlook :

The current total order book of Rs 4461 crs for the segment provides revenue growth visibility over the next 15-18 months. In addition, we have also indicated some of the larger orders that have been secured in early Q3.

While there is a definite slowdown in the international projects business, the more promising opportunities are within countries like Saudi Arabia, Qatar, and Oman given their surplus oil and gas revenues. Despite the economic slowdown, the Jasmine revolution has given an impetus to these GCC governments to use their accumulated reserves to maintain a certain level of minimum investment in infrastructure development for betterment of their economies.

In the International markets, the major challenge relates to intense competition (resulting in the compression of bidding margins), apart from slow decision making and conscious postponement of awarding contracts. In fact, it is not uncommon to find several large projects being re-tendered at lower values and with more austere specifications. That being said, business prospects appear to be emerging in UAE (realty sector), Abu Dhabi (airports), and KSA (built environment and urban infrastructure such as King Abdullah Sports City, etc). With its Middle - East presence augmented by JVs in both KSA and Oman, the Company is pursuing an aggressive bidding strategy. The Management is reasonably optimistic about booking adequate orders over the upcoming quarters, albeit at sedate margins.

In the Domestic projects business, the more substantial prospects lie in infrastructure development, which continues to be prioritized by the Government – considerable investments chalked out in the current (11^{th}) five year plan will necessarily be carried forward into the 12^{th} plan while opportunities in the Built Environment Sector are expected to more than double in the next five years. The segment includes healthcare, hospitality, educational institutions, commercial and retail spaces, and sporting venues, among others. With 50% of India's population expected to live in cities by 2025, there is also a pressing need to build and upgrade infrastructure for water, power, urban mass transport (Metro rail), sanitation etc.

Although the pace of Governmental decision making is currently constrained by corruption scandals and other political considerations, we expect the thrust in capacity building / modernization of roads, railways, ports, civil aviation and power sector to pick up and stabilize, particularly in the run up to the crucial 2014 general elections.

There is of course another school of thought that anticipates a deeper crisis and a couple of years of greater economic turmoil before the business cycle turns and confidence begins to return. Be that as it may, Voltas with its proven capabilities, established track record and balance sheet resilience is well placed to capitalize and seize longer term growth opportunities as and when they appear.

Segment B - Engineering Products & Services

The segments turnover at Rs 120 crores, declined by 5% over the same period last year. Note however that the transfer of Material Handling business makes revenue and results of the current quarter non-comparable to the previous year.

Both the Textile Machinery and Mining and Construction Equipment divisions have contributed to higher segment revenue as compared to the same period last year. Segment results have however, been under pressure in the Mining and Construction equipment business primarily due to tough business conditions. The general economic slowdown, inflation and high interest rates have significantly impacted investment sentiment and forward visibility is limited. IIP numbers indicate that the Capital goods segment has been particularly volatile – swinging from 38.2% in June to a negative 13.7% in July and returning to a mildly positive 3.9% in August. The poor pace of environmental clearance for mines (Karnataka, Goa, Orissa, MP ….) has also particularly impacted the investment sentiment resulting in lower equipment sales and commission.

As announced earlier, there has been a consolidation amongst global equipment manufacturers with Bucyrus and Letourneau (our erstwhile principals) being taken over by Caterpillar and Joy respectively. Although we face tough competition from entrenched Indian distributors of the acquirers, we are in talks and continue to await formal clarity about their future plans.

The Textile Machinery division has done better than the same period last year. While the pending order book remains robust, the pace of replenishment has slowed down due to significant profitability concerns in the user industry. Although the Government has announced its intention to continue TUF beyond 2012, environmental problems at Tirupur and the change in business confidence and investment sentiment may begin to take its toll in forward quarters.

Segment C - Unitary Cooling Products for Comfort and Commercial Use

Published Gfk-Nielsen reports indicate that the total sales volume across the Room AC Industry in India has declined significantly in the second quarter. This downturn is firmly attributable to the significant impact of unfavourable weather duly compounded by the general economic downturn caused by soaring inflation across the full range of household consumables and high interest rates. The company's AC sale by volume has also declined, but lesser than that of the industry. We have strategically, partly compensated the AC downturn by a strong sales push across water coolers and other commercial refrigeration products that we deal in. In essence, we have managed to contain our volume shortfall in the Unitary cooling business to 18%.

At the same time, the strength of the Voltas Brand has supported us in maintaining our price levels, in a highly competitive environment, resulting in a revenue decline of just 7% in the second quarter, much lesser than the industry average. At the same time Voltas has been able to sustain its number 2 position in the AC market with a share of 17.6% as at the end of the quarter. We have achieved the number 1 position in the Northern region as per the GFK Nielsen Report and have aggressive plans to further build our market shares in other regions too.

The AC industry is also facing a turmoil of sorts with increasing fragmentation on the one hand and an extra aggressive play by lead players and Japanese competitors with deep pockets. They have also in the last 6 months exponentially increased their advertising spends and have significantly reduced unit prices. Although this has helped them gain some market share, they are still in and around the 5% level.

Voltas has responded to these challenges by also increasing its advertising spend considerably, but more importantly by concentrating on expanding its distribution reach and network into Tier II and Tier III towns. Considerable emphasis is being placed on strengthening our service capabilities for improved customer satisfaction for which we are working with various NGOs and a number of ITIs across the country. We have already trained and developed over 800 candidates from underprivileged sections of the society and are targeting 2000 numbers by end 2012. This, apart from ensuring a sustainable livelihood for these youngsters, will help us in effectively expanding our service reach with localized infrastructure.

We are also concerned about the high levels of inventory across the industry which could lead to some players with cash constraints discounting their products. Although Voltas is also impacted by high inventory, our brand strength combined with nil borrowings provides a sense of resilience in holding firm in this environment. Upward volatility of commodity prices and a weak rupee is a further matter to be dealt with.

As part of the business gearing up for future growth, its manufacturing facilities at Pantnagar have achieved ISO90001 and OHSAS certification. As a preparatory measure for meeting expected product demand in Q4, we are exploring various flexible sourcing options for procuring the best quality at optimum prices.

Outlook:

Long-term prospects for the AC industry remain highly promising. Household disposable incomes are rising, and spreading well beyond metros and large towns. More flexible consumer lending practices are creating a new generation of affluent middle-class consumers influenced considerably by lifestyles and tastes of developed countries. There is also better national power availability, a steady rise in home construction, and an upward trend in social and aspirational factors. Given increasing affordability of AC products and low market penetration (3% compared with 55% for TVs) we see a sizeable longer term growth opportunity.

As a company, we are well seized of the short term challenges as well as the longer term opportunities in this segment of our business. Marketing and Product strategy is therefore continuously developed and dovetailed to respond to the expected changes in this dynamic market.

Overall

We have spoken about several short term challenges and several long term opportunities as well. The dull environment we currently see around us may continue to last for a few more quarters and there could be a possibility of the further deterioration and the business cycle turning even more adverse.

Our response in managing these developments will necessarily need to be swift and proactive. We are hence already engaged with various initiatives that will help in balancing the short term concerns, but without losing sight of our longer term prospects. In certain parts of the business, we are aggressively cutting less productive costs whist retaining the capability to quickly ramp up as opportunities eventually arise. Although payment cycle elongation and working capital engagement is a given in the emerging environment, there are areas where we can manage better and cushion the impact of inflation.

We will also use the current lull in business to build our internal people capabilities, on the one hand by recruiting new talent and on the other by training and developing our existing people resources.

The one thing we are confident about is that as a Company we are in the right kind of businesses which cannot but grow ! This is because we remain conscious of the enormous quantum and type of investments that are being planned across both the domestic and international markets that we service. We have also spoken about the growing trends in consumerism that auger well for our cooling products. To sum up, we are definitely concerned about the short term, but remain fairly optimistic about our future.

Cautionary Statement

Statements in this release describing the Company’s objectives, projections, estimates and expectations may be ‘forward-looking statements’ within the meaning of applicable securities laws and regulations. Actual results could differ materially from those expressed or implied. Important factors that could make a difference to the Company’s operations include economic conditions affecting demand/supply and price conditions in the domestic and overseas markets in which the Company operates, changes in the Government regulations, tax laws and other statutes and other incidental factors.

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