VOLTAS
A TATA Enterprise

ANALYSIS OF RESULTS
QUARTER ENDED 31st December 2015

It was not too long ago when the IMF predicted that risks to global growth remains tilted to the downside, pertaining as it does to the several ongoing adjustments in the global economy. Major points of concern revolved around a slowdown in emerging markets, China's rebalancing, lower commodity prices and a gradual exit from the accommodative monetary conditions in the United States

The truth is that we live in turbulent times, and it is proving increasingly difficult to fathom the extent of change and economic re-adjustment that continues to sweep our world. Dramatic as it seems, the effects are often deep and damaging – The Economic Times has reported that stock indices across the World have largely been on a 'stampede of selling' since the start of this calendar year. Increasing fears of a Chinese slowdown, further slide in global oil prices and poor domestic company results compounded by the US Federal Reserve statement of an impending rate hike have sent major indices into a tailspin. The fall ranged from approx. 22% (Shanghai Composite), 18% (DAX and Nikkei) to 11% and 10% (FTSE and Dow Jones respectively). The Sensex in India was no exception and was wedged in-between at a decline of 12.2% during the same period. Investor confidence is clearly shaken and threatens to remain so for some time to come.

At the same time there is a significant crisis in the Middle East, a geography which more directly impacts our international business. The plunge of the Brent crude oil price to a 12-year low (below $30 a barrel, from around $110 just 18 months ago), has given the six Gulf Cooperation Council countries their biggest economic challenge in more than a decade. In fact, a recent survey of companies by ME Construction News points out to a 'dramatic' decline in optimism. Apart from visibly restrained and extra cautious spending, Respondents complain about longer payment periods, certification delays and a substantial increase in the number of commercial disputes they encounter.

On the domestic front, economic activity lost momentum in Q3 of 2015-16, pulled down by slackening agricultural and industrial growth. The Index of Industrial Production (IIP) stood at a negative 1.3% in December 2015, that too following a 3.4% decline in the earlier month of November. While the Manufacturing output decline of 2.4% may be attributed to the floods in Chennai, it is not the full story as a 19.7% contraction in capital goods is indicative of sluggish investments. Meanwhile, retail inflation has jumped to a 17 month high in January which poses a dilemma of sorts, considering the need to increase Govt. spending (to spur investments) whilst allowing the RBI to follow through with further interest rate cuts.

Coming to Voltas' Performance in Q3, Profit from Ordinary Activities after Finance Costs but before Exceptional Items was lower at Rs. 67 crores compared to Rs. 76 crores in the previous year. The decline was largely owing to revenue from certain uncertified variations and an acceleration claim in an overseas project that could not be accounted (per AS7 guidelines), apart from the absence of a one-off operating income last year. Similarly, Profit before Tax (PBT) was lower at Rs. 69 crores as compared to Rs. 121 crores last year, partly due to a non-recurring net exceptional gain of Rs. 45 crores (sale of property) reckoned in Q3 of the previous year. The lack of the said capital gain in current year has also resulted in a higher tax rate, leading to Profit from Ordinary Activities after Tax at Rs. 56 crores and an EPS of Rs. 1.64 (Face value per share of Rs. 1) for the quarter under consideration.

Consolidated Sales/Income from Operations for the quarter ended 31st December, 2015 was higher at Rs. 1301 crores as compared to Rs. 939 crores in the corresponding quarter last year. Alongside, the Voltas balance sheet continues to remain strong with low debt, strong reserves and a comfortable cash position.

We present below our detailed comments on the performance of the various business segments in which we operate.

Segment Reporting	Q3		% Growth over PY	% of Total Revenue	
	ACT FY 16	ACT FY 15		ACT FY 16	ACT FY 15
1. Revenue					
Segment A : Eng. Projects	722	461	56%	55%	49%
Segment B : Eng. Products	111	81	38%	9%	9%
Segment C : Unitary Cooling	435	384	13%	33%	41%
Net Revenue from Operations	**1301**	**939**	**39%**		
2. Segment Results				**Results to Revenue**	
Segment A : Eng. Projects	(9)	9	-194%	-1%	2%
Segment B : Eng. Products	25	23	5%	22%	29%
Segment C : Unitary Cooling	50	51	-1%	12%	13%
Total	**70**	**84**	**-16%**		
3. Capital Employed				**ROCE (Annualised)**	
Segment A : Eng. Projects	634	665	-5%	2%	4%
Segment B : Eng. Products	85	80	6%	130%	132%
Segment C : Unitary Cooling	396	396	0%	67%	70%

Segment A – Electro-Mechanical Projects and Services

Segment Revenue was higher at Rs. 722 crores as compared to Rs. 461 crores in the corresponding quarter last year. The increase in turnover was mainly across International Projects, esp. Qatar where execution of a couple of newer private sector projects have been stepped up. A project in UAE had also been accelerated to meet a stringent completion deadline, which has since been successfully achieved. Segment results are however, reflective of the deeply adverse international project environment including consequent challenges in obtaining timely certification of certain variations and an acceleration claim which is currently under negotiation.

As mentioned earlier, the environment in the Middle East region is marked by an element of pessimism driven by the unprecedented decline of crude oil prices. Given the reality of deficit national budgets, political analysts are increasingly certain of forced austerity and conservative spending, not to speak of definite reduction in the scale of public subsidies and perhaps even some elements of direct taxation, should the situation continue. The fuel crisis also impacts the region's banking system given lower resources at hand to aggressively support infrastructure rollout plans over the immediate future. Oft spoken and observed trends (such as a slower pace of project execution, reluctance to officially extend project timelines, 'engineered' delay in settlement of commercial entitlements, increasing tendency to legally dispute, go to arbitration, etc.), appear to have now become the norm and common practice. It is no longer surprising to hear of stressed balance sheets, cost overruns, huge provisions, large outstandings and cash strapped situations across well-known companies within the industry.

Given this environment, we are particularly careful about potential risks and the possibility of mitigation whilst considering new orders in our International business. Whilst making conscious efforts to improve our order book, our oft repeated focus on cash and profitability will not be diluted. We therefore continue to pick up orders selectively in an appropriately risk mitigated manner and currently have an order book of Rs. 1360 crores in International. A couple of new orders are currently in advanced stages of negotiations and will hopefully be concluded, subject to satisfactory commercial terms and conditions.

That said, the Domestic Projects business is on a steady path towards recovery demonstrating better performance in terms of both revenue and results compared to last year. The benefits of business improvement program initiated last year are yielding results. At the same time, RIEL (a 100% subsidiary) is also turning around supported as it is by the Govt. thrust and focus on rural electrification.

However, the liquidity constraints of the current business environment remain as the RBI has refrained from further reduction of the borrowing rates in its more recent policy review meeting. Accordingly, a much needed uptick in private spending is yet to be seen. Nevertheless, orders booked during the current quarter were Rs 496 crores which include Rs. 220 crores for MEP works of a convention center in Mumbai and Rs. 96 crores for water project in Cuttack. The order book for the Domestic Division now stands at Rs. 2154 crores at end Dec-15.

Overall Order Book of the Segment stood at Rs. 3514 crores as compared to Rs. 3949 crores in the corresponding quarter last year.

Segment B – Engineering Products and Services

Segment Revenue and Result was higher at Rs. 111 crores and Rs. 25 crores as compared to Rs. 81 crores and Rs. 23 crores respectively, in the corresponding quarter last year. As is well known, the business environment for both Mining and Textile Machinery businesses continues to be challenging.

Although activity levels remain rather subdued on the textiles front, we have been able to work with our Principals LMW to leverage existing sentiment and available central / state subsidies to improve our market share to beyond 60%. The drop in demand levels from China with its negative impact on Indian yarn exports needs watching. Additionally, the recently announced Amended Textile Upgradation Fund (ATUF) scheme has de-prioritized Spinning and increased focus on Post Spinning activities. Going forward, industry players in spinning will need to re-adjust to a non-subsidized environment while planning new investments.

Given limited on the ground improvement in the domestic Mining & Construction Equipment business, the business has been exploring new avenues to improve its performance. Accordingly, results of this quarter include a significant one-off transaction for sale of an imported and refurbished loader. Meanwhile, our business in Mozambique continues to grow on the back of customer satisfaction. We have now added even more additional heavy equipment to our service portfolio at Vale.

Segment C – Unitary Cooling Products

Segment Revenue was higher at Rs. 435 crores as compared to Rs. 384 crores in the corresponding quarter last year due to improved festive season demand driven by focused advertising spends and sales promotion activities. With key players in the industry being saddled with higher inventory, the intensity of competition has increased exponentially. Many of the established names have resorted to price cuts, mouthwatering consumer schemes and enticing dealer incentives in an attempt to gain market share. Despite this onslaught, Voltas has not only protected its market leadership position (21.8% MBO market share as at Dec), but has also expanded its lead vis-a-vis the nearest competitor.

Despite the challenging competitive environment described above, the business has successfully retained the EBIT margin at a comfortable 12% with a segment result of Rs 50 crores. It is also important to recognize that Q3 is a traditionally weaker quarter for the AC industry, not to mention the extra spend now incurred on selling expenses to protect our leadership position.

Using the learnings from the limited launch of Air Coolers earlier this year, the Company has suitability increased its product range and dealership network in preparation for the upcoming season. Similarly, various initiatives on Commercial Refrigeration products have yielded encouraging results with addition of new customers as well as fresh business from older accounts.

Sum-up

The forward business environment will be substantially dependent on the various governmental actions, global readjustments taking place and the resultant business sentiment. In India, all eyes are on the upcoming budget with hopes of structural reforms that can sensibly boost growth in tandem with a lower interest cost regime.

We perceive a gradual recovery in private sector spending which will reveal opportunities in the project business, both in India and overseas. Our attempt will be to strengthen our order book with the addition of suitably risk mitigated, higher quality orders. At the same time, we will not lose focus on the satisfactory conclusion of commercial negotiations and speedy financial closure of older projects. Meanwhile, the Unitary Cooling business prepares for the upcoming peak season with a strategy that includes a wider portfolio of customer centric products, a refreshed advertisement campaign and the determination to protect our leadership position.

15th February 2016