VOLTAS
A TATA Enterprise

ANALYSIS OF RESULTS

QUARTER AND NINE MONTHS PERIOD ENDED 31st DECEMBER 2016

Last quarter, we commented upon the increasingly unpredictable world we live in. The sentiment has if anything, accentuated as the globe continues to be overshadowed by a move towards protectionist policies. The new US administration led pronouncements, the tepid economic recovery or the lack of it, fragile movements in oil prices, commodity swings and the debt overhang in China have further sharpened the ambiguities.

In India, the Government continues to demonstrate serious intent to fast forward the reform agenda with the passage of the constitutional amendment for implementation of the GST (Goods and Services Tax) and the Demonetisation of high denomination currency notes. The short term impact of the latter has become visible in the toned down estimates for the GDP, which has now been brought down to around 7%, from the 7.8% anticipated earlier. Although some green shoots are visible in select macroeconomic indicators like inflation, interest rates, etc., Private Sector spending continues to remain subdued. In fact, the recently announced IIP (Index of Industrial Production) numbers for December underlines a contraction, with Manufacturing, Capital Goods and Consumer Goods at a negative 2%, 3% and 6.8% respectively.

The Consolidated Income from Operations for the nine months ended December 31, 2016 was higher by 4%, at Rs. 4011 crores as compared to Rs. 3870 crores in the previous year, largely contributed by Unitary Cooling Products. Corresponding numbers for Q3 were however subdued at Rs. 1194 crores for the Qtr, impacted as it was by weak trade sentiments and slower than expected project execution, largely led by demonetisation and an unsupportive business environment.

Net profit for both the 9 month period as also the Qtr under review, was however well ahead with a respective delta of Rs. 82 crs and Rs. 24 crs. While this includes some benefit from higher Other Income, EBITDA margins have increased by as much as 300 bps (YTD 240 bps). Earnings per Share (not annualized) as at December 31, 2016 has also improved to Rs. 9.4 as compared to Rs. 6.9 last year (Face Value per share - Re. 1). Other Comprehensive Income recognized as per Ind-AS mainly includes notional mark-to-market gains on movement in market share price of certain strategic long term equity investments. Accordingly, Total Comprehensive Income for the nine months period ended December 31, 2016 was Rs. 347 crores as compared to Rs. 237 crores last year. The Balance sheet remains robust with low debt and a comfortable cash position.

Analysis by segment:

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

Segment Reporting	For the quarter ended		% Growth over PY	% of Total Revenue	
	Dec'16	Dec'15		Dec'16	Dec'15
1. Revenue					
Segment A : Eng. Projects	703	724	-3%	59%	57%
Segment B : Eng. Products	81	111	-27%	7%	9%
Segment C : Unitary Cooling	411	431	-5%	34%	34%
Income from Operations (Gross)	**1194**	**1266**	**-6%**		
2. Segment Results				**Results to Revenue**	
Segment A : Eng. Projects	27	(4)	775%	4%	-1%
Segment B : Eng. Products	20	25	-20%	25%	23%
Segment C : Unitary Cooling	43	50	-14%	10%	12%
Total	**91**	**71**	**28%**		
3. Capital Employed				**ROCE (Annualised)**	
Segment A : Eng. Projects	729	626	16%	15%	-3%
Segment B : Eng. Products	61	85	-28%	131%	118%
Segment C : Unitary Cooling	297	400	-26%	58%	50%

To ensure comparability the figures for the previous periods have been appropriately regrouped / restated as per the new Indian Accounting Standards (Ind-AS).

Segment A – Electro-Mechanical Projects and Services

Segment Revenue for the quarter was lower at Rs. 703 crores as compared to Rs. 724 crores in the corresponding quarter last year due to slower than expected progress on certain new orders and an environment led sluggish pace of execution. However, Segment Result improved to Rs. 27 crores as compared to a loss of Rs. 4 crores, last year. This reflects the positive closure of certain old projects as well as the higher margins in newer ones. Order Book for the Segment also stood higher at Rs. 4196 crores as compared to Rs. 3640 crores in the same quarter last year, providing better forward revenue visibility.

In the Domestic Projects business, our conscious strategy of targeting public sector spending has been one of the key drivers for improving the intrinsic performance of this business. The focus on government projects especially across smart cities, urban infrastructure, educational institutions, rural electrification and water has been designed to compensate the subdued private sector sentiment. The domestic carry forward order book now stands at Rs. 2360 crores. Orders booked during the quarter of Rs. 450 crores, includes Rs. 128 crores for rural electrification in the state of Madhya Pradesh in Central India. With more Banks passing on the benefit of a lower interest rate regime to industry, we are hopeful of a gradual improvement in private sector sentiment as well. Meanwhile, in tune with the current market scenario, the business would sensibly progress on order booking without losing focus on profitability and cash.

Middle East, a geography which more directly impacts our international business, remains in a state of slow recovery given the volatility in oil prices, combined with fiscal deficits. The sequential impact on liquidity with client led progress deferrals and consequent certification & payment delays is well known. With an internal task force focused on optimum closure of older projects, we are confident of speedy settlement and commercial closure within this fiscal year, barring a couple of projects under arbitration.

Apart from the strategic focus on strengthening commercial proficiency to suitably protect our contractual entitlements, building longer term service capability provides an avenue to improve and sustain profitability. In projects, emphasis is being placed on strengthening the order pad with suitably risk mitigated orders at the right threshold margins. Currently, the pending order book of the International projects business stands at Rs. 1836 crores.

Segment B – Engineering Products and Services

Segment Revenue and Result for the quarter were Rs. 81 crores and Rs. 20 crores as compared to Rs. 111 crores and Rs. 25 crores, respectively in the corresponding quarter last year. A direct comparison to the previous year is vitiated by the presence of a large mining equipment sale, a one-off transaction.

The high dependency of the domestic Textile industry on cash based transactions is well known. Consequently, the impact of demonetization has been extra severe, evidenced by margin pressures and sluggish demand for both machinery and parts. Additionally, the lower amount of credit flows from Banking channels into the industry has had an impact on the quantum of capital expenditure spending by the textile mills.

Given the travails of the mining industry in general, grid locked by policy, the domestic Mining & Construction Equipment business has been exploring new avenues to improve core performance. An example of the above would be our growth via attempts to leverage the increased road construction activity in India, by pushing up the sale of Crushing & Screening equipment. Meanwhile, our overseas business in Mozambique continues to drive the performance, and the increase in global coal prices augurs well for our client.

Segment C – Unitary Cooling Products

Segment Revenue and results were Rs. 411 crores and Rs. 43 crores as compared to Rs. 431 crores and Rs. 50 crores respectively in the previous year.

Although the Qtr began on a strong note given the festive season, subsequent sales across the consumer durables basket were affected in varying degrees owing to demonetization. While sales to the trade are through the Banking channel, a proportion of secondary sales by the dealers to end customers operates on a cash basis. As also reported by a well reputed independent market research agency, secondary sales of ACs at Multi-brand outlets across industry de-grew by 11% in volume terms (Q3).

That apart, this is traditionally a lean Qtr with primary sales for the Room Air-conditioner business driven mainly by festival season sale and post festival re-stocking. Accordingly, consumer sentiment, promotional offers and expectation of sales going forward are important determinants of the performance in these winter months – all these were impacted by demonetization in the later part of the current Qtr.

As market leaders and in contrast to some other players, Voltas has remained conscious about the longer term protection of its market. We have therefore been cautious about irrational and unsustainable reduction of prices for short term gains. It is important to note that the Company maintains its dominant position in Room Air Conditioners with YTD market share of 21.7%, apart from a YTD EBIT profitability of 13.4%.

The impact of demonetization is also visible in the Air Cooler and Commercial refrigeration businesses. In the Air Cooler segment, we have considerably enhanced the variety and number of models, with an expectation of higher growth as we go forward.

In overall terms, our emphasis remains on delighting our consumers with high quality, technologically advanced products, attractively priced in a sustainable manner, backed by a strong and readily accessible service infrastructure. While competition is a given, we are well poised in terms of a relevant product portfolio and a new communication campaign to deal with the challenges of the upcoming summer season. The depth of our distribution, our financial strength and operating leverage is also a definite advantage.

Sum-up

We remain reasonably confident about the longer term potential of all the businesses that we are currently present in. While the competitive intensity and trend of rising input costs would exert some pressure on margins, we expect to do better than competition. Additionally, as and when the sentiments turn positive, our mix of business and cash reserves provides a much required resilience.

16th February 2017