

**HOLD**  
TP: Rs 1,000 | ▲ 10%

**VOLTAS**

| Consumer Durables

| 02 November 2022

### Dismal Q2; UCP margins at decadal low

- UCP EBIT margin at 10Y low of 7.3% with flat revenue; exit market share at 23% in Aug'22 vs. 24% in Jun'22
- EMP business in the red owing to one-off losses on overseas contract annulment
- Competitive edge ebbing; we cut FY23/FY24 EPS ~12% and revise our target P/E to 45x (vs. 50x) for a TP of Rs 1,000 (vs. Rs 1,100) – retain HOLD

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**Subpar quarter:** VOLT's Q2FY23 revenue was in line with our/consensus estimates at Rs 17.7bn, but its EBITDA margin fell to a two-year low of 5.7% (-70bps QoQ, -190bps YoY). Profitability suffered as the unitary cooling product (UCP) business clocked a decadal-low EBIT margin of 7.3% due to high-cost inventory and intense competition while the electromechanical product (EMP) division posted losses on provisioning for one-off expenses.

**Competitive edge losing sheen:** VOLT's market share has fallen off in recent years – from 26.8% in Aug'20 YTD to 22.8% in Aug'22 YTD (24.1% at end-Q1FY23), due to intensifying competition in room air conditioners (RAC) from LG, Blue Star, Samsung and Lloyd. The company's RAC operating margin has declined for two successive quarters to 7.3% in Q2 (vs. the 2Y average of 12%), reflecting deterioration in the premium it has commanded over peers. The aggressive pursuit of market share by rivals (Lloyd: 3Y revenue CAGR at 33% vs. VOLT's 26%) has compelled VOLT to forego margins.

**Tepid EMP business:** The EMP business posted mere 3% YoY growth in Q2FY23 to Rs 5.5bn with subpar margins of 2.6% (ex-exceptional). A flat carry-forward order book YoY (Rs 60bn vs. Rs 58bn in Q2FY22) and maturing projects muted topline growth. Additionally, VOLT had to set aside provisions for cancellation of an overseas contract, resulting in operational losses of Rs 920mn.

**TP cut to Rs 1,000; HOLD:** VOLT remains the leader in RACs, but its market share and margins have come under sustained fire in recent years from intensifying competition. We expect the stress on UCP margins to persist in the near term as peers chase market share gains. We thus lower our FY23/FY24 EPS estimates by 13%/12% and cut our target P/E multiple from 50x to 45x – in line with the 7Y average. Post multiple revision and valuation rollover to Sep'24E, our TP stands reduced to Rs 1,000 (vs. Rs 1,100) – retain HOLD.

### Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	VOLT IN/Rs 909
Market cap	US\$ 3.6bn
Free float	70%
3M ADV	US\$ 13.9mn
52wk high/low	Rs 1,348/Rs 857
Promoter/FPI/DII	30%/24%/30%

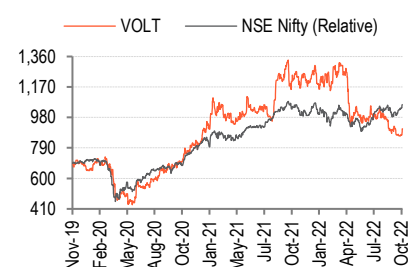
Source: NSE | Price as of 2 Nov 2022

### Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	79,345	88,613	107,669
EBITDA (Rs mn)	6,816	6,591	9,143
Adj. net profit (Rs mn)	5,060	4,649	6,415
Adj. EPS (Rs)	15.3	14.1	19.4
Consensus EPS (Rs)	15.3	18.1	24.3
Adj. ROAE (%)	9.6	8.3	10.9
Adj. P/E (x)	59.5	64.7	46.9
EV/EBITDA (x)	44.1	45.6	32.9
Adj. EPS growth (%)	(4.3)	(8.1)	38.0

Source: Company, Bloomberg, BOBCAPS Research

### Stock performance



Source: NSE



**Fig 1 – Quarterly performance**

Particulars (Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)
Revenue	17,684	16,891	4.7	27,680	(36.1)
EBITDA	1,008	1,291	(21.9)	1,770	(43.0)
EBITDA Margin (%)	5.7	7.6	(190bps)	6.4	(70bps)
Depreciation	97	95	-	85	-
Interest	67	62	-	40	-
Other Income	644	483	-	268	-
PBT	1,488	1,617	(8.0)	1,913	(22.2)
Tax	195	385	-	508	-
Adjusted PAT	990	1,050	(5.7)	1,089	(9.1)
Exceptional item	1,064	-	-	0	-
Reported PAT	(74)	1,050	(107.1)	1,089	(106.8)
Adj. PAT Margin (%)	5.6	6.2	(60bps)	3.9	170bps
EPS (Rs)	3.9	3.7	5.0	4.2	(8.0)

Source: Company, BOBCAPS Research

**Fig 2 – Actual vs. Estimates**

Particulars (Rs mn)	Actual	Estimates	Variance (%)
Revenue	17,684	17,723	(0.2)
EBITDA	1,008	1,263	(20.2)
EBITDA Margin (%)	5.7	7.1	(140bps)
Adj. PAT	990	923	7.3

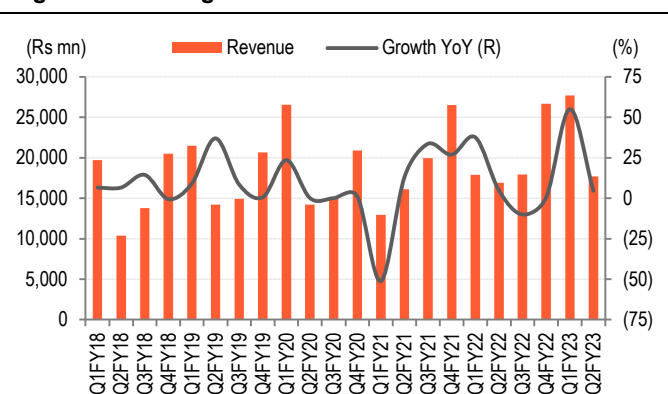
Source: Company, BOBCAPS Research

**Fig 3 – Peer comparison: UCP business**

UCP segment	EBIT margin Q2FY23 (%)	Revenue 3Y CAGR (%)	Revenue growth YoY (%)	Revenue growth QoQ (%)
VOLT	7.3	26	4	(52)
Lloyd	(20.0)	33	21	(62)

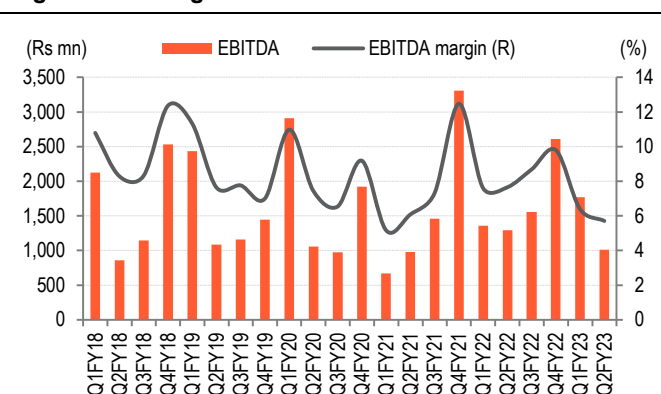
Source: Company, BOBCAPS Research |

**Fig 4 – Revenue growth**



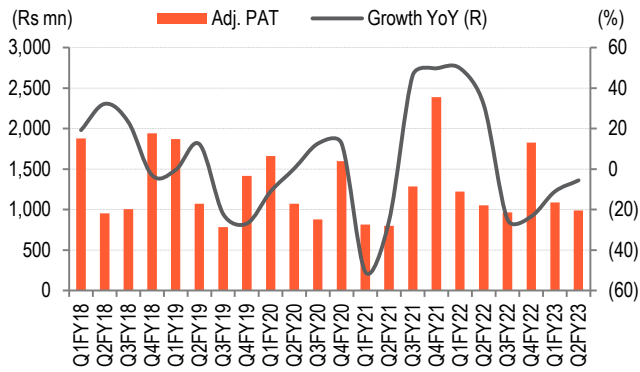
Source: Company, BOBCAPS Research

**Fig 5 – EBITDA growth**



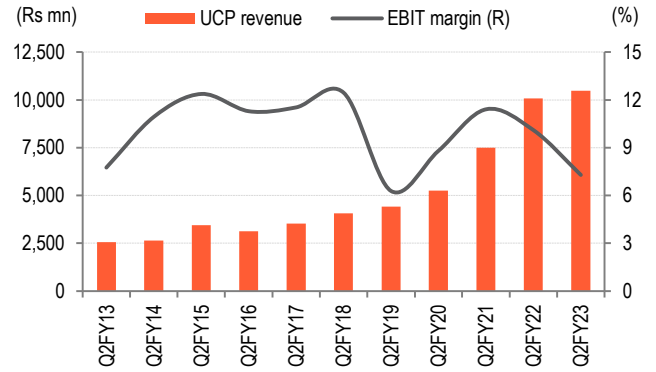
Source: Company, BOBCAPS Research

**Fig 6 – PAT growth**



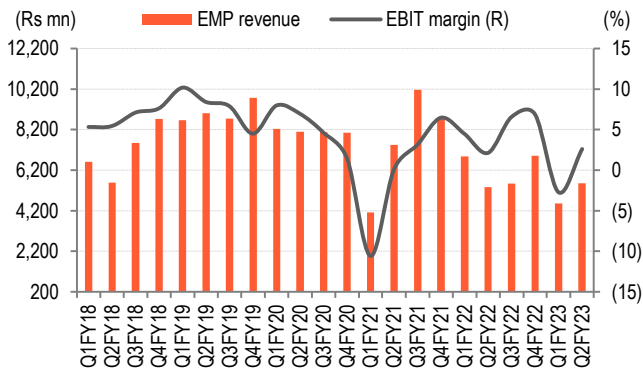
Source: Company, BOBCAPS Research

**Fig 7 – UCP business growth**



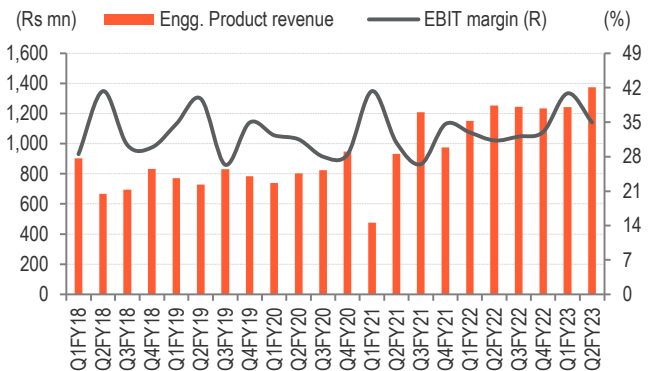
Source: Company, BOBCAPS Research

**Fig 8 – EMP business growth**



Source: Company, BOBCAPS Research

**Fig 9 – Engineering Product business growth**



Source: Company, BOBCAPS Research

## Earnings call highlights

- **Market share:** VOLT's exit market share stood at 23% in Aug'22 vs. 24% in Jun'22, a drop of 1ppt. However, the company still maintains a sizeable lead of 750bps over the #2 player. Secondary sales for VOLT were lower during August which hurt market share towards the end of the quarter. Management reiterated its balanced long-term approach on margins and market share in order to maintain its market leadership.
- **Pricing action:** There was no pricing action across the RAC industry during Q2FY23. Management does not expect to immediately pass along the benefits of raw material cost deflation.
- **A&P expenses:** VOLT had incurred lower A&P expenses due to Covid-19 but expects to revert to the normal 2-2.5% of sales, with a focus on digital media over television and print.
- **Inventory:** Inventory with channel partners stands at 35-40 days (90-100 days from manufacturers' perspective).
- **In-house manufacturing vs. outsourcing:** In-house manufacturing requires VOLT to carry sufficient inventory amidst seasonality and vice versa for outsourcing. In the current low-margin climate with lower implied ROCE, VOLT is looking at a new inventory management system and new manufacturing setup to bolster ROCE.
- **Backward integration:** Management expects sourcing from India to improve over the next couple of years. The company has restricted its backward integration to heat exchangers and plastic components and expects to produce 50% of in-house requirements for heat exchangers. While compressors and heat exchanger manufacturing could be localised over the next few years, imports of key components are likely to continue.
- **Voltas Beko:** The vertical has registered a 15-20% YoY revenue decline in Q2FY23 due to lower volumes – in line with the industry-wide trend in kitchen appliances.
- **Highly JV:** The company awaits more clarity on the new joint venture norms announced by the government, but remains cautiously optimistic about its JV with Hong Kong-based Highly International to manufacture compressors in India.

## Valuation methodology

VOLT remains the leader in RACs, but its market share and margins have come under sustained fire in recent years from intensifying competition. We expect the stress on UCP margins to persist in the near term as peers chase market share gains. We thus lower our FY23/FY24 EPS estimates by 13%/12% and cut our target P/E multiple from 50x to 45x – in line with the stock’s seven-year average. Post multiple revision and valuation rollover to Sep’24E, our TP stands reduced to Rs 1,000 (vs. Rs 1,100); retain HOLD.

**Fig 10 – Revised estimates**

Particulars (Rs mn)	New		Old		Change (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Sales	88,613	107,669	88,613	107,669	0.0	0.0
EBITDA	6,591	9,143	7,508	10,279	(12.2)	(11.1)
PAT	4,649	6,415	5,335	7,266	(12.9)	(11.7)
EPS (Rs)	14.1	19.4	16.1	22.0	(12.9)	(11.7)
EBITDA Margin (%)	7.4	8.5	8.5	9.5	(100bps)	(110bps)

Source: Company, BOBCAPS Research

## Key risks

Key risks to our estimates are:

- **Upside risks:** Higher market share gains than expected
- **Downside risks:** Elongated distress in UCP margins and more incidents of contract revocation in the EMP business

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Amber Enterprises	AMBER IN	0.8	2,016	2,100	HOLD
Blue Star	BLSTR IN	1.4	1,224	1,100	HOLD
Crompton Greaves	CROMPTON IN	2.8	365	500	BUY
Dixon Technologies	DIXON IN	3.3	4,568	5,200	BUY
Havells India	HAVL IN	9.2	1,220	1,500	BUY
Orient Electric	ORIENTEL IN	0.7	272	310	HOLD
Polycab India	POLYCAB IN	5.1	2,810	3,300	BUY
V-Guard Industries	VGRD IN	1.4	265	250	HOLD
Voltas	VOLT IN	3.6	909	1,000	HOLD

Source: BOBCAPS Research, NSE | Price as of 2 Nov 2022

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
<b>Total revenue</b>	<b>75,558</b>	<b>79,345</b>	<b>88,613</b>	<b>107,669</b>	<b>127,359</b>
EBITDA	6,414	6,816	6,591	9,143	11,579
Depreciation	339	373	588	813	1,063
EBIT	6,075	6,443	6,003	8,330	10,516
Net interest inc./(exp.)	(262)	(259)	(307)	(373)	(441)
Other inc./(exp.)	1,889	1,892	1,986	2,086	2,190
Exceptional items	0	0	0	0	0
EBT	7,702	8,076	7,683	10,043	12,266
Income taxes	1,804	1,913	1,934	2,528	3,087
Extraordinary items	0	0	1,064	0	0
Min. int./Inc. from assoc.	(610)	(1,103)	(1,100)	(1,100)	(1,100)
<b>Reported net profit</b>	<b>5,288</b>	<b>5,060</b>	<b>3,585</b>	<b>6,415</b>	<b>8,078</b>
Adjustments	0	0	1,064	0	0
<b>Adjusted net profit</b>	<b>5,288</b>	<b>5,060</b>	<b>4,649</b>	<b>6,415</b>	<b>8,078</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Accounts payables	24,645	29,421	33,989	41,888	49,548
Other current liabilities	7,882	7,707	8,607	10,324	12,213
Provisions	0	0	0	0	0
Debt funds	2,514	3,432	3,833	4,657	5,509
Other liabilities	1,580	1,909	2,087	2,454	2,833
Equity capital	331	331	331	331	331
Reserves & surplus	49,603	54,665	56,264	60,529	66,457
Shareholders' fund	49,934	54,996	56,595	60,860	66,788
<b>Total liab. and equities</b>	<b>86,555</b>	<b>97,463</b>	<b>105,111</b>	<b>120,183</b>	<b>136,890</b>
Cash and cash eq.	4,588	5,717	3,286	(152)	(5,912)
Accounts receivables	18,009	21,097	23,064	25,074	29,659
Inventories	12,796	16,614	18,451	21,239	25,123
Other current assets	16,501	15,365	17,160	20,691	24,475
Investments	0	0	0	0	0
Net fixed assets	2,384	2,305	3,716	5,403	6,840
CWIP	88	593	662	805	952
Intangible assets	941	999	999	999	999
Deferred tax assets, net	0	0	0	0	0
Other assets	31,248	34,775	38,837	47,188	55,818
<b>Total assets</b>	<b>86,555</b>	<b>97,463</b>	<b>106,175</b>	<b>121,247</b>	<b>137,954</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
<b>Cash flow from operations</b>	<b>5,561</b>	<b>5,842</b>	<b>5,106</b>	<b>8,516</b>	<b>6,437</b>
Capital expenditures	0	0	(2,000)	(2,500)	(2,500)
Change in investments	(3,257)	(3,910)	0	0	0
Other investing cash flows	698	264	(3,953)	(8,127)	(8,398)
<b>Cash flow from investing</b>	<b>(2,559)</b>	<b>(3,646)</b>	<b>(5,953)</b>	<b>(10,627)</b>	<b>(10,898)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(5,110)	(166)	401	824	852
Interest expenses	0	0	0	0	0
Dividends paid	3,895	(905)	(1,985)	(2,151)	(2,151)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(1,215)</b>	<b>(1,070)</b>	<b>(1,584)</b>	<b>(1,326)</b>	<b>(1,299)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>1,787</b>	<b>1,126</b>	<b>(2,431)</b>	<b>(3,438)</b>	<b>(5,760)</b>
<b>Closing cash &amp; cash eq.</b>	<b>4,588</b>	<b>5,717</b>	<b>3,286</b>	<b>(152)</b>	<b>(5,912)</b>

### Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23E	FY24E	FY25E
Reported EPS	16.0	15.3	10.8	19.4	24.4
Adjusted EPS	16.0	15.3	14.1	19.4	24.4
Dividend per share	5.0	5.5	6.0	6.5	6.5
Book value per share	150.9	166.2	171.1	183.9	201.9

### Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23E	FY24E	FY25E
EV/Sales	4.0	3.8	3.4	2.8	2.4
EV/EBITDA	46.9	44.1	45.6	32.9	26.0
Adjusted P/E	56.9	59.5	64.7	46.9	37.2
P/BV	6.0	5.5	5.3	4.9	4.5

### DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23E	FY24E	FY25E
Tax burden (Net profit/PBT)	68.7	62.7	60.5	63.9	65.9
Interest burden (PBT/EBIT)	126.8	125.3	128.0	120.6	116.6
EBIT margin (EBIT/Revenue)	8.0	8.1	6.8	7.7	8.3
Asset turnover (Rev./Avg TA)	31.7	34.4	23.8	19.9	18.6
Leverage (Avg TA/Avg Equity)	0.1	0.0	0.1	0.1	0.1
Adjusted ROAE	11.4	9.6	8.3	10.9	12.7

### Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
<b>YoY growth (%)</b>					
Revenue	(1.3)	5.0	11.7	21.5	18.3
EBITDA	(6.6)	6.3	(3.3)	38.7	26.7
Adjusted EPS	1.5	(4.3)	(8.1)	38.0	25.9
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	8.5	8.6	7.4	8.5	9.1
EBIT margin	8.0	8.1	6.8	7.7	8.3
Adjusted profit margin	7.0	6.4	5.2	6.0	6.3
Adjusted ROAE	11.4	9.6	8.3	10.9	12.7
ROCE	11.2	9.4	8.2	10.6	12.1
<b>Working capital days (days)</b>					
Receivables	87	97	95	85	85
Inventory	62	76	76	72	72
Payables	119	135	140	142	142
<b>Ratios (x)</b>					
Gross asset turnover	15.5	16.2	15.1	13.2	12.0
Current ratio	1.5	1.4	1.3	1.2	1.1
Net interest coverage ratio	23.2	24.9	19.6	22.4	23.9
Adjusted debt/equity	0.1	0.1	0.1	0.1	0.1

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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**BUY** – Expected return >+15%

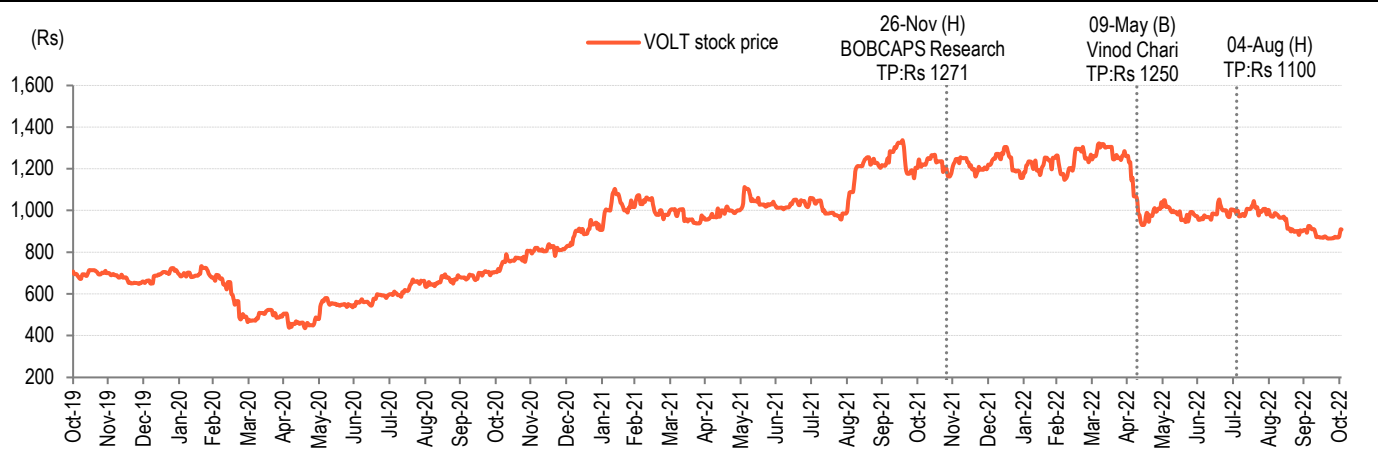
**HOLD** – Expected return from -6% to +15%

**SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

### Ratings and Target Price (3-year history): VOLTAS (VOLT IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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