Cooling Business; Feeling The Heat

Air conditioners and electro-mechanical services providers Blue Star and Voltas are not comparable to each other in true sense. While Voltas makes revenue from hawking engineering products and services for textile and mining industries, Blue Star's business includes marketing and maintenance of hi-tech professional electronic and industrial products. **Devangi Joshi** takes a look into the companies' performance

HEAD 2 HEAD

BLUE STAR

PREMIER AIR-CONDITIONING and commercial refrigeration provider Blue star works under three business segments and earns 7% of its total revenues through exports. The electro mechanic project and packaged air-conditioning system business contributes the most to its top line. The segment comprises central air-conditioning, packaged air-conditioning and electrical contracting businesses, besides after- sale services and customised original equipment manufacturing business. Under the segment, the company provides HVA (heating, ventilation and air-conditioning), M&E (mechanical and engineering) and VRF (variable refrigerant flow) products and services. Blue Star is the country's first and only manufacturer of VRF systems and owns nearly 20% market share.

Blue Star offers a range of contemporary window and split air-conditioners under cooling products segment. It also manufactures and markets a range of commercial refrigeration products and services catering to the industrial, commercial and hospitality sectors.

The electronics segment exclusively distributes hi-tech professional electronic equipment and industrial products . The company has moved up in the value chain by offering system integration, apart from distributing products like analytical instruments, medical electronics, data communication products, material testing, and measuring instruments from global manufacturers.

The company exports to middle-east countries like the UAE, Qatar, Bahrain, Oman and Kuwait.

FINANCIALS

Falling demand has affected the top line and profitability in the electro mechanic (EM) and cooling segments . Both the segments, which contribute nearly 80% to the bottom line, showed a negative growth in profitability in the December quarter. On the other hand,

Beta:	0.52
Institutional Holding:	8.12%*
Current dividend Yield:	5.22%
Current P/E	7.57
Current m-cap:	Rs 1205 cr
Current Market Price:	Rs 134

* Dec'08

electronics segment posted a 31% growth in revenues and 19% growth in profits during the quarter. On the export side, though the product export business witnessed profitability, it was contributable to a 10% dollar appreciation against the rupee in the quarter. However tight control over total expenses has helped profit margins post stability in the last three quarters.

GROWTH POTENTIALS

Contracting global and domestic demands are expected to have a significant effect on the electro mechanic and cooling business, especially pertaining to the retail and building sectors. However, the company is expecting to see good prospects from the hospitality, healthcare and education sectors. The company is aggressively pursuing business from infrastructure sector, especially government projects as it has received several orders from government for air conditioning various stadiums for the Commonwealth Games in 2010.

The company also undertakes water management and LEED (leadership in energy and environment design certification) consultancy for green buildings as a part of its after sales services. It has submitted bids for a number of such projects, that can be implemented in the coming months.

In the December quarter, the order inflow has seen a rise of 12%, while carry forward order book as of December 2008 has grown by a 52% compared to the same period last year.

RISKS

The company's gross block has seen a compounded annual growth rate (CAGR) of 19% in the last four years, while the interest payment rose by 86% during the period. The interest cover ratio has, on the other hand, has declined in the last three quarters, from 33.2 in March 2008 to 10 in December 2008. This, in turn, has affected the company's net profit in September and December quarters of FY09. Company exports to the west Asian region, where the construction activity has been slowing down. Moreover, growth in the exports would be dependent on the dollar's strength against the local currency.

The liquidity crunch and economic downturn could affect the company's project execution and top line.

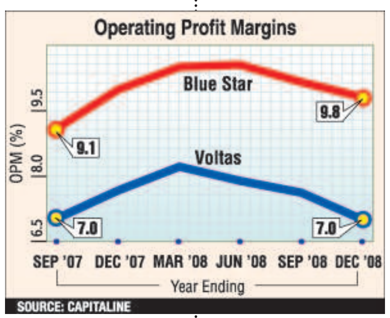
TO SUM IT UP

Blue Star has a healthy carry-forward order book, slowing demand from the construction and retail sectors may impact the company's top line. Moreover, the liquidity crunch can lead to delays in project executions. However, the company focuses to reap the benefits from the growth in infrastructure, health care and hospitality sectors. A healthy 60% CAGR of net cash from operations in the last four years and sustained dividend payouts during the period makes the company a value buy. Lower beta and high debt-to-equity ratio makes it a safer bet for risk-averse investors.

Financials Of Blue Star

	DEC '08 QUARTER*	TRAILING FOUR QUARTER ENDED DEC '08*	YoY CHANGE %
Net Sales	566.8	2,552.4	23.4
Other Income	0.1	39	618.8
Raw material Expense	444.7	1,955.3	24.5
Employee Expense	44.1	177	16.5
Operating Profit	52.3	250.7	21.4
Interest	5.3	13.8	65.3
Depreciation	7	25	13.7
PAT	32.2	159.1	15.5
OPM (% of net sales)	9.2	9.8	-16 BPS
Net Margin (% of net sales)	5.7	6.2	-43 BPS

SOURCE: CAPITALINE * Note : Includes the results of the Electrical Contracting businessacquired from Naseer Electricals in January 2008 (RS CR)



VOLTAS

VOLTAS IS a major engineering service provider whose operations is organised into four independent strategic business units. Under the engineering products and services segment, the company designs and manufactures, machine tools, mining & construction equipment and sells textile machinery. About 80% of the revenues from this segment comes from manufacturing of forklift, trucks, cranes, warehousing equipment and construction equipment and sale of accessories, spare parts and maintenance services, while the rest 20% comes from commission income.

The company provides electrical, mechanical, HVAC and refrigeration solutions under the EM projects and services division.

Water treatment and management is also a part of this business, which contribute the most to the total revenues and profits.

Cooling appliances and commercial refrigeration products are manufactured and marketed under unitary cooling products division. The company is also in chemicals trading business, but it contributes less than 1% to the top line. Voltas earns 5% of its revenues from its foreign operations, which mainly include execution of projects in Middle East, Far East and South East Asia.

FINANCIALS

The company posted a 29% growth in revenue during December 2008. In comparison, total operating expenditure during the quarter was up by 33% YoY. This resulted in contraction in its operating margin which hit its bottomline. On expense side, the employee cost rose over 40% in year ended December 2008.

GROWTH STRATEGY

In last few years, it has changed its business strategy to emerge as a one-stop solution provider rather than a

Beta:	0.94
Institutional Holding:	26.54%*
Current dividend Yield:	3.34%
Current P/E	5.45
Current m-cap:	Rs1337 cr
Current Market Price:	Rs 40.4

* Dec'08

manufacturer. The strategy has paid-it handsomely. At the end of September '08, its domestic order book in EM projects and services segment stood at Rs 1,000 crore, while international order book stood at Rs 4,500 crore with an average completion cycle of 24-30 months. For the domestic market, the company has formed industrial verticals in order to focus on areas like airports, power and steel, which are likely to have sustained growth.

RISKS

Historically, Voltas tends to sit on higher inventories, which depressed its cash flows. In last few years, it has cleaned up its act but, its cash flows from operations continues to be erratic.

The company is a big importer of equipment and cooling products. The recent depreciation in the rupee raised the cost imported goods which hurt its profitability.

Bulk of Voltas' overseas business is in West Asia especially UAE and Qatar. The global credit crisis and falling crude oil prices has hit these economies hard leading to a slowdown in construction activities. This will have an adverse impact on Voltas's earnings in next few quarters.

TO SUM IT UP

Voltas is expected to take a hit on its earnings and profitability thanks to its high exposure to the gulf countries as well as slowing construction and engineering activities in domestic market.

The company earns substantial non-operating other income from recurring rental income and investment of surplus funds. However, this segment is likely to hit due to a gloomy realty sector and fall in yields across asset classes.

It doesn't have a track record of higher dividend pay. However, with a higher beta, the company could turn out a well fit for risk-loving investors.

devangi.joshi@timesgroup.com

Financials Of Voltas

	DEC '08 QUARTER*	TRAILING FOUR QTR ENDED DEC '08*	YoY CHG %
Net Sales	862.5	3,629.4	24.2
Other Income	13.7	113.9	-18.2
Raw material Expense	618.2	2,631.6	22.3
Employee Expense	115.9	388.1	46.8
Operating Profit	45.8	254.2	13.3
Interest	-4.6	-6.8	-217.3
Depreciation	4.3	17.3	38.0
PAT	42.4	245.1	-10.2
OPM (% of net sales)	5.3	7.0	-67 BPS
Net Margin (% of net sales)	4.9	6.8	-258 BPS

SOURCE: CAPITALINE (RS CR)