

Estimate change 

 TP change 

 Rating change 
CMP: INR498
TP: INR435 (-13%)
Neutral

UCP season gone; Projects business faces execution challenges

UCP revenue down 70% YoY as leverage increases

- Blue Star (BLSTR) barely managed to report operating profit in 1QFY21 as revenue for Unitary Cooling Products (UCP) and Electromechanical Projects (EMP) declined 70% and 50%, respectively. Profitability was further affected in the EMP segment as BLSTR took an INR150m provision. Loss of key-season sales in the UCP segment dented profitability in spite of certain cost-cutting initiatives undertaken by the company. While employee cost and other expenses reduced by ~39% and 53%, respectively, we expect most of these cost elements to return once sales normalize.
- To maintain adequate liquidity and working capital requirement, BLSTR opted for debt funding of INR3.5b, leading to net debt of INR4.3b at the end of 1QFY21 v/s nil debt YoY (end-FY20 net debt stood at INR1.5b).
- We have cut our FY21E/FY22E earnings by 59%/12%, as we factor: **(a)** likely weak primary sales in the UCP segment in FY21 until inventory normalizes, and **(b)** weak order inflow and execution in the EMP segment as the company focuses on cash conservation, and **(c)** an increase in interest expense on account of higher borrowings. Our SOTP-based TP stands at INR435 (prior: INR450) – Maintain **Neutral**. We continue to prefer Voltas over BLSTR to play the underpenetrated AC market in India.

Profitability takes a hit on lower operating leverage and provisions

- Revenue declined 60% YoY to INR6.3b and was **13% below our expectation**. EBITDA declined 99% and barely reached breakeven, although it was better than our expectation of EBITDA loss. Employee cost was cut by 39% YoY. Interest cost jumped to INR185m and was way ahead of our expectation of INR70m. PAT loss stood at INR197m and was better than our expectation of INR329m loss.
- Key segmental highlights: (a) EMP** – Revenue declined 50% to INR3.1b and was 22% below our expectation. The segment reported PBIT loss, with a PBIT margin of -3.4%. **(b) UCP** – Revenue was down 70% to INR2.7b and was 8% below our expectation. The segment reported PBIT loss, with a PBIT margin of -1.4%.

Liquidation of RAC inventory is key; Projects business recovery far off

- UCP: (a)** Secondary sales for Room AC (RAC) recovered to ~70% in June v/s last year, while they stood at ~77% in July'20. In June'20, northern India saw ~85% recovery of last-year sales. **(b)** RAC inventory in the channel is higher than 30 days v/s normal levels. **(c)** Price levels have dropped by 10–12% for the industry post the lockdown as the peak summer season has ended and the focus has been on inventory liquidation.
- Projects business: (a)** The order book stood at INR29.2b (+3% YoY). **(b)** Owing to the ongoing situation, BLSTR made INR150m additional provisions for doubtful receivables. **(c)** BLSTR had ~150 active project sites with ~10.5k laborers. Currently, it operates ~50 active sites with 1,500 laborers (v/s the requirement of 3,000 laborers).

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Bloomberg	BLSTR IN
Equity Shares (m)	96
M.Cap.(INRb)/(USD\$b)	47.9 / 0.7
52-Week Range (INR)	887 / 425
1, 6, 12 Rel. Per (%)	-4/-31/-32
12M Avg Val (INR M)	56

Financials & Valuations (INR b)

Y/E Mar	2020	2021E	2022E
Sales	53.6	42.9	56.5
EBITDA	2.8	1.6	3.3
PAT	1.5	0.3	1.6
EBITDA (%)	5.3	3.6	5.8
EPS (INR)	15.3	2.7	16.4
EPS Gr. (%)	-21.4	-82.5	512.9
BV/Sh. (INR)	81.2	82.3	88.9

Ratios

Net D/E	0.2	0.5	0.3
RoE (%)	18.8	3.3	18.5
RoCE (%)	13.6	4.9	13.9
Payout (%)	156.2	60.0	60.0

Valuations

P/E (x)	32.6	186.0	30.3
P/BV (x)	6.1	6.1	5.6
EV/EBITDA (x)	17.5	33.1	15.4
Div Yield (%)	4.0	0.3	2.0
FCF Yield (%)	7.8	-3.3	4.6

Shareholding pattern (%)

As On	Jun-20	Mar-20	Jun-19
Promoter	38.8	38.8	38.8
DII	23.0	22.8	19.5
FII	8.8	8.8	10.9
Others	29.5	29.6	30.8

FII Includes depository receipts

Nilesh Bhaiya – Research Analyst (Nilesh.Bhaiya@MotilalOswal.com)

Pratik Singh – Research Analyst (Pratik.Singh@MotilalOswal.com)

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Valuation and view

We have cut our FY21E/FY22E earnings by 59%/12%, as we factor: **(a)** likely weak primary sales in the UCP segment in FY21 until inventory normalizes, **(b)** weak order inflow and execution in the EMP segment as the company focuses on cash conservation, and **(c)** an increase in interest expense on account of higher borrowings. We forecast FY20–22E revenue/EBITDA/PAT growth at 3%/8%/4%, with any recovery in FY21E expected only toward 4QFY21. Our SOTP-based TP stands at INR435 (prior: INR450) – Maintain **Neutral**. We continue to prefer Voltas over BLSTR to play the underpenetrated AC market in India.

Quarterly performance

Y/E March	FY20				FY21E				FY20	FY21E	FY20	Var.
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		1QE	Vs Est	
Sales	15,755	12,495	12,359	12,994	6,260	9,100	11,600	15,940	53,602	42,900	7,200	-13%
Change (%)	4.5	21.0	12.5	-18.6	-60.3	-27.2	-6.1	22.7	2.4	-20.0	-54.3	
EBITDA	1,149	736	570	373	14	332	485	729	2,828	1,560	-175	NA
Change (%)	-16.0	26.7	34.7	-65.9	-98.8	-54.8	-15.0	95.3	-18.4	-44.8	-115.2	
As of % Sales	7.3	5.9	4.6	2.9	0.2	3.7	4.2	4.6	5.3	3.6	-2.4	
Depreciation	203	216	223	237	209	250	250	240	880	949	250	
Interest	82	68	76	69	185	150	150	115	295	600	70	
Other Income	217	106	61	64	86	70	70	74	447	300	50	
Extra-ordinary Items	0	-17	-16	-8	0	0	0	0	-40	0	0	
PBT	1,080	558	332	131	(295)	2	155	448	2,100	310	-445	NA
Tax	325	169	120	40	-95	3	41	129	653	78	-111	
Effective Tax Rate (%)	30	30	36	30	32	137	27	29	31	25	25	
MI/Share of profit from JV	14	8	(1)	5	3	10	9	4	26	26	5	
Reported PAT	768	379	196	89	(197)	9	122	324	1,433	258	-329	NA
Change (%)	-16.1	94.1	NM	-88.9	-125.6	-97.7	-37.6	263.8	-24.6	-82.0	-142.9	
Adj PAT	768	397	212	96	(197)	9	122	324	1,473	258	(329)	NA
Change (%)	0.6	78.0	239.5	-88.3	-125.6	-97.8	-42.2	235.5	-21.4	-82.5	-142.9	

Segment-wise details

Description	(INR m)									
	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	FY20
EMP & CAS	6,194	6,310	6,555	8,423	6,239	7,835	7,588	6,604	3,124	28,267
PE & IS	577	582	520	499	446	887	569	427	387	2,329
UCP	8,308	3,431	3,915	7,036	9,069	3,772	4,202	5,963	2,749	23,006
Total	15,078	10,322	10,990	15,958	15,755	12,495	12,359	12,994	6,260	53,602
PBIT										
EMP & CAS	397	448	301	363	335	446	390	32	-105	1,203
PE & IS	83	126	69	161	44	244	180	75	102	543
UCP	950	82	94	733	989	120	77	438	-38	1,623
Total PBIT	1,430	655	464	1,257	1,369	810	646	544	-41	3,369
Segment PBIT (%)										
EMP & CAS (%)	6.4	7.1	4.6	4.3	5.4	5.7	5.1	0.5	-3.4	4.3
PE & IS (%)	14.3	21.6	13.2	32.2	9.9	27.5	31.6	17.6	26.3	23.3
UCP (%)	11.4	2.4	2.4	10.4	10.9	3.2	1.8	7.3	-1.4	7.1
Total PBIT (%)	9.5	6.3	4.2	7.9	8.7	6.5	5.2	4.2	(0.7)	6.3

Highlights from management commentary

EMP segment

- Order inflow stood at INR2.7b in 1QFY21 (v/s INR9.7b in 1QFY20). BLSTR saw healthy order inflows from segments such as BFSI, Healthcare, Pharma, and Government.
- BLSTR had ~150 active project sites with ~ 10,500 laborers. Currently, it has reduced this to ~50 active sites with 1,500 laborers (v/s the requirement of 3,000 laborers).
- The order book stands at INR29.2b (+3% YoY).
- ~30% of order book exposure is toward the Construction segment (electromechanical and AC systems).
- Provisions taken stood at ~INR150m in 1QFY21.

UCP segment

- The RAC industry is expected to have declined 65% YoY in 1QFY21. Even after the lockdown was lifted, footfall was lower and the focus was on inventory liquidation.
- BLSTR's revenue decline was in line with market decline.
- Secondary sales in July'20 are likely to have recovered to 77% v/s the previous year. **Price levels have dropped by 10–12% for the industry post the lockdown as the peak summer season has ended and the focus has been on inventory liquidation.**
- In June'20, sales recovered by 71% for the industry, with recovery in northern India sales at 85%.
- The e-commerce channel gained traction, with BLSTR's sales improving to 12% during the quarter. Industry e-com sales stood at 17% of the total sales during the quarter.
- Inventory in the channel is likely to be higher by 30 days.
- **In 2Q, revenue is expected to recover by 80% and by 90% in 3Q; 4Q is expected to be at 100% of last year and may witness 5–10% growth if there is no fresh wave of COVID-19 infection.**

Cost savings

- Warehousing, logistic, and ad costs are variable in nature.
- 50% of the total cost savings are expected to be sustainable; the other 50% depends on incremental sales.

Cash flow from operations

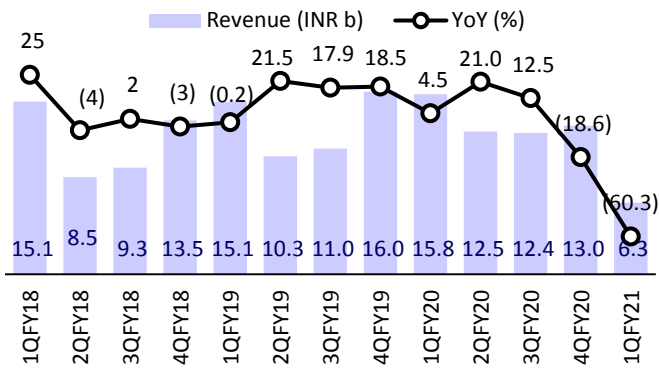
- Gradual liquidation in inventory would help release cash.
- Free cash would be used to pay off creditors.
- The company would focus on the latter part of the year to lower its borrowings. It targets INR3.5–4.0b net borrowings by the end of FY21.

Other takeaways

- **Import substitution:** There is no final policy as of now. However, certain sectors are being prioritized, such as ACs and Furniture. **Custom duty is likely to be enhanced.**
- BLSTR believes R&D is required to innovate and be price-competitive. The government should provide incentives on R&D to aid industry.
- BLSTR would not manufacture components such as motors or compressors. The company would, however, indigenize inner door units (IDUs) and drives.
- Another way to make the RAC industry competitive would be to reduce GST to 18% from 28% currently so it gives impetus to volume and leads to economies of scale.

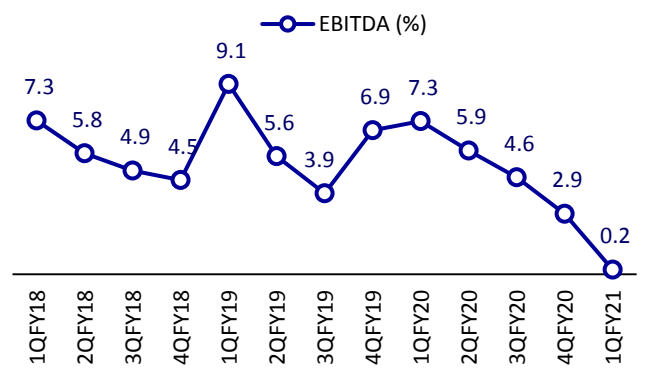
Story in charts

Exhibit 1: Revenue declined 60% YoY on lower sales from EMP and UCP segments



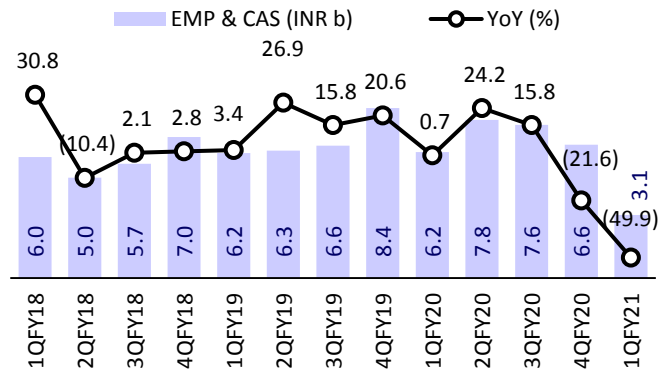
Source: MOFSL, Company

Exhibit 2: EBITDA was barely at breakeven on lower operating leverage



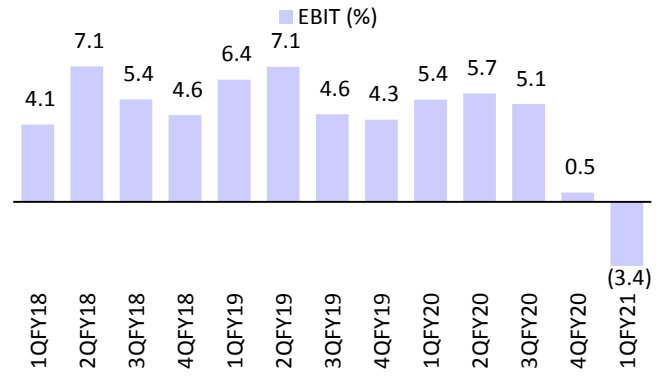
Source: MOFSL, Company

Exhibit 3: EMP segment declined ~50% YoY on loss of execution from April'20 to mid May'20



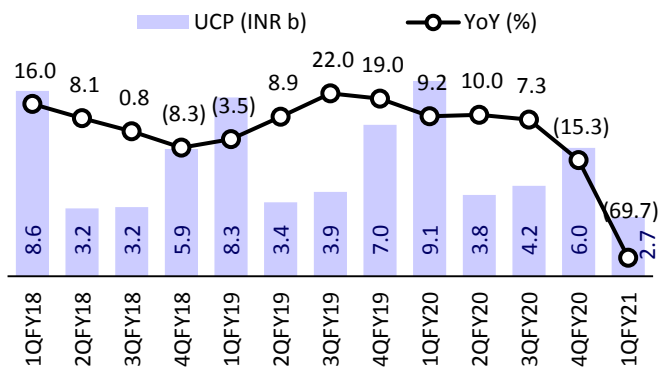
Source: MOFSL, Company

Exhibit 4: EBIT margin stood negative on lack of execution and additional provisioning during the quarter



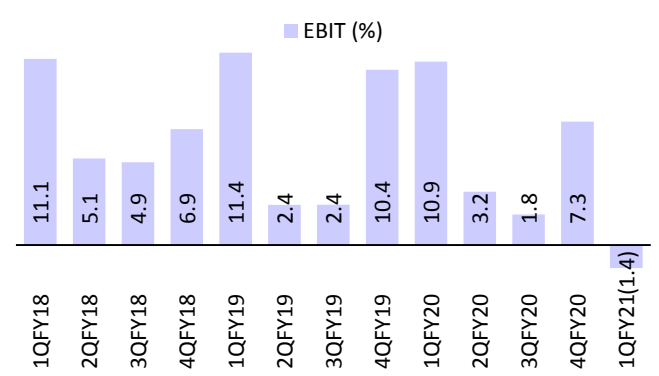
Source: MOFSL, Company

Exhibit 5: UCP revenue declined 70% YoY on loss of peak season sales

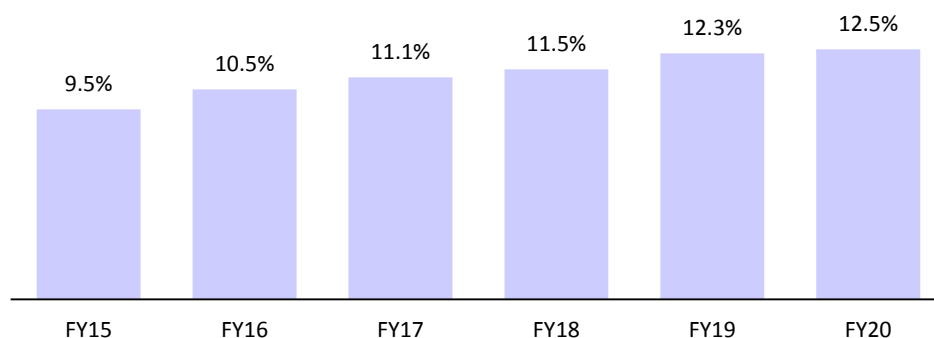


Source: MOFSL, Company

Exhibit 6: EBIT margin stood negative on lack of operating leverage



Source: MOFSL, Company

Exhibit 7: Market share gains in Room AC (a highly competitive market)

Source: Company

Valuation and view

- COVID-19 impact leads to further earnings cut in FY21E/FY22E:** We cut our FY21E/FY22E earnings by 59%/12%, as we factor: **(a)** likely weak primary sales in the UCP segment in FY21 until inventory normalizes, **(b)** weak order inflow and execution in the EMP segment as the company focuses on cash conservation, and **(c)** an increase in cost on account of higher borrowings and the normalization of sales. We forecast FY20–22E revenue/EBITDA/PAT growth at 3%/8%/4%, with any recovery in FY21E expected only toward 4QFY21. However, we note that margin volatility in the case of BLSTR challenges the earnings forecast, leading to a sharp earnings downgrade.
- Market leader in EMP segment; focus on RAC via higher ad spend:** BLSTR remains the leader in the Electromechanical business, with a host of solutions and products under various categories. Management has been focused on expanding the RAC business in terms of reach by spending adequately on branding and advertisement. Its Water Purifier business is expected to be earnings-neutral toward end-FY21, thus giving a further fillip to the UCP segment.
- Maintain Neutral, with TP of INR435:** We have reduced our SOTP-based TP to INR435 from INR450 earlier (the UCP business at 35x Mar'22E EPS, EMP at 10x, and Professional Electronics at 10x) – Maintain **Neutral**.

Exhibit 8: We cut FY21E/FY22E estimates by 59%/12% to build-in impact of weak primary sales in UCP in FY21 and weak order inflow and execution in EMP

Earnings Change INR m	Old		New		Change	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Revenue	45,000	57,500	42,900	56,500	-5%	-2%
EBITDA	1,922	3,438	1,560	3,283	-19%	-5%
EBITDA margin	4.3%	6.0%	3.6%	5.8%	-0.6%	-0.2%
Adj. PAT	631	1,791	258	1,581	-59%	-12%

Source: MOFSL, Company

Financials and valuations

Income Statement						(INR m)
Y/E March	2018	2019	2020	2021E	2022E	2023E
Total Revenues	46,390	52,348	53,602	42,900	56,500	61,723
Change (%)	5.8	12.8	2.4	-20.0	31.7	9.2
EBITDA	2,659	3,465	2,828	1,560	3,283	3,646
% of Total Revenues	5.7	6.6	5.3	3.6	5.8	5.9
Other Income	170	247	447	300	339	370
Depreciation	638	749	880	949	1,043	1,168
Interest	287	479	295	600	500	300
Exceptional items	53	27	-40	0	0	0
PBT	1,956	2,511	2,060	310	2,079	2,548
Tax	494	420	653	78	523	641
Rate (%)	25.3	16.7	31.7	25.2	25.2	25.2
Reported PAT	1,440	1,900	1,433	258	1,581	1,933
Change (%)	18.0	32.0	-24.6	-82.0	512.9	22.2
Adj. PAT	1,387	1,874	1,473	258	1,581	1,933
Change (%)	12.7	35.1	-21.4	-82.5	512.9	22.2

Balance Sheet						(INR m)
Y/E March	2018	2019	2020	2021E	2022E	2023E
Share Capital	192	193	193	193	193	193
Reserves	7,735	8,538	7,631	7,734	8,367	9,140
Net Worth	7,927	8,731	7,824	7,927	8,559	9,333
Minority Interest	15	18	23	28	32	37
Loans	3,699	3,445	4,489	6,489	5,489	4,489
Deferred Tax Liability	-1,136	-1,076	-818	-818	-818	-818
Capital Employed	10,506	11,119	11,519	13,626	13,263	13,041
Gross Fixed Assets	5,363	6,194	7,344	7,844	8,844	9,844
Less: Depreciation	1,443	2,192	2,907	3,856	4,899	6,067
Net Fixed Assets	3,920	4,002	4,438	3,989	3,946	3,778
Capital WIP	254	412	674	674	674	674
Investments	132	146	169	199	229	260
Curr. Assets	26,921	27,874	28,295	26,043	31,170	33,189
Inventory	10,171	8,693	8,698	7,640	9,288	10,146
Debtors	9,504	11,121	8,377	8,815	10,062	10,146
Cash & Bank Balance	809	1,009	2,939	2,889	2,997	3,257
Loans & Other current assets	6,437	7,051	8,281	6,699	8,823	9,639
Current Liab. & Prov.	20,721	21,315	22,056	17,278	22,755	24,858
Creditors	15,327	15,346	15,824	12,341	16,253	17,756
Other liabilities	5,394	5,969	6,233	4,936	6,501	7,102
Net Current Assets	6,200	6,558	6,239	8,765	8,415	8,331
Application of Funds	10,506	11,119	11,519	13,627	13,264	13,041

Financials and valuations

Ratios						
Y/E March	2018	2019	2020	2021E	2022E	2023E
Basic (INR)	15.0	19.7	14.9	2.7	16.4	20.1
Adj EPS	14.4	19.5	15.3	2.7	16.4	20.1
Cash EPS	21.1	27.2	24.4	12.5	27.3	32.2
Book Value	82.6	90.7	81.2	82.3	88.9	96.9
DPS	7.5	10.0	19.9	1.6	9.9	12.0
Payout (incl. Div. Tax.)	62.3	61.6	156.2	60.0	60.0	60.0
Valuation (x)						
P/E	34.5	25.6	32.6	186.0	30.3	24.8
Cash P/E	23.6	18.3	20.4	39.7	18.3	15.5
EV/EBITDA	19.1	14.5	17.5	33.1	15.4	13.5
EV/Sales	1.1	1.0	0.9	1.2	0.9	0.8
Price/Book Value	6.0	5.5	6.1	6.1	5.6	5.1
Dividend Yield (%)	1.5	2.0	4.0	0.3	2.0	2.4
Profitability Ratios (%)						
RoE	17.5	21.5	18.8	3.3	18.5	20.7
RoCE	13.8	18.7	13.6	4.9	13.9	15.6
RoIC	15.8	22.7	15.8	4.3	16.7	19.5
Turnover Ratios						
Debtors (Days)	75	78	57	75	65	60
Inventory (Days)	80	61	59	65	60	60
Creditors. (Days)	121	107	108	105	105	105
Asset Turnover (x)	4.4	4.7	4.7	3.1	4.3	4.7
Leverage Ratio						
Debt/Equity (x)	0.4	0.3	0.2	0.5	0.3	0.1

Cash Flow Statement						(INR m)
Y/E March	2018	2019	2020	2021E	2022E	2023E
PBT before EO Items	1,956	2,511	2,060	310	2,079	2,548
Depreciation	638	749	880	949	1,043	1,168
Interest & other income	(41)	157	417	300	161	(70)
Direct Taxes Paid	(451)	(352)	(854)	(78)	(523)	(641)
(Inc)/Dec in WC	(1,913)	(432)	2,072	(2,578)	459	345
CF from Operations	189	2,633	4,574	(1,096)	3,219	3,349
(Inc)/Dec in FA	(924)	(837)	(814)	(500)	(1,000)	(1,000)
Free Cash Flow	(735)	1,797	3,760	(1,596)	2,219	2,349
Investment in liquid assets	40	138	(68)	300	339	370
CF from Investments	(883)	(698)	(882)	(200)	(661)	(630)
(Inc)/Dec in Debt	1,534	(274)	943	2,000	(1,000)	(1,000)
(Inc)/Dec in Equity	129	98	-	-	-	-
Interest Paid	(285)	(479)	(311)	(600)	(500)	(300)
Dividend Paid	(864)	(1,154)	(2,301)	(155)	(949)	(1,160)
Others	23	74	(93)	-	-	-
CF from Fin. Activity	537	(1,734)	(1,762)	1,245	(2,449)	(2,460)
Inc/Dec of Cash	(158)	201	1,930	(51)	109	260
Add: Beginning Balance	966	808	1,010	2,940	2,889	2,997
Closing Balance	808	1,010	2,940	2,889	2,997	3,257

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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