Sharekhan by BNP PARIBAS

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Stock Update

Result Update

Blue Star Ltd

Stellar Q4, outlook stays robust

Capital Goods	Sharekhan code: BLUESTARCO

Reco/View: Buy	↔	CMP: Rs. 1,072	Price Target: Rs. 1,250	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 30.66

Updated Jan 08, 2022

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

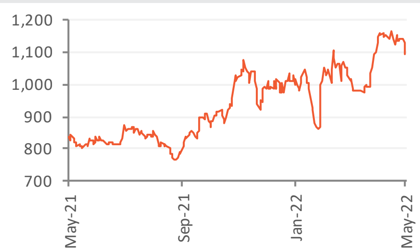
Company details

Market cap:	Rs. 9,630 cr
52-week high/low:	Rs. 1,134 / 758
NSE volume: (No of shares)	1.17 lakh
BSE code:	500067
NSE code:	BLUESTARCO
Free float: (No of shares)	5.9 cr

Shareholding (%)

Promoters	38.8
FII	11.8
DII	22.4
Others	27.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-5.2	6.0	4.8	28.2
Relative to Sensex	3.7	12.5	13.5	15.5

Sharekhan Research, Bloomberg

Summary

- Blue Star reported better than expected performance with strong revenue growth across business verticals, OPM was also ahead of expectations despite gross margin pressures. Net profit came in-line with estimates.
- Expect growth momentum to continue in Q1FY23 given strong room air conditioner (RAC) sales in April. The company expects 25-30% growth vs 20-25% expected for RAC industry in FY2023 through market share gains.
- The management expects margin to improve in FY23 given better inventory management, cost control initiatives and higher sales volumes.
- We maintain a Buy rating on Blue Star Limited (Blue Star) with revised PT of Rs. 1,250, given strong performance in Q4 and FY22 and robust outlook across segments going forward.

Blue Star's consolidated revenues were much ahead of our and street estimates. Revenues came in at Rs. 2,248 crore vs Rs. 1,612 crore in Q4FY21 (up 39.5% y-o-y), our estimate was Rs. 2,040 crore. The growth is attributed to strong performance across its verticals. Operating profit grew by 40% y-o-y to Rs. 143 crore (vs estimate of Rs. ~113 crore). While gross margin dropped by 120 bps y-o-y to 20.6% due to high raw material cost, tight control on employee and other cost resulted in flat y-o-y operating margin at 6.4% (higher than our estimate of 5.5%). A sharp y-o-y decline of 84% in other income restricted the net profit growth to 12.2% and net profit came in-line with estimates at Rs. 76 crore. The company remains confident of strong performance in FY23 and is well poised to target 15% market share by FY2024/25 from 13.25% now. The management expects margin to improve in FY23 given adequate inventory and supply chain management, cost-control initiatives and higher sales volumes.

Key positives

- Robust revenue growth of ~46%/32% in EMPS/UCP verticals led by improved execution in projects and early onset of summers in products.
- Strong management commentary for FY23 on sales and profitability fronts, company well placed in terms of inventory and supply chain management, project business also on the right footing with healthy and diversified order book.

Key negatives

- Gross margins stayed under pressure y-o-y due to increase in commodity prices and freight cost.
- Net debt as of March 2022 was ~Rs. 67 crore as compared to a net cash balance of ~Rs. 151 crore as of March 2021 due to advancement in inventory levels to de-risk supply chain constraints, and capacity expansion at Sri City.

Management Commentary

- Growth momentum to continue in FY23 with operating margin in AC business expected to be around 8-8.5%. The company is confident of outpacing the expected industry growth of 20-25% in RAC by delivering 25-30% growth.
- Sri City first phase is expected to commission in Q3FY2023, which would be able to serve all the southern states and save logistics cost and improve delivery time by 10-12 days.
- EMP and commercial AC systems should post remarkable growth in FY2023 led by healthy order inflow both from government and private sector.

Revision in estimates – We have revised our estimates upwards for FY2023-FY2024 following strong FY22 performance and exepctations of healthy performance given various growth catalysts.

Our Call

Valuation – Maintain Buy with revised PT of Rs. 1,250: Blue Star is expected to outperform the industry as well as its peers driven by a strengthening distribution network, rising market share, and improving product mix. Besides, scale-up in commercial refrigeration products, backward integration, increase in in-house manufacturing would also aid growth. Similarly, the EMPS segment's growth prospects are brighter given continued traction in order inflows. We expect revenue/PAT to clock a CAGR of ~20%/39% over FY22-24E. At CMP, the stock trades at ~32xFY24E EPS. We maintain our Buy rating on the stock with a revised PT of Rs. 1,250.

Key Risks

An increase in input costs could put pressure on margins. Intense competition across segments is a key concern.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Net Sales	4,264	6,046	7,365	8,695
OPM (%)	5.6%	5.7%	6.2%	6.6%
Adjusted PAT	101	168	231	325
Y-o-Y growth	-32%	67%	38%	41%
Adj. EPS	10.5	17.4	24.0	33.8
P/E	101.8	61.0	44.3	31.5
P/B	11.6	10.1	8.9	7.4
EV/EBITDA	35.8	28.6	21.9	16.6
ROCE (%)	16.3	20.9	25.0	30.6
ROE (%)	11.4	16.5	20.1	23.5

Source: Company; Sharekhan estimates

Healthy performance across verticals with beat on sales and operating profit: Q4FY22 consolidated revenues were much ahead of our and street estimates. Revenues came in at Rs. 2,248 crore vs Rs. 1,612 crore in Q4FY21 (up 39.5% y-o-y), our estimate was Rs. 2,040 crore. The EMPS segment recorded revenue growth of 46% y-o-y to Rs. 1,136 crore driven by revival of the construction cycle and improved pace of execution; thereby contributing 51% to total sales. Unitary Products which include RACs grew by 32% y-o-y to Rs. 1,034 crore, contributing 46% to total sales. Strong pent-up demand coupled with the onset of early summers, and an improvement in the consumer sentiments across India enabled good growth in revenue for the RAC business. Profitability in EMPS segment improved as it reported PBIT margin at 6.7% (6.2% in Q4FY21), while Unitary products reported EBIT margin of 7% (vs 7.9% in Q4FY21). Overall, operating profit grew by 40% y-o-y to Rs. 143 crore (vs estimate of Rs. ~113 crore). While gross margin dropped by 120 bps y-o-y to 20.6% due to high raw material cost, tight control on employee and other costs resulted in flat y-o-y operating margins of 6.4% (higher than our estimate of 5.5%). Sharp y-o-y decline of 84% in other income restricted the net profit growth to 12.2% and net profit came in at Rs. 76 crore (vs our estimate of Rs. 74cr).

Well placed to tap growing business opportunities: The management is confident of strong growth momentum in FY23 with operating margins of the AC business expected to be between 8-8.5%. The company is confident of outpacing the expected industry growth of 20-25% in RAC by delivering 25-30% growth. Sri City Phase-1 is expected to commission in Q3FY2023, which would be able to serve all the southern states and save logistics cost and improve delivery time by 10-12 days. Further, EMPS and commercial AC systems should post remarkable growth in FY2023 led by healthy order inflow both from government and private sector. The company has been expanding its distribution reach into tier-3, 4 and 5 cities and consolidating market share. The mass premium product portfolio in RAC has seen encouraging response and has gained traction in Q4 and expected to do well going forward. Blue star would be targeting to increase its market share to 15% by FY24/2025 from 13.25% currently.

Blue star's Q4FY2022 Concall Highlights

- **Q4 performance:** Robust show is a result of improving demand environment across its business segments coupled with an early onset of summer in some parts of the country despite a three-week disruption caused by the Omicron variant.
- **Strong order book in EMPS segment:** Order inflows from factories and light industrial sector continued to be encouraging driven by the continued focus on the government's Make in India initiative. Order inflows from the commercial buildings sector and other traditional customer segments in the EMPS and commercial air conditioning business are encouraging. Order Book as on March 31, 2022, stood at Rs. 3,253 crore (up 10% y-o-y).
- **Industry growth rates:** The company stated that in the best case scenario also, the RAC industry would not be able to grow beyond 25-30% in FY23 given supply side constraints, shortage of semi-conductors and rising interest rates affecting consumer sentiments.
- **FY2023 outlook:** The mass premium product portfolio in RAC has seen encouraging response and expected to gain momentum in Q1FY2023. The company expects to outpace the industry growth expectations of 20-25% by delivering 25-30% growth in FY23.
- **Price hikes:** The company hiked prices by 2-3% in RACs effective from April 01,2022. It has already taken cumulative price hike of 15% in 2021. The company has sufficient inventory back up and may not face shortage of essential components during Q1FY23. However, in case it faces shortage of inventory and has to procure materials at higher prices, the company may consider price hikes in July.

- **Expansion:** The Sri City commercial operations is expected to start in Q3FY2023 which would house company's third RAC manufacturing unit along with PLI led manufacturing. Sri city first phase is expected to commission in Q3FY2023, which would be able to serve all the southern states and save logistics cost and improve delivery time by 10-12 days.
- **Commercial refrigeration business:** The commercial refrigeration business witnessed increased traction across all product categories owing to the revival of demand from traditional customer segments such as ice cream, processed foods, dairy, and restaurants. Blue star is a leader in the commercial refrigeration business. However, the market size is small and therefore its share in the total revenues is not substantial as yet.
- **E-Commerce:** Blue Star's share of e-commerce sales is close to the industry levels.
- **Net Debt:** Net debt as of March 2022 stood at Rs. 67.14 crore as compared to a net cash balance of Rs. 151 crore on March 2021 due to a planned advancement in inventory levels in order to de-risk supply chain constraints. Further, RAC capacity expansion at Sri City led to increase in borrowings. The company would repay 50% of the NCD of Rs. 350 crore (raised in June 2020) in May 2022 owing to strong cash position.

Results (Consolidated) Rs cr

Particulars	Q4FY22	Q4FY21	y-o-y (%)	Q3FY22	q-o-q (%)
Revenue	**2,248**	**1,612**	**39.5%**	**1,506**	**49.2%**
Operating profit	**143**	**102**	**40.4%**	**91**	**57.8%**
Other Income	6	40	-84.2%	13	-53.1%
Interest	13	13	-3.6%	12	11.9%
Depreciation	23	25	-7.2%	22	2.7%
PBT	**113**	**103**	**9.6%**	**70**	**61.9%**
Tax	38	36	3.9%	23	65.5%
Reported PAT	76	68.0	12.2%	48	60.6%
Adj. PAT	**76**	**68.0**	**12.2%**	**48**	**60.6%**
Adj.EPS	7.9	7.1	12.2%	4.9	60.6%
Margin			**bps**		**bps**
OPM (%)	**6.4**	**6.3**	**4.3**	**6.0**	**34.6**
NPM (%)	3.4	4.2	(82.4)	3.2	24.0
Tax rate	33.2	35.1	(182.0)	32.5	72.1

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Bright growth prospects given under penetration of high value consumer electronics

The air-conditioner segment has long-term structural growth triggers in terms of suitable demographics, rising per capita income, rising urbanisation, low penetration levels, various financing options and uninterrupted availability of power etc., which would help companies maintain a healthy growth trajectory in the long term. RAC penetration level in India is at ~14-16% which is way behind as compared to the global average of 42%. This implies there is a significant growth opportunity for AC industry. The industry grew at a healthy pace of ~14%/16% in value and volume terms, respectively over FY15-20. However, last two summer seasons have been adversely impacted due to the COVID-led lockdown. Hence, given the lower base and pent-up demand of the last two years, AC industry is expected to grow at 20-25% in the next two years. Moreover, long-term growth triggers being intact for the industry, we expect a CAGR of ~20% over FY21-25E. Further, commercial refrigeration adoption in India is only at a sub-5% level. However, given rapid urbanisation, growth in pharmaceuticals and food & beverage industries, opening of shops, malls and offices post pandemic, pick up in construction activities, the industry is expected to post strong growth. Blue Star being a leading player with wide reach and range of products in both ACs and commercial refrigeration will be one of the key beneficiaries. Further, the company is well poised to leverage its experience in electro-mechanical projects (EMPs) and commercial air-conditioning products which are expected to witness healthy growth because of increase in public and private capex in sectors such as infrastructure, metro rail, power, retail and healthcare.

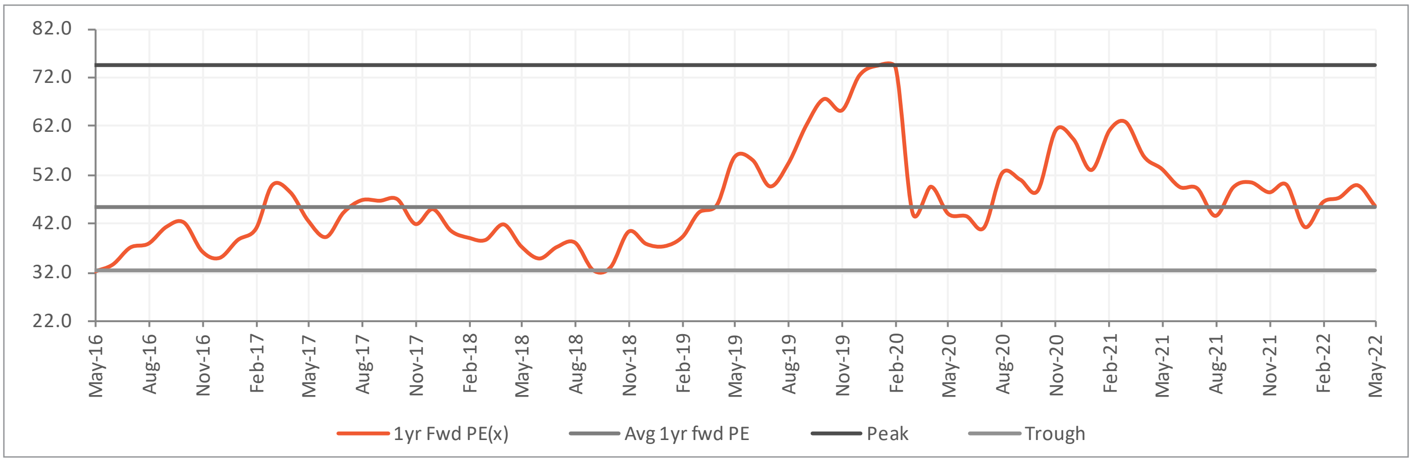
■ Company Outlook – Long-term growth opportunities intact

Blue Star has a strong brand strength and distribution network and is well entrenched at both retail and institutional level in terms of its distribution network. The company is also becoming self-sufficient by commencing new manufacturing facilities in both RACs as well as commercial refrigeration which would lead to reduce its dependency on imports and cost saving led by backward integration. RAC and commercial refrigeration businesses are expected to gain traction gradually. Healthcare, pharma, and processed foods segments will continue to offer good opportunities for the commercial refrigeration business in the new normal. Increased awareness on building immunity will offer good prospects for the water purifiers business. Digitization and healthcare initiatives offer good prospects for professional electronics and industrial systems. Moreover, the growth outlook for these categories is promising, considering expansion plan of end-user industries such as food processing and cold-chain logistics providers, pharmaceutical manufacturers, and hospitals as well as large and medium-format modern retail stores.

■ Valuation – Maintain Buy with revised PT of Rs. 1,250

Blue Star is expected to outperform the industry as well as its peers driven by a strengthening distribution network, rising market share, and improving product mix. Besides, scale-up in commercial refrigeration products, backward integration, increase in in-house manufacturing would also aid growth. Similarly, the EMPS segment's growth prospects are brighter given continued traction in order inflows. We expect revenue/PAT to clock a CAGR of ~20%/39% over FY22-24E. At CMP, the stock trades at ~32xFY24E EPS. We maintain our Buy rating on the stock with a revised PT of Rs. 1,250.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Blue Star is India's leading air conditioning and commercial refrigeration company, with an annual revenue of over Rs. 5,000 crore, network of 32 offices, five modern manufacturing facilities, and 3,880 channel partners. The company has over7,500 stores for room ACs, packaged air conditioners, chillers, cold rooms as well as refrigeration products and systems. Blue Star's integrated business model of a manufacturer, contractor, and after-sales service provider enables it to offer an end-to-end solution to its customers, which has proved to be a significant differentiator in the marketplace. The company has three business segments – Electro-Mechanical Projects (EMP) & commercial air conditioning systems, Unitary cooling products (UCP) and Electronics and Industrial Systems (EIS) which contribute 53%/43%/4% to FY22 revenues respectively. The company fulfills the cooling requirements of a large number of corporate, commercial as well as residential customers. Blue Star has also forayed into the residential water purifiers business with a stylish and differentiated range, including India's first RO+UV hot and cold water purifier as well as air purifiers and air coolers.

Investment theme

Structural growth visibility in the Indian white goods segment remains high due to favourable demographics (urbanisation, per capita GDP, and low AC ownership similar to China's levels in 1998-2000). We believe Blue Star remains one of the key beneficiaries of rising AC penetration in India, led by its improving market share, impressive product profile, and strong service network. The company is well poised to grow driven by its strategy of –1. growing faster than the market 2. improving profits by scale and backward integration 3. deepening distribution through conventional and e-commerce channels.

Key Risks

- Sharp rise in key raw-material prices pose a key challenge
- Intense competition

Additional Data

Key management personnel

Mr. Ashok M. Advani	Chairman and MD
Mr. Suneel M. Advani	Vice Chairman
Mr. Vir S. Advani	MD
Mr. B Thiagarajan	Jt. MD

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Ashok Mohn Family Trust	12.41
2	SMA Family Private	8.02
3	SBI Fund Management Pvt. Ltd.	5.75
4	Kotak Mahindra AMC	4.98
5	Advani Suneel Mohan	2.92
6	ICICI Pru AMC	2.91
7	Advani Ashok Mohan	2.70
8	HDFC AMC	2.45
9	T Rowe Price Group Inc.	2.15
10	Franklin Templeton India	1.93

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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