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Blue Star Limited

Healthy performance with market share gains

Capital Goods	Sharekhan code: BLUESTARCO	Result Update

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		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 843**	
Price Target: **Rs. 1,200**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

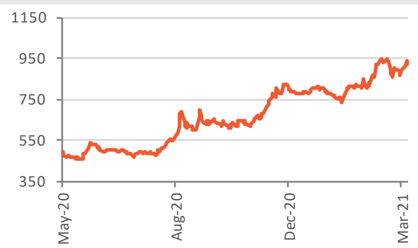
Company details

Market cap:	Rs. 8,123 cr
52-week high/low:	Rs. 1,025 / 452
NSE volume: (No of shares)	91.8 lakh
BSE code:	500067
NSE code:	BLUESTARCO
Free float: (No of shares)	5.9 cr

Shareholding (%)

Promoters	38.8
FII	12.9
DII	21.6
Others	26.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-7	4	26	70
Relative to Sensex	-6	8	11	14

Sharekhan Research, Bloomberg

Summary

- We maintain Buy on Blue Star Limited (Blue Star) with an unchanged a PT of Rs. 1,200, given its high net earnings growth trajectory for FY2021-FY2023E and favourable relative valuation.
- Overall, Q4 results were good with broad-based growth seen across segments leading to beat in revenue and profitability. Margins came in lower than estimates largely due to high input cost.
- Blue Star continued to grow faster than the market in RAC, achieved breakeven in water purifier, and maintained its leadership position in commercial refrigeration.
- Barring the likely COVID-led impact in Q1FY2022, management is optimistic of growth prospects with overall goal of market share gains, cost management, and OCF generation.

Blue Star Limited (Blue Star) reported a good quarter despite commodity headwinds with visible growth across segments. Blue Star's revenue increased by 24% y-o-y to Rs. 1,612 crore (better than estimates) with improved business sentiments and the early onset of summer in some parts of the country. Gross margin declined by 358 bps, led by unprecedented rise in commodity prices reflected in rising key input costs. Increasing input costs were partially offset by 5%-8% price hikes taken in in January 2021 by the company. However, OPM improved by 344 bps y-o-y to 6.3% (lower than estimates) on account of lower employee costs (down 233 bps y-o-y as a % of sales) and other expenses (down 469bps y-o-y as a % of sales). Hence, operating profit rose by 2.7x y-o-y to Rs. 102 crore. Additionally, higher other income (up 6.3x y-o-y due to Rs. 32 crore profit from sale of property in Mumbai) led to APAT of Rs. 68 crore versus Rs. 9.6 crore in Q4FY2021 (better than estimates). The demand environment remained healthy during Q4FY2021 till mid-April post which it felt the impact of lockdown restrictions. April 2021 had an impact of 20% compared to April 2020, which along with current regional restrictions is expected to affect Q1FY2022. However, the company continued to gain market share (currently at 13.25%) during Q4FY2021 in RAC (industry growth of 27% vis-à-vis 33% growth of the company). The current inventory levels in RAC are normal, while the company does not expect it to be significantly higher by Q1FY2022 end. Further, the company has maintained its market leadership in the pharma and healthcare segments in commercial refrigeration. Blue Star has seen traction in new Iceline Refrigerators, pharma cold rooms, and supermarket refrigeration equipment while usual ice creams and restaurants etc. are yet to improve. The company's water purifier segment is at a breakeven level, while it has achieved 3% market share. The company's next critical target is to reach 5%-6% share in water purifier post which it will hit physical stores. In the EMP division, order inflows from factories and the light industry sector improved in FY2021. Order inflow stood at Rs. 2,244 crore during FY2021. EMP's order book rose by 5.4% y-o-y to Rs. 2,149 crore as of FY2021 end. Continued traction in the healthcare, pharma, industrial, and government segments enabled growth for the commercial air conditioning business and remains encouraging going ahead. The company ended FY2021 with market share gains across products along with turning net cash positive. Management remains optimistic despite challenges and believes it has the potential to navigate through the current situation and bounce back once the situation improves. Overall, the goal is to grow faster than the market, keep operating costs under control, and manage the balance sheet prudently. We have fine-tuned our earnings estimates for FY2021-FY2022. With healthy cash flow, lean working capital cycle, and a comfortable leverage position, Blue Star is placed favourably as compared to listed brands in terms of its valuation vis-à-vis RoE and EPS growth prospects. Hence, we maintain our Buy rating on the stock with an unchanged price target (PT) of Rs. 1,200.

Key positives

- During Q4FY2021, the RAC industry grew by 27% while the company's growth was 33%, indicating market share gains.
- The UCP segment grew by 31% y-o-y, given healthy demand environment during Q4FY2021.

Key negatives

- Gross margin declined by 358 bps, led by higher raw-material cost.

Our Call

Valuation – Maintain Buy with unchanged PT of Rs. 1,200: Blue Star has made consistent, rapid progress, and outperformed the industry as well as its peers driven by a strengthening distribution network, rising market share (as seen in Q4FY2021), and improving product mix. Besides, scale-up in commercial refrigeration products and water purifier would also aid growth. Similarly, the EMPS segment's growth prospects are brighter given continued traction in the healthcare, pharma, industrial, and government segments, enabling growth prospects or the commercial air conditioning business. Overall, management remains optimistic despite challenges and believes it has the potential to navigate through the current situation and bounce back once the situation improves. Overall goal is to grow faster than the market, keep operating costs under control, and manage the balance sheet prudently. With rising return ratios, healthy cash flow, lean working capital cycle, and a comfortable leverage position, Blue Star is placed favourably compared to listed brands in terms of its valuation vis-a-vis RoE and EPS growth prospects. We have fine-tuned our earnings estimates for FY2021-FY2022. The company is currently trading at P/E of 29x its FY2023E EPS. We maintain our Buy rating on the stock with an unchanged price target (PT) of Rs. 1,200.

Key Risks

Slowdown in the domestic macro-environment and higher loss funding in roads can negatively affect business outlook and earnings growth.

Valuation (Consolidated)

Rs cr

Particulars	FY20	FY21	FY22E	FY23E
Revenue	5,360	4,264	5,857	6,805
OPM (%)	5.3	5.6	6.4	6.8
Adjusted PAT	147	100	203	273
% YoY growth	*-21.4*	*-31.9*	*101.9*	*34.9*
Adjusted EPS (Rs.)	15.3	10.4	21.0	28.4
P/E (x)	54.6	80.1	39.7	29.4
P/B (x)	10.3	9.1	8.3	7.2
EV/EBITDA (x)	26.4	28.5	19.9	15.4
RoNW (%)	17.8	12.0	21.8	26.2
RoCE (%)	19.5	16.3	24.4	29.8

Source: Company; Sharekhan estimates

Healthy performance: Blue Star reported a good quarter despite commodity headwinds with visible growth across segments. The company's revenue increased by 24% y-o-y to Rs. 1,612 crore (better than estimates) with improved business sentiments and early onset of summer in some parts of the country. Segmentally, unitary cooling revenue improved by 31.1% y-o-y to Rs. 782 crore on better demand recovery in RAC, increased share of e-commerce channel, and traction in retail/pharma. The electro mechanical (EMP) segment's revenue increased by 18% y-o-y to Rs. 780 crore. The pharma, healthcare, and government sector orders aided topline. Order backlog remained almost flat y-o-y at Rs, 2,952.4 crore. Prof. electronics revenue increased by 17% y-o-y to Rs. 50 crore. Gross margin declined by 358 bps, led by unprecedented rise in commodity prices reflected in increasing key input costs. The rise in input costs was partially offset by 5%-8% price hikes taken in January 2021 by the company. However, OPM improved by 344 bps y-o-y to 6.3% (lower than estimates) on account of lower employee costs (down 233bps y-o-y as a % of sales) and other expenses (down 469bps y-o-y as a % of sales). Hence, operating profit rose by 2.7x y-o-y to Rs. 102 crore. Additionally, higher other income (up 6.3x y-o-y due to Rs. 32 crore profit from sale of property in Mumbai) led to APAT of Rs. 68 crore versus Rs. 9.6 crore in Q4FY2021 (better than estimates).

Management optimistic despite challenges: The demand environment remained healthy during Q4FY2021 till mid-April post which the company felt the impact of lockdown restrictions. April 2021 had an impact of 20% compared to April 2020, which along with current regional restrictions is expected to affect Q1FY2022. However, the company continued to gain market share (currently at 13.25%) during Q4FY2021 in RAC (industry growth of 27% vis-à-vis 33% growth of the company). The current inventory levels in RAC are normal, while the company does not expect it to be significantly higher by Q1FY2022 end. Further, the company maintained its market leadership in the pharma and healthcare segments in commercial refrigeration. The company has seen traction in new Iceline Refrigerators, pharma cold rooms, and supermarket refrigeration equipment, while the usual ice creams and restaurants are yet to improve. The company's water purifier segment is at breakeven level, while it has achieved 3% market share. The company's next critical target is to reach 5%-6% share in water purifier post which it will hit physical stores. In the EMP division, order inflows from the factories and light industry sector improved in FY2021. Order inflow stood at Rs. 2,244 crore during FY2021. EMP's order book rose by 5.4% y-o-y to Rs. 2,149 crore as of FY2021 end. Continued traction in the healthcare, pharma, industrial, and government segments enabled growth for the commercial air conditioning business and remains encouraging going ahead. The company ended FY2021 with market share gains across products along with turning net cash positive. Management remains optimistic despite challenges and believes it has the potential to navigate through the current situation and bounce back once the situation improves. The overall goal is to grow faster than the market, keep operating costs under control, and manage the balance sheet prudently.

PLI participation: The company will not be applying for PLI schemes as incentives of the schemes pertain to components and not finished products. However, the company will get indirect benefits arising from sourcing from domestic manufacturing units.

Bluestar Q4FY2021 Concall Highlights

- **Demand environment:** The demand environment remained healthy during Q4FY2021 till mid-April post which it felt the impact of lockdown restrictions. April 2021 has an impact of 20% compared to April 2020. Q1FY2022 is expected to be affected by COVID-led restrictions. During Q4FY2021, the RAC industry grew by 27%, while the company's growth was 33%, indicating market share gains. The company's current market share is 13.25%. Current inventory levels are normal, while the company does not expect them to be significantly higher by Q1FY2022 end.

- **Electro-Mechanical Projects:** Order inflows from factories and the light industry sector improved in FY2021. The order inflow stood at Rs. 2,244 crore during FY2021. EMP's order book rose by 5.4% y-o-y to Rs. 2,149 crore as of FY2021 end. The order book mix is office (29%), metros (22%), hospitality (9%), industrial (9%), power (6%), malls, (4%) and others (21%).

- **Commercial Air Conditioning Systems:** The segment saw order inflows from healthcare, pharma, industrial, and government segments. Order inflows from IT, offices, and marriages among others remained dormant.
- **Unitary Cooling Products:** The non-RAC segment comprised 40%, of which commercial refrigeration is the biggest. The company has maintained its market leadership in the pharma and healthcare segment in commercial refrigeration. The company has seen traction in new Iceline Refrigerators, pharma cold rooms, and supermarket refrigeration equipment, while the usual ice creams and restaurants are yet to improve. Performance of water coolers was lower than expected. The company's water purifier segment is at breakeven level, while it has achieved 3% market share. The water purifier segment is distributed through the e-commerce channel. The company's next critical target is to reach 5%-6% share in water purifier post which it will hit physical stores. Overall EBIT margin of UCP stood at 7.9% in Q4, which the company will try to hold on going forward.
- **Price increase:** The company took 5%-8% price hike in January 2021 on account of unprecedented rise in raw-material prices. The price increase has partially covered increased input costs. The company further took a 3%-5% hike from April 1, 2021.
- **Other costs:** The company's lower travel expenses and rental negotiations aided in a decrease in other expenses. Advertising and marketing costs have been brought back in Q4FY2021, which were in proportion of FY2018 and FY2019 levels.
- **Other income:** Other income included Rs. 32 crore profit on sale of property in Mumbai.
- **Turning net cash:** The company reduced its debt by Rs. 282.46 crore in Q4FY2021. Gross debt stood at Rs. 155 crore, with debt-to-equity ratio at 0.21x as of FY2021. The company's net cash stood at Rs. 151.45 crore as of FY2021 versus net debt of Rs. 131.01 crore in FY2020.
- **PLI:** The company will not be applying for PLI schemes as incentives of the schemes pertain to components and not finished products. However, the company will get indirect benefits arising from sourcing from domestic manufacturing units.
- **New product launched in RAC:** The company launched a new range of 'Mass Premium' product in room air conditioners.
- **Import ban:** The company has nil finished goods imports; hence, it does not see any impact of import ban.

Results (Consolidated) **Rs cr**

Particulars	Q4FY21	Q4FY20	Y-o-Y %	Q3FY21	Q-o-Q %
Revenue	1,612	1,299	24.0%	1,124	43.4%
Operating profit	102	37	-	82	24.8%
Other Income	40	6	-	8	-
Interest	13	7	94.3%	15	-10.1%
Depreciation	25	24	4.9%	26	-4.1%
PBT	103	12	-	49	-
Tax	36	4		13	-
EO	-	1		-	
Reported PAT	68	8.9	-	37	85.1%
Adj. PAT	68	9.6	-	37	85.1%
Adj.EPS	7.1	1.0	-	3.8	85.1%
Margin			BPS		BPS
OPM (%)	6.3	2.9	344.5	7.3	(93.9)
NPM (%)	4.2	0.7	347.5	3.3	95.0
Tax rate	35.1	32.0	-	26.5	-

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view – Strong headroom for growth given underpenetration

The AC segment has long-term structural growth triggers in terms of suitable demographics, rising per capita income, increasing urbanisation, low penetration levels, and uninterrupted availability of power etc., which would aid in maintaining a healthy growth trajectory over the long term. RAC penetration level in India (8%) lags when compared to the global level (42%), implying there is a significant growth opportunity. Commercial refrigeration adoption in India is only at a sub-5% level, which translates into huge opportunities for Blue Star, which has the widest range of refrigeration products in the industry. Low penetration levels in ACs and commercial refrigeration provide immense growth potential to the industry, led by structural growth drivers.

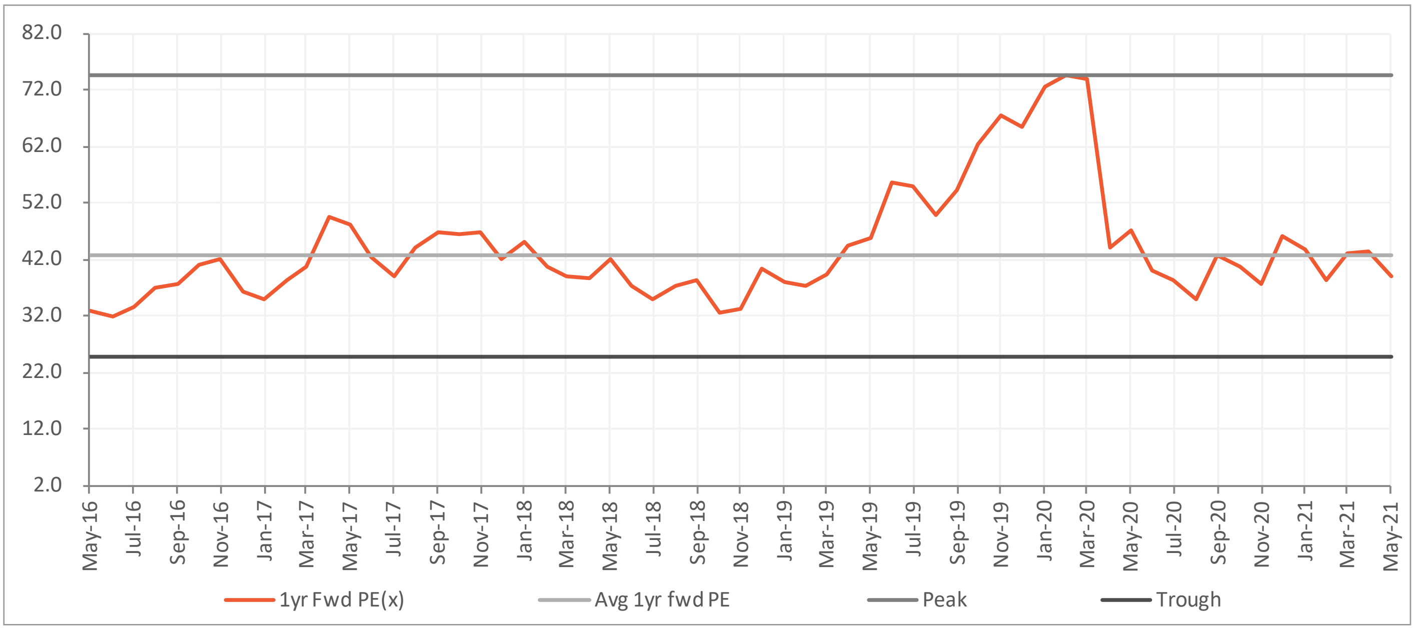
■ Company outlook – Long-term growth opportunities remain intact.

Blue Star has a strong brand strength and distribution network. To further leverage these, Blue Star is well entrenched at both retail and institutional level in terms of its distribution network and continues to prioritise project execution based on cash flow. Room air conditioners and the 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. Digitisation and healthcare initiatives offer good prospects for professional electronics and industrial systems. Outlook on these categories is promising, considering the 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 unchanged TP of Rs 1200

Blue Star has made consistent, rapid progress, and outperformed the industry as well as its peers driven by a strengthening distribution network, rising market share (as seen in Q4FY2021), and improving product mix. Besides, scale-up in commercial refrigeration products and water purifier would also aid growth. Similarly, the EMPS segment's growth prospects are brighter given continued traction in the healthcare, pharma, industrial, and government segments, enabling growth prospects or the commercial air conditioning business. Overall, management remains optimistic despite challenges and believes it has the potential to navigate through the current situation and bounce back once the situation improves. Overall goal is to grow faster than the market, keep operating costs under control, and manage the balance sheet prudently. With rising return ratios, healthy cash flow, lean working capital cycle, and a comfortable leverage position, Blue Star is placed favourably compared to listed brands in terms of its valuation vis-a-vis RoE and EPS growth prospects. We have fine-tuned our earnings estimates for FY2021-FY2022. The company is currently trading at P/E of 29x its FY2023E EPS. We maintain our Buy rating on the stock with an unchanged price target (PT) of Rs. 1,200.

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. 5,360 crore, a network of 32 offices, five modern manufacturing facilities, and 3,880 channel partners. The company has 6,000 stores for room ACs, packaged air conditioners, chillers, cold rooms as well as refrigeration products and systems, along with 1,060 service associates reaching out to customers in over 900 towns. 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 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 businesses.

Investment theme

Structural growth visibility in the Indian white goods segment remains high due to favourable demographics (urbanisation, per capita GDP, and AC ownership similar to China's levels in 1998-2000). Expectation of a high growth potential in ACs (8%-10% CAGR in FY2020-FY2025F, despite COVID-19 impact) as penetration for white goods such as room air conditioners remained quite low at 5%. We believe Blue Star remains one of the key beneficiaries of rising AC penetration in India, led by its improving market share, product profile, and strong service network. With the company's new FY2021-FY2024 strategy in place with three objectives – grow faster than market, improve profits by scale, and backward integration, deepen distribution through conventional and e-com channels – provides a healthy visibility and outlook.

Key Risks

- Fluctuations in raw-material prices pose a key challenge
- Sharp depreciation in Indian Rupee vis-à-vis Chinese Yuan
- Intense competition

Additional Data

Key management personnel

Mr. Ashok M Advani	Chairman & MD
Mr. Suneel M Advani	Vice Chairman
Mr. Vir S Advani	M.D
Mr. B Thiagarajan	Jt. M. D
Mr. Neeraj Basur	CFO

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	HDFC AMC	4.30
5	ICICI Pru AMC	2.97
6	Advani Nargis Suneel	2.95
7	Advani Suneel Mohan	2.92
8	Kotak Mahindra AMC	2.92
9	Advani Ashok Mohan	2.70
10	T Rowe Price Group Inc	2.45

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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