



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 Updated Jan 08, 2022 30.66

High Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 9639 cr
52-week high/low:	Rs. 1091/701
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	11.1
DII	22.8
Others	27.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.5	-0.8	19.0	24.9
Relative to Sensex	-0.7	0.8	10.8	8.7

Sharekhan Research, Bloomberg

Blue Star Ltd

Strong Q3, Demand outlook positive

Capital Goods

Sharekhan code: BLUESTARCO

Reco/View: Buy



Upgrade



Maintain



Downgrade

CMP: Rs. 1,001

Price Target: Rs. 1,200

Summary

- We maintain Buy on Blue Star Limited (Blue Star) with an unchanged a PT of Rs. 1,200, given that demand is expected to be robust going ahead.
- Blue Star reported better than expected performance with strong revenue growth across business verticals, OPM stayed in-line despite gross margin pressures, overall leading to net earnings beat.
- Expect growth momentum to continue in Q4 and FY2023. It expects to grow faster than RAC industry in FY2023 gaining market share. EBIT margins expected to remain stable.
- Wada deep freezer plant expected to commission over next three months. Sri city first phase in Q3FY2023.

Blue Star reported better-than-expected performance for Q3FY2022 with consolidated revenues rising by 34% y-o-y to Rs. 1506 crore led by strong growth across verticals Electro-Mechanical Projects and Commercial Air Conditioning Systems (up 42% y-o-y), Unitary Products (up 24% y-o-y) and Professional Electronics & Industrial systems (up 47% y-o-y). The OPM at 6% (-124bps y-o-y) was in-line as higher input costs, higher ocean freight and roll back of discretionary spends exerted pressure despite it taking YTD 15% price hikes in Unitary products. Further, higher other income, lower depreciation and lower interest expense was partially offset by higher effective tax rate leading to 29.4% y-o-y rise in consolidated net profit at Rs. 48 crore. The company remain confident of strong performance for Q4FY2022 while it would target 15% market share in FY2023 from 13.2% now. The margins are expected to remain stable in Q4 in absence of price hike while depending upon competitive scenario in upcoming festive season, it may decide take pricing actions in Q1FY2023.

Key positives

- Strong revenue growth across verticals led by healthy demand bounce back partly in November and December months.
- Blue star RAC value growth in primary market for Q3FY2022 stood at 28% vis-à-vis 25% for the industry partly led by 15% price hike undertaken YTD.

Key negatives

- Gross margins continued to remain under pressure y-o-y due to increase in commodity prices and ocean freight.
- Net debt increased to Rs. 165 crore as against Rs. 131 crore in Q3FY2021 due to build of inventories to mitigate possible supply chain disruptions for upcoming season.

Management Commentary

- Growth momentum to continue in Q4 with stable PBIT margins. For FY2023, it is still under planning stage for its outlook on growth and pricing while it would target to increase its RAC market share to 15% from 13.2% now.
- Deep freezer plant at Wada to commission over next three months. Sri city first phase expected in Q3FY2023.
- EMP and Commercial AC systems can grow 12-15% y-o-y in FY2023 led by healthy order inflow outlook both from government and private sector capex spend.

Revision in estimates – We have fine tuned our estimates for FY2022-FY2024.

Our Call

Valuation – Maintain Buy with unchanged PT of Rs. 1,200: 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 and PLI led manufacturing would also aid growth. Similarly, the EMPS segment's growth prospects are brighter given continued traction in the order inflows. The company is currently trading at P/E of 33x its FY2024E 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)

Particulars	FY21	FY22E	FY23E	FY24E
Net Sales	4,264	5,857	6,805	7,910
OPM (%)	5.6%	5.6%	6.1%	6.2%
Adjusted PAT	100	149	228	291
yoy Growth	-31.9%	48.9%	52.5%	27.6%
Adj. EPS	10.4	15.5	23.7	30.2
P/E	95.3	64.0	42.0	32.9
P/B	10.8	9.9	8.5	12.0
EV/EBITDA	33.5	28.0	21.3	17.6
ROCE (%)	16.3%	20.1%	25.4%	29.6%
RONW (%)	12.0%	16.1%	21.8%	24.3%

Source: Company; Sharekhan estimates

Strong performance across verticals with in-line OPM

The company's consolidated revenues grew by 34% y-o-y (+21.5% q-o-q) to Rs. 1506 crore which was higher than our estimate. Revenues from electro-mechanical projects and commercial air conditioning grew by 41.7% y-o-y (+14.7% q-o-q) at Rs. 830 crore. Unitary products revenues grew by 23.7% y-o-y (+34.1% q-o-q) at Rs. 610 crore. Professional electronics and industrial systems revenues grew by 46.8% y-o-y (+8.2% q-o-q) at Rs. 67 crore. The consolidated operating margins were in-line with estimate at 6.0% (-124bps y-o-y, +31bps q-o-q). Increase in commodity prices, ocean freight and roll back of FY2021 cuts in discretionary spends impacted OPM y-o-y. Overall, operating profit grew by 11.1% y-o-y to Rs. 90.6 crore which was higher than our estimate. Strong revenue growth along with higher other income (up 65% y-o-y, receipt of subsidy for one of its manufacturing plant) led to 29.4% y-o-y rise in consolidated net profit at Rs. 47.5 crore, which was much higher than our estimate. Its net borrowing increased to Rs. 165 crore compared to Rs. 131 crore in Q3FY2021 on account of inventory built up to meet the demand for upcoming seasons and investments in expansion projects at Sri city and Wada.

Management stay optimistic on demand environment

The management expects the growth momentum to continue through Q4 leading up to the next summer season. The company has been expanding its distribution reach and consolidating market share. For FY2023, the company is still under planning stage and would be sharing its outlook on growth and pricing in March 2022. The mass premium product portfolio in RAC has seen encouraging response which is expected to gain traction in Q4 and Q1FY2023. Blue star would be targeting to increase its market share to 15% in FY2023 from 13.2% now. The deep freezer plant at Wada is expected to be commissioned over three months which will double its deep freezers production capacity. The Sri city first phase is expected to complete in Q3FY2023. The plant will have phased roll out of products with Room ACs to begin with.

Blue star's Q3FY2022 Concall Highlights

- ♦ **Q3 performance:** The company has been expanding its distribution reach and consolidating market share. Increase in raw material prices, higher ocean freight and roll back of discretionary spends exerted pressure on OPM.
- ♦ **Q4 outlook:** It expects good growth in Q4. If competitive pressure eases and commodity prices remain stable the PBIT margins in EMP & Commercial ACs is expected to be 5.5-6%, Unitary products 7% and Professional electronics 18-20%.
- ♦ **FY2023 outlook:** The company is still under planning stage and would be sharing its outlook on growth and pricing in March 2022. The mass premium product portfolio in RAC has seen encouraging response which is expected to gain traction in Q4 and Q1FY2023. Blue star would be targeting to increase its market share to 15% in FY2023 from 13.2% now.
- ♦ **Industry growth rates:** During Q3, the RAC industry primary market in value terms has grown by 25% while blue star has grown by 28% (partly led by value led growth). In 9MFY2022, RAC industry grew by 33-34% while blue star has grown by 36%. The RAC industry had been growing at 15-18% CAGR before the pandemic and is expected to return to that normal growth trajectory from FY2023.
- ♦ **Price hikes:** The company took three price hikes in 2021 aggregating 15%. It is now planning to take any price hike in Q4 and expects other large players to increase prices.
- ♦ **Expansion:** The Deep freezer plant at Wada would be live in three months which would aid in substituting few SKUs which it is importing. It has spend Rs. 100 crore over two years. 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. The company would be augmenting capacities at Sri city to reach its two Himachal plants to increase in-house manufacturing to 70-75% levels from 50-55% now.
- ♦ **Distribution reach:** The company is touching 7500 plus stores which had been increased by 15-20% y-o-y. It targets to reach 8000 stores by FY2023 end.
- ♦ **Channel inventory:** By December end, the top few players has seen inventory level getting normalised. It is unlikely to exert pricing pressure.

- ♦ **E-commerce:** The share of e-commerce for the industry was 10% and for Blue star was 8% for Q3. During 9MFY2022, industry e-com share was 18% vis-a-vis Blue star's 14-15%.
- ♦ **Project business:** The company has been focusing on select customers having high credibility. It expects 12-15% growth possible for FY2023.
- ♦ **Net Debt:** The net debt stands at Rs. 165.11 crore (D/E of 0.18x) compared to Rs. 131.01 crore (0.16x) in Q3FY2021.
- ♦ **Tax rate:** The company would be shifting to new tax regime in FY2023. The benefit of its upcoming manufacturing plant would accrue in FY2024 lowering the overall tax rate.
- ♦ **EMP & Commercial ACs:** The EMP segment order inflows increased by 34% y-o-y to Rs. 852.82 crore. The order book increased 4.2% y-o-y to Rs. 2311 crore.
- ♦ **Unallocable expense:** It contains corporate management salaries. The company had earlier taken 35-50% salary cuts which has been rolled back which led to higher unallocable expense. At steady state rate, it should be 1.5-1.7% of overall turnover.

Results (Consolidated)

Particulars	Rs cr				
	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)
Total Income	1,506	1,124	34.0%	1,240	21.5%
EBITDA	91	82	11.1%	71	28.1%
Other Income	13	8	65.4%	8	64.8%
Interest	12	15	-22.5%	11	3.4%
Depreciation	22	26	-13.4%	20	9.9%
PBT	70	49	43.3%	47	48.2%
Total Tax	23	13	75.5%	16	42.3%
Reported PAT	48	36.7	29.4%	31	51.5%
Adjusted PAT	48	36.7	29.4%	31	51.5%
Adjusted EPS	4.9	3.8	29.4%	3.3	51.5%
Margin			BPS		BPS
OPM	6.0	7.3	(124.3)	5.7	31.2
PAT Margin	3.2	3.3	(11.4)	2.5	62.4
Tax Rate	32.5	26.5	597.2	33.9	(135.1)

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%), implies there is a significant growth opportunity. Commercial refrigeration adoption in India is only at a sub-5% level, 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.

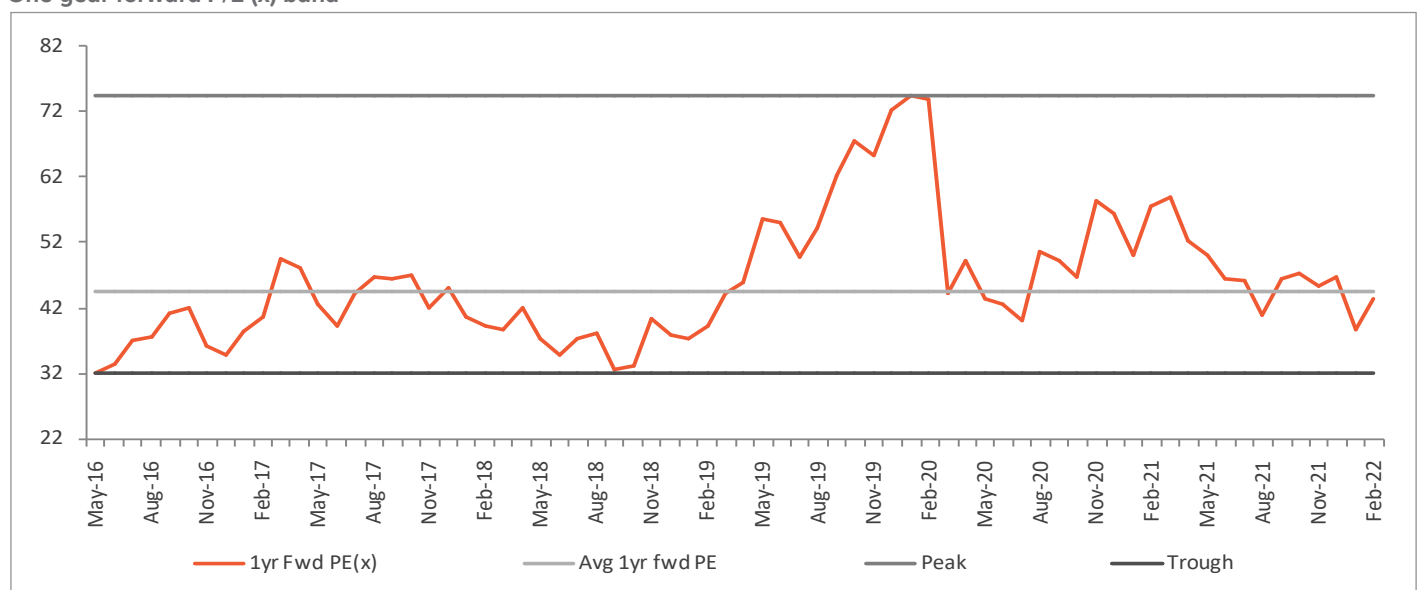
■ Company outlook - Long-term growth opportunities remain intact

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 PT of Rs. 1,200

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 and PLI led manufacturing would also aid growth. Similarly, the EMPS segment's growth prospects are brighter given continued traction in the order inflows. The company is currently trading at P/E of 33x its FY2024E 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 and MD
Mr. Suneel M. Advani	Vice Chairman
Mr. Vir S. Advani	MD
Mr. B Thiagarajan	Jt. MD
Mr. Neeraj Basur	CFO

Source: Bloomberg

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

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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 deteriorating 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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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

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