



## 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

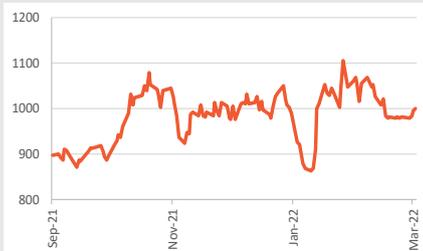
## Company details

Market cap:	Rs. 9,630 cr
52-week high/low:	Rs. 1,134 / 758
NSE volume: (No of shares)	1.43 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	-1.5	2.3	11.4	15.7
Relative to Sensex	-7.2	1.5	15.5	-3.2

Sharekhan Research, Bloomberg

## Consumer Electronics

## Sharekhan code: BLUESTARCO

Reco/View: Buy



CMP: Rs. 1,000

Price Target: Rs. 1,200



Upgrade



Maintain



Downgrade

## Summary

- Our interaction with multi-brand consumer electronics outlets indicate strong pent-up demand for air-conditioners (ACs) post the pandemic in Q4FY22 (particularly March) and Q1FY23. Further, soaring temperatures across India and introduction of new energy-efficient models with attractive features would help ease the impact of a 7-8% hike in prices (across brands).
- Blue Star would continue to outpace the industry by market share gains, backward integration, deeper penetration (launch of affordable mass-premium products) and expansion of distribution network through conventional and e-Commerce channels.
- The company has low debt, shorter working capital cycle and healthy operating cash flows. We expect Revenue/PAT to clock a CAGR of 23%/43% over FY21-24E. At CMP, the stock trades at ~32x FY24E EPS.
- We maintain a Buy on the stock with an unchanged PT of Rs.1,200, given that a harsh summer would brighten prospects for its AC business, healthy growth in project business and commencement of new manufacturing facilities.

Blue Star has emerged as a leading player in the domestic white goods consumer electronics space through market share gain (from ~6% in FY11 to 13.25% currently) by increasing penetration, broadening its distribution network and rapidly expanding its store count. It has been continuously launching new and affordable air-conditioner (AC) models to establish itself as a 'mass-premium' player and aims to achieve a market share of 15% in FY2023. On the project side as well, healthy order book of Rs 2,311 cr and pick up in public and private sector capex would drive growth. The company has emerged as a leading player in the AC and commercial refrigeration segments despite a challenging business environment and intensifying competition in the past 2-3 years. Further, the company has low debt, high fixed asset turnover and healthy return ratios.

- Well placed to leverage rising room air conditioners (RAC) demand:** The AC industry reported a healthy growth of ~14%/16% in value and volume terms respectively over FY15-20. However, last two summer seasons have been adversely impacted due to lockdown during the pandemic leading to a decline in volumes as compared to FY2020. Our interaction with multi-brand outlets indicate a strong summer season in Q4FY22 and Q1FY23. Hence, given the lower base and pent-up demand of the last two years coupled with rising heat, the AC industry is expected to grow at ~20-25% this season. Further, structural growth triggers such as rising per capita income, increasing urbanisation, low penetration levels (7-8%), various financing options and better availability of power etc., would help maintain a healthy growth trajectory over the long term. Blue Star, being the fourth-largest player with a value market share of 13.25% (first three players being Voltas, LG and Daikin) in the RAC segment is well placed to tap this opportunity backed by increase in its market and distribution reach, store expansion and launch of new products in the "mass-premium" category.
- Price hikes to ease effect of rising input costs:** Blue Star hiked prices thrice in 2021 aggregating 15%, to mitigate margin pressure due to sharp increase in input cost. Currently, the company has sufficient inventory to last for most of the summer season (at least until May). Therefore, the recent spike in commodity prices may not affect margins much. However, in case of a better-than-expected summer, the company may hike prices on new models in mid-April to factor in the rise in commodity prices because of Russia-Ukraine war. However, we expect margin pressure to continue in the short term. Although going forward, higher operating advantage as the business environment improves, backward integration in ACs as well as commercial refrigerators and exports growth shall lead to improvement in margins in the medium to long term.
- Commencement of new factories to boost indigenisation and aid in export growth:** The first phase of the company's third AC manufacturing facility in Sri City, Andhra Pradesh would get commissioned in Q3FY22 and produce ~1.2 lakh units. This is likely to scale up to 12 lakh units by 2026. The plant which qualifies under production-linked incentive (PLI) scheme will be a fully integrated plant and have higher in-house manufacturing content, which would reduce its dependency on imported components. The plant will cater to the Southern market which is a stronghold of Blue Star. Similarly, its Wada, Maharashtra plant for commercial deep freezers and water coolers would double its capacity by the start of FY23. Besides leading to backward integration, these new plants would help the company tap the exports potential of these products.

Revision in estimates – We have kept our estimates unchanged.

## 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 order inflows. We expect revenue/PAT to clock a CAGR of 23%/43% over FY21-24E. At CMP, the stock trades at ~32x FY24E EPS. We maintain our Buy rating on the stock with an unchanged PT of Rs. 1,200.

## Key Risks

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

## Valuation (Consolidated)

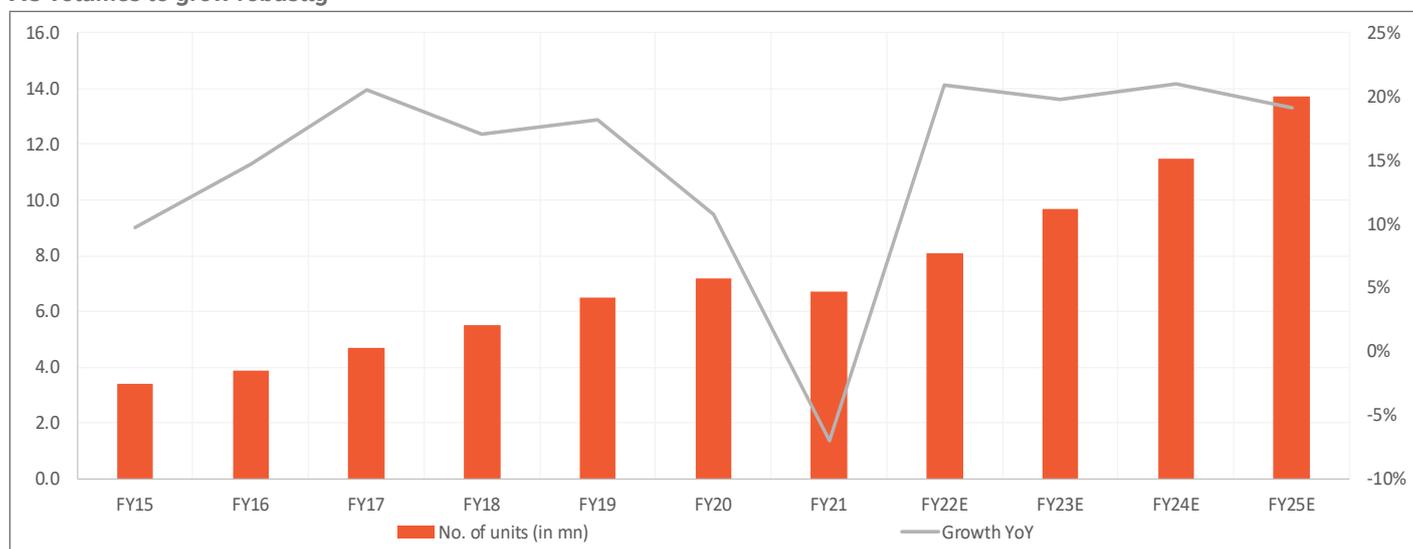
Particulars	Rs cr			
	FY21	FY22E	FY23E	FY24E
Net Sales	4,264	5,857	6,805	7,910
OPM (%)	5.6	5.6	6.1	6.2
Adjusted PAT	100	149	228	291
Growth (YoY %)	-31.9	48.9	52.5	27.6
Adj. EPS	10.4	15.5	23.7	30.2
P/E	95.2	68.2	44.7	32.3
P/B	10.8	9.9	8.5	12.0
EV/EBITDA	33.5	29.0	22.2	17.4
ROCE (%)	12.0	15.1	20.5	24.8
RONW (%)	16.3	19.1	24.0	30.2

Source: Company; Sharekhan estimates

## Room air conditioners (RAC) industry poised for a remarkable growth

Penetration of ACs in India stands at 7-8%, way below the global average of 42%. This implies a significant growth opportunity for the industry given the long-term structural growth triggers such as conducive demographics, rising per capita income, increasing urbanisation, availability of various financing options, uninterrupted power as well as energy efficient models. As per industry reports, AC industry reported a healthy growth of ~10%/16% in value and volume terms, respectively over FY15 to FY20. However, business in the last two summers had been hit by the COVID-led lockdowns. Hence, given a lower base and pent-up demand of the last two years, the AC industry is expected to grow at ~20-25 % in the next two years vis-à-vis pre pandemic volumes. 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 pharma and food & beverage industries, opening of shops, malls and offices post pandemic, the industry is expected to post strong growth. Blue Star being a leading player with a wide reach and range of products in both ACs and commercial refrigeration will be one of the key beneficiaries of growth.

### AC volumes to grow robustly



Source: Frost and Sullivan Analysis, Sharekhan Research

### New manufacturing facilities would reduce import dependency and boost exports

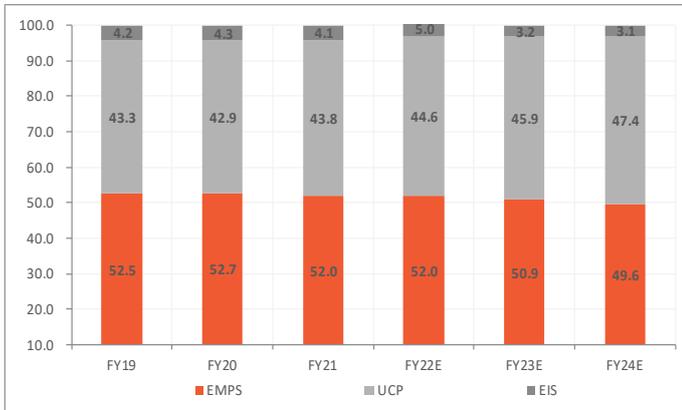
The company is setting up a new air conditioner plant in Sri City in Andhra Pradesh at an outlay of Rs 525 crore. The first phase which entails an investment of Rs 220 crore and capacity of around 1.2 lakh units is likely to be commissioned in Q3FY23. In FY24, it expects to scale up to 3.5 lakh units and aims to reach 17 lakh units by 2026. It will be a fully integrated plant and have higher in-house manufacturing content, which would reduce imports. The plant would slash logistics cost as it would cater to the Southern Indian market, which was earlier served through its Himachal Pradesh plant. Moreover, the company would receive Rs. 73 crore for sheet metal components and heat exchangers under production-linked incentive (PLI) over a five-year period from FY24 onwards. Further, brownfield expansion for an outlay of Rs. 100-130 crore at Blue Star's Wada, Maharashtra plant would double the capacity for commercial deep freezers and water coolers. Besides leading to backward integration and reducing import content, these new plants with their excess capacity would help the company tap export markets.

### Inquiries for electro-mechanical projects and commercial AC systems rising

EMP segment order inflows increased by 34% y-o-y to Rs. 852.82 crore in Q3FY22 led by orders from the infrastructure sector including MEP projects in water distribution. The order book increased by 4.2% y-o-y to Rs. 2,311 crore. Further, the company is well poised to leverage its experience in EMP and commercial air-conditioning products which are seeing a pick-up in orders and enquiries because of increase in capex in infrastructure, commercial construction, metro rail, power, retail and healthcare.

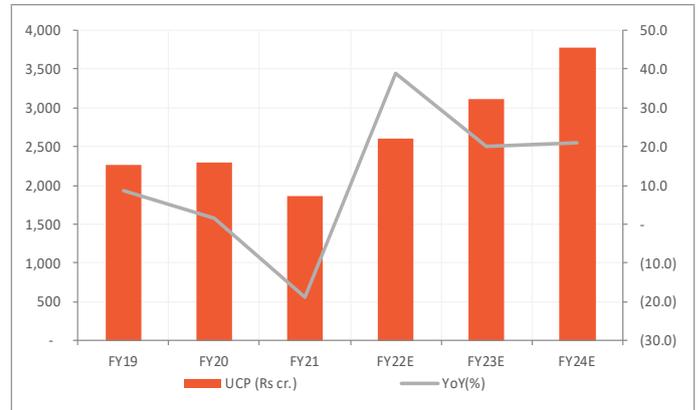
**Financials in charts**

**Segment wise Revenue break-up (%)**



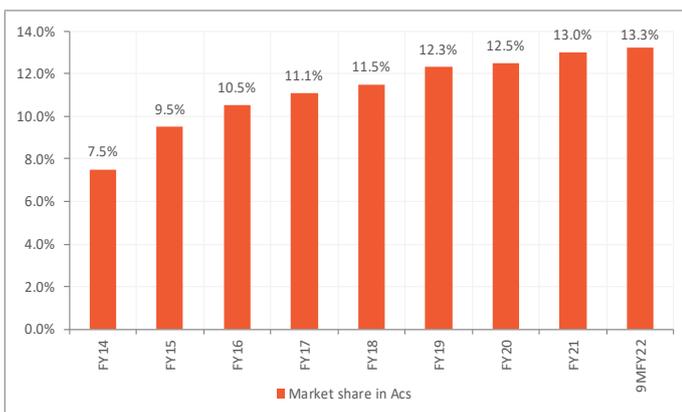
Source: Company, Sharekhan Research

**UCP segment revenue growth (%)**



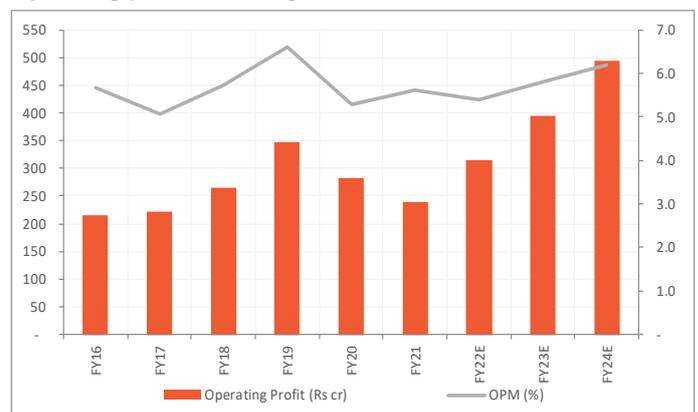
Source: Company, Sharekhan Research

**Market share in ACs**



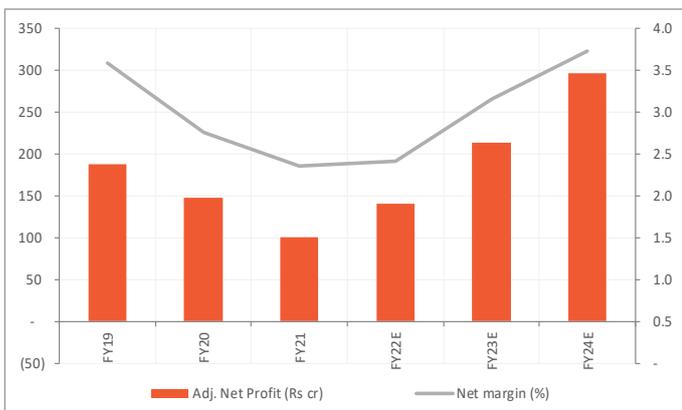
Source: Company, Sharekhan Research

**Operating profit and margin trend**



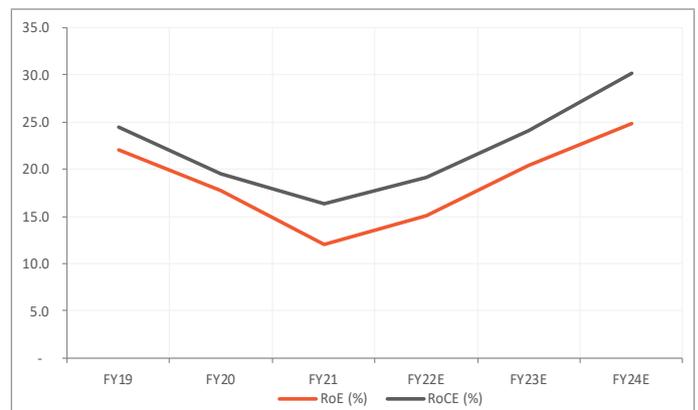
Source: Company, Sharekhan Research

**Net profit and margin trend**



Source: Company, Sharekhan Research

**Return Ratios trend**



Source: Company, Sharekhan Research

## Outlook and Valuation

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

The AC segment has long-term structural growth triggers in terms of suitable demographics, rising per capita income, increasing 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 reported a healthy growth 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.

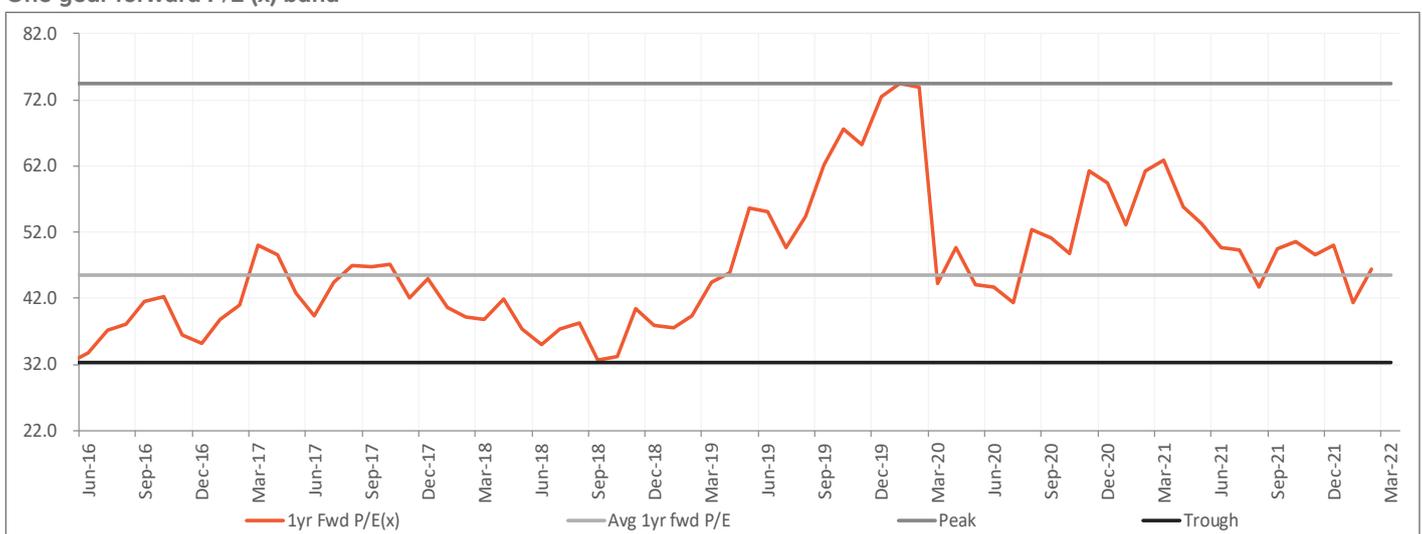
### ■ Company outlook – Long-term growth opportunities intact

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. RACs 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. Digitization and healthcare initiatives offer good prospects for professional electronics and industrial systems. Moreover, the growth outlook for 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 strengthening distribution network, rising market share, increasing capacity and improving product mix. Besides, scale-up in commercial refrigeration products, backward integration, stepping up of in-house manufacturing and incentives under PLI scheme would also aid growth. Similarly, the EMP segment's growth prospects are brighter given continued traction in the order inflows. The company is currently trading at P/E of ~32x 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. 5,000 crore, network of 32 offices, five modern manufacturing facilities, and 3,880 channel partners. The company has over 7,500 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 contributed 53%/43%/4% to FY21 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

- ♦ Fluctuations in key raw-material prices could impact margins
- ♦ Increasing competitive intensity

## 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: 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
7	Kotak Mahindra AMC	4.98
6	Advani Suneel Mohan	2.92
5	ICICI Pru AMC	2.91
8	Advani Ashok Mohan	2.70
4	HDFC AMC	2.45
9	T Rowe Price Group Inc.	2.15
10	Franklin Templeton India	1.93

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

# Sharekhan

by BNP PARIBAS

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