Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Blue Star Ltd

Healthy growth visibility; Upgrade to Buy

Capital Goods	Sharekhan code: BLUESTARCO

Reco/View: Buy ↑	CMP: **Rs. 969**	Price Target: **Rs. 1,160** ↑

↑ 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 29.2

Updated Aug 08, 2023

Medium Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 19,917 cr
52-week high/low:	Rs. 992/553
NSE volume: (No of shares)	0.90 lakh
BSE code:	500067
NSE code:	BLUESTARCO
Free float: (No of shares)	5.9 cr

Shareholding (%)

Promoters	36.5
FII	14.9
DII	25.2
Others	23.4

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	6.4	30.2	37.8	71.2
Relative to Sensex	7.3	29.2	30.9	64.7

Sharekhan Research, Bloomberg

Summary

- We upgrade Blue Star to Buy with a revised PT of Rs. 1160, rolling forward our valuation multiple to September 2025E earnings and increasing valuation multiple to factor in strong earnings growth trajectory over the next 2-3 years.
- The company reported strong operational beat for Q2FY2024 led by robust revenue growth and EBIT margin expansion in the Unitary products business.
- It expects to grow its RAC business at 15% y-o-y while the industry growth rate is estimated at 10% plus for FY2024. Overall, order inflows and backlog remain strong.
- The company's recent QIP fundraise would aid in manufacturing capacity expansions, R&D, digitalisation and financing incremental working capital requirements.

Blue Star reported strong operational beat for Q2FY2024, led by Unitary Products' performance. Consolidated revenues were up 19.9% y-o-y at Rs. 1890 crore, led by 39% y-o-y growth in Unitary products revenues (industry growth estimated at 30% y-o-y) while EMP segment reported 12% y-o-y revenue growth. Consolidated OPM at 6.5% (up 106 bps y-o-y) surprised positively by Unitary products (EBIT margins up 227 bps y-o-y at 8.4% led by scale, product realignments, and lower ad spends). Overall, consolidated operating profit/net profit was up 43% y-o-y/66% y-o-y at Rs. 123 crore/Rs. 71 crore (much higher than our estimates). The company's recent Rs. 1000 crore fundraise through QIP would help fund manufacturing capacities expansion (Sri city phase 2 to double cooling products capacity to 1.2 mn units, venture into sub 300 litre deep freezers and other new products). Overall capacity building and a healthy demand environment would entail a high growth trajectory for the company.

Key positives

- Unitary products revenues were up 39% y-o-y with EBIT margin expansion of 227 bps y-o-y to 6.5%.
- Order inflows grew by 47% y-o-y to Rs. 1765 crore, with carry forward order backlog growing by 44% y-o-y to Rs. 6009 crore.

Key negatives

- EMP segment revenue growth at 12% y-o-y and EBIT margin of 6.1% were lower than expected.
- Professional Electronics and Industrial systems reported a 9% y-o-y decline in revenues.

Management Commentary

- The management estimates RAC market growth of at least 10% y-o-y while it may grow at 15% y-o-y in FY2024.
- EMPS EBIT margins are expected at 6.5-7% for FY2024. Unitary products' EBIT margins are estimated at 8-8.5% for FY2024 due to increased competition and its strategy of venturing into an affordable product range.
- The company would incur Rs. 650 crore capex over the next two years. It would invest in Sri City Phase 2, sub 300 litre deep freezers, and other new products. Additionally, it will be spending on R&D, digitalisation and on incremental working capital requirements.

Revision in estimates – We have fine-tuned our earnings estimates for FY2024-FY2025E.

Our Call

Valuation – Upgrade to Buy with a revised PT of Rs. 1160: Blue Star is well placed to leverage on the opportunities in the domestic RAC and commercial cooling and the refrigeration industry. The company also plans to explore exports opportunities in countries like USA and Europe. The long-term growth momentum would continue, given sectoral tailwinds regarding soaring temperatures across India and changing consumer lifestyles. The EMPS segment's growth prospects are brighter, given robust order book and continued traction in order inflows in domestic and international markets. We introduce our FY2026E earnings in this note. We expect revenue/adjusted PAT to post a CAGR of ~17%/~32% over FY2023-2026E. At the CMP, the stock trades at 39x/31xx its FY2025E/FY2026E EPS, which we believe provides further room for upside. Hence, we upgrade the stock to Buy with a revised price target (PT) of Rs. 1160, rolling forward our valuation multiple to September 2025E earnings and increasing valuation multiple considering strong earnings growth trajectory over the next 2-3 years.

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	FY23	FY24E	FY25E	FY26E
Net Sales	7,977	9,369	10,987	12,886
OPM (%)	6.2-	6.8-	7.0-	7.3-
Adjusted PAT	261	381	481	604
y-o-y growth (%)	56-	46-	26-	25-
Adj. EPS (Rs.)	13.5	19.8	25.0	31.3
P/E (x)	71.5	48.9	38.8	30.9
P/B(x)	14.0	12.6	10.8	8.9
EV/EBITDA(x)	37.4	27.8	22.8	18.3
ROCE (%)	25.7-	30.9-	36.3-	39.8-
RONW (%)	19.6-	25.7-	27.8-	28.7-

Source: Company; Sharekhan estimates

Key conference call highlights

- **Outlook:** The management estimates RAC market growth of at least 10% y-o-y while it may grow at 15% y-o-y in FY2024. EMPS EBIT margins are expected at 6.5-7% for FY2024. Unitary products EBIT margins are estimated at 8-8.5% for FY2024 due to increased competition and its strategy of venturing into affordable product range.
- **Q2FY2024 highlights:** Consolidated revenues grew by 19.5% y-o-y to Rs. 1890 crore, EBITDA stood at Rs. 123 crore with EBITDA margin of 6.5% compared to 5.4% in Q2FY2023, PBT grew by 65.2% y-o-y to Rs. 95 crore and PAT grew by 66% y-o-y to Rs. 71 crore. Carry forward order backlog increased by 44% y-o-y to Rs. 6009 crore. Net Cash stood at Rs. 286 crore as against net debt of Rs. 393 crore in Q2FY2023.
- **EMPS:** EMPS revenues grew 12% y-o-y to Rs. 1077 crore. Order inflows grew 47% y-o-y to Rs. 1765 crore. Carry forward, the order backlog grew 51% year-to-year at Rs. 4609 crore.
- **Unitary products:** The segment revenues grew by 38% y-o-y at Rs. 729 crores. The cooling industry growth rate is estimated at 30% y-o-y while it reported 39% y-o-y growth. The company's market share for H1 is estimated at 13.5%.
- **Professional electronics and industrial systems:** Segment revenue declined by 9% y-o-y to Rs. 84 crore, partially impacted by a slowdown in the data security business.
- **Capex:** The company would incur Rs. 650 crore capex over the next two years. It would invest in Sri City Phase 2 expanding its manufacturing capacity from 6,00,000 to 1.2 million units. It will also be investing in sub 300 litre deep freezers and other new products it will launch. Additionally, it will be spending in R&D, digitalisation and incremental working capital requirements. Currently, it has 28% market share in the deep freezer market. As of last year, 50% of the deep freezers consumed in India were imported from China.

Results (Consolidated) Rs cr

Particulars	Q2FY24	Q2FY23	y-o-y (%)	Q1FY24	QoQ (%)
Net Sales	**1,890**	**1,576**	**19.9**	**2,226**	**-15.1**
Operating profit	**123**	**86**	**43.3**	**145**	**-15.4**
Other Income	13	9	51.6	9	37.9
Interest	18	12	46.0	18	-1.9
Depreciation	23	24	-6.0	23	1.0
PBT	**95**	**58**	**65.0**	**114**	**-16.4**
Tax	24	15	62.9	30	-19.8
Exceptional gain or loss	-	-		-	
Reported PAT	**71**	**43**	**65.7**	**83**	**-15.2**
Adjusted PAT#	**71**	**43**	**65.7**	**83**	**-15.2**
Adj. EPS (Rs.)	**3.7**	**2.2**	**65.7**	**4.3**	**-15.2**
Margin (%)			**BPS**		**BPS**
OPM	6.5	5.4	106.0	6.5	(2.4)
NPM	3.7	2.7	103.3	3.7	(0.6)
Tax rate	25.5	25.9	(32.0)	26.6	(107.8)

Source: Company Data,# after adjusting for tax on exceptional gains of Rs. 171 crore

Outlook and Valuation

■ Sector Outlook – Bright long-term growth prospects, given the 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 the global average of 42%. This implies there is a significant growth opportunity for the AC industry. The industry grew at a healthy pace of ~14%/16% in value and volume terms, respectively, over FY2015-FY2020. However, FY2021-2022 were adversely impacted due to the COVID-led lockdown. Hence, given the last two years' lower base and pent-up demand, the AC industry grew by 20-25% in FY2023. For FY2024, unseasonal rains have played spoilsport, and therefore, the industry is expected to grow at a moderate pace of 10-15%. Although long-term growth triggers are intact for the industry.. Further, commercial refrigeration adoption in India is only at a sub-5% level. However, the industry is expected to grow strongly, given rapid urbanisation, growth in pharmaceuticals and food and beverage industries, the opening of shops, malls and offices post-pandemic, and pick-up in construction activities. Blue Star, a leading player with a wide reach and range of ACs and commercial refrigeration products, will be one of the key beneficiaries. Further, the company is well poised to leverage its experience in electromechanical projects (EMPS) and commercial air-conditioning products, which are expected to witness healthy growth because of an increase in public and private capex in sectors such as infrastructure, metro rail, power, retail, and healthcare.

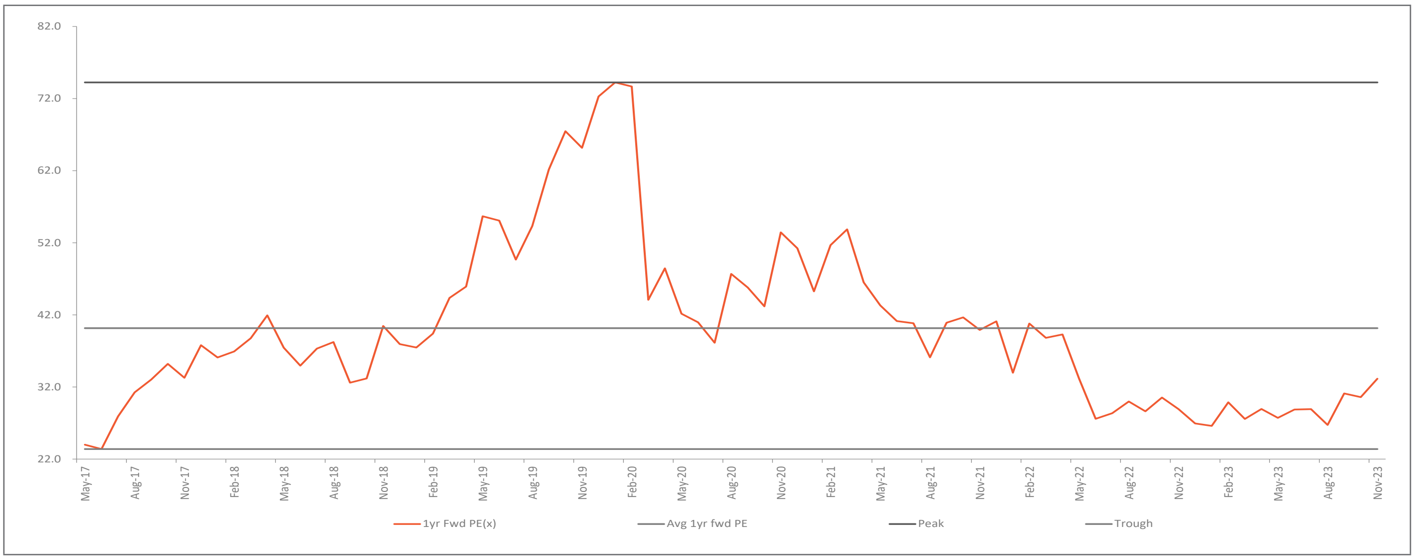
■ Company Outlook – Long-term growth opportunities intact

Blue Star has a strong brand strength and distribution network and is well entrenched at both retail and institutional levels in terms of its distribution network. The company is also becoming self-sufficient by commencing new manufacturing facilities in both RACs and commercial refrigeration, which would reduce its dependency on imports and cost savings, led by backward integration. It will also help the company tap the export markets. The 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 of building immunity will offer good water purifier business prospects. Digitisation 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 – Upgrade to Buy with a revised PT of Rs. 1160

Blue Star is well placed to leverage on the opportunities in the domestic RAC and commercial cooling and refrigeration industry. The company also plans to explore export opportunities in countries like USA and Europe. The long-term growth momentum would continue, given sectoral tailwinds regarding soaring temperatures across India and changing consumer lifestyles. The EMPS segment's growth prospects are brighter, given the robust order book and continued traction in order inflows in domestic and international markets. We introduce our FY2026E earnings in this note. We expect revenue/adjusted PAT to post a CAGR of ~17%/~32% over FY2023-2026E. At the CMP, the stock trades at 39x/31xx its FY2025E/FY2026E EPS, which we believe provides further room for upside. Hence, we upgrade the stock to Buy with a revised price target (PT) of Rs. 1160, rolling forward our valuation multiple to September 2025E earnings and increasing valuation multiple considering strong earnings growth trajectory over the next 2-3 years.

One-year forward P/E (x) band



Source: Sharekhan Research

About the company

Blue Star is India's leading air conditioning and commercial refrigeration company, with an annual revenue of over Rs. 5,000 crore, a 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, 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 – electromechanical projects (EMP) and commercial air conditioning systems, unitary cooling products (UCP), and electronics and industrial systems (EIS), which contribute 50%/46%/4% to FY2023 revenue, respectively. The company fulfils 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 purifiers 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). 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 profit by scale and backward integration; and 3) deepening distribution through conventional and e-commerce channels. We believe near to medium-term growth could moderate due to weakness in the RAC industry.

Key Risks

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

Additional Data

Key management personnel

Ashok Advani	Chairman Emeritus
Suneel Advani	Chairman Emeritus
Vir Advani	Vice Chairman/MD
B Thiagarajan	MD
Nikhil Sohoni	CFO

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	SBI Funds Management Limited	7.7
2	Kotak Mahindra Asset Management Company	6.1
3	Axis Asset Management Company Limited	3.6
4	T Rowe Price Group Incorporation	2.3
5	Vanguard Group Incorporation	2.1
6	Nippon Life India Asset Management	1.2
7	Caisse de Depot et Placement du Quebec	1.0
8	Vaswani Suneeta Nanik	1.0
9	Franklin Resources Incorporation	0.8
10	BlackRock Incorporation	0.8

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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