



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	✗	↔	✗

Company details

Market cap:	Rs. 26,590 cr
52-week high/low:	Rs. 1,299/673
NSE volume: (No of shares)	3.62 lakh
BSE code:	500067
NSE code:	BLUESTARCO
Free float: (No of shares)	13.1 cr

Shareholding (%)

Promoters	36.5
FII	15.4
DII	24.8
Others	23.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	19.1	28.1	77.3	77.2
Relative to Sensex	16.1	17.3	65.2	54.2

Sharekhan Research, Bloomberg

Blue Star Ltd

Strong quarter, healthy prospects

Capital Goods

Sharekhan code: BLUESTARCO

Reco/View: Buy



CMP: Rs. 1,293

Price Target: Rs. 1,490



Upgrade



Maintain



Downgrade

Summary

- PAT increased 56% y-o-y to Rs. 100 crore, supported by strong revenue growth of 25% y-o-y, margin improvement of 75bps, higher other income, and lower interest expense.
- EMP/ unitary products/professional electronics and industrial systems segments posted robust growth of 18%/36%/20% y-o-y. Despite subdued rainfall, the company continued to witness strong demand from Tier 3, 4, 5 markets.
- Management believes India is going to be the fastest-growing market for RAC and expects to improve its market share in FY2025.
- We maintain Buy with a revised PT of Rs. 1,490, rolling forward our valuation multiple to FY2026E earnings and increasing our valuation multiple to factor in strong earnings growth trajectory over the next 2-3 years.

Blue Star's consolidated revenue increased 24.9% y-o-y to Rs. 2,241 crore, led by 36% y-o-y growth in unitary products revenue, while EMP and professional electronics and industrial systems segment reported 18%/20% y-o-y revenue growth. The company reported significant growth due to festive sales and pent-up demand for room air conditioners. Consolidated OPM improved to 6.9% (up 76bps y-o-y), led by EMP (EBIT margin up 103bps y-o-y to 8.2%). Overall, consolidated operating profit/net profit grew 40% y-o-y/56% y-o-y to Rs. 155 crore/Rs. 100 crore. The company's carried-forward order book grew 24.2% y-o-y to Rs. 6,039 crore in Q3FY2024 as compared to Rs. 4,862 crore in Q3FY2023.

Key positives

- EMP revenue increased 18% y-o-y, with EBIT margin expansion of 103bps y-o-y to 8.2%.
- Professional electronics and industrial systems revenue increased 20% y-o-y with EBIT margin expansion of 196bps y-o-y to 14.7%.
- Carried-forward order book grew 24.2% y-o-y to Rs. 6,039 crore.

Key negatives

- Unitary products' EBIT margin declined 31bps to 7%.

Management Commentary

- With in the EMP division, demand in commercial air conditioning system continued to grow due to increased demand from Tier-3 and Tier-4 cities. Delay in order finalisation in the commercial building sector has continued, while inquiries and order inflows from factory and data centres continue to remain healthy.
- The room AC business witnessed strong growth supported by strong festive sales. Commercial refrigeration business also witnessed significant growth, led by strong demand for deep freezers, modular cold rooms, and growing investments in the warehousing and logistics sector.
- The company plans to incur capex of Rs. 250-350 crore for at least the next two to three years. The company plans to do capital expenditure for building manufacturing capacities, product development, and digitalisation.
- The company's net cash position stood at Rs. 157 crore in Q3FY2024 as compared to net borrowing of Rs. 396 crore in Q3FY2022.

Revision in estimates – We have increased our FY2024-FY2026 earnings estimates to factor in higher growth assumption.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 1,490: 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 the robust order book and continued traction in order inflows in domestic and international markets. We expect revenue/adjusted PAT to post a CAGR of ~18%/~38% over FY2023-FY2026E. At the CMP, the stock trades at ~37x its FY2025E EPS. We roll forward our estimates to FY2026E EPS and maintain our BUY rating on the stock with a revised price target (PT) of Rs. 1,490.

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	9,471	11,197	13,191
OPM (%)	6.2%	7.0%	7.4%	7.9%
Adjusted PAT	261	416	535	683
Adj. EPS	13.5	21.6	27.8	35.4
Growth (YoY) %	55.6	59.5	28.6	27.6
P/E	95.5	59.9	46.6	36.5
P/B	18.7	16.4	13.7	11.0
EV/EBITDA	49.3	35.4	27.9	22.1
ROE (%)	22.2%	29.2%	32.1%	33.4%
ROCE (%)	25.7%	32.4%	38.9%	42.4%

Source: Company; Sharekhan estimates

Key conference call highlights

Revenue: The company reported significant growth due to festive demand. Moreover, demand for room air conditioners in Tier 3, 4, 5 towns continues to outperform.

EMP Division: Demand in commercial air conditioning systems continues to grow due to increased demand from Tier-3 and Tier-4 cities. Delay in order finalisation in the commercial building sector has continued, while inquiries and order inflows from factory and data centres continue to remain healthy. The company continues to improve its global footprint, apart from growing in the Middle East and Africa. The company is in the process of getting approval for commercial air conditioning products for Europe and North America markets.

Unitary Products Division: The room AC business witnessed strong growth supported by strong festive sales. The commercial refrigeration business also witnessed significant growth, led by strong demand for deep freezers, modular cold rooms, and growing investments in the warehousing and logistics sector.

Outlook: Despite subdued rainfall, the company continued to witness strong demand from Tier 3, 4, 5 markets. Management believes India is going to be the fastest-growing market for RAC.

Competition Intensity: Management expects competition to be intense in the air conditioning market; however, the company expects its market share to improve to 15% by FY2025 from 13.75% currently.

Order book: The company's carried-forward order book stood at a record Rs. 6,038 crore; Carried-forward order book of the electro-mechanical projects business grew 26.1% to Rs. 4,648 crore. Management expects the order book to be executed in 24 months.

Capex: The company plans to incur capex of Rs. 250-350 crore for at least the next two to three years. The company plans to do capital expenditure for building manufacturing capacities, product development, and digitalisation.

Exports: The company expects to generate USD500 million of business from the international market over the next three years.

Debt: The company's net cash position stood at Rs. 157 crore in Q3FY2024 as compared to net borrowing of Rs. 396 crore in Q3FY2023.

Results (Consolidated)

Particulars	Q3FY24	Q3FY23	YoY (%)	Q2FY24	QoQ (%)
Net Sales	2,241	1,794	24.9	1,890	18.6
Operating profit	155	111	40.4	123	26.6
Other Income	13	5	145.5	13	-2.2
Interest	10	14	-26.4	18	-42.0
Depreciation	23	16	51.1	23	2.1
PBT	134	86	55.5	95	41.4
Tax	34	22	56.8	24	39.9
Reported PAT	100	64	55.9	71	42.1
Adjusted PAT	100	64	55.9	71	42.1
Adj. EPS (Rs.)	5.2	3.3	55.9	3.7	42.1
Margin			BPS		BPS
OPM (%)	6.9	6.2	76.4	6.5	44.3
NPM (%)	4.5	3.6	89.1	3.7	74.1
Tax rate (%)	25.3	25.1	20.6	25.5	(27.9)

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - 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% and 16% in value and volume terms, respectively, over FY2015-FY2020. However, FY2021 and FY2022 were adversely impacted due to 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.

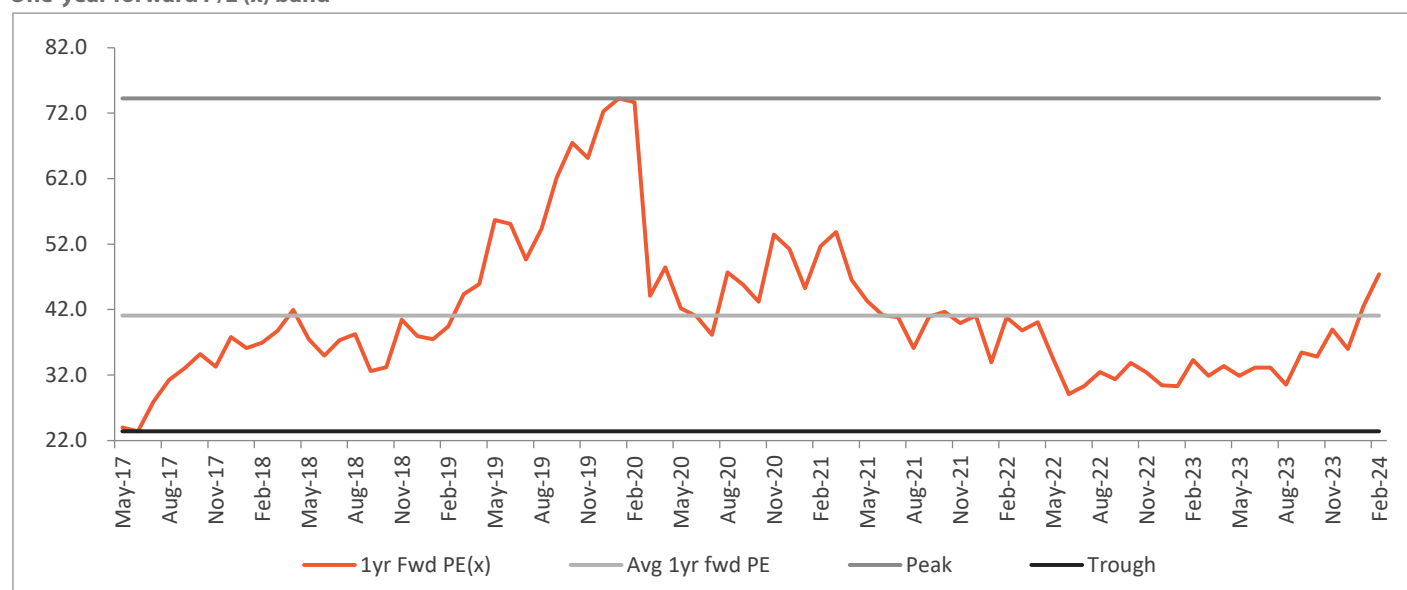
■ Company outlook - Long-term growth opportunities intact

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 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 - Maintain Buy with a revised PT of Rs. 1,490

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 the robust order book and continued traction in order inflows in domestic and international markets. We expect revenue/adjusted PAT to post a CAGR of ~18%/~38% over FY2023-FY2026E. At the CMP, the stock trades at ~37x its FY2025E EPS. We roll forward our estimates to FY2026E EPS and maintain our BUY rating on the stock with a revised PT of Rs. 1,490.

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, 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 end-to-end solutions 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%, and 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 poses 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 Ltd	7.87
2	Kotak Mahindra Asset Management Co	6.18
3	Axis Asset Management Co Ltd/India	3.04
4	Vanguard Group Inc/The	2.27
5	GOVERNMENT PENSION FUND - GLOBAL	1.91
6	Norges Bank	1.91
7	Nippon Life India Asset Management	1.18
8	T Rowe Price Group Inc	1.15
9	FIL Ltd	1.1
10	Fidelity Funds - India Focus Fund	1.04

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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