Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Blue Star Ltd

Healthy Margins, Premium valuations

Capital Goods	Sharekhan code: BLUESTARCO

Reco/View: Hold ↓	CMP: **Rs. 1,616**	Price Target: **Rs. 1,772** ↑

↑ 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		↔	

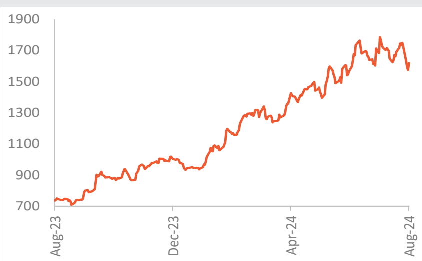
Company details

Market cap:	Rs. 31,140 cr
52-week high/low:	Rs. 1,906/702
NSE volume: (No of shares)	0.84 lakh
BSE code:	500067
NSE code:	BLUESTARCO
Free float: (No of shares)	12.96 cr

Shareholding (%)

Promoters	36.5
FII	17.1
DII	23.6
Others	22.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-9.3	14.1	39.0l	120.0
Relative to Sensex	-8.0	7.3	29.6	99.1

Sharekhan Research, Bloomberg

Summary

- Q1FY25 revenues grew by 28.7% to Rs 2,865 crore in line with our estimate of Rs 2,895 crore. Unitary products segment (room ACs and commercial refrigeration) grew by 44% to Rs 1,729 crore on increased demand due to soaring temperatures and a harsh summer. EMP sales grew by 9% to Rs 1039 crore.
- Operating profits rose by 64% to Rs 237.8 crore leading driving up margins by 178.9 bps. Adjusted PAT grew by 102% led by higher other income and a lower tax outgo.
- Export sales are expected to increase gradually and Blue Star guided for a growth of only 7-8% in FY25.
- Stock currently trades at 51x/38x to FY25/FY26 EPS respectively. We downgrade our rating to Hold with a PT of Rs. 1,772 given the premium valuations.

Consolidated revenue increased 28.7% y-o-y to Rs. 2,865 crore, led by 44% y-o-y growth in unitary products revenue, while EMP and professional electronics and industrial systems segments reported a 9%/23% y-o-y revenue growth. The Unitary product segment had a huge growth due to soaring temperature and harsh summer. The EMP segment 9% growth was aided by high commercial air conditioner orders carrying high margins. Consolidated OPM improved to 8.3% (up 178 bps y-o-y), led by EMP (EBIT margin up 290bps y-o-y to 9.9%) and Unitary product (EBIT margins up 170bps y-o-y to 9.2%). Overall, consolidated operating profit/net profit grew 64% y-o-y/102% y-o-y to Rs. 238 crore/Rs. 169 crore. The company's carried-forward order book grew 14% y-o-y to Rs. 6,080 crore.

Key positives

- Unitary product segment grew by 44% with EBIT margin improvement of 170 bps y-o-y.
- EMP revenues rose by 9% y-o-y, with EBIT margin expansion of 290bps y-o-y.
- Carried-forward order book grew by 14% y-o-y to Rs. 6,080 crore.
- Company took a price of hike of 3% to substantiate commodity price hike.

Key negatives

- Slowdown in infrastructure orders due to elections.

Management Commentary

- Commercial AC business saw incremental demand from the manufacturing and retail segment.
- Expanded the product range with launch of Chillers for data center. The company expect huge demand for Chiller and EMP going forward.
- The company plans to incur capex at 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.
- Net cash position stood at Rs. 1000 crore due to increase in collections in Q1FY25.

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

Our Call

Valuation – Hold with a PT of Rs. 1,772: 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 the US and Europe. We expect revenue/adjusted PAT to post a CAGR of ~18%/~28% over FY2023-FY2026E. At the CMP, the stock trades at ~51x/38x to its FY25/26 EPS, respectively. Given premium valuations, we downgrade our rating to Hold and value the company on segment wise SOTP basis on FY26E EPS for a target price of Rs 1,772.

Key Risks

An increase in input costs could stress margins. Intense competition across segments is a key concern.

Valuation (Consolidated) Rs cr

Valuations	FY23	FY24E	FY25E	FY26E
Net Sales	7,977	9,686	11,973	14,490
OPM (%)	6.2%	6.9%	7.4%	8.0%
Adjusted PAT	261	414	611	817
Adj. EPS	13.5	21.5	31.7	42.4
Growth (YoY) %	55.6	58.8	47.5	33.7
P/E	119.4	75.2	51.0	38.1
P/B	23.4	11.9	10.4	8.7
EV/EBITDA	61.2	43.7	27.9	22.1
ROE (%)	22.2%	21.0%	21.8%	24.9%
ROCE (%)	25.7%	26.2%	28.3%	32.5%

Source: Company; Sharekhan estimates

Key conference call highlights

- **Revenue:** The company reported significant growth on a harsh summer. . Moreover, demand for room air conditioners in Tier 3, 4, 5 towns continue to outperform.
- **EMP Division:** Management guided for a growth of 20-25% with EBIT margins in the range of 8-8.5%.
- **Unitary Products Division:** The room AC business witnessed strong growth supported due to soaring temperature. Blue star market share remains at 13.75% and targets to reach 15% by 2025.
- **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.
- **Capex:** The company plans to incur a 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.

Results (Consolidated) Rs cr

Particulars	Q1FY25	Q1FY24	YoY (%)	Q4FY24	QoQ (%)
Net Sales	**2,865**	**2,226**	**28.7**	**3,327**	**-13.9**
Operating profit	**238**	**145**	**64.0**	**241**	**-1.4**
Other Income	24	9	152.9	12	91.8
Interest	8	18	-57.6	12	-37.3
Depreciation	28	23	22.9	28	-1.1
PBT	**226**	**114**	**98.9**	**213**	**6.1**
Tax	57	30	89.4	54	5.2
Reported PAT	**169**	**83**	**102.4**	**157**	**7.7**
Adjusted PAT	**169**	**83**	**102.4**	**157**	**7.7**
Adj. EPS (Rs.)	**8.2**	**4.3**	**89.6**	**8.1**	**0.8**
Margin			**BPS**		**BPS**
OPM (%)	8.3	6.5	178.6	7.2	105.2
NPM (%)	5.9	3.7	214.2	4.7	117.7
Tax rate (%)	25.3	26.6	(127.4)	25.5	(20.5)

Source: Company Data

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 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 to 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 & beverage industries, the opening of shops, malls & 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.

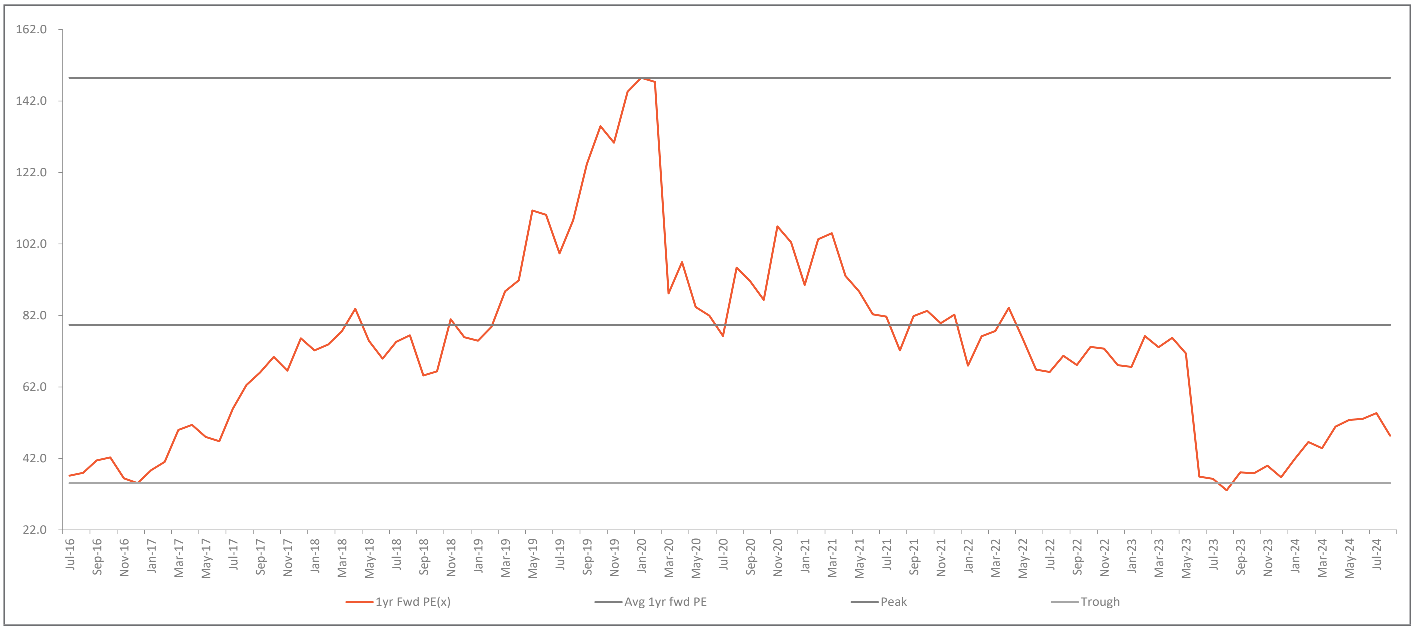
■ Company Outlook – Long-term growth opportunities intact

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 – Hold with a PT of Rs. 1,772

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 the US and Europe. We expect revenue/ adjusted PAT to post a CAGR of ~18%/~28% over FY2023-FY2026E. At the CMP, the stock trades at ~51x/38x to its FY25/26 EPS, respectively. Given premium valuations, we downgrade our rating to Hold and value the company on segment wise SOTP basis on FY26E EPS for a target price of Rs 1,772.

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 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	6.16
2	Kotak Mahindra Asset Management Co	6.14
3	Axis Asset Management Co Ltd/India	2.99
4	Government Pension Fund - Global	2.08
5	Norges Bank	1.92
6	Vanguard Group Inc/The	1.69
7	FIL Ltd	1.58
8	Fidelity Funds - India Focus Fund	1.29
9	BlackRock Inc	1.04
10	Nippon Life India Asset Management	1.03

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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