

Disappointing results, Reiterate Underperform

Blue Star (BS) reported 3QFY11 sales of Rs. 6bn, up 4% yoy, 13% below our expectation. Persistent weakness in the Electro mechanical projects (EMP) more than offset the 35% growth in Cooling Products. EBITDA margin contracted by 270bps yoy and 125bps qoq to 6.7%, due to weak revenue momentum and higher input cost. Effective tax rate increased to 29% as compared to 24% in FY10 due to expiration of tax shelters resulting in a PAT of Rs. 224mn a 37% drop yoy. Incorporating the 3Q's poor performance, we have downgraded our FY11E & FY12E PAT estimates by 15% and 7%.

Our thesis on oversupply in commercial realty, vulnerability of fixed cost contracts (at competitive rates) to rising commodity prices and deteriorating working capital burdening profits & capital efficiency, has been clearly panning out for the last couple of quarters – witnessed by deteriorating performance and plunge in stock price (27% in 3M). Although on absolute basis our TP of Rs. 371 (15x FY12E earnings) provides an upside of 9% on CMP driving us to change our absolute rating to ADD, the stock would continue to underperform owing to multiple headwinds – ongoing earnings downgrades, gloomy outlook in project biz, and worsening capital efficiency (RoCEs 51% in FY09 to 23% in FY12E).

Key takeaways from the post results conference call

- **EMP – Tardy execution, gloomy outlook:** Segment sales de-grew by 4.9% yoy on delays from customers and slow down in execution from BS as receivables stretch. EBIT margin contracted by 411bps to 6.7% on the back of low revenue and higher input costs. Commercial realty (50% of project book) continues to be a laggard and recovery is a year away, in our view. While there was some pick up in enquiries in Sept'10, the enquiry levels have subsided now. Further, the company has raised its margin and WC threshold for bidding which would further restrain inflows, good for long term though. Inflows in project biz declined by ~5% yoy leading to an order book of Rs. 21bn (BTB 1.1x FY11E)
- **Cooling products continues to stand tall:** Cooling product division continues to contribute positively with revs growing 35% yoy to Rs. 1.2bn. However, EBIT margin contracted by 75bps yoy to 7.9% despite 2% price hike, due to high competition and increasing RM cost.
- **High Debt levels amidst rising interest cost environment:** Current debt of ~Rs. 3.5bn (Rs. 800mn for D.S Gupta) implies a D/E of 0.6x. Given the rising trend in working capital (Cap employed up ~20% vs. rev growth of 4% yoy), debt levels are likely to remain high despite management efforts to be selective in new orders

Financial summary (Consolidated – *including DS Gupta)

Year	Revenue (Rs. mn)	EBITDA (Rs. mn)	PAT (Rs. mn)	EPS (Rs.)	P/E(x)	EV/EBITDA
FY10	25,250	2,747	2,008	22.33	15.2	11.1
FY11E*	30,114	2,653	1,774	19.72	17.2	11.7
FY12E*	36,334	3,408	2,226	24.75	13.7	9.0

3QFY11 Update

Date: Feb 02, 2011

Market Data

SENSEX	18091
Nifty	5432
Bloomberg	BLSTR IN
Shares o/s	90mn
Market Cap	Rs. 31bn
52-wk High-Low	Rs. 554-328
3m Avg. Daily Vol	Rs. 22mn
Index member	BSE 500

Latest shareholding (%)

Promoters	40
Institutions	19
Public	41

Stock performance (%)

	1m	3m	12m
BLSTR	-24%	-27%	-11%
Sensex	-12%	-12%	9%
CG Index	-14%	-20%	0%

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Quarterly Financial Results

CMP	Rs. 340	Absolute	ADD
Target	Rs. 371	Relative	Underperform

Quarterly financial results (Standalone)

Rs. mn\Period	31-Dec-10	31-Dec-09	yoy Growth	30-Sep-10	qoq Growth	FY10	FY11E	yoy Growth
Revenues	6,068	5,862	3.5%	6,818	-11.0%	25,250	28,514	12.9%
Cost of Goods Sold	4,641	4,491	3.4%	5,307	-12.5%	18,821	21,899	16.4%
Employee Costs	520	430	20.9%	508	2.3%	1,849	2,025	9.5%
Other expense	501	390	28.5%	461	8.7%	1,833	2,082	13.5%
Total operating expense	5,661	5,310	6.6%	6,275	-9.8%	22,503	26,005	15.6%
EBITDA	407	552	-26.3%	542	-25.0%	2,747	2,509	-8.7%
<i>Margins</i>	6.7%	9.4%	-271 bps	8.0%	-125 bps	10.9%	8.8%	-208 bps
Depreciation	80	88	-8.4%	79	1.9%	347	317	-8.6%
EBIT	327	464	-29.7%	464	-29.5%	2,400	2,192	-8.7%
Other income	66	28	132.7%	146	-54.7%	311	375	20.4%
Interest expense	79	23	248.5%	49	62.4%	85	190	124.8%
PBT (underlying)	314	470	-33.3%	561	-44.1%	2,627	2,377	-9.5%
Exceptional items	0	87.3	nm	0	nm	140	4	-96.9%
PBT	314	557	-43.7%	561	-44.1%	2,766	2,381	-13.9%
Tax	90	134	-32.9%	174	-48.4%	651	700	7.5%
effective tax rate %	29%	24%	462 bps	31%	-240 bps	24%	29%	586 bps
PAT (Reported)	224	423	-47.2%	386	-42.1%	2,115	1,681	-20.5%
PAT (Adjusted)	224	357	-37.4%	386	-42.1%	2,008	1,678	-16.4%
Margins %	4%	6%	-240 bps	6%	-198 bps	8%	6%	-207 bps
Adj. EPS (Rs.)	2.5	4.0	-37.4%	4.3	-42.1%	22.3	18.7	-16%

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Segment Analysis (Standalone)

Rs. mn\Period	31-Dec-10	31-Dec-09	yoy Growth	30-Sep-10	qoq Growth	FY09	FY10	yoy Growth
Revenues								
Electro Mech. Projects	4,342	4,567	-4.9%	4,704	-7.7%	17,331	17,940	3.5%
Cooling Products	1,278	948	34.8%	1,439	-11.2%	5,975	5,830	-2.4%
Professional Electronics	448	346	29.3%	674	-33.6%	1,721	1,480	-14.0%
Total	6,068	5,862	3.5%	6,818	-11.0%	25,026	25,250	0.9%
EBIT								
Electro Mech. Projects	292	495	-40.95%	444	-34.2%	2,182	2,126	-2.6%
Cooling Products	101	82	23.1%	165	-38.4%	754	835	10.8%
Professional Electronics	117	88	33.3%	163	-28.2%	383	457	19.3%
EBIT Margins (%)								
Electro Mech. Projects	6.7%	10.8%	-411 bps	9.4%	-272 bps	13%	12%	-74 bps
Cooling Products	7.9%	8.7%	-75 bps	11.5%	-352 bps	13%	14%	171 bps
Professional Electronics	26.1%	25.3%	77 bps	24.1%	195 bps	22%	31%	861 bps

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Business Overview

CMP

Rs. 340

Absolute

ADD

Target

Rs. 371

Relative

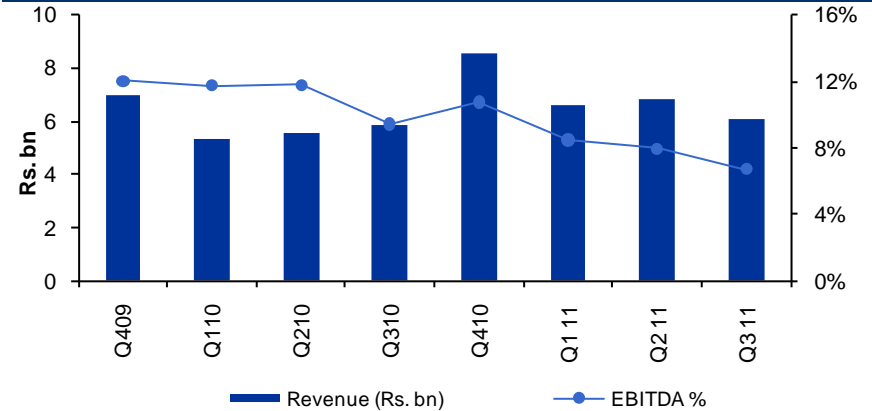
Underperform

Key estimate revision (cons. including DS Gupta)

	FY11E			FY12E		
	Old	New	Change	Old	New	Change
Revenue	31,836	30,114	-5%	37937	36,334	-4%
EBITDA	3,077	2,653	-14%	3740	3,408	-9%
Margin (%)	9.7%	8.8%		9.9%	9.4%	
PAT	2,088	1,774	-15%	2,387	2,226	-7%
PAT Margin	6.6%	5.9%		6.3%	6.1%	
EPS	23.22	19.72	-15%	26.54	24.75	-7%

All figures in Rs. mn, except EPS, which is in Rs.

Revenues and margins on a downward trend



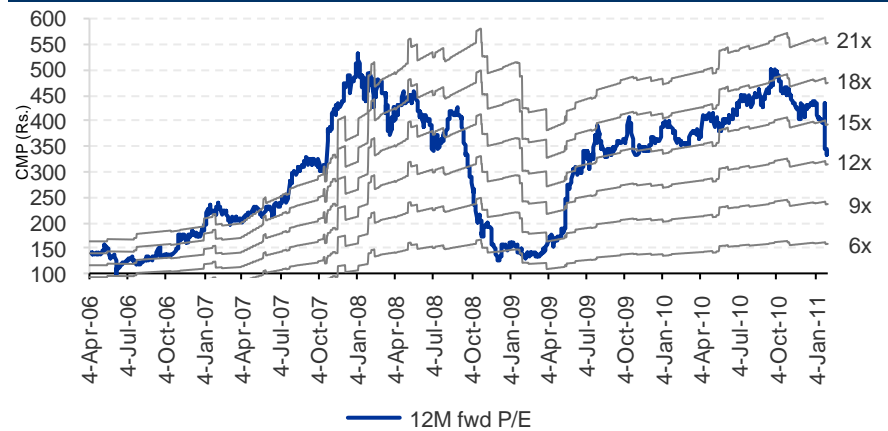
Source: Bloomberg, Spark Capital Research

Constrained inflows, flattish order book



Source: Company data, Spark Capital Research

P/E trend (1yr forward Bloomberg estimate)



Source: Bloomberg, Spark Capital Research

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Financial Summary

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Abridged Financial Statements				
Rs. mn	FY09	FY10	FY11E	FY12E
Profit & Loss				
Revenues	25,026	25,250	28,514	34,534
EBITDA	2,596	2,747	2,509	3,246
Depreciation	259	347	317	328
EBIT	2,337	2,400	2,192	2,918
Other Income	218	451	379	425
Interest	173	85	190	360
PBT	2,382	2,766	2,381	2,983
Net Profit	1,803	2,115	1,681	2,118
Adjusted Net Profit	1,803	2,008	1,678	2,118
Balance Sheet				
Shareholders Equity	3,671	4,917	5,598	6,611
Total debt	273	89	3,000	3,000
Total Netw orth & Liabilities	3,950	5,006	8,598	9,611
Net fixed assets	1,876	1,977	1,809	1,681
CWIP	248	16	116	166
Investments	44	42	1,083	1,083
Current assets	10,379	13,928	17,673	21,073
Current liabilities	8,602	10,971	12,097	14,406
Net current assets	1,777	2,957	5,576	6,667
Total Assets	3,950	5,006	8,598	9,611
Cash Flows				
Cash flow s from Operations	1,697	1,070	374	1,197
Cash flow s from Investing	(808)	(112)	(912)	175
Cash flow s from Financing	(860)	(920)	1,911	(1,105)
Cash Generated	30	38	1,373	267
Opening Cash	27	92	132	1,506
Closing Cash	92	132	1,506	1,772

Key metrics				
	FY09E	FY10	FY11E	FY12E
Growth ratios (%)				
Sales	12.7%	0.9%	12.9%	21.1%
EBITDA	16.4%	5.8%	-8.7%	29.4%
Adj. Net Profit	21.5%	11.4%	-16.4%	26.2%
Margin ratios (%)				
EBITDA	10.4%	10.9%	8.8%	9.4%
EBIT	9.3%	9.5%	7.7%	8.4%
Adj. Net Profit	7.2%	8.0%	5.9%	6.1%
Performance ratios				
RoA (%)	51.6	44.8	24.7	23.3
RoE (%)	57.2	46.8	31.9	36.5
RoCE (%)	50.9	41.0	22.7	22.8
Sales / Total Assets (x)	7.16	5.64	4.19	3.79
Fixed Assets Turnover (x)	13.6	12.3	14.6	18.3
Financial stability ratios				
Total Debt to Equity (x)	0.07	0.02	0.54	0.45
Inventory & Debtor days	119.1	180.3	190.0	190.0
Creditor days	125.5	158.6	140.0	140.0
Valuation metrics				
Current Share Price (Rs.)	340			
Market Cap (Rs.mn)	30,578	30,578	30,578	30,578
Fully Diluted Shares (mn)	90	90	90	90
Adjusted EPS (Rs.)	20.0	22.3	18.7	23.5
P/E (x)	17.0	15.2	18.2	14.4
EV (Rs.mn)	30,715	30,493	30,990	30,723
EV to Sales (x)	1.2	1.2	1.1	0.9
EV/ EBITDA (x)	11.8	11.1	11.7	9.0
Dividend Yield (%)	2.06	2.35	2.79	3.09

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Absolute Rating Interpretation

BUY	Stock expected to provide positive returns of > 15% over a 1-year horizon
ADD	Stock expected to provide positive returns of <=15% over a 1-year horizon
REDUCE	Stock expected to fall <=15% over a 1-year horizon
SELL	Stock expected to fall >15% over a 1-year horizon

Relative Rating Interpretation

OUTPERFORM	Stock expected to outperform sector index /sector peers in our coverage
UNDERPERFORM	Stock expected to underperform sector index/ sector peers in our coverage

Recommendation History

Date	CMP	Target price	Absolute Rating	Relative Rating
6-Jan-11	435	398	Reduce	U-PF
14-Dec-10	424	398	Reduce	U-PF
3-Nov-10	458	398		U-PF
8-Oct-10	477	342		U-PF
30-Jul-10	440	342		U-PF

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