

February 2, 2011

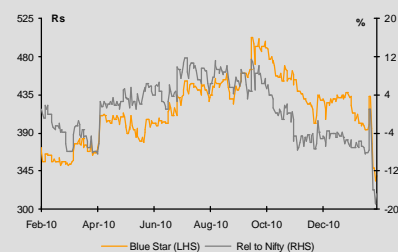
Reco	Previous Reco
Buy	Accumulate
CMP	Target Price
Rs340	Rs455
EPS change FY11E/12E (%)	-9 / -9
Target Price change (%)	-11
Nifty	5,432
Sensex	18,091

Price Performance

(%)	1M	3M	6M	12M
Absolute	(22)	(26)	(21)	(8)
Rel. to Nifty	(11)	(17)	(21)	(18)

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

Sector	Engineering & Capital Goods
Bloomberg	BLSTR@IN
Equity Capital (Rs mn)	180
Face Value(Rs)	2
No of shares o/s (mn)	90
52 Week H/L	554/328
Market Cap (Rs bn/USD mn)	31/679
Daily Avg Volume (No of sh)	55964
Daily Avg Turnover (US\$m)	0.5

Shareholding Pattern (%)

	D'10	S'10	J'10
Promoters	40.1	40.1	40.1
FII/NRI	9.7	9.5	9.0
Institutions	11.0	10.6	10.0
Private Corp	5.9	6.2	6.7
Public	33.3	33.7	34.3

Source: Capitaline

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- **Blue Star reports weakest performance of last 16 quarters - net profits decline 33% yoy to Rs224 mn – led by low revenue growth of 4% yoy to Rs6.1 bn**
- **Gross margins improve 60 bps yoy – pointing at negative impact of operating leverage on Ebidta margins, resulting in 210 bps decline in Ebidta margins**
- **Revise earning estimates by -9% - Revised earnings of Rs20.2/Share and Rs26.0/Share for FY11E and FY12E respectively**
- **Post 20% price correction in past week, stock trades at 13X FY12E. Upgrade from 'Accumulate' to Buy' with revised target price Rs455/Share**

Net profit decline 33% yoy to Rs224 mn – Weakest performance of last 16 quarters

Blue Star (BLSR) reported its weakest performance of last 16 quarters in Q3FY11 - reported 33% yoy decline in net profits to Rs224 mn. This was attributed to (1) Low revenue growth at 4% yoy to Rs6.1 bn – led by 5% yoy decline in EMP&PAC segment (2) 210 bps yoy drop in EBIDTA margins, influenced by operating leverage (3) jump in interest costs (up 249% yoy to Rs79 mn).

EMP& PAC segment performance was impacted by slowdown in execution on projects in Infrastructure sector & commercial sector, delayed recovery in IT sector and lower billing by BLSR in few projects (in view of pending dues). However, Cooling Products and PEIS registered strong growth at +35% yoy and +29% yoy respectively.

...But gross margins improve 60 bps yoy – pointing at negative impact of operating leverage on Ebidta margins

Q3FY11 performance remains below expectation, but certainly not impacted by the input costs. Gross margins at company level, remain intact at 24% - improve 60 bps on yoy basis from 23.7% to 24.3%. Further, the sequential increase in fixed costs (employee and others) was nominal at 5.3% → hence, impact on EBIDTA margins (down 210 bps yoy) were led by muted revenue growth and corresponding impact of operating leverage.

Order accretion at Rs6.8 bn, Order book at Rs20.1 bn

Order accretion stood at Rs6.8 bn (up 7% yoy) – below estimates. Major orders bagged include (1) Power sector – Indu Projects (500MW), Reliance Infrastructure (2x300MW) (2) Integrated MEP – Godrej group, Chandigarh, (3) HVAC orders - Infosys, DLF, HCL, Volkswagen, Hindalco. Consequently order book increased to Rs20.1 bn (up 5% qoq and 11% yoy). Considering, inflows YTD, the implied run-rate for Q4FY11 is Rs9.9 bn → which management believes is achievable.

Financial Snapshot

YE-	Net	EBITDA		EPS	EPS	RoE	EV/			
Mar	Sales	(Core)	(%)	APAT	(Rs)	% chg	(%)	P/E	EBITDA	P/BV
FY09	25,026	2,823	11.3	1,829	20.3	29.5	58.2	22.3	15.9	11.1
FY10	25,250	2,935	11.6	1,999	22.2	9.3	46.6	20.4	14.9	8.3
FY11E	29,826	3,368	11.3	2,249	25.0	12.5	40.2	18.2	12.7	6.5
FY12E	35,410	3,966	11.2	2,662	29.6	18.4	37.6	15.3	10.5	5.2

Quarterly Results

Rs mn	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	YoY (%)	QoQ (%)	YTD'11	YTD'10	Gr (%)
Revenue	5,887	8,747	6,648	6,948	6,134	4.2	-11.7	19,730	16,833	17.2
Expenditure	5,310	7,628	6,040	6,275	5,661	6.6	-9.8	17,976	14,970	20.1
Consumption of RM	4,491	6,441	5,043	5,307	4,641	3.4	-12.5	14,991	12,509	19.8
as % of sales	76.3	73.6	75.9	76.4	75.7			76.0	74.3	
Employee Cost	430	481	473	508	520	20.9	2.3	1,501	1,368	9.7
as % of sales	7.3	5.5	7.1	7.3	8.5			7.6	8.1	
Other expenditure	390	705	523	461	501	28.5	8.7	1,485	1,093	35.8
as % of sales	6.6	8.1	7.9	6.6	8.2			7.5	6.5	
EBITDA	578	1,120	609	672	473	-18.1	-29.7	1,754	1,863	-5.8
Depreciation	88	91	76	79	80	-8.2	1.9	235	256	-8.4
EBIT	490	1,029	533	593	392	-19.9	-33.9	1,519	1,606	-5.4
Other Income	3	27	4	16	0	-90.0	-98.1	20	40	-49.8
Interest	23	25	20	49	79	248.5	62.4	148	50	195.6
PBT	470	1,030	517	561	314	-33.3	-44.1	1,392	1,597	-12.8
Total Tax	134	245	150	174	90	-32.9	-48.4	414	407	1.9
Adjusted PAT	336	785	367	386	224	-33.5	-42.1	977	1,190	-17.9
Extra ordinary items	87	0	4	0	0	-100.0	NA	4	140	-96.9
Reported PAT	423	785	372	386	224	-47.2	-42.1	982	1,330	-26.2
Adjusted EPS	3.7	8.7	4.1	4.3	2.5	-33.5	-42.1	10.9	13.2	-17.9

Margins (%)						(bps)	(bps)			(bps)
EBIDTA	9.8	12.8	9.2	9.7	7.7	-210	-200	8.9	11.1	-220
EBIT	8.3	11.8	8.0	8.5	6.4	-190	-210	7.8	9.8	-200
EBT	8.0	11.8	7.8	8.1	5.1	-290	-300	7.1	9.5	-240
PAT	5.7	9.0	5.5	5.6	3.6	-210	-190	5.0	7.1	-210
Effective Tax rate	28.5	23.8	29.0	31.1	28.7	20	-240	29.8	25.5	430

BLSR changes strategy – to increase focus on residential market

W.e.f Jan'11, BLSR would increase focus on the residential room air-conditioners (RAC) market (so far focused largely on commercial RAC market). The idea is to participate in 30% CAGR residential RAC market and improve the growth trajectory of Cooling Products division. Towards this end, BLSR has launched a new range of split air-conditioners, which will be distributed through reputed retail chain in select cities alongside current dealer network. BLSR expects share of residential RAC to increase from about 25% to 50% of total RAC revenues (under Cooling Products).

Earning revision of -9% - unnerved by high asking rate in Q4FY11E

With lower-than expected performance for YTD 2011 and Q3FY11 specifically, we have revised our assumptions on bookings in EMP & PAC segment and company-level Ebitda margins. Consequently, we have revised earning estimates for FY11E and FY12E by -9% to Rs20.2/Share and Rs26.0/Share respectively.

Post earnings revision, FY11E earnings estimates factor implied earnings for Q4FY11E at Rs9.3/Share (up 7% yoy and 46% of FY11E earnings). This is higher-end of consensus estimates. Considering stable gross margins in YTD 2011, we remain relatively confident on BLSTR meeting our FY11E estimates (though being higher than consensus).

Revision in Earning Estimates

Y/E, Mar (Rs. mn)	FY11E			FY12E		
	Earlier	Revised	% Change	Earlier	Revised	% Change
Revenues	30,781	29,628	-3.7	37,468	36,011	-3.9
EBITDA	3,315	3,066	-7.5	4,117	3,843	-6.6
EBITDA Margin (%)	10.8	10.3	-40 bps	11.0	10.7	-30 bps
APAT	1,992	1,814	-8.9	2,562	2,341	-8.6
EPS (Rs)	22.2	20.2	-8.9	28.5	26.0	-8.6

Upgrade to BUY with revised price target of Rs455

We continue to maintain a positive bias on Blue Star. Post the recent price correction (stock has corrected +21% in the past week and 39% since Sep'10 peak), the stock is attractively valued at 16.9X FY11E and 13.1X FY12E earnings. We upgrade rating from 'Accumulate' to 'BUY' with revised target price of Rs455 per share (@ 17.5X FY12E earnings).

Quarterly Segmental Results

Rs mn	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	YoY (%)	QoQ (%)	YTD'11	YTD'10	Gr (%)
Segment Revenues										
EMP & PAC	4,567	6,130	3,742	4,705	4,342	-4.9	-7.7	12,788	11,892	7.5
Cooling Products	948	1,869	2,534	1,431	1,278	34.8	-10.7	5,243	3,967	32.2
PEIS	346	547	323	674	448	29.3	-33.6	1,445	931	55.3
Less: Intersegment Rev.	0	0	0	0	0	-	-	0	0	-
Total	5,862	8,546	6,598	6,810	6,068	3.5	-10.9	19,476	16,790	16.0
Segment Results										
EMP & PAC	495	790	340	444	292	-41.0	-34.2	1,077	1,314	-18.0
Cooling Products	82	287	352	165	101	23.1	-38.4	618	564	9.7
PEIS	88	198	55	183	117	33.4	-36.2	354	257	37.9
Total	665	1,276	747	792	510	-23.2	-35.6	2,049	2,134	-4.0
Add- Unall Income / (Exp)	-172	-221	-210	-182	-118	-	-	-510	-436	-
Less- Interest Exp	23	25	20	49	79	248.5	62.4	20	40	-49.8
PBT	470	1,030	517	561	314	-33.3	-44.1	2,539	2,530	0.4
Segment Capital Employed										
EMP & PAC	4,219	4,107	4,971	5,542	5,256	24.6	-5.2	5,256	4,219	24.6
Cooling Products	830	1,055	1,005	1,275	1,113	34.1	-12.7	1,113	830	34.1
PEIS	437	432	534	497	638	46.1	28.4	638	437	46.1
Unallocated	-509	152	-394	-1,639	-1,109	117.7	-32.4	-1,109	-509	117.7
Total	4,976	5,745	6,116	5,675	5,898	18.5	3.9	5,898	4,976	18.5
Segment Margins (%)										
EMP & PAC	10.8	12.9	9.1	9.4	6.7	-410	-270	8.4	11.0	-260
Cooling Products	8.7	15.4	13.9	11.5	7.9	-80	-360	11.8	14.2	-240
PEIS	25.3	36.2	16.9	27.1	26.1	80	-110	24.5	27.6	-310
Average	11.3	14.9	11.3	11.6	8.4	-290	-320	10.5	12.7	-220

Note - EMP & PAC - Electro Mechanical Projects & Packaged Air-conditioners

PEIS - Professional Electronics & Industrial Systems

Financial

Income Statement

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
Net Sales	25,026	25,250	29,628	36,011
<i>Growth (%)</i>	12.7	0.9	17.3	21.5
Expenditure	22,203	22,315	26,562	32,167
Materials Consumed	18,743	18,821	22,514	27,364
Employee Cost	1,828	1,855	2,177	2,646
Manufacturing Exp	101	103	137	167
Other Exp	1,531	1,536	1,735	1,991
EBITDA	2,823	2,935	3,066	3,843
<i>Growth (%)</i>	19.6	3.9	4.5	25.4
EBITDA margin (%)	11.3	11.6	10.3	10.7
Depreciation	259	347	326	367
EBIT	2,565	2,588	2,740	3,477
EBIT margin (%)	10.2	10.2	9.2	9.7
Other Income	16	147	42	42
Interest expenses	173	85	207	171
PBT	2,409	2,650	2,575	3,348
Tax	579	651	761	1,006
<i>Effective tax rate (%)</i>	24.1	24.6	29.6	30.1
Adjusted PAT	1,829	1,999	1,814	2,341
<i>Growth (%)</i>	29.5	9.3	-9.3	29.1
Net Margin (%)	7.3	7.9	6.1	6.5
E/O items	-26	139	4	0
Reported PAT	1,803	2,138	1,818	2,341
<i>Growth (%)</i>	3.6	18.6	-15.0	28.8

Cash Flow

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
PBT (Ex-Other income)	2,382	2,766	2,575	3,348
Depreciation	259	347	326	367
Interest Provided	173	85	207	171
Other Non-Cash items	143	35	4	0
Chg in working cap	-379	-1,278	-2,726	-997
Tax paid	-631	-732	-761	-1,006
Operating Cashflow	1,947	1,223	-375	1,882
Capital expenditure	-851	-239	-500	-500
Free Cash Flow	1,096	983	-875	1,382
Other income	-7	-3	0	0
Investments	-32	62	0	0
Investing Cashflow	-38	59	0	0
Equity Capital Raised	0	0	0	0
Loans Taken / (Repaid)	-93	-184	3,000	-1,000
Interest Paid	-172	-85	-207	-171
Dividend paid (incl tax)	-737	-737	-887	-1,067
Income from investments	0	0	0	0
Others	0	0	0	0
Financing Cashflow	-1,001	-1,005	1,906	-2,238
Net chg in cash	57	38	1,032	-856
Opening cash position	27	92	132	1,164
Closing cash position	83	130	1,164	309

Balance Sheet

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
Equity share capital	180	180	180	180
Reserves & surplus	3,491	4,737	5,668	6,943
Net worth	3,671	4,917	5,848	7,123
Secured Loans	273	89	3,089	2,089
Unsecured Loans	0	0	0	0
Loan Funds	273	89	3,089	2,089
Net deferred tax liability	6	-15	-15	-15
Total Liabilities	3,950	4,991	8,923	9,198
Gross Block	3,325	3,519	4,019	4,519
Less: Depreciation	1,449	1,542	1,868	2,235
Net block	1,876	1,977	2,151	2,284
Capital work in progress	248	16	16	16
Investment	44	42	42	42
Current Assets	10,379	13,928	17,972	20,244
Inventories	2,081	2,580	3,384	4,113
Sundry debtors	6,086	6,282	8,474	10,300
Cash & bank balance	92	132	1,164	309
Loans & advances	1,255	1,324	1,919	2,333
Other current assets	865	3,609	3,031	3,190
Current Lia & Prov	8,602	10,971	11,257	13,388
Current liabilities	7,521	9,811	10,097	12,228
Provisions	1,081	1,160	1,160	1,160
Net current assets	1,777	2,957	6,715	6,856
Misc. exp	6	0	0	0
Total Assets	3,950	4,991	8,923	9,198

Key Ratios

Y/E, Mar	FY09	FY10	FY11E	FY12E
Profitability (%)				
EBITDA Margin	11.3	11.6	10.3	10.7
Net Margin	7.3	7.9	6.1	6.5
ROCE	73.4	57.9	39.4	38.4
ROE	58.2	46.6	33.7	36.1
RoIC	81.0	61.9	43.8	42.1
Per Share Data (Rs)				
EPS	20.3	22.2	20.2	26.0
CEPS	23.2	26.1	23.8	30.1
BVPS	40.8	54.7	65.0	79.2
DPS	7.0	8.0	8.5	10.5
Valuations (x)				
PER	16.4	15.0	16.5	12.8
P/CEPS	14.3	12.8	14.0	11.1
P/BV	8.2	6.1	5.1	4.2
EV / Sales	1.2	1.2	1.1	0.9
EV / EBITDA	11.7	10.9	11.5	9.0
Dividend Yield (%)	2.1	2.4	2.6	3.2
Gearing Ratio (x)				
Net Debt/ Equity	0.0	(0.0)	0.3	0.2
Net Debt/EBITDA	0.1	(0.0)	0.6	0.5
Working Cap Cycle (days)	23.3	34.2	59.6	68.8

Recommendation History: Blue Star – BLSTR IN

Date	Reports	Reco	CMP	Target
30/12/2010	Blue Star Management Meet Update	Accumulate	430	513
03/11/2010	Blue Star Q2FY11 Result Update	Accumulate	456	543
29/07/2010	Blue Star Q1FY11 Result Update	Buy	446	464
09/07/2010	Blue Star Management Meet Update	Buy	441	464

Recent Research Reports

Date	Reports	Reco	CMP	Target
28/01/2011	Thermax Q3FY11 Result Update	Buy	664	943
21/01/2011	BHEL Q3FY11 Result Update	Buy	2,218	3,030
17/01/2011	Larsen & Toubro Q3FY11 Result Update	Buy	1,681	2,015
02/11/2010	Punj Lloyd Q2FY11 Result Update	Hold	125	132

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