

July 29, 2010

BUY

Price Rs 446	Target Price Rs 464
Sensex	17,992

Price Performance

(%)	1M	3M	6M	12M
Absolute	6	9	16	23
Rel. to Sensex	5	8	5	5

Source: Bloomberg

Stock Details

Sector	Engineering & Cap Goods
Reuters	BLUS.BO
Bloomberg	BLSTR@IN
Equity Capital (Rs mn)	180
Face Value(Rs)	2
No of shares o/s (mn)	90
52 Week H/L	464/325
Market Cap (Rs bn/USD mn)	40/856
Daily Avg Volume (No of sh)	83355
Daily Avg Turnover (US\$m)	0.7

Shareholding Pattern (%)

	J'10	M'10	D'09
Promoters	40.1	40.1	40.1
FII/NRI	9.0	9.0	7.7
Institutions	10.0	7.6	7.5
Private Corp	6.7	8.7	9.3
Public	34.3	34.6	35.4

Source: Capitaline

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- In Q1FY11, Blue Star reported revenue growth of 25% yoy to Rs6.6 bn led by strong traction in all business segments, but net profit declined by 11% yoy to Rs367 mn
- Order inflows increase 25% qoq to Rs9 bn and order book increases 14% qoq to Rs20 bn – order inflow in core business and inroads in electricals (power) and mechanical (industrial)
- Management has guided for strong growth outlook in EMP& PAC (25% growth backed by Rs20 bn order book), Cooling Products (buoyancy in room air conditioners) & PEIS
- Upside to earnings from acquisition of DS Gupta Construction. Reiterate BUY with a price target of Rs464/Share (yet to factor DS Gupta Construction)

Mixed bag – Revenues increase 25%, but net profits decline 11% yoy

In Q1FY11, Blue Star (BLSR) reported healthy revenue growth at 25.2% yoy to Rs6.6 bn (in-line with estimates) led by continued traction in all business segments – (1) EMP&PAC segment grew 18.9% yoy to Rs3.7 bn, (2) Cooling Products division grew by 33.1% yoy to Rs2.5 bn and (3) 30.9% yoy growth in PEIS division to Rs323 mn. However, reported net profit declined 10.8% yoy to Rs367 mn, against expectation of 20% yoy growth, owing to - (1) 280 bps yoy decline in EBITDA margins (versus estimate of stable margins) attributed to higher input costs, change in revenue mix and bad debt provisions of Rs20 mn and (2) high income tax rate (29.0% Vs 24.2%) – attributed to lower income-tax exemption on Himachal Pradesh unit. (Note – beginning Q1FY11, BLSR will factor provisions for bad debts on quarterly basis as against earlier policy of annual provisions in Q4 alone).

Order inflows grow 25% qoq – led by orders in core business and inroads in electricals (power sector) and mechanicals (industrials sector)

Order book grew 14% qoq to Rs19.8 bn, led by order inflows across sectors. Order inflows grew 25% qoq to Rs9.3 bn – remained ahead estimates. BLSR made good inroads in the power sector (for electrical orders) and industrial sector (for mechanical & instrumentation orders). Few orders received in the quarter are (1) 220 kV substation order from Reliance Infrastructure (2) 15 units of 33/11kV substation order from MP Electricity Board (4) Gas boosting and servicing package from Tata Steel. BLSR has been short listed for HVAC package of MIAL – to be finalised in next two weeks.

Strong growth outlook shared in Q1FY11 earnings conference call

Strong growth outlook was directed by management in the Q1FY11 earnings conference call. Segment-wise highlights are as under (1) EMP&PAC – expect 25% growth in revenue booking, based on Rs20 order backlog and project execution status (2) Cooling Products (commercial refrigeration and room air-conditioning) – both evincing strong buoyancy in market and (3) PEIS - will see traction from execution of industrial projects (mechanical and instrumentation). Overall, operating margins will remain stable in all business segments, excepting PEIS which would undergo change in revenue mix and lower margins on execution of industrial projects.

Financial Snapshot

Rs Mn

YE-	Net Sales	EBITDA (Core)	EBITDA (%)	APAT	EPS (Rs)	EPS %Chg	ROE (%)	P/E	EV/ EBITDA	P/BV
Mar										
FY09	25,026	2,823	11.3	1,829	20.3	29.5	58.2	21.9	15.6	10.9
FY10	25,250	2,935	11.6	1,999	22.2	9.3	46.6	20.0	14.6	8.1
FY11E	29,826	3,368	11.3	2,249	25.0	12.5	40.2	17.8	12.4	6.4
FY12E	35,410	3,966	11.2	2,662	29.6	18.4	37.6	15.0	10.3	5.1

Maintain our FY11E & FY12E estimates, Reiterate 'BUY'

We continue to hold positive bias on BLSR in view of (1) +95% exposure to domestic markets (2) eyeing growth beyond HVAC (mechanical) – i.e. electrical and plumbing to augment growth (3) leveraging mechanical skill-set to get industrial projects – erection or piping work in Steel & Hydrocarbons (4) strong order book at Rs20 bn, rendering adequate visibility and (5) buoyancy in room air-conditioners and commercial refrigeration. There are upsides to our earnings estimates on consolidation of the acquired business of D.S.Gupta Constructions. Until then, we maintain our earnings estimates for FY11E and FY12E at Rs25.0/Share and Rs29.6/Share respectively. We reiterate 'BUY' rating with price target of Rs464/Share (price target will be revised after factoring contribution from DS Gupta Construction).

Key Financials – Quarterly

Rs mn	Q1FY10	Q2FY10	Q3FY10	Q4FY10	Q1FY11	YoY (%)	QoQ (%)
Revenue	5,310	5,635	5,956	8,747	6,648	25.2	(24.0)
Expenditure	4,675	4,986	5,392	7,628	6,040	29.2	(20.8)
Consumption of RM	3,800	4,219	4,574	6,441	5,043	32.7	(21.7)
<i>as % of sales</i>	<i>71.6</i>	<i>74.9</i>	<i>76.8</i>	<i>73.6</i>	<i>75.9</i>		
Employee Cost	464	474	430	481	473	2.0	(1.6)
<i>as % of sales</i>	<i>8.7</i>	<i>8.4</i>	<i>7.2</i>	<i>5.5</i>	<i>7.1</i>		
Other expenditure	411	293	389	705	523	27.4	(25.8)
<i>as % of sales</i>	<i>7.7</i>	<i>5.2</i>	<i>6.5</i>	<i>8.1</i>	<i>7.9</i>		
EBITDA	635	650	564	1,120	609	(4.2)	(45.6)
Depreciation	82	87	88	91	76	(7.8)	(17.2)
EBIT	554	563	476	1,029	533	(3.6)	(48.1)
Other Income	4	33	3	27	4	(7.3)	(85.7)
Interest	15	13	9	25	20	37.9	(20.0)
PBT	543	583	470	1,030	517	(4.8)	(49.8)
Total Tax	131	141	134	245	150	14.2	(38.7)
Adjusted PAT	412	442	336	785	367	(10.8)	(53.2)
Extra ordinary items	0	52	87	0	4	NA	NA
Reported PAT	412	494	423	785	372	(9.8)	(52.7)
Adjusted EPS	4.6	4.9	3.7	8.7	4.1	(10.8)	(53.2)

Margins (%)						(bps)	(bps)
EBIDTA	12.0	11.5	9.5	12.8	9.2	(280)	-360
EBIT	10.4	10.0	8.0	11.8	8.0	(240)	-370
EBT	10.2	10.3	7.9	11.8	7.8	(240)	-400
PAT	7.8	7.8	5.6	9.0	5.5	(220)	-350
Effective Tax rate	24.2	24.2	28.5	23.8	29.0	480	520

Segmental performance

Rs mn	Q1FY10	Q2FY10	Q3FY10	Q4FY10	Q1FY11	YoY (%)	QoQ (%)
Segment Revenues							
EPM&PAC	3,147	4,178	4,628	6,130	3,742	18.9	(39.0)
Cooling Products	1,903	1,116	954	1,869	2,534	33.1	35.5
PEIS	247	337	349	547	323	30.9	(40.9)
Less: Intersegment Revenues	0	0	0	0	0	-	-
Total	5,297	5,630	5,931	8,546	6,598	24.6	(22.8)
Segment Results							
EPM&PAC	346	473	477	790	340	(1.5)	(56.9)
Cooling Products	332	149	90	287	352	6.1	22.7
PEIS	71	99	87	198	55	(22.8)	(72.5)
Total	748	721	653	1,276	747	(0.1)	(41.4)
Add- Unall Income / (Exp)	-191	-73	-86	-221	-210	-	-
Less- Interest Exp	15	13	9	25	20	37.9	(20.0)
PBT	543	636	558	1,030	517	(4.8)	(49.8)
Segment Capital Employed							
EPM&PAC	3,791	4,107	4,223	4,107	4,971	31.1	21.0
Cooling Products	1,033	1,055	937	1,055	1,005	(2.7)	(4.7)
PEIS	343	432	439	432	534	55.9	23.7
Unallocated	-492	152	284	152	-394	(19.8)	(359.6)
Total	4,675	5,745	5,883	5,745	6,116	30.8	6.4
Segment Margins (%)						(bps)	(bps)
EPM&PAC	11.0	11.3	10.3	12.9	9.1	(190)	-380
Cooling Products	17.5	13.4	9.4	15.4	13.9	(350)	-150
PEIS	28.6	29.2	24.8	36.2	16.9	(1,170)	-1940
Average	14.1	12.8	11.0	14.9	11.3	(280)	-360

Note 1 - EMP&PAC - Electro Mechanical Projects & Packaged AC

PEIS - Professional Electronics & Industrial Systems

Note 2 - Q1FY10 numbers have been restated

Key Financials

Income Statement

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
Net Sales	25,026	25,250	29,826	35,410
Growth (%)	12.7	0.9	18.1	18.7
Expenditure	22,203	22,315	26,458	31,444
Materials Consumed	18,743	18,821	22,470	26,855
Employee Cost	1,828	1,855	2,191	2,601
Manufacturing Exp	101	103	138	163
Other Exp	1,531	1,536	1,659	1,825
EBITDA	2,823	2,935	3,368	3,966
Growth (%)	19.6	3.9	14.8	17.8
EBITDA margin (%)	11.3	11.6	11.3	11.2
Depreciation	259	347	408	459
EBIT	2,565	2,588	2,960	3,507
EBIT margin (%)	10.2	10.2	9.9	9.9
Other Income	16	147	68	68
Interest expenses	173	85	47	47
PBT	2,409	2,650	2,981	3,529
Tax	579	651	733	867
Effective tax rate (%)	34.8	32.2	32.2	32.2
Adjusted PAT	1,829	1,999	2,249	2,662
Growth (%)	29.5	9.3	12.5	18.4
Net Margin (%)	7.3	7.9	7.5	7.5
E/O items	(26)	139	-	-
Reported PAT	1,803	2,138	2,249	2,662
Growth (%)	3.6	18.6	5.2	18.4

Cash Flow

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
PBT	2,382	2,766	2,981	3,529
Depreciation	259	347	408	459
Interest Provided	173	85	47	47
Other Non-Cash items	143	35	0	0
Chg in working cap	-379	-1,278	1,045	-538
Tax paid	-631	-732	-733	-867
Operating Cashflow	1,947	1,223	3,748	2,629
Capital expenditure	-851	-239	-500	-500
Free Cash Flow	1,096	983	3,248	2,129
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	0	0
Interest Paid	-172	-85	-47	-47
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	-933	-1,113
Net chg in cash	57	38	2,315	1,015
Opening cash position	27	92	132	2,447
Closing cash position	83	130	2,447	3,462

Balance Sheet

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
Equity share capital	180	180	180	180
Reserves & surplus	3,491	4,737	6,099	7,694
Net worth	3,671	4,917	6,279	7,874
Secured Loans	273	89	89	89
Unsecured Loans	0	0	0	0
Loan Funds	273	89	89	89
Net deferred tax liability	6	(15)	(15)	(15)
Total Liabilities	3,950	4,991	6,353	7,948
Gross Block	3,325	3,519	4,019	4,519
Less: Depreciation	1,449	1,542	1,950	2,409
Net block	1,876	1,977	2,069	2,110
Capital work in progress	248	16	16	16
Investment	44	42	42	42
Current Assets	10,379	13,928	15,445	18,894
Inventories	2,081	2,580	2,753	3,268
Sundry debtors	6,086	6,282	7,305	8,673
Cash & bank balance	92	132	2,447	3,462
Loans & advances	1,255	1,324	1,524	1,809
Other current assets	865	3,609	1,417	1,682
Current lia & Prov	8,602	10,971	11,218	13,113
Current liabilities	7,521	9,811	10,058	11,953
Provisions	1,081	1,160	1,160	1,160
Net current assets	1,777	2,957	4,227	5,780
Misc. exp	6.0	-	-	-
Total Assets	3,950	4,991	6,353	7,948

Key ratios

Y/E, Mar	FY09	FY10	FY11E	FY12E
Profitability (%)				
EBITDA Margin	11.3	11.6	11.3	11.2
Net Margin	7.3	7.9	7.5	7.5
ROCE	73.4	57.9	52.2	49.0
ROE	58.2	46.6	40.2	37.6
RoIC	61.5	46.7	51.6	63.9
Per Share Data (Rs)				
EPS	20.3	22.2	25.0	29.6
CEPS	23.4	26.0	29.5	34.7
BVPS	40.8	54.7	69.8	87.5
DPS	7.0	8.0	8.5	10.5
Valuations (x)				
PER	21.9	20.0	17.8	15.0
P/CEPS	19.0	17.1	15.1	12.8
P/BV	10.9	8.1	6.4	5.1
EV / Sales	1.6	1.6	1.3	1.0
EV / EBITDA	15.6	14.6	12.4	10.3
Dividend Yield (%)	1.6	1.8	1.9	2.4
Gearing Ratio (x)				
Net Debt/ Equity	0.0	(0.0)	(0.4)	(0.4)
Net Debt/EBITDA	0.1	(0.0)	(0.7)	(0.9)
Working Cap Cycle (days)	23.3	34.2	44.0	51.6

Recommendation History: Blue Star – BLSTR IN

Date	Reports	Reco	CMP	Target
09.07.2010	Blue Star Management Meet Update	Buy	441	464
19.05.2010	Blue Star Q4FY10 Result Update	Buy	396	464

Recent Research Reports

Date	Reports	Reco	CMP	Target
27.07.2010	Larsen & Toubro Q1FY11 Result Update	Accumulate	1,863	2,126
22.07.2010	Thermax Q1FY11 Result Update	Hold	792	790
09.07.2010	Blue Star Management Meet Update	Buy	441	464
25.06.2010	Punj Lloyd Company Update	Hold	129	132

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