

Blue Star

Buy

CMP: Rs291
**Target Price: Rs340
(12 Months)**
Surbhi Chawla

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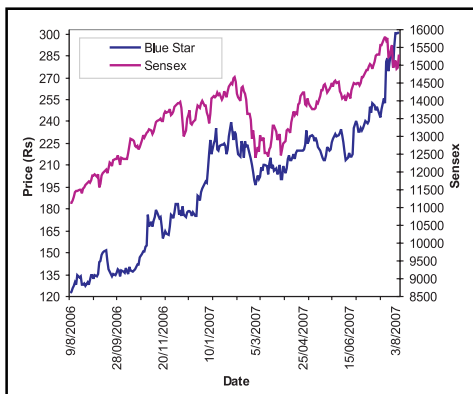
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Stock Info

Sector	Airconditioning
Market Cap (Rs cr)	2,617
Beta	0.4
52 Week High / Low	307/121
Avg Daily Volume	33364
Face Value (Rs)	2
BSE Sensex	14,868
Nifty	4,333
BSE Code	500067
NSE Code	BLUESTARCO
Reuters Code	BLUS.BO
Bloomberg Code	BLSTR IN

Shareholding Pattern (%)

Promoters	40.2
MF / Banks / Indian FIs	8.1
FII / NRIs / OCBs	14.2
Indian Public / Others	37.5


Sparkling 'Star'

The Central Airconditioning segment is expected to be the biggest growth driver for Blue Star over the next few years. We believe the company will maintain its market leadership position given its expertise, superior energy-efficient products and skilled personnel. The Cooling Products segment is expected to boost revenues as well as profitability on the back of increasing sales of split airconditioners, refrigeration products and systems driven by the Cold chain business. We expect the company to outperform the market given the strong growth potential, earnings visibility and improvement in operating efficiencies. At the CMP, the stock trades at 26.2x and 17.8x FY2008E and FY2009E earnings. **We initiate coverage on the stock with a Buy recommendation and 12-month Target Price of Rs340.**

- Growing economy, industrialisation bolster demand for airconditioning:** The central airconditioning market has been growing at a CAGR of 25% over the last three years and is expected to sustain this pace going ahead. A booming construction sector driven by high-growth segments such as retail, IT/ITES, industrial, healthcare, hospitality, entertainment, telecom and banking, is expected to result in higher airconditioning demand to the tune of Rs5,986cr over the next three-five years.
- Overall EBIT margins to improve to 10.1% in FY2009:** We expect overall revenues to increase 35% and 39% in FY2008E and FY2009E, respectively. Overall EBIT margins (including other income and un-allocated expenses) are expected to improve to 10% in FY2009E from 9% in FY2007 following operating efficiencies in the three segments. The segments are expected to witness an improvement in margins on account of cost reduction due to economies of scale, higher output from Himachal plant and change in product mix.
- Cold chain business – the future growth driver:** The Cold chain business driven by the Retail revolution is expected to create huge demand for front and back-end refrigeration to the tune of Rs1,500cr each; of which the Blue Star would garner Rs750cr. The company is in a strong position in the cold chain business on account of having a range of products from the pack houses at the farm end to the supermarket refrigeration equipment for retail outlets.

Key Financials

Y/E March (Rs cr)	FY2006	FY2007	FY2008E	FY2009E
Net Sales	1,171	1,595	2,160	3,002
% chg	27.7	36.2	35.4	39.0
Net Profit	48.9	71.2	103.3	151.9
% chg	24.9	45.6	45.1	47.1
Diluted EPS (Rs)	5.4	7.9	11.5	16.9
EBITDA Margin (%)	7.1	6.9	7.3	7.6
P/E (x)	55.4	38.0	26.2	17.8
P/CEPS (x)	41.3	30.2	21.5	14.9
RoE (%)	28.3	33.4	36.3	37.4
RoCE (%)	29.0	33.1	36.9	40.3
P/BV (x)	3.1	12.7	9.5	6.7
EV/Sales (x)	0.5	1.8	1.3	0.9
EV/EBITDA (x)	7.4	25.3	17.8	12.4

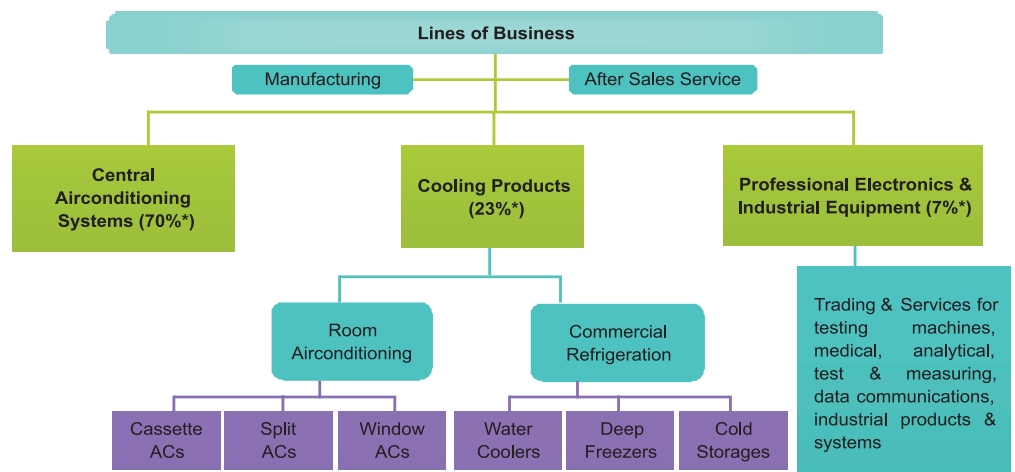
Source: Company, Angel Research

Blue Star primarily focuses on the corporate and commercial markets including institutional, industrial, government organisations and commercial establishments

Company Background

Blue Star is India's largest central airconditioning and commercial refrigeration company, with a track record of over six decades of providing expert cooling solutions. The company founded by Mohan T Advani in 1943 has a network of 23 offices and five manufacturing facilities. Blue Star is also into import distribution and maintenance of professional electronic and industrial equipment and systems. These include turnkey engineered solutions in banking, telecom, healthcare, defense, pharmaceutical, manufacturing and R&D. Blue Star has expertise in technical, engineering and contracting.

Exhibit 1: Business Segments



Source: Company, Angel Research; Note: *Contribution to FY2007 Topline

Blue Star primarily focuses on the corporate and commercial markets including institutional, industrial and government organisations alongwith commercial establishments such as showrooms, restaurants, banks, hospitals, theatres, shopping malls and boutiques.

Central Airconditioning Systems

The Central Airconditioning segment continues to be the key growth driver for the company and contributes 70% to Topline

This involves design, engineering, manufacturing, installation, commissioning and support of large central airconditioning plants, packaged airconditioners and ducted split airconditioners. It also promotes after-sales service as a business by offering several value-added services such as upgrades and enhancements, and air, water and energy management.

Central Airconditioning comprises two sub-segments – Central plant projects and Packaged airconditioners. This segment contributes 70% to the company's Topline and continues to be the key growth driver for the company. The company, which has a marketshare of 30% in this segment, is a manufacturer, contractor and after-sales service provider for the segment's products.

- (A) Central plant projects:** The company offers a wide range of chillers including screw, reciprocating and scroll and a wide array of airside products such as air handling units and fan coil units.
- (B) Packaged airconditioners:** The company offers floor and ceiling mounted packaged airconditioners as well as ducted split airconditioners.

Cooling Products

Blue Star offers a wide range of contemporary window and split airconditioners. The company manufactures and markets a comprehensive range of commercial refrigeration products and

The Cooling Products segment contributes around 23% to the company's Topline

services that cater to the industrial, commercial and hospitality sectors. These include water coolers, bottled water dispensers, deep freezers, cold storages, bottle coolers and ice cube machines. Cooling Products comprise two sub-segments – Room Airconditioners and Commercial Refrigerations. This segment contributes around 23% to the company's Topline.

Professional Electronics and Industrial Equipment

Blue Star's Electronics Division has been an exclusive distributor in India for many internationally renowned manufacturers of hi-tech professional electronic equipment and services as well as industrial products and systems. The company has carved out a profitable niche for itself in most of the specialised markets that it operates in. This segment represents import-distribution of professional electronic equipment from world-renowned manufacturers. It is characterised by high-value, low-volume business, with a wide range of complex, hi-tech and large value equipment.

This segment has six SBUs catering to Healthcare, Manufacturing, R&D, Quality Control, Petrochemicals, Banking, etc:

- ★ Material Testing Equipment & Systems
- ★ Data Communication Products & Services
- ★ Test & Measuring Instruments
- ★ Analytical Instruments
- ★ Industrial Products
- ★ Medical Diagnostic Equipment

Investment Argument

Growing economy and industrialisation bolster demand for airconditioning

India's growing economy and industrialisation continue to bolster demand for airconditioning. The central airconditioning market has been growing at a CAGR of 25% over the last three years and is expected to sustain this pace going ahead as well. A booming construction sector is expected to result in higher airconditioning requirements. The construction sector is expected to surge driven by booming segments such as retail, IT/ITES, industrial, healthcare, hospitality, entertainment, telecom and banking. These segments would in turn fuel growth of the commercial airconditioning industry.

Recent surge in the commercial real estate sector in India has been fuelled by the increased revenues of companies in the services business, particularly in the IT & ITES sectors. The commercial Real Estate sector, which is expected to grow at 25% will in turn create a similar growth potential for the airconditioning segment as well.

In this segment, the company's major clients are the IT/ITES and Retail sector, who contribute around 70% to revenues of the segment. The other sectors are the Multiplex/Entertainment, Telecom, Industrial, Healthcare, Hospitality and Banking.

Exhibit 2: Airconditioning potential over next 3-5 years

Sectors	Area (mn sq.ft)	Airconditioning potential (Rs cr)
IT/ITES	188	2,820
Retail	200	3,000
Malls & Multiplex	11	166
Total	399	5,986

Source: Angel Research; Assuming Airconditioning requirement @ Rs150 / sq. ft

Central Airconditioning segment emarked on growth path

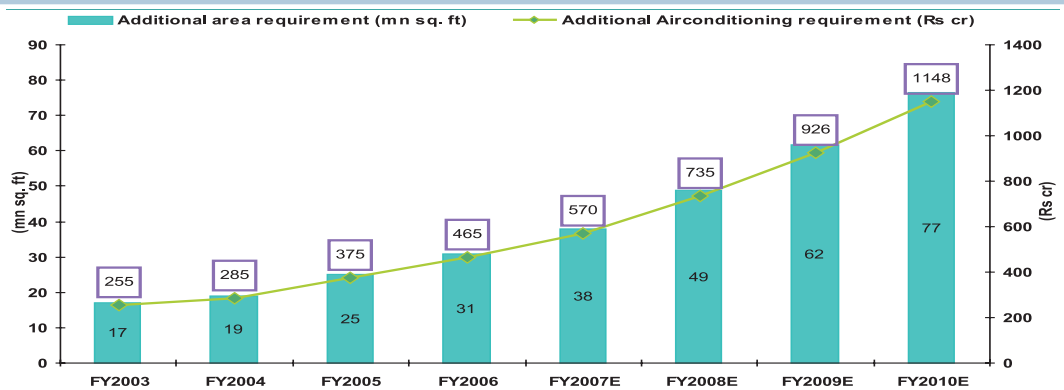
The IT/ITES sector would require additional space of approx. 188mn sq. ft between FY2008 and FY2010 translating into airconditioning requirement of Rs2,820cr

IT / ITES

Providing cost-effective and efficient software solutions has catapulted India to the top position globally in the IT/ITES industry. The IT/ITES sector is expected to continue to grow in excess of 25% pa., over the next three years, which will result in increased demand for commercial space and will in turn fuel the growth potential for airconditioning. The IT/ITES sector would require additional space of approx. 188mn sq. ft between FY2008 and FY2010 translating into airconditioning requirement of Rs2,820cr.

This segment entails a huge potential for Blue Star. The company has a complete set of solutions for the software industry viz., the energy efficient Chillers, low noise AHUs and PCPAs. Given the capability and wide product range, we believe the company will be able to gain significant share in the sector.

Exhibit 3: Space required for IT/ITES sector



Source: Cris Infac, Angel Research

In Retail , we estimate addition of 200mn sq.ft of floor space over the next five years creating demand for airconditioning to the tune of Rs3,000cr

Retail

Organised Retail in India is on a high growth trajectory growing at 25% plus annually. The Retail industry is estimated at around Rs15,00,000cr, with organised retail accounting for a mere 4% of the India's total retail market. Organised retail penetration is expected to increase to 8% by 2010 growing at a CAGR of 26% (Source: Cris Infac). Growth of organised retail is expected to be driven by demographic factors, increasing disposable incomes, change in perception, entry of international retailers and the growing number of retail malls.

Exhibit 4: Retail - Expected investments by 2010-11

Retail Players	Amount (Rs cr)
Reliance Retail	25,000
Bharti - Wal Mart	30,000
A V Birla Group	15,000
Pantaloon Retail	4,000
Others	10,000
Aggregate Investments	84,000

Source: Industry

The major retail chains have envisaged huge capex plans over the next five years. Reliance Industries plans to invest Rs25,000cr in its retail venture spread across 784 cities and 6,000 towns in the country entailing development of around 100mn sq.ft of area over the next five years. Other retailers like Aditya Birla, Pantaloon, Tata Group, RPG and Vishal Megamart, among others, also have their plans in place. We estimate this to translate into addition of 200mn sq.ft of floor space over the next five years creating airconditioning demand of Rs3,000cr.

Potentially, India is looking at over 1,100 multiplex screens by 2010 translating into airconditioning demand worth Rs166cr.

Malls and Multiplexes

Over the last few years, a number of multiplexes have come up in India. As of March 2005, there were 73 multiplexes in India with 276 screens. As of June 2007, there were an estimated total 135 multiplexes with 478 screens. As per the announced plans of various companies, potentially India is looking at over 1,100 multiplex screens by 2010. With this, we expect additional 11mn sq.ft of floor space to be developed translating in airconditioning demand worth Rs166cr.

Exhibit 5: Multiplex: Changing scenario

Multiplex	No. of Screens		
	2007	2010E	CAGR (%)
PVR Cinemas	82	220	39
INOX	54	170	47
Adlabs	74	150	27
Fun Cinemas	48	150	46
Cinemax	38	141	55
Fame Cinemax (Shringar)	39	105	39
Others	143	197	11
Total	478	1,133	33

Source: Company Websites, Angel Research

Telecom

Telecom companies' subscriber base is expected to double over the next three years to 500mn necessitating 50,000 additional cell sites and creating airconditioning opportunity of Rs1,000cr

Blue Star enjoys a dominant 50% marketshare in the Telecom segment with its customised range of packaged airconditioners especially designed for the Telecom industry. The company has already supplied its equipment to major telecom service providers such as Hutch, Airtel, Reliance Telecom, BSNL, TTSL, Spice Telecom and Essar as well as to other infrastructure providers like GTL, Quipo, TVS and Tower Vision. The company's Telecom business for airconditioning cell sites grew 185% in FY2007. The Telecom companies' subscriber base is expected to double over the next three years to 500mn necessitating 1,50,000 additional cell sites and creating airconditioning opportunity of Rs1,000cr.

Industrial

The company has already executed major power plant projects for NTPC, NPCIL and Jindal. The company expects to bag significant power plant project orders in the medium term with Eleventh Five Year Plan chalking out an addition of 48,000MW of thermal power. Growth in the Pharmaceutical segment is also expected to boost demand for airconditioning and would present a huge opportunity for the company.

National / Major accounts contribute around 40% to revenues

The company gets 40% of segmental revenues from National / Major account customers viz., Reliance, DLF, Infosys, Café Coffee Day, HCL, Hutch, HDFC, HSBC, Moser Baer, Microsoft, Future, Shoppers' Stop, Satyam, Wipro, ICICI, RMZ, Raymonds, PVR, Dr Reddy's, Bharti, etc. All these players are expected bolster demand for airconditioning. We believe Blue Star, being a market leader, will be able to garner a significant share of such potential demand.

Repeat business gives Earnings visibility

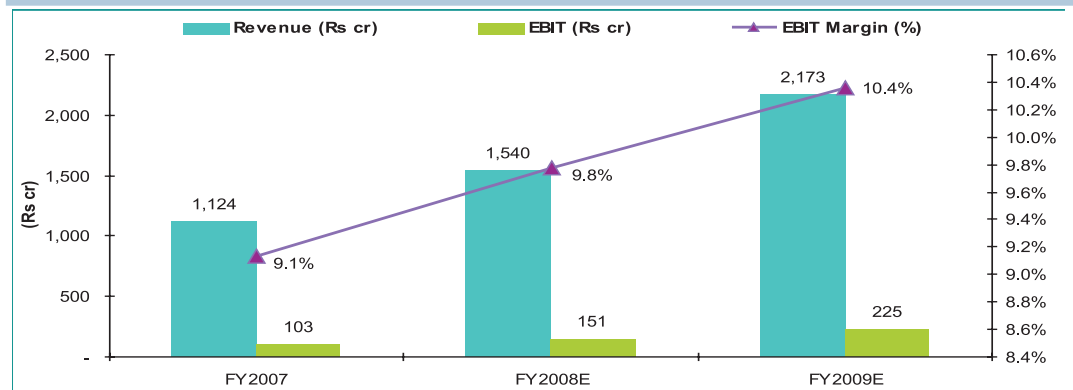
The company's strong organisational capabilities have resulted in repeat business from many corporate customers. The company receives around 40% of its revenues from repeat business, which provides good visibility of its future earnings.

The company's strong organisational capabilities have resulted in repeat business

Segment performance

We estimate the segment to grow at a CAGR of 39% over the next two years. We expect margins of the segment to expand on the back of higher volumes - due to economies of scale and cost reduction with an increase in productivity. We expect Blue Star's Central Airconditioning segment to post revenues of Rs1,540cr and Rs2,173cr and EBIT to the tune of Rs151cr and Rs225cr during FY2008E and FY2009E, respectively. The segment is expected to contribute 70.8% and 71.9% in FY2008E and FY2009E respectively, to overall revenues.

Exhibit 6: Central Airconditioning - Financial Performance



Source: Company, Angel Research

Airports and SEZs present potential demand for the Central Airconditioning segment

We expect Airports and SEZs to be future growth drivers for the company. SEZs present airconditioning demand of around Rs5,000cr over the next three to four years. Blue Star received the Nagpur airport project during Q1FY2008. Further, the Civil Aviation Ministry plans modernisation of 35 non-metros and metro airports. We believe the company is well-placed to garner higher share and increase contribution from this sub-segment.

Cooling Products

Cost reduction as volumes rise to result in economies of scale

Room Airconditioners: The company offers a wide range of window and split airconditioners. This sub-segment contributed 59% to the segment revenue in FY2007. The room airconditioner market size in FY2007 stood at around 1.8mn units, of which Blue Star sold around 90,000 units, with more than 70% of the sales coming from split airconditioners. This sub-segment is characterised by intense competition. The company strategically chooses to focus on the corporate and commercial players in this segment.

The differentiating factor of Blue Star's split airconditioners comprises specialised products such as hiper splits, mega splits and cassette airconditioners. This has resulted in an impressive performance by the segment. Further, Blue Star is a reputed brand in split airconditioners amongst the corporate and commercial buyers and witnessed volume growth of over 75% in FY2007. Following higher volume growth, the company expects to reduce costs leading to economies of scale.

Higher output from Himachal plant to improve margins

The company commissioned phase-I of its Room Airconditioner plant at Kala Amb in Himachal Pradesh in May 2005. This plant manufactures window and split airconditioners and shipped out 30,000 units in FY2006 and 90,000 units in FY2007. The plant enjoys excise and income tax exemptions, thus lowering costs. The plant's total capacity is 150,000 units on a single shift basis, which the company expects to enhance to 200,000 units going ahead.

Change in product mix to enhance margins

We expect this sub-segment to grow at a CAGR of 30% over the next two years, with higher contribution coming from split airconditioners. The split airconditioners enjoy better margins than window airconditioners. Going ahead, the Room Airconditioner segment is expected to witness expansion in margin on account of changing product mix, higher contribution from split airconditioners and higher output from the Himachal plant.

Major growth driver for this sub-segment is the company's Cold Chain business

Retail revolution to drive growth of the Cold Chain business

Blue Star has bagged a contract of airconditioning 50-70% of Reliance's Retail outlets and to set up refrigeration for all its distribution centers and half the stores, giving high earnings visibility

Commercial Refrigeration: The company manufactures and markets a comprehensive range of commercial refrigeration equipment like cold chain equipment, deep freezers, water coolers/ bottled water dispensers, bottle/milk coolers. This sub-segment contributed 41% to the segment revenue in FY2007.

Over the last few years, the company has established its leadership position in commercial refrigeration products. Major growth driver for this sub-segment is the cold chain business. The company has a tie-up with ISA, Italy for the aesthetically appealing supermarket display equipment. The company has several new customer accounts in the cold chain business. For instance, the company bagged refrigeration display cabinet orders from two new supermarket chains viz., Aditya Birla and Vishal Megamart during the last quarter.

Organised retail in India is on high growth trajectory growing 25% plus annually. Size of the Retail industry is estimated at around Rs990,000cr (FY2005), with organised retailing accounting for a mere 3.5% of the total retail market. Organised retail penetration to expected increase to 8% by 2010 growing at a CAGR of 26% (Source: Cris Infac). Demand from the retail sector is expected to be manifold emerging from the super markets, branded chains, standalone outlets, etc.

Exhibit 7: Retail revolution

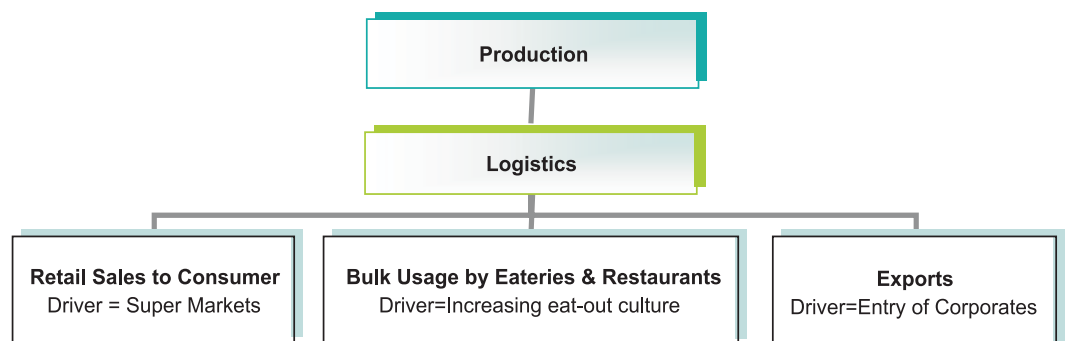
Home needs	Super market chains (Reliance/ Hypercity, etc.)
Eateries	Branded/ Formatted Chains (Café Coffee Day, McDonalds, etc.)
Luxury Goods	Malls with multiple brand outlets and Standalone chains

Source: Company

Many retailers have huge investment plans rolled out for expansion, with total investments to be around Rs60,000cr in this space. Reliance Retail has envisaged investments to the tune of Rs25,000cr over the next five years. Blue Star has bagged a contract of airconditioning 50-70% of Reliance's Retail outlets and to set up refrigeration for all its distribution centers and half the stores, giving high earnings visibility. Blue Star also has various other national accounts of players who have chalked out huge expansion plans.

Cold chain entails a logistic system that provides a series of facilities for maintaining ideal storage conditions for perishables from the point of production to the point of consumption in the food chain. The retail revolution will drive the cold chain business creating huge opportunity for the company's refrigeration business at different stages of the process.

Exhibit 8: The Cold Chain



Source: Company, Angel Research

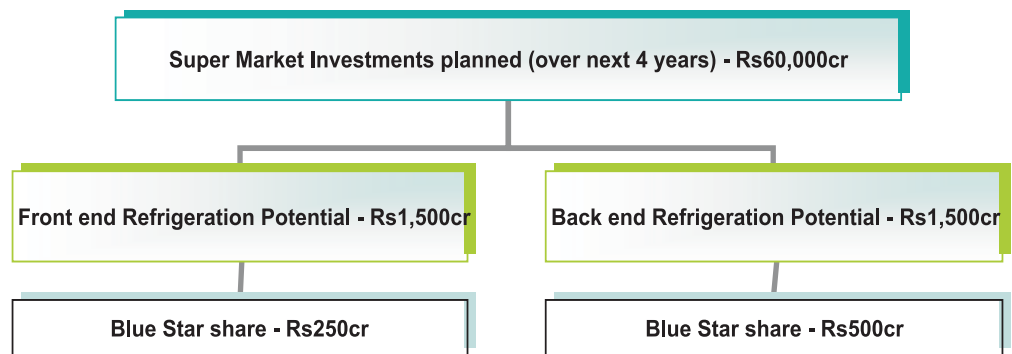
The various formats planned by the retailers will result in huge opportunity for airconditioning and refrigeration

Demand for cold chain comes from:

- ★ Changing consumer mindset– Indians are adapting to processed foods and packaged fruits and vegetables
- ★ Increase in consumption of imported produce
- ★ Organised retailing gaining popularity
- ★ Modern formats of retailing
- ★ Perishable storage on the rise among modern retailers
- ★ Growth of imports indicates growing demand for good quality fruits round the year
- ★ Corporates planning cold stores due to absence of quality cold chain network

The various formats planned by the retailers will result in huge opportunity for airconditioning and refrigeration. Huge growth is expected in the Commercial refrigeration segment driven by the cold chain. Hyper markets (100,000sq.ft.) would require about Rs150lakh refrigeration investment per store. Refrigeration investment per store in the Supermarkets (20,000sq.ft.) would be to the tune of Rs30lakh and Rs6lakh in Convenience stores. All this is expected to fuel demand for refrigeration. The Supermarkets business is expected to create opportunities to the tune of Rs750cr for Blue Star.

Exhibit 9: Supermarkets to drive Cold Chain business



Source: Company, Angel Research

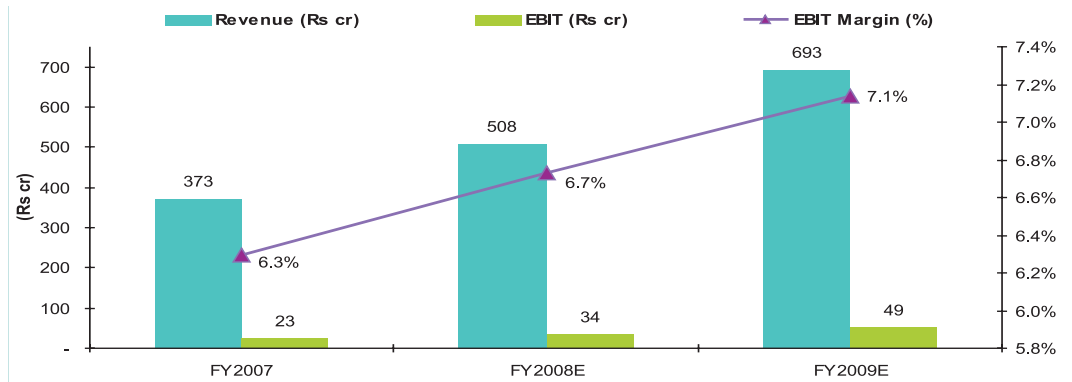
The company is in a strong position to capitalise on the impending boom in the cold chain business on the back of products being offered right from the pack houses at the farm end to the supermarket refrigeration equipment for retail outlets. Also, with its tie-up with ISA, the company is confident of emerging a lead player in the sunrise supermarket segment.

Segment Performance

In FY2007, the Cooling Products segment registered a growth of 37.5% driven by higher split airconditioner sales, refrigeration products and system sales such as deep freezers, water coolers and cold storages. We estimate the segment to grow at a CAGR of 36% over the next two years. We expect margins in the segment to expand on the back of cost reduction as volume growth will lead to economies of scale, higher output from Himachal plant and change in product mix. We expect the Cooling Products segment to post revenues of Rs508cr and Rs693cr and EBIT of Rs34cr and Rs49cr for FY2008E and FY2009E, respectively. The segment is expected to contribute around 23% in FY2008E and FY2009E to overall revenues.

In FY2007, the Cooling Products segment registered a growth of 37.5% driven by higher split airconditioner sales, refrigeration products and system sales

Exhibit 10: Cooling Products - Financial Performance



Source: Company, Angel Research

Professional Electronics & Industrial Equipment segment

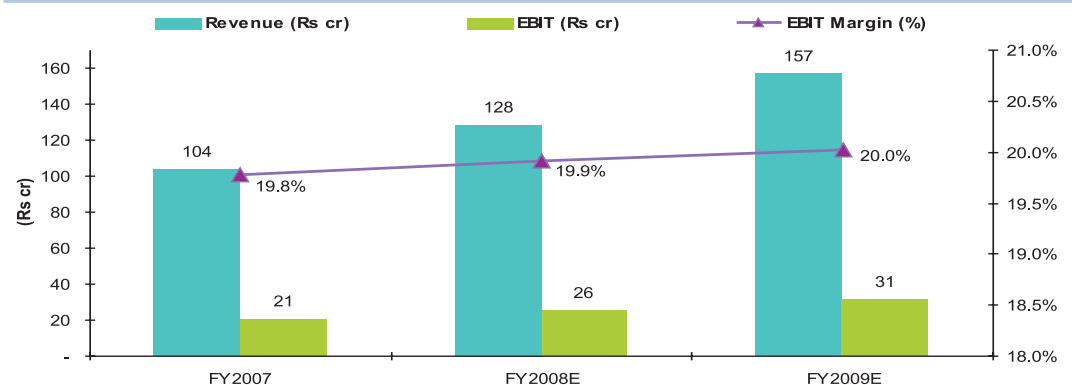
In the Professional Electronics & Industrial Equipment segment the company has business alliances with world renowned technology leaders

The Professional Electronics & Industrial Equipment segment represents leading global manufacturers in India like Hitachi and JEOL from Japan, Thales e-security from UK, Yxlon from Germany, Mindray from China, Aeroflex, Panametrics and NuAire from USA. Commission on sales constitutes a major portion of the segment's revenues.

During FY2007, the company bagged major order from Man Industries and Pratibha Industries for non-destructive testing systems. Blue Star also received orders from Tata Steel for overhead yard utility pipeline, oxygen pressure reducing stations and LD gas mixing stations for a value of Rs31cr.

In FY2007, the Professional Electronic & Industrial Equipment segment registered a growth of 29.7%. We estimate the segment to grow at a CAGR of 23% over the next two years with a marginal improvement in margins. We expect the segment to post revenues of Rs128cr and Rs157cr and EBIT of Rs26cr and Rs31cr in FY2008E and FY2009E, respectively. The segment is expected to contribute 5.9% and 5.2% to FY2008E and FY2009E overall revenues, respectively.

Exhibit 11: Segment's Financial Performance



Source: Company, Angel Research

The segment is expected to contribute 5.9% and 5.2% to FY2008E and FY2009E overall revenues, respectively

Overall EBIT margins are expected to improve to 10% in FY2009E from 9% in FY2007 on the back of operating efficiencies in all the three segments

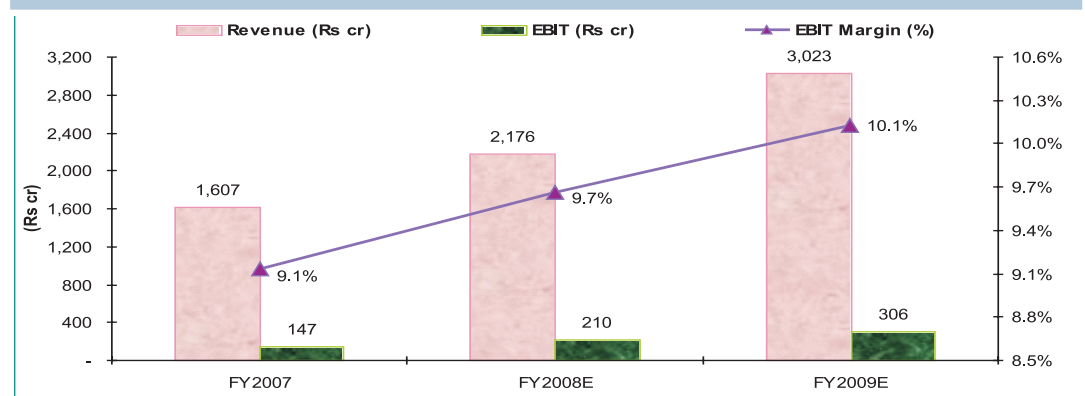
Operating Performance

Blue Star registered yoy Topline growth of 36.2% and Net Profit growth of 45.6% in FY2007. The company witnessed a decline in gross margins by 38bp due to a sharp increase in input costs like copper and steel. Employee costs were also higher by 39% in FY2007 due to change in one-time accounting on account of employee benefits to the tune of Rs14.9cr. However, the company registered expansion in Net profit margins by 28bp on the back of lower taxes.

Going ahead, the company expects to incur capex of Rs120-140cr over the next two years, which would be mainly utilised for expansion at its Wada and Kala Amb plants. The company would fund its expansion plans from internal accruals (including depreciation cashflows) and debt without resorting to equity dilution.

We expect overall revenues to increase by 35% and 39% in FY2008E and FY2009E, respectively. Increase in margins of all the three segments coupled with operating efficiencies is expected to improve overall EBIT margins (including other income and un-allocated expenses) to 10.1% in FY2009E from 9.1% in FY2007.

Exhibit 12: Financial Performance



Source: Company, Angel Research

Concerns

Volatility in raw material prices: The two main raw materials that the company requires are steel and copper. Hence, any fluctuation in the price of these raw materials affects the company's performance. Further, on account of operating in a competitive environment the company cannot pass on any increase in the raw material prices. Nevertheless, the company is focusing on improving operating efficiencies, which would improve margins going ahead.

Availability of manpower: Retention and addition of technically qualified skilled manpower is very crucial for the company as it is at high growth phase to tap the emerging business opportunities.

Macro-economic slowdown: Blue Star's growth is dependent on the domestic economy and derives demand from other segments as well. Hence, any slowdown would adversely affect the company's profitability.

Competition from MNCs: The domestic market offers huge growth potential and could attract the well-entrenched MNCs. But, currently given the small ticket size it is likely to keep the MNCs at bay. Currently, in the central airconditioning segment, the average ticket size that Blue Star executes is to the tune of Rs5-6cr and around Rs40 lakh in packaged airconditioning.

We expect the company to outperform the market given the strong growth potential, high earnings visibility and improvement in operating efficiencies

Outlook

The Central Airconditioning segment is expected to be the biggest growth driver for Blue Star over the next few years. We believe the company will maintain its market leadership position given its expertise, superior energy-efficient products and skilled personnel. We believe the key growth drivers for the segment would be robust growth in the IT/ITES and Retail segments. We expect the segment to clock a CAGR growth of 39% over the next two years. The Cooling Products segment is also expected to boost revenues and profitability on the back of increasing sales of split airconditioners and refrigeration products and systems driven by the Cold Chain business. The company's Products business will contribute in coming years driven by low penetration of airconditioners, higher disposable income and tax incentives for manufacturing in tax havens. In the Cold Chain business the company is well positioned to leverage on the booming demand.

The Professional Electronics and Industrial Systems business will continue to be attractive and enhance the company's profitability going ahead. Although demand for the company's products and services is derived from the other segments, we believe that riding high on favourable macro-economic trends, all the three segments are poised to register robust growth going ahead. We expect the company to outperform the market given the strong growth potential, high earnings visibility and improvement in operating efficiencies. The company's strategic plan is to increase its presence in Bundled contract projects where there exists immense future potential for growth. Currently, only 10-15% market is bundled (electrical, plumbing and airconditioning) in India. Going ahead however, such contracts are expected to grow in numbers. In Q3FY2007, the company set up its Electrical business in its bid to have a presence in this segment. The company targets to record an orderbook of Rs60-80cr from South India for bundled contracts.

Valuation

At the CMP, the stock trades at 26.2x and 17.8x FY2008E and FY2009E earnings. We believe the stock at current levels provides good risk-adjusted returns for investors given the strong growth potential and improving operating efficiencies. **We initiate coverage on the stock with a Buy recommendation and 12-month Target Price of Rs340**, translating into 17% upside from current levels.

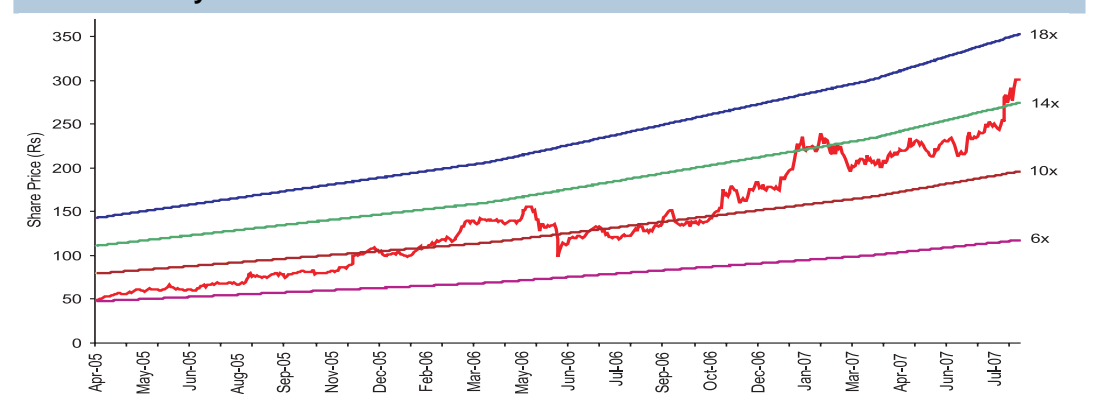
We believe the stock at current levels provides good risk-adjusted returns for investors given the strong growth potential and improving operating efficiencies

Exhibit 13: Peer comparison

Company	P/E (x)		P/BV (x)		RoE (%)	
	FY2008E	FY2009E	FY2008E	FY2009E	FY2008E	FY2009E
Voltas	35.8	26.7	11.2	8.4	34.2	33.5
Blue Star	26.2	17.8	9.5	6.7	36.3	37.4

Source: Bloomberg; Angel Research

Exhibit 14: 1-year forward P/E Band Chart



Source: Company, Angel Research

Exhibit 15: Segment-wise Financials
Segmental Break-up of Total Income

Y/E March (Rs cr)	FY2006	FY2007	FY2008E	FY2009E
Central Air-conditioning Systems	821.3	1,124.3	1,540.1	2,172.6
Cooling Products	271.2	372.8	507.5	693.0
Professional Electronics & Industrial Systems	80.4	104.2	128.2	157.0
Residual	1.7	-	-	-
Total Segment Result	1,174.6	1,601.3	2,175.8	3,022.6

Segment-wise Break-up of EBIT

Y/E March (Rs cr)	FY2006	FY2007	FY2008E	FY2009E
Central Air-conditioning Systems	80.0	102.7	150.5	225.1
Cooling Products	13.2	23.5	34.2	49.5
Professional Electronics & Industrial Systems	15.3	20.6	25.5	31.4
Residual	(0.8)	-	-	-
Total Segment Result	107.7	146.8	210.2	306.0

Exhibit 16: Assumptions
Segment-wise Growth of Total Income (%)

Y/E March	FY2006	FY2007	FY2008E	FY2009E
Central Air-conditioning Systems	26.1	36.9	37.0	41.1
Cooling Products	29.3	37.5	36.1	36.5
Professional Electronics & Industrial Systems	35.6	29.7	23.0	22.5
Total Segment Result	27.6	36.3	35.9	38.9

Segment-wise EBIT Margin (%)

Y/E March	FY2006	FY2007	FY2008E	FY2009E
Central Air-conditioning Systems	9.7	9.1	9.8	10.4
Cooling Products	4.9	6.3	6.7	7.1
Professional Electronics & Industrial Systems	19.0	19.8	19.9	20.0
Total Segment Result	9.2	9.2	9.7	10.1

Source: Company, Angel Research

Profit & Loss Statement

Rs crore

Y/E March	FY2006	FY2007	FY2008E	FY2009E
Net Sales	1,170.7	1,594.6	2,159.8	3,001.9
% chg	27.7	36.2	35.4	39.0
Total Expenditure	1,087.9	1,484.4	2,001.8	2,774.1
EBIDTA	82.8	110.2	158.0	227.8
(% of Net Sales)	7.1	6.9	7.3	7.6
Depreciation & Amortisation	15.9	20.9	22.6	28.2
Interest	5.7	9.5	11.9	14.4
Other Income	7.9	12.8	16.0	20.7
PBT	69.1	92.6	139.5	205.9
(% of Net Sales)	5.9	5.8	6.5	6.9
Tax	20.2	21.4	36.2	54.0
(% of PBT)	29.2	23.1	26.0	26.2
PAT	48.9	71.2	103.3	151.9
% chg	24.9	45.6	45.1	47.1

Balance Sheet

Rs crore

Y/E March	FY2006	FY2007	FY2008E	FY2009E
SOURCES OF FUNDS				
Equity Share Capital	18.0	18.0	18.0	18.0
Reserves & Surplus	154.7	195.0	266.7	387.8
Shareholders Funds	172.7	213.0	284.7	405.8
Total Loans	75.9	89.0	118.4	132.6
Deffered Tax Liability	9.1	6.5	6.8	7.8
Total Liabilities	257.6	308.5	409.8	546.2
APPLICATION OF FUNDS				
Gross Block	197.7	230.8	287.9	346.6
Less: Acc. Depreciation	101.0	116.7	139.4	167.6
Net Block	96.8	114.1	148.5	179.0
Capital Work-in-Progress	11.1	2.4	10.3	13.6
Investments	5.2	5.3	5.3	5.3
Current Assets	481.7	629.0	868.8	1,201.5
Current liabilities	340.4	444.5	623.1	853.2
Net Current Assets	141.3	184.5	245.7	348.3
Miscellaneous Exp.	3.3	2.2	-	-
Total Assets	257.6	308.5	409.8	546.2

Cash Flow Statement

Rs crore

Y/E March	FY2006	FY2007	FY2008E	FY2009E
Profit before tax	69.1	92.6	139.5	205.9
Depreciation	15.9	20.9	22.6	28.2
Change in Working Capital	(54.8)	(44.9)	(52.3)	(99.2)
Direct taxes paid	(11.9)	(8.6)	(36.2)	(47.4)
Cash Flow from Operations	22.4	64.2	62.7	72.5
Inc./ (Dec.) in Fixed Assets	40.3	27.9	65.0	62.0
Free Cash Flow	(17.9)	36.3	(2.3)	10.5
Inc./ (Dec.) in Investments	-	0.1	-	-
Issue of Equity	-	-	-	-
Inc./ (Dec.) in loans	38.6	13.2	29.3	14.2
Dividend Paid (Incl. Tax)	(20.4)	(47.3)	(6.2)	(31.6)
Others/Extra ordinary items	(0.4)	0.2	(11.9)	10.2
Cash Flow from Financing	17.8	(33.9)	11.2	(7.1)
Inc./ (Dec.) in Cash	(0.1)	2.2	8.9	3.5
Opening Cash balances	2.5	2.4	4.6	13.5
Closing Cash balances	2.4	4.6	13.5	16.9

Key Ratios

Y/E March	FY2006	FY2007	FY2008E	FY2009E
Per Share Data (Rs)				
Diluted EPS	5.4	7.9	11.5	16.9
Diluted Cash EPS	7.3	10.0	14.0	20.1
DPS	2.4	3.0	3.0	3.0
Book Value	19.2	23.7	31.7	45.1
Operating Ratio				
Cost of Material / Sales (%)	77.6	77.9	77.7	77.5
Inventory (days)	47	43	43	43
Debtors (days)	74	80	76	76
Debt / Equity (x)	0.4	0.4	0.4	0.4
Returns (%)				
ROE	28.3	33.4	36.3	37.4
ROCE	29.0	33.1	36.9	40.3
Dividend Payout (%)	44.1	37.9	26.1	17.8
Valuation Ratio (x)				
P/E	55.4	38.0	26.2	17.8
P/E (Cash EPS)	41.3	30.2	21.5	14.9
P/BV	3.1	12.7	9.5	6.7
EV / Sales	0.5	1.8	1.3	0.9
EV / EBITDA	7.4	25.3	17.8	12.4

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