



## Blue Star

<b>STOCK INFO.</b>	<b>BLOOMBERG</b>
BSE Sensex: 14,302	BLSTR IN
	<b>REUTERS CODE</b>
S&P CNX: 4,318	BLUS.BO
Equity Shares (m)	89.9
52-Week Range	459/122
1, 6, 12 Rel. Perf. (%)	28/-26/-27
M. Cap. (Rs b)	22.5
M. Cap. (US\$ b)	0.5

19 May 2009

Buy

Previous Recommendation: Buy

Rs250

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GRTH (%)	P/E (X)	P/BV (X)	RoE (%)	RoCE (%)	EV/ SALES	EV/ EBITDA
03/08A	22,330	1,468	16.3	106.2			73.1	58.5		
03/09E	25,691	1,803	20.0	22.8	12.5	6.1	56.9	72.2	0.9	8.3
03/10E	28,257	2,031	22.6	12.6	11.1	4.6	47.1	62.3	0.8	7.3
03/11E	32,400	2,311	25.7	13.8	9.7	3.6	41.2	57.3	0.7	6.3

- 4QFY09 profits above expectation:** Blue Star's 4QFY09 operating income is broadly in line at Rs7.25b (our estimate Rs7.17b), up just 2% YoY. However, adjusted PAT is up 55% YoY at Rs668m (our estimate Rs459m). The main reason for this is a significant higher EBITDA margin at 13% (our estimate 10.4%), up 280bp YoY. This can be attributed to: (1) softening of raw material prices, (2) tight cost control measures, and (3) enhanced price realizations.
- FY10 to be a year of consolidation:** In the post-results concall, the management guided for FY10 to be a year of consolidation. Visibility for 1HFY10 is reasonably high due to an order backlog of Rs13.4b. However, 4QFY09 order inflow growth is negative YoY for the first time ever in the last 8 quarters. Thus, performance in 2HFY10 is contingent on order inflow during FY10. We believe the company will be able to slightly better its FY09 margins through a combination of: (1) lower material costs, (2) judicious price hikes, and (3) cost savings through value engineering and check on overheads.
- 16-22% upgrade in EPS estimates, FY09-11E EPS CAGR of 13%:** We have modified our estimates to incorporate: (1) Lower capex in FY09 and FY10, (2) Lower working capital, hence, lower debt and interest, and (3) lower tax rates going forward. Based on the same, Blue Star's FY10E EPS is upgraded by 22.5% to Rs22.6 (up 13% YoY) and FY11E EPS by 16% to Rs25.7 (up 14% YoY).
- Near zero debt, high RoE and payout, P/E of 11x FY10E, maintain Buy:** Blue Star has only Rs230m debt as on end-FY09. Its RoE is consistently over 40%, as is dividend payout. We believe this merits premium valuation. The stock is trading at 11x FY10E EPS. We maintain **Buy** with a target price of Rs308 (12x FY11E).

### QUARTERLY PERFORMANCE

Y/E MARCH	(RS MILLION)									
	FY08				FY09				FY08	FY09
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
<b>Operating Income</b>	<b>4,623</b>	<b>5,478</b>	<b>5,149</b>	<b>7,081</b>	<b>6,309</b>	<b>6,465</b>	<b>5,667</b>	<b>7,249</b>	<b>22,330</b>	<b>25,691</b>
Change (%)	48.0	45.7	39.1	30.4	36.5	18.0	10.1	2.4	39.5	15.0
Total Expenses	4,243	4,794	4,592	6,357	5,739	5,776	5,146	6,304	19,985	22,964
<b>EBITDA</b>	<b>379</b>	<b>684</b>	<b>557</b>	<b>725</b>	<b>570</b>	<b>690</b>	<b>522</b>	<b>945</b>	<b>2,345</b>	<b>2,727</b>
Change (%)	139.4	108.4	134.3	63.0	50.4	0.8	-6.4	30.5	100.6	16.3
EBITDA Margin (%)	8.2	12.5	10.8	10.2	9.0	10.7	9.2	13.0	10.5	10.6
Depreciation	50	52	55	62	57	61	70	71	220	259
Interest	22	16	16	22	20	44	53	19	76	136
Other Income	1	8	1	7	17	12	1	20	17	50
Extraordinary Inc/ (Exp)	0	0	0	353	0	0	0	0	353	0
<b>PBT</b>	<b>308</b>	<b>624</b>	<b>487</b>	<b>1,001</b>	<b>510</b>	<b>596</b>	<b>400</b>	<b>876</b>	<b>2,420</b>	<b>2,382</b>
Tax	85	164	133	297	146	147	78	208	679	579
Tax/PBT (%)	27.5	26.3	27.3	29.7	28.6	24.6	19.6	23.8	28.1	24.3
<b>Reported PAT</b>	<b>223</b>	<b>460</b>	<b>354</b>	<b>704</b>	<b>364</b>	<b>449</b>	<b>322</b>	<b>668</b>	<b>1,741</b>	<b>1,803</b>
<b>Adjusted PAT</b>	<b>223</b>	<b>460</b>	<b>354</b>	<b>430</b>	<b>364</b>	<b>449</b>	<b>322</b>	<b>668</b>	<b>1,468</b>	<b>1,803</b>
Change (%)	205.8	149.8	208.2	26.7	63.1	-2.2	-9.2	55.1	106.2	22.8
PAT Margin (%)	4.8	8.4	6.9	6.1	5.8	7.0	5.7	9.2	6.6	7.0

### 4QFY09 profits above expectation

Blue Star's 4QFY09 operating income is broadly in line at Rs7.25b (our estimate Rs7.17b), up just 2% YoY. However, EBITDA margin at 13% (up 280bp YoY) is significantly higher than our estimated 10.4%. EBITDA at Rs945m (our estimate Rs746m) is up 30.5% YoY.

Adjusted PAT is up 55% YoY at Rs668m (our estimate Rs459m). The main reason for this is a significant higher EBITDA margin at 13% (our estimate 10.4%), up 280bp YoY. This can be attributed to: (1) softening of raw material prices, (2) tight cost control measures, and (3) enhanced price realizations.

### Profit performance is strong across all business segments

Blue Star's 4QFY09 sales appear low due to pass through of fall in raw material prices. However, profitability is good in all its business segments.

#### SEGMENT ANALYSIS (RS M)

	4QFY08	4QFY09	YOY (%)	FY08	FY09	YOY (%)
<b>Segment income</b>	<b>7,081</b>	<b>7,247</b>	<b>2.3</b>	<b>22,330</b>	<b>25,689</b>	<b>15.0</b>
Electro-mechanical projects	5,014	5,132	2.4	15,563	17,909	15.1
Cooling products	1,704	1,634	-4.1	5,324	6,039	13.4
Prof. Electronics	364	481	32.0	1,443	1,741	20.6
<b>Segment EBIT</b>	<b>849</b>	<b>1,096</b>	<b>29.1</b>	<b>2,767</b>	<b>3,240</b>	<b>17.1</b>
Electro-mechanical projects	597	766	28.3	1,897	2,131	12.3
Cooling products	179	228	27.2	581	749	28.9
Prof. Electronics	73	102	40.8	289	360	24.6
Unallocable exps (net)	179	201	12.4	624	722	15.7
<b>Total EBIT</b>	<b>670</b>	<b>895</b>	<b>33.6</b>	<b>2,142</b>	<b>2,518</b>	<b>17.5</b>
<b>Seg. EBIT Margin (%)</b>	<b>12.0</b>	<b>15.1</b>	<b>3.1</b>	<b>12.4</b>	<b>12.6</b>	<b>0.2</b>
Electro-mechanical projects	11.9	14.9	3.0	12.2	11.9	-0.3
Cooling products	10.5	14.0	3.4	10.9	12.4	1.5
Prof. Electronics	19.9	21.2	1.3	20.0	20.7	0.7
<b>Total EBIT Margin (%)</b>	<b>9.5</b>	<b>12.3</b>	<b>2.9</b>	<b>9.6</b>	<b>9.8</b>	<b>0.2</b>

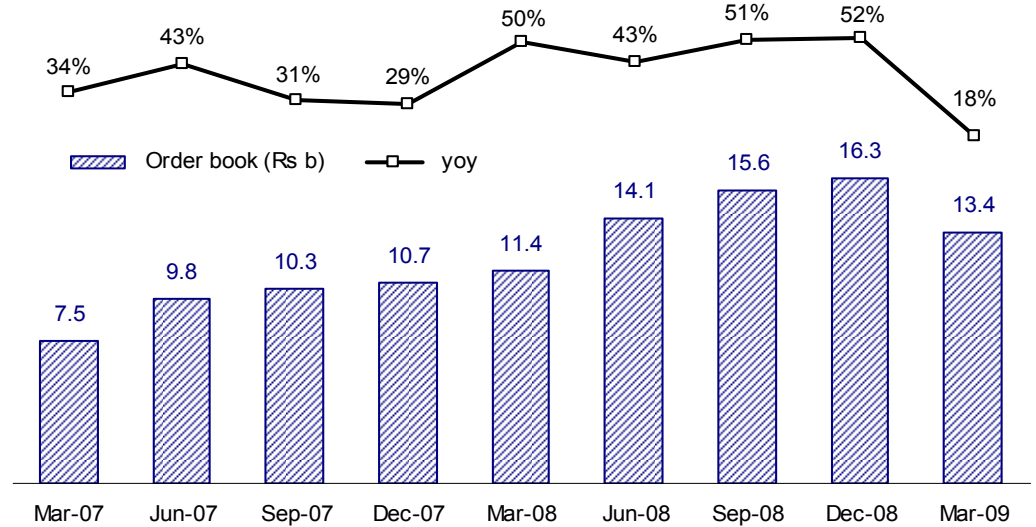
Source: Company / MOSL

### FY10 to be a year of consolidation

In the post-results concall, the management guided for FY10 to be a year of consolidation. Visibility for 1HFY10 is reasonably high due to an order backlog of Rs13.4b. However, 4QFY09 order inflow growth is negative YoY for the first time ever in the last 8 quarters. Thus, performance in 2HFY10 is contingent on order inflow during FY10.

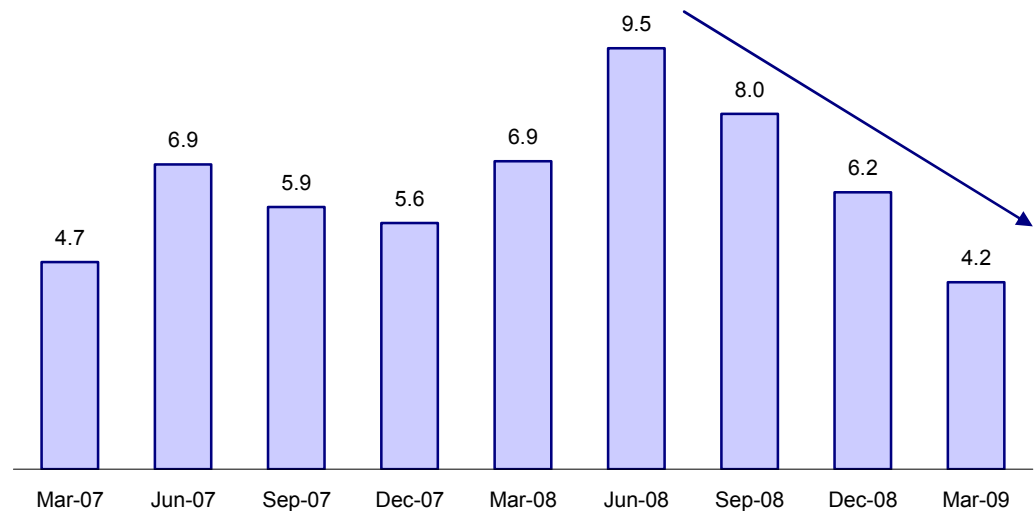
We believe the company will be able to slightly better its FY09 margins through a combination of: (1) lower material costs, (2) judicious price hikes, and (3) cost savings through value engineering and check on overheads.

**BLUE STAR'S ORDER BOOK AT RS13.4B AS ON 1 APRIL 2009**



Source: Company / MOSL

**BLUE STAR'S ORDER INFLOW REFLECTING ECONOMY SLOWDOWN (RS B)**



Source: Company / MOSL

**16-22% upgrade in EPS estimates, FY09-11E EPS CAGR of 13%**

The following are our major assumptions for Blue Star's FY10 and FY11 earnings estimates (including change in assumptions):

- Sales growth unchanged at 10% for FY10 and 15% for FY11
- EBITDA margin raised from 10.2-10.3% to 10.9-11% due to fall in raw material prices, and Blue Star's own cost control strategy including value engineering and SAP.
- Lower capex of Rs800m (Rs1,000m earlier) for FY09 and Rs500m (Rs600m earlier) for FY10.
- Lower finished goods inventory at 20 days of sales against 35 earlier.
- Lower debt and interest due to better working capital management (incidentally, Blue Star is now virtually a debt-free company with only Rs236m debt on the balance sheet as of March 2009).

- Lower tax rate of 26% for FY10 and 28% for FY11, against 29% earlier for both years.

Incorporating the above, we arrive at FY10 EPS of Rs22.5 (22.5% upgrade, +13% YoY) and for FY11 Rs25.7 (16% upgrade, +14% YoY). FY09-11E EPS CAGR works out to a steady 13%.

**Near zero debt, high RoE and payout, P/E of 11x FY10E, maintain Buy**

Blue Star is a near zero debt company with March 2009 debt figure of just Rs236m. Its FY09 RoE is a high 57%. Blue Star has a long, uninterrupted dividend track record, and its payout in the past few years has been over 40% of profits. We believe Blue Star stock merits premium valuation.

The stock is trading at 11x FY10E EPS and 10x FY11E EPS. We maintain **Buy** with a target price of Rs308 (12x FY11E).

## Blue Star: an investment profile

### Company description

Blue Star is India's leading Central Air-conditioning company with a market share of over 30%. Besides, it also makes a wide range of window and split ACs, and refrigeration products such as deep freezers, cold storages, water dispensers, visi-coolers, etc.

### Key investment arguments

- Blue Star's products and services cater to a wide range of industries – IT, Healthcare, Hospitality, Retail, Power, Railways, Banks, Education, etc.
- Blue Star has several national accounts (i.e. large all-India customers) leading to high repeat business. These include names like Infosys, Wipro, Bharti Airtel, DLF, Aditya Birla Retail, etc.
- The company has attained critical mass of cash flows to support its own growth and also manage healthy dividend payout of over 40% of profits

### Key investment risks

- Prolonged slowdown in user industries, led by global recession.
- Sharp increases in input prices such as copper and steel, affecting margins.

### Recent developments

- February 2008: Blue Star completes acquisition of Naseer Electricals, an electrical contracting company, for a consideration of Rs420m.
- January 2008: Blue Star sells 29% stake in ducting JV company, Rolastar Pvt Ltd, to Tomkins Plc for Rs367m; balance 20% to be sold by September 2009.

### Valuation and view

- 13% EPS CAGR FY09-FY11E; valuations at 11x FY10E EPS of Rs22.6.
- Maintain **Buy** with a price target of Rs308 (12x FY11E).

### Sector view

- The AC and refrigeration equipment sector is in the midst of a lull after a high-growth phase.
- Demand for central AC is shifting from IT and retail sectors to airports, metro rail and power plants. Growth in room ACs is led by higher income levels and lifestyle aspirations.
- Investments in SEZs and cold chain are expected to sustain the growth momentum over the long term.

#### COMPARATIVE VALUATIONS

		BLUE STAR	VOLTAS
P/E (x)	FY10E	11.1	11.6
	FY11E	9.7	10.4
Price / Book (x)	FY10E	4.6	3.1
	FY11E	3.6	2.5
EV / Sales (x)	FY10E	0.8	0.5
	FY11E	0.7	0.5
EV / EBITDA (x)	FY10E	7.3	8.0
	FY11E	6.3	7.0

#### SHAREHOLDING PATTERN (%)

	MAR-09	DEC-08	MAR-08
Promoters	40.1	40.1	40.2
Domestic Inst	7.3	8.1	9.9
Foreign	8.3	7.8	8.3
Others	44.3	44.0	41.6

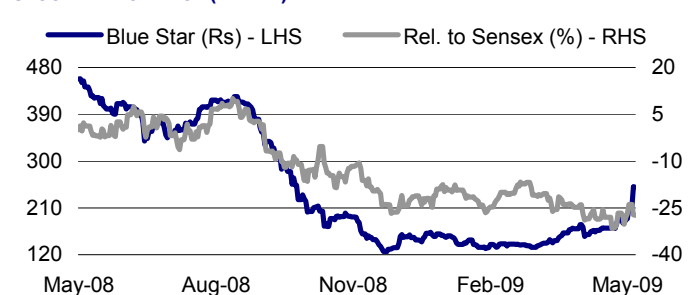
#### EPS (RS): MOST FORECAST VS CONSENSUS

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY10	22.6	20.5	10.2
FY11	25.7	25.7	-

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
250	308	23	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs MILLION)				
Y/E MARCH	2007	2008	2009	2010E	2011E	
<b>Net Sales</b>	<b>16,013</b>	<b>22,330</b>	<b>25,691</b>	<b>28,257</b>	<b>32,400</b>	
<i>Change (%)</i>	36.3	39.5	15.0	10.0	14.7	
Raw Materials	12,427	16,909	19,497	21,334	24,462	
<i>% of Net Sales</i>	77.6	75.7	75.9	75.5	75.5	
Staff Cost	1,229	1,544	1,823	2,094	2,406	
<i>% of Net Sales</i>	7.7	6.9	7.1	7.4	7.4	
Admin. & Other Exp.	1,188	1,532	1,644	1,757	1,976	
<i>% of Net Sales</i>	7.4	6.9	6.4	6.2	6.1	
<b>EBITDA</b>	<b>1,169</b>	<b>2,345</b>	<b>2,727</b>	<b>3,072</b>	<b>3,556</b>	
<i>Change (%)</i>	34.9	100.6	16.3	12.6	15.8	
Depreciation	209	220	259	337	371	
<b>EBIT</b>	<b>960</b>	<b>2,125</b>	<b>2,468</b>	<b>2,735</b>	<b>3,184</b>	
Interest	95	76	136	16	0	
Other Income	61	17	50	25	25	
Non Recurring Income	0	353	0	0	0	
<b>PBT</b>	<b>926</b>	<b>2,420</b>	<b>2,382</b>	<b>2,744</b>	<b>3,209</b>	
Total tax	214	679	579	713	899	
<i>Tax/PBT (%)</i>	23.1	28.1	24.3	26.0	28.0	
Reported PAT	712	1,741	1,803	2,031	2,311	
<b>Adjusted PAT</b>	<b>712</b>	<b>1,468</b>	<b>1,803</b>	<b>2,031</b>	<b>2,311</b>	
<i>Change (%)</i>	45.6	106.2	22.8	12.6	13.8	
<i>EBITDA Margin (%)</i>	7.3	10.5	10.6	10.9	11.0	
<i>PAT Margin (%)</i>	4.4	6.6	7.0	7.2	7.1	

BALANCE SHEET		(Rs MILLION)				
Y/E MARCH	2007	2008	2009E	2010E	2011E	
<b>Net Worth</b>	<b>2,130</b>	<b>2,635</b>	<b>3,702</b>	<b>4,912</b>	<b>6,297</b>	
Share Capital	180	180	180	180	180	
Reserves	1,950	2,456	3,522	4,732	6,117	
Total debt	890	365	239	0	0	
Net Deferred Tax	65	36	0	0	0	
<b>Capital Employed</b>	<b>3,085</b>	<b>3,037</b>	<b>3,941</b>	<b>4,912</b>	<b>6,297</b>	
Gross Fixed Assets	2,308	2,726	3,717	4,217	4,517	
Less: Acc. Depreciation	1,167	1,348	1,607	1,944	2,316	
<b>Net Fixed Assets</b>	<b>1,141</b>	<b>1,377</b>	<b>2,109</b>	<b>2,272</b>	<b>2,201</b>	
Capital WIP	24	181	50	50	50	
Investments	53	46	46	689	1,825	
<b>Curr. Assets</b>	<b>6,495</b>	<b>8,913</b>	<b>10,155</b>	<b>11,162</b>	<b>12,789</b>	
Inventory	2,086	2,898	2,440	2,677	3,070	
Debtors	3,507	4,837	6,335	6,968	7,989	
Cash & Bank	46	27	57	60	60	
Loans, Adv. & Others	856	1,151	1,324	1,457	1,670	
<b>Curr. Liabilities</b>	<b>4,650</b>	<b>7,495</b>	<b>8,419</b>	<b>9,261</b>	<b>10,569</b>	
Creditors	1,896	3,259	3,775	4,140	4,742	
Other Liabilities	2,600	3,251	3,728	4,100	4,702	
Provisions	154	985	917	1,021	1,126	
<b>Net Curr. Assets</b>	<b>1,845</b>	<b>1,419</b>	<b>1,736</b>	<b>1,900</b>	<b>2,220</b>	
Misc. Expenses	22	14	0	0	0	
<b>Total Assets</b>	<b>3,085</b>	<b>3,037</b>	<b>3,941</b>	<b>4,912</b>	<b>6,297</b>	

E: MOSL Estimates

RATIOS		(Rs MILLION)				
Y/E MARCH	2007	2008	2009E	2010E	2011E	
<b>Basic (Rs)</b>						
<b>EPS</b>	<b>7.9</b>	<b>16.3</b>	<b>20.0</b>	<b>22.6</b>	<b>25.7</b>	
Cash EPS	10.2	18.8	22.9	26.3	29.8	
Book Value	23.7	29.3	41.2	54.6	70.0	
Dividend per share	3.0	7.0	7.0	7.8	8.8	
Payout incl Div. Tax (%)	42.8	42.3	40.9	40.4	40.1	
<b>Valuation (x)</b>						
P/E		15.3	12.5	11.1	9.7	
Cash P/E		11.5	10.9	9.5	8.4	
Price/Book Value		8.5	6.1	4.6	3.6	
EV/Sales		1.0	0.9	0.8	0.7	
EV/EBITDA		9.7	8.3	7.3	6.3	
Dividend Yield (%)		2.8	2.8	3.1	3.5	
<b>Profitability (%)</b>						
RoE	36.9	73.1	56.9	47.1	41.2	
RoCE	36.1	58.5	72.2	62.3	57.3	
<b>Turnover Ratios</b>						
Debtors (days of sales)	80	79	90	90	90	
Inventory (days of sales)	48	47	35	35	35	
Creditors (days of exp.)	47	60	60	60	60	
Asset Turnover (x)	5.2	7.4	6.5	5.8	5.1	
<b>Leverage Ratio</b>						
Debt/Equity (x)	0.4	0.1	0.1	0.0	0.0	

CASH FLOW STATEMENT		(Rs MILLION)				
Y/E MARCH	2007	2008	2009E	2010E	2011E	
PBT excl. EO items	926	2,067	2,382	2,744	3,209	
Add: Depn & amortisation	219	228	273	337	371	
Interest paid	95	76	136	16	0	
Less: Direct Taxes Paid	-214	-679	-579	-713	-899	
(Incr)/Decr in WC	-409	407	-288	-161	-320	
<b>CF from Operations</b>	<b>617</b>	<b>2,098</b>	<b>1,924</b>	<b>2,222</b>	<b>2,362</b>	
Extraordinary Items	0	353	0	0	0	
CF including EO items	617	2,452	1,924	2,222	2,362	
(Incr)/Decr in FA	-295	-613	-860	-500	-300	
(Pur)/Sale of Investments	-1	7	0	-643	-1,136	
<b>CF from Inv. activity</b>	<b>-296</b>	<b>-606</b>	<b>-860</b>	<b>-1,143</b>	<b>-1,436</b>	
Incr/(Decr) in Net worth	0	0	0	0	0	
Incr/(Decr) in Debt	106	-554	-162	-239	0	
Interest Paid	-95	-76	-136	-16	0	
Dividend Paid (incl. div. tax)	-309	-737	-737	-821	-926	
<b>CF from Fin. activity</b>	<b>-298</b>	<b>-1,865</b>	<b>-1,034</b>	<b>-1,076</b>	<b>-926</b>	
<b>Incr/(Decr) of Cash</b>	<b>22</b>	<b>-19</b>	<b>30</b>	<b>4</b>	<b>0</b>	
Add: Opening Balance	24	46	27	57	60	
<b>Closing Balance</b>	<b>46</b>	<b>27</b>	<b>57</b>	<b>60</b>	<b>60</b>	

**NOTES**



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<b>Disclosure of Interest Statement</b>	<b>Blue Star</b>
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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