

Healthy order book, but execution overhang

Execution challenges in EMP; foray into residential segment drives cooling product revenues

Blue Star's revenue grew 4.7% YoY to ₹9.15bn, led by a 42.2% growth in cooling products at ₹2.65bn (driven by foray into residential air-conditioner market), a 13.8% growth in professional electronics at ₹623mn and 5% decline in electromechanical projects (EMP) at ₹5.8bn (due to the slowdown in billing and execution of large projects). The EBIDTA margin declined 160bps YoY to 11.2% due to a sharp 460bps YoY decline in cooling products profitability to 10.8%. This was because of the sharp rise in input costs and increase in CENVAT rate with one of the factories coming out of a tax holiday in Himachal Pradesh.

For the full year FY11, the revenues grew 16.4% YoY led by 35.2% growth in cooling products at ₹7.88bn, a 39.7% growth in professional electronics at ₹2.06bn and 10.4% growth in EMP at ₹19.8bn. The EBIDTA margin declined 140bps YoY to 9.5% mainly because of 270bps YoY decline in EMP margin to 9.2% (due to poor execution and billing and a consequent sharp increase in overheads).

Order book at ₹19.7bn; FY11 order inflow up 6.6% YoY

The order book as on 31 March 2011 stood at ₹19.7bn, up 13.6% YoY, with an average 15-month execution cycle. DSGPL's order book stood at ₹2.5bn. Order inflows grew 17.2% YoY to ₹8.25bn mainly led by orders from the power, hospitality and hospital sectors. For the full year FY11, the order inflows grew 6.6% YoY to ₹31.25bn. In terms of industry outlook, Blue Star is witnessing a slower than expected recovery in the retail and IT sector, sluggishness in commercial real estate and cut-back in capex on the telecom sector.

Poor EMP revenue guidance; margin pressure expected to ease

Revenue and margin outlook: The company expects muted revenues in EMP (due to the focus on receivables and cash flows), ~ 20% growth in cooling products (driven by its residential foray) and 15% growth in professional electronics in FY12E. The EBIDTA margin is expected to improve on a YoY basis due to better inventory management and various cost control measures undertaken by the company.

Capex: Blue Star incurred capex of ₹220mn in FY11 and plans to incur capex of ₹500mn in FY12E.

Valuation and view

Despite the headwinds in the last two years, the company has been able to successfully grow its revenues and order book. However, with the company's renewed focus on cash flows and receivables coupled with macro-economic headwinds in the near-term, we expect a slowdown in order inflow growth momentum. Consequently, we downgrade FY12E and FY13E EPS by ~4% each to factor lower growth in EMP revenues. We downgrade the stock to **Accumulate** due to limited upside form current levels.

Financial summary

Yr-end March (₹ mn)	FY09A	FY10A	FY11E	FY12E	FY13E
Net sales	25,026	25,250	30,082	33,033	38,427
Net profit	1,803	2,115	1,610	1,921	2,367
EPS (Rs)	20.0	23.5	17.9	21.4	26.3
RoCE (%)	56.0	46.5	24.1	22.1	23.8
RoE (%)	57.2	49.3	31.7	33.1	33.2
P/E (x)	7.8	13.8	18.1	15.1	12.3
EV/EBITDA (x)	5.3	10.6	11.5	9.4	7.8
P/BV (x)	3.8	5.9	5.6	4.6	3.7

Source: Alchemy Research, Company

Downgrade from Buy

ACCUMULATE

Sector view: Equalweight

Sector relative view: Marketperform

TP: ₹368 (14%)

CMP: ₹324

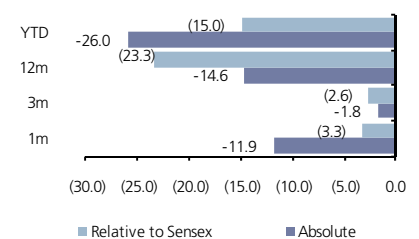
Company data

Shares outstanding	90mn
Market cap	₹29bn/US\$0.64bn
52-wk high/low	₹554/315
Avg. daily traded volume	0.03(mn shrs)

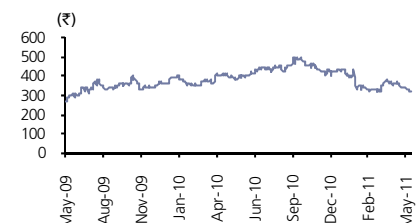
Shareholding pattern (%)

Promoter	FII	DII	Others
40.1	6.4	13.3	40.2

Performance (%)

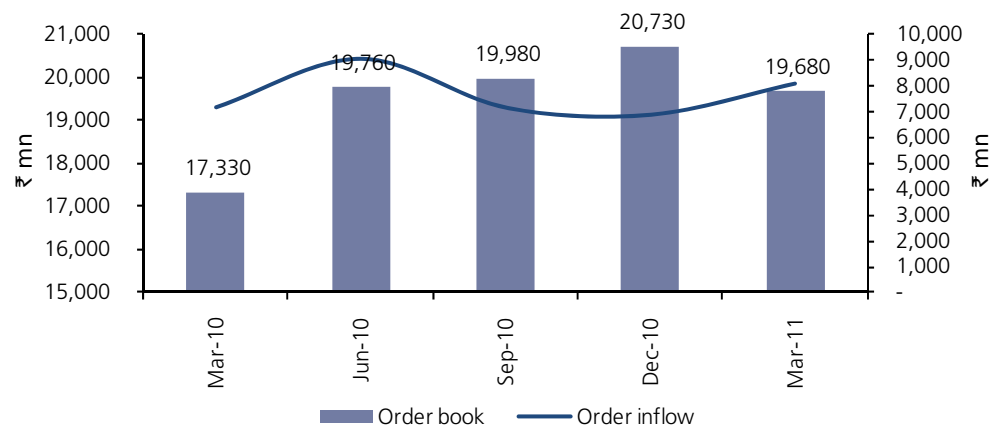


Share price movement



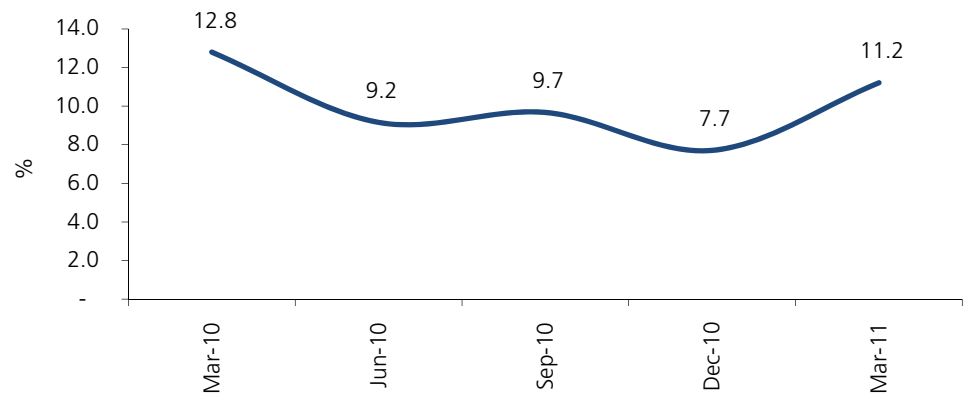
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Exhibit 1: Order book and order inflows



Source: Company, Alchemy Research

Exhibit 2: EBITDA margin



Source: Company, Alchemy Research

Exhibit 3: Standalone quarterly results

₹ mn, Year-end 31 March	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
Total income	8,747	6,648	6,948	6,134	9,156
YoY (%)	22.6	25.2	23.3	3.0	4.7
QoQ (%)	46.9	(24.0)	4.5	(11.7)	49.3
Total Expenditure	7,628	6,040	6,275	5,661	8,129
Raw Material Consumed	6,688	5,322	5,489	5,116	7,705
Stock Adjustment	(246)	(279)	(182)	(475)	(842)
% of sales	73.6	75.9	76.4	75.7	75.0
YoY (%)	26.1	32.7	25.8	1.5	6.5
QoQ (%)	40.8	(21.7)	5.2	(12.5)	47.9
Employee Expenses	481	473	508	520	561
% of sales	5.5	7.1	7.3	8.5	6.1
YoY (%)	(0.1)	1.9	7.1	20.9	16.6
QoQ (%)	11.9	(1.6)	7.3	2.3	7.9
Other Expenses	705	523	461	501	705
% of sales	8.1	7.9	6.6	8.2	7.7
YoY (%)	23.8	27.4	57.5	28.9	(0.0)
QoQ (%)	81.6	(25.8)	(12.0)	8.7	40.9
EBITDA	1,120	609	672	473	1,026
OPM (%)	12.8	9.2	9.7	7.7	11.2
YoY (bps)	(90.1)	(280.7)	(185.2)	(175.8)	(159.0)
YoY (%)	14.5	(4.2)	3.5	(16.1)	(8.3)
Other Income	27	4	16	0	26
Interest	25	20	49	79	96
YoY (%)	(53.4)	37.9	280.5	778.9	284.4
Depreciation	91	76	79	80	82
YoY (%)	28.6	(7.8)	(9.0)	(8.1)	(9.9)
Exceptional items	-	4	-	-	-
PBT	1,030	521	561	314	874
Tax	245	150	174	90	306
Fringe Benefit Tax	-	-	-	-	-
Deferred Tax	-	-	-	-	-
Tax / PBT (%)	23.8	28.7	31.1	28.7	35.0
PAT	785	372	386	224	568
NPM (%)	9.0	5.6	5.6	3.6	6.2
YoY (%)	17.7	(9.8)	(21.9)	(47.2)	(27.6)
QoQ (%)	85.5	(52.7)	4.0	(42.1)	154.2
Equity	180	180	180	180	180
EPS	8.7	4.1	4.3	2.5	6.3
Face Value	2	2	2	2	2

Source: Company, Alchemy Research

Revenue growth mainly driven by 42% YoY growth in cooling products due to its foray into the residential air-conditioner market in 4QFY11.

Sharp increase in tax rate with one of the factories in Himachal Pradesh coming to the end of its tax holiday.

Exhibit 4: Segmental results

₹ mn	Year-end	31 March	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
Revenue							
EMP			6,130	3,742	4,705	4,342	5,804
YoY (%)			24.5	18.9	12.6	(6.2)	(5.3)
Cooling products			1,869	2,534	1,439	1,278	2,658
YoY (%)			16.5	33.1	29.0	34.0	42.2
Professional electronics			547	323	674	448	623
YoY (%)			15.6	30.9	99.9	28.3	13.8
Total			8,546	6,598	6,818	6,068	9,085
EBIT							
EMP			790	340	444	292	699
YoY (%)			1.3	(1.5)	(6.1)	(38.7)	(11.5)
Cooling products			287	352	165	101	286
YoY (%)			25.0	6.1	10.3	12.8	(0.3)
Professional electronics			198	55	163	117	205
YoY (%)			85.1	(22.8)	65.1	34.9	3.3
Total			1,276	747	772	510	1,190
EBITM (%)							
EMP			12.9	9.1	9.4	6.7	12.0
YoY (bps)			(296)	(188)	(189)	(357)	(84)
Cooling products			15.4	13.9	11.4	7.9	10.8
YoY (bps)			104	(354)	(194)	(149)	(460)
Professional electronics			36.2	16.9	24.1	26.1	32.9
YoY (bps)			1,361	(1,172)	(509)	128	(336)
Capital employed							
Electro-mechanical Projects			4,038	4,971	5,542	5,256	5,021
Cooling products			1,034	1,005	1,275	1,113	1,390
Professional electronics			527	534	497	638	648
Residual			-	-	-	-	-
Total			5,599	6,510	7,314	7,007	7,059
Unallocated net assets / liabilities			(593)	(394)	(1,639)	(1,109)	(1,108)
Total			5,006	6,116	5,675	5,898	5,951

Source: Company, Alchemy Research

Strong revenue growth driven by the foray into the residential air conditioner market in 4QFY11.

Sharp QoQ EMP margin improvement led by better cost control and management.

Margin decline due to one of the factories coming to the end of its tax holiday, and rising input costs.

Financial statements and assumptions

Profit and loss account

Yr-end March (₹ mn)	FY09A	FY10A	FY11E	FY12E	FY13E
Net sales	25,026	25,250	30,082	33,033	38,427
Raw materials	18,743	18,821	22,870	24,774	28,820
Employee cost	1,823	1,849	2,151	2,366	2,721
Other expenses	1,813	1,833	2,196	2,444	2,805
Total expenditure	22,378	22,503	27,217	29,585	34,346
EBITDA	2,648	2,747	2,866	3,448	4,081
Other income	166	311	16	68	79
Interest	173	85	256	421	396
Depreciation	259	347	319	349	382
PBT	2,382	2,766	2,311	2,745	3,381
Total tax	556	651	728	823	1,014
PAT	1,803	2,115	1,583	1,921	2,367
Less: Adjustments	—	—	(27)	—	—
Adjusted PAT	1,803	2,115	1,610	1,921	2,367

Balance sheet

Yr-end March (₹ mn)	FY09A	FY10A	FY11E	FY12E	FY13E
Equity capital	180	180	180	180	180
Reserves & surplus	3,491	4,737	5,057	6,189	7,715
Net worth	3,671	4,917	5,237	6,369	7,894
Minority interest	—	—	—	—	—
Total debt	236	89	4,339	4,089	3,839
Total	3,907	5,006	9,576	10,458	11,734
Net block	1,876	1,977	1,882	2,033	1,901
Capital WIP	248	16	16	16	16
Total fixed assets	2,124	1,992	1,898	2,049	1,916
Investments	44	42	272	272	272
Net working capital	1,685	2,825	6,796	7,335	8,553
Current assets	12,398	16,655	19,818	20,991	24,480
Inventories	2,081	2,580	4,121	4,073	4,738
Debtors	6,086	6,282	8,242	9,050	10,528
Cash & bank	92	132	595	787	977
Other current assets	4,139	7,660	6,861	7,082	8,238
Current liabilities & provisions	10,622	13,698	12,428	12,869	14,950
Creditors	3,828	5,531	5,748	5,769	6,712
Other liabilities	3,694	4,280	5,009	5,260	6,119
Provisions	3,100	3,887	1,671	1,839	2,119
Net deferred tax assets	(6)	15	15	15	15
Miscellaneous exp.	6	—	—	—	—
Total	3,944	5,006	9,576	10,458	11,734

Source: Alchemy Research, Company

Ratios

Yr-end March	FY09A	FY10A	FY11E	FY12E	FY13E
Percentage of net sales					
Raw material costs	74.9	74.5	76.0	75.0	75.0
Employee costs	7.3	7.3	7.1	7.2	7.1
Total expenses	89.4	89.1	90.5	89.6	89.4
EBIDTA	10.6	10.9	9.5	10.4	10.6
PAT	7.2	8.4	5.4	5.8	6.2
Asset-based ratios (%)					
RoCE	56.0	46.5	24.1	22.1	23.8
RoE	57.2	49.3	31.7	33.1	33.2
Turnover ratios (days)					
Debtor days	78	88	88	96	93
Inventory days	36	34	41	45	42
Creditor days	65	91	90	85	79
Working capital days	23	34	63	86	84
Growth ratios (%)					
Net sales	12.7	0.9	19.1	9.8	16.3
EBITDA	18.8	3.7	4.3	20.3	18.4
EPS	3.6	17.3	(23.9)	19.4	23.2
CEPS	5.2	19.4	(22.7)	19.4	21.1
Per share (Rs)					
EPS	20.0	23.5	17.9	21.4	26.3
CEPS	22.9	27.4	21.1	25.2	30.6
BV	40.8	54.7	58.2	70.8	87.8
DPS	7.0	8.0	7.0	7.5	8.0
Valuations (x)					
P/E	7.8	13.8	18.1	15.1	12.3
P/CEPS	6.8	11.8	15.3	12.8	10.6
P/BV	3.8	5.9	5.6	4.6	3.7
Yield (%)	4.5	2.5	2.2	2.3	2.5
EV/EBITDA	5.3	10.6	11.5	9.4	7.8
EV/sales	0.6	1.2	1.1	1.0	0.8
Solvency ratios					
Current ratio	1.2	1.2	1.6	1.6	1.6
Quick ratio	—	—	—	0.1	0.1
D/E ratio	0.1	—	0.8	0.6	0.5
Interest coverage ratio	11.2	24.5	6.9	5.3	6.7

Cash flow statement

Yr-end March (₹ mn)	FY09A	FY10A	FY11E	FY12E	FY13E
PAT	1,803	2,115	1,610	1,921	2,367
Add: Depreciation	259	347	319	349	382
Add: Interest expense	173	85	256	421	396
Less: Other income	(166)	(311)	(16)	(68)	(79)
Change in working capital	(293)	(1,140)	(3,971)	(540)	(1,218)
Others	—	—	—	—	—
Cash flow from operations	1,777	1,095	(1,803)	2,085	1,849
Change in fixed assets	(825)	(216)	(225)	(500)	(250)
Change in investments	2	2	(230)	—	—
Other income	166	311	16	68	79
Others	—	—	—	—	—
Cash flow from investing activities	(657)	97	(439)	(432)	(171)
Change in debt	(129)	(147)	4,250	(250)	(250)
Dividend & dividend tax	(737)	(842)	(737)	(789)	(842)
Change in equity & share premium	—	—	—	—	1
Interest paid	(173)	(85)	(256)	(421)	(396)
Other adjustments	(30)	(21)	—	—	—
Cash flow from financing activities	(1,068)	(1,094)	3,257	(1,461)	(1,487)
Change in cash & cash equivalents	60	105	1,015	192	190
Opening cash & cash equivalents	27	92	132	595	787
Closing cash & cash equivalents	87	197	1,147	787	977

Source: Alchemy Research, Company

The ratings are based on the absolute upside of our target price from the current price.

Upside >25%	Strong Buy	Sector relative call		Sector weight
Upside between 15% and 25%	Buy	Outperform	>5% upside to sector benchmark	Overweight
Upside up to 15%	Accumulate	Marketperform	+5% to -5% of sector benchmark	Equal weight
Downside up to 15%	Reduce	Underperform	>5% downside to sector benchmark	Underweight
Downside >15%	Sell			

Sales

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Trade execution

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