



India Equities
Airconditioning

Quarterly Update

Blue Star Limited

HOLD

Sakshi Bahl

Email: sakshi@parsoli.com

Tel: +91-22-40912786

CMP **Rs 377**
Target Price **Rs 396**

Investment horizon 12 months
Sensex 16,358
Nifty 4,882

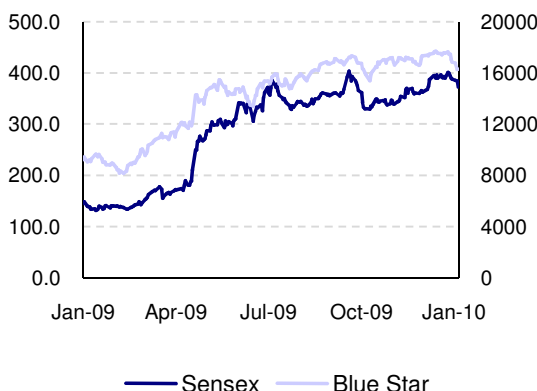
Stock Details

BSE Code	500067
NSE Code	BLUESTARCO
Reuters Code	BLUS.BO
Bloomberg Code	BLSTR IN
Market Cap (Rs cr)	3,387.4
Beta	0.65
52 W High / Low (Rs)	425.0 / 124.6
Avg Daily Volume	15,204
Face Value (Rs)	2.00

Shareholding Pattern (%)

Promoters	40.14
MF/Banks/Indian FIs	7.51
FII / NRIs / OCBs	17.05
Indian Public	35.30

Price Chart



Performance Highlights

Order book growth continues to remain under pressure: The carry forward order book of Blue Star has shown a growth of 16.2% yoy from Rs 1,626cr in Q3FY2009 to Rs 1,890cr in Q3FY2010. However, the order inflow has declined by 5.3% from Rs 663cr in Q3FY2009 to Rs 628cr in Q3FY2010. The order inflow continues to decline and an expected revival in the market is likely to come after 6-8 months. The growth remains under pressure due to demand concerns and project execution delays, negatively impacting the revenues. Though the management is aggressively targeting sectors like education, healthcare and airports, the growth remains restrained across the industry.

Net sales down 8.0% yoy for 9mFY2010: The net sales of the company have declined by 8.0% yoy to Rs 1,694.7cr as compared to Rs 1,841.3cr in 9mFY2009. The Q3FY2010 sales are up 4.8% to Rs 593.1cr. The fall in revenues during 9mFY2010 has been due to continuous decline in Electro mechanical projects and packaged airconditioning systems segment's revenues by 5.7% during 9mFY2010. This segment contributes around 70.0% of the total sales.

Valuation: We have used Relative Valuation based on average of EV/EBIDTA and Price/Earnings (P/E) ratios. The stock is currently trading at EV/EBIDTA of 12.1x FY2011E and P/E of 17.8x FY2011E earnings. The sales have been impacted due to the slowdown and, going forward, they are expected to remain subdued for Q4FY2010 and H1FY2011. **We recommend a Hold on the stock with a Target Price of Rs 396.**

Exhibit 1: Quarterly Financials

Particulars	Q3FY2010	Q3FY2009	YoY(%)	Q2FY2010	QoQ(%)
Revenue	593.1	565.8	4.8	563.0	5.3
Other Income	2.9	1.0	187.9	3.8	(24.8)
Total Income	595.9	566.8	5.1	566.8	5.1
Total Expenditure	539.2	514.5	4.8	498.6	8.2
EBIDTA	53.8	51.3	5.0	64.5	(16.5)
<i>EBIDTA Margin</i>	9.1	9.1	-	11.5	-
Depreciation	8.8	7.0	25.0	8.7	1.0
EBIT	47.9	45.3	5.9	59.6	(19.6)
Interest	0.9	5.3	(82.9)	1.3	(29.9)
Profit before					
Exceptional Items and Tax	47.0	40.0	17.5	58.3	(19.4)
Exceptional Items	8.7	0.0	-	5.2	-
Profit before Tax	55.8	40.0	39.3	63.6	(12.3)
Tax	13.4	7.8	71.4	14.1	(5.0)
Net Profit	42.3	32.2	31.5	49.4	(14.4)
<i>PAT Margin (%)</i>	7.1	5.7	-	8.8	-
EPS	4.7	3.6	-	5.5	-

Source: Company data, Parsoli Research



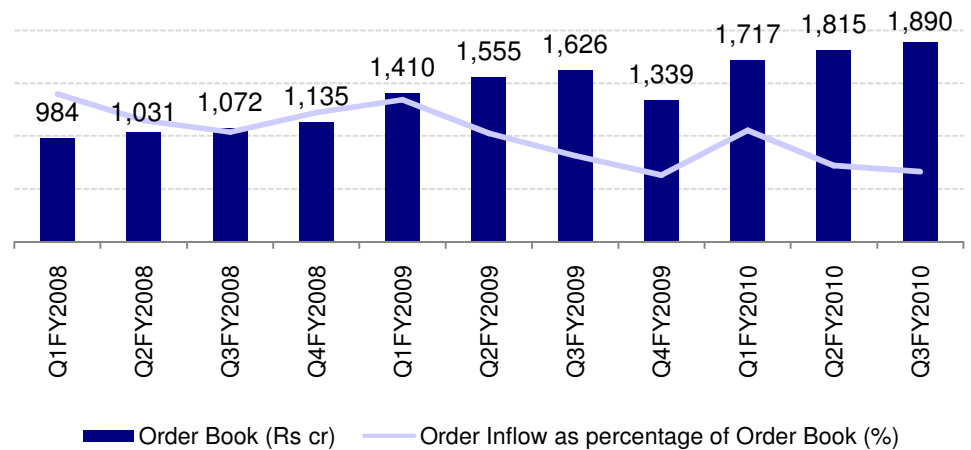
During Q3FY2010, Blue Star's order book grew by 16.2% to Rs 1,890cr with the order inflow at Rs 663cr

Key Updates

Order book continues to remain subdued

During Q3FY2010, the carry forward order book increased by 16.2% yoy and 4.1% qoq to touch Rs 1,890cr. The order inflow was at Rs 628cr during Q3FY2010 as against Rs 663cr, showing a decline of 5.3% yoy. Going forward, the growth continues to look restrained in the domestic market as most of the projects are still not being executed on account of the growth concerns. Though there are signs of recovery, it is likely to take some more time for growth to return to pre-recession levels. The company continues to target sectors like infrastructure, healthcare, education, telecom and hospitality segments. The sectors like IT/ITeS and retail, which were earlier major contributors to the company's revenues, are still reeling under the slowdown.

Exhibit 2: Order Book Growth



Source: Company data, Parsoli Research

The management expects H1FY2011 to remain neutral in terms of growth and revival is expected in H2FY2011

Going forward, the management expects that the pressure on order inflow is likely to continue for Q4 and H1FY2011 would be neutral in terms of growth. An optimistic and sustainable revival in growth is expected only during H2FY2011. The company further plans to explore opportunities in the power sector in areas like substations, transmission distribution, etc.

The revenue from Electro mechanical projects & packaged airconditioning systems segment increased by 9.6% yoy during the quarter with margins improving by 42bps yoy

Electro Mechanical Projects & Packaged Airconditioning Systems

This segment contributes around 70.0% of the total revenues and the company's order book remains highly dependent on performance in this segment. Since the onset of slowdown, with sluggish growth in sectors like IT/ITeS, retail and realty; there has been a decline in the total sales. During the quarter, the segment saw a 9.6% yoy increase in sales at Rs 462.8cr which indicates an improved performance as this segment has been seeing continuous decline in revenues at around 12-15% since the beginning of FY2010. The billing for the segment improved as the order book execution picked up and the projects booked during Q4FY2009 and Q1FY2010 are now being billed. The segment margin also showed an improvement of 42bps yoy to 10.3%. During the quarter, the company won an order worth Rs 33cr from ESIC Hospital, Mumbai for the combined mechanical and electrical works. It also booked an integrated Mechanical, Electrical and Plumbing (MEP) order valued at Rs 32cr from Market City Group for their proposed Shangri-La Hotel coming in Mumbai. In addition, the company won an order from Mumbai



The company is seeing growth from the PCPA segment being driven by the telecom sector and the emerging trend of shifting of data centres to India

The company continues to focus on booking MEP/HVAC (bundled) contracts that leverage its electrical services

The Cooling Products segment's revenues remained flat with operating margin declining by 141bps yoy

The sales from Professional Electronics and Industrial Systems segment declined by 25.2% and profits were down by 29.4%

International Airport for airconditioning the south-west pier of the airport. There were two other orders from the power sector from NTPC and Reliance.

The company's Precision Control Packaged Airconditioners (PCPA) also performed well with orders from Financial Software Services Ltd, Chennai; Ness Technologies, Bengaluru and CDAC, Chennai. The growth in the PCPA segment is coming on account of a rapid expansion of data centres driven by the telecom sector and an increasing trend of shifting of the data centres to India. According to the management, the market for PCPA stands at around Rs 200cr, with Blue Star's market share at around 20.0%.

Blue Star continues to cross-sell its electrical services (which include Naseer Electricals' operations) to existing customers in order to book integrated MEP orders which bundle the mechanical, electrical, airconditioning, plumbing works under a single contract. Currently, nearly 30-35% of the total contracts booked are integrated MEP contracts (including electrical, airconditioning, plumbing and other works) and the segment is expected to grow further on the back of continuous project bundling. Blue Star stands to grow in this segment as only a few players in India are capable of executing such MEP/HVAC contracts and competition from smaller players (that offer only electrical works) is minimal. During the quarter, the company also booked several standalone electrical contracting orders from Grasim Industries, Secunderabad; Marriot Hotel, Bengaluru; Vikas Telecom, Bengaluru and Lanco Township, Delhi.

Cooling Products

In this segment, the revenues remained flat during the quarter at Rs 95.4cr as compared to Rs 95.0cr in Q3FY2009. The operating margin for the segment declined 141bps yoy to 9.4%, mainly due to a change in the product/project mix and Q3 being a lean season for unitary cooling products such as room airconditioners and water coolers.

During the quarter, the company booked large orders for the commercial split airconditioners from Tata Communications, Bata India, Federal Bank, Muthoot Finance, Systema Shyam Teleservices, Religare, Kotak Mahindra, Universal Sampo, Reliance Capital and Carnation Auto. The refrigeration products business was driven by enhanced sales of chest coolers and chest freezers with large orders from the ice cream and dairy segments. In the cold chain segment, the company witnessed an improvement in demand from third party refrigerated logistics players like S K Logistics and Transmart.

Professional Electronics and Industrial Systems

In this segment, sales continued to decline during Q3FY2010 also, down by 25.2% yoy at Rs 34.9cr. The margin also declined by 38bps yoy to 24.8% during the quarter. The profits were down by 29.4% to Rs 8.7cr in Q3FY2010 from Rs 12.3cr in Q3FY2009.



The net sales declined 12.8% yoy to Rs 563.0cr but the operating margin expanded by 91bps to 10.5%

We expect the revenues to grow at a low CAGR of 3.7% (FY2009-12) to reach Rs 2,844.3cr by FY2012

Decline in revenues for 9mFY2010 but margins expand

During Q3FY2010, the company's revenues were up by 4.8% to Rs 593.1cr. However, for 9mFY2010, the total revenues have shown a decline of 8.0% yoy and stood at Rs 1,694.7cr as against Rs 1,841.3cr for 9mFY2009. The decline in net sales has been due to delays in order execution as many projects are still stuck on the drawing stage. The average time for the order book execution has, however, come down from 14-15 months. During the quarter, the EBIDTA margin sustained at 9.1% level and the PAT margin was up 145bps yoy due to exceptional items worth Rs 8.7cr on account of sale of investments. The positive effect of decline in interest charge was offset by higher tax rate during the quarter. However, for 9mFY2010, the EBIDTA margins have improved by 108bps yoy to reach 10.6% on account of lower COGS. The PAT margins have further shown an improvement of 168bps yoy during 9mFY2010 to touch 7.8%. This improvement has been due to a 77.5% decline in the interest charges to Rs 2.6cr. Going forward, the management expects that the 9mFY2010 margins would be sustained during Q4FY2010.

Valuation

We expect the company's revenues to show sluggish growth at a CAGR of 3.7% (FY2009-12) to reach Rs 2,844.3cr. Blue Star's performance continues to remain under pressure as many projects are facing execution delays. In addition, the order inflow is slow and growth in sectors like IT/ITeS, retail and realty, etc. is restrained. The company is, however, increasingly targeting other emerging sectors like education, healthcare and airports. Going forward, the management expects growth to remain neutral during H1FY2011 and a revival in demand is likely to come during H2FY2011. Even with the recent improvement in margins, the scope for growth in company's profits is expected to be limited.

Relative Valuation

Blue Star currently trades at an EV/EBIDTA multiple of 12.7x FY2010E and 12.1x FY2011E. The current industry average stands at 17.2. The company's operating margins are expected to sustain at current levels during FY2010 but there is not much scope for their improvement unless the revenues pick up. Going forward, however, we expect the company to perform better during FY2011 with its focus on sectors like airports, healthcare, education, etc. We have discounted the peer group average and assigned a multiple of 14.0 to value the stock. Using this target multiple on our FY2011 EBIDTA estimates of Rs 265.8cr, we arrive at a target price of Rs 414.3 per share.

When considering the P/E multiple, the stock currently trades at 18.5x FY2010E and 17.8x FY2011E earnings. The peer group average stands at 22.2. We expect the EPS to grow at a low CAGR of 1.8% (FY2009-12) to touch Rs 21.2. We are assigning a multiple of 18.5 to value the stock. Employing this target multiple on our FY2011 EPS estimates of Rs 20.4, we arrive at a target price of Rs 377.7.

Blue Star has performed well till now but, going forward, with the expected slow growth in revenues and no significant improvement in margins from here on, the stock does not look very attractive. Though the stock has come down from the earlier high levels, it does not offer much scope in terms of potential upside. The weighted average of the price estimated through EV/EBIDTA and P/E methodologies gives us an upside of 5.1% and **we recommend Hold on the stock with a target price of Rs 396.**



Blue Star

HOLD

We recommend Hold on the stock with a target price of Rs 396 per share

Exhibit 3: Valuation

Pricing Methodologies	Weight Assigned	Target Price
Target price using EV/EBIDTA approach	50.0%	414.3
Target price using P/E approach	50.0%	377.7
Weighted average target price (Rs)		396.0
Current Market Price (CMP)		376.8
Upside from current levels (%)		5.1

Source: Company data, Parsoli Research



Financial Statements

Exhibit 4: Profit & Loss Statement					Rs cr
	FY2008	FY2009	FY2010E	FY2011E	FY2012E
Net Sales	2,221.6	2,552.3	2,400.5	2,555.6	2,844.3
<i>% chg</i>	39.3	14.9	(5.9)	6.5	11.3
Total Expenditure	1,998.5	2,296.4	2,146.0	2,289.8	2,565.5
<i>% chg</i>	34.6	14.9	(6.5)	6.7	12.0
EBIDTA	223.1	255.9	254.5	265.8	278.7
<i>Margin (%)</i>	10.0	10.0	10.6	10.4	9.8
Other Income	48.5	21.8	14.4	28.4	33.7
Depreciation & Amortisation	22.0	25.9	32.4	39.1	47.9
Interest	7.6	13.6	3.0	0.0	0.0
PBT	242.0	238.2	233.5	255.0	264.6
<i>Margin (%)</i>	10.9	9.3	9.7	10.0	9.3
Total Tax	67.9	57.9	60.7	71.4	74.1
<i>(% of PBT)</i>	28.1	24.3	26.0	28.0	28.0
PAT	174.1	180.3	172.8	183.6	190.5
<i>% chg</i>	144.6	3.6	(4.2)	6.3	3.7
<i>Margin (%)</i>	7.8	7.1	7.2	7.2	6.7

Source: Company data, Parsoli Research

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