



India Equities
Airconditioning

Quarterly Update

Blue Star Limited

BUY

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CMP **Rs 338**

Target Price **Rs 400**

Investment horizon 12 months

Sensex 16,158

Nifty 4,796

Stock Details

BSE Code 500067

NSE Code BLUESTARCO

Reuters Code BLUS.BO

Bloomberg Code BLSTR IN

Market Cap (Rs cr) 3,038.2

Beta 0.54

52 W High / Low (Rs) 425.0 / 122.1

Avg Daily Volume 21,723

Face Value (Rs) 2.00

Shareholding Pattern (%)

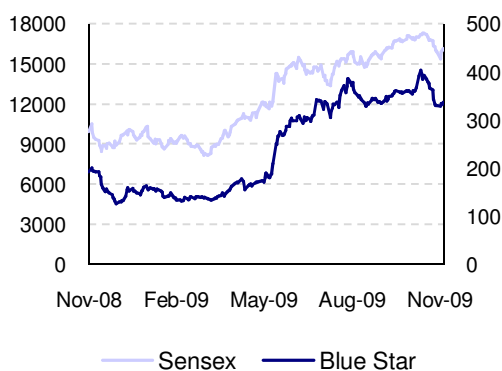
Promoters 40.14

MF/Banks/Indian FIs 7.16

FII / NRIs / OCBs 17.20

Indian Public 35.50

Price Chart



Performance Highlights

Order book grows, but with lower order inflow: The carry forward order book of Blue Star has shown a growth of 16.7% yoy from Rs 1,555cr in Q2FY2009 to Rs 1,815cr in Q2FY2010. However, the order inflow has declined by 17.9% from Rs 798cr in Q2 FY2009 to Rs 655cr in Q2FY2010. The average time for project execution, which till last year stood at around 8-9 months, now stands at 14-15 months, delaying the revenue inflow. Going forward, with the expected revival in the market, the company expects this to come to under 12 months.

Net sales decline 12.8% yoy: The net sales of the company declined by 12.8% yoy to Rs 563.0cr in Q2FY2010 as compared to Rs 645.6cr in Q2FY2009. On qoq basis, the net sales were up 4.5%. The decline can be primarily attributed to a 12.1% decline in revenues from Electro Mechanical Projects and Packaged Air-conditioning Systems segment which contributes more than 67.0% of 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 11.6x FY2011E earnings and P/E of 16.4x FY2011E EPS. The sales have been impacted due to the slowdown and, going forward, sales are expected to remain subdued for FY2010. However, we expect the sales to increase in FY2011 once the project execution activity picks up. **We continue to find the stock attractive and recommend Buy on the stock with a Target Price of Rs 400.**

Exhibit 1: Quarterly Financials

Particulars	Q2FY2010	Q2FY2009	YoY(%)	Q1FY2010	QoQ(%)
Revenue	563.0	645.6	(12.8)	538.5	4.5
Other Income	3.8	2.1	83.1	1.7	125.6
Total Income	566.8	647.7	(12.5)	540.2	4.9
Total Expenditure	498.6	577.6	(13.7)	477.3	4.5
EBIDTA	64.5	68.1	(5.3)	61.2	5.3
<i>EBIDTA Margin (%)</i>	<i>11.5</i>	<i>10.5</i>	<i>-</i>	<i>11.4</i>	<i>-</i>
Depreciation	8.7	6.1	41.4	8.2	5.8
EBIT	59.6	64.0	(6.9)	54.7	8.9
Interest	1.3	4.4	(70.5)	0.4	205.9
Profit before					
Exceptional Items	58.3	59.6	(2.2)	54.3	7.4
and Tax					
Exceptional Items	5.2	0.0	-	0.0	-
Profit before Tax	63.6	59.6	6.6	54.3	17.0
Tax	14.1	14.7	(3.8)	13.1	7.5
Net Profit	49.4	44.9	10.0	41.2	20.1
<i>PAT Margin (%)</i>	<i>8.8</i>	<i>7.0</i>	<i>-</i>	<i>7.6</i>	<i>-</i>
EPS	5.5	5.0	-	4.6	-

Source: Company data, Parsoli Research



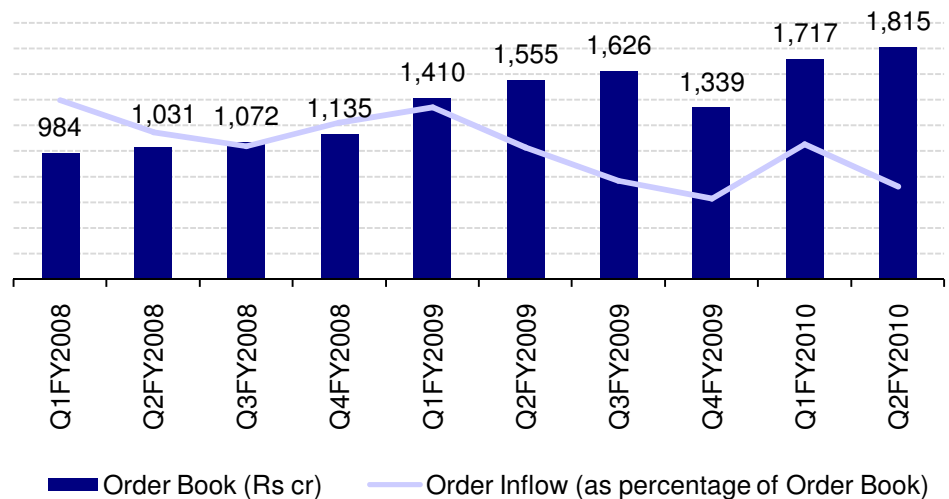
During Q2FY2010, Blue Star's order book grew by 16.7% to Rs 1,815cr with the order inflow at Rs 655cr

Key Updates

Order book impacted by decline in order inflow

During Q2FY2010, the carry forward order book increased by 16.7% yoy and 5.7% qoq to touch Rs 1,815cr. The order inflow was at Rs 655cr during Q2FY2010 as against Rs 798cr, showing a decline of 17.9% yoy. However, going forward, the company sees good prospects in sectors like infrastructure, hospitals, hotel, education etc. and continues to target government-funded projects like Delhi Metro projects.

Exhibit 2: Order Book Growth



Source: Company data, Parsoli Research

The management expects the order inflow to pick up in Q4FY2010 and Q1FY2011

Going forward, the management expects that the pressure on order inflow is likely to continue for Q3 and some pick up in the order inflow is expected only in Q4FY2010 and Q1FY2011. Though the company has started receiving order enquiries from sectors like steel and power, the management expects that the projects will start getting finalized in Q4FY2010, which would eventually increase the order inflow. The management expects that it would take another 6-8 months before the company knows the true business potential from companies in the power sector like NTPC, Adani Power, etc.

Electro Mechanical Projects & Packaged Airconditioning Systems

The revenue from Electro Mechanical Projects & Packaged Airconditioning Systems segment declined by 12.1% yoy during the quarter, but the margins sustained at 11.3%

This segment contributes nearly 85-90% of the order book and around 67.0% of total sales. Since this segment has seen a decline in activity across sectors like IT/ITeS, retail and realty; there has been a marked decline in the net sales as this segment contributes a major portion of the revenues. During the quarter, the segment saw a 12.1% yoy decline in sales at Rs 417.8cr, but the segment margin sustained at 11.3%. During Q1FY2010, Blue Star had won a Rs 172.0cr MEP (Mechanical, Electrical and Plumbing) project for the proposed Delhi Airport Metro Express Line of 23km. The company's scope of services would cover design, supply, fabrication, erection, testing, inspection and commissioning of HVAC (Heating, ventilating and air conditioning), electrical, fire fighting, plumbing, Station Management System, Access System and Track Side Auxiliary System for the entire project. During Q2FY2010, the company saw good prospects in infrastructure, healthcare, education and hospitality sectors and won a number of orders from these segments. Going forward, the company plans to tap the



The company performed well in the packaged airconditioning segment booking orders from Siemens and ABB

The Cooling Products segment's operating margins expanded by 26bps yoy due to introduction of differentiated products leading to higher price realizations

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

opportunity of metros coming up in major cities with Kolkata, Bengaluru, Chennai and Hyderabad. The company plans to actively pursue the MEP opportunities in metro projects in these cities which are expected to be finalized in 3-4 months and stand at around Rs 1,100-1,200cr.

In the packaged/ducted airconditioning and small chillers segment, the company booked airconditioning orders from Siemens and ABB. The company's Precision Control Packaged Airconditioners (PCPA), specially designed for the IT sector performed well and registered a growth of 75%. This growth was there on account of the rapid expansion of data centres across India which has now resulted in increasing the demand for PCPA. During the quarter, Blue Star booked PCPA orders from IBM, Hewlett-Packard, Essar Steel and Tech Mahindra.

Cooling Products

In the Cooling Products segment, the sales were down by 13.5% yoy at Rs 111.6cr. However, the segment's operating margin increased 263bps from 10.7% in Q2FY2009 to 13.4% in Q2FY2010. The operating margin was up as the company offered differentiated products which resulted in higher price realizations. The room airconditioners segment performed well during the quarter with nearly one-third of the demand coming from the education sector, mainly from colleges in Andhra Pradesh, Tamil Nadu and Karnataka. The demand for airconditioners from the residential segment was also up due to extended summers and poor monsoon. In the commercial refrigeration products and services segment, the company saw two-third of chest freezer sales from ice cream parlors and dairy segment. During the quarter, the company introduced a seed storage system called Precision Climate Seed Storage (PCSS) System which facilitates seed storage at precise temperatures and humidity levels in order to reduce waste and enable preservation for longer time duration.

Professional Electronics and Industrial Systems

In this segment, the revenues declined by 18.8% yoy to Rs 33.7cr during the quarter. The operating margin for the segment, however, expanded by 584bps from 23.4% in Q2FY2009 to 29.2% in Q2FY2010 due to stringent cost control measures and efficient supply management.

Decline in net sales due to delays in project execution

Overall, during Q2FY2010, net sales declined by 12.8% yoy and stood at Rs 563.0cr as compared to Rs 645.6cr in Q2FY2009. The decline in net sales has been due to lower order inflow and a marked increase in project execution time. The average time for the order book execution has moved up from 8-9 months to 14-15 months. Since most of the companies are either not paying up for the projects or delaying the execution, the revenues of Blue Star remain under pressure. The management expects the situation to improve only after Q4FY2010 when the project execution picks up and the average time comes under 12 months.

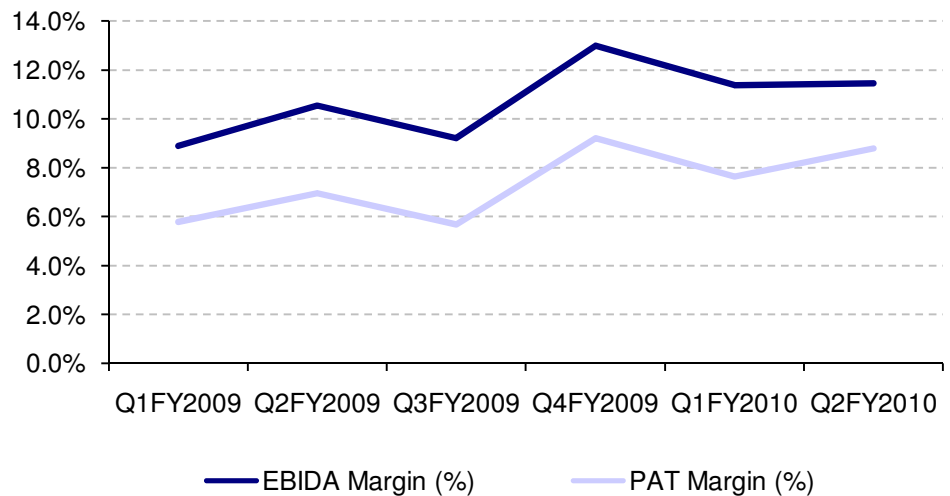
Margins continue to expand despite a decline in sales

The operating margin for Q2FY2010 stood at 11.5%, showing a 91bps increase from 10.5% in Q2FY2009. During the quarter, the COGS were down at 74.9% of sales as compared to 77.1% in Q2FY2009. On a qoq basis, the COGS is up by 160bps due to a rise in raw material prices. Going forward, the management sees the input costs moving up, but expects them to remain in control. The employee expenses continued to remain high at 8.4% of sales due to increments in employee salaries and benefits. The other expenditure, however, declined by 59bps yoy and 148bps qoq due to cost control measures and efficiency enhancement programmes initiated by the company.



Exhibit 3: EBIDTA and PAT Margins

%



Source: Company data, Parsoli Research

During the quarter, the PAT margins were up by 182bps yoy to 8.8% due to lower interest and tax rate

The PAT margins also expanded 182bps to 8.8% in Q2FY2010 from 7.0% in Q2FY2009 on account of lower interest payout during the quarter. The interest payment for the quarter stood at Rs 1.3cr, a 70.5% yoy decline from Rs 4.4cr in Q2FY2009. This is primarily due to an overall decline in interest rates and company's measures to bring down its debt levels to zero. Also the taxes were down by 41bps yoy on account of tax benefits enjoyed by the company's Himachal Pradesh plant, further contributing to PAT margins.

For 6mFY2010, the net sales are down by 13.6% at Rs 1,101.6cr as compared to Rs 1,275.4cr. The operating margins for 6mFY2010 are also up by 122bps to 13.3%. Going forward, the management expects that the revenues for FY2010 would be down by 0-10% over FY2009.

We have used Relative valuation based on EV/EBIDTA and P/E methodologies to value the stock

Valuation

For valuing the company, we have used Relative Valuation based on EV/EBIDTA and Price/Earnings (P/E) multiple methodologies considering CY2010 estimates. A comparative valuation using EV/EBIDTA methodology helps us in comparing the company's performance with its peers irrespective of their depreciation and finance expenditures. The P/E multiple methodology helps in comparing peer group performance with the company with respect to earnings potential. We have considered an investment horizon of 12 months.

The EV/EBITDA method gives us a target price of Rs 420.5 per share

Relative Valuation

Blue Star currently trades at an EV/EBIDTA multiple of 12.2x for FY2010E and 11.6x FY2011E. When considering the current EV/EBIDTA multiple, the stock trades at a discount of 34.7% to the industry average of 16.1. We believe that the company's operating margins will be impacted during FY2010 on account of lower sales and project execution delays. Going forward, however, we expect the company to perform well during FY2011 and FY2012 focusing on sectors like metro rail, hotels, education, hospitals, etc. The company is expected to maintain its operating margin at 10.6% in FY2011 and marginally expand it to 11.0% in FY2012. We have discounted the peer group average by 10.9% and assigned a multiple of 14.5 to value the stock. Using this target multiple on our FY2011 EBIDTA estimates of Rs 260.0cr, we arrive at a target price of Rs 420.5 per share.



Blue Star

BUY

Using the P/E method, we arrive at a target price of Rs 380.2 per share

The weighted average price on the basis of EV/EBITDA and P/E methodologies gives a target price of Rs 400 per share

When considering the P/E multiple, the stock currently trades at 17.5x FY2010E and 16.4x FY2011E earnings. The peer group average stands at 20.6. We expect the EPS to grow, though not at the same pace as reflected in the last couple of years. We expect the EPS to grow at a CAGR of 7.5% to touch 24.9 by FY2012. We are assigning a multiple of 18.5 to value the stock. Employing this target multiple on our FY2011 EPS estimates of Rs 20.6, we arrive at a target price of Rs 380.2.

Blue Star has already achieved our previous target price of Rs 423 and, since then, the price has come down to attractive levels. We still find value in the stock and by taking the weighted average of the price estimated through EV/EBITDA and P/E methodologies, **we arrive at a fresh target price of Rs 400 representing an upside of 18.5%.**

Exhibit 4: Valuation

Pricing Methodologies	Weight Assigned	Target Price
Target price using EV/EBITDA approach	50.0%	420.5
Target price using P/E approach	50.0%	380.2
Weighted average target price (Rs)		400.4
Current Market Price (CMP)		338.0
Upside from current levels (%)		18.5

Source: Company data, Parsoli Research



Financial Statements

Exhibit 5: Profit & Loss Statement					Rs cr
	FY2008	FY2009	FY2010E	FY2011E	FY2012E
Net Sales	2,221.6	2,552.3	2,294.6	2,446.4	2,880.6
<i>% chg</i>	39.3	14.9	(10.1)	6.6	17.7
Total Expenditure	1,998.5	2,296.4	2,044.5	2,186.4	2,563.3
<i>% chg</i>	34.6	14.9	(11.0)	6.9	17.2
EBIDTA	223.1	255.9	250.1	260.0	317.3
<i>Margin (%)</i>	10.0	10.0	10.9	10.6	11.0
Other Income	48.5	21.8	16.1	27.8	35.1
Depreciation & Amortisation	22.0	25.9	32.4	39.5	49.4
Interest	7.6	13.6	3.0	0.0	0.0
PBT	242.0	238.2	230.8	248.3	302.9
<i>Margin (%)</i>	10.9	9.3	10.1	10.2	10.5
Total Tax	67.9	57.9	57.7	63.6	78.8
<i>(% of PBT)</i>	28.1	24.3	25.0	25.6	26.0
PAT	174.1	180.3	173.1	184.8	224.2
<i>% chg</i>	144.6	3.6	(4.0)	6.7	21.3
<i>Margin (%)</i>	7.8	7.1	7.5	7.6	7.8

Source: Company data, Parsoli Research

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