India Equities
Airconditioning

Quarterly Update

Blue Star Limited

HOLD

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CMP	**₹ 445**
Target Price	**₹ 476**
Investment horizon	12 months
Sensex	18,288
Nifty	5,486

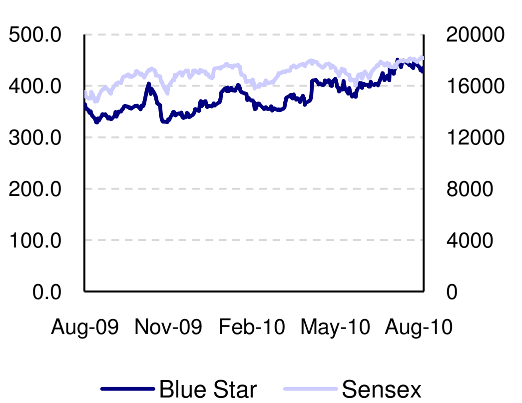
Stock Details

BSE Code	500067
NSE Code	BLUESTARCO
Reuters Code	BLUS.BO
Bloomberg Code	BLSTR IN
Market Cap (₹ cr)	4,004.0
Beta	0.55
52 W High / Low (₹)	464.0 / 325.0
Avg Daily Volume	23,326
Face Value (₹)	2.00

Shareholding Pattern (%)

Promoters	40.13
MF/Banks/Indian FIs	9.96
FII / NRIs / OCBs	15.65
Indian Public	34.26

Price Chart



Performance Highlights

Order inflow remains slow: Blue Star's carry forward order book showed a growth of 15.1% yoy from ₹ 1,717cr in Q1FY2010 to ₹ 1,976cr in Q1FY2011. The order inflow during the quarter stood at ₹ 925cr as compared to ₹ 903cr in Q1FY2010. Going forward, the management expects the order inflow to remain slow for next few months and growth to pick up in about 6 months time. The order book is currently being driven by the private sector including hotels, hospitals and educational institutes, etc.

Profit margin to remain under pressure: During Q1FY2011, EBIDTA margin declined by 281bps yoy to 9.2% from 12.0% in Q1FY2010. The operating margin was negatively impacted due to higher input costs as compared to Q1FY2010 when input costs were at their lowest. Also, the net profit and PAT margin were affected due to higher tax rate as one of Blue Star's factories has come out of income tax benefits which is expected to hike future tax rate.

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 13.9xFY2011E and P/E of 17.8xFY2011E earnings. While the revenues for the quarter look promising, the profit margins would be under pressure in FY2011 and growth in order inflow would be key to future improvement in business earnings. **We recommend Hold on the stock with a Target Price of ₹ 476**.

Exhibit 1: Quarterly Analysis **₹ cr**

Particulars	**Q1FY2011**	**Q1FY2010**	***YoY(%)***	**Q4FY2010**	***QoQ(%)***
Revenue	664.8	531.0	*25.2*	874.7	*(24.0)*
Other Income	0.4	0.4	*(7.3)*	2.7	*(85.7)*
Total Income	665.2	531.4	*25.2*	877.4	*(24.2)*
Total Expenditure	604.0	467.5	*29.2*	762.8	*(20.8)*
EBIDTA	60.9	63.5	*(4.2)*	112.0	*(45.6)*
EBIDTA Margin (%)	*9.2*	*12.0*	-	*12.8*	-
Depreciation	7.6	8.2	*(7.8)*	9.1	*(17.2)*
EBIT	53.7	55.8	*(3.7)*	105.5	*(49.1)*
Interest	2.0	1.5	*37.9*	2.5	*(20.0)*
Profit before Exceptional Items and Tax	51.7	54.3	*(4.8)*	103.0	*(49.8)*
Exceptional Items	0.4	0.0	-	0.0	-
Profit before Tax	52.1	54.3	*(4.0)*	103.0	*(49.4)*
Tax	15.0	13.1	*14.2*	24.5	*(38.7)*
Net Profit	37.2	41.2	*(9.8)*	78.5	*(52.7)*
PAT Margin (%)	*5.6*	*7.8*	-	*9.0*	-
EPS	4.1	4.6	-	8.7	-

Source: Company data, Parsoli Research

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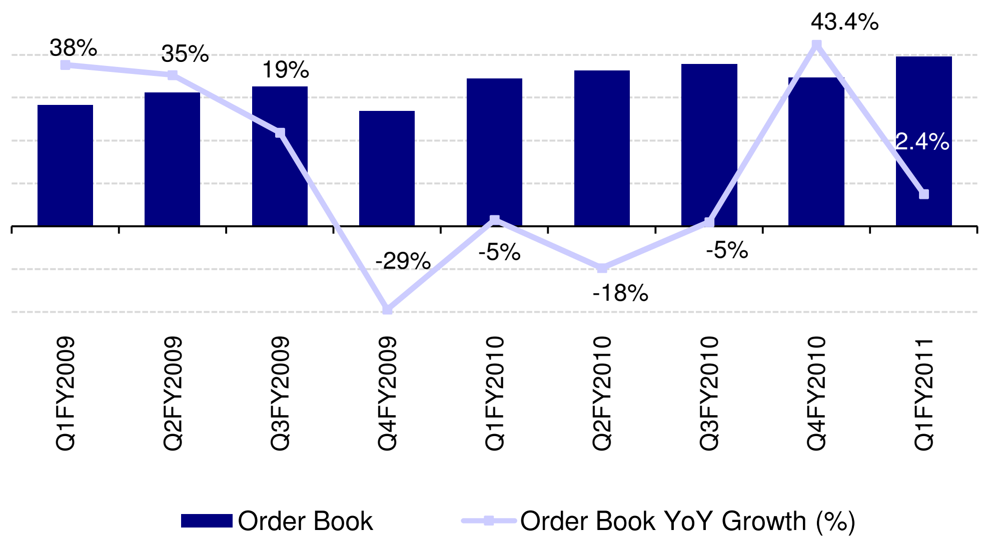
Key Updates

Revenue growth continues though order inflow remains slow

Blue Star's carry forward order book grew to ₹ 1,976cr in Q1FY2010 representing a yoy growth of 15.1% with the order inflow at ₹ 925cr

Blue Star's carry forward order book for Q1FY2011 stood at ₹ 1,976cr, representing an increase of 15.1% yoy from ₹ 1,717cr in Q1FY2010. The order inflow during the quarter was marginally up by 2.4% yoy to ₹ 925cr as compared to ₹ 903cr in Q1FY2010. The order book is primarily driven by the private sector including hotels, hospitals, educational institutes, etc.

Exhibit 2: Order Book Growth ₹ cr



Source: Company data, Parsoli Research

The order inflow growth is expected to take another 6 months before seeing a completed revival

While the company has been posting promising revenue growth, the order inflow continues to be slow from the large buyers in the electromechanical services projects. The slow pick up in order inflow growth is the reason why companies are facing pricing pressures in projects as on one hand the raw material costs have gone up, the companies cannot raise prices as that might lead to losing out on projects. Going forward, the management remains confident that the revenues would improve in FY2011 supported by the current carry forward order book. However, the management has indicated that the markets will take 6 months before seeing a recovery in order inflow. Once the order inflow starts to pick up, it is expected to take another 6 months before the pricing pressures subside.

Revenues up 25.2% yoy but margins depress

The revenues improved by 25.2% yoy but the profit margins were impacted by rising input costs and higher tax rate

Exhibit 3: Cost Analysis % of sales

	Q1FY2011	Q1FY2010	*bps change yoy*
COGS	75.9	71.6	430
Employee Expenses	7.1	8.7	(162)
Other Expenditure	7.9	7.7	13
Total Expenditure	90.8	88.0	281

Source: Company data, Parsoli Research

During Q1FY2011, the total revenues grew by 25.2% yoy from ₹ 531.0cr in Q1FY2010 to ₹ 664.8cr in Q1FY2011. The total revenues include the segmental revenue contribution as well as other operating income. The EBIDTA declined by 4.2% yoy and the EBIDTA margin was down by 281bps yoy to 9.2% during the quarter. The decline was mainly on account of a 430bps yoy increase in COGS due to a rise in raw material costs across all segments as compared to the raw material costs in Q1FY2010. The employee expenses were down by 162bps yoy to 7.1% of sales. Overall, the total expenditure (as % of sales) was up by 281bps yoy to 90.8% in Q1FY2011 as against 88.0% in Q1FY2010. The total net profit declined 9.8% yoy to ₹ 37.2cr, impacted by the higher tax rate as one of Blue Star's factories has come out of income tax benefits and, hence, a higher tax rate is expected in the coming years. The PAT margin declined by 217bps yoy from 7.8% in Q1FY2010 to 5.6% in Q1FY2011.

Segment Performance

While the total segmental revenues were up 24.6%, the segment profits remained flat at around ₹ 74.8cr

Exhibit 4: Segment Performance, Q1FY2011 ₹ cr

REVENUES	Q1FY2011	Q1FY2010	% change yoy
Electro Mechanical Projects and Packaged Air-conditioning Systems	374.2	314.7	*18.9*
Cooling Products	253.4	190.3	*33.1*
Professional Electronics and Industrial Systems	32.3	24.7	*30.9*
Total segment revenue	**659.82**	**529.73**	***24.6***
SEGMENT RESULT			
Profit/(Loss) Before Interest & Tax			
Electro Mechanical Projects & Packaged AC Systems	34.0	34.6	*(1.5)*
Cooling Products	35.2	33.2	*6.1*
Professional Electronics & Industrial Systems	5.5	7.1	*(22.8)*
TOTAL	**74.73**	**74.84**	***(0.1)***
SEGMENT MARGINS (%)			
Electro Mechanical Projects & Packaged Air-conditioning Systems	*9.1*	*11.0*	*(1.88)*
Cooling Products	*13.9*	*17.5*	*(3.54)*
Professional Electronics & Industrial Systems	*16.9*	*28.6*	*(11.72)*

Source: Company data, Parsoli Research

Electro Mechanical Projects & Packaged Airconditioning Systems

Electro mechanical projects & packaged airconditioning systems segment's revenues were up 18.9% yoy to ₹ 374.2cr during the quarter

This segment comprises of central airconditioning, electrical contracting, plumbing & fire fighting contracting and packaged airconditioning which are collectively known as Electro Mechanical Projects and Packaged Airconditioning Systems. The segment contributed 57% of sales in Q1FY2011. During the quarter, the segment revenues grew by 18.9% yoy to ₹ 374.2cr from ₹ 314.7cr in Q1FY2010. The segment margin, however, declined by 188bps yoy to 9.1% as against 11.0% in Q1FY2010. The decline in margin has been on account of higher raw material prices as compared to Q1FY2010 which probably had the lowest input cost.

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The company saw contracts coming in from the healthcare, education, hospitality, power and steel segments

During the quarter, in the central airconditioning business, Blue Star won contracts in the healthcare, education, hospitality, power and steel segments. The company won three Heating, ventilating and air conditioning (HVAC) orders in the power sector including order from Lanco for their super thermal power plant in Amarkantak; an order from BGR Energy for power plants in Kalisindh, Rajasthan and a ventilation order from NTPC for Nabinagar power plant. The company also received orders from Rockland, Shivam and GMR Care Hospitals; Gautam Budh and Sharda Universities and Taj Hotels. The management has indicated that the company is seeing a modest recovery in the retail and real estate segments.

In the electrical projects business, which caters to both the commercial building market and the power sector, the company received standalone electrical orders for substations from Madhya Pradesh Electricity Board, Indore, Central Electricity Supply Utility, Orissa and Reliance Infrastructure. In commercial buildings, the company won and executed orders from HCL for Shiv Nadar University; Kerala Technopark, Trivandrum; Rockland Hospital, Manesar; GMR, Delhi International Airport; Gateway Hotel, Kolkata and West Bank Hospital, Kolkata.

In packaged/ducted airconditioning and small chillers business, the company saw a good order inflow from the light commercial segment such as showrooms as well as educational institutions. During the quarter, Blue Star signed rate contracts with Aegon Religare, Mahindra Finance, Dhanalakshmi Bank, Timex Infra and Liliput Kidswear for their airconditioning requirements incorporating ducted splits. Blue Star's Precision Control Packaged Airconditioners (PCPAs) continued to perform well driven by the rapid expansion of data centres and the company bagged the largest PCPA order in its history from Nokia Siemens, Bengaluru.

Going forward, the management continues to see opportunities in the infrastructure segments like metro rail, airports, power and steel. In addition, there has been increased demand across education, healthcare and hospitality on account of a substantial demand-supply gap and sectors like real estate, retail and IT/ITeS are also showing signs of a revival. However, there is still some time before the market revives completely and the order inflow comes back on track.

Cooling Products

The Cooling products segment performed well showing a robust 33.1% yoy growth in revenues though the margins were impacted by higher input costs

The segment performed quite well during the quarter showing a 33.1% yoy growth in revenues from ₹ 190.3cr in Q1FY2010 to ₹ 253.4cr in Q1FY2011. The segment operating profits grew marginally by 6.1% yoy to ₹ 35.2cr in Q1FY2011. The operating margin declined by 354bps yoy from 17.5% in Q1FY2010 to 13.9% in Q1FY2011. The operating margin for this segment declined on account of a significant increase in the input costs as compared to Q1FY2010 when raw material prices were at their lowest levels.

During Q1FY2011, the room airconditioner business performed well growing at a robust rate of 34%. The sales from the residential segment were also significant due to the harsh summer season. Blue Star doubled its room airconditioner sales from National Accounts during the quarter and signed three new accounts also.

The commercial refrigeration business saw higher demand for water coolers, chest coolers and freezers and bottled water dispensers

In the commercial refrigeration products business, the company saw a healthy demand in the water cooler business, mainly from the manufacturing and educational institutions. There was considerable growth in the chest coolers and freezers business driven by the ice cream and dairy segments. The bottled water dispensers saw increased demand from the residential segment, small offices and commercial establishments. During the quarter, the company booked significant orders the hospitality segment also.

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The net sales in the Professional electronics and industrial systems business increased by 30.9% yoy, though the profits declined on account of lower commission income and lower than expected performance in the Industrial Projects business

Professional Electronics and Industrial Systems

During the quarter, the segment revenues grew by 30.9% yoy to ₹ 32.3cr. Though the revenue growth was healthy, the segment operating profits were down by 22.8% yoy to ₹ 5.5cr. The margins for the segment also declined from 28.6% in Q1FY2010 to 16.9% in Q1FY2011. This was on account of lower commission income on imports due to delays and cancellations in orders. Another reason for the decline in profits was a lower than expected performance in the Industrial Projects business.

Overall, the Material Testing business which was adversely impacted due to the slowdown in the automobiles, construction and steel segments, grew impressively due to the economic revival as well as change in the product mix offering. The company won orders from Surya Global Steel Tubes, Delhi Metro, BHEL, Trichy, Shell India, PPN Power and KSB Pumps. The Medical Equipment business also preformed impressively with a large order from Suraksha Diagnostic, Kolkata. And although the billings fell short of expectations, the Industrial Projects business booked orders worth ₹ 33cr from Tata Steel.

The company acquired D S Gupta Construction Private Limited which is expected to strengthen Blue Star's presence as an integrated MEP contractor

Acquisition in the plumbing and fire fighting business

During the quarter, Blue Star acquired the plumbing and fire fighting business of D S Gupta Construction Private Limited which is the largest independent plumbing and fire fighting contracting company in India. The company was acquired for ₹ 80cr and had a turnover of ₹ 130cr in FY2010. D S Gupta Construction, having pan-India operations, functions across segments such as hotels, hospitals, educational institutions, commercial buildings, IT/ITeS parks and residential complexes. It has a carry forward order book of around ₹ 300cr.

The acquisition is in line with Blue Star's goal of becoming an integrated provider of Mechanical, Electrical, Plumbing & Fire fighting (MEP). Blue Star had earlier acquired Naseer Electricals in 2008, which marked its entry into electrical contracting. Post the completion of acquisition, Blue Star plans to integrate its operations under a subsidiary Blue Star Electro Mechanical Ltd (BSEML).

Blue Star had long recognized the transition in the electro mechanical segment from having several contractors working on a single project to employing a single contractor that offers all the services. With the recent acquisition, Blue Star has enhanced its offerings to become an integrated provider of airconditioning, electrical, plumbing and fire fighting solutions. Blue Star has worked alongside D S Gupta Construction in the past on several projects. The management expects this acquisition to fortify Blue Star as an integrated MEP contractor as well as enable the company to bid for standalone plumbing and fire fighting contracting projects by cross-selling its services to its existing airconditioning and electrical contracting customers.

Valuation

We expect the company's revenues to grow at a CAGR of 16.3% during FY2010-12 to touch ₹ 3,413.0cr

We expect Blue Star to expand its revenues at a CAGR of 16.3% (FY2010-12) to reach ₹ 3,413.0cr. While the revenue growth looks promising, the company continues to face pressure from order inflow growth and rising inputs costs. The management expects order inflow to improve in 6 months but the operating margin and PAT margin are expected to decline in FY2011. Going forward, we expect the EBIDTA margin to stand at around 10.1% and the PAT margin at 7.9% in FY2011.

The acquisition of D S Gupta Construction, once consolidated in the operations, is expected to improve the revenues further. The acquisition would help the company in augmenting its service offerings in the MEP segment and enable Blue Star to bid for standalone contracts also.

Relative Valuation

We recommend Hold on the stock with a target price of ₹ 476 per share

Blue Star currently trades at an EV/EBIDTA multiple of 13.9xFY2011E and 11.3xFY2012E. The current industry average stands at 16.7x. The company's EBIDTA margin is expected to slightly decline to around 10.1% in FY2011 on account of cost pressures. For valuing the stock, we have discounted the peer group average by 15.2% and assigned a multiple of 14.5. Using this target multiple on our FY2011 EBIDTA estimates of ₹ 287.2cr, we arrive at a target price of ₹ 464 per share.

When considering the P/E multiple, the stock currently trades at 17.8xFY2011E and 14.4xFY2012E earnings. We expect the EPS to grow at a CAGR of 14.8% (FY2010-12) to touch ₹ 31.0 in FY2012. The industry average which stands at 24.9x has been discounted by 27.6%. We are assigning a multiple of 19.5 to value the stock. Employing this target multiple on our FY2011 EPS estimates of ₹ 25.1, we arrive at a target price of ₹ 489 per share.

While the company is struggling in terms of order inflow growth and the rise in input costs, the management expects the revenue growth to remain strong and the cost pressures to subside. The recent acquisition is also expected to improve the revenues and open new opportunities for bidding contracts. **We recommend Hold on the stock with a target price of ₹ 476.**

Exhibit 5: Valuation

Pricing Methodologies	Weight Assigned	Target Price
Target price using EV/EBIDTA approach	50.0%	463.8
Target price using P/E approach	50.0%	488.5
Weighted average target price (₹)		476.2
Current Market Price (CMP)		445.2
Upside from current levels (%)		7.0

Source: Company data, Parsoli Research

Financial Statements

Exhibit 6: Profit & Loss Statement					₹ cr
	FY2008	FY2009	FY2010	FY2011E	FY2012E
Net Sales	2,221.6	2,502.6	2,525.0	2,857.3	3,413.0
% chg	*39.3*	*12.7*	*0.9*	*13.2*	*19.4*
Total Expenditure	1,998.5	2,243.0	2,250.3	2,570.1	3,061.5
% chg	*34.6*	*12.2*	*0.3*	*14.2*	*19.1*
EBIDTA	223.1	259.6	274.7	287.2	351.5
Margin (%)	*10.0*	*10.4*	*10.9*	*10.1*	*10.3*
Other Income	48.5	21.8	31.1	34.3	44.4
Depreciation & Amortisation	22.0	25.9	34.7	8.5	8.5
Interest	7.6	17.3	8.5	0.0	0.0
PBT	242.0	238.2	262.7	312.9	387.4
Margin (%)	*10.9*	*9.5*	*10.4*	*11.0*	*11.4*
Total Tax	67.9	57.9	65.1	87.6	108.5
(% of PBT)	*28.1*	*24.3*	*24.8*	*28.0*	*28.0*
PAT	174.1	180.3	211.5	225.3	278.9
% chg	*144.6*	*3.6*	*17.3*	*6.5*	*23.8*
Margin (%)	*7.8*	*7.2*	*8.4*	*7.9*	*8.2*

Source: Company data, Parsoli Research

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