

Blue Star Ltd – HOLD

UCP segment growth to pickup

Blue Star managed to report strong results on the back of strong execution in the project business and robust growth in commercial refrigeration business. Project business grew 16% yoy led by faster execution in factories and office space. This segment has witnessed strong growth in FY19 as execution has picked up and the company continued to gain market share in segments like chillers, ducted products and VRF. Margins remain steady at 4.3% in Q4 and the company expects this to improve close to 5%. EMP segment order inflow remained strong at Rs.29.5bn in FY19 and order book at the end of FY19 stood at Rs.17.2bn.

Unitary Cooling (UCP) segment registered 20.6% yoy growth, boosted by robust growth in commercial refrigeration business. Room AC business grew 6% yoy against de-growth for the industry. The company has increased its market share to 12.3% in FY19 from 11.5% in FY18. RAC segment margins expanded due to superior product mix, marginal price hikes in room AC and cost optimization. AC demand has picked up in majority of India as summer has kicked in. The management expects to outgrow the market led by higher penetration and strong product portfolio. We believe RAC segment would register robust growth in FY20 as room AC demand has picked up and the company witnesses strong traction in non-AC businesses. Debt levels have corrected from their peak in H1 FY19 and are flat on a yoy basis at the end of FY19. Improvement in margins coupled with robust revenue growth would lead to 22% earnings CAGR over FY19-21E. However, at 23.7x FY21E P/E valuations appear reasonable. We recommend a Hold rating with a price target of Rs.705.

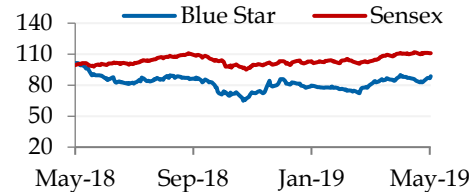
CMP (Rs) 697		12-mts Target (Rs) 705		Upside 1%	
Stock data (As on May 03, 2019)			Sector: Consumer Electricals		
Sensex:	38,963	Stock performance			
52 Week h/l (Rs)	828 / 507				
Market cap (Rs bn)	67,179	Shareholding pattern (As of Mar'19 end)			
Enterprise value (Rs bn)	69,557	Promoter	38.8%		
6m Avg t/o (Rs mn):	8.2	FII+DII	30.6%		
FV (Rs):	2	Others	30.6%		
Div yield (%):	2.5				
Bloomberg code:	BLSTR IN				
BSE code:	500067				
NSE code:	BLUESTARCO				

Exhibit 1: Result table (Consolidated)

(Rs m)	Q4 FY19	Q4 FY18	% yoy	Q3 FY19	% qoq
Net sales	15,958	13,463	18.5	10,990	45.2
Operating profit	1,094	604	81.3	423	158.5
OPM (%)	6.9	4.5	237 bps	3.9	301 bps
Depreciation	(237)	(183)	29.5	(183)	29.7
Interest	(110)	(107)	2.7	(131)	(16.0)
Other income	61	38	58.4	104	(41.7)
PBT	808	352	129.5	214	278.4
Tax	(7)	(82)	(92.0)	(10)	(33.3)
Effective tax rate (%)	0.8	23.4		4.6	
Adjusted PAT	802	270	197.2	204	293.5
Minority int/exceptional	(3)	47	-	(213)	(98.5)
OCI	(17)	17	-	(9)	86.8
Reported PAT	781	334	133.7	(18)	-

Source: Company, YES Sec – Research

Segment 1: Electro-Mechanical Projects (EMP) and Packaged Air Conditioning Systems (PAC)

- ✓ EMP & PAC revenue grew 16% yoy and 20.6% yoy in FY19 and Q4 FY19 to Rs.27.5bn and Rs.8.4bn, respectively. The growth was driven by robust execution of projects and healthy revenue from chillers and VRF systems in commercial air conditioning business. Faster execution was witnessed in factories and office space. Order booking was strong in industrial EPC and substation projects, leading the growth in FY19.
- ✓ EMP segment witnessed strong order inflow of Rs.29.5bn in FY19 as against Rs.24.9bn in FY18. Order book as at end of March'19 was Rs.17.2bn as against Rs.14bn as on March'18. Orders from Office space (both IT and non-IT) accounted for 41.8% of the total EMP order book, while the remaining came from Hospitals (15.6%), Industrial (12.7%), Malls (6.2%), Mixed use development (5.4%), Metro (5.2%), Power generation and distribution (2.9%) and others (10.1%).
- ✓ Commercial air conditioning business grew faster than market in Q4 FY19 and FY19. Blue star market share in ducted products, chillers and VRF systems improved to 39%, 15% and 17% respectively. Key segment that contributed to the gain was government, hotels, industrials, metro, hospitals, schools, educational institutional and other retails spaces such as showrooms and boutiques.
- ✓ International market for the company witnessed good growth with robust performance from Africa, Middle East and SAARC countries. JV in Qatar and Malaysia continue to post healthy growth. Management is positive on the overall international business for the coming years.

Segment 2: Unitary Cooling products (UCP)

- ✓ UCP segment revenue grew 9% and 19% in FY19 and Q4 FY19 to Rs.22.7bn and Rs.7bn, respectively. Margin for the segment expanded 353bps yoy to 10.4% in Q4 FY19. Improved profitability was largely driven by better product mix inclined towards inverter room air conditioners (RAC) which forms 47% of the company's total AC sales, better realization in commercial refrigeration business, price hikes in the select RAC models and cost efficiencies. EBITM for the segment is expected to touch 9% in FY20.
- ✓ UCP EBIT margin in FY19 saw an impact of 150bps on account of increased investments in water purifier and increased spends in marketing, brand building and R&D.
- ✓ Summer was tepid in FY19; however, it has picked up in March'19 leading to demand revival in southern, central and some parts of northern India. This led to 6% increase in RAC segment in Q4 FY19 and 3% in FY19 (against the industry which de-grew 4-5% yoy). The product category saw better realization on account of new rating norms compared to last year, whereas the volume growth for this category was lower. RAC market share for Blue Star improved from 11.5% in FY18 to 12.3% in FY19. RAC market is expected to grow 12-15% in FY20.
- ✓ In RAC segment, the company has launched 75 new SKU's having features such as inbuilt filter and precision and IOT enabled models. RAC would witness rating change in January' 20.
- ✓ The company has significantly expanded its presence in the northern market. Currently, revenue contribution of the northern market is similar to that of western region.
- ✓ 60% of the RAC inventory sold is manufactured inhouse. As part of backward integration, the company is looking to manufacture IDU

in-house and also plans to manufacture few more critical components in the coming years.

- ✓ **Commercial refrigeration** segment grew 34% yoy in FY19 (faster than the industry) driven by ice-cream and frozen food segment. Medical and retail commercial refrigeration is also showing healthy sign of growth.
- ✓ **Water purifier** saw healthy growth in Q4 FY19 and witnessed 2x volume growth in FY19. Blue star has gained market share in this category by 200 bps yoy and aims to scale up this business aggressively with a target to touch 10% market share by FY21. The company has increased focus on marketing and trade promotions and has a network of 2,800 touch points and 130 town and cities.
- ✓ Management stated that hereon the company would spend less on A&P for water purifier and air cooler category.

Segment 3: Professional Electronics and Industrial Systems

- ✓ The segment revenue grew 10% yoy and de-grew 11.4% yoy in FY19 and Q4 FY19. EBIT margin saw significant spurt from 12.9% in Q4 FY18 to 32.2% in Q4 FY19 led by execution of high margin order.
- ✓ Industrial capex has improved partially on the back of adoption of industry 4.0 (IOT and BS VI).
- ✓ Pending order book is healthy, however execution should be monitored for the segment growth.

Other key highlights

- ✓ Blue Star would incur Rs.1bn as capex in FY20. Additionally, it would spend Rs.800-900mn over the next 12-15 months on Wada plant expansion to support its commercial refrigeration business.

- ✓ Tax expense was Rs.420mn in FY19 as against of Rs.494mn in FY18. This was largely due to a one-time deferred tax credit recognized by the company's subsidiary Blue Star Engineering & Electronics Ltd. Management stated that the tax rate should remain in 27-28% range in the coming years.

Exhibit 2: Cost analysis

As a % of net sales	Q4 FY19	Q4 FY18	bps yoy	Q3 FY19	bps qoq
Material costs	75.1	70.2	489	76.2	(113)
Personnel Costs	6.8	8.0	(117)	9.7	(286)
Other overheads	11.2	17.3	(610)	10.2	98
Total costs	93.1	95.5	(237)	96.1	(301)

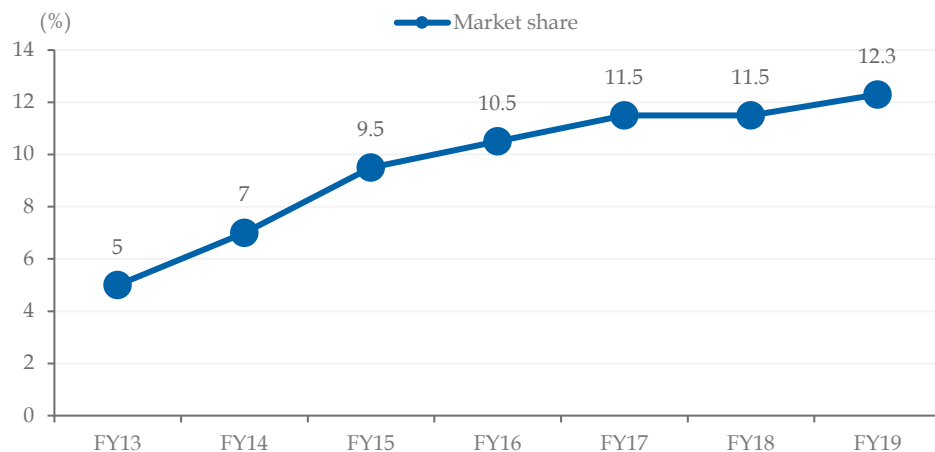
Source: Company, YES Sec - Research

Exhibit 3: Segmental analysis

(Rs m)	Q4 FY19	Q4 FY18	% yoy	Q3 FY19	% qoq
Revenue					
EMP & AC	8,423	6,987	20.6	6,555	28.5
Cooling products	7,036	5,914	19.0	3,915	79.7
Prof. Elec. & Ind. sys.	499	563	(11.4)	520	(4.0)
Total	15,958	13,463	18.5	10,990	45.2
EBIT					
EMP & AC	363	318	14.1	301	20.5
Cooling products	733	408	79.9	94	680.8
Prof. Elec. & Ind. sys.	161	73	121.2	69	134.4
Total	1,257	798	57.5	464	171.1
EBIT margins			bps yoy	bps qoq	
EMP & AC	4.3	4.6	(24)	4.6	(29)
Cooling products	10.4	6.9	353	2.4	802
Prof. Elec. & Ind. sys.	32.2	12.9	1,931	13.2	1,903
Blended	7.9	5.9	195	4.2	366

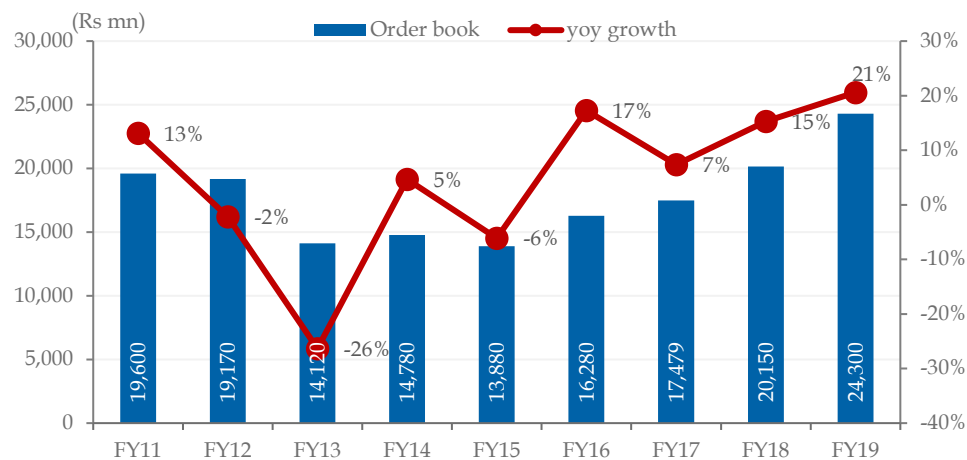
Source: Company, YES Sec - Research

Exhibit 4: Blue star has consistently gained market share



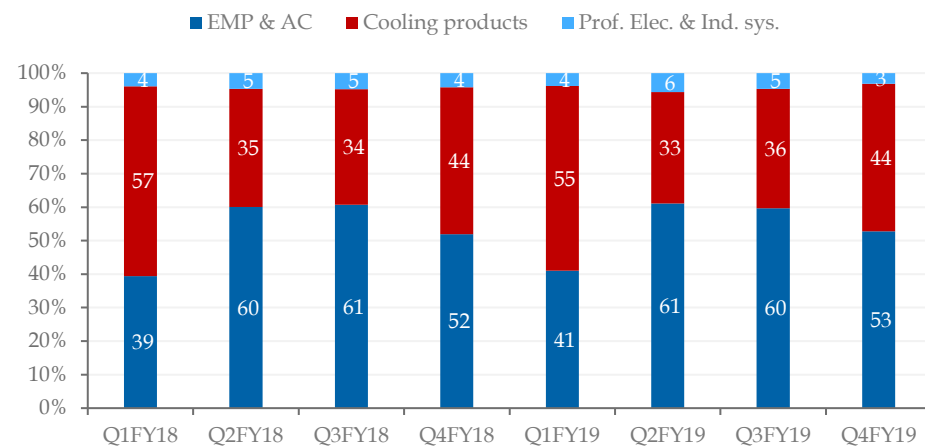
Source: Company, YES Sec - Research

Exhibit 5: Total order book position has been inching upwards



Source: Company, YES Sec - Research

Exhibit 6: Segmental contribution over the past eight quarters



Source: Company, YES Sec - Research

Exhibit 7: Financial Summary (Consolidated)

Y/e 31 Mar (Rs mn)	FY17	FY18	FY19	FY20E	FY21E
Revenues	43,852	46,390	52,348	58,099	65,577
yoy growth (%)	15.5	5.8	12.8	11.0	12.9
Operating profit	2,221	2,659	3,465	4,183	4,918
OPM (%)	5.1	5.7	6.6	7.2	7.5
Pre-exceptional PAT	1,228	1,336	1,874	2,346	2,829
Reported PAT	1,228	1,388	1,901	2,346	2,829
yoy growth (%)	47.9	13.1	36.9	23.4	20.6
EPS (Rs)	12.8	13.9	19.5	24.4	29.4
P/E (x)	54.3	50.1	35.8	28.6	23.7
Price/Book (x)	8.8	8.4	7.7	6.8	5.8
EV/EBITDA (x)	30.5	26.3	20.1	16.4	13.9
Debt/Equity (x)	0.3	0.5	0.4	0.4	0.3
RoE (%)	17.7	17.2	22.5	25.2	26.3
RoCE (%)	19.9	20.5	24.8	28.8	30.3

Source: Company, YES Sec - Research

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ADD 5% to 15%

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SELL > - 15%

NOT RATED

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