June 3, 2016

Blue Star

Performance Highlights

Y/E March (₹ cr)	4QFY2016	4QFY2015	% chg (yoy)	3QFY2016	% chg (qoq)
Net Sales	**1,103**	**1,005**	**9.8**	**686**	**60.9**
EBITDA	57	69	*(17.4)*	28	*104.9*
EBITDA margin (%)	*5.2*	*6.9*	*(170)bp*	*4.1*	*111bp*
Adj. PAT	**24**	**68**	***(64.8)***	**7**	***253.9***

Source: Company, Angel Research (Standalone)

Blue Star's standalone numbers for 4QFY2016 were subdued on the margin and bottom-line front mainly on account of the company having to provide for the last leg of the legacy orders. Sans the provision for legacy orders, the operating profile was in-line with our estimates. The top-line grew by 9.8% yoy while the margin contracted by 170bp yoy to 5.2%. The company over the past two years has carried out multiple restructuring initiatives which include transferring its PEIS business to its wholly owned subsidiary and amalgamating its associate Blue Star Infotech (BSIL) with itself. There was net exceptional income of ₹48cr arising from profit on sale of IT business of BSIL, as well as cost update on major contracts. Also owing to BSIL's merger, the depreciation expense was significantly higher. Adjusting for the exceptional item, the net profit for the quarter came in at ₹24cr.

Improvement in macro scenario to support growth: The Cooling/Unitary Products Division (CPD/UPD) has been the key performer for the company, largely due to its room air conditioning (RAC) business. The RAC business has been outgrowing the industry by ~10% points over the last few quarters, resulting in the company consistently gaining market share from ~7% in FY2014 to 10.5% at present. Various industry players as well as the company Management have upgraded the FY2017 growth guidance for the industry from 12-15% earlier to 20% now which augurs well for the division. The company has also forayed into other products such as air coolers, water purifiers and air purifiers which should drive growth for the division. As for Electro Mechanical Projects and Packaged Air-conditioning Systems (EMPPAC) division, the order book is now clean and order inflow has started to pick up but execution is a near term monitorable. We expect the gradual improvement in the macro scenario to drive the performance of the division.

Outlook and valuation: We have upgraded our numbers to factor in higher revenue guidance for the RAC business as well as improvement in performance of the EMPPAC division. As reported in our earlier report(s), the merger with BSIL has improved the balance sheet strength of the company by way of cash infusion which the company will utilize to grow the UPD division as well as the exports of the company. At the current market price, the stock trades at 20.1x its FY2018E earnings and at 0.8x FY2018E EV/sales (while its close peer Voltas trades at 1.4x its FY2018E EV/sales). **We maintain our BUY recommendation on the stock with a target price of ₹495.**

Key financials (Consolidated)

Y/E March (₹ cr)	FY2015	FY2016E	FY2017E	FY2018E
Net Sales	**3,182**	**3,770**	**4,351**	**5,024**
% chg	*8.4*	*18.5*	*15.4*	*15.5*
Net Profit	**96**	**103**	**164**	**197**
% chg	*23.1*	*7.5*	*59.3*	*20.2*
EBITDA (%)	5.3	5.7	6.4	7.1
EPS (₹)	**10.6**	**11.4**	**17.2**	**20.6**
P/E (x)	39.0	36.3	24.2	20.1
P/BV (x)	8.2	5.6	5.2	4.5
RoE (%)	20.5	18.4	23.1	24.1
RoIC (%)	16.6	22.2	28.4	32.2
EV/Sales (x)	1.3	1.1	0.9	0.8
EV/EBITDA (x)	24.4	18.7	14.4	11.3

Source: Company, Angel Research

BUY

CMP	₹415
Target Price	₹495
Investment Period	12 Months

Stock Info	
Sector	Cons. Durable
Market Cap (₹ cr)	3,733
Net Debt	87
Beta	0.6
52 Week High / Low	444 / 306
Avg. Daily Volume	11,723
Face Value (₹)	2
BSE Sensex	26,843
Nifty	8,221
Reuters Code	BLUS.BO
Bloomberg Code	BLSTR IN

Shareholding Pattern (%)	
Promoters	39.5
MF / Banks / Indian Fls	22.5
FII / NRIs / OCBs	10.6
Indian Public / Others	27.4

Abs.(%)	3m	1yr	3yr
Sensex	10.7	(1.3)	36.9
BLUESTAR	25.9	22.1	149.3

3 Year Price Chart

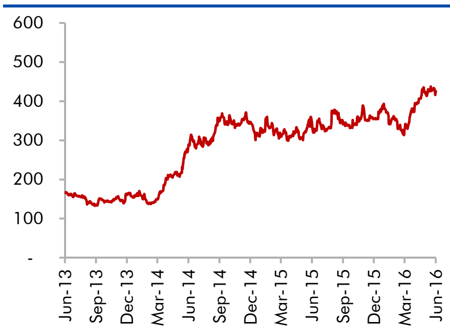

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Exhibit 1: 4QFY2016 performance highlights (Standalone)

Y/E March (₹ cr)	4QFY2016	4QFY2015	*yoy chg (%)*	3QFY2016	*qoq chg (%)*	FY2016	FY2015	*% chg*
Net Sales	1,103	1005	*9.8*	686	*60.9*	3,414	3,081	*10.8*
Net raw material	813	720	*12.9*	472	*72.2*	2,427	2,134	*13.8*
(% of Sales)	*73.7*	*71.6*	*205bp*	*68.9*	*482bp*	*71.1*	*69.3*	*184bp*
Staff Costs	71	69	*3.4*	67	*6.5*	262	257	*2.1*
(% of Sales)	*6.4*	*6.8*	*(40)bp*	*9.7*	*(328)bp*	*7.7*	*8.3*	*(66)bp*
Other Expenses	162	148	*10.1*	119	*36.4*	547	517	*5.8*
(% of Sales)	*14.7*	*14.7*	*4bp*	*17.4*	*(265)bp*	*16.0*	*16.8*	*(75)bp*
Total Expenditure	1,046	936	*11.8*	658	*59.0*	3,237	2,907	*11.3*
Operating Profit	57	69	*(17.4)*	28	*104.9*	178	174	*2.4*
OPM	5.2	6.9	*(170)bp*	*4.1*	*111bp*	5.2	5.6	*(43)bp*
Interest	9	11	*(21.8)*	9	*(1.9)*	36	43	*(18.3)*
Depreciation	19	10	*82.2*	11	*67.0*	51	39	*29.8*
Other Income	5.5	3.6	*51.9*	1.4	*302.2*	9	10	*(8.9)*
Exceptional Item	48	38		(2)		30	42	
PBT	83	89	*(7.5)*	7	*1,106.1*	130	143	*12.6*
(% of Sales)	*7.5*	*8.9*		*1.0*		*3.8*	*4.6*	
Tax	11	(17)		2		21	(10)	
(% of PBT)	13	(19)		30		16	(7)	
Reported PAT	72	106	*(32.4)*	5	*1394.2*	110	153	*(28.0)*
Extraordinary Item	(48)	(38)		2		(30)	(42)	
Adjusted PAT	24	68	*(64.8)*	7	*253.9*	80	111	*(28.0)*
PATM	2.2	6.8		*1.0*		2.3	3.6	

Source: Company, Angel Research

Margin and bottom-line below expectations mainly on account of provision

For 4QFY2016, the standalone top-line grew by 9.8% yoy to ₹1,103cr which is in-line with our estimates. On the operating front, the EBITDA margin contracted by 170bp yoy to 5.2% largely owing to a 205bp yoy increase in raw material cost to 73.7% of sales. The depreciation expense was significantly higher on account of BSIL's merger, which added by ~₹6cr to this expense head. There was a net exceptional income of ₹48cr arising from profit on sale of IT business of BSIL, as well as cost update on major contracts. Adjusting for the exceptional item, the net profit came in at ₹24cr.

Segment-wise performance

Exhibit 2: Segment-wise performance (Standalone)

Y/E March (₹ cr)	4QFY2016	4QFY2015	% chg (yoy)	3QFY2016	% chg (qoq)
Total Revenue					
A) EMPPAC	439	361	21.5	459	(4.3)
B) Cooling Products	238	197	21.0	246	(3.2)
C) PEIS	9	38	(76.2)	12	(27.9)
Total	**686**	**596**	**15.1**	**717**	**(4.3)**
Less: Inter-Segmental Rev.	-	-		-	
Net Sales	686	596	15.1	717	(4.3)
Segmental Profit					
A) EMPPAC	26	3	785.5	26	(2.2)
B) Cooling Products	17	10	67.5	14	20.6
C) PEIS	2	7	(76.0)	2	(21.5)
Segmental Margin (%)					
A) EMPPAC	5.8	0.8	505bp	5.7	12bp
B) Cooling Products	7.1	5.1	198bp	5.7	140bp
C) PEIS	18.7	18.5	17bp	17.2	153bp

Source: Company, Angel Research

Concall Takeaways

- Order inflow for the year was up by ~19.0% yoy to ₹3,652cr while carry forward order book grew by ~17.0% yoy to ₹1,628cr.
- Metro accounts for ~22% of the order book and is likely to perform well. The balance is made up of 18% industrial, 14% offices, 11% mixed use development, 11% of power generation and distribution, 8% Malls, 8% hospitals and 8% others.
- While the order inflow has improved for the EMPPAC segment, the Management is however cautious on the execution part in the near term on factoring in the near term liquidity scenario. It has guided for margins to be in the range of ~6%.
- The RAC industry growth estimate has been revised to ~20% for FY2017 and the company has guided for growth in excess of 30% for the same period.
- The Jammu plant will likely be the first to commence production among upcoming facilities, which is in FY2018E, and will add to the overall capacity by 1.5 lakh units.
- The company is focusing on growing its products business in the export markets and is looking at three new countries in Africa.

Investment Rationale

Improvement in macro scenario to support growth

The EMPPAC division of Blue Star contributed ~54% of total revenues in FY2015. The division mainly caters to industrial/institution clients in sectors like IT/ITeS, retail (including malls and multiplexes), healthcare, hospitality, infrastructure, etc. The order execution and finalization has been witnessed to be sluggish in the recent past, thereby affecting the segment. With slow recovery in various client industries and improvement in the economic environment post interest rate cuts, we expect the segment to recover and be a key contributor to the company's overall top-line.

Quality order execution to support EBITDA margin expansion

The company continues to be selective in terms of order booking; such practice has hurt its margins in the past. So far, the delay in execution of high-margin projects, coupled with delayed closure of low margin jobs, has resulted in snail-paced expansion of the EBITDA margin. The carry forward order book has been witnessing upward movement over the past few quarters and with legacy jobs coming off the books, we expect the segment's profitability to improve from here on.

Cooling Products division to be the backbone

The superior performance of the division is mainly on the back of high growth seen in the RAC segment which is consistently growing at 10% points faster than the overall RAC market. The company has been able to leverage on its cultivated perception of being a "Cooling Expert" and successfully grown its market share from ~7% levels in FY2015 to the present 10.5%. As a result of this growth, the Cooling Products segment's share as a percentage of total revenue has increased from 23.4% in FY2009 to ~43.2% in FY2016 (ex of BSIL numbers) and the segment in recent times has been delivering better profitability than the other major segment - EMMPAC. We expect the division to be a key contributor as there is significant potential to capitalize on the underpenetrated RAC market in India. Blue Star can add to its current market share as it has good channel coverage and it has been selectively expanding the channel network in tier 3, 4 and 5 cities.

Foray into newer products and focus on growing international business

Blue Star has forayed into new areas like air purifiers and air coolers in FY2016. As per Management estimates, the domestic air purifiers market is of ~₹200cr, which it expects to grow by 5x over the next five years. Further the Management sounded confident that it can rely on its brand equity to successfully scale up the air coolers business using its vast channel network.

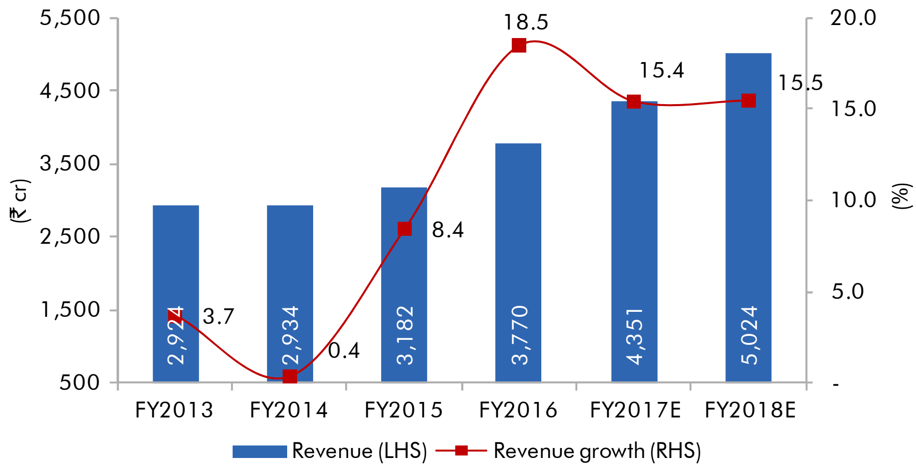
Additionally, the company post its merger with Blue Star Infotech Ltd (BSIL) will be using the cash influx to grow its international business. Apart from this, the company has entered into a 51% joint venture with W. J. Towell & Co. LLC, Oman, in the MEP contracting business. The company intends to scale up the business to ₹500cr over the next few years.

Financials

Improvement in revenue growth

We are building in revenue CAGR of 15.4% over FY2016-18E to ₹5,024 on account of 1) strong growth prospects of the Cooling/Unitary Products division led by increased demand and penetration of room air conditioners and 2) improvement in prospects of the EMPPAC division.

Exhibit 3: Revenue growth estimates

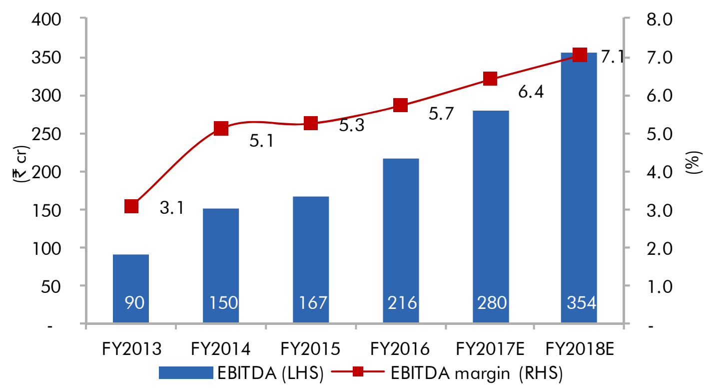


Source: Company, Angel Research

EBITDA margin to improve

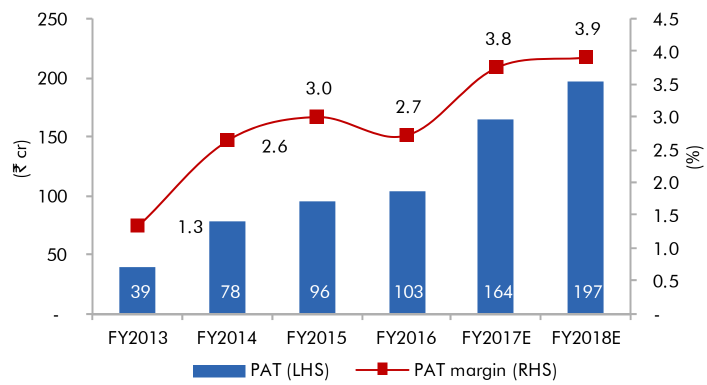
We expect the EMPPAC segment's performance to improve considering that the order book clean up has now been done and that the new margin should be at ~6.0% as guided by the Management. We expect the EBITDA margin to improve from 5.7% in FY2016 to 7.1% in FY2018E. Consequently, the net profit is expected to be at ₹197cr in FY2018E.

Exhibit 4: EBITDA margin to improve



Source: Company, Angel Research

Exhibit 5: PAT expected to improve

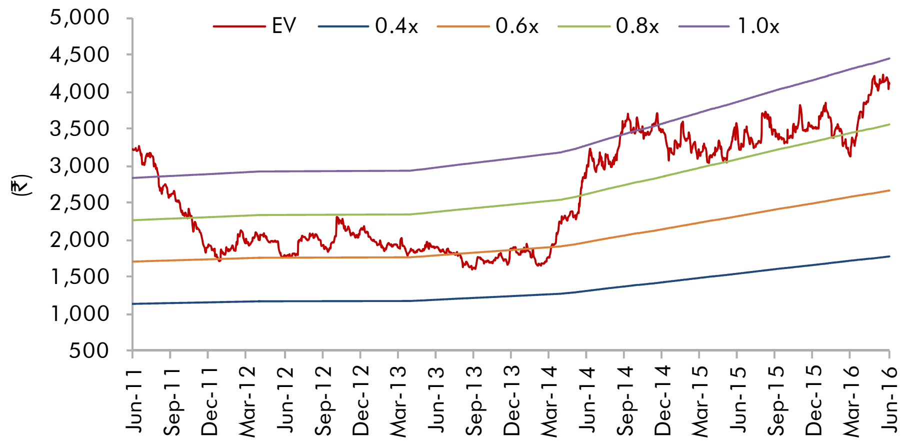


Source: Company, Angel Research

Outlook and valuation

We have upgraded our numbers to factor in higher revenue guidance for the RAC business as well as improvement in performance of the EMPPAC division. As reported in our earlier report(s), the merger with BSIL has improved the balance sheet strength of the company by way of cash infusion which the company will utilize to grow the UPD division as well as the exports of the company. At the current market price, the stock trades at 20.1x its FY2018E earnings and at 0.8x FY2018E EV/sales (while its close peer Voltas trades at 1.5x its FY2018E EV/sales). **We maintain our BUY recommendation on the stock with a target price of ₹495.**

Exhibit 6: One year forward EV/sales band



Source: Company, Angel Research

Key concerns

- Slowdown in investment cycle may impact order inflow, thus impacting revenue. It may also force the Management to compromise on its strategy of avoiding low margin projects.
- Any slowdown in consumer segments like IT/ITES, healthcare, hospitality and infrastructure could impact the company's growth.
- Foreign exchange fluctuations have a direct impact on the profit of the Cooling Products division since commercial refrigerators are imported. Any further depreciation in the local currency may impact the company's profits.
- The RAC industry has been witnessing high traction and the company has been able to outperform the industry over the past few years. Any unexpected drop in performance of the RAC industry would pose a threat to our estimates.

Company Background

Blue Star is India's largest central air-conditioning company with a network of 32 offices, seven manufacturing facilities, over 2,000 dealers and around 2,500 employees. The company's operations could be classified under three main segments:

EMPPACS: This segment comprises central and packaged air-conditioning (involving design, engineering, manufacturing, installation, commissioning and support of large central air conditioning plants, packaged air conditioners and ducted split air conditioners) as well as electrical projects and plumbing and fire fighting projects. In addition, the company promotes after-sales service as a business, by offering several value added services in the areas of upgrades and enhancements, air management, water management, energy management and LEED consultancy for Green Buildings.

Cooling Products: Blue Star offers a wide range of contemporary window and split air conditioners. The company also manufactures and markets a comprehensive range of commercial refrigeration products and services that cater to the industrial, commercial and hospitality sectors.

PEIS: This division has been the exclusive distributor in India for many internationally renowned manufacturers of hi-tech professional electronic equipment and services, as well as industrial products and systems.

Profit and loss statement (Consolidated)

Y/E March (₹ cr)	FY2014	FY2015	FY2016E	FY2017E	FY2018E
Total operating income	**2,934**	**3,182**	**3,770**	**4,351**	**5,024**
% chg	*0.4*	*8.4*	*18.5*	*15.4*	*15.5*
Net Raw Materials	2,087	2,214	2,607	3,010	3,487
Personnel	248	267	346	387	432
Other	450	533	600	674	751
Total Expenditure	2,784	3,015	3,554	4,072	4,670
EBITDA	**150**	**167**	**216**	**280**	**354**
% chg	*(1.8)*	*8.3*	*17.9*	*14.6*	*14.7*
(% of Net Sales)	*5.1*	*5.3*	*5.7*	*6.4*	*7.1*
Depreciation& Amortisation	38	43	60	56	63
EBIT	**113**	**124**	**156**	**223**	**291**
% chg	*97.4*	*10.2*	*25.4*	*43.4*	*30.5*
(% of Net Sales)	*3.8*	*3.9*	*4.1*	*5.1*	*5.8*
Interest (incl. forex loss)	54	49	43	37	33
Other Income	18	8	17	21	22
(% of Net Sales)	*0.6*	*0.3*	*0.4*	*0.5*	*0.4*
Exceptional Items	*(0.1)*	*(41.4)*	*5.6*	-	-
PBT	**76**	**43**	**135**	**207**	**281**
% chg	*87.1*	*(44.0)*	*217.5*	*53.0*	*35.7*
Tax	2	(8)	27	44	84
(% of PBT)	*2.9*	*(18.5)*	*19.9*	*21.0*	*30.0*
PAT (reported)	**74**	**51**	**108**	**164**	**197**
Extraordinary (Expense)/Inc.	0	41	(6)	-	-
Share of Profit of Associate	4	4	-	-	-
Minority Interest			0		
ADJ. PAT	**78**	**96**	**103**	**164**	**197**
% chg	*98.6*	*23.1*	*7.5*	*59.3*	*20.2*
(% of Net Sales)	*2.6*	*3.0*	*2.7*	*3.8*	*3.9*
Basic EPS (₹)	**8.6**	**10.6**	**11.4**	**17.2**	**20.6**
Fully Diluted EPS (₹)	**8.6**	**10.6**	**11.4**	**17.2**	**20.6**
% chg	*198.6*	*123.1*	*107.5*	*150.3*	*120.2*

Balance sheet (Consolidated)

Y/E March (₹ cr)	FY2014	FY2015	FY2016E	FY2017E	FY2018E
SOURCES OF FUNDS					
Equity Share Capital	18	18	18	19	19
Pref. Share Capital/Suspense	18	-	173	-	-
Reserves& Surplus	443	438	472	735	857
Shareholders' Funds	**479**	**456**	**663**	**754**	**876**
Minority Interest	-	-	1	1	1
Total Loans	494	398	364	333	305
Deferred Tax Liability	(1)	(17)	(22)	(22)	(22)
Other Long Term Liabilities	4	7	11	11	11
Total Liabilities	**976**	**843**	**1,016**	**1,077**	**1,171**
APPLICATION OF FUNDS					
Gross Block	514	549	625	700	784
Less: Acc. Depreciation	269	304	364	420	483
Net Block	**245**	**245**	**260**	**279**	**300**
Capital Work-in-Progress	15	22	15	60	60
Goodwill	11	11	9	8	6
Investments	33	36	223	111	111
Long term Loans & adv	120	139	190	205	221
Current Assets	**1,911**	**1,704**	**1,870**	**2,088**	**2,391**
Cash	68	44	54	44	37
Loans & Advances	130	116	112	128	148
Inventory	466	479	540	627	718
Debtors	833	795	888	971	1,122
Other current assets	414	270	275	317	366
Current liabilities	**1,359**	**1,315**	**1,551**	**1,673**	**1,919**
Net Current Assets	**552**	**389**	**319**	**414**	**472**
Misc. Exp. not written off	-	-	-	-	-
Total Assets	**976**	**843**	**1,016**	**1,077**	**1,171**

Cash flow statement (Consolidated)

Y/E March (₹ cr)	FY2014	FY2015	FY2016E	FY2017E	FY2018E
Profit before tax	76	43	135	207	281
Depreciation	38	43	60	56	63
Change in Working Capital	(47)	139	79	(105)	(65)
Other income	(18)	(8)	(17)	(21)	(22)
Direct taxes paid	(2)	(7)	(33)	(44)	(84)
Others	37	28	-	-	-
Cash Flow from Operations	**83**	**237**	**226**	**93**	**173**
(Inc.)/Dec. in Fixed Assets	(71)	(43)	(66)	(118)	(83)
(Inc.)/Dec. in Investments	(6)	(3)	(187)	111	-
(Inc.)/Dec. In L.T loans and adv	(8)	(20)	(51)	(14)	(17)
Other income	18	8	17	21	22
Others	62	(14)	-	-	-
Cash Flow from Investing	**(6)**	**(71)**	**(286)**	**0**	**(77)**
Issue of Equity	18	(18)	173	2	-
Inc./(Dec.) in loans	73	(97)	(33)	(31)	(28)
(Dec.)/Inc. in long term prov.	(1)	2	5	-	-
Forex diff. on cash equivalent	-	-	-	-	-
Dividend Paid (Incl. Tax)	(42)	(54)	(70)	(75)	(75)
Others	(74)	(23)	(4)	-	-
Cash Flow from Financing	**(26)**	**(190)**	**70**	**(103)**	**(103)**
Inc./(Dec.) in Cash	52	(24)	10	(10)	(7)
Opening Cash balances	**17**	**68**	**44**	**54**	**44**
Closing Cash balances	**68**	**44**	**54**	**44**	**37**

Key ratios

Y/E March	FY2014	FY2015	FY2016E	FY2017E	FY2018E
Valuation Ratio (x)					
P/E (on FDEPS)	48.1	39.0	36.3	24.2	20.1
P/CEPS	32.3	26.9	22.9	18.0	15.2
P/BV	7.8	8.2	5.6	5.2	4.5
Dividend yield (%)	1.0	1.2	1.6	1.6	1.6
EV/Sales	1.4	1.3	1.1	0.9	0.8
EV/EBITDA	27.6	24.4	18.7	14.4	11.3
EV / Total Assets	4.3	4.8	4.0	3.7	3.4
Per Share Data (₹)					
EPS (Basic)	8.6	10.6	11.4	17.2	20.6
EPS (fully diluted)	8.6	10.6	11.4	17.2	20.6
Cash EPS	12.8	15.4	18.1	23.1	27.2
DPS	4.0	5.0	6.5	6.5	6.5
Book Value	53.2	50.7	73.7	79.1	91.9
Returns (%)					
ROCE (Pre-tax)	12.5	13.6	16.7	21.3	25.9
Angel ROIC (Pre-tax)	14.6	16.6	22.2	28.4	32.2
ROE	17.7	20.5	18.4	23.1	24.1
Turnover ratios (x)					
Asset Turnover (Gross Block)	6.1	6.0	6.4	6.6	6.8
Inventory / Sales (days)	61	54	49	49	49
Receivables (days)	104	93	81	81	81
Payables (days)	176	162	147	150	150
WC cycle (ex-cash) (days)	57	47	29	27	29
Solvency ratios (x)					
Net debt to equity	0.9	0.8	0.4	0.2	0.2
Net debt to EBITDA	2.6	1.9	0.4	0.6	0.4
Interest Coverage (EBIT / Int.)	2.1	2.6	3.6	6.0	8.9

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Disclosure of Interest Statement	**Blue Star**
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

Ratings (Based on expected returns over 12 months investment period):	*Buy (> 15%)*	*Accumulate (5% to 15%)* *Reduce (-5% to -15%)*	*Neutral (-5 to 5%)* *Sell (< -15)*