

Blue Star Q3FY20

Financial Results & Highlights

Brief Company Introduction

Blue Star is India's leading air conditioning and commercial refrigeration company, with an annual revenue of over ₹5200 crores (over US\$ 750 million), a network of 32 offices, 5 modern manufacturing facilities, 2800 employees, and 2900 channel partners. The Company has 5000 stores for room ACs, packaged air conditioners, chillers, cold rooms as well as refrigeration products and systems, along with 765 service associates reaching out to customers in over 800 towns.

The Company fulfils the cooling requirements of a large number of corporate, commercial as well as residential customers. Blue Star has also forayed into the residential water purifiers business with a stylish and differentiated range including India's first RO+UV Hot & Cold water purifier; as well as the air purifiers and air coolers businesses.

Blue Star's other businesses include marketing and maintenance of imported professional electronics and industrial products and systems, which is handled by a wholly owned subsidiary of the Company called Blue Star Engineering & Electronics Ltd.

Standalone Financials (In Crs)								
	Q3FY20	Q3FY19	YoY %	Q2FY20	QoQ %	9MFY20	9MFY19	YoY%
Sales	1068.45	1006.56	6.15%	1065.72	0.26%	3628.45	3320.37	9.28%
PBT	4.81	-19	125.32%	22.56	-78.68%	132.22	121.02	9.25%
PAT	0.59	-19.86	102.97%	12.79	-95.39%	87.61	80.35	9.04%
Consolidated Financials (In Crs)								
	Q3FY20	Q3FY19	YoY %	Q2FY20	QoQ %	9MFY20	9MFY19	YoY%
Sales	1242	1109.34	11.96%	1260.07	-1.43%	4099.18	3657.64	12.07%
PBT	31.67	14.22	122.71%	54.04	-41.40%	193.67	173.93	11.35%
PAT	19.7	13.23	48.90%	37.16	-46.99%	132.3	131.6	0.53%

Detailed Results:

1. The company had good revenue growth of 12% in Q3. Pat also grew by 49% YoY.
2. EBITDA for the company grew 34.6% YoY to Rs 57 Cr in Q3.
3. Carry forward order book for the company grew 23.5% YoY to Rs 2812 Cr.
4. Capital employed was reduced to Rs 1020 Cr from Rs 1173 Cr last year.
5. Net borrowings were reduced to Rs 127 Cr from Rs 376 Cr a year ago.
6. Segment revenue for the Electro-Mechanical Projects & Commercial Air Conditioning Systems grew 15.8% YoY with order inflows of Rs 550 Cr in the quarter.
7. The company maintained its leadership position in MEP projects space in India.

8. The company bagged major orders from Phoenix Market City (Indore), Chalet Hotels (Bangalore) and Manyata Promoters (Bangalore) for its Electro-Mechanical Projects business.
9. The company bagged major orders from Ambuja Cement (Jaipur), Telangana State Industrial Infrastructure Corporation (Hyderabad), ISRO (Sriharikota) and Police Headquarters (Mumbai) for its Commercial Air Conditioning Systems business.
10. In the unitary products segment, the company saw revenue growth of 7.3% YoY. Margins contracted to 1.8% in Q3 from 2.4% last year. This was mainly on account of higher advertisement expenses during the festive season.
11. In RAC business, the company grew 10% YoY vs industry growth of 5% in the quarter. Close to 36% of the sales were through consumer finance schemes.
12. The company saw good growth in the Commercial Refrigeration business with major orders bagged from Reliance Retail, Top and Town, Dairy Fun, Rebel Foods, and Jubilant Foodworks.
13. The Professional Electronics and Industrial Systems business saw revenue growth of 9.4% YoY. The segment margins were at 31.6% in Q3 vs 12.2% last year.
14. Revenue growth was driven by certain high-value orders from Data Security solutions, Healthcare, and Non-Destructive Testing business.
15. The management stated that regulatory requirements on data localization and increased thrust on digital payment solutions created good short opportunities for Data Security Solutions business.

Investor Conference Call Highlights:

1. The un-allocable expenses for the company were higher in the quarter due to some onetime expenses like office renovation. The management maintains that broadly un-allocable expenses have a run rate of Rs 22-24 Cr per quarter.
2. The margins for the products business has been down for the quarter mainly due to the higher ad expenses arising from the acquisition of Virat Kohli as the brand ambassador. This quarter was the first one with the additional brand expenses and overall, the management expects annualized margins for this segment to be around 8.5-9%.
3. The management maintains that the inherent demand for the RAC industry is strong across all segments and although the company provides products for all categories in this industry, its focus remains on the mid-premium segment. The penetration levels are low signifying significant room for growth and market capture.
4. The management maintains that the biggest driver for the RAC industry remains the intensity of the summer season.
5. The company expects to receive all the raw material shipments from China by early March at the latest. It has already received part of the procurements and the management does not expect major disruptions arising from the Coronavirus situation.
6. The major concern for the company in the electromechanical projects and commercial AC segments remains the slowdown in the real estate and infrastructure sectors. The current order book from the government remains healthy with major orders secured from Mumbai Metro in Q1.

7. The management maintains that once the real estate and infra sectors revive, the company can accelerate growth in these business segments easily with its current capability.
8. The revenue from the water purifier segment is expected to be around Rs 60 Cr for FY20 with a market share of 2%. The company expects to break even in this product segment in FY20.
9. The growth expectation for the EMP and commercial AC segments is guided to be 10-12% for FY20 while the growth in unitary products is guided to be 10-12% by the management.
10. Margin profiles for MEP and CAC are expected to be around 4.5-5.5% while for unitary products it is expected to be 8.5-9%.
11. The management is expecting pricing competitiveness from other players in the market like newcomer Samsung but it is not expecting any let-down in pricing pressures at all.
12. The management maintains that the company does not have any inventory hangover like a few quarters ago and thus it will not be forced to take corrective price actions which may drive realizations down.
13. The management has stated that it will definitely aim to expand the market for the water purifier product and chase its earlier guidance of a 10% market share in FY21. But the management is confident that this business will breakeven at a 3-3.5% market share. The company will also be prioritizing profitability milestones ahead of scaling up for this business.
14. The management is comfortable with the overall component pricing levels and does not see much reason for worry in this area for RAC business.
15. The management has admitted that the difference in margins and realizations between H1 and H2 for the company's products is mainly driven by scale and nothing else.
16. The management admits that the RAC business is indeed dependent on imports although the company has somewhat reduced this dependence by starting to manufacture its own indoor units rather than import these units. But it is still dependent on China for importing the raw materials to make these units.
17. The management does not expect the price premium for inverter ACs to reduce further and has mentioned that mostly the reason for pricing pressures is mostly inventory levels or push to gain market share. The company will continue to moderate its pricing and discounting on a monthly basis to stay on top of such developments in the industry.
18. 60% of the company's products are made in house by the company and the management is always on the lookout for opportunities to increase cost conversion efficiencies and mitigate industry pricing pressures.
19. The management expects that going forward around 50% of the products will be made by the company itself. The management also expects around 70-75% of IDUs to be manufactured in-house by the company.
20. The company will continue to maintain the old tax rate until it exhausts its MAT reserves. After that only will it switch to the new tax regime. The pending MAT credit is at Rs 70 Cr at the end of Q3.

21. The company does not intend to manufacture all of its water purifiers in house and the management will be looking to pursue the best ratio of in-house vs outsourced that would be best for the company.
22. The management explains that there is a lag between project announcement and commencement in the MEP and commercial AC divisions and thus there is a lag in order growth in comparison to the real estate and infra projects announcement. There may also be additional lags in between like time taken to achieve financial closure for the said project which is out of the hand of the company.

Analyst's View:

Blue Star is one of the largest cooling solutions providers in the country. It is one of the biggest branded players in the RAC market. The company has also done well to establish itself as one of the leading commercial cooling and electromechanical project solutions providers in India. Furthermore, the company has also expanded into the still underpenetrated water purifier segment where the vast majority of the addressable market remains untapped. The current quarter results were decent considering that it is an off-season for a cooling solutions provider like Blue Star. Although the margins for the quarter were low due to higher advertising expenses from signing Virat Kohli as the brand ambassador, the management seems to think that this is a temporary blip and margins should normalize going forward. It remains to be seen how long the current slowdown in the real estate and infra sectors will continue as this has restricted growth in the commercial cooling solutions business. The heightened ad expenses from investing in Virat Kohli a brand ambassador are also yet to be justified as it will take some time for these ad efforts to solidify the brand image. Nonetheless, given its robust market positioning and the big potential for all forms of cooling solutions and products in a tropical country like India, Blue Star is a good cooling solution stock to watch out for.

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