Blue Star Limited (Revised)

June 01, 2020

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Actions
Proposed Non-convertible Debenture	350.00 (Rupees Three Hundred and Fifty crore only)	CARE AA+; Negative (Double A Plus; Outlook: Negative)	Final Rating

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The final rating was assigned to the NCD of Blue Star Limited (BSL) based on the final term sheet received from the company. The term sheet was in line with the draft term sheet considered by CARE at the time of assigning the provisional rating.

The reaffirmation of the ratings assigned to the bank facilities/instruments of Blue Star Ltd (BSL) continue to takes into account the presence of BSL in the industry for more than seven decades, well established brand name 'Blue Star', strong dealership network across locations with overall market share of 12.50% in the room air conditioning business. The rating benefits from the consistent & growing revenue base with strong order book position translating into short term revenue visibility along with low yet stable profitability margins. The overall credit profile of BSL stands comfortable with robust capital structure, comfortable debt protection metrics, improving cash flow position and comfortable liquidity position.

The strengths are however tempered by the slow moving real estate & infrastructure sector which may affect the flow of liquidity & credit in the project business and smooth execution of mid/large size orders. Further, while the company manages working capital efficiently, the business continues to be working capital intensive during the peak selling season for BSL's products business, faces risk of technology obsolescence with the requirement to maintain adequate inventory levels. Further, the profitability margins of BSL are susceptible to commodity price fluctuation & foreign exchange fluctuation risk, though BSL adequately manages the currency risks through appropriate hedging policy.

There has been nationwide shutdown since March 24, 2020 till May 4, 2020 announced by the government to contain the Covind-19, which has led to shutdown in production, as well closure of sales, and distribution channel which would have negative impact on financial performance of the company in the short term.

Rating Sensitivities

Positive Factors:

- Improvement in overall PBILDT margins to 10% with Segment I & II reporting minimum of 8% at PBILDT level respectively
- Decrease in dependence of imports as percentage of overall raw material cost by 30%

Negative Factors:

- Collection period of more than 120 days on sustained basis
- Gross gearing to remain higher than 1.20 times on sustained basis
- Impact of pandemic coronavirus on the total revenue and profitability of the company

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[1]*Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*

Outlook: Negative

The outlook of the company has been revised to negative from stable due to temporary shutdown of manufacturing facilities , and an expectation of lower demand of consumer durables in the near to medium term. The COVID-19 related disruptions are expected to impact the overall credit profile of the company (especially debt coverage indicators and working capital turnover) in the near to medium term. Moreover, extension of lockdown beyond the anticipated period, may exert pressure on the company's revenues and profitability and is likely to cause a deterioration in its credit profile.

The outlook may be revised to 'Stable' in case of faster than anticipated recovery in demand resulting in sustained improvement in the company's business and financial risk profile.

Detailed description of the key rating drivers

Established track record with extensive experience of promoters

Incorporated in 1949, BSL has its presence in the industry for more than seven decades. The company was promoted by late Mr. Mohan T. Advani in 1949. Mr. Vir S. Advani (Vice Chairman & Managing Director) and Mr. B Thiagarajan (Managing Director) handle the overall operations of the group, with guidance from the board.

Sustained leadership in the central air-conditioning and cooling products business

BSL is India's leading central air-conditioning and commercial refrigeration company, with over seven decades of experience in providing expert cooling solutions. The company continued its dominant presence with a market share of 12.50% in H1FY20, in the room air-conditioner segment in India. The company fulfills cooling requirements and provides end-to-end solutions as a manufacturer, contractor and after-sales service provider to corporate, commercial, residential and institutional customers.

Pan-India presence with wide marketing and dealer network along with expanding presence in overseas markets

The company has a wide marketing and dealer network across the country to provide comprehensive product information and distribution of products. The company has more than 2,900 channels partners with around 6000 stores in 575 locations for room air conditioners, packaged air conditioning, chillers, cold rooms and refrigeration products and systems. On the export front (5% of consolidated net sales in FY19), it offers various cooling products under its own brand name in Middle Eastern and African markets through various partners.

Diversified revenue streams with significant contribution from EMP & UP segments

Overall business is classified in three segments – 1) Electro Mechanical Project business (EMP, Segment I), 2) Unitary Products (UP, Segment II) 3) Professional Equipment's & Industrial Systems (PEIS, Segment III) contributing around 53%, 43% and 4% respectively to the consolidated net sales in FY20. The revenue profile is fairly diversified within each of these segments in terms of products/services offered and geographies. Across the three businesses, BSL follows an integrated business approach, where it acts as manufacturer, contractor and after-sales service provider, thus providing an end-to-end solution to its customers.

Consistent profit margins, expected to soften in FY21

PBILDT margins declined by 40 bps in FY20 to 4.98% vs FY19, mainly due to lower profitability of businesses in Q4FY20. The business profitability is lower in Q4-FY20 as the company made significant expenses on marketing, publicity, and promotion but was not able to benefit from these expenses in form of higher sales volume due to Covid-19 related slowdown in sales in the month of March 2020. Further, the TOI, profitability levels and margins will be adversely impacted in H1FY21 due to the impact of nationwide lockdown for pandemic covid-19.

Strong order book position

Total order book position stood at of Rs.2,947 crore as on March 31, 2002, which is the highest order book position in the company's history. The order book is 73% of company's overall sales in FY20. Of the total order book, 70% of the orders pertains to Segment-I, and would be executed 18 to 24 months; thus providing short to medium term visibility on revenues.

Though the company has considerable order book position, the project execution pace has not picked up since BSL maintains a tight control over operating cash flows in this segment and credit flow in the real estate & infrastructure sectors remains a constraint. To mitigate the same, the company has been cautiously monitoring its timely receipt of cash flows to efficiently manage its working capital cycle

Rationale for the on-going project

The custom duty hike in certain components of manufacturing has resulted in increase in the cost of production. Thus the company intends to reduce the imports by manufacturing the components in-house. In FY20, BSL would manufacture at-least 50-60% of the overall indoor unit consumption in the Himachal factory, proportion of which would increase to 70-80% by FY21 & FY22. For other components, BSL is exploring alternate sources of procurement other than China and including some FTA countries which will to some extent have mitigating effect on the custom duty hike.

Comfortable capital structure

Total debt increased during 2020 on account of increase in long term debt to fund the capex and increase in working capital borrowing to fund its operations. Overall gearing (including LC acceptances) increased to 0.97x as on March 31, 2020 from 0.71x as on March 31, 2019 & 0.87x as on March 31, 2018. However, Net Gearing stood at comfortable level of 0.60 times as on March 31, 2020

The working capital requirement is projected to increase during FY21 on account of increase in inventory and debtors. The company plans to issue medium term NCDs of Rs.350 crore as a means to finance its long term working capital requirements.

Covid-19 business plan to protect margins

In light of challenges posed by Covid-19, the company has embarked on business plan focused on cost rationalization. The plan would focus on reducing various fixed overheads – Lease rentals, Marketing, employee expenses, and planned shutdown of plants to bring production in line with demand. It plans to achieve 20pct reduction in the fixed costs by Sep-2020. The company has also revised its capital expansion plans for FY21 to conserve cash. It will focus on pushing sales during the Indian festive season in Q3-FY21, and summer season of 2021. As on May 8, 2020, 1) It has started gradual re-opening of plants with adequate safety precautions. Two of its plants at Wada, and Dadra, are operational, and it has received government permission to resume operations at its other plant in Himachal Pradesh, and Gujarat 2) 3000 retail outlets (50% of its retail channel), is open, and selling its products

Key Rating Weaknesses

Working capital intensive business

The business model is working capital intensive during the peak selling season for its products business due to substantial raw material imports, and seasonality in the air conditioning business. In the air conditioning business, demand peaks in Q1 and Q2, and the stocking of inventory is done during Q4 which leads to higher debt levels in Q4 as compared to other quarters. The increase in the inventory levels during Q4 is partly financed by availing working capital borrowings from banks and commercial paper. BSL also has substantial requirements of bank guarantees in its project business. It enjoys strong support from its lenders, and is able to avail various bank limits at competitive rates.

The company has been consistently efficient in managing its working capital cycle. In EMP segment, the collections are in accordance to percentage stage completion. Thus overall the company extends credit period of around 90 days to its customers. Further BSL has been availing credit period of around 90-120 days. Thus the ability of the company to efficiently manage the operating cycle would be crucial from credit perspective.

Competitive & fragmented industry

The air conditioning segment is fragmented with 25 well known players, including Indian & global corporates with top five players accounting for about 60% of the market share. In domestic market, Voltas is leading market share in fixed-speed

ACs (window & spilt ACs) and faster growing inverter AC segment. Voltas Limited has annual market share across the multi brand outlets around 23.7% *(Source: Volta's annual report FY19)*.

Commodity & currency fluctuation risk

BSL is exposed to fluctuation in prices of copper & aluminum, which are key inputs for its products. However, any change in commodity prices affects all the players equally and the impact of price increased is passed to customers. BSL also has substantial imports and is exposed to foreign exchange fluctuation risk. BSL has well defined forex risk management policy, and uses forward contracts to reduce its forex exposures. The company has unhedged receivables amounting to Rs.128.40 crore and unhedged payables of Rs.108.53crore as on March 31, 2019 (vis-à-vis Rs.85.12crore of receivables & Rs.163.68crore of payables as on March 31, 2018). However on the net-off basis, the un-hedged forex exposure is minimal. The major part of risk is covered on account of natural hedge and the company has net un-hedged receivables which remains susceptible for any adverse currency fluctuation.

Impact of Covid-19 on consumer durables industry

On March 24, 2020, the government imposed a large scale lockdown in the country, till May 03, 2020 temporarily halting the production at most consumer durables as well as creating logistics roadblocks in movement of goods across the country. The industry is likely to suffer considerable loss in sales going forward with the already existing slowdown during FY20. It is to be noted here, that even if the pandemic is curtailed, the consumer sentiments are expected to be unfavourable and demand is expected to remain muted during H1FY21 led by uncertain economic conditions.

Liquidity: Strong

The cash and cash equivalent stood at Rs.286 crore as on March 31, 2020. The net cash flow from operations stood at Rs 457 crores during FY20 which supports the liquidity position of the company. BSL maintains sufficient cash accruals to meet the debt obligations and to fund the capex requirements. Average utilization of fund based and non-fund based limits was 22% & 74% respectively for the past twelve months ending April 2020. It has total available bank limits of Rs 2324 crore - Rs 325.30 crores (fund based), and Rs 1,999 crores (non-fund based, out of which Rs.260crore is fungible into fund based).

Analytical approach: Consolidated owing to financial and operational linkages between the parent and subsidiaries, common management, fungible cash flows and corporate guarantee provided by BSL. The consolidated financials of BSL includes the below mentioned companies.

Name of the Company	% of holding
Blue Star Engineering and Electronics Ltd	100%
Blue Star Qatar WLL	49% (It is a subsidiary by virtue as BSL controls the management of the company)
Blue Star International FZCO	100%
Blue Star Systems & Solutions LLC	Subsidiary of Blue Star International FZCO. (It is a subsidiary by virtue as BSL controls the management of the company)
Blue Star M&E Engineering Sdn Bhd	49% (Joint Venture in Malaysia between Blue Star International FZCO and Amcorp Properties Bhd, Malaysia)
Blue Star Oman Electro ' Mechanical Company LLC	51% (Joint Venture in Oman between W J Towell & Co LLC and the company)

Applicable Criteria
Manufacturing Companies
Rating Outlook and Credit Watch
Factoring Linkages in Ratings
CARE's default recognition policy
Financial ratios - Non Financial Sector
Rating Credit Enhanced Debt
Policy on Assignment of Provisional Ratings

About the Company
BSL was incorporated in 1949 (established in 1943) by late Mr. Mohan T Advani. As on March 31, 2020, the promoter group held 38.76% equity stake in the Company. The company is India's leading central air-conditioning and commercial refrigeration company and its manufacturing facilities are spread across various locations in India including Ahmedabad, Dadra, Wada and Himachal Pradesh. The company's operations can be classified into three segments, namely Electro Mechanical Projects & Packaged Air Conditioning Systems (EMP), Unitary Products (UP) and Professional Electronics and Industrial Systems (PEIS) contributing 53%, 43% and 4% respectively to the consolidated net sales of the Company for FY20. BSL also exports its products to multiple countries across the Middle East, Africa, SAARC and ASEAN region.
The **EMP segment** covers the design, manufacturing, installation, commissioning and maintenance of central air-conditioning plants, packaged/ducted systems, and variant refrigerant flow systems. The company also undertakes contracting services in electrification, plumbing and fire-fighting. It also comprises of after-sales services such as revamp, add and upgrades. BSL had recently introduced engineering facilities management which covers series of operation & maintenance services for efficient functioning of electro-mechanical utilities.
In **UP segment**, BSL offers room air conditioners for residential as well as commercial applications. BSL also manufactures & markets commercial refrigeration products and cold chain equipment. The company also has kitchen refrigeration products, supermarket refrigeration products, medical refrigeration products, water purifiers, air purifiers and air coolers in its product portfolio.
In **PEIS segment**, BSL has been distributor in India for manufacturers of professional electronic equipment & services, as well as industrial products & systems. The business is managed by BSL's wholly owned subsidiary Blue Star Engineering & Electronics Limited [BSEEL - rated CARE AA+ (CE); Stable]. The segment operates in two broad segments vide eight lines of business:

(a) Professional electronics which comprises Healthcare systems, Data Security Solutions, Infra Security Solutions and Communication Systems
(b) Industrial Systems which encompasses Testing Machines, Non-Destructive Testing Systems and Industrial Automation, NDT Products and Industrial Products.

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)	FY20 (A)*
Total operating income	4,610	5,219	5,405
PBILDT	237	332	323
PAT	143	190	143
Overall gearing including LC acceptances (times)	0.87	0.71	0.97
Interest coverage (times)	8.27	6.94	10.98

*A: Audited*Abridged financials*

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Debentures-Non Convertible Debentures	June 01, 2020	7.65%	3 years from date of Issu	350.00	CARE AA+; Negative

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT-Cash Credit	LT	50.00	CARE AA+; Negative	1)CARE AA+; Negative (18-May-20)	1)CARE AA+; Stable (22-Jan-20)	1)CARE AA+; Stable (08-Jan-19)	1)CARE AA+; Stable (23-Nov-17)
2.	Non-fund-based - ST-BG/LC	ST	518.00	CARE A1+	1)CARE A1+ (18-May-20)	1)CARE A1+ (22-Jan-20)	1)CARE A1+ (08-Jan-19)	1)CARE A1+ (23-Nov-17)
3.	Commercial Paper	ST	500.00	CARE A1+	1)CARE A1+ (18-May-20)	1)CARE A1+ (22-Jan-20)	1)CARE A1+ (08-Jan-19) 2)CARE A1+ (14-Jun-18)	1)CARE A1+ (23-Nov-17)
4.	Fund-based/Non-fund-based-LT/ST	LT/ST	1270.00	CARE AA+; Negative / CARE A1+	1)CARE AA+; Negative / CARE A1+ (18-May-20)	1)CARE AA+; Stable / CARE A1+ (22-Jan-20)	1)CARE AA+; Stable / CARE A1+ (08-Jan-19)	-
5.	Debentures-Non Convertible Debentures	LT	350.00	CARE AA+; Negative	1)Provisional CARE AA+; Negative (18-May-20)	-	-	-

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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