Blue Star Limited

Q4 FY22 and FY22 Earnings Conference Call

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MANAGEMENT: **MR. B. THIAGARAJAN – MANAGING DIRECTOR**
MR. NEERAJ BASUR – GROUP CHIEF FINANCIAL OFFICER

Moderator: Ladies and gentlemen, good day and welcome to the Q4 FY22 and FY22 Earnings Conference Call of Blue Star Limited.

We have with us today from the management. Mr. B. Thiagarajan – Managing Director, Blue Star Limited.

As a reminder, all participant lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. B. Thiagarajan. Thank you and over to you, sir.

B. Thiagarajan: Thank you. Good afternoon, ladies and gentlemen. It's a pleasure interacting with you. I have stepped in because as you are aware Mr. Neeraj Basur has decided to leave Blue Star. So, I wanted to provide continuity before the next Group CFO comes in. So, perhaps this and next quarter, I will interact with you over this quarterly investor call.

First, I would like to place on record my deep sense of appreciation and gratitude to Mr. Neeraj Basur and Mr. Vir Advani joins me in conveying the same. He for over eight years did an exceptional job in taking our corporate financial services function to a next level. He played an active role in implementation of digitalization programs, the enterprise risk management framework, most importantly, the operational support in bringing quite a few businesses well under control in terms of ROCE. So, we will miss him and we wish him all the very best. After my opening remarks, he is still going to continue with the highlights of the quarter.

Before that, I wanted to also share with you that the quarterly results that you've seen, you must look at it with one perspective that these results are achieved despite losing the summer season and easily in my estimate, we should have delivered something like Rs.75 crores to Rs.80 crores more if the summer season of 2021 would have been an active quarter, but that is unfortunate, but we will look at the results with that particular perspective that this was possible even though the summer season was lost.

The second important thing is that we had a huge commodity price increase and consequently, the price increases implemented by Blue Star on April 1, 2021, again in July 1, 2021, again in October 1, 2021, and we continued with that and now on 1st April 2022, we have implemented a price increase. So, the commodity price increase is so much and despite price increase we have delivered lesser margin as far as the cooling product segment is concerned.

The other important highlight is also the fact that throughout the free cash flows is excellent and you will see when Neeraj speaks how we had performed in terms of the cash flows and the borrowings.

Another important aspect is that in every business, whether it is Room Air Conditioners or Commercial Refrigeration or it is Electro-Mechanical Projects, Commercial Air Conditioning, Professional Electronics, each and every business performed exceedingly well.

Lastly, you have the numbers of last quarter and I think you would have gone through, you would have analyzed in your own way. But the important thing that I want to share is April had gone on well, the outlook for Q1 is very good, and despite the interest rate hikes, I still hold an optimistic view as far as the room air condition demand is concerned.

With that, I will hand it over to Mr. Neeraj Basur for the opening remarks on the results and I will be happy to answer any questions later. Thank you very much.

Neeraj Basur: Thank you very much, Mr. Thiagarajan, and good afternoon, ladies and gentlemen. Firstly, it's been a privilege and an honor for me all these years to have interacted with you so very regularly and it's been a great learning journey for me as well and I wish you all the best in your respective endeavors.

So, as Mr. Thiagarajan has already set the context, I will now walk you through the key highlights of our financial results and business results for Q4 and the full year. First, let me take you through the Financial Highlights.

1. FINANCIAL HIGHLIGHTS

The momentum gained in Q3FY22 continued in Q4FY22 despite a three-week disruption caused by the Omicron variant. The demand for our offerings across various segments not only continued but also accelerated in the month of March. Further, the policy announcements in the Union Budget 2022-23 resulted in positive business sentiments. The early onset of summer in some parts of the country also helped revenue growth in several product categories. In this backdrop, the Company delivered record revenue and profits in Q4FY22 and ended the year on a high note despite losing the 2021 summer season.

Financial highlights for the quarter ended March 31, 2022, on a consolidated basis, are summarized below:

-Revenue from operations for Q4FY22 grew 39.5% to Rs 2247.58 cr as compared to Rs 1611.56 cr in Q4FY21.

-EBIDTA (excluding other income and finance income) for Q4FY22 was Rs 142.95 cr (EBITDA margin 6.4% of revenue) as compared to Rs 101.81 cr (EBITDA margin 6.3% of revenue) for Q4FY21.

-Profit before tax grew 9.2% to Rs 113.91 cr in Q4FY22 as compared to Rs 104.32 cr in Q4FY21.

-Net profit for Q4FY22 grew by 12.0% to Rs 76.27 cr as compared to Rs 68.09 cr in Q4FY21.

-Healthy cash from operations enabled a reduction of Rs 97.97 cr in net borrowings in Q4FY22.

Financial highlights for the year ended March 31, 2022, on a consolidated basis, are summarized below:

-Revenue from operations for FY22 grew 41.8% to Rs 6045.58 cr as compared to Rs 4263.59 cr in FY21.

-EBIDTA (excluding other income and finance income) for FY22 was Rs 346.47 cr (EBITDA margin 5.7% of revenue) as compared to Rs 239.81 cr (EBITDA margin 5.6% of revenue) in FY21. Despite pressures on gross margin due to escalation in commodity prices, the impact of scale enabled preservation of profitability levels.

-PBT before exceptional items grew 69.8% to Rs 250.90 cr in FY22 as compared to Rs 147.75 cr in FY21.

-Tax expense for FY22 was Rs 82.90 cr as compared to Rs 47.09 cr in FY21.

-Net profit for FY22 grew by 66.9% to Rs 168.00 cr as compared to Rs 100.66 cr in FY21.

-The Company has returned to growth path and a dividend of Rs 10 per share has been recommended.

-Carried-forward order book as of March 31, 2022, grew by 10.2% to Rs 3253.30 cr, compared to Rs 2952.42 cr as on March 31, 2021.

-Due to planned increase in inventory levels owing to advancement in the procurement of long lead raw materials and components in order to de-risk supply chain constraints and capacity expansion capital investments in the new manufacturing projects at Wada and Sri City, capital employed as on March 31, 2022, stood at Rs 1087.69 cr (March 31, 2021: Rs 736.41 cr).

-Our strong operating cash flows ensured that we ended March 31, 2022, at a moderate net borrowing level of Rs 67.14 cr resulting in debt equity ratio of 0.07 (March 31, 2021: net cash balance of Rs 151.45 cr).

-We had raised Rs 350 cr through issue of Unsecured Non-Convertible Debentures (NCD) in June 2020 in order to strengthen our Balance Sheet with a repayment tenor of 3 years with a call option to repay 50% of the NCD in May 2022. Due to our current strong fund position after meeting our capacity expansion plans, we propose to exercise the said call option and reduce the residual NCD obligation.

II. BUSINESS HIGHLIGHTS FOR Q4FY22

Segment I: Electro-Mechanical Projects & Commercial Air Conditioning Systems

Segment I revenue grew 45.6% to Rs 1135.97 cr in Q4FY22, as compared to Rs 779.96 cr in Q4FY21. Segment result was Rs 75.84 cr (6.7% of revenue) in Q4FY22 as against a profit of Rs 48.50 cr (6.2% of revenue) in Q4FY21.

Segment revenue for the year grew 44.0% to Rs 3194.46 cr as compared to Rs 2218.72 cr in FY21. Segment result was Rs 194.82 cr (6.1% of revenue) in FY22 compared to Rs 106.49 cr (4.8% of revenue) in FY21.

Order inflow for the quarter grew by 42.0% to Rs 932.05 cr as compared to Rs 656.54 cr in Q4FY21.

1. Electro-Mechanical Projects business

Revival of capex cycle led to improved pace of project execution as compared to the previous quarters. With continued focus on the Make in India program, order inflows from the factories, data center, and infrastructure sectors continued to be encouraging. Commercial buildings sector revival was also witnessed.

Carried-forward order book of the Electro-Mechanical Projects business was Rs 2295 cr as on March 31, 2022, as compared to Rs 2149 cr as on March 31, 2021, a growth of 6.8%.

Segment-wise break-up of the carry forward order book of the Electro-Mechanical Projects business as of March 2022 is as follows:

Application Segment	**Share**
Office (IT/Non-IT)	24%
Metro Rail	16%
Water MEP projects	16%
Industrial / Factory / Data Center	13%
Hospitals	5%
Airport	5%
Malls	4%
Others	17%

2. Commercial Air Conditioning Systems

A healthy flow of opportunities from the industrial, healthcare and government customer segments supported by the revival of demand from the manufacturing, light commercial and education segments enabled growth for the commercial air conditioning business during the quarter.

We continued to maintain our number 1 position in Conventional and Inverter Ducted Air Conditioning Systems as well as Scroll Chillers. We remained number 2 in VRF and gained market share and moved up to the 2nd position in Screw Chillers.

3. International Business

The economic activities and consumer confidence continued in the Middle East and enabled growth in revenue during the quarter. Increased demand from QSRs and the pharma industry enabled growth for our refrigeration business during the quarter.

With a pickup in the business sentiment, the prospect for growth of our international business in the Middle East region is very positive.

The projects business in Qatar continued to do well. The operations at the joint venture at Malaysia continued to be impacted due to the restrictions on account of COVID.

We will continue to focus on the expansion of the Blue Star product range and building brand awareness and brand visibility in different markets that we are present in.

Segment II: Unitary Products

Segment II revenue grew 32.3% to Rs 1034.01 cr in Q4FY22 as compared to Rs 781.81 cr in Q4FY21. Segment result was Rs 72.05 cr (7.0% of revenue) in Q4FY22 as compared to Rs 62.06 cr (7.9% of revenue) in Q4FY21. Continued headwinds in input costs, disruptions in the international supply chain and increased supply lead time led to a drop in segment margins for the quarter.

Revenue for the year grew by 39.4% to Rs 2603.77 cr in FY22 as compared to Rs 1868.28 cr in FY21. Consequently, segment results improved to Rs 155.86 cr (6.0% of revenue) in FY22 as compared to Rs 108.82 cr (5.8% of revenue) in FY21.

1. Cooling and Purification Products business

Strong pent-up demand coupled with positive consumer sentiment and early onset of summers in some parts of the country enabled a 47% growth in revenue for our room air conditioner business during the quarter. We grew faster than the market and ended the financial year with a market share of 13.25% (FY21: 13%).

Our comprehensive range of affordable ACs continued to resonate well with the price sensitive customers and first-time buyers especially in Tier 3, 4 and 5 markets and we further consolidated our position as a mass premium brand in our target customer segments.

Due to continuing increase in commodity prices and logistics costs, we have implemented a price increase of 2-3% effective April 1, 2022.

2. Commercial Refrigeration business

Commercial Refrigeration business witnessed growth momentum with demand for Deep Freezers, Modular Cold Rooms, Visi Coolers and Supermarket Refrigeration products from diverse segments such as Dairy and Ice Cream, Processed foods, Pharma, QSRs and, Food Delivery etc.

We continue to maintain leadership position in Deep Freezers, Storage Water Coolers and Modular Cold Rooms. In modular Cold Rooms, demand from the QSRs has almost restored back to pre-pandemic levels. Some of the breakthrough orders were from Ola Food Technologies, Reliance Retail, Dunzo Digital, Zomato, D Mart and proprietary cold room customers for mushroom and dry fruits storage.

We continue to enjoy high market share in Pharma segment for products and solutions such as Cold Rooms and Medical Refrigeration products. We received large orders from Reliance Retail for Supermarket Refrigeration products for supply across the country, apart from other retail players, including Shell outlets.

We also launched a new range of indigenously designed and manufactured deep freezers and augmented our manufacturing footprint with our new world-class manufacturing facility at Wada, which is expected to get operationalized soon.

Segment III: Professional Electronics and Industrial Systems

Segment III revenue grew by 55.9% to Rs 77.60 cr in Q4FY22 as compared to Rs 49.79 cr in Q4FY21. Segment result was Rs 14.34 cr (18.5% of revenue) in Q4FY22 as compared to Rs 7.22 cr (14.5% of revenue) in Q4FY21.

Segment revenue for the year grew by 40.1% to Rs 247.35 cr as compared to Rs 176.59 cr in FY21. Segment result was Rs 42.49 cr (17.2% of revenue) in FY22 as compared to Rs 33.81 cr (19.1% of revenue) in FY21.

With the revival of corporate capex, we witnessed growth across all segments that we operate in. Growth in revenue from the healthcare and data security solutions business enabled a growth in revenue for the quarter. The Testing Machines business also continued to witness growth with a revival of investments in the manufacturing sector.

Major orders were bagged from Axis Bank, HDFC bank, ICICI Bank, JSW Steel and Hindustan Aeronautics Limited to name a few.

With a wide portfolio of contemporary products and solutions forming part of our offerings, the prospects for this business segment continue to be positive.

III. BUSINESS OUTLOOK

Robust demand witnessed throughout the quarter enabled us to end the year on a strong note with healthy growth across all segments. After the washout of two consecutive summers, we expect strong growth in Q1FY23. With ebbing of the pandemic impact, the business and market disruptions have progressively reduced, aiding growth and revival of opportunities. The launch of our new range of products in room air conditioners and commercial refrigeration is expected to significantly aid growth going forward. With the increase in corporate capex and revival of demand from traditional customer segments, prospects for the electro-mechanical projects and commercial air conditioning business are encouraging.

Given the ongoing geopolitical conflict between Russia and Ukraine, input cost pressures and supply chain challenges are expected to persist in the short term. However, we have taken adequate measures to ensure availability of raw materials and components for the ongoing peak selling season. The cost optimization initiatives and prudent working capital management will help us to sustain growth and profitability.

We would like to build on the momentum in Q3FY22 and Q4FY22 into Q1FY23 and the subsequent quarters.

With that ladies and gentlemen, I am done with the opening remarks. I would like to now pass it back to the moderator, who will open the floor to questions. I will try and answer as many questions as I can. To the extent I am unable to, we will get back to you via e-mail.

With that, we are open for questions.

Moderator: We will now begin the question-and-answer session. The first question is from the line of Bhoomika Nair from DAM Capital.

Bhoomika Nair: I wanted to understand this whole price hike and the cost escalations that we're seeing. You mentioned that in April, we've taken about a 2% to 3% price hike. Now, given the recent events of March, April due to the geopolitical issues, the kind of cost escalations that we're seeing and the freight costs, etc., which are also going up, is this adequate enough to kind of take back our margins to that 8%-plus trajectory and how much more will we need to take? Also, if you can talk about the impact of cost escalation once the BEE ratings kicks in from 1st of July?

B. Thiagarajan: As you may recall, we have launched a new range of affordable premium air conditioners, which are reengineered and have achieved a cost reduction. Unwanted features have been removed, given the fact more than 90% of the buyers are first-time buyers, 65% of the buyers are from tier-3, 4, 5 markets, the growth is driven by aspirational middle class and 45% of the sales are financed through consumer finance. These customers are looking for a product which is functionally delivering air conditioning. In addition to managing price escalations, it is also necessary to address these customer segments or the belly of the market to grow our market share from 12% to 15%. Therefore, the entire product range has been rejigged.

There are 22 models currently available which are future ready taking into account the energy label change that will come into effect on 1st July 2022. There are also a set of actions connected with procurement and value chain such as localization, backward integration and alternate vendors. China dependence risk mitigation that is a part of our enterprise risk management framework is also being addressed. There are a few component manufacturers such as compressor manufacturer - GMCC, the global leader who is expected to commence trial production shortly. A component ecosystem is developing in the country very fast, thanks to the PLI Scheme. In all probability, we will commence production at the Sri City facility in Q3 FY'22 which bring down the logistics costs. Presently, incoming raw materials are transported all the way from Nhava Sheva port to Kala Amb in Himachal Pradesh and the finished goods are transported from Kala Amb to all over the country. Southern region constitutes 45% of the sales. This also leads to additional holding of around 10 to 12 days of inventory that is in transit.

Sri City as a location can receive the raw material in Ennore port or Krishnapatnam port which are located at less than 50 kilometers distance from the factory. All the states in South India, Telangana, Andhra Pradesh, Puducherry, Tamil Nadu, Kerala, Karnataka can be served overnight from Sri City. Therefore, there will be substantial cost savings once the Sri City plant commences production. We would like to pass on cost increase to the market to the extent possible, but then have to bear in mind the competitive intensity as well. We will indeed pursue our market share goal of 15% by 2025, which remains unaltered which we may be able to achieve even by FY'24 depending on the market dynamics.

We will continue to look to re-engineer our products to make them affordable for the belly of the market. All possible cost reduction levers will be used and finally, we expect to witness softening of commodity prices later this year. We had earlier expected the cycle to continue for 12 to 18 months but with the inflation control measures being taken, we expect the prices to soften by end of this calendar year.

Taking all these into account, we expect to get back to 8% to 8.5% operating margin this year. Yet another important development is the reduction in advertising expenses. The spend by the industry is almost Rs.100 crores lower than the pre-COVD levels. That is another lever all brands will have, not only Blue Star. Therefore, it should be possible for us to achieve a margin in the range of 8% to 8.5% as against 7% that we have achieved in the quarter ended 31st March 2022. This elaborate answer will help others who may have a similar question.

Bhoomika Nair: So, this this improvement in margin will be more back ended. Near term pressure on margins would kind of continue given the cost escalations and these benefits out of Sri City to only be more towards the end of the year?

B. Thiagarajan: Given the improvement in margins steadily over Q1, Q2, Q3, Q4 and the new models launched in the month of January and the healthy demand, our estimate is we should be witnessing something improved margin in Q1 itself.

Bhoomika Nair: You did speak about indigenization and component ecosystem development over the medium term, but more from a very near term perspective, given the supply chain disruption that we're seeing and particularly in China, lockdown, etc., and on the flip side, we have a very strong surge in demand for March & April, would they be shortage of material and inability to kind of supply to the strong demand that comes in by the end of the month or by the end of the season in that sense in June, July?

B. Thiagarajan: We were the first one to talk about shortage of components even before automobile industry. The shortage started in December 2020. There was huge component shortage from December 2020 to March 2021 and in addition the ocean freight had gone up three times. At that time, the automobile industry also didn't speak about shortage of semiconductors which continues even today. There is a challenge. The mitigation measure is advance planning. In other words, inventory holding levels that would have been 45-days have now increased to 90-days. There is a rush to block quantities from the vendors for components like semiconductors, where we have locked till 2024 end. We do not have a problem till July. There is also a prevailing view that market will grow by 50% to 70% this summer. However, we have been maintaining that it will be 20% to 25% market growth over summer 2019, which is April, May, June, July 2019. We have adequate inventory to cater to a 30% growth.

Our expectation is that the market may grow between 20% and 25% and we aim to grow between 25% to 30% over the summer of 2019. There could be a shortage in some SKUs and few locations, but we are adequately stocked till July. We are now planning for August, September but the feedback from the international vendors is by then the logistics bottlenecks should be over. From August, September, quite a few components are going to be available in India as well. Most importantly, compressors should be available and we no longer dependent on imports for drives. Of course chips are required to be imported and I think it should ease out by August, September.

Moderator: The next question is from the line of Bhavin Vithlani from SBI Mutual Fund. Please go ahead.

Bhavin Vithlani: I have two questions. One is on the commercial refrigeration segment. What was the growth in the segment in the fiscal year gone by and what percentage of the business is the commercial refrigeration? The second question is more on the services part. What is the share of the services in our business? I believe commercial refrigeration and both commercial air conditioning, there will be an element of after-sale services. On a slightly longer period, do you believe that this share of services grows as we see in some of the global multinationals and that kind of adds to the structural improvement in the margins for the company as a whole? So, when we look at some of the global companies likes of Daikin, Johnson Controls, so after-sales services is a significant part of the profitability for these companies, because in room air conditioners after sales is actually not there. But the OEMs like yours only do the after-sales in case of commercial refrigeration and commercial air conditioning. So, is that something that we see structurally going up as your install base rises, and that kind of adds to your profitability on a longer period of time?

B. Thiagarajan: There is no public information on the break-up of revenues of Daikin or Johnson, and we won't be able to comment on that. In commercial refrigeration, we are a player with the entire range of products other than transport refrigeration such as water cooler, bottle water dispenser, deep freezers, ripening chambers, cold rooms etc. We do not undertake turnkey projects, which are not sizable, but will require quite a bit of bought out material. Other than that in commercial refrigeration, we are the largest player, holding more than 30% market share in every category. If you look at fast food chains, whether it is Yum! or McDonald's or food delivery platforms like Swiggy, Zomato etc. everyone will be our customers. We will hold close to 40% market share in Ice Creams segment, whether it is for modular cold room or deep freezers. However, the market size in India for the commercial refrigeration products is very small. It will continue to grow and one day it should be as large as room air conditioner growing at a CAGR of close to 20%. Coming into commercial air conditioning, we are no.1 in ducted air conditioning and ducted inverters. We are no. 2 in VRF. And there is the chillers product range which has presence of multinationals and we are no.2 in that category as well. Service revenue comes even room air conditioners because we are a large institutional player, perhaps we may be the largest institutional player for room air conditioners like ATM or offices, quite a few national accounts buy our split air conditioners. Service revenue will however be predominantly from commercial air conditioning systems. As the volume grows, the AMC revenue grows. It is profitable but it would be a selective disclosure to disclose the revenue or the profitability from service. In addition to annual maintenance contracts, we sell spare parts and also undertake revamp, retrofit and replacement. So, it is an integrated model which commercial air conditioning or commercial refrigeration business pursues.

Bhavin Vithlani: Just a follow up on this, more qualitatively, is the profitability higher than the profitability of the original equipment sales? Is the services margins much higher than the new products?

B. Thiagarajan: At the gross margin level both should be same but then in the product manufacturing you have the CAPEX invested. Service it is not a highly capital-intensive activity. Therefore, the operating margins will be relatively higher for service.

Moderator: The next question is from the line of Ankur Sharma from HDFC Standard Life Insurance. .

Ankur Sharma: Two questions. One, if you could talk about the competitive landscape on the room AC side, any significant changes that you want to highlight, any players getting aggressive and all? Also to kind of connected with the import ban on with gas compressors, so, has that led to any of the Japanese brands losing share or have they kind of managed to now start assembly in India, consolidation is what I mean?

B. Thiagarajan: The competitive landscape is not going to change as all the players including multinationals who are present continue to be active players. It is also driven by the penetration levels which are expected to reach 10% in three years from the current level of 6%. Therefore, all players would be aggressively pursuing this opportunity. Another aspect is the expected doubling of manufacturing capacity in the next three years' time, thanks to the PLI Scheme. Incentives under the PLI scheme works not only based on the investment but also on the incremental sale over

FY'21. Therefore, if someone invests in the PLI scheme, they won't earn the incentive unless and until there is an incremental sale over FY'21 6% of which is the incentive under the PLI scheme. All these would increase competitive intensity.

Whatever is earned as incentive is also expected to be passed on the customers by way of discounts and may not add to the bottom line. However, it would help build scale leading to a competitive ecosystem. The combination of this will result in higher margins, as had happened across the globe. For such a huge country like India, a market size of Rs 15,000 crores is very surprising, but good days are here, for next five years, it will be a golden period for room air conditioners, it will grow exponentially because of these factors. With this competitive ecosystem in place and the rising temperatures, people want to mitigate the summer by installing air conditioners. The tier 3, 4, 5 markets are ready to consume these products. Therefore, there will be accelerated growth.

Coming to competition, the Indian players, including Blue Star blossomed when liberalisation took place. If liberalization would not have taken place, and the Korean, Japanese players would not have come in, it will not be the Indian companies which would have been shining. All of us began to grow, invested in R&D and manufacturing and the results are visible now. The Indian players are doing well despite the multinational competition. Therefore, in a high growth period, intense competition, it will benefit companies like Blue Star. There are no challenges whatsoever with legislations such as import on gas compressors as people are ready to manufacture here. The manufacturing hesitancy was basically because of two reasons. The first being scale and the second is the energy label changes. Everyone will have to develop a new product for a new energy label, even if outsourced from a vendor in China. However, now with the development of an Indian component ecosystem, large number of units will be manufactured in India We will be able to compete as far as Blue Star is concerned whether it is a product, pricing, promotion, distribution. We may not fall short of anyone else and where there is a gap, we are already acting and investing in.

Ankur Sharma: On the overall industry growth in volumes for the current fiscal, any number you want to put there versus I think 2019 was the peak volume, I think last time around, so where do you think this year the turnout to be?

B. Thiagarajan: Right from February, we have been saying that the market should grow between 20% and 25% during the summer season, and our target is to grow between 25% to 30%. When the summer were intense, there have been reports that it will grow by 50%, 70%, so on and so forth. But at that kind of growth, material will not be available and there may be also be some correction driven by the rising interest rate. Therefore, growth in the range of 25% to 30% is more realistic.

Moderator: The next question is from the line of Renjith Sivaram from Mahindra Manulife Mutual Fund.

Renjith Sivaram: One thing I see that the trade receivables have increased by close to Rs.400 crores and inventories have increased closer to Rs.260 crores. So, is that the timing issue, or you said some conscious decision on the inventories, at least given the summer?

Neeraj Basur: It's all linked to the scale change that happened in FY'22. Our revenue growth, specifically in Q4, is close to 40% and obviously, that results in higher billing, and some of that billing will be reflected in receivables. It's all normal, nothing to be worried about, it is all fine and collectable. As far as inventory is concerned, there are two reasons. We have consciously taken a call to advance procurement of some long lead time raw material components, because we wanted to make sure our Q1 production runs normally and also to support the scale growth that's expected in the next financial year. Therefore, it's all absolutely normal and we are continuing to look at very healthy operating cash flow, as you heard us speak about it in the beginning as well.

Moderator: The next question is from the line of Anupam Gupta from IIFL Capital.

Anupam Gupta: You gave a pretty detailed picture on the portfolio, the changes which you're doing. So, can you give a similar picture on the distribution side? I think last year, you were at close to about 7,000 retail points, and you have talked about higher focus on the north, and also on the tier 3, 4, 5 markets. So, just give us a more color on how the distribution is being focused for driving this growth?

B. Thiagarajan: There has been a systemic change that has been happening. While we were worried about two summer seasons are lost, so on and so forth, what has been happening is the growth in e-commerce channel. Today, around 17% of the sales takes place through that channel and in the summer season, it may go up to 20%. Sales through e-commerce platform is driven by pricing and for the past couple of years, our share in e-commerce is coming closer to the share of the industry itself. There are also modern retailers or the power retailers who are having multiple stores and their behavior will be similar to that of the e-commerce channel. There are dedicated teams to handle these channels in terms of product, prices, service standards, profitability, so on and so forth.

As far as the North Indian market is concerned it is highly price-sensitive and geographically well spread. For instance, cities like Moradabad will be very significant markets and they will continue to grow. We do have the estimate of a town wise market and what our share should be and within that counter-wise sales. Now, it will not be a retailer directly, it will be a distributor, which means one distributor handling some 600, 700 sub-dealers and we are correcting that part of it. Right now, it is not about the outlet numbers. Appointing a dealer is the easiest of the job, for the simple reason, he is going to ask you for certain commission structure and quite a few dealers will be asking you for a display unit, quite a few dealers will be also charging for the space and quite a few dealers will ask for in-shop demonstrator. So, when you walk into a store, the in-shop demonstrators are all placed in most stores by the brands. Therefore, rather than appointing a dealer the key factor is to identify the potential counters where our share is low and to bring it up in line with all India share.

This is the process that we are on. We have achieved significant success from Q3 onwards. Q3, Q4, our numbers are good because of the corrections that have taken place in the north Indian market. And this exercise will continue through summer and beyond. Our process is well defined there and there is no concern with regard to that. The connected aspect is having got a dealer, the product and a strategy to reach that market share pull for the brand is also important. It is for that reason why a company like Blue Star with close to eight decades of existence, seen as an engineering company, we are ensuring that our connect with the consumer for room air conditioners is perfect. That is why Virat Kohli was brought in and he will continue to be our brand ambassador. In terms of media, we have been advertising in vernacular dailies for the past couple of years and to our surprise, digital consumption is also high in tier 3, 4, 5 towns. Therefore, a significant amount of our advertising is in digital mediums and it is close to 30% of our advertising spend this summer.

Moderator: The next question is from the line of Sandeep Tulsiyan from JM Financial.

Sandeep Tulsiyan: My first question is pertaining to the order inflows. We have reported a very strong growth in inflows as well as execution in the current quarter. So, if you could give more color, where are these orders coming in from, are there any large orders which got concentrated in the fourth quarter or is it many number of small orders which are driving this growth? Also if you could give the market share in each of the categories, the ducted, VRF as well as chillers, where we are?

B. Thiagarajan: The carried forward order book is Rs.3253 crores as of 31st March 2022, roughly around 10% higher than 31st March 2021. Order inflow has been uniform throughout the quarter. Our segment 1 it is not seasonal in nature and the orders keep flowing regularly. In terms of the execution, the Q4 may be much bigger quarter compared with the other quarters. Orders from is the manufacturing sector are driven by capacity expansion which in turn is driven by PLI for quite a few sectors, including mobile phones, so on and so forth. In the automobile sector, specifically electric vehicles, say for example, MEP for the Ola factory has been executed by us. Therefore, the first segment that is driving growth is the manufacturing, followed by data centers. We are a leading player there. The third one is connected with the offices segment itself, specifically IT. At some point of a time in 2020 we shared with you, we are worried that the world has changed and whether people will go back to office, so on and so forth. Slowly, IT itself is consuming a lot of office space. So, it has come back. Then you have the infra segment such as airports, metro railways and the water MEP projects.

As far as package air conditioning and VRF, there was initially a lull, but again here manufacturing is driving growth. Secondly sectors such as small hotel, small offices, many healthcare, 50-bed hospital, 100 bed hospital, are also driving growth. Sectors such as marriage halls or educational institutions may take a little longer but will eventually come back.

Geographically, the tier 3, 4 towns are doing extremely well. In dealer awards, you will see, it is not a Mumbai dealer who is number one, but a Belgaum dealer will be number one or an Aurangabad dealer. Those cities are beginning to consume, the shop, showroom, boutiques, etc. Now go to the market share part of your question, in the MEP part of it, the market is very huge, we are selective, we are interested in doing the job where the cash flows are good and it is profitable. We are not running after market share. Even in an infra project like airport or metro, you may be ending up being a L1 in order to grow your market share. We can scale up but we will be measured there because we want to improve the margin there, we want to have a clean balance sheet, that is our goal there. But still, it will grow at 25% CAGR because there is a shortage of MEP contractors. The market share for chillers should be close to 18%. In case of VRF, we will be close to between 20% and 22%. In VRF, we are not playing in the residential tower segment, which are large buildings which are equipped with the VRF system. We go very cautiously there, because these residential towers get concluded as jobs get extended and the occupants will have to come in to accept your product and it is a different ball game altogether. So, therefore, even without that residential segment, we will be having 22% market share. In chiller, we are no.2. It is pertinent to note that as an Indian player against multinationals, we are no.2. In inverter ducted or the ducted, which are consumed largely by shops, showroom, boutiques, we are no.1.

Moderator: The next question is from the line of Ravi Swaminathan from Spark Capital.

Ravi Swaminathan: My first question is with respect to the cooling product segment, the breakup between air conditioners and non-air conditioners revenue and what kind of revenue growth do you expect in the entire cooling products segment for FY'23?

B. Thiagarajan: If we were to give a breakup, that will be a selective disclosure. All we can say is substantial part is room air conditioners because refrigeration market is very negligible. We do not operate in the transport refrigeration. The addressable market therefore will be Rs 4,000 crores and the Rs 16,000 crores is the market for the room air conditioner in a normal year. In the COVID impacted year, it may be Rs 12,500 to Rs 13,000 crores. Our ambition is to grow that segment by at least 25% and going by what is happening in the summer, it should be possible for the entire segment for FY'23.

Ravi Swaminathan: With respect to the margins in the MEP business, it has been quite healthy at 6% Are you confident of maintaining such kind of margins vis-à-vis earlier we used to clock 4.5%-5% margins?

B. Thiagarajan: I think so. What we have delivered, it should be possible to sustain and even improve upon because the construction cycle is on.

Moderator: The next question is from the line of Naval Seth from Emkay Global.

Naval Seth: Can you elaborate on the 47% growth in RAC, how various regions would have done like east, west, north, south because south as per our checks suggested was quite kind of weak in March but picked up in April, so, how things have panned out in Q4?

B. Thiagarajan: We do not see any difference at all. You're comparing the growth with the COVID impacted year and in the COVID impacted year, you know the different locations had different lockdown restrictions, some states allowed retail trade while some other states allowed e-commerce etc. Therefore, region-wise comparison of growth with last year may not be apt. Currently, the growth is significant in double digits in every location including very large markets like Chennai, Tamil Nadu, Andhra Pradesh, Maharashtra, Gujarat, entire NCR and Punjab. East maybe relatively lower growth. In UP, it is about building our market share. Every location here is competing with each other and all of them are doing well.

Moderator: The next question is from the line of Praveen Sahay from Edelweiss Financial.

Praveen Sahay: Is there any down trading happening in the market and how is the inventory level in the market right now?

B. Thiagarajan: At Bluestar, we do not have any inventory problem, at least we do not foresee that till June. We hear from the dealers is there are shortages in quite a few markets.

Moderator: The next question is from the line of Sujit Jain from ASK Investment Managers.

Sujit Jain: So, just wanted to check the 10% to 11% price increase you would have taken for room ACs for FY'22. Was it sufficient for the RM inflation, and if that was not sufficient, to what extent, it was not sufficient?

B. Thiagarajan: Our operating margin has come down from 7.9% to 7%. The decrease in the operating margin was lower due to improvement in the leverage relating to the operating costs. In other words, if we had increased the prices by something like 14.5%, we would have maintained the margin. We have taken a price increase in April which should help improve the margin. In taking price increase, we are not dictated by anyone at all and we have been doing it from right from January that's 2021 whenever required.

Sujit Jain: After April price increase, now, you're fully covered for the price inflation in the raw materials?

B. Thiagarajan: We are sure up to the summer. We are not sure about July, August and September. If the sales are very high, and we run out of the inventory, we may have to do some quick purchases in which case we may have to review the prices by June first week itself. If the market growth is around 25% and we grow by 30%, our next price revision will be reviewed in the first week of July based on the raw material prices prevailing. If the commodity prices come down due to this inflation containment measures, we will be a brand to go ahead and even reduce the prices if required. In addition to July, August, September, that decision will cover the festival season as well. With the interest rate hike, the EMI is going to go up or the consumer finance related buyout expenses will also go up. In summary if the market continues to explode and we run out of material by the first week of June, we will take a call on price revision depending on how we are going to mobilize this material.

Moderator: The next question is from the line of Vishal Biraia from Max Life Insurance.

Vishal Biraia: In the new plant at Wada that we plan to commission specifically for commercial refrigeration, what could be the increase in localization that you will see and how does this compared to our peers in commercial refs specifically?

B. Thiagarajan: We had a factory in Ahmedabad which manufactured only 400 litre and 500 litre deep freezers. There are also deep freezers of other capacities such as the 300 litre, 250 litre, 100 litre and the 75 litre. Deep freezers are used predominantly for ice cream distribution. When the ice cream penetration goes to smaller towns, smaller retailers, the OEMs will appoint the retailers and those kirana shops are going to be selling with a deep freezer that will occupy a space. Over the years, the skew is towards 300 litre, 200 litre, 100 litre because in tier 4, the retailers' consumption will be lower, So, the demand for lower capacity deep freezers have been growing. And this was manufactured for us in China by two to three OEMs. But in line with our Enterprise Risk Management framework, we wanted to derisk dependency on China. The work has been going on for the past three years. As per that we decided to go and do 300 litre this year, 200 litre next year. In the meanwhile, even 400 -500 litre, Ahmedabad plant has reached its full capacity this summer. With great difficulty, we are managing the Ahmedabad plant now. So, therefore, Wada factory is coming up for expanding 400,-500 litre and 300 litre is fully indigenized this year, we are stopping the imports, and later on, the next summer season 250 litre, then later on 100 litre There is a phased program. This is the reason for setting up this factory. So, therefore, it is to do with the capacity expansion indigenization. Now you asked a question to what extent it is backward integrated. It is only the compressors that are imported. All other components such as puf insulation, sheet metal, condensers etc. are available in India. It is only the compressor which is not manufactured in the country and I don't think it will be manufactured. That will continue to be import dependent.

Vishal Biraia: When you compare us to some of the peers that we have in commercial refrigeration, where would we stand in terms of import content and localization? Also, in terms of margins, could you elaborate a bit on as to how do you see this high growth sector? So, basically, this leverage we are playing out because of the high growth and we are working currently?

B. Thiagarajan: We are addressing a Rs.4,000 crores market that is highly fragmented. There are deep freezer players. There may be cold room players, but they may not be doing the ripening refrigeration, for example, and there are regional players which will not be preferred by large national accounts, say, for example, brands like Amul, Mother Dairy, Yum!, Swiggy these are all large national customers and like Reliance Retail for example is a very major customer for us. So, therefore, it is highly fragmented. You have numerous local players. This can be compared to 1990 air conditioner market. It will change because from 1st January 2023 there is an energy labeling that is coming for deep freezer. At that point of time, there could be some kind of consolidation. In deep freezers and modular cold rooms, we will be number one. In other applications such as fruit, vegetable, flower, floriculture, agriculture, sericulture, including silk etc., we will be the only player dominating in that segment. The market size is still not significant enough. In the next, five years' time, commercial refrigeration could be a very big game changer for Blue Star. That's why we continue to invest in manufacturing and R&D. In terms of profitability, commercial refrigeration business is more profitable than room air conditioners.

Moderator: Ladies and gentlemen, due to time constraints, that was the last question for today.

Neeraj Basur: Thank you very much, ladies and gentlemen. With this, we conclude this quarter's earnings call. Do feel free to revert to us in case any of your questions were not fully answered and we will be happy to provide you additional details by e-mail or in person. Thank you very much and good bye.

Moderator: On behalf of Blue Star Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.