"Blue Star Limited's

Q3 & 9M FY23 Earnings Conference Call"

January 31, 2023

MANAGEMENT: MR. B. THIAGARAJAN – MANAGING DIRECTOR
MR. NIKHIL SOHONI – GROUP CHIEF FINANCIAL OFFICER

Moderator: Ladies and gentlemen, good evening and welcome to Blue Star Limited's Q3 and 9M FY'23 Earnings Conference Call. We have with us today from the management, Mr. B Thiagarajan – Managing Director, Blue Star Limited and Mr. Nikhil Sohoni – Group Chief Financial Officer, Blue Star Limited.

As a reminder, all participants lines will be in 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, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note this conference is being recorded.

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

B. Thiagarajan: Good evening, ladies and gentlemen. Thank you for joining this call. In the normal course, we would have scheduled this call tomorrow. However, in view of the Union Budget presentation tomorrow, we had scheduled this interaction today itself. You might have viewed the results which have been already uploaded.

It is the fifth consecutive quarter we have done well. All segments have done well. And as I have been intimating on television channels or in the press and to some of you, the margins continue to be under pressure. The good news is that we are on course to achieve our plan for the financial year.

In B2C segment, the preparations for the summer season is on and the Sri City factory has just commenced commercial production. Q4FY23 will be a very important quarter in the build up to the summer. In B2B segment, the order inflows are very healthy and the pace of execution space is satisfactory. Blue Star Engineering and Electronics or the Professional Electronics and Industrial systems segment is also doing well.

I have with me, Mr. Nikhil Sohoni – Group Chief Financial Officer who will give you a Comprehensive Update on the Quarter-ended December 31, 2022, followed by the question and answers session.

In summary, we are very optimistic about the prospects for Blue Star for this financial year. We will continue to grow faster than the market, we will stay focused on costs, we will continue our policy of prudent capital allocation and we have set for ourselves pragmatic growth targets. We are confident of ending the fourth quarter also on a high note, and we are well prepared for the summer season ahead. There will be certain headwinds. However, we have learnt to cope with that. If there is a custom duty increase on the components in the Union Budget tomorrow, many of you will have questions on how the margin will be impacted. There could also be questions around the summer season, capacity additions, competition in room air conditioner business, impact of inflationary pressure on project execution etc. Our risk management framework is comprehensive to handle these challenges.

I will hand it over to Mr. Nikhil Sohoni for the Comprehensive Update on the Quarter and then we will answer your questions. Thank you very much. Over to you, Nikhil.

Nikhil Sohoni: Thank you, Mr. Thiagarajan. Good evening, ladies and gentlemen. This is Nikhil Sohoni and I will be providing you an Overview of the Results of the Blue Star for the Quarter-ended December 2022.

Despite inflationary pressures and general slowdown in the western economies, business and consumer sentiments in India continue to be optimistic during the quarter. Enquiries and order inflows in our B2B business continue to be buoyant. Simultaneously, the demand for our B2C products continue to be healthy. Consequently, we ended the quarter on a high note with growth across all segments and a robust order book.

1) **Financial highlights for the quarter-ended December 31, 2022, on a consolidated basis are summarized below:**

- Revenue from operations for Q3FY23 grew 18.7% to Rs 1788.20 crore as compared to Rs 1506.22 crore in Q3FY22.

- EBIDTA (excluding other income and finance income) for Q3FY23 was Rs 104.71 crore (EBITDA margin 5.9% of revenue) as compared to Rs 90.59 crore (EBITDA margin 6.0% of revenue) in Q3FY22.

- Till Q2FY23, the Company followed Written Down Value method of accounting depreciation. Since the Company is investing significantly in capacity expansion, it was decided to relook at the depreciation methodology. Based on review of the expected pattern of consumption of future economic benefits embodied in Property, Plant and Equipment, it is concluded by the management that 'straight line' method of depreciation reflects the pattern in which such benefits from use of the assets are expected to be consummated. Accordingly, the depreciation method has been changed from 'written down value' method to 'straight line method' with effect from October1, 2022. This led to a lower depreciation charge for the quarter by Rs 10.80 crore.

- Profit before tax grew to Rs 80.05 crore in Q3FY23 as compared to Rs 70.32 crore in Q3FY22.

- Tax expense for Q3FY23 was Rs 21.64 crore as compared to Rs 22.75 crore in Q3FY22.

- Net profit for Q3FY23 grew to Rs 58.41 crore as compared to Rs 47.57 crore in Q3FY22.

- Carried-forward order book as of December 31, 2022, grew by 47.3% to a record Rs 4861.99 crore, compared to Rs 3301.33 crore as on December 31, 2021.

- Capital Employed as on December 31, 2022, increased to Rs 1505.56 crore as compared to Rs 1107.41 crore as on December 31, 2021, owing to higher inventory holding to prepare for the upcoming season and mitigate supply chain risks and capital investments for manufacturing capacity expansion projects, at Wada and by the subsidiary Blue Star Climatech Limited at its plant at Sri City.

- Consequently, we ended the quarter with a net borrowing of Rs 395.85 crore (debt equity ratio of 0.36 on a net basis) as compared to a net borrowing of Rs 165.11 crore (debt equity ratio of 0.18 on a net basis) as on December 31, 2021.Coming to business highlights:

2) Business Highlights for Q2FY23

<u>Segment I: Electro-Mechanical Projects and Commercial Air Conditioning Systems</u>

- Segment I revenue grew 20.5% to Rs 1000.09 crore in Q3FY23, as compared to Rs 829.85 crore in Q3FY22. Segment result was Rs 71.68 crore (7.2% of revenue) in Q3FY23 as compared to Rs 52.41 crore (6.3% of revenue) in Q3FY22.

- Order inflow for the quarter grew by 97.1% to Rs 1680.76 crore as compared to Rs 852.82 crore in Q3FY22.

1. Electro-Mechanical Projects business:

Investment plans in infrastructure and manufacturing facilities continued to be actively pursued leading to improvement in enquiries and order finalizations. We continued to witness healthy order inflows from all segments including factories and data centers. We also booked significant orders in the newly entered railway electrification segment.

Carried-forward order book of the Electro-Mechanical Projects business was at Rs 3685.23 crore as on December 31, 2022, as compared to Rs 2310.72 crore as on December 31, 2021, a growth of 59.5%.

Major orders were received during the quarter from Bangalore Metro Rail Corporation Limited and Central Organisation for Railway Electrification.

2. Commercial Air-Conditioning System:

Demand from the government, industrial, healthcare and hospitality sectors continued to be encouraging. This coupled with continued focus on channel expansion across tier 2, 3 and 4 towns enabled growth in revenue during the quarter.

We continued to maintain our number 1 position in Conventional and Inverter Ducted Air Conditioning Systems as well as Scroll Chillers and second position in VRFs and Screw Chillers.

Some of the major orders received during the quarter were from Udaipur Cement Works Ltd., Reliance Projects & Property, etc. to name a few.

We have also received a major order from Amdavad Municipal Corporation for the newly launched state-of-the-art large capacity centrifugal chillers.

3. International business:

We observed growth across all segments with increasing demand for our products in the international markets. We witnessed strong demand for our room air conditioners and VRFs and ended the quarter with a healthy order book.

The pace of execution of projects and order inflow in Qatar witnessed slow down due to preparations and restrictions in the run up to the FIFA World Cup. The operations of the joint venture at Malaysia continued to be impacted owing to a slowdown in construction and order finalizations amidst weak macroeconomic conditions in the country.

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 15.1% to Rs 701.90 crore in Q3FY23 as compared to Rs 609.68 crore in Q3FY22. Segment result improved to Rs 51.83 crore (7.4% of revenue) in Q3FY23 as compared to Rs 38.78 crore (6.4% of revenue) in Q3FY22, due to the benefit of scale and higher share of revenue from our own manufactured products.

The Cooling and Purification Products business:

Despite subdued festive demand, our room air conditioner business registered a growth of 15%, with channels beginning to stock up in December for the upcoming season.

We grew in line with the market and maintained a market share of 13.25%.

The new plant at Sri City commenced commercial production in January 2023 and is expected to aid improvement in margins going forward.

Commercial Refrigeration business:

The commercial refrigeration business continued to witness traction across all segments with a substantial increase in consumption levels. We also witnessed strong demand from tier 3, 4 and 5 cities, enabling growth in revenue for the quarter.

We have also been receiving major orders for cold storages for the logistics segment, which is expected to offer significant opportunities in the coming months.

We continued to maintain our leadership position in Deep Freezers, Storage Water Coolers and Modular Cold Rooms.

Some of the major orders received during the quarter were from Reliance Retail, Dr Reddy's Pharma, Milma, Hatsun Agro, and several proprietary agro customers to name a few.

Segment III: Professional Electronics and Industrial Systems

Segment III revenue grew 29.3% to Rs 86.21 crore in Q3FY23 as compared to Rs 66.69 crore in Q3FY22. Segment result was Rs 10.98 crore (12.7% of revenue) in Q3FY23 as compared to Rs 12.76 crore (19.1% of revenue) in Q3FY22, impacted by planned investments in business development, marketing and other initiatives for future growth.

We continued to witness strong demand for our healthcare offerings driven by increasing awareness and investments in the sector. Demand for the non-destructive testing business from the industrial sector and data security solutions for the BFSI sector also continued to be encouraging.

Major orders were bagged from Arcelor Mittal Nippon Steel India Ltd., Indian Overseas Bank, Bharat Heavy Electricals Limited, ICICI Bank, Hero MotoCorp to name a few.

Business outlook:

The Company has performed well for the fifth consecutive quarter and expects to maintain the growth momentum in the coming quarters. We will continue to stay focused on rejigging our product portfolio, introduction of new product categories and expansion in domestic and international markets. Simultaneously, the Company is investing in enhancing its R & D capabilities and various programs to mitigate supply chain risks and profitability improvement.

We are optimistic about the prospects for the fourth quarter.

With that, ladies and gentleman, I'm done with the opening remarks. I'd like to now pass it back to the moderator. We'll open the floor to questions. We'll try and answer as many questions as we can. To the extent we are unable to, we'll get back to you via e-mail.

Moderator: Ladies and gentlemen, we will now begin the question-and-answer session. We have a first question from the line of Ravi Swaminathan with Spark Capital. Please go ahead.

Ravi Swaminathan: So, we had seen margin expansion in the projects and cooling products business of more than 7% we had clocked in this quarter. How sustainable is this, how do we think about profitability in both the segments? And also on the professional E&I segment, it has dropped to 12.7%, historical numbers used to be 15%, 17% average. Why has it dropped so much, your thought process?

B. Thiagarajan: The Electro-Mechanical projects segment is a combination of Electro-Mechanical projects and commercial air-conditioning business that has sale of equipment as well. Margins may vary quarter-to-quarter depending on the business mix. It also depends on the profile and pace of projects being executed as not that all projects earn the same margin. We are very happy with the margin this quarter, but continue to maintain the margin outlook at 6% to 6.5%. In the cooling products segment, we had increased the prices five times consecutively before the summer of 2022, but post-summer of 2022, we have been maintaining the prices to strike a balance between market share and margin. We sincerely hope that the commodity prices softening will help improve the margins. As indicated in the last conference call, improvement in margin due to softening of commodity prices is getting offset by the rupee depreciation. The obvious question could be around a price increase. In the build up to the summer, a new range of products are being introduced, including a lot of them from Sri City. Sri City in addition to the new affordable range of products, also provides cost-Optimisation around incoming raw material as well as outbound finished products. Of course, in this financial year it would be contribute three months' production. However, there is a leverage in terms of logistics and working capital, as compared to the 10 to 12 days of transit inventory, any of the locations in south can be served overnight from Sri City. Coming back to the question of price increase it would be factor of new product launches by us as well as competition. Our product launches are scheduled from February 7th onwards in various locations. We are clear about our direction to grow our market share to 15, but that is not going to be at any cost. We have to manage our costs in order to compete to get to that market share. The margin outlook for the segment remains unaltered at 8% to 8.5% There could be some impact on the PBT due to interest and depreciation on the CAPEX investments. In a broader sense, we are very happy about the CAPEX cycle across the country which benefits us through increased opportunities across businesses such as packaged air conditioning and Electro-Mechanical projects. However, Blue Star also is into a high CAPEX cycle with investments in Wada plant and Sri City. Therefore, we have changed methodology to the 'Straight Line Method' and we are prudent in ensuring that our capacity expansion is in line with our growth. Pressure on margins will continue due to competition but we will continue to pursue our goal.

Ravi Swaminathan: And the margins of professional E&I segment?

B. Thiagarajan: That segment also has agency business and therefore, the top line and bottom line may not have direct correlation at all times. We are a system integrator and the segment does not deal in our own manufactured items. In the medical electronics business, we are doing refurbishing as well. Similar to the projects business, the margins may vary quarter on quarter depending on the mix. Therefore, a full year margin comparison would be more appropriate in that segment rather than a quarter to quarter basis.

Moderator: We have next question from the line of Sandeep Tulsiyan with JM Financial. Please go ahead.

Sandeep Tulsiyan: First question is pertaining to the industry profitability, where, of course, a lot of guys are setting up local capacity that will increase materially. But, at the same time, we see barring the two listed Voltas, Blue Star, all the other listed players are making a loss, right from Lloyd to IFB, Whirlpool or Hitachi. So, where do you see the profitability normalizing over what time period going forward, if you could give your thoughts on that please?

B. Thiagarajan: This is happening period for the industry. Therefore, this question keeps arising among analysts, management, our board and the other relevant stakeholders India's penetration in room air-conditioner segment is very, very low at a sub-7%. At some point of a time, it should rapidly move up to at least 25%. There is a huge market growth opportunity with changing weather conditions, urbanization and higher disposable income. It was not affordable at some point in time, not because of the capital cost, but the recurring cost, but thanks to the energy labeling, air-conditioner consumes only 20% of what it consumed in 2020 in terms of energy which helps reduce the recurring expenses. So, there is a growth opportunity. There is focus on indigenization and capacity expansion thanks to the PLI scheme. PLI itself is also going to be based on the incremental sales over FY21. Therefore, every brand wants to achieve incremental sale of the particular component in order to earn the PLI benefit. We have been maintaining this is likely to drive market growth. Competitive intensity will be high whenever there is a growth opportunity. Everybody is eyeing this market due to the low penetration. Competition is intensifying due to this opportunity. From Blue Star's point of view, we are prepared to compete. In 2010, there were apprehensions as to how a B2B company being a late entrant in the B2C space would grow. There were also apprehensions as to if we will grow largely as an institutional player beyond 5% market share and also if we would ever get to a double digit market share. We have grown and now aspire to get to a 15% market share. We have not stated we aspire to be number 1 or the number 2 player nor have we stated that we want to become a 20% market share player. Our goal we believe is doable, with the right mix of customer segments and our products portfolio which we are working at. What we have done is only now 50%-plus. We have some more to do in order to ensure that we are able to deliver consistent results, in terms of products portfolio, in terms of distribution footprint, in terms of our own manufacturing capacity etc. On the question of the likely margin, it is dependent on the competitive landscape. We are confident that Blue Star will reach 15% market share and the conviction that we will deliver at least the 8% operating margin. We are a significant player in institutional sales, we are number1. We do extremely well in quite a few geographies, within India where we hold the number1 or number 2 position. We have to replicate that largely in the north India market in the Hindi speaking belt. We will pursue a long-term goal which is pragmatic and keep working towards that to deliver consistent results. We would be aiming to get to 15% market share but that would not be at any cost. From a strategic planning perspective, we have set out that, we will grow faster than the market and attempt 15% market share by FY'25 with an operating margin of 8% to 8.5% operating margin. Our actions and decisions will be driven by that objective. We are prepared for possible seasonal impact in some summers in-between. Blue Star's portfolio will continue to focus on both B2B and B2C.

Sandeep Tulsiyan: Second question is on the numbers. The unallocable expense has increased materially, if we look at it on a year-on-year basis, all the segmental numbers look good. How should we read that number, is it predominantly A&P expenses which is being shown up here and we should associate this with the unitary product segment?

B. Thiagarajan: There is no material change in any specific item as there are multiple items in that line. It includes the FOREX gain/loss which are really unallocable, certain professional fees on corporate initiatives in order to either improve the manufacturing margins or manufacturing excellence. There is also a marketing campaign cutting across the product lines. Therefore, there is no single item contributing to the increase nor is it going to be the trend. Our policy of allocating everything that is identifiable with the business that continues.

Moderator: We have our next question from the line of Praveen Sahay with Prabhudas Lilladher. Please go ahead.

Praveen Sahay: My question is pertaining to what you've guided about the new range of products going to be increased. So, it will be largely the mass premium product segment which will be from the Sri City?

B. Thiagarajan: Sri City will produce both the range of products. We have classified the product category into three, affordable, affordable premium and premium. The three-year strategic plan is based on these categorizations. Sri City and Himachal plants will produce a mix of all these categories. The new products that are going to be launched predominantly are in the affordable range while here would be some launches in the premium range as well. As mentioned earlier, we are a number 1 player in institutional segment and high end residential customers and quite a few products that are required for that segment are premium. Affordable range will enable the margins to be protected even while growing the market share in the Hindi-speaking belt. Therefore, the products that will be launched for the season will be a mix of these categories.

Praveen Sahay: One clarification on what you had said about the 8.5% margin target. So, fair to understand that whatever the benefit from the Sri City you will receive, it will pass on to the margin, it will not considered for some price action to gain market share?

B. Thiagarajan: The operating margin that we would like to deliver is 8% to 8.5%. We have to grow faster than the market in order to benefit from scale. There would also be a PLI benefit that could contribute to margin. The margin earned would be a factor of PLI, scale benefit and operating leverage, The PLI benefit would be available from FY24 and would be determined at the end of FY24 based on incremental sale duly certified by a chartered accountant certificate and filed with the DPIIT. Therefore, its impact may not be visible quarter-on-quarter.

Moderator: We have next question from the line of Dhananjai Bagrodia with ASK Investment Managers. Please go ahead.

Dhananjai Bagrodia: Sir, just wanted to know with Sri City now we've been focusing on it and a lot more other players have also started focusing on South, how is that in terms of so much capacity coming on impact a), and b), what margin working capital asset turnover do we see for this project?

B. Thiagarajan: We never had a factory in the south and therefore were incurring huge costs on incoming raw material and the outgoing products from the Himachal plant. In addition, we had to hold inventory of raw material as well as the finished goods in that 10-day period. Therefore, producing at Sri City has a cost leverage. In any case, our Himachal plant has reached its full capacity. If we had not commissioned the Sri City factory in record time, we would have fallen short of capacity. Some of the Q4 requirement is also going to be met from the Sri City plant. Working capital turns will improve due the reduction in in-transit inventory of both raw materials and finished goods. In addition, there would be savings on transportation costs as compared to the costs that would have been incurred on transportation from Kala Amb near Chandigarh to various locations in the south. There would be additional interest and depreciation on account of the new investments and the new facility is expected to break-even in around three years like any other investment.

Dhananjai Bagrodia: Sir, this maybe a little longer-term question. What are we doing in terms of our positioning in room AC where we are being able to see such strong growth and let's say a market leader is not being able to see the similar growth and it's not like we are undercutting them in prices? So, are we going to different channels, what would be our strategy in this?

B. Thiagarajan: Perhaps we were underperforming in the past and had some inefficiencies, which we sincerely believe we are addressing now. Compared to the market leader we were lagging on market share and margins which also widened at some point of time it widened and the leader would have benefited from scale. We believe we have been able to catch up due to addressing some of the inefficiencies we probably had.

Dhananjai Bagrodia: Sir, are we available with many large retailers like some of the ones or are we more with let's say smaller mom and pop shops, because a lot of the large retailers still working with only the global players or the Indian leader?

B. Thiagarajan: Each player has a set of customers and a process of servicing certain geographies, and through certain products with certain features at certain price points. With our premium product range, we may not have been able to earn margin in line with our targets. We didn't want to grow our market share by underselling our products. Over the past two to three years we have repositioned our products portfolio in order to widen the addressable market. We have to segment the market through a micro analysis of addressable market. Of the total population of India of 1.30 billion people the customer base could be only 30 million e even in FMCG and only 1 million in a few other categories. We were very clear that we could grow market share beyond 10% until we address the affordable premium segment which helped us to address a wider customer base who may not be willing to pay the premium.

Moderator: We have the next question from line of Anupam Gupta from IIFL Securities. Please go ahead.

Anupam Gupta: The first question is related to the projects business. So, clearly order inflows and order book are growing very well for you. How do you see the outlook here for the next few quarters and should ideally the revenue or the execution could also follow there or do you see any slowdown in execution run rate at this point of time or let's say a couple of quarters down the line?

B. Thiagarajan: The execution pace is expected to be good. In fact, there is pressure in quite a few projects to get them executed quickly. The CAPEX plans that were impacted by the pandemic is catching up so as to be ready when the global recessionary pressures reduce. Similarly, in quite a few infra projects, the public sector undertakings would like them to be completed as early as possible. Unless and until something completely unforeseen happens, most customers want to get their projects executed quickly. Consequently, revenue will follow the order inflow. The enquiry funnel is good. Even office space is getting consumed. There could be headwinds. If we consider room air-conditioners, a market size of Rs 17,500 crores looks very miniscule. The value of MEP projects getting finalized in a year is around Rs 6,500 crores which in our view is only 20% of what is required and the other 80% is an opportunity. That could drive consistent growth.

Anupam Gupta: The second question is related to the margins in this quarter specifically. So, given that you have changed the depreciation policy, if I look at the EBIT margins for both the segments, obviously is higher because of lower depreciation if you look QoQ or YoY. So, ideally, your margin guidance should also be higher just because the depreciation would be lower incrementally going ahead at the segment EBIT level. So, is that the right reading or would you still maintain your margin guidance at 8%, 8.5% for products and 6%, 6.5% for projects?

B. Thiagarajan: So far, our track record has been good and by and large we have met, what we have been indicating. The margins indicated are our minimum margin target and could increase. However, we would like to maintain that margin outlook in the near term.

Moderator: We have the next question from the line of Gopal Nawandhar with SBI Life Insurance. Please go ahead.

Gopal Nawandhar: Sir, can you just give the rationale for the change in the depreciation accounting method, is it like across all plant & machinery we have changed or just only for the new CAPEX which you have completed?

Nikhil Sohoni: The accounting standards requires to consider change in the pattern of consumption going forward. As you would have heard during the call that we have invested heavily in capacities this year at both Sri City and Wada which required us to review the pattern of consumption for all our assets. It was felt appropriate that this is a right time to look at whether straight line method is a more appropriate way of depreciating the assets. If you look at the accounting policy, the useful life of an asset is estimated at around 20-years. For a manufacturing company, it has to be equally depreciated over a period of time. Under the WDV method, which also is an acceptable method, almost 70% to 75% of the asset will get depreciated in 10-years. We have been following it historically, and the standard requires us to can give it a relook when there is a trigger. So, this year given that we have capitalized a large part of the plant and machinery, there was an opportunity to relook and the depreciation method was changed after an appropriate review.

Gopal Nawandhar: So what was the capitalized amount for Sri City plant?

Nikhil Sohoni: We have capitalized capacities at Sri City and Wada plants in the current year and the total capitalization is in the region of around Rs.280 crores.

Gopal Nawandhar: If I multiply this amount by 20 so, that amount comes to Rs.300 crore. So, are we saying there is no remaining depreciable amount from the past projects?

B. Thiagarajan: The capitalization for the full year will be Rs.280 crores. The assets were depreciated earlier also and the impact of change in the method for the quarter and Year-To-Date is Rs.10 crores which has been disclosed in the results.

Moderator: The next question is from the line of Manoj Gori with Equirus Securities. Please go ahead.

Manoj Gori: Just want to reconfirm. You said about 15% market share. So, probably, if I am wrong, please correct me, is this 15% for FY'24 or FY'25 that we are guiding for or we are aspiring for?

B. Thiagarajan: It is FY25.

Manoj Gori: So, probably this year we should be exiting somewhere around 13.5% to 13.75% and probably next two years we will be looking for another 100-150 basis points of market share gain?

B. Thiagarajan: That's right.

Moderator: We have next question from the line of Atul Mehra with Motilal Oswal Asset Management. Please go ahead.

Atul Mehra: Just one question in terms of competitive intensity again. In a scenario where like you said, if the market penetration is so low and it has so much room, there can be competition for room market share, would be a priority over margin, while our philosophy is the two. So, in an environment where more where competition focuses on market share over margin, like how would you react in terms of would you still want to maintain 8.5% at the cost of market share or would you reevaluate at that point in time?

B. Thiagarajan: It's a genuine question. We are clear about a few things. Firstly, we want to be an air-conditioning and refrigeration-focused company and as of now, we do not have any plans to get into white goods. Secondly within this category, there are opportunities within India and we have stated that we will also look to enhance our international footprint. Further, there is a huge construction cycle and capacity extension in progress which would benefit us across segments. Driven by this development, we expect the market to grow. We would not be looking to grow market share at the cost of margin. At the end of the day, the shareholders are looking for results. There is no foolproof model that dilution of the prices leads to increased market share. That could trigger a reaction from other players and at the end of the day the whole industry will be going downs. There is no data-point to prove that such a step is sustainable. A product like room air conditioners has a brand value and price alone is not the factor driving customer preference. We believe it will be ay futile exercise to go ahead and aim to increase the market share to 20% instead of 15% by diluting the margin to 6%. There is no rationale for this at all. That strategy could lead to a situation where our product will sell only on price and each time the channel partner will only be asking for reduction in price. Blue Star brand is valuable. At the end of the day, ROE and return on capital employed are also important. We would like to deliver more shareholder value by widening product categories in which we are not present, indigenize to improve margins and expand international footprint that would create long-term value. We are clear, and there is no desperation for us to be moving up the ranking and improve the market share by diluting the margins. We don't have deep pockets to be doing that, and any industry that did it destroyed itself. Our own view is that no brand has survived adopting that kind of a strategy.

Atul Mehra: Just one follow-up question is we have been one of the early movers in terms of understanding the value of manufacturing and so on like we have been doing that since quite some time. But, going forward your views on outsourcing to some of the PLI players versus setting up your own manufacturing from a three to five year perspective, would you say that like the proportion of own manufacturing will go up actually speaking in the next five years or so?

B. Thiagarajan: We will not be outsourcing finished goods at all but only the components. Our PLI benefit is only for sheet metals and powder coating and we have not invested in motors, drives and plastic injection molding. We will look to source these components from entities that have the PLI benefit in those categories. We will not completely outsource and put a label as that would not give us the brand value.

Moderator: We have next question from the line of Khadija Mantri with Sharekhan. Please go ahead.

Khadija Mantri: I wanted to know, what is your estimate for the room air-conditioner industry growth for FY'23 and FY'24?

B. Thiagarajan: March will be a very big month There are many views in the industry. I am of the view in value terms that industry will grow by 15% minimum – the industry, that is my estimate.

Khadija Mantri: That is for Q4?

B. Thiagarajan: No, full year FY24 over FY23 the growth for room air-conditioner should be at least 15%

Khadija Mantri: Also, you would have observed that one of our competitors talks that they have lost market share. So, have we been able to gain a little bit of that market share in some of the regions?

B. Thiagarajan: If you ask about this quarter, it is stable; for the full financial year, we have gained marginally.

Khadija Mantri: But have we gained it from our competitors or is it because of our penetration into new regions?

B. Thiagarajan: We have gained through increased presence in certain underrepresented markets and widening the product portfolio.

Moderator: We have next question from the line of Rahul Gajare with Haitong Securities. Please go ahead.

Rahul Gajare: Can you discuss the inventory level of Blue Star and that of the industry right now before the season starts?

B. Thiagarajan: Our view is everybody will hold 20% to 25% more inventory than the previous year in anticipation of market growth and course correct as may be required. In addition, there has been an increase in lead time for some of the components that is leading to increase inventory holding and not the finished goods inventory

Rahul Gajare: So, let me just rephrase. When I'm talking about winter, I meant, inventory which was not sold, old inventory, I'm sure –

B. Thiagarajan: It would be very negligible. There could have been old inventory in Q2 due to the energy level change and a subdued festival season. The focus now will be to produce new models in preparation for the summer season. We don't think inventory is an issue at all now.

Moderator: We have next question from the line of Shrinidhi with HSBC. Please go ahead.

Shrinidhi: Sir, you attributed some of the margin in this year that you demonstrated in room AC business to own a manufactured product. So, one thing is would it be possible to share how much of your finished products are currently coming from own manufacturing and how is it likely to evolve over the next two to three years as Sri City ramps up?

B. Thiagarajan: Most of the products are own manufactured product, the only difference being that they would have been manufactured in in Himachal earlier and now they are getting manufactured in Sri City as well. Commercial production started in Sri City on 1st of January and in our estimate, around 15% of annual sales will be coming in this financial year from Sri City.

Shrinidhi: Correct me if I'm wrong, so, are you saying that all of the finished air-conditioners that Blue Star will sell in FY'23, all those came from in-house manufacturing?

B. Thiagarajan: Anyway, the government had stopped the import because of certain other regulations

Shrinidhi: No, not even domestic assemblers of the finished goods we're not procuring that at all, is it?

B. Thiagarajan: We outsource only Window air-conditioners, which account for around 5% to 6% of our total sales. All other air-conditioners are manufactured by us. A large part of components continue to be imported by all players today, because India doesn't have the component ecosystem.

Shrinidhi: Second question I have is that you have come out with this affordable product range. Wondering, is this product range a margin-neutral margin-additive or margin-dilutive at an overall level?

B. Thiagarajan: Margin-neutral. This product range is benchmarked against what is available in the market or what is the customer expectation and we are protecting our margins.

Moderator: Ladies and gentlemen, that concludes our question-and-answer session. I'd now like to hand the conference back over to Mr. Nikhil Sohoni for closing comments. Over to you, sir.

Nikhil Sohoni: Good evening, and thank you very much, ladies and gentlemen. With this, we conclude the quarter's earning call. Do feel free to revert to us in case any of your questions are not fully answered, and we'll be happy to provide you additional details by e-mail or in-person.

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