"Blue Star Limited Q1 FY-15 Earnings Conference Call"

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MODERATORS: MR. VIR ADVANI – EXECUTIVE DIRECTOR & PRESIDENT - ELECTRO MECHANICAL PROJECTS BUSINESS, BLUE STAR LIMITED
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Moderator Ladies and gentlemen good day and welcome to the Blue Star Q1 FY15 Earnings Conference call. We have with us on the call today Mr. Vir Advani – Executive Director & President – Electro Mechanical Projects Business and Mr. B. Thiagarajan – Executive Director & President – Airconditioning & Refrigeration Products Business. As a reminder all participants' 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 this conference call, please signal an operator by pressing '*' then '0' on your Touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Vir Advani. Thank you and over to you, Sir.

Vir Advani Good morning ladies and gentlemen, this is Vir Advani. I have with me Mr B Thiagarajan and we will be giving you an overview of the results for Blue Star Limited for the quarter ended June 30, 2014.

The following are the financial highlights of the Company for the *quarter (Q1FY15)*

- The Company reported Total Operating Income of Rs 845.48 crores for the quarter ended June 30, 2014, as compared to Rs 770.82 crores in Q1FY14, representing an increase of 10%.

- Operating Profit (PBIDT excluding Other Non Operating Income) for the quarter increased 37% to Rs 53.08 crores from Rs 38.62 crores in Q1FY14.

- During the quarter, Other Income declined 15% to Rs 3.54 crores as compared to Rs 4.18 crores during the same period last year.

- Financial Expenses for the quarter declined marginally by 6% to Rs 11.04 crores from Rs 11.70 crores in Q1FY14.

- Tax expense for the quarter was Rs 5.16 crores as compared to no expense in the same period last year.

- Consequently, Net Profit grew 36% from Rs 22.77 crores in Q1FY14 to Rs 31.01 crores during the quarter.

- Earnings per share for the quarter (Face value of Rs 2.00) stood at Rs 3.45 vis-à-vis Rs 2.53 in the corresponding quarter of the previous year.

- Carry Forward Order Book as on June 30, 2014 increased by 9% to Rs 1572 crores compared to Rs 1438 crores as at June 30, 2013.

- The total Capital Employed of the Company stood at Rs 901 crores on June 30, 2014 as compared to Rs 960 crores on March 31, 2014. The borrowings came down from 431 crores as on March 31, 2014 to Rs 343 crores on June 30, 2014.

- The Electro Mechanical Projects and Packaged Airconditioning Systems business, accounting for 40% of the total revenues in the quarter, declined 4% while segment results registered a sharp decline of 70% to Rs 5.42 crores. The decrease in profitability was mainly due to slower execution of projects resulting in lower billings coupled with cost overruns in specific legacy projects.

- Cooling Products revenue comprised 57% of the total revenues of the Company during the quarter. The segment registered a growth of 22% driven by enhanced sales of room airconditioners and refrigeration products due to an extended summer and superior brand perception. Segment results grew significantly by 67% to Rs 70.59 crores over the same period mainly due to higher manufacturing capacity utilisation due to indigenisation, stable foreign exchange and higher price realisation.

- The Professional Electronics and Industrial Systems business revenues increased by a marginal 2%, while segment results declined 24% to Rs 4.27 crores, owing to the unfavourable business climate.

I will now spend some time on each of our lines of business and give you both financial as well as operating highlights for the quarter.

Segment I (Electro Mechanical Projects & Packaged Airconditioning Systems)

In view of the General Elections in May, most of the order finalizations were delayed. However, post the formation of a stable Government, there are signs of some revival in this business. Moreover, the recent budget has given impetus to the infrastructure segment which is likely to benefit the business in the long-term. Integrated commercial complexes, IT, Metro Rail and Healthcare are likely to drive growth and the Company has witnessed an increase in enquiry levels from these segments.

During the quarter, this segment registered a sharp drop in margins from 5.1% to 1.6% mainly due to lower than expected pace of billings on new projects due to the pre-Election impasse. In addition, considering the imminent improvement in the economic climate, the Company thought it prudent to close specific legacy jobs during the quarter, in order to release its resources on these projects and focus and prepare for new opportunities. This had an adverse impact on margins. Even on the central airconditioning equipment front, the demand was sluggish further affecting the profitability. . The Capital Employed in this Segment Increased from Rs 454 crores as on March 31, 2014 to Rs 494 crores as on June 30, 2014 mainly on account of lower collections due to the liquidity crunch.

The order inflow in Q1FY15 for this segment grew 14% from Rs 366 crores to Rs 418 crores. The airconditioning projects business as well as the electrical projects business contributed to the growth in the order inflow. The carry-forward order book stood at Rs 1491 crores as at June 30, 2014.

In the electro mechanical projects business, the Company continued to focus on improving the quality of new orders, in terms of margins as well as commercial terms. It intends to on enhance its portfolio of multi-service orders (mechanical, electrical, plumbing and fire-fighting). It also plans to selectively target high-rise residential towers being built by established developers and focus on light industrial projects for its multi-service business.

In the central plant equipment segment, even though Blue Star is a market leader in scroll chillers, the Company has been witnessing a slowdown in the segment. The Company continues to do well in screw chillers, while centrifugal chillers with magnetic bearings offer significant potential for growth.

While the ducted systems market continued to be muted during the quarter, VRF systems grew by about 15%. Blue Star offers both - the digital scroll and inverter-based systems in the VRF segment. The Company has recently introduced new products such as free match inverters and hot water generators and is likely to enhance its presence in segments such as commercial, residential, hotels and hospitals with these products.

Segment II (Cooling Products)

The room airconditioners industry performed well mainly due to an extended summer. While the summer lacked consistency, a late burst in June enabled healthy growth for the quarter. The industry recorded a growth of 10% in volume terms and 20% in value terms during the period with the 3-star, 5-star and Inverter Split AC models witnessing a significant increase in demand.

During the quarter, the Cooling Products segment registered a sharp increase in margins from 10.7% to 14.6% mainly due to enhanced capacity utilization and better price realization. The Cenvat benefit also helped in increasing the margins to some extent. The Capital Employed decreased from Rs 251 crores as on March 31, 2014 to Rs 186 crores as on June 30, 2014 mainly since the summer season had concluded and the inventory build-up which was required in March to cater to the summer demand was not required.

The room airconditioners business of the Company did remarkably well during the quarter registering a healthy growth of 15% in volumes and 28% in value over the same period in the previous year. The growth mainly came from the residential segment with the Western and Eastern regions driving growth. During the summer, consumers showed a clear preference for specialist AC players over general consumer durable brands. Blue Star's perception as an expert player in the AC category coupled with its enhanced distribution reach, effective advertising and comprehensive range of products were mainly responsible for it registering a growth higher than the industry.

As regards to the commercial refrigeration products business, the business did well with enhanced demand for deep freezers and coolers from the ice cream and dairy segments. While the stable foreign exchange helped in enhancing margins to some extent, margins will continue to be under pressure mainly due to the unorganised segment and several foreign players who plan to enter the business.

Segment III (Professional Electronics and Industrial Systems)

Though the economic environment is now showing signs of improvement, this business faced another sluggish quarter due to the General Elections. However, with the formation of a stable Government, most of the segments that this business targets are likely to make capital expansion investments, which will improve its performance in the medium-term.

During the quarter, the segment registered a decline in margins from 21.7% to 16.3% over the same period last year. Given its nature of businesses, quarterly performance is typically not a good indicator for this segment and the prospects for the whole year are positive. The Capital Employed declined from Rs 31 crores as at March 31, 2014 to Rs 27 crores as at June 30, 2014.

In the data communications business, digital signatures and authentication is likely to see a rise given the Government's initiatives in e-Governance. The upgradation of data networks of banks is also likely to boost the ATM/POS security business. The healthcare systems business has begun targeting the pharma segment which will enhance its prospects. Also, the test and measuring equipment business is expected to get benefited with the upgradation of infrastructure of defense, paramilitary forces, police and space sectors.

Exports

During the quarter, the Product Exports business registered good growth. The Company received significant inflow of orders for room airconditioners, water coolers, unitary products and refrigeration products from OEM accounts and various distributors in UAE, Oman, Qatar, Yemen and Kuwait. The Company participated in BuildExpo Nairobi 2014 held in May 2014 at Nairobi, Kenya. This expo holds the reputation of catering to the demand of the entire East African region and proved to be a great opportunity to meet potential distributors who expressed interest in associating with Blue Star for the East African market. Several distributors were also appointed in Nepal, Sri Lanka, Maldives, Bangladesh, Bhutan & Vietnam during the quarter.

In conclusion, the economic environment is showing signs of improvement with the formation of a stable Government. While the electro mechanical projects business continues to be adversely impacted mainly due to significant correction in project estimates of specific legacy orders, the performance is likely to improve in the medium term with the revival of the commercial construction segment. The cooling products business driven by the residential segment has been performing better than the industry owing to superior brand equity, wider distribution reach and impressive product range. The Company intends to continue to focus on prudent cost control and fiscal management in order to sustain this performance for the rest of the year.

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

Moderator Thank you. Ladies and gentlemen, we will now begin with the question and answer session. We have the first question from the line of Anant Narayan from Kotak. Please go ahead.

Anant Narayan Sir, during the last call you gave us a break up of the order book, in terms of legacy orders and the orders which carry higher margins. Where do stand now in terms of legacy orders?

Vir Advani We have about Rs. 125 crores of legacy orders. The number of jobs has dropped to 80-85 jobs.

Anant Narayan And the balance orders will have margins in the range of 7%-11%?

Vir Advani Yes.

Anant Narayan And Sir, if you can also give us the break up between various segments in terms of real estate, infrastructure etc.?

Vir Advani I think our infrastructure order book stands at about 25% right now. Commercial real estate is obviously the largest but within that IT and hospitals are the two next largest segments. Also there are integrated commercial complexes which comprise hotels, retail blocks and office buildings. Put together that will be probably the fourth in the list.

Moderator Thank you. The next question is from the line of Renjith Sivaram from Batliwala & Karani Securities. Please go ahead.

Renjith Sivaram Sir, in the annual report it is that mentioned the company has around Rs. 400 crores of multi service MEP kind of orders. Will the margins be lower compared to our normal orders?

Vir Advani It was for the last year. This year, the multi service business continues to grow. The margins are in the range of 10%-12%.

Renjith Sivaram Would this include orders like the one which we received from Oberoi?

Vir Advani Yes. There are number of multi service orders booked in the last year and during the current year. Some are high rise like Oberoi, Delhi Metro. There are some hospitals and **integrated commercial complexes** which we booked during the current year.

Renjith Sivaram So will these orders are at margins higher than the earlier ones?

Vir Advani No, the margins are roughly the same. There is no margin arbitrage yet. We expect over a period of time as the business grows and as we differentiate ourselves the margins in the multi service jobs will be higher than single service mainly because the nature of competition will be different. But that is yet to happen because we are still cultivating the market to move to multi service. Hence currently the margins are at single digit levels.

Renjith Sivaram What was the growth rate in the room airconditioner segment?

B. Thiagarajan Our growth should be in the order of 25% in the value terms and margins would be somewhere between 9% and 10%. Going ahead, everything will depend on the movement of foreign exchange

Renjith Sivaram Sir, but this quarter itself it was higher. So was there any one off there or is it largely to do with higher volumes? In the next nine months, will it come back to 8% to 9%? Is it right to assume that for full year it will be around 9% to 10%?

B. Thiagarajan The first thing to note here is that normally in Q1 and Q4 volumes are very high compared to Q2 and Q3 which are very low. Number two is that we have gone ahead and improved the capacity utilization by indigenization. The third thing is that the foreign exchange is stable at this particular point of time, especially since the past three months. Forth, the Cenvat reduction of 2% which was announced in the interim budget and subsequently confirmed extended till December. And then the commodity prices have been attractive. Because of all these reasons the margins have improved and there is no one off there at all.

Going forward I think Q2 and Q3 will be lower, as seen in the past and in Q4 it will again improve. Hence at this juncture I foresee margins somewhere around 10%.

Renjith Sivaram Will there be any dilution due to amalgamation?

B. Thiagarajan The shareholding will not change because of amalgamation. So everything stays as it is.

Renjith Sivaram In our annual report, we have reported a MAT credit of Rs. 32 crores. So have we booked some tax provisions in this quarter? For this year, what will be the tax rate?

B. Thiagarajan We are running at MAT in the current year. But we do have some benefits on R&D and some other items, specifically our Himachal Pradesh plant due to which the average tax rate for FY15 will run at about 15%.

Moderator Thank you. The next question is from the line of Salil Desai from Premji Invest. Please go ahead.

Salil Desai You earlier made a statement that in the markets we have seen shift in perception towards pure AC players versus general consumer durable players. So what has changed? If you can elaborate on what have you done to change this perception or is there something external which has helped you in this?

B. Thiagarajan This has been the scenario since quite some time, at least for the past two years or so. There are only three or four players who are only into airconditioning. There are many who are in to brown goods as well as white goods. And Blue Star probably is one among the three players focused only on air-conditioners not even refrigerators. And therefore we are perceived as an expert. In fact we have been driving this message for quite some time as the expert cooling solutions provider. It began by saying air-conditioners from air-conditioning experts and we are positioned that way which not many other companies are.

And this is proven by the research as well that Blue Star is perceived as the superior expert cooling solution provider. So it is not the communication alone but the products and services that the company offers. And this might be the reason for our growing acceptance in the market place.

Salil Desai And how is the competition, people who are also in to other durables, reacting? Are they losing the market share or are you seeing them getting aggressive? In terms of pricing, a new product offering or something like that?

B. Thiagarajan See actually the biggest player is Voltas who is also air-conditioning centric player. The multinationals who are in to consumer durables indeed will be interested in acquiring that slot. More than us, the pressure is on other big players. We are number six. And indeed the competition is intense in the market place. The good thing is that we entered into retail space three years ago and in all the quarters we have either maintained or grown our market share.

The market right now is at 3.5 million and the penetration is very low. It can reach 20 million in next five to six years. So there is an exponential growth that is in the offing. You keep seeing this symptom very well in the sense that though the summer was extended it was also an erratic summer. So I think the multinationals focus will be to wait for that situation. There could be some game changers in terms of technology or price points which will lead to intense competition and we are prepared for that.

Salil Desai And Sir, you mentioned about the indigenization in the air-conditioning products. Is there say a number you can give and to what extent has indigenization increased? Or what has been specifically indigenized in terms of say equipment or components?

B Thiagarajan We have started manufacturing some condensing units or the outdoor units of air-conditioners which we used to earlier import or contract manufactured in China.

Moderator Thank you. The next question is from the line of Nirav Vasa from Motilal Oswal Securities. Please go ahead.

Nirav Vasa My query first pertains to your project business. Sir, as we understand that you are taking projects in which the margins are higher. So just wanted to check from the enquiry base that you are getting right now, were there any instances wherein you did not bid because the contractual terms were not up to your satisfaction? Also, is there any major change in industry trend when it comes to ordering activity, especially for the MEP and full-fledged projects?

Vir Advani The enquiry levels are significantly higher, around 30%, compared to a year ago. So it is very encouraging; that is one. Second is that the enquiry base has changed because we are no longer bidding on civil contractor or general contractor projects. There is a certain segment of the market like the builder segment, some government projects where customers prefer to work with the general contractor and have MEP & HVAC under them. We no longer operate in that market. We are also staying away from the power generation market for airconditioning and ventilation work because we already have a large portfolio of legacy jobs in that segment. We will not re-enter that market until we finish them. So to that extent our enquiry base does look a little different.

The competition continues to be similar; whom so ever we were competing with a year ago continues to be in the market. Of course given that order finalizations are slow, competition is quite severe. But having opted out of certain segments of the market which do not make commercial sense for us, we are not facing any significant issues on terms. Booking margins continues to be a concern because of pressure and limited order finalizations.

So having said that we continue to be selective which is one of the reasons why we continue to have these low operating margins because our fixed cost, which is not machinery and CAPEX but it is technical manpower and all our overheads, have reduced from the last year. At this level we are underutilized and until the quality order inflows resumes, we will continue at this level. In the meanwhile we have decided to accelerate our legacy job closure because having seen the enquiry base increasing, we are very clear that by the year end the order inflow will resume. So next two quarters we are going to stay focused on closing out the legacy orders and hence we anticipate pressure on margins in the next couple of quarters.

Nirav Vasa Sir, you mentioned that legacy order book stands at Rs. 125 crores, right?

Vir Advani Correct.

Nirav Vasa By when you see these orders getting completed?

Vir Advani We are hopeful that by year end legacy orders will move out but we are hoping to finish the bulk of business in the next two quarters.

Nirav Vasa Have we booked the costs?

Vir Advani Yes and no. As I have mentioned in the last three quarters, as we close out this large set, the last 100 jobs are the hardest jobs to close ever since we started the clean-up drive two and half years ago. Obviously these are very old jobs and we anticipate some additional costs to impact us, as we saw in Q1. There will be some additional impact but it has to be done so that we prepare for the turnaround.

Nirav Vasa Sir, my second question is related to the manpower cost. You did your restructuring exercise in Q3FY14. If my understanding is right, for Q4FY14 the manpower cost was Rs. 62 crores and now it has come to almost Rs. 61 crores. Is it correct to assume that this will be the normal rate or how do you see manpower cost for FY15?

Vir Advani It should be about that. For the year, it should be marginally lower than the run rate of Q1FY15 despite of increments. We have completed major part of our downsizing. We are also exiting certain projects which will bring down the manpower to some extent. Hence for the full year, it should be better than Q1.

Moderator Thank you. The next question is from the line of Tanuj Makhija from Ambit Capital. Please go ahead.

Tanuj Makhija Sir, you have constantly mentioned that Blue Star has gained market share in Room AC segment. Can you name the players losing their market share?

B. Thiagarajan It will be unfair to name them in this forum. GfK publishes the data in its retail audit which pertains to residential segment.. You can see from the figures that our revenue growth is higher than the market growth. So that implies that we have gained the market share.

Tanuj Makhija You mentioned about that pure air-conditioning companies have done better than the broad basket consumer durable companies because of expert solutions.

B. Thiagarajan No, I did not say that. The question is that there are very few airconditioning only players. There are chances that they are being perceived differently by the consumers. But in our case, our research shows that our brand salience is driven by this particular fact. I can only talk about why people prefer Blue Star.

Tanuj Makhija Is there any specific parameter or some product differentiation that you think is enabling Blue Star to gain market share?

B. Thiagarajan We have to be very modest here. Number one, we are a very small player in the retail segment, wherein we are present since the past three years only. So we are bound to grow. The second thing is that it is the end-to-end solution in terms of product selection, installation, and service, where we will score. We are not a box seller at all. The third thing is that we have been focused on energy efficiency. Certain innovative features in line with what a consumer will look for, say a simple thing of accurate temperature conditions,are the things which differentiate us from others.

Tanuj Makhija With evolving technology in the Room AC segment, we have seen it move towards the inverter ACs. How do you think Blue Star will cope with the technology changes and compete against global players who have access to technology and also access to a large R&D base?

B. Thiagarajan We have been around for 70 years and during this period many technologies have changed. VRF systems came in; rotary compressors came in; window air-conditioners moved to split air-conditioners; many digital electronics have entered the airconditioning space. We have successfully demonstrated that we can develop, manufacture and launch the products which are in line with the global standards.. And our R&D spends have grown year-on-year and we have recognized the fact that being an Indian player, we have to do it ourselves and we are doing so. While we do not have a joint venture or other types of avenues, we collaborate with other players as and when required.

In a globalized environment, you can source certain products for a provisional period till the time your own product is ready. So we have been successfully demonstrating, like the indigenization I mentioned, that we have learnt to manufacture on our own after importing for two to three years. But all these in my opinion is not going to determine the success or I would say it is not formidable given the fact that the market is going to explode in the next five years. And when that growth is so much and if you are doing things reasonably well you will automatically grow.

Tanuj Makhija One last question. Can you please highlight the competition intensity in VRF and the acceptance of our recently launched VRF product?

B. Thiagarajan Competition is as almost similar to Room Airconditioners. There are many multinational players and we have launched products which are uniquely positioned. For example, ours is probably the only VRF which can work non-stop at 50 degree Celsius. We have the system engineering, design system integration, installations and servicing capabilities much better than any other brand. So we are hopeful that we will keep improving our market share there.

Moderator Thank you. The next question is from the line of Ankit Fitkariwala from Jefferies. Please go ahead.

Ankit Fitkariwala My question is in regard with the Cooling Product segment. The segment contributes 60% to of your total topline. So going forward, if the electromechanical segment picks up what is your idea on how much that segment will contribute?

B. Thiagarajan Normally in quarter one, this is the scenario. Also, once the commercial construction opens up, let us say in about four to six quarters, it may be 50/50.

Ankit Fitkariwala Secondly Sir, in the last quarter result you had mentioned that typically in a room airconditioner, 70% of the components are imported. So with the indigenization being done, what would be percentage now? Has it come down?

B. Thiagarajan It may be around 65%.

Ankit Fitkariwala Did you give a guidance of 9% to 10% margins for this segment going forward?

B. Thiagarajan For FY15, yes.

Ankit Fitkariwala Even though we are doing 14% for this quarter, it will be 9% to 10% for the full year?

B. Thiagarajan At the moment that is what I am ready to commit.

Moderator Thank you. The next question is from the line of Ruchi Vora from UBS. Please go ahead.

Ruchi Vora Wanted to clarify. How does the residual order book, ex-legacy, with 7% to 11% margins translate to the EBIT margins?

Vir Advani We cannot translate the margins as our Segment I constitutes our projects as well as products business. If you pull out 3% to 4% of overheads, you will get the net margins.

Ruchi Vora So this would be probably an EBIT margin of something like 6% to 7%?

Vir Advani Around 4% to 5%, varying from project-to-project.

Ruchi Vora Let us say if there is a significant order flow over the next two years. How well are we geared in terms of CAPEX and also in terms of our manpower on the project side? Just wanted to understand how your trajectory of order execution can pan out.

Vir Advani So CAPEX is very limited. We invest limited amount in to site infrastructure related tools. Also the lead time is relatively short and the investments do not exceed more than Rs. 2 crores to Rs. 3 crores during a year. So it is a minor amount. The manpower is where the issue is. As it stands today, we have capacity to execute about 35% higher volumes which is underutilized right now because for two reasons. It is not that they are sitting on the bench but they are actually engaged in closing out old jobs which has got very little revenue and profit. So if we can finish that by December, we will have about 35% incremental capacity which should see us through the next year. Going ahead, we need to start rebuilding our capability mainly in the areas of engineering and procurement. Sales and construction and manpower is adequate because we have been bringing in fresher resources from engineering schools even during the last three years in spite of the challenges.

Procurement in engineering, being a more specialized area, we need to now restart that program and so to that extent there will be some lag for us. But we have some time because the first round of order inflow will get executed by that 35% capacity which we have. Post that, we have to worry about resources.

Ruchi Vora What is the lead time in the inquiries that you are getting? I mean is it for execution starting this year or is it for execution starting next year?

Vir Advani Our jobs have moved from the smaller to mid sized and large sized jobs. So any job more than say Rs. 75 crores value booked this year will only generate revenue for us next year because the engineering time will run around 6 to 8 months. In case we book jobs between Rs. 10 crores to Rs. 30 crores now, we may get revenue in Q4 because there is a lead time of about 4 to 5 months for those jobs. So really this year we are relying on our UFO.

Actually our UFO is quite healthy and we have the capacity to execute it. The only issue is cash flow, which is not there. So it is not a capacity constraint right now that is preventing us - it is the cash flow. The new order inflow will help the cash flow certainly but we are now doing cash flow on a project basis. Though we collect an advance in a new job and we pump that money in to an old job that money is retained in the job. So really it is about the old jobs cash flow moving again which will allow us to move forward.

Ruchi Vora My last question on Cooling Product segment. I think we do expect market to pick up probably this year or next year or in the next two to three years. Just wanted to understand how geared are you in terms of your manufacturing capacity? Second, how are you looking at expanding the distribution network and lastly also your product development? Mr. Thiagarajan did touch upon some of the areas but if you could just sum it up for us it will be great.

B. Thiagarajan As far as the manufacturing capacity is concerned, probably till December 2015 we have adequate capacity. Beyond that indeed we need to think about it. First, we have an option whether the contract manufacturing facilities are available in excise free locations as the current excise concession for Himachal Pradesh plant will come to an end by June 2015. There are many other places which are available where we can get excise concessions till 2020 through contract manufacturing. Second, we have been talking about setting up a facility in South. We have put that on hold for the time being because we want to understand whether there will be certain concessions available in Seemandhra or Telangana. There are talks about some kind of concessions which will be made available for the manufacturing sector. So we have sufficient time to think about it and ours is not a capex intensive industry. The lead time required for setting up a factory is anything between 12 to 18 months of time because in room airconditioners it is more of an assembly rather than backward integrated manufacturing. So that answers the first part of the question.

Second part of the question is to do with the product development. In line with the energy efficiency norms, the time table is fairly known though the exact dates are not frozen. We are closely working on that like any other player. The products are on the anvil because it takes two years to deliver the product.

With regards to our distribution network, more than 50% of our sales comes from Tier-III, IV andV markets as of now. With India being such a vast country, different locations are evolving in different manner. With 72 SKUs that we offer in room airconditioners the scale is the focus. In other words, while we will keep expanding the distribution network, the focus for next two years will be productivity of the channels; in the sense how each outlet can improve.

Ruchi Vora So no matter how fast the market picks up, we are well placed to tap that growth, at least in terms of our distribution?

B. Thiagarajan Absolutely.

Moderator Thank you. The next question is from the line of Neha Majithia from Microsec Capital. Please go ahead.

Neha Majithia You mentioned that you are receiving few enquiries right now. So can I just know what is the average order size for that?

Vir Advani The average ranges between Rs. 10 crores and Rs. 20 crores.

Neha Majithia Any big projects enquiries? I have asked the same question during our Q3FY14 call because we know big companies like Google, Flipkart or Amazon are looking for some properties in India. So I guess there is a big boom in IT sector.

Vir Advani Bangalore as a market has picked up quite well. It is probably the most buoyant market in the country today. Pune is very active; NCR is reasonably active right now. Mumbai, Chennai and Hyderabad are not. Eastern region is quiet. It is a mix but Bangalore being an IT hub seems to have picked up first. So certainly we are seeing large number of enquiries coming up there. So that is one input. Other than that, there are no significant large projects now. Mainly midsized projects are back in the enquiry list. Of course we have a long list of large projects but I am not anticipating any of them being finalized in this current calendar year. May be Q4 onwards we will start to see the project market upwards of Rs. 75 crores picking up.

Neha Majithia Is it possible for you to share the revenue contribution particularly from IT sector?

Vir Advani I do not have that information. It varies every year. It had reached a peak of about 60% and is now probably running at about 30%.

Neha Majithia If we take out legacy orders from the total order book, is it right to assume that the margins for FY16 should will be in range of 4% to 5% for Segment I?

Vir Advani No. As Segment I is a mix of EPC projects, product sales, service, etc you can expect an operating margin of around 8%.

Neha Majithia And what about the third segment?

Vir Advani Do not look at the quarterly variations but on an annualized basis between 18% and 20%.

Moderator Thank you. The next question is from the line of Varun Parasrampuria from Nirmal Bang. Please go ahead.

Varun Parasrampuria What is the correlation of the MEP projects with GDP?

B. Thiagarajan I wish we knew. GDP has more to do with commercial construction, in the sense if the commercial construction is growing it will. Normally when the GDP grows, the residential sector grows followed by light commercial and the commercial construction begins. It is to do with the employment generation and then the office spaces grow. Once the employment goes up, the retail and other things like hotels, airports etc follow. So it is a cycle and we all believe that it is in the offing. It is probable that the construction sector will revive in a big way within the next two years. But it is also connected with the land acquisition, land availability, and the interest rates that will prevail. And I suppose the Government is working towards that and it should happen.

Moderator Thank you. Ladies and gentlemen, we will now close the question queue. I would now like to hand the floor back to Mr. Advani for closing comments. Please go ahead.

Vir Advani Thank you very much everyone for logging in. If there are any further questions that were left unanswered, please send us an email and we will try our best to revert to you. Otherwise we will be talking again in the next quarter. Thanks again and all the best.

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