"Blue Star India Limited Q1-FY13 Earnings Conference Call"

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MANAGEMENT: **MR. VIR S ADVANI – PRESIDENT, ELECTRO MECHANICAL PROJECTS GROUP & EXECUTIVE DIRECTOR.**
MR. B THIAGARAJAN – PRESIDENT, AIR-CONDITIONING & REFRIGERATION PRODUCTS GROUP.

Moderator Ladies and gentlemen good day and welcome to the Q1-FY2013 Earnings Conference Call of Blue Star India Ltd. Joining us on the call today are Mr. Vir Advani-President Electromechanical Projects Group and Executive Director and Mr. B Thiagarajan-President, Air conditioning and Refrigeration Products Group. As a reminder for the duration of this conference all participants' lines will be in the listen only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference please signal an operator by pressing '*' and then '0' on your touch tone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Vir Advani of Blue Star India ltd. Thank you and over to you sir.

Vir S 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, 2012.

The following are the financial highlights of the Company for the quarter (Q1FY13)

- The company reported a Total Operating Income of Rs 731.42 crore for the quarter ended June 30, 2012, as compared to Rs 704.03 crore in Q1FY12, representing a growth of 4% over same period last year.

- The Gross Margin for the quarter was 25.4%, marginally higher than 24.6% in Q1FY12 due to lower mark to market changes in margins

- Operating Profit (PBIDT excluding Other Income) for the quarter increased 22% to Rs 33.53 crore from Rs 27.53 crore in Q1FY12.

- During the quarter, Other Income grew to Rs 7.01 crore viz a viz. Rs 0.73 crore during the same period last year mainly on account of interest on income tax refunds, provision write backs and foreign exchange gains.

- Financial Expenses for the quarter increased to Rs 12.53 crore from Rs 8.17 crore in Q1FY12, primarily due to cost of hedging and foreign exchange losses. Interest costs for the quarter were marginally lower than Q1FY12 on account of lower borrowings

- Provision for taxation for the quarter was nil compared to Rs 3.17 crore during the same period last year. Although the Company is required to make a provision for MAT, due to the set-off of the carried forward business loss of the previous year, there is no taxable income for the year and hence no provision was required for tax.

- Consequently, Net Profit grew 110% from Rs 9.79 crore in Q1FY12 to Rs 20.54 crore during the quarter.

- Earnings per share for the quarter (Face value of Rs 2.00) stood at Rs 2.28 vis-à-vis Rs 1.09 in the corresponding quarter of the previous year.

- Carry Forward Order Book as on June 30, 2012 stands lower at Rs 1848 crore compared to Rs 2019 crore as at June 30, 2011, due to continued sluggishness in the market and our focus on improving quality of order inflow.

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.

The Electro Mechanical Projects and Packaged Airconditioning business accounting for 50% of the total revenues in the quarter, grew by 7.1%. Segment results grew by 240% to Rs12.4 crore. The Operating Margin of this business in Q1FY13 increased to 3.4% compared to -2.6% in Q1FY12. The improvement in Operating Margin is on account of a relatively higher proportion of better margin air-conditioning projects being billed out in this quarter, higher volumes in our central airconditioning equipment businesses and normal impact of mark-to-market changes in planned costs and revenues.

The Capital Employed in the business as at end of June 2012 was about Rs 406 crore significantly lower than the Rs 606 crore at end of June 2011 and marginally higher than the levels of Rs 351 crore at end of March 2012. The increase over Q4FY12 is primarily on account of selectively paying down vendors and business associates despite slower collections, a function of the tight liquidity in the market. We are focused on controlling the capital employed in the business and are carefully managing material delivery and billing in-line with project progress and payment.

Overall, the economic environment continues to be challenging with delays in project finalizations across all sectors. Despite the overall sluggishness, the company in this quarter witnessed demand from sectors such as Power, Hospitality, IT/ITeS, Retail and Offices.

During the Quarter, Blue Star won prestigious orders in the above segments namely, OP Jindal Thermal Power Plant - Raigarh, Chandrapur Thermal Power Project - Chandrapur, Singhitarai Thermal Power Project - Chhatisgarh, PIU Trauma Hospital - Ahmedabad, Kohinoor Commercial - Mumbai, Oberoi Grand - Mumbai, Lodha Boulevard - Thane , Tishman Speyer India Wave Rock IT Park - Hyderabad , UL Cyber Park - Calicut, Mind Tree Consulting - Bengaluru , Apollo Reach Hospitals - Nellore, Sheraton hotel - Greater Noida , and Welspun Solar AP ltd – Jodhpur.

In Packaged/Ducted Air-conditioning and small chillers, there was good demand in this quarter from segments such as Educational institutions, Retail, Offices, Hotels & Restaurants, and Industrial. The company has witnessed good demand for VRFs in particular for segments like hotels, and hospitals. Some of the important projects executed by Blue Star in Q1 FY13 were Salgaokar College - Goa, Gotri Medical College - Baroda, Shiv Nadar University - Delhi, Virata Retail - Hyderabad, Haveli Restaurant - Amritsar, Kalyan Silks - Thiruvallur, JC Brothers Retail - Hyderabad, Mayfair Spaces - Baroda, Premier Inn Hotel - Pune, Godavari power & Ispat - Nagpur, Jaimata Infra - Mumbai, Sumeet Snyfab India - Raipur, Volkswagen India - Pune, IOCL - Mumbai, Kences Constructions - Chennai, Adlabs - Mumbai, Jeumont - Baroda, Wipro – Secunderabad.

We retained our market leadership position in the packaged air-conditioning and ducted systems markets and our re-entry into the VRF segment is making good progress despite stiff competition from MNCs. We have created a new division focused on the marketing and sales of Chillers and are confident of building a leadership position on the back of our competitive products, ability to offer a range of solutions and deep customer and consultant relationships.

In the Cooling Products segment, revenue registered a marginal increase of 2% in the quarter, while segment results declined by 15% to Rs 37.55 crore. Operating Margins of 11.26% in this quarter, though lower than the 13.46% in Q1FY12, are a noticeable improvement from the margins of 9.7% % in Q4 of FY12, respectively.

The Room Airconditioner market continues to grow, despite a delayed summer, and our efforts at new product introductions, increase in distribution reach and a good mix of residential and light commercial customers has helped us to show marginal growth.

Demand in the commercial refrigeration business is robust with demand for Water Coolers coming from Educational Institutions, Industry and Government segments while Freezers witnessed a good demand from the Ice Cream and Dairy segments. In Cold storage products, we witnessed good demand in segments such as Pharma, Fast Foods, Banana ripening & Healthcare. We have won prestigious orders from Dominos, YUM, Mc Donalds, Biocon, Dr.Reddy's, Gland Pharma, Sun Pharma etc.

Margins are under pressure due to intense competition from a growing number of multinational players and continuing increases in input costs. We have raised prices to compensate for increases in input costs and are closely reviewing the market situation. Our attempt will be to manage the margins while maintaining our competitive position in the market place.

The Capital Employed in this segment reduced from Rs 279 crore as at June 30, 2011 to Rs 216 crore as at June 30, 2012, primarily due to good inventory planning.

We believe we have a good and sustainable competitive position in this segment and continue to invest in new product development, increasing distribution reach in tier-3/4 and 5 markets, innovations in marketing, sales force training and overall productivity improvement.

In the Professional Electronics and Industrial Systems segment, revenues dropped by 8%, while segment results declined 10% to Rs7.18 crore. As you are aware, demand in this segment is closely linked to the industrial capex cycle which continues to be uncertain due to procedural delays and the need for re-evaluating project budgets to reflect the current and expected forex and commodity prices.

The quarter, however, saw some demand from medical electronics, industrial products and material testing segments. Some of the prestigious orders won by the company in this quarter were Bhilai Steel Plant - Bhilai, Abhi Diagnostic Centre - Mumbai, & Reliance – Mumbai.

Margins in this segment are largely stable except for changes in the business mix.

As indicated in our last call, the company has focused to put the aberration in performance of FY12 behind it and returning back to profits. We have achieved this despite facing a challenging external environment through improvement in quality of new orders won and a concerted effort to improve profit margins through value engineering and cost control. The company has also worked hard on bringing down capital employed and continues to strike a balance between profitable growth & productivity. Our endeavour will be to maintain this focus through the year in what continues to be a very challenging macro-economic environment.

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 very much sir. Ladies and gentlemen. We will now begin the questions and answers session. Our first question is from Ruchi Vora of UBS, please go ahead.

Ruchi Vora You indicated that there was a combination of execution of high margin projects and volumes in central A/C coupled with marked-to-market(MTM) adjustment of some costs. Just wanted to know how much of the margins are on account of the MTM adjustments?

Vir S Advani What I meant was that from now on every quarter we will be having normal MTM changes because we relook at our cost on a quarterly basis. Based on changes in input as well as progress of projects we will continue to make changes to our cost. So now it will move into a normal cycle and there won't be any significant negative impact in the quarter.

Ruchi Vora So is the cost provisioning that we were doing over the last one year, will it be completed in terms of review of projects?

Vir S Advani Like we indicated in Q4, we have completed our review of projects,. Now we have moved into a normal cycle, we are not anticipating anything substantial like last year. However if there is any further deterioration in the economic environment and projects, we will continue to make those changes.

Ruchi Vora So is it fair to assume that our margins will be around 6%-7%, as we discussed in the last call, for the whole year?

Vir S Advani Yes, it will be maintained around 7%.There is some cool off on commodity prices. If there is any delay in projects, it would likely be offset by copper and steel prices cooling off. Hence we should be able to maintain that 7%.

Ruchi Vora My last question on the tax rate, is it fair to assume a zero tax for the year?

Vir S Advani Yes that is what we are aiming to do.

Moderator Our next question is from Pritesh Chedda of Emkay Global.

Pritesh Chedda Question pertaining to first division. Is there any bad debt provision or write back or any other one-off in the quarter?

Vir S Advani There wasn't any write back in the current quarter. As far as provision for bad debt is concerned, we are continuing on that on our normal basis that we have been doing in every quarter.

Pritesh Chedda Have the operations in DS Gupta also normalized? Any comments there on both the acquired companies?

Vir S Advani The first one, the electrical, is integrated into our Blue Star operations. The 7% margin seen includes electrical business. As far as the plumbing, firefighting business, which is our subsidy Blue Star Electromechanical, we had mentioned in Q4 that we are working on that front in Q4 and it continues into Q1. We had covered about half of that order book in Q4 and the rest is underway right now. But it is most likely that those margins will land up at the same level as our segment one margins.

Pritesh Chedda My question now is on the order inflow which is about Rs.600 plus crore. What kind of margins are we seeing in this? The terms of the trade in the new inflow which is there in the market and for you? Lastly if you could give us some color on the likely inflow for this year and also the chiller market in tonnage terms in your opinion, what it could be?

Vir S Advani I will take the first part and I will ask Thiag to handle the Chiller question. As far as business is concerned, we had relatively low order inflow. Our order book is actually shrinking right now because we don't feel that there is an adequate quality business available in the market. So the reality is that the funnel continues to look fantastic but we are not so certain that all of that will actually be finalized in the current financial year specially based. Having said that the business which we are taking is at what we had mentioned last year what we have started in August-September is the historical margins in that 12% to 14% range as well as our own terms of payment which are historically towards sort of beneficial to us, that has very clearly happen so we are trading of volume of inflow for quality of business, we will continue this for another quarter. Obviously there is a minimum amount of business that we would like to book and if we are seeing further delays in finalization we may need to take some decisions but largely we are sticking to our strategy that we have started in September of last year.

Pritesh Chedda So if the business doesn't flow in, would you then adjust the benchmark margin and the payment terms that you are looking at currently?

Vir S Advani We would not compromise on commercial terms because it doesn't make financial sense to do that, but on margins we would have to look quarter-to-quarter and job-to –job. As we are seeing some cooling off in commodity prices, we may be able to correct some of that going forward. But it is still early and we are not changing our track right now.

Pritesh Chedda On the cost side you had mentioned about cutting down cost. So if you could give some color and the progress there?

Vir S Advani We had mentioned that we are looking at improvement in productivity and part of that is reduction in headcount. All of that is under way. We are seeing those productivity improvements slowly coming in, it has not been anything dramatic because most of last year we had spent in addressing the erosion in margins. Now that they are moving back to an even key, we are starting to focus on the cost side. We have already started up a procurement efficiency program in the company across the board and we are hoping that some benefits will come in through that. That may not be cost cutting but it would certainly be cost reduction. We're hoping that these efficiencies will offset some of the pricing pressure we are seeing.

Pritesh Chedda For room air conditioners, could you tell us what would be the industry growth in volume and value in Q1? Also, what could be your volume growth?

B Thiagarajan The residential segment continues to do well; there is absolutely no doubt about it. Though there were doubts with regards to delayed summer etc., but my estimate is that the market would have grown by at least 15% in value terms and around 5% in volume terms. Then the commercial segments which are shops, showrooms, boutiques, small offices also continue to do well. These are segments where there is no land clearance or gestation period is much shorter. So therefore on air conditioning and refrigeration products as well as package air conditioning part, which is part of segment one, I'm not seeing any slowdown at all at this moment.

Pritesh Chedda But then versus that our growth was less? I'm just wondering, did we have any channel expansion?

B Thiagarajan We can either go for growth or for maintaining the margins. As you may recollect in this particular segment is dominated by the room air conditioners. When the industry was anticipating a huge growth, the exchange rate combined with the new energy label and the change in the Cenvat structure pushed up the prices. One could have grown, like some of our competitors have done, by sacrificing margins substantially. We were not interested in that. We wanted to wait and play this game in a manner that margins won't be eroded and the capital employed will be under control. We have achieved both. In this particular segment, around 70% of our value is imported and so there is a huge foreign exchange fluctuation as well in this. So going forward again as Vir mentioned that, we are not interested in diluting the commercial terms but if we have to participate in the growth we have to sacrifice some margins indeed and we will do so.

Moderator Our next question is from Pranab Gokhele of Religare Asset Management, please go ahead.

Pranab Gokhele Just a confirmation, 6% to 7% margins which you spoke about in the first segment, is it site margins or is it EBIT margins which you report?

Vir S Advani 7% is the site margin on our projects business.

Pranab Gokhele So when you talk about the 6%-7% margins, is it on the entire order book including some legacy orders and also new orders?

Vir S Advani This is an aggregate weighted average carry forward margin which includes some 0% business, some low margins business in the range of 5% to 6% range and also some normal margin business in the range of 12% to 14%.

Pranab Gokhele When you are looking for the room air conditioner as a business, are you also looking for AMC spares?

B Thiagarajan Room air conditioners is sold to commercial or corporate segment only. Roughly around 30% of our business comes from that segment. It carries five years warranty for compressors. So basically it is not a service friendly business at all.

Pranab Gokhele Where do you really account for spares in AMC business, is it in the first segment or the second segment?

B Thiagarajan It is combined with the respective products. For example central air conditioning and package air conditioning, the service business whether it is AMC or parts or an operating contract it is accounted under segment 1. For room air conditioners, deep freezers, cold storages, water coolers etc it is accounted under segment 2.

Moderator Our next question is from Sanjiv Zarbade of Kotak, please go ahead.

Sanjiv Zarbade Wanted the clarification, like you said the 6% to 7% broad indicative margins for the current year that we are targeting, is that site level?

Vir S Advani Yes, these are the site margins in our project business.

Sanjiv Zarbade In this quarter our EBIT margin was at 3.4%. What would be the site level margins?

Vir S Advani This 7% is an aggregate number like I mentioned, purely depends on what projects we billed in the year based on customer requirements.

In Q1, we billed out some higher margins business in our air conditioning projects business. So to that extent, it is marginally higher than the 7%.Overall segment one is the combination of projects and products.

Sanjiv Zarbade It would be fair to assume that we could see a significant improvement coming in the 2^{nd} Quarter itself?

Vir S Advani I am not seeing any significant improvement in the whole year actually. Like I mentioned in our opening remarks because on the product side the dollar has moved significantly which is putting pressure on margins and the project business. I think, we will continue to see a big challenge because part of the recovery of the projects business is based on quality order inflow and that inflow is not happening. We are also concerned that the government is not taking any suitable action in infrastructure nor RBI is taking any on the interest rate front. Because of that capital liquidity is going to be further under pressure. We are very clear that we are not billing out our projects unless our customers are paying us. You have to understand that we have a sitting cost and fixed cost in the projects business. Unless we are able to bill out at a certain volume, we will always have a challenge at the operating levels. So I'm right now not expecting an improvement in the second half. I'm hoping that we will maintain this kind of a performance through the year.

Sanjiv Zarbade Just one another question, in the interest cost you said that it consists of interest as well as hedging cost, is it possible to segregate these two?

Vir S Advani What we mentioned is that our interest cost has actually down. Our borrowing in Q1 is about Rs380 crore, which is significantly lower than Q1FY12. So to that extent our interest cost is down. On the flip side our foreign exchange costs, gain as well as loss as well as hedging cost, there is a net loss of about Rs3 crore.

Moderator Our next question is from Sanjay Satapathy of Merrill Lynch, please go ahead.

Sanjay Satapathy My first question is that while the overall environment was not good there were 3-4 segments like power, hospital, realty and IT services where you got good amount of new orders. Just wanted to understand on the power side, will this trend continue?

Vir S Advani As far as air conditioning and ventilation projects in the power sector is concerned, I'm not very hopeful on that for the rest of the year as financing for power projects is under severe pressure.

Sanjay Satapathy What about the realty where you also saw good orders?

Vir S Advani Again real estate is very weak. Builders are not finalizing contracts / projects. There are dozens of projects for which we are bidding but not confident that any of these is going to get finalized in the next 3 to 6 months. There are certain markets in the country where demand has picked up like Bangalore and Hyderabad. Mumbai is doing terribly, NCR has slowed down and there is no movement in Calcutta.

Sanjay Satapathy My last question would be that you also highlighted that the competition is increasing. Who are the new players you are talking about? Also, what is the kind of sustainable margins considering this kind of competition you are looking forward to?

B Thiagarajan This is basically in our equipment business and not project business. So practically in room air-conditioner we have all multinationals. In the case of chillers, we now have 4 to 5 new players from Europe coming in. In case of refrigeration products like deep freezers there are plenty, actually the entry barrier has diminished completely and people look forward to a huge growth in refrigeration areas in the future, so you witness lot of competition out there. But the good news is that in most of the product categories in which we operate, probably other than room air-conditioners we are the leaders, we hold excess of 25% of market share. That is the good news but then with the foreign exchange fluctuation and with this competition who are trying to build a base by buying market share, it becomes difficult to hold on to the margins or growth. So we will play this game depending on what is happening each quarter.

Sanjay Satapathy And the sustainable margin part, if you can just give a sense before closing it?

B Thiagarajan Very difficult to say at this point of time. But the margins that we reported in Q1, we would ideally like it to be sustained throughout the year.

Moderator Our next question is from Ashish Jain of Morgan Stanley, please go ahead.

Ashish Jain Just wanted to have a sense on your order book, out of that Rs180 million that you indicated, how much is from the first segment?

B Thiagarajan Around 80% of the pending order book comes from there

Ashish Jain Can you give some color in terms of how we are seeing trends in individual segments within that order book like IT, retail?

Vir S Advani No sector looks interesting at this point. We have not seen any significant demand in IT, retail, healthcare, across the board. It is much muted now and is more a regional thing. Bangalore the market office-space is increasing, Hyderabad the market office space is increasing, Chennai we are seeing some signs of some IT space being added, Mumbai is very quiet, regardless of whether there is a hospital or retail, NCR which was doing relatively well the whole last year, across the board, whether it was malls, or whether it was IT or hospitals,I am seeing a complete quiet down in demand and Calcutta/ Eastern region has been quiet for two years now and continues to be. So really it is not a segment thing anymore, it is more regional.

Ashish Jain What kind of orders inflows are we looking at, in case you are comfortably giving some sense, of order flows in this segment? Could your order book shrink as we move ahead?

Vir S Advani I think I would not be surprised if the order book ends the year lower. Simply because there are significant delays in finalizations, we are not seeing a turnaround unless some government action kicks in. If it does, of course like I said that the funnel exists the bids are out. We have had first and second rounds discussions with clients. So it is not as though we are starting from zero, it is really about the clients wanting to spend money or committing to spend money where it is stuck and I think they are waiting for a cue from the macro environment. So I'll say that if there is a turn in the next couple of months we should see an order inflow pick up in the last quarter. If there is no change at the government level then I would be surprised if we ended up at the same level we would probably be lower.

Moderator Our next question is from Nitin Bhasin of Ambit Capital, please go ahead.

Nitin Bhasin You are talking about orders. So just wanted to know from you on the orders from the power side. What is the largest size of an order that you are getting in power and what could be the end to end duration from the time you get the orders to get complete it?

Vir S Advani This quarter we had got our largest power sector order was of Rs 40 crore and duration will be around two and half years. If you are private sector power generation company that already has installed capacities in the country you can probably do it in three years. If you are a start-up power generation company my guess is that you cannot do it in less than five years. So that is the reality of that market. I'll just clarify this is about thermal power. I'm not talking about hydro, solar or wind power.

Nitin Bhasin But given that you have come into this and taken this order and you said two and half years execution, how much of this certainty of this order getting executed in that time because we know that power projects are getting delayed. But definitely when you are coming in a lot of capital would have been committed or it is very early days for these projects also?

Vir S Advani As far as the air conditioning ventilation is concerned, we usually come in when they have already committed the capital. But that does not mean anything in today's world. I think what makes more point is that they have already spent a lot of money in civil construction as well as the electrical. We come in towards the latter half of the projects. But that is no guarantee that it still will not get stalled. So that is the risk you carry in these long gestation projects and therefore we are very selective and careful about whom we work with.

Nitin Bhasin So are these again higher ends of orders in terms of margins? Because if you are getting three or four orders from power sector in one quarter, I believe in out of that Rs 600 crore of inflow closer to Rs150 could be from these segments and a long gestation, would you make more than your guided 7 to 8% margin of 13 or 14 at the site level?

Vir S Advani As I said, 7% is the margin of our carry forward. It has nothing to do with what we are booking right now. We are obviously booking at 12 to 14% and power we would be pricing higher to account for the long gestation.

Nitin Bhasin In case of metros, there was lots of hope that Delhi Metro is opening up another phase of the project this year and there would be some 3 or 4 new projects coming out from there, what is the sense on that?

Vir S Advani Delhi Metro phase 3 prequalification has been announced this month. We are prequalified on all packages in phase 3 which means that theoretically we have about Rs2500 crore of work to quote on. This work will get finalized starting in March-April'14 and will continue through about September –October. So that 6 to 8 months period of next financial year we will have about Rs2500 crore of orders finalized. We are obviously working hard now as we know we are prequalified.

Nitin Bhasin And any other large mega infra projects which are at a similar stage or at the bidding stage?

Vir S Advani No, there is nothing actually.

Nitin Bhasin People are saying some international players are looking at entering India for doing the MEP projects. Have you heard anything on that? Also the competitive intensity from the smaller players and the segmented players in this, what is happening on the competitive dynamics right now?

Vir S Advani In the manner of speaking we welcome them. If you look at the consumer durable sector, the entry of multinationals change the way the business is being done like the commercial terms or quality of products or competitiveness. So if there are people who can come in, they are welcome but at the moment they are talking, nobody is coming. But at the smaller end, I think smaller contractors continue to be present and as far as we are concerned, we are moving into larger projects. We do not see an issue with that because I don't think that at our overheads and our cost, we are able to manage smaller projects profitably. So I think there is an organized segmentation going on in the market.

Nitin Bhasin So when you say small and large, I think, then you are vacating the under Rs5 crore market, is that so?

Vir S Advani Not yet, but we're getting there. Maybe by next year we will be there, but we are vacating smaller projects in that right now.

Moderator Our next question is from Prerna Jhunjhunwala of HSBC Invest, please go ahead.

Prerna Jhunjhunwala Just wanted to get further clarity on the raw material cost. There has been a very good reduction in raw material costs. Is there anything other than commodity prices that you can attribute to this reduction?

Vir S Advani There is a reclassification of some of our costs from gross margin down to our operating expense, relating to our service business again. As per the new accounting standards, we have made mention of that in Q4 as well, and again in this quarter. So I think the reality is that there is no cooling off in raw material prices. I had said that we're expecting copper and steel to begin to cool off. But as far as Q1 and Q2 are concerned, it continues to be unabated. Very high raw material costs, coupled with the exchange rate, is not being beneficial.

B Thiagarajan In other words, look at the operating margins not gross margins.

Prerna Jhunjhunwala Have you taken any further price hikes in this quarter?

B Thiagarajan We did twice, in April as well as in May.

Prerna Jhunjhunwala And the price hike would be in the project segment or in the air conditioner and other product segments?

B Thiagarajan In the product segment.

Moderator Our next question is from Ranjit Sivaram of Batlivala & Karani Securities, please go ahead.

Ranjit Sivaram What's our current market share in the product segment?

B Thiagarajan There are various products. In room air conditioners, we will be having a market share of around 7%. In case of storage water coolers its around 35%. In case of deep freezers our market share will be in the range of 25%. In package air-conditioners we will be having a market share of close to 30%.

Ranjit Sivaram How this has been moved year-on-year?

B Thiagarajan In room air conditioners, in FY12 we gained a percentage point and remained stagnant in Q1against our plan of increasing it by 2%.

Ranjit Sivaram We get to hear some media articles regarding the Koreans and Japanese exiting the window A/C market. What is your sense on that?

B Thiagarajan It is indeed true, it is quite likely all will vacate in year or so. Basically the price difference between a window air conditioner and a split air conditioner is narrowing. Most importantly, for the window air conditioner the current energy labeled standard is one bar below the split air conditioners. When it catches up with split air conditioner, the price of window will also go up. And last point is there is no R&D that is being done across the globe on window air conditioners. So by a natural process that market may decline and in about two years time it will go away.

Ranjit Sivaram So currently if you want to put a figure like the total industry how much would be the window AC?

B Thiagarajan It will be around 15%.

Ranjit Sivaram So is this the reason why most of the domestic players have increased their market share in the total room AC?

B Thiagarajan There is no connection between this. The market share improvement has come from selling more splits.

Ranjit Sivaram Okay and last question will be the net working capital movement, how would that be?

Vir S Advani You can see from the results it is down by Rs200 crore over the prior year.

Ranjit Sivaram If you break it into debtors and inventory days?

Vir S Advani We don't get into that detail. Essentially we have managed to bring down our debtors in our project business and we managed to control our inventory in our product business. We had to payout creditors at a faster rate than last year. So the net result is what you see so there is some improvement in the balance sheet over the last 12 months.

Moderator Our next question is from Kirti Dalvi of Enam Asset Management, please go ahead.

Kirti Dalvi Would it be fair to consider that performance of subsidiary would be similar or you think the consolidated performance will be a tad bit lower than Q1?

Vir S Advani I presume it will be lower.

Kirti Dalvi You have fairly elaborated on your outlook per se. But what I'm having doubt is if you are saying your volume of the business will go down because of your commercial trades or you want to keep it constant? You are paying out your creditors fast. So how will you reduce your working capital going forward? Also do we have a risk of lower turnover in FY 14 as well if we don't get the sufficient orders?

Vir S Advani So all that is true. There is a risk of turnover in FY 14, there are lack of advances currently, we are paying our creditors faster but yet we are managing our capital employed. The answer there is that we have a very large debtor position that we are trying to clear out. The debtor position even today is not comfortable and there is a lot of room for improvement. So our effort is that we have to pay out creditors and we need to collect our overdues and I think with that we should be able to manage the balance sheet for the year. Of course it is very difficult but we are doing our best. But clearly order inflow is a concern. It is not a big enough concern for us to start booking unprofitable or unattractive business so we are choosing to take this strategy. We will see either hopefully it is the right way to do it or I am hopeful that this big funnel that we have will eventually convert into useful business sometimes Q4FY13 or Q1FY14. So we are just staying firm on this strategy as of now.

Kirti Dalvi But sir there would be certain fixed costs which you need to cover. What I meant to say is what would be the lever where you will get into the zone where you have to probably go below your threshold margins which you have set for individual your segments?

Vir S Advani I will clarify so the fixed cost what I keep talking about in our projects business, they over a longer-term period are variable because we don't have manufacturing capacity. We're carrying that fixed cost right now because we need that cost to manage this very difficult business.

However if the inflow continues at the current level of Q1, then we will take further action on reducing that cost, which is around people and some infrastructure which we can sell. So we have to prepare for next financial year with a lower cost base. For the current year, we can manage with this cost base. If order inflow doesn't improve by end of H1FY13 then we will be planning to reduce that cost base for the next financial year.

Kirti Dalvi So probably we will never compromise and we will not see the balance sheet deterioration which is happening over the last two years coming again probably in FY14 irrespective of the business environment getting worst.

Vir S Advani Never is a very difficult thing to agree to but we will certainly try not to do so for some time.

Kirti Dalvi So where do we see our consolidated debt of last year of almost Rs400 crore which you have reduced to Rs380 crore, by year-end? Do we see a significant reduction in this number?

B Thiagarajan Very early to say. Probably this question can be answered in the Q3 con call because planning for the summer of 2013 will significantly alter this. Let us say that we will achieve Rs50 crore reduction in the borrowings or so but the question will be, are we going to plan for a major growth in summer in which case, we will be buying out inventories and planning cost for (so very early to talk about) year end borrowings.

Moderator Ladies and gentlemen that was the last question, I would now like to hand the floor to Mr. Vir Advani for closing comments.

Vir S Advani Thank you very much everyone for logging into our call. As usual if we have not answered any questions please send us an e-mail and we will respond otherwise we look forward to talking to you in three months now.

Moderator Thank you very much sir. Ladies and gentlemen on behalf of Blue Star India Ltd that concludes this conference call.