"Blue Star Limited Q1 FY-'16 Earnings Conference Call"

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Moderator: Ladies and Gentlemen Good Day and Welcome to Blue Star Limited Q1 FY-'16 Earnings Conference Call. We have with us today from the management, Mr. Vir Advani – Executive Director and President, Electro Mechanical Projects Business and Mr. B. Thiagarajan – Executive Director and President, Airconditioning and Refrigeration Products Business. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touch tone 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 Mr. Advani.

Vir Advani: Thank you. Good afternoon 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, 2015.

The following are the financial highlights of the Company for the quarter (Q1FY16) on a standalone basis.

- The Company reported Total Operating Income of Rs 908.58 crores for the quarter ended June 30, 2015, as compared to Rs 837.61 crores in Q1FY15, representing an increase of 8%.
- Operating Profit (PBIDT excluding Exceptional Items and Other Non Operating Income) for the quarter increased 9% to Rs 65.74 crores from Rs 60.16 crores in Q1FY15.
- During the quarter, Other Income was Rs 0.44 crores as compared to Rs 1.62 crores during the same period last year.
- Financial Expenses for the quarter declined by 25% to Rs 8.29 crores from Rs 11.04 crores in Q1FY15, mainly due to overall cost reduction owing to reduced borrowing levels.
- There was no exceptional gain/loss during the quarter as compared to an exceptional loss of Rs 5.16 crores during Q1FY15.
- Tax expense for the quarter was Rs 9.79 crores as compared to Rs 5.16 crores in Q1FY15 since the Company is now on normal tax rate as compared to MAT in the same period last year.
- Consequently, Net Profit grew 26% to Rs 39.04 crores from Rs 31.01 crores in Q1FY15.
- Earnings per share for the quarter (Face value of Rs 2.00) stood at Rs 4.34 vis-à-vis Rs 3.45 in the corresponding quarter of the previous year.
- Carry Forward Order Book as on June 30, 2015 increased by 8% to Rs 1493 crores compared to Rs 1388 crores as at March 31, 2015.

- The Total Capital Employed of the Company stood at Rs 972 crores on June 30, 2015 as compared to Rs 901 crores on June 30, 2014. The net borrowings came down from 333 crores as on June 30, 2014 to Rs 295 crores on June 30, 2015.

Segment-wise results for Q1FY16

- The revenues of the Electro Mechanical Projects and Packaged Airconditioning Systems business, declined marginally by 3%, while segment results registered a decline of 17% to Rs 8.76 crores. The decrease in profitability was mainly due to sluggish execution of projects.
- Cooling Products, comprising 61% of the total revenues of the Company during the quarter, registered a growth of 17%. Segment results grew 12% to Rs 79.01 crores. Despite the fact that the summer was not harsh with rains in several parts of the country in April and May, the business did much better than the industry mainly due to the Company's strong brand equity coupled with an enhanced product portfolio and distribution.
- The Professional Electronics and Industrial Systems (PE&IS) business has been carried out by Blue Star Engineering and Electronics Limited (BSEEL), a wholly owned subsidiary of the company effective from April 1, 2015. Consequently, results for the current quarter are not comparable with the previous periods. During the year, certain contracts of the PE&IS business were also executed by Blue Star Limited. Thus, the revenues and profit for this business during the quarter were split between the parent Company and its subsidiary. On a combined basis, the business recorded a revenue growth of 59%, while the results grew 72% to Rs 7.36 crores. These combined figures are based on management accounts, and have not been subjected to audit or a limited review by the auditors.

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)

During Q1FY16, this segment registered a marginal decline of revenue growth of 3% to Rs 327.08 crores. The segment registered a decline in profit of 17% to Rs 8.76 crores as compared to Rs 10.58 crores in Q1FY15. This resulted in a segment margin of 2.7% as compared to 3.1% during the same period last year. The execution of projects was much slower than anticipated, while operating costs were maintained at last year's levels, resulting in a drop in operating margin. The Capital Employed in this segment decreased from Rs 494 crores as on June 30, 2014 to Rs 463 crores as on June 30, 2015.

The order inflow in Q1FY16 for this segment grew 5% to Rs 437 crores as compared to Rs 416 crores during the same period last year. The carry-forward order book for this segment stood at Rs 1451 crores as at June 30, 2015 as compared to Rs 1340 crores as at March 31, 2015, an increase of 8%.

In the electro mechanical projects business, the market continued to remain muted except for a marginal improvement in fresh enquiry inflow from the West and North India. Segments such as industrial and healthcare witnessed enhanced demand, while commercial spaces linked to offices and retail remained adversely affected.

In the central plant equipment segment, enquiry inflow was poor from infrastructure, IT/ITeS and the developer segments. However, there was some movement witnessed in marriage/banquet halls, educational institutions, showrooms and industrial segments.

As mentioned in the previous update, the Company has forayed into the centrifugal chiller category in order to provide a comprehensive range of chillers for various applications and this initiative met with an encouraging response during the quarter. Since water cooled screw chillers with Variable Frequency Drives (VFDs) are gaining popularity, the Company introduced this product line during the quarter. With the enhancement of its range of chillers, the Company is looking at increasing its market share in this category.

As regards to packaged airconditoning, while the ducted systems market continued to be muted during the quarter, variable refrigerant flow (VRF) systems grew by about 10%. The VRF product category is gaining popularity and is making deep inroads in segments which were using chillers or ducted systems.

During the quarter, the Company announced the launch of its next generation, 100% inverter VRF system named Blue Star VRF IV Plus. This is the country's first 'Made in India' 100% inverter VRF system which is 'Made for India' since it's well suited for the varying climatic conditions as well as wide voltage fluctuations. Manufactured at the Company's modern Dadra plant, with this launch, Blue Star has proved that an Indian manufacturer can develop a product, equipped with the right technology and robust R&D capabilities, which is best-in-class and can challenge any product globally. The Company is confident that with this new offering, it will further strengthen its foothold in the fast-growing VRF market.

Segment II (Cooling Products)

During the quarter, the Cooling Products segment of the Company registered a 17% increase in revenues to Rs 556.21 crores. Segment result also registered a 12% growth from Rs 70.59 crores to Rs 79.01 crores. Segment margins reduced marginally from 14.9% to 14.2% over the same period in the previous year due to decline in demand. The Capital Employed as on June 30, 2015 was Rs 186 crores, about the same as on June 30, 2014.

The room airconditioners industry registered a meager growth of 3% in the quarter mainly due to an inconsistent summer disrupted by rains in several parts of the country. Further, crop damage in north west and central India resulted in decline in offtake. However, the Company's room airconditioner business performed well registering a healthy growth of 18%, thereby increasing its market share to 9.5% from 8.5% over the same period last year. Strong brand salience, enhanced product portfolio and deeper penetration resulted in this impressive performance. Due to the market demand in Q1FY16 being much lower than anticipated, there is a significant build up in inventory levels of most room airconditioner players and this is likely to negatively impact prices and margins in the short-term. However, with the commodity prices going southwards, this adverse impact may get offset to some extent.

In the commercial refrigeration products business, the overall freezer market was sluggish with the hard top chest freezer market declining. However, glass top freezers continued to grow well. Bottled water dispensers and water coolers witnessed a reasonable growth. The modular cold rooms business has been encouraging with the Company making deep inroads into the fast-growing Quick Service Restaurant (QSR) segment. The demand from the pharmaceuticals, dairy and ice cream segment was also on the rise. During the quarter, a new first-of-its-kind set-up for cold room panel manufacturing with eco-friendly foaming process using cyclopentane commenced production at the Company's Wada Plant.. This will enable the Company to differentiate its cold room business on an eco-friendly platform.

Segment III (Professional Electronics and Industrial Systems)

As mentioned earlier, the revenues and profit for this business during the quarter were split between the parent Company and its subsidiary, Blue Star E&E Ltd. On a combined basis, the business recorded a revenue growth of 59% to Rs 41.61 crores, while the results grew 72% to Rs 7.36 crores. Segment margins increased from 16.3% to 17.7% during the quarter. These combined figures are based on management accounts, and have not been subjected to audit or a limited review by the auditors. Quarterly performance is typically not a good indicator for this business, and while the prospects of its business are positive, it is prudent to assess its performance over a longer period.

During the quarter, the 'Make in India' initiative resulted in enhanced demand for the testing machines business. The destructive testing business performed well mainly due to orders from the automotive segment and industrial testing. In the non-destructive testing business, power, refineries and aeronautics performed well. The data communications business also performed impressively, doubling its revenues during the quarter as compared to the same period last year mainly due to enhanced demand from the BFSI segment buoyed by the 'Jan Dhan Yojna' and 'Digital India' initiatives. The healthcare systems business received significant orders for Bone Mineral Densitometers, Raman spectrometers and a 16-slice CT Scanner, apart from orders for 5 MRI Systems.

International Business

During the quarter, the Global Products business registered good growth with healthy inflow of orders for room airconditioners, water coolers, ducted systems and refrigeration products from OEM accounts and various distributors in UAE, Oman, Qatar and Kuwait. The Company participated in large trade shows in Johannesburg and in Qatar displaying its range of products which garnered good brand visibility in these markets. Blue Star will begin contract manufacturing for a reputed US-based multinational to cater to the Saudi Arabian market, complying with SASO regulations, for safety and performance, which is now mandatory. These products are with the eco-friendly 410A refrigerant and have been developed and tested in a third party lab in Thailand, which is approved under SASO regulation.

In conclusion, though the commercial construction cycle is yet to pick up, the Company is confident that its expertise and credentials will hold it in good stead when the growth opportunities revive. The Company is hopeful of a normal monsoon, which will ensure that the demand for cooling products is sustained 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 very much, sir. We will now begin the Question-and-Answer Session. The first question is from the line of Anand Narayan from Kotak. Please go ahead.

Anand Narayan: What is the status of our legacy orders and can you share the break-up of order book? Also at present, how much is the borrowing?

Vir Advani: On the legacy order book, there has been no change since our last call. We did not see much progress in our legacy orders, Rs.25-30 crore of legacy orders continues. That is the answer to your first question. The second question was on the segmental break-up of the order book. It remains largely unchanged over the last time. On the level of borrowings, it was Rs.295 crore.

Anand Narayan: What is the outlook for '16 in terms of company as a whole?

Vir Advani: As you all know, we do not give any guidance. What we are saying is that it is going to be another tough year. I do not think there is any significant improvement in the market; for projects things are still slow, both in terms of order inflow and execution. As seen from our Q1 numbers, we are not operating at the level that we want to. So, I am expecting that while there will be some revenue growth in Segment-I, operating margins will continue to be under pressure like last year. As far as the Cooling Products business is concerned, while Q1 was reasonably good, the industry did not grow too well. We are hoping that this monsoon pans out all right but we are really unsure right now as to what is going to be the outcome of this monsoon. If we have a normal monsoon, then the rest of the year we will continue to grow at this rate. If we do not, then it will obviously be slightly lower. Hence it is a little unclear right now.

Moderator: Thank you. The next question is from the line of Renjith Sivaram from B&K Securities. Please go ahead.

Renjith Sivaram: What is our outlook in terms of Segment-I order intake for the full year and what kind of order book are we looking at?

Vir Advani: In Q1, our order inflow was up marginally 5%. The full year the order inflow may improve to about 15% but it is subject to certain large projects getting approved etc. The first quarter has not been very different compared to Q4 of last year. So, while the order inflow for the first six months of this calendar year is certainly better than the first six months calendar year last year, we had expected a much faster pick up in Q2 & Q3 which does not appear to be happening. Hence, overall for the year it will be up about 15%.

Renjith Sivaram: As the Segment-I because the margins were quite low, was there any provision?

Vir Advani: No, we have not done any provisioning in Q1. This is essentially around low volume of business. As I explained in my opening remarks, we were not able to bill at a faster pace. So we have a carry forward order book which we were not able to bill because we are watching our capital employed and cash flow. Hence the operating cost is holding, the revenue is lower and this is translating into weak operating margins of something less than 3%. This 3% will begin to climb once the billing picks up. We were expecting the whole year billing to be substantially higher than the last year. If we were able to bill our projects at the base that we wanted, then the Segment-I operating margin should increase to about 6% in the current year. But that as of today, which is beginning of August, it is looking tough because we have already passed the first four months and there is no substantial pick up in billing. But, we are still controlling the cash flow. As and when some cash flow ease comes in, is when we will pick up the billing.

Renjith Sivaram: So probably it might be some 5-6% kind of growth in Segment-I for the full year?

Vir Advani: The billing may grow by 4-5% on the top line, which will not help our operating margins expand substantially over last year.

Renjith Sivaram: In Segment-III, will we book that 50% for the full year or after couple of quarters it will stop?

Vir Advani: No. What will happen is that in every quarter that percentage will reduce in the parent company. Because we were closing out a large number of orders that were booked in the parent during Q4, we had to bill them out in the parent and not in the subsidiary. But effective April 1, all the new order inflow is in the subsidiary. So all that billing will obviously be in the subsidiary. Also the carry forward orders that we needed to execute in the parent will come down because we did transfer or sale across most of the carry forward orders to the subsidiary. Hence you will see quarter-on-quarter reduction in the Segment-III of the parent company. Our intention is to bring it down to zero but it may take us a little longer because we have some long-term government contracts which are not assignable and so those we may need to bill out in the parent.

Renjith Sivaram: What will be the tax rate for the full year?

Vir Advani: Tax rate for this year should be 20%.

Moderator: Thank you. The next question is from the line of Gaurav Sanghvi from Bajaj Allianz. Please go ahead.

Gaurav Sanghvi: My question is related to Cooling Products. As you mentioned 3% growth for the industry and we have registered 18% growth. So, is this the volume growth or value?

B. Thiagarajan: Value growth.

Gaurav Sanghvi: And sir, we have also mentioned that there is a build up in the inventory. So, does it mean the growth at the ground level or dealer level would be lower than the 18%?

B. Thiagarajan: No, there are two-three things. One, we anticipated that the market will grow by 15% and we by 25%- 10% growth over and above the market growth. Unfortunately, the market has not grown by that 15% as the summer season was weak. In the process, everybody has got inventory. Because of this, we may have a price war as everybody will be interested in getting rid of the inventory. From our side, if we had planned for 25% and if we have grown only by 18% or so, to that extent we may have some 45-days more inventory than what would have been an ideal scenario.

Gaurav Sanghvi: What is our view on the demand side given the build-up in the inventory and short summer?

B. Thiagarajan: My expectation is that by the year-end, hopefully, the market will register at least 10% growth. The festival season can be good, the monsoon can be good and the February-March could be another period where high growth can happen in preparation for the summer. So therefore, right now, I am optimistic that perhaps 10% growth will take place in the industry.

Gaurav Sanghvi: The other thing is on the pricing. As you mentioned because of the inventory build-up, what was the scenario in Q1? Have we seen any competitive intensity?

B. Thiagarajan: It was highly competitive in the second part of May and June-July.

Gaurav Sanghvi: So, have we started seeing irrational pricing or still it is profitable competition?

B. Thiagarajan: I am not sure about irrational, the competitor maybe thinking it is rational, but the thing is there is a price war and the prices are dropping.

Moderator: Thank you. The next question is from the line of Sujit Jain from Yes Securities. Please go ahead.

Sujit Jain: Sir, my question is on the AC business where you just mentioned that we may carry about 45-days of more inventory because initially we had estimated 25% value growth while actually it is 17-18%. So, what would have been the normal inventory days otherwise?

B. Thiagarajan: No, I am saying over and above the normal, we will be carrying 45-days more of inventory. Normally, we will carry inventory of something like six weeks.

Sujit Jain: In terms of our market share, we said that market share increased to 9.5% from 8.5% YoY. In terms of QoQ, what has been the change in the market share?

B. Thiagarajan: More or less it would have remained the same. We are yet to see the actual reports which may come soon. May be we may have improved by 0.5%.

Sujit Jain: This is a question on the Segment-I. We spoke about legacy order still being in the range of Rs.25-30 crore. What kind of provisions do we expect as we come to the closure of these orders?

Vir Advani: Like we have been saying in all calls, this is last of the lot. We would imagine that they are also the hardest of the lot. So, we will keep you informed as and when we do manage to close out these contracts. I am hopeful that we will recover some of these but it is likely that we may have to provide a fair amount of this percentage.

Sujit Jain: On Segment-III, where close to about 40% out of Rs.41 crore total revenues, we have booked Rs.16 crore in our subsidiary, BSSEL. But like you said, every quarter it will progressively go down. So what kind of booking can we expect for the full year for us to model accordingly?

Vir Advani: Last year we did billing of about Rs.147 crore. That should grow this year by 15% on a consolidated basis. Out of that, while in Q1 we booked only 40%, thereby in Q4 it will be sort of 95%. We have not done this modeling specifically but my sense is that probably out of that Rs.165-odd crore, maybe Rs.65 crore or so will be in the parent and about Rs.100 crore will be in the subsidiary.

Moderator: Thank you. The next question is from the line of Nitin Bhasin from Ambit Capital. Please go ahead.

Nitin Bhasin: Project segment is not actually witnessing that sort of a billing and the operating environment is also not looking that great. Any specific cost cutting measures that you are taking on the contracting business so that it becomes leaner?

Vir Advani: We have cut manpower over the last two years. We are now looking at further reduction on the execution side. So while we keep the Sales, Engineering and Business Development teams in place, we are looking to reduce the size of the execution team. The main cost in that business is of course the people. That is where we are focused. Other than that, we are also expecting some billing pick up in Q3 and Q4. We should hopefully see a better H2.

Nitin Bhasin: Are we looking at commercial and industrial side for the billing pick up? What is the median size of a project which we are we looking for? Rs.15 crore, Rs.25 crore or something like lesser than that?

Vir Advani: Whatever inflow we are seeing is of the mid-sized projects. Mid-size now is about Rs.10-20 crore in value. We are seeing very few Rs.50 crore plus jobs. There are many enquiries but very few finalizations, if any. As we are now focused more on larger projects, we do not keep a track of sub-10 crore projects. We are seeing demand from Healthcare and Industrial segments, plus some selective IT business pickup in Bengaluru. Bengaluru is actually doing rather well as a market for commercial in the IT.

Nitin Bhasin: So it is more commercial space that we are looking at. Would you be talking more about the Chiller base business or is it the ducted business which is keeping this order inflow afloat?

Vir Advani: It is across, both Chiller as well as Ducted.

Nitin Bhasin: Is VRF eating the share of Ducted? The market is also gradually moving a little bit towards VRF. So, what do you think of VRF versus Ducted in the next 2-years?

B. Thiagarajan: Ducted demand will be lower than that of VRF. Let us say, for example, if Ducted is growing at 5%, VRF will grow at around 20%. So, cost-sensitive segments such as some builders and Tier-III, IV, V cities will prefer Ducted.

Nitin Bhasin: VRF is largely real estate-driven market. With what we are seeing is that residential sector coming under pressure. Would VRF not come under pressure again?

B. Thiagarajan: VRF and Ducted both have got an outdoor unit as well as an indoor unit. In VRF, many kinds of indoor units can be used; it can be High Wall, Ducted Split and Air-Handling Unit. So, when we are in both outdoor as well as indoor, when we talk about Ducted, in the Ducted indoor part of it is also used in VRF projects. Actually, we are indifferent to this; which market is going to grow and which is not. As far as Blue Star is concerned, we are there from Window Airconditioners to Chillers. We are worried about market segment growth rather than product segment growth. It does not matter to us which one grows.

Nitin Bhasin: Where I was coming from is that, if Ducted possibly does not grow at a same pace and VRF grows faster, how do the margin profile and the payment cycles change for the segment?

B. Thiagarajan: Payment will not change at all because it is a dealerised business and mostly it operates on something like 45-50 days credit. Payment is not the issue at all, the customer segment or the behavior will be. In case of the margins, Ducted is a place where there are only four competitors whereas in VRF there maybe eight active competitors. And probably, at the operating margin level it maybe a couple of percentage points lower.

Nitin Bhasin: About sustainable margins in the Cooling Products business, especially the Room AC business. Sometime back it was about 9-10% and the competition has also moved up their sustainable margin expectations. Are 14% margins sustainable for you alongside market share gains or do you think these margins are very high right now and they might just get moderated? What is your view on these margins?

B. Thiagarajan: It depends on the demand in a particular year. If you are going to be in this business, you should be prepared for one year of huge demand and another year of weak. But I am of the opinion at this point of time, the margin is somewhat very high basically because the commodity prices are low and the exchange rates are stable. If somebody asks "What is the sustainable margin", I think 9.5-10% will be a safe bet.

Nitin Bhasin: But you have not taken price hikes, am I right in the last 6-months, in the Room AC business?

B. Thiagarajan: I do not think so. Prices were somewhat stable. People have dropped prices. We have held on to our rate but we may be compelled to do so.

Nitin Bhasin: If the volumes were to decline by 10% as an industry or let us say in a hypothetical case, because I am just trying to understand the margin exposure to a volume growth, do you think margins would decline to about 8.5-9%?

B. Thiagarajan: I do not think there is an algorithm like this. It is a question of what market share I want to have. If we decide that I want to maintain my market share and if the market is not growing at all, you will indeed have a problem. At that point of time, how much margin will dip? I am unable to guess because it is dependent on what other players are going to do.

Nitin Bhasin: You mentioned 2-3-years back that you want to be a 9.5-10% sort of market share. You have reached that. What is the next market share target or you believe that from here on we just go as the brand picks up, etc and hence we are not setting ourselves any target?

B. Thiagarajan: Our ambition is that this year we should move the market share to somewhere around 11%. I do not think it will happen but it will be somewhere around 10.5%. In the next three years time, if we can move it up to 12%, it will be fantastic.

Nitin Bhasin: How do you measure your market share? I remember your selling mechanism is very different from the others, you do from the larger distributors and you do a lot more as compared to the other competitors that you have. Also your distribution is different.

B. Thiagarajan: As far as the Retail chain is concerned, it is based on the GFK data. As far as the institutional sale is concerned, based on what orders are booked versus orders lost. This information is generally available in the market and there is some other syndicated study which is done by many agencies from time-to-time.

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

Ankit Fitkariwala: Just wanted a bit sense on the Room AC segment in terms of the split between window and split airconditioners? Also which one has grown faster?

B. Thiagarajan: We are selling very negligible volumes of Window. So what is growing is generally Split.

Ankit Fitkariwala: Typically, what is the margin difference between the two?

B. Thiagarajan: In our case, it is same.

Ankit Fitkariwala: When you say that the industry has grown by 3% in this quarter. Again there you will say that mostly it has been driven by the Split?

B. Thiagarajan: Both would have grown. In North India, in quite a few states like Punjab, 40% is Window Airconditioners. In NCR region, 30% is Window Airconditioners.

Ankit Fitkariwala: For the year, now you are sensing it will be close to 10% from the estimated 15%.

B. Thiagarajan: We always maintain that if the market grows by 5%, we will grow by 15%. If the market grows by 10%, we will grow by 20%.

Ankit Fitkariwala: Just kind of a long-term question. What I wanted to understand that for over the last 4-5-years this segment along with your competitors, the margin profile has completely changed. So barring the commodity, which is a recent phenomenon for say 6-months to 1-year, what is essentially changing structurally in the industry which is leading to this margin trajectory change? Any sense on that?

B. Thiagarajan: It is not the industry. You have visibility of Voltas plus Blue Star and to some extent Hitachi. Otherwise among the top three, Samsung, LG are there, and there are many other Japanese players. I do not think everyone's margin profile has changed at all.

Second, in case of Blue Star, the volumes have grown and our marketing strategy has also helped. We are not fighting for the market share and have positioned ourselves as a premium brand. So far it has worked out well.

Ankit Fitkariwala: What I am trying to get at is, is it something like, say product quality has improved, warranty costs have gone down or something like that on the saving side?

B. Thiagarajan: In our case it is the same. Volumes have grown and the external environment has helped along with our own positioning. Otherwise, everything is same – the logistics cost per unit or warranty is same and nothing has changed in the past 10-years.

Moderator: Thank you. The next question is from the line of Salil Utagi from Systematix Shares. Please go ahead.

Salil Utagi: Can you throw some light on your region wise distribution network? Also, do you sell more through Modern Retail or through Standalone Retailers?

B. Thiagarajan: In terms of network, we are strong in all the regions except North, other than NCR. The reason is simple. You cannot acquire a distribution network. North India is a very price-sensitive market. The average price realization also is lower in Northern region. The second reason is that Window Airconditioner proportion is very high and we are not focusing on it, in the sense whether Blue Star should have a value for money model kind of a strategy is something we have not attempted at all. We are evaluating whether we should have some models meant for these. Third is with regard to the vernacular advertising. We experimented with this in the Hindi belt and did meet with some success in these markets. So therefore we will go ahead with vernacular communication in our promotions as well. To your next question, there is no difference. I would say we are equally present in both.

Salil Utagi: But the market share will remain the same in both the categories?

B. Thiagarajan: Correct.

Salil Utagi: Sir, what is your strategy behind Inverter ACs? What is your market share right now and what kind of growth are you seeing in that?

B. Thiagarajan: Roughly 8% of the total Room Airconditioner sales come from Inverter ACs. It will continue to grow. I think in about 3-years' time, 30-40% or more will be the Inverter ACs contribution. There is an Inverter labeling program which will be in place within a couple of years. Our share also is more or less in line with the market; if 8% of the market is Inverter, we are also selling 8% of the market.

Salil Utagi: The demand for Inverter is coming from the Replacement or from the first time buyers?

B. Thiagarajan: First-time buyers.

Moderator: Thank you. The next question is from the line of Rabindra Nayak from SBI CAP Securities. Please go ahead.

Rabindra Nayak: Sir, regarding Professional Electronics business, can you please give me the consolidated EBIT number and the capital employed between the parent and subsidiary?

Vir Advani: The consolidated operating profit is Rs.7.36 crore for segment-III. To your question on Capital employed between the parent and subsidiary, as against last year's capital employed of Rs.27 crore in Q1, this year the capital employed was Rs.37 crore.

Moderator: Thank you. The next question is from the line of Madan Gopal from Sundaram Mutual Fund. Please go ahead.

Madan Gopal: Sir, my question is on the segmental results. You have an unallocable expenditure of around Rs.35.5 crore and for the full year last time you had Rs.98 crore sort of a number. Does it carry any one-offs? What is the nature of these expenditures?

Vir Advani: There is no one-off cost there. Advertising is one. Other than that, we will have corporate expenses as well, for example, our IT, Central Management expenses, etc.

Madan Gopal: This number is volatile every quarter primarily because of the advertisement expenditure, is it?

Vir Advani: Yes.

Moderator: Thank you. The next question is from the line of Rahil Shah from HDFC Securities. Please go ahead.

Rahil Shah: I was just going through your annual report and I noticed that it is mentioned that you are targeting the overseas markets going ahead since you do not see that stronger growth in India. Can you just elaborate on that please?

Vir Advani: Yes, we have an international business group that is basically mirror of Blue Star in India. So we have a product export business and then we have International Projects business there. In Projects, we work in only two countries right now, Qatar and Malaysia through joint ventures. Hence it is not very substantial. In our Product

Export business, we export HVAC equipment to 16 countries right now, primarily in the Middle East and in Africa. All together it is relatively small right now and accounts for less than 5% of our overall revenue. The idea going forward is that we want our International business contribute 15% to overall revenue of the company. Hence we are increasing our international footprint by adding more countries and geographies as well as adding more international projects joint ventures in a few more countries going forward. Effective beginning of this year, we have consolidated all that into a new line of business and we will keep reporting progress on that in the years to come.

Rahil Shah: So it is still in the early stages and it would take 2-3-years to scale up?

Vir Advani: Minimum 3-years to scale up. As it is a long-term play, maybe 5-10-years is when we start witnessing see some benefit.

Rahil Shah: On gross margins, given the slump in commodity prices, going ahead do we see our margins expanding or are we going to pass it on?

Vir Advani: There will be some benefit which will accrue on account of the unfilled orders because those are fixed price contracts. We are hurt when the commodity prices increase and we benefit when they come down. But other than the unfilled order book, as far as new orders and the equipment sales are concerned, we do end up passing benefits to the customers as the market has not yet recovered, volumes and demand are still low. So, I would expect that a large part of these benefits would get passed down to the customer.

Rahil Shah: But, like on the Cooling Products side, I do not think the benefits need to be passed on or is it that competitive that you kind of have to?

B. Thiagarajan: Absolutely, in fact, Cooling Products is the most competitive business that we have. So like we said, the industry has only grown by 3%. In the industry, inventory has piled up; our inventory is up as well. Unless the monsoon is normal and demand picks up again, you will start seeing price cutting which is essentially transferring that benefit to customers.

Moderator: Thank you. The next question is from the line of Sanjeev Zarbade from Kotak Securities. Please go ahead.

Sanjeev Zarbade: My question pertains to the subsidiaries. In the previous fiscal, our Blue Star Design & Engineering has reported sharp decline in revenue as well as profit. So, if you could throw some light on that because we would be merging the Segment-III with this company?

Vir Advani: Our subsidiary now has our Professional Electronics business there. It has a small amount of Plumbing business which is otherwise being moved back into the parent in Segment-I and it has a set of properties of ours for the group. So going forward, the revenue and profit will be through the Professional Electronics business and the real estate assets that are sitting there. We feel that the current year will be a good one because Professional Electronics business is doing well. While it will not register 100% of the business in the current year, it will be still be substantial and so we expect a good year.

Sanjeev Zarbade: These real estate assets are basically in the form of some land or we have some building?

Vir Advani: It is just office spaces and no land parcels.

Sanjeev Zarbade: Regarding the Segment-I. Of course you did throw some light on the business scenario. But for the current full year, how are we looking at the segment margins? Would it be around 5% or something or is it the previous year margins?

Vir Advani: I will say that it will be slightly better than the last year but it will not be substantially better; between 4% and 5%.

Moderator: Thank you. The next question is from the line of Ravi Swaminathan from Spark Capital. Please go ahead.

Ravi Swaminathan: I would like to know the volume numbers of Room ACs sales this quarter vis-à-vis the previous quarter?

B. Thiagarajan: It becomes some selective disclosure. So you can always compute it as an average price of something like Rs.25,000 and arrive at it.

Ravi Swaminathan: I was going through the Annual Report. In that, the advertising and sales promotion expense was around Rs.52 crore during FY15. A part of it is included in the Cooling Products?

B. Thiagarajan: That is true. The classification is advertising and sales promotion. So therefore, what is actually happening is that certain promotional expenses are getting accounted there. So therefore majority of it will get accounted in the Cooling Products.

Ravi Swaminathan: In unallocable, how much of it would be there?

B. Thiagarajan: It depends on a particular quarter actually; in some quarter it can be 40%. Some of our advertising is corporate in nature. Something is connected with exhibitions where we participate which are combined for Blue Star as a whole.

Moderator: Thank you. Our last question is from the line of Sujit Jain from Yes Securities. Please go ahead.

Sujit Jain: My question is on imports. What is the import content in the total raw material cost of ours? Or let us say for the average selling price of Rs.25,000, as an example of a AC unit, what portion would be import?

Vir Advani: Something like 60% to 70% depending on the SKU.

Moderator: Thank you. I would now like to hand the floor back to the management for closing comments. Over to you, sir.

Vir Advani: Thank you very much for everyone to log into this call. We will be talking to you next at the end of Q2. If there are any questions that were unanswered, please e-mail us and we will get back to you.

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