"Blue Star Q3 FY13 Earnings Conference Call"

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Moderator Ladies and gentlemen, good day and welcome to the Blue Star Q3 FY13 Earnings Conference Call. We have with us today from Blue Star Mr. Vir Advani – President, Electromechanical Projects Group and Executive Director and Mr. B Thiagrajan – President, Air-conditioning & Refrigeration Products Group. As a reminder for the duration of this conference, all participant 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 any assistance during this conference please signal an operator by pressing * and then 0 on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference to Mr. Vir Advani. Thank you and over to you sir.

Vir Advani 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 December 31, 2012.

The following are the financial highlights of the Company for the *quarter (Q3FY13)*

- Total Operating Income stood at Rs 598.80 crores for the quarter ended December 31, 2012, as compared to Rs 584.01 crores in Q3FY12, representing an increase of 2.5%.
- Operating Profit (PBIDT excluding Other Income) for the quarter increased to Rs 25.43 crores from a loss of Rs 8.81 crores in Q3FY12.
- Financial Expenses for the quarter decreased by 38% to Rs 13.72 crores from Rs 22.10 crores in Q3FY12.
- Provision for taxation for the quarter was nil, same as that in Q3FY12. 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 is Rs 5.37 crores as compared to a Net Loss of Rs 32.76 crores during the same quarter of the previous year.
- Earnings per share for the quarter (Face value of Rs 2.00) stood at Rs 0.60 vis-à-vis a negative of Rs 3.64 in the corresponding quarter of the previous year.
- Carry Forward Order Book as on December 31, 2012 reduced to Rs 1628 crores compared to Rs 1678 crores as on September 30, 2012, due to

slower new order bookings as well as a concerted effort to improve the quality of new orders won.

I will now go through the general outlook of each segments that we are operating in, followed by specifics of our performance in each of these segments:

General Outlook for the Segments:

Segment I

Overall the electro-mechanical projects market continues to be sluggish with demand slowing across sectors. Though enquiries are getting floated, the finalisation of jobs continues to be slow because of political uncertainty, cash flow problems of builders, high Interest rates etc. There is however some positive movement in enquiry flow lately in segments like Hospitals, IT/ITeS, Industrials, Mixed Used Development, Educational Institutions and Commercial Complexes.

At an aggregate level, the Central air-conditioning equipment market continues to grow marginally. Central plant market is roughly flat, the ducted AC market is growing at 5% this year and the market for VRFs continues to grow at 15%, with demand coming primarily from Industrial, Offices and Retail.

Segment II

The Room AC Industry went through one more quarter of de-growth in Q3FY13. According to our estimates, the market would have de-grown by around 10% over last year. The reason being lower than expected festival business across the country, increased power tariff and decreased power availability in a few states.

The 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. However, the competition is increasing in the market and price realization is expected to be under pressure as we enter the summer season.

In Cold storage products, the traditional segments of Pharma, Fast Food & Restaurants, Ice cream, Banana ripening and Fruits & Vegetables storages continue to fetch good business opportunities.

Segment III

Demand for hi-technology imported equipment has been flat over last year owing to the foreign exchange position. Government, scientific, education, etc. have been cautious in adding new equipment.

Demand for Destructive and Non-destructive testing machines continues to be reasonable with the light and medium industrial market continuing to make incremental capital investments.

There has been a significant slowdown and deferment of capex finalization in core industrial segments particularly Steel, Mines and Metals and Oil & Gas for the entire year. This has impacted our Industrial Projects business quite substantially.

Our Performance:

Segment I

The Electro Mechanical Projects and Packaged Airconditioning business accounting for 66% of the total revenues in the quarter, has grown by 7.6% to Rs 396.02 crores. Segment results grew to Rs 22.94 crores in Q3FY13 compared to a loss of Rs.15.18 crores in Q3FY12. The Operating Margin of this business in Q3FY13 increased to 5.79% compared to -4.13% in Q3FY12 mainly due to better gross margins and focus on business from more profitable segments.

As indicated in our last call, the Segment Operating Margin has dropped from 7.03% in Q2FY13 to 5.79% in Q3FY13. The drop is primarily due to drop in billing as projects execution continues to be slow.

The Capital Employed in the business as at end December 2012 was Rs 477 crores, which was higher than Rs 423 crores at the end of September 2012. The increase in this quarter is primarily on account of substantial drop in our collection of advances on new orders booked, selectively paying down vendors and business associates, increase in inventory levels in our equipment business and the overall tight liquidity in the market. It is also becoming increasingly challenging to improve the capital employed levels due to low collections and creditors needing to be paid out quickly.

The Company has witnessed a shrinkage in order inflow in Q3FY13 as well. This is because we continue to be selective in booking orders with better terms of payment & other commercial terms. Besides, we have been aggressively pursuing existing customers for price escalations & variations.

In Central AC equipment business, despite facing challenges like aggressive pricing in the market by competition, customers preferring other solutions like VRFs etc., the company is confident of achieving growth by expanding the product range, reach and also by developing good relationships with consultants and customers.

The Company is also closely monitoring the new trends emerging in the market like demand for water cooled ducted split ACs, eco-friendly gas based ducted systems, and is geared up well to cater to customer's needs and thereby achieve good growth in this segment despite stiff competition from multi-nationals.

Some of the major orders won by Blue Star during the quarter in Segment 1 are

Electro-mechanical Projects: QRG Hospital - Faridabad, Shankara Cancer Hospital - Bengaluru, Capital Greens - Delhi, Pearl City Walk - Bhatinda, Wells Fargo India Solutions -Hyderabad & Bengaluru and JSW Toshiba - Chennai

Packaged AC Sytems: Posco - Pune, HCL Technologies - Chennai, Lafarge - Chittorgarh, Lakshmi Diamonds - Surat, Volkswagen - Mumbai

Central AC Products: Gift City - Ahmedabad, SKF Head office - Puna, Sai Fertilizers - Mumbai, Infosys - Bengaluru, SPI - Mysore, CPWD Indian Maritime City - Chennai, Velammal Medical College-Madurai, Metro cash & Carry - Chennai, Aditya Birla Retail Limited - Secundrabad , Renata Pharma - Bangaldesh etc.

Segment II

In the Cooling Products segment, revenue registered a decline of 5% in the quarter, while segment results declined by 47% to Rs 3.78 crores. Quarter 3 is generally a lean season for this business.

Blue Star had a de-growth in the room air-conditioner business this quarter as compared to the same quarter last year. Last year there was an additional trigger of a BEE Table change resulting in panic buying by customers in December 2011 in anticipation of steep price increases by manufacturers which is not there in this year. Our de-growth however was slightly lower than the market de-growth.

The company also witnessed an impact of erosion in margins in Q3FY13. This is due to multiple reasons namely:

A) Sales Volume drop in Room AC category for reasons explained above.

B) Losses in the business of sourcing and selling of installation accessories such as copper pipes, Refrigerant and insulation material, which has been subjected to high commodity price fluctuations. This has adversely affected segment results. As explained last quarter, this business is expected to be wound up by March 2013.

C) Dropping operating margins in the refrigeration products business. You may be aware that we had invested in a new factory in Ahmedabad in H1FY13. Excess manufacturing capacity and its related overheads have resulted in lower operating profits in this business. This is expected to be reversed as we sequentially load the factory for the upcoming summer.

The Capital Employed in Segment 2 reduced from Rs 237 crores as on September 30, 2012 to Rs 216 crores as on December 31, 2012.

Going forward the Company expects the budget stimulants, its plans of Channel expansion and a focus on the light commercial segment to help it achieve a slender growth in FY13.

Some of the major orders won by Blue Star during the quarter in Segment 2 are:

RAC : SRM University - Delhi, ISB - Hyderabad, (c) IL& FS - Hyderabad, Sriram Housing - Vizag, Mphsis - Bengaluru, Hindalco - Raipur.

Refrigeration Systems and Products: Dr.Reddy's, Biocon, Mylan Pharma, Dominos, YUM international, Mc Donalds, AMUL, Vadilal, Mother Dairy etc.

Segment III

In the Professional Electronics and Industrial Systems segment, the revenues reduced by 9%, while segment results declined 18% to Rs 9.56 crores in the quarter, owing to the unfavourable business climate and declining demand in the capital goods sector.

As you are aware, Segment III consists mainly of three components namely a) Agency business, b) System Integration business and c) Industrial Projects business.

As explained earlier, the Agency business in Q3FY13 continued to be lower vis-a-vis Q3FY12 due to the impact of a strengthening dollar. We have de-grown by around 10% in this business.

The System Integration business is doing reasonably well and showing some growth.

The order inflow for the industrial Projects business has reduced significantly on account of bleak demand in core metallurgical, Oil & Gas and Power industries . This has led to lower billing and with sitting costs remaining intact, the profitability is substantially down. Unfortunately the situation is expected to continue for next 2 - 3 quarters. However, the company is confident that with its good customer base namely SAIL, RINL, JSPL, Tata Steel, etc. and with the industrial capex cycle improving by Q3FY14, the Industrial Projects business should see better business and profitability in H2 next year.

Some of the prestigious orders won by Blue Star in this segment in Q3FY13 were:

Indian Space Research Organization - Bengaluru, IIT - Guwahati, Wipro - Mumbai, Kosei Minda Aluminium - Chennai, Specialise Instruments - Mumbai, Volkswagen - Pune, HDFC Bank - Mumbai

Outlook

The external environment looks extremely sluggish. In such volatile market conditions, the company is making concerted effort to grow the business profitably by focusing on equipment business, executing select big projects with better margins, quickly closing non -profitable legacy jobs, improving sourcing and operational efficiency, carrying out value engineering and cost control measures and bringing down capital employed to desired levels.

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 Renjith Sivaram from B&K Securities. Please go ahead.

Renjith Sivaram What was the order intake during the quarter? How much of that is from Central AC and how much is from packaged and chillers? Also can you break up the order book in terms of mix of low margin jobs, which are close to 0% margin and high margin jobs? Has it improved from last quarter? And finally like if you can quantify the impact of that product segment sourcing and selling installation accessories if we had hived off?

Vir Advani I will try and break it. The order inflow in the current quarter has been lower than Q2, which was expected. But it has been roughly the same level as Q3 of last year. So that is the first point. Second point you asked about was the carry forward order book of Segment-1. I had updated you all in the last quarter that there have been very minor changes in the order book, substantial changes in the overall margin of the order book. Given the number of jobs in the order book, it is difficult to keep the track of aggregate number month to month. So what we do is that we look at it twice a year. We gave the mix at the half year. We will look at it again at the end of the year. The objective as I had mentioned to you is to bring down the number of jobs with zero margin to the extent we can bill them out in the current year. We plan to bill 70% zero margin business during the year. So we will still be carrying part of it. It is not as good as we would want but it is better than what is happening in the market. Finally you had asked a third question, which is what is the impact of our spare parts marketing business that we have decided to shut down. I would request Thyag to answer it.

B. Thiagarajan It is around Rs.1.6 crore of loss we booked this quarter. Cumulative so far it would have been around Rs.5 crore primarily out of copper price, insulation material as well as refrigerants.

Renjith Sivaram And is there anything remaining in the fourth quarter or is it completely off?

B. Thiagarajan Probably around Rs,75 lacs to Rs.1 crore may be in the worst cast scenario.

Moderator Thank you. The next question is from the line of Anant Narayana from Kotak Mahindra. Please go ahead.

Anant Narayana What will be the present debt levels? It was around Rs.418 crore I think in September?

Vir Advani Yes, so as of December the debt is up by about 40 to 50 crore.

Anant Narayana So it will be at around Rs.450-460 crore.

Vir Advani In the middle of the year we had talked about bringing the debt down to about Rs.350 crore by March 2013 which was the same level as March of 2012. While the internal target continues to be that I think we are signaling more closely to around Rs.400 crore by year end.

Anant Narayana And Sir how is the performance of the subsidiary Blue Star Electromechanical, if you can give us some numbers?

Vir Advani I do not have those numbers here but essentially it is running in line with the parent business. Like I had mentioned to you we had got to that order book after we had finished the parent company order book. So what we are seeing is margin reversals in that business similar to the ones we had seen in the parent company over the last few quarters. So we will have another year of loss in that business in FY13. We will have a better idea of it by the end of the year. We are expecting that once we do this from next year we will break even and be positive.

Anant Narayana Any plans to merge Blue Star Electromechanical into Blue Star?

Vir Advani No, we have no such plans.

Anant Narayana And sir just one last question, what is the hedging policy presently? Do we hedge 100%?

Vir Advani Our policy falls for a minimum hedge of 50% and also has an upper limit of an amount of dollars one can have un-hedged. But what we are running at right now is about 80% to 85% cover.

Moderator Thank you. The next question is from the line of Prerna Jhavar from Emkay Global. Please go ahead.

Prerna Jhavar Is there any FX component in the interest cost?

Vir Advani You mean in the finance cost?

Prerna Jhavar Yes.

Vir Advani So the finance cost line has both interest cost as well as the impact on our foreign exchange borrowing. It is the summation of the two typically and that is how it usually is. And about 50% of the finance cost will be borrowing interest cost and about 50% of it will be the exchange difference on our borrowings.

Prerna Jhavar And how was that in H1 sir?

Vir Advani For the half year, our finance cost was about Rs.24 crore. About Rs.13 crore of it was interest and about Rs.11 crore was the exchange difference on borrowing. In this current quarter, Rs.7 crore is interest and bank charges and another Rs.7 crore is the exchange difference. So it is running roughly the same.

Prerna Jhavar And sir just wanted to know of the spare parts business which you are winding up, what was the revenue that we recorded YTD?

B. Thiagarajan Roughly around Rs.35 crore.

Prerna Jhavar And how is this in FY12?

B. Thiagarajan It would have been roughly doubled last year.

Moderator Thank you. The next question is from the line of Prashant Talwar from Saif Partners. Please go ahead.

Prashant Talwar Wanted to know from you the split of Segment-1 order book, in terms of site margins less than 5%, 5% to 7% and greater than 7%. And also if you could give me a split of margins between Segment-2, between commercial air-conditioning, room air-conditioning and other cooling products?

Vir Advani I am sorry I do not think we break up all of this like this. What I have been explaining is the carry forward margin on Segment-1. Segment 2 to break it up into margins is difficult but let me try and go back to this carry forward of Segment-1. We are talking about last year's clean order inflow was about Rs.900 crore and this year we are running at a lower rate. I think if I am correct about a Rs.100 crore would be a zero margin business. About Rs.300-400 crore would be at about 5% and the remaining would be between 7% and

12% depending on nature of business and when it was booked. So that ratio is changing as we execute this order book. What I mentioned is we are aiming to get down to zero of zero margin business carry forward by March 2013. We will be a little short of that but we will get pretty close to that. Next is we wanted to bring down that Rs.300-400 crore of 5% business at a much faster pace. We have not been able to do as successfully because of the capital employed impact associated as these are sort of slow moving, non moving jobs. So that we will still be carrying forward into next year, some amount of that. As far as the clean business is concerned we had hoped to bill much faster as you know. You can see from the results that we are struggling to bill at the rate we want to and more importantly the capital employed is actually increasing in Segment-1 quarter on quarter, it is primarily because the inflow of cash has been slow in spite of executing the running jobs. So we are continuing to manage the billing in line with the capital employed and in Q4 our intention is to bring down Segment-1 capital employed quite substantially and therefore there will be some impact on the overall billing for the quarter. So that is what I can tell you on the Segment-1 carry forward. I think in the half year I mentioned to you that our aim was to close about 650 jobs. I think we had closed about 270 jobs mid-year. I am revising that 650 to about 600 jobs. We are on track to do that and so we should get to about 600 jobs this year.

Prashant Talwar Sir any guidance on margins of Segment-2 between room air-conditioners and the commercial air-conditioners?

Vir Advani No, first of all Segment-2 is made up of two types of businesses as room air-conditioner business and there is a refrigeration products business. We actually do not break out the margins separately for each of the businesses. But what I explained to you is that the one is Q3 itself is always a slow quarter so that goes without saying. But really this quarter we had lower than expected operating margin largely on account of the room air-conditioner business. I will repeat one reason is that in December 2011, which is last year, there was a big push for room air-conditioners into the market because there was a BEE table change that came into effect on 1st January 2012. So we did quite a bit of billing in December of 2011, which we did not do in December 2012 because the table does not change this year. So obviously you will understand that the lower the billing in that business the lower will be the operating margin. So that was one reason. The other reason for the lower operating profit in Segment-2, again we explained was these spare parts marketing business where we had, Rs1.5-2 crore correction in the margin in this quarter, which was not there in December 2011. The refrigeration products business continues to do relatively well, margins seems to be on track and there does not seem to be any significant issue in that business other than there is an increasing amount of competition in that business with new multinationals coming in and price realization is going to be a challenge for us going forward. So as we enter the summer season we are going to watch our refrigeration products, business margins quite carefully because we have to stay competitive in the market. So on an overall basis for the quarter it was a room air-conditioner volume push and it was the spare parts marketing business both that led to this lower than expected contribution.

Moderator Thank you. The next question is from Chirag Setalvad from HDFC Mutual Fund. Please go ahead.

Chirag Setalvad You mentioned in the past that in the projects business you are bidding at 12% site level margins and 7% at about EBIT margins. I wanted to understand does that include the services component in this business or does it exclude it?

Vir Advani So when we say site margins we are typically talking about the sale margin which will include the site margin plus any equipment margins associated with that project to the extent that there are any pre-negotiated service contracts that are finalized at the time of bidding or finalization. To that extent, the service margins will be included but those are sort of 1 in 10 contracts will get finalized with pre-negotiated rates. So by and large it does not include the service component.

Chirag Setalvad And it would exclude the historical services component.

Vir Advani Yes, it would definitely.

Chirag Setalvad And approximately what will be the breakup of this Rs.1600 crore order book between projects and products?

Vir Advani Projects is about 80% and about 20% would be the product.

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

Nitin Bhasin If I look at your Segment-1 revenues, you are marginally up from the last year and your margins have also improved materially. Now when you look at three quarters now and given that you are saying that you are choosing projects very selectively, where do we see the next 12 months? Let us say FY14. Can they be relatively trend wise better margins from what you have booked till now?

Vir Advani Yes, the issue is a little different. The gross margins are definitely higher which is reflected. The problem for us is the operating margin, which right now is looking better than last year obviously, but it is not a like-to-like comparison. On a standalone basis for the Segment-1, margin of 4-5% is obviously not acceptable to us given the capital levels that are required for the business. So really the challenge for us going to next year is how do we cut our cost substantially in Segment-1 because I am not expecting a significant revenue growth at all. So you can see from the carry forward order book that there is no real improvement. I still am a little hopeful that in Q4 we will be successful on some large business but again it is a touch and go. So while I continue to be hopeful that some business will get finalized, you can see from the order book levels that the order book will not support a revenue growth in Segment-1. And so if I presume that revenue is going to be flat and we have to do better than we are doing currently, we are going to have to cut cost substantially. If we do not cut cost then actually what will end up happening is that the operating margin in Segment-1 will drop next year versus current year and obviously even the current year levels are not acceptable to us.

Nitin Bhasin Just staying on this, I get your point that it is not acceptable because considering the very good past, whether it is FY10 or FY11, how much is the cost reduction? Because at one point in time you said that you want to reduce your cost by about 20% but you are seeing a better visibility in the system so you held back. Now again you are saying that the visibility is not that great. So just assuming that the top-line remains broadly here and there in terms of plus-minus 5% and you are able to achieve because you are cognizant of the fact that there is an issue in the system you will be cutting down some costs. So on a trend level if this 7.5% which we see in the 9-months till now it will definitely look closer to 100-150 bps, at least better, because you are executing the orders of past which are at lower margins and you are now booking 12% gross margins as you said. So definitely the trend is upwards, the intensity of the trend could be very different from here on. Is that right way to summarize it that you can close it to 6.5-7% if system remains what it is today?

Vir Advani Yes, so I will just clarify. You know we have been signaling that Segment-1 operating margin will be in that 4% range. I know YTD is still looking better. But I am still cautious about the year- end figures because we are trying to close out some zero margin business very aggressively which we are not able to. There will be a dip in the year end margin. So keeping that in mind I would say that whatever we close this year you should see an improvement next year between cost cutting and the general improvement in the gross margin certainly. But it is very far to see 7% and 9% in all as of now. We will have to work on that.

Nitin Bhasin But definitely better. That is one thing. The other thing is in the second segment business, in one of the press articles it was mentioned by Mr. Thiagarajan that they are expecting that if a market grows at 15%, you are expecting kind of a 9% market share. If we can have some color on that, how do you intend to achieve that? Second, there was a comment in the same article that market is witnessing a growth of 15% to 17% whereas earlier in the call you said that the market is declining by a closure to 5%-10%. So if you could have some sense on this?

B. Thiagarajan For past two consecutive years, when the market was growing, we grew around 5% more than the market. This time while the market has degrown by around 5% or so, our decline by the end of the year would not be that much at all. So as far as the next year is concerned it is dependent on two important aspects. One is how severe the summer will be. Two, the power situation across the country, which as of now is very pathetic. But everyone in the industry agrees around 15% growth. The feeling that we are still around 3.4 million to give you a sense, China's market size is 50 million. So 3.4 million to 50 million you can imagine. Both the countries more or less are keeping pace with each other in terms of the market growth. In this category there is a huge penetration gap. And as far as we are concerned the products are ready, range is complete, distribution network expansion is happening and we are investing in other marketing activities including advertising. We should grow if the market is growing by 15%. So this is the context of that announcement.

Nitin Bhasin So if the market grows by 15% you expect to grow at 20-25%.

B. Thiagarajan May not be. As of now all that we are saying is that we will grow in line with the market. I am not committing about it because this gain is all about their four months performance which determines the rest of the year. You have a very little room for correcting it later. The price points must be known. So what actually happens is that if the market is not going to open up the people will become desperate and distraught then you should be able to alter the prices and this is the game actually. Right now I will not commit that we will grow better than the market. Our growth should be in line with the market.

Nitin Bhasin In the same article you said that the market is witnessing a growth. Is there any kind of a growth in the December month or any other time?

B. Thiagarajan The festival season has been reasonably good but not like last year, so the confusion is this right. Why it is not growing like last year? Last year is a different thing altogether. That is December you have to get rid of all the stock across all the manufacturers, so it has to be a primary movement that will be taking place in the market. So right now the festival season has been good. I would say among all the segments like we generally divide as the large commercial space than medium space like shops, showrooms, boutiques and the third one is residential. Residential is doing reasonably well despite this economy.

Nitin Bhasin In Segment-3, typically you have done margins in excess of 20% at PBIT level. Only one quarter, which was Q2, you had a very poor margin about 7-8%. Now you have come back again to 20% or so, on a reduced scale of business as well. So do you think this margin is kind of going to be stable at this level now? There was a one-off thing which was in Q2 and hence you lost margins over there, a reduced scale of business also because you mentioned earlier in the call that third quarter is where you see some inflows now.

Vir Advani First of all we believe that our steady state margin in Segment-3 is north of 25%. This entire year we have had lower than that, I think it was 22% in Q4 of last year, 23% in Q1, it dropped to 7.5% in Q2 and it is up to 20.3% in Q3. This is all below what it needs to be. Now it is on account of a few things. So Q2 itself was a one-off event, we explained it to you saying that it was in the industrial projects business where we had an issue. That has been taken care of. There are three parts of this business. There is an agency business, there is a system integration business, and there is a projects business. The agency business in FY13 is running about 10% lower than the prior years because this dollar moved up and all the budgets as you know were finalized at the beginning of the year at a different dollar rate. So there is still a lot of scrambling going on to get reissued all of that. The system integration business which is mid-sized CAPEX investment for industrial customers is growing at single-digit type of volume. The industrial projects business which is about a third of its business is severely impacted. So what you are seeing in Q3 at about 20% is a muted industrial projects business and a (-10) to 0 sort of growth in the other parts of the business. As we pick up order inflow in the projects business by H2 of next year you will see the margins in this business climbing back to 25% plus. So in the interim we are going to have this level of margin, around 20% or so because we are catching up on that but you are not going to see it. It is unlikely that it will drop to this 7-10-15% that we saw last quarter. That is a one-off event.

Nitin Bhasin You mentioned that third quarter is where you expect deep pickup in orders. How do you come to that in terms of where do you see third quarter of FY14?

Vir Advani You are asking about the industrial projects?

Nitin Bhasin Yes.

Vir Advani Honestly it is a year out. I do not have any better sense of that. It is just like the commercial business. We are continuing to have inquiries, we are bidding on, bids are in, and they need to be opened. Opening is getting delayed in the steel, oil & gas, and petrochem industry. I do not know when it is going to lift. We feel it is a year out but it could be shorter, it could be longer. I do not think we are glued in that market to really have a clear judgment on that.

Nitin Bhasin So overall company in terms of growth direction is going to be again single digits to very early double digits unless and until something meaningfully changes for Segment-1 during the course of the year.

Vir Advani Correct.

Moderator Thank you. The next question is from the line of Mahesh Bendre from Quantum Securities. Please go ahead.

Mahesh Bendre Just wanted to understand what is your outlook on order booking next year? Will it be better than this year or may be, still the situation is too tight?

Vir Advani We do not have a clue what is going to happen. I think we are just forecasting projects business, order inflow will continue to be at this kind of level which is quite low. We are still hopeful that the equipment business will continue to see some marginal growth. But we really do not have a good sense. All I know is that our inquiry levels are as high as they were a year ago and as high as they were six months ago. But that does not seem to translate into order inflow and so it is difficult to judge what is going to happen next year.

Mahesh Bendre As a company, do you think worst is behind us? In terms of execution, new order booking and margin?

Vir Advani I believe the worst is behind us in terms of execution and margins. Order inflow, I am still a little cautious because this year our order inflow will perhaps be the lowest it has been in maybe four years and we are not changing our strategy on order inflow. So if the conditions continue like this or get worse then we may see further pressure going to next year on order inflow. So that is the only metric I am not sure where it will end.

Mahesh Bendre And Sir the order book we have, that is Rs.1600 crore what portion will be getting executed over the next 12 to 15 months?

Vir Advani Typically this order book is about a 2-year cycle and so I suppose about a half of it will get executed next year.

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

Nirav Vasa Sir I just wanted to know one thing. Now that you are targeting to get orders with minimum 12% site margin, so what are the competitive levels that you are seeing right now in the industry per se? Because what my understanding is that there are many regional players in this business who are ready to work at lower margins. So are they still ready to work at lower margins or they also are bidding with higher prices?

Vir Advani No, there are definitely small contractors, regional and even present in certain cities, that are usually willing to work at lower margins and on different commercial terms, etc. So I do not think that is going away anytime. I do not think they are raising their prices necessarily. What we are seeing is that there is a certain size of project above which the customer does not want to take a risk with smaller contractors. So they will not consider those contractors in such projects or there may be cases where customers do give larger projects to these contractors in which case we have little choice but to wait out for the execution of the contract and let the customer experience the difference between small contractor and an organized contractor. So I would say that they are very much there. They continue to be a threat. That is part of the reason why order inflow is slow. But we have to live with them. I think our only way forward is to differentiate on engineering, on execution, which is what we are doing.

Nirav Vasa So effectively if I take this conversation forward and what my understanding is that going forward in the next year, the order inflow which is expected to come could be mainly from the quality orders wherein the ticket size would be higher, where the competition of the smaller players would be limited.

Vir Advani That is right, Yes absolutely right.

Nirav Vasa So you are trying to reduce your project sites and concentrate more on high value projects.

Vir Advani Absolutely, correct.

Nirav Vasa Sir if you are concentrating in these higher value projects then the competition from the mid-tier segment players would be equally ferocious. As per my understanding because they also have burned their fingers in the project business because of delays and commodity hikes. So are you sensing that competition from these mid-sized players to be equally intensive?

Vir Advani We are booking business; it is not that we are booking nothing. So the fact that we are booking business or be it at a lower volume implies that at this kind of pricing there are customers who want to give you the work and there are also competitors who are taking business away from our similar level of pricing. So I will have to imagine that the larger MEP players are quoting more reasonable rates just like we are and I think definitely over the last 15 months or so there has been some kind of rationalization of pricing in the market, of course above a certain value. Below a certain value it is like we mentioned smaller players operating at a different cost base and competing.

Moderator Thank you. The next question is from the line of Hairsh Bihani from CIMB. Please go ahead.

Harish Bihani My question is on Segment-1 and 2. Given the issues whatever we have seen in the last 1.5 to 2 years, can you highlight some of the cyclical issues which we are facing at this point of time or near-term issues, and some issues which are structural in nature?

Vir Advani From a cyclical point of view we are in the middle of a building cycle that we are stuck in. Commercial real estate is at a certain point in most markets. When that cycle will turn and when business will keep up again we keep guessing and anticipating and unfortunately I have never been able to judge it. So I am not in a position to really forecast out what is going to happen. Commercial real estate is clearly in a particular cycle as it is. Structurally I think commodity pricing is in somewhat of a cycle we are seeing. We have seen for the last 6 to 8 months some stabilization of commodity pricing, of course the dollar has misbehaved but commodities have largely behaved. Again I do not know what is going to happen with commodities as we go forward. So as a business there are two cycles we are dealing with – one is the commercial real estate demand cycle and the other is the commodity price cycles which are the two challenges for us. From a structural point of view on the project side two clear differences – one is we moved into the electromechanical space instead of just the HVAC space. So I have some of our competitors and so there are certain number of MEP contractors in the market that are competing for mid-size, large-size projects which in turn has created a space for smaller local contractors to operate in single service smaller projects and so that is a structural change that we are not anticipating, will go away anywhere anytime soon. It has created some more space for the smaller contractors who are willing to work on terms and conditions that some of us are not willing to work on. That is on the project side. On the equipment side, different challenges. Segment-2, large structural change is the entry of multinationals into the business continuing to increase. We have got large number of formidable players, Japanese, American, European not just Chinese, Korean which typically we have been able to manage. These are technology heavy-weights who are competing very aggressively in the market, whether it is our room air-conditioner business or our refrigeration products business, etc. So that is a definite structural change. Many of these markets had between 5 to 10 competitors sometime ago. Today there are 15-plus competitors in each of these markets so it has a different set of challenges for the company. The other structural change in that business has been the energy efficiency and the refrigeration related changes. These are all permanent in nature. Energy efficiency norms will keep getting more stringent. Refrigerants that are anti-environment will keep getting phased out and so for structural changes that unless you own your own technology or your own R&D, your own ability to bring products to the market there is very little place for you in the market and so we have been gearing for that for the last 3 or 4 years and are quite confident of addressing this structural change in the industry. So it is a big question that I have tried to answer very quickly but I hope you get a sense of it.

Harish Bihani Another question could be in terms of your advances from customers or your working capital requirement. Advances have gone down and working capital has increased and looks like some of this is structural in nature rather than cyclical. Can you conquer on this particular fact, one and secondly in your annual report you had highlighted a clear focus on cash flow and how it is going to trend in FY13. If you can talk a little bit about cash flow and how it will shape up by FY13 and going forward in FY14?

Vir Advani So the working capital requirements are not structural in our opinion, they are cyclical. Advances being lower are hopefully cyclical and not permanent; if it is permanent then we do not really have a business. So I am presuming that as market picks up you will see advances improving but advances only contribute partially to your working capital, it is not a big component. Real issue with working capital is collecting your money that is rightfully, legally due from your customers and again I am an optimist. So I presume that the interest rate issue in the country will not last forever. I therefore presume that the liquidity crunch that exists in this market today will not continue and so contractually we are due large sums of money. Practically it is not payable by customers for reasons we all know. I continue to believe it is a cyclical issue and not a structural issue. Obviously finding the right clients to work with and working with them properly and tightening up our own ship and all that is very critical and we are doing that but other than that I think the issue is cyclical, that is point #1. The other one you asked is on the capital employed for the company, we continue to be obsessed about capital employed. Unfortunately quarter-to-quarter the capital employed in the company is actually deteriorating instead of improving. Our intention like I had mentioned was actually to land up at the same level as the end of last year which I am now revising marginally and saying that we may not achieve that goal, it may be about Rs.50 crore higher than last year. We of course still intend to try and get to last year level if we can but like I said there is a trade-off between billing and capital employed and we feel that with the quality of customers improving slowly, your capital being with better quality customers there is some risk we have to take. So we are taking that risk carefully. But I think for the year it will continue to be a challenge. I am hoping that there will be some changes that will be announced over the next year and the next couple of months between now and the budget that will help ease some of this liquidity and if it does then you will see this capital employed come down. And may be what we will choose to then do is strategically bill some more because if it is with safe customers then we rather be billing and collecting our money after sometime and keeping it in the bank. So that is where we are on the capital employed.

Moderator Ladies and gentlemen due to time constraints no further questions can be taken. I would now like to hand over the floor back to Mr. Vir Advani for closing comments.

Vir Advani Thank you very much. Thanks for taking the time to sit in on this call. If there are any questions we are unable to answer, please send us an email and we will do our best to respond otherwise we will be speaking to at the end of the year once the financial results are out.

Moderator Thank you. On behalf of Blue Star that concludes this conference.