"Blue Star Limited Q2 FY-'16 Earnings Conference Call"

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MANAGEMENT: **MR. VIR ADVANI – EXECUTIVE DIRECTOR AND PRESIDENT, ELECTRO MECHANICAL PROJECTS BUSINESS**
MR. B. THIAGARAJAN – EXECUTIVE DIRECTOR AND PRESIDENT, AIR CONDITIONING AND REFRIGERATION PRODUCTS BUSINESS

Moderator: Good day, ladies and gentlemen and welcome to the Blue Star Limited Q2 FY-'16 Earnings Conference Call. We have with us today from the management, Mr. Vir Advani – ED and President – Electro Mechanical Projects Business and Mr. B. Thiagarajan – ED and President, Air Conditioning 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 this 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, Sir.

Vir Advani: Good morning ladies and gentlemen, this is Vir Advani. I have with me Mr B Thiagarajan and we will be giving you an overview of the results for Blue Star Limited for the quarter ended September 30, 2015.

The following are the financial highlights of the Company for the quarter (Q2FY16) on a standalone basis:

- The Company reported Total Operating Income of Rs 716.66 crores for the quarter ended September 30, 2015, as compared to Rs 642.24 crores in Q2FY15, representing an increase of 12%.

- Operating Profit (PBIDT excluding Exceptional Items and Other Non Operating Income) for the quarter was Rs 27.00 crores as compared to Rs 35.50 crores in Q2FY15. There was erosion in gross profit of about Rs 8 crores across the underlying businesses which resulted in the decrease in profitability. Further, the professional electronics and industrial systems business has been transferred to a separate subsidiary effective April 1, 2015 and hence around Rs 6 crores of operating profit of this business is now accounted in the subsidiary and does not reflect in the standalone results.

- During the quarter, Other Income was Rs 1.97 crores as compared to Rs 2.78 crores during the same period last year.

- Financial Expenses for the quarter declined by 12% to Rs 9.31 crores from Rs 10.57 crores in Q2FY15 owing to a reduction in the cost of funds and flexible management of the borrowing mix.

- There was an exceptional loss of Rs 15.80 crores during the quarter as compared to an exceptional loss of Rs 9.51 crores during Q2FY15. The cost of the voluntary retirement scheme as well as other expenses related to the closure of the Company's manufacturing facility in Thane accounted for the exceptional loss in Q2FY16.

- Consequently, there was a Net Loss of Rs 5.79 crores as compared to a Net Profit of

Rs 9.05 crores in Q2FY15.

- Carry Forward Order Book as on September 30, 2015 increased by 8% to Rs 1604 crores compared to Rs 1492 crores as at September 30, 2014.

- The Total Capital Employed of the Company stood at Rs 1057 crores on September 30, 2015 as compared to Rs 968 crores on September 30, 2014. The net borrowings were up marginally to 375 crores as on September 30, 2015 as compared to Rs 370 crores on September 30, 2014.

Segment-wise results for Q2FY16 are as follows:

- The revenues of the Electro Mechanical Projects and Packaged Airconditioning Systems business, increased by 15%, while segment results registered a decline of 9% to Rs 26.27 crores.

- Cooling Products registered a healthy growth of 19%, while segment results were flat at Rs 14.01 crores. The Company significantly increased its distribution network with about 2250 dealers as compared to 1950 dealers during the same period in the previous year which helped in enhancing revenue.

- The Professional Electronics and Industrial Systems business has been transferred to its subsidiary, Blue Star E&E Ltd with effect from April 1, 2015. The segment revenue and results reported in the Blue Star Limited standalone figures relate to some specific orders that were part of the order pipeline booked in the last financial year and necessitated execution by only Blue Star. The quantum of billing from such orders has been reducing progressively. 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 marginal revenue growth of 1%, while the results declined 24% to Rs 6.34 crores. These combined figures are based on management accounts, and have not been subjected to audit or a limited review by the auditors.

The following are the financial highlights of the Company for the quarter (Q2FY16) on a consolidated basis which has not been subjected to audit or a limited review by the auditors:

- The Total Operating Income was Rs 772.98 crores for the quarter ended September 30, 2015, as compared to Rs 669.66 crores over the same period in the previous year, representing an increase of 15%.

- Profit before Tax and Exceptional Items declined from Rs 17.29 crores in Q2FY15 to Rs 14.90 crores during the quarter under review, representing a decline of 16%.

- Net Profit declined to Rs 2.26 crores from Rs 9.21 crores in Q2FY15.

The following are the financial highlights of the Company for the half year (H1FY16) on a standalone basis:

- For the half-year ended September 30, 2015, the Company reported Total Operating Income of Rs 1625.24 crores, as compared to Rs 1479.85 crores over the same period in the previous year, a growth of 10%.

- Operating Profit (PBIDT excluding Other Non Operating Income) declined marginally by 3% from Rs 95.66 crores to Rs 92.74 crores.

- Net Profit declined 17% to Rs 33.25 crores from Rs 40.06 crores in H1FY15.

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 Q2FY16, this segment registered a revenue growth of 15% to Rs 458.64 crores, while the segment results declined 9% to Rs 26.27 crores as compared to Rs 28.86 crores in Q2FY15. This resulted in a segment margin of 5.7% as compared to 7.2% during the same period last year. The sluggish execution of projects coupled with a higher cost structure, resulted in a decline in operating margins. In addition, the after-sales service business mix led to erosion in gross margins in this business, which is expected to get corrected on an annualized basis. The Capital Employed in this segment decreased from Rs 485 crores as on September 30, 2014 to Rs 446 crores as on September 30, 2015.

The order inflow in Q2FY16 for this segment grew 67% to Rs 561 crores as compared to Rs 335 crores during the same period last year. The carry-forward order book stood at Rs 1554 crores as at September 30, 2015 as compared to Rs 1451 crores as at June 30, 2015, an increase of 7%.

In the electro mechanical projects business, there was an improvement in order inflow in select markets such as Gujarat, Andhra Pradesh, Tamil Nadu and parts of Maharashtra. Segments such as healthcare, malls, power, metro and industrial witnessed enhanced demand during the quarter, while corporates continued to remain cautious on fresh investments. The integrated MEP projects segment gained more traction, especially in segments such as hospitality, healthcare and malls.

In the central plant equipment segment, while the market showed some signs of improvement, especially in Tier 2/3/4 markets, cash flow continued to be a concern coupled with pressure on margins. Segments such as quick service restaurants, healthcare and hospitality contributed to the growth during the quarter.

During the quarter, the VRF segment recorded the fastest growth rate amongst all the categories with growing preference for energy efficient technologies. The demand for air cooled screw chillers with Variable Frequency Drives (VFDs) is also on the rise. While the ducted systems market is on the decline, the Company made deep inroads in the VRF segment with its latest offering, VRF IV Plus, which has met with a positive response in the market place. Blue Star VRF IV Plus 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 voltage fluctuations faced across the country. Blue Star's 4th generation VRF IV Plus has several unique advantages, over and above the requisite features.

Segment II (Cooling Products)

During the quarter, the Cooling Products segment of the Company registered a 19% increase in revenues to Rs 245.56 crores. However, the segment results were flat at Rs 14.01 crores as compared to the same period last year. Q2 is typically a lean season for the cooling products business as the demand declines during this quarter. Segment margins reduced from 6.8% to 5.7% attributed to build up of inventory due to an inconsistent summer season. Further, high competitive price pressures owing to excess inventory of other players adversely impacted price realizations in the market. The Capital Employed as on September 30, 2015 was Rs 207 crores, as compared to Rs 192 crores as on September 30, 2014.

As reported in the previous quarter update, the room airconditioners industry registered a meager growth of 3% in Q1FY16 mainly due to an inconsistent summer disrupted by rains in several parts of the country. However, in Q2FY16, the industry is estimated to have grown by about 10% in terms of primary billing value. However, since Q2 is a lean season and accounts for only about one-sixth of the annual sales, the H1 industry growth is estimated to be about 4%. The festival season in certain parts of the country witnessed good off take due to improving macro economic conditions, although the rural demand continued to be sluggish due to a poor monsoon which has had an adverse impact on the disposable income of this segment.

During the quarter, the room airconditioners business of the Company continued to perform faster than the market growing at 19%. There is a rising preference for inverter ACs and this category now accounts for about 10% of the sales of the industry. In line with the trend of Blue Star performing better in higher energy efficiency products, its inverter share amongst all categories is 15% signifying a higher market share in the inverter segment as compared to its average market share. This is an encouraging trend since the inverter segment is expected to grow exponentially.

In the commercial refrigeration products business, the deep freezers market was sluggish with the hard top chest freezer market declining. However, glass top freezers continued to grow with the expansion of frozen foods and ice cream outlets. The water cooler business witnessed a marginal growth, with an increase in demand for water coolers with purifiers especially from educational institutes. Bottled water dispensers performed well as the Company expanded its distributor and retail presence. The modular cold room market has also shown considerable growth in the ripening segment as well as enhanced demand from the food processing industry. Introduction of the eco-friendly cyclopentane panels during Q1FY16 met with an encouraging response in the market place during the quarter.

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 marginal revenue growth of 1% to Rs 37.03 crores, while the results declined 24% to Rs 6.34 crores. Segment margins decreased from 22.8% to 17.1% during the quarter. Quarterly performance is typically not a good indicator for this business and for the half year ended Sep 30, 2015, this business recorded a 25% growth in revenues to Rs 78.64 crores and 8% growth in results to Rs 13.70 crores. These combined figures are based on management accounts, and have not been subjected to audit or a limited review by the auditors. The margins were adversely impacted due to service tax applicability on the commission income in H1FY16, which was not applicable in H1FY15. Going forward, the business plans to change the business mix towards system integration and trading which will mitigate the impact.

International Business

GCC countries have always been the primary markets for the exports of cooling products. While the construction industry in these countries continues to remain stagnant, with the introduction of additional products complying with new energy regulations in UAE, the international business recorded good growth. Other than the UAE market, there is increased focus on Oman, Qatar and Bahrain where distributors are being appointed for enhancing penetration. The Company has made good progress in SAARC countries such as Bangladesh, Sri Lanka, Maldives and Nepal. There has been a good order inflow for various categories of unitary products as well as applied systems like chillers, air handling units and fan coil units. The Company's recently launched 100% Inverter VRF system, VRF IV Plus, is also planned to be introduced in select international countries. This will find place in commercial, residential and retail segments where diversity to the usage is critical.

In conclusion, the electro mechanical projects business shows a modest revival in order inflow and an improvement in cashflow. The cooling products business continues to perform reasonably well with the residential and light commercial segments contributing significantly to growth in this business. A recent strategic review of Blue Star calls for an enhanced focus on its core businesses of airconditioning, commercial refrigeration, MEP contracting and after-sales service. The Company intends to leverage its brand equity and distribution network to expand its product portfolio beyond airconditoning and refrigeration, for participating in the emerging growth opportunities in the market and will make prudent investments in service delivery, manufacturing and R&D in the next few quarters.

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 question and answer session. We have the first question from the line of Kunal Jagda from Karvy Stock Broking. Please go ahead.

Kunal Jagda: Sir, there is a squeeze in the EBITDA margins. It has fallen from 6% to 4%. What are the reasons for the same and what measures are you taking to correct it?

Vir Advani: There are two primary reasons for it. One is a drop in gross margins across our product line; that is combination of dollar movement and a tough summer. As you are aware, in our Room Air conditioner business, due to build up of inventory in the market, it led to lower price realization. We also had excess inventory and have managed to bring it down over the last three to four months. With regards to our Service business, it is not an issue of cost. It is more to do with the change in business mix which will get regularized by the end of the year. We are not seeing it as a long-term issue. It is estimated for about 8 crores this quarter. There was a subsidiarization of our PE&IS business which we have spoken about for the last two quarters. That business is primarily now in the subsidiary which is not getting consolidated. There is of course some amount of revenue and profit that is still in Blue Star Limited in Q2 because these are old government contracts which needs to be executed in the parent company before new orders are taken in the subsidiary. Our estimate is that between the gross margin pressure of about 8 crores and the subsidiarization of the business which is about 6 crores, there is about 14 crores at the operating level from these things. Subsidiarization is not a concern because it is still a 100% subsidiary of Blue Star. The gross margin issue in the room AC business has been a concern but we expect to end the year operating margin to be at the same level as last year, about 9.5% or 10%. The same will be corrected in H2 because we can already see an improvement in demand. As far as the Service business margin is concerned, like I mentioned, it is just a quarterly issue and will be settled out in a year. So I think that Q2 is not representative of the overall year that we are looking at.

Kunal Jagda: With an aggressive competition in the market, are you looking forward to any price cuts in your product business?

B. Thiagarajan: I do not think so. It was true in Q2 because post summer everybody had huge stocks. But my sense is that with the festival season performing well, the price cutting should go away. Also for the next season, people will line up their new products and hence I do not foresee the price cut at all at this point of a time.

Moderator: Thank you. Next question is from the line of Gaurav Sanghvi from Bajaj Alliance. Please go ahead.

Gaurav Sanghvi: Sir, my question is on the Room AC segment. What is your view on the segment now as you mentioned there was high competition intensity in Q2? What is your outlook on the margins, whether the discount levels have come down or still it remains high?

B. Thiagarajan: The festival season is one indication wherein the demand is good and I do not expect any more discounts. If the demand is good, inventories are not high. On the other hand, there is rupee depreciation due to which the cost would have gone up. Also the commodity prices have come down. China imports may be attractive which partially neutralizes this particular factor. So my guess is that there should not be any price war in the market place in the coming months.

Gaurav Sanghvi: So is it right to assume that the inventory situation is now corrected?

B. Thiagarajan: I can only talk about Blue Star and we got it under control in September itself. The information that I have got is the industry as a whole has got it more or less under control.

Gaurav Sanghvi: Okay. And Sir, what is our market share vis-à-vis last year for Room AC?

B. Thiagarajan: It would have gone up by 0.5% to 10% now as against 9.5% during same period last year. Our goal for this year is to reach 10.5%.

Gaurav Sanghvi: As we mentioned in the call, we also plan to add some products in the cooling product segment. Request you to please highlight the company strategy on new product addition?

B. Thiagarajan: You will have to wait for the formal announcement. We keep evaluating the adjacencies to our core business and certain discussions will be taken. It is too early for me to say anything now.

Gaurav Sanghvi: Okay. And Sir overall how is the competitive intensity in the Room AC segment. Do you think intensity has come down vis-à-vis Q1? Because in Q1, intensity was very high wherein companies were offering high discounts and credit periods. Are those things restored or still the intensity remains high?

B. Thiagarajan: This is an extension to your earlier question. The fact of the matter is that whosoever was supposed to be in the marketplace, whether it was Japanese, Korean, all of them have been here. And so it is not that we are going to expect some new entrant to come in at all. Second, it is a question of demand versus supply. Since summer was not good, it led to higher inventory and price wars. Like any other consumer durable product, season to season it will differ. But from our point of view, we are optimistic about the restoration of margins and growth in the coming quarters.

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

Ankit Fitkariwala: Sir, my question is with regards to Segment-II. You said that the Inverter market share is 15% for yourself compared to 10% overall. Can you give a sense as to what is the trend that you are seeing in the Inverter sales? Where do you expect it to go in the next one - two years as the price difference between a normal Split AC and an Inverter AC is quite huge, about 8K to 10K?

B. Thiagarajan: An Inverter AC is a higher energy efficiency air conditioner compared to 5 Star. As you are aware, the star ratings are from one to five. Now inverter air conditioners were not labeled till now but have come under voluntary labeling. The formal mandatory labeling will be from 1st January 2018. So in the build-up to that, all the manufacturers will start launching the Inverter air conditioner because at some point of time the current five star will become a three star. Now in this particular scenario, you should also keep in mind that 100% of the Room air conditioners sold in Japan are inverter ACs. In China, it is close to 60%. In India, it is around 10% now and our estimate is that by 2018 minimum 30% will be inverters. In fact, people expect that even 50% of the air conditioners sold will be Inverter as already 5-Star contributes around 25%. The good news for Blue Star is that our share of Inverter has been growing faster than the market. Are we well prepared? Yes, we are well prepared.

Ankit Fitkariwala: When you say that Inverter ACs are the next thing that will be there, what I am trying to understand is that since for a normal split AC and Inverter AC the main difference is an Inverter component and that is what the increase in cost is. Are those components also indigenously manufactured in India by anybody or everybody is still importing that component?

B. Thiagarajan: It is imported and for the matter compressors and plastics get imported in large quantities. So overall somewhere around the 60% of the total cost is import content.

Ankit Fitkariwala: And lastly, can you give a bit of trend on the VRF? Correct me if I am wrong, VRF is getting integrated with Inverter ACs and it is becoming more efficient. So what is that?

B. Thiagarajan: There is nothing like that. Room air conditioner Inverter is nothing but a compressor which runs with the current is converted from AC to DC and that is why it is called Inverter there. Now coming to VRF System – the Refrigeration flow is controlled and there were two types of VRF Systems, one using digital compressors and other using Inverter compressors . So today, the VRF Systems are with Inverters. Hence the digital things are slowing getting phased out. In fact I do not thing digital will exist at all. When you refer to VRF System, it will be only Inverter based VRF System. Blue Star has introduced a VRF System which has got 100% Inverters. Many other VRF System in the country are analog system or a normal system combined with the inverter. So here we have a 100% Inverter VRF System.

Ankit Fitkariwala: So whatever Blue Star is selling currently is 100% Inverter Systems only?

B. Thiagarajan: That is right.

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

Renjith Sivaram: In the Cooling Product division, how much would be the growth if you are able to adjust for the dealer addition?

B. Thiagarajan: In the Restaurant business, they measure the consumption per person. With an increase in the customers, their revenue goes up. So when we are adding the dealers, you can understand that it will grow slowly. There will be dealers whose volume may have come down or gone up. But I can tell you that the average number of machines sold by the dealer may have gone up which is one measure that we have got. Also per dealer productivity has gone up in Northern region now. Because if you recollect, we have stated that there are certain markets where we have been doing badly and we want to accelerate in that particular market viz Northern region market. Other than that I do not have any other figure.

Renjith Sivaram: So for the primary market what would have been the industry growth for this quarter?

B. Thiagarajan: So in value terms, the industry growth is 9% and our growth is 19%.

Renjith Sivaram: And Sir, there have been some legacy projects in the Project segment which we have been talking about. Are we completely done with that or is there anything still left in the Legacy projects part?

Vir Advani: Yes, we had opened the year with about 30 crores worth of Legacy projects, some 20 project - 25 projects. Not too many of those were closed in Q2. In Q4 we will close 100% of that.

Renjith Sivaram: When we see Q1and Q2 numbers, our other unallocable expenditure has been on the higher side. Is there anything exceptional out there? Will it come down going forward?

Vir Advani: It is primarily due to the marketing and promotion related expenses. We have stated here that there are many developmental expenses across the company and we will accelerate it.

Renjith Sivaram: In the exceptional items, you told that it consists of two components, one is the VRF related expense and other is the closing of factory. So can you help us in giving a break-up of that?

B. Thiagarajan: It is mostly VRF, 15 crores is VRF.

Renjith Sivaram: Will it recur for the next two quarters?

B. Thiagarajan: It will not.

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

Ravi Swaminathan: My question is on the first segment. Currently, from which segments are we seeing traction in terms of order inflow?

Vir Advani: I had mentioned that order inflow has been quite strong. It has grown 67% for the quarter. This growth is more to do with our focus on booking new business as compared to a general improvement in the market because if you remember that for the last two years we have been saying that we are very cautious about booking any new orders until we get the legacy projects under control. Now that has passed, though we still have a little bit to go. But bulk of the work is passed and hence we are more active in the markets. We are gaining market share and returning to our normal levels, that is one side of the story. The market itself continues to be sluggish. I do not think there has been much growth in H1, in terms of order finalizations as compared to last year at industry level. Wherever there is a finalization, it is not in infrastructure segment. It is primarily in light industrial. On the commercial real estate side, Bangalore and Pune are probably the only two markets which are showing some activity.

Ravi Swaminathan: Okay. And what will be typical ticket size of these orders, Sir?

Vir Advani: In H1, most of our projects have been in the range of Rs 20- 30 crores.

Ravi Swaminathan: Would we see higher competition coming in the projects with this particular ticket size? Given the fact that there are 'n' numbers of players in the market giving separate E&P services?

Vir Advani: Yes. So we are focusing on standalone HVAC and integrated MEP projects, which are the two main parts of the market. We operate the segment wherein we are very competitive. The standalone E& P ends up with local contractors. So we tend to stay away from those projects. Having said that, we are seeing market move significantly to MEP. So now if a project is say, anything about 40 crores to 50 crores in size, most likely it will be bundled MEP. The larger projects are yet to be finalized. I think with the recent reduction in the interest rate, we should see some improvement in H2 order inflow as well as order finalization. So as far as big picture of Segment-I is concerned, what I have been saying for the last few years, is that there are two early indicators of the recovery in that market – one is order inflow and the other is cash flow. Now order inflow has improved for us but not for the overall market in general. Cash flow has improved substantially, both for us and in the market. What is yet to happen of course is a pick-up in the execution cycle time. So that continues to be relatively slow and we are yet to see that happen. We expect H2 order inflow to increase substantially and in next year it should be more towards normalized execution pace.

Ravi Swaminathan: When you sense Infra segment, are metro and airport projects picking up?

Vir Advani: We are seeing some tenders now. So maybe a year to 15 months from now, we should see part of the market pick-up. But we will see commercial pick-up before infra as far as timing is concerned.

Ravi Swaminathan: In Cooling Product segment, what would be the ultimate market share that you would be looking at say three years from now?

B. Thiagarajan: We will be very happy if we are somewhere around 12.5% to 13%.

Moderator: Thank you. Next question is from the line of Mahesh Bendre from Way 2 Wealth. Please go ahead.

Mahesh Bendre: Sir, few days' back you informed that Blue Star has entered into JV for MEP business in Oman. So what is your outlook in terms of investment and business opportunity over the next two years - three years?

Vir Advani: We have formed a JV with W. J. Towell, a leading Omani conglomerate for executing MEP projects in Oman. W. J. Towell has already been running an MEP business called Oman Electro-Mechanical Contracting Company in which we have acquired a 51% stake. We will take over its management. The JV company is to be called Blue Star Oman Electro-Mechanical Company and it is starting with an order book of approximately Rs 150 crores. We intend to scale this to 500 crore business in the coming few years. This move is actually a part of our larger strategy of building a large international footprint for Blue Star, for both MEP business as well as for our product exports. We have just completed the transaction on Thursday and will be sending out a formal press release later today. Maybe in the next call we will be able to give you some more information. But in essence, we are now managing and running MEP business in Oman although there are challenges in construction in the Gulf. We see it as a very exciting opportunity given the partner with whom we have form this JV.

Mahesh Bendre: Sure. And Sir, On the Project side we have an order book of 1,492 crores. So out of this how many orders will be older two years?

Vir Advani: About 70% of the order book as on today would be within the last two years and about 30% of that would be prior to that.

Mahesh Bendre: Last question on the Room Air Conditioner business. We have increased our distribution network by around 15%. E-commerce has also become additional channel for us. Our products are quite visible on Flipkart and Snapdeal. So how do you see the sales from these platforms going forward?

B. Thiagarajan: We have made a beginning on E-commerce platforms. The question today is that the value proposition is based on price. We are not tuned to that all, in the sense that we can dramatically increase the market share by dropping the prices. Hence we would like to have our brand positioning very clear there. For the value of the brand and product features we should command certain premium in the normal channels. We are looking for the same kind of premium on the e-commerce portals as well. It is quite likely that as the competition intensifies, all our competitors will have to come to terms with this. Today, less than 3% of the durables get sold and the Air Conditioners sold in that channel are less than 1%. It will increase in my opinion and we will pay the game in the same way; that is we are not going to sell on the proposition of the cheap price. Simultaneously, what is also happening is that on our own website you can buy the product. The third is all our big dealers have opened their own portal. So our intention is to stay engaged in that and grow the business.

Mahesh Bendre: Sir, does e-commerce platform offer some benefit to us in terms of reduction in distribution or any other cost?

B. Thiagarajan: To tell you the truth, it is expensive channel for a manufacturer today. The commissions that the operators ask for are very high compared to the physical channels. Then probably the volumes are also low. As the volumes pick-up, probably they will go in for lesser commission. It is not offering any kind of advantage today.

Moderator: Thank you. The next question is from the line of Rabindra Nayak from Dolat Capital. Please go ahead.

Rabindra Nayak: Sir, the order inflow and order book has been very robust for the first segment in this particular quarter. Can you please tell me from which segments have we got the orders? Secondly, is VRF contributing to this in terms of order inflow? And thirdly, the margin guidance for this segment in FY16?

Vir Advani: As far as segments are concerned, I had mentioned the Light Industrial segment has contributed. This is manufacturing facilities where we are executing MEP project. In the Commercial Building market, it is hospitals primarily around the country as well as commercial and IT buildings in Bangalore and Pune. As far as VRF is concerned, order inflow for VRF is also included in Segment-I. We did mention that we have launched our new all inverter products and solutions in the beginning of Q2. So that has started contributing to order inflow as well. As far as the outlook for the segment is concerned, there is an improvement in cash flow but the pace of execution has not improved. That continues to be a concern because as I mentioned for the last few quarters we are carrying an overhead in this business which is primarily related to project sites and engineering procurement construction team. Unless the pace of execution picks-up and our resources get fully utilized, there is going to be pressure on the operating margins of this business. Now with some improvement in the credit position we are hoping that H2 order execution pace will improve. If that execution pace improves, then we should see an operating margin for the year which will be slightly better than the year before. But now, as we have finished October, there is still no significant improvement. It is little early for us to say how the year is going to end. Having said that, looking at the order inflow and enquires, and finalizations that are expected, we expect to return to normal execution cycle by next year. Hence even if the execution pace does not improve; the volume of business will have to increase which will allow us to cover our overheads and return to normal profitability.

Rabindra Nayak: Last year we have reported around 4% EBIT margin. Should we expect an EBIT margin in the similar range?

Vir Advani: Like I said it really depends on execution pick-up in next four to five months. And of course we have to close those legacy projects. But it should be around last year's level if not better.

Rabindra Nayak: Is VRF business bit profitable in the other Product business or we have similar margin?

B. Thiagarajan: It is profitable.

Rabindra Nayak: Regarding the tax rate, will it be at normal tax rate or will it remain at MAT levels?

B. Thiagarajan: It will be in the order of 28% or so by the year end.

Moderator: Thank you. The next question is from the line of Mayur Patel from DSP BlackRock. Please go ahead.

Mayur Patel: Just is it possible to reiterate your commentary on the Room AC business. My question is; a couple of months back we heard a bearish commentary from all the players about a lot of inventory in the system and overall the yearly growth looking more like 0% to 5%. Even Blue Star's commentary few months back was not very bullish. Now I just heard your comment saying that industry witnessed 9% this quarter. So what has changed on the demand side? Is it Dussehra or Festival Season or anything else would you like to comment?

B. Thiagarajan: As far as the concall opening remarks are concerned it will be uploaded on the website and you can go through it. For this particular quarter, due to festival season the demand has picked-up. I think it should be sustained during the rest of the season.

Mayur Patel: And any comments on the inventory levels at the dealers end currently?

B. Thiagarajan: We have completely liquidated inventory from our side as well as our dealers. I can only guess that the competition has also reduced their inventory. I do not have the access to their exact figures.

Mayur Patel: Okay. And what would be the sustainable margin in UCP segment?

B. Thiagarajan: Say anywhere between 9% and 9.5%.

Moderator: Thank you. Next question is from the line of Ashwini Agarwal from Ashmore Investment Advisors. Please go ahead.

Ashwini Agarwal: A couple of questions. In your opening comments you had spoken about the mix of Services and businesses changing that lead to a margin drop. Could you elaborate on that please?

Vir Advani: See in service, we have annual maintenance contract and the other is spare part sales. The third is operating contract and the four is revamp and retrofit. In this particular review period, revamp retrofit business volume was much higher. In revamp retrofit generally the margin levels are lower than the annual maintenance contract. That is what I had referred to in opening remarks.

Ashwini Agarwal: And on the Electronics business which is in the subsidiary, could you give some outlook or some comments on how that business is doing? What do you expect from it?

Vir Advani: The business is doing fine. We had a tough quarter but that is more to do with business mix. We are not concerned on a long-term basis. A lot of our business is to institutions and to government. They get budgets done towards the beginning of the year at an average dollar rate. When the dollar moves away, as it did in Q2, those budgets get thrown out of whack which leaves them to having go back and get revised budget. So that is really what has hit the business in Q2. Now that we have a more stable dollar at these levels, we are expecting those budgets to get improved and business will resume. In general we are seeing strong demand. Had not been for this sudden shift of the dollar, the enquiry levels are much stronger across institutions, government, space research, etc., where we operate. So I think Q3 will be a little muted and Q4 will be much better and outlook for next year is very strong.

Ashwini Agarwal: And last question, on the Segment-I where you started accepting new orders after a couple of years of going slow. I heard all the comments you have made about the outlook on margins. Are the margins much lower than what they use to be two years ago or are they stable? What is your margin profile like for this new business?

Vir Advani: Margins have returned to where they were and should have been at 12%. There is reasonable amount of business still of course. But the volume of that is limited. It has not yet picked-up but clearly we are seeing better margin business and better terms and a little more stable quality of business.

Moderator: Thank you. Ladies and gentlemen due to paucity of time that was the last question. I now hand the conference over to Mr. Vir Advani for his closing comments.

Vir Advani: Thank you very much everyone. Do join us for our next quarter call. I understand that there are some more questions that we had left unanswered, please do send them to us and we will be happy to respond to you. Thanks again and look forward to our Q3 call.

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