Transcript

Conference Call of Blue Star Limited

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Presentation Session

Moderator: Good morning ladies and gentlemen. I'm Shirley, moderator for this conference. Welcome to the conference call of Blue Star Limited. We have with us today Mr. B. Thiagarajan, Executive Vice President of Blue Star Limited. At this moment, all participants are in listen-only mode. Later, we will conduct a question and answer session. At that time, if you have a question, please press * and 1 on your telephone keypad. Please note this conference is recorded. I would now like to hand over the conference to Mr. Thiagarajan.

B. Thiagarajan: Good morning ladies and gentlemen. This is B. Thiagarajan and I will be giving you an overview of the results of Blue Star Limited for the quarter ended June 30, 2008. The following are the financial highlights for the company for the quarter. We reported a total income of Rs.632.54 crores for the quarter ended June 30, 2008, representing 37% growth over the corresponding quarter in the previous year. Net sales for the quarter at Rs.630.89 crores were up by 36% over Q1 of FY08. Gross margin grew from 22.3% to 24.2%. Operating profit, that is, PBDIT excluding other income for the quarter at Rs.57.04 crores was up by 50% as compared to operating profit of Rs.37.92 crores earned in Q1 of FY08. The operating margin increased to 9% in Q1 FY09 compared to 8.2% in Q1 of FY08. Scale, higher price realizations, lower cost of sales and well-controlled expenses contributed to margin improvement. In accordance with accounting standard AS15 revised to 2005 on employee benefits issued by ICAI, the company has re-assessed its liability towards certain employee benefits covered by the standard. The liability on such re-assessment as on June 30 2008 is estimated at Rs.7.46 crores. The same has been included in the employees cost of the quarter ended June 30, 2008. Without this expense, the operating margin is 10.2%. Other income for the quarter was Rs.165 lakhs (It was 7 lakhs in Q1 of FY08) mainly on account of dividend from the associate company Blue Star M&E Engineering, Malaysia. Net profit for the quarter was Rs.36.41 crores, up 63% over net profit of Rs.22.32 crore for Q1 of FY08. The earnings per share, face value of Rs.2 for the quarter was Rs.4.05 as against the EPS of Rs.2.48 in Q1 of FY08. Carry forward order book as on June 30, 2008, increased to Rs. 1410 crores compared to Rs.984 crores as at June 30 2007 representing an increase of 43%. Order inflow during the quarter grew from Rs.687 crores in Q1 of FY08 to Rs.949 crores, an increase of 38%.

I will spend some time on each of our lines of business and give you both financial as well as operating highlights for the quarter. The central airconditioning and packaged airconditioning and electrical contracting business collectively now called Electro Mechanical Projects and Packaged Airconditioning Systems, grew by a healthy 37% during the quarter. Segment results increased by 53% in the quarter compared to corresponding quarter in the previous year.

In the central airconditioning business, over the last few quarters, the company has been witnessing increased demand from new emerging segments such as infrastructure, power, healthcare, and hospitality. Though the sharp price in raw material inputs such as steel and copper have put the margins under pressure, better procurement coupled with value engineering measures and cost control in project management helped to enhance operating margins from 10.15% in Q1 FY08 to 11.3% in Q1 FY09.

In packaged and ducted airconditioning and small chillers, while the IT, ITES and organized retail segment showed some signs of a slowdown, the business witnessed enhanced demand from offices, multiplexes, and eateries. The Company's recently launched eco-friendly range of VRF systems also met with a tremendous response from the market. Blue Star is India's first and only manufacturer of VRF systems and has significant advantages over its foreign counterparts. The Company registered a 270% growth during the quarter in this product category driven by demand from premium residences, offices, hotels, and hospitals.

The newly formed electrical projects business made steady gains during the quarter, booking several orders. After the acquisition of Naseer Electricals in January 2008, the Company has been focusing on rolling out the operations to other regions in the country and cross-selling to its existing central airconditioning customers.

The cooling product segment also registered a good growth of 36% driven by sales of newly launched star rated split airconditioners as well as commercial refrigeration products. Segment results grew by 68% during the quarter. Benefits of scale, higher price realizations due to differentiated products and tax benefits contributed to substantial increase in margins from 10.4% in Q1FY08 to 12.8% in Q1FY09 despite raw materials inputs cost pressures.

During the quarter, despite higher prices of the Company's star rated units vis-à-vis the other non-star rated machines in the market place, the sales of Blue Star split airconditioners outperformed the market growth. In the refrigeration products business, the premium refrigerated display cabinets from ISA, Italy continued to do well. In the cold chain segment, the Company won a prestigious order from a new emerging market for seed storages. This order from Sungrow Seeds, Delhi, includes storage of seeds with composite temperature and humidity control equipment. Blue Star also booked significant integrated pack-house orders.

In the Professional Electronics and Industrial Systems business, over the years, the Company has changed its business model from merely being a distributor of leading global manufactures to that of a system integrator and value-added reseller, thereby moving up the value chain. The Company has executed several turnkey engineering projects in the areas of manufacturing, telecom, healthcare, defense, pharmaceuticals, banking and R&D. During the quarter, all individual SBUs within this business group performed well. While the segment revenue registered a growth of 30%, there was a modest increase of 8% in the segment profit of Q1 FY09 compared to Q1 FY08. As we have always highlighted before, given the nature of business, quarterly performance is not a true indicator of the overall performance of the business. The prospect of this business continues to be good.

In conclusion, in spite of a deteriorating economic situation, the Company produced very good results in Q1. Blue Star aggressively pursued business in the fast growing sectors like infrastructure-led electromechanical projects, increased its market share in room airconditioners business, and its innovative and value-added services are being well accepted. At the same time, the Company intends to continue its value engineering drive and cost control measures to minimize the impact of inflationary input cost increases. Though the economic outlook is not clear, the management is optimistic about outperforming the market growth and producing a good performance over 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 the floor to questions. I will try and answer as many questions as we can. To the extent I am unable to, I will get back to you all as well. With that, I am open for questions. Thank you.

Question and Answer Session

Moderator: Thank you sir. Ladies and gentlemen we will now begin the question and answer session. If you have a question, please press * and 1 on your telephone keypad and wait for your turn to ask the question. If your question has been answered before your turn and you wish to withdraw your request, you may do so by pressing # key.

Our first question comes from **Mr. Kenin Jain of Voyager Capital.**

Kenin Jain: Good morning sir.

B. Thiagarajan: Good morning.

Kenin Jain: Sir, I just want to understand that the order backlog of 1400 crores, which we have, how we are placed in terms of the back-to-back raw material price risk, does this order backlog have fixed price contracts or there is a clause whereby we can pass on the rising raw material prices to our clients?

B. Thiagarajan: See, out of 1400 odd crores orders, I would reckon around 300 to 400 crores of orders would have been booked at revised prices. The entire industry with effect from June began increasing the prices accounting for the raw material price hike; this is between 5% to 7%. In a few equipment, it was 3%; otherwise a 5% to 7% price increase has been affected. So, the orders booked in the month of June, most probably are at a revised price. As far as the room airconditioners business is concerned, the pending or carry forward order book will be barely 15 days or so. The rest, around 1000 crores of orders would have been booked at old prices. You can safely assume, out of that 50% would have some kind of price variation clause or some contingency margins that are inevitable, because we have been sensing this price increase right from April onwards. On the balance 500 crores or so, I do not think there will be any kind of protection. Basically, the input raw material and also the exchange rate of dollar, because we import quite a few equipment or raw material from abroad. So, on that, you may have to absorb the margin, there is no other way. So, to sum up, out of roughly 1400 crores, 400 crores you have booked it at new prices; around 500 crores, you have some contingency or a price escalation available; and on another 500 crores, you will absorb. That is how it will work out, roughly. Now, as we go back to the customers, the industry as a whole also has been going back to the customers to say that this is unprecedented and we want you to accommodate this price increase, but most of the customers will not. That is the risk one has to take in the business.

Kenin Jain: Sir, so this 5% to 7% price increase, which you have taken on a 400-crore contract, is it sufficient enough to compensate you for the rising raw material prices and whether this 5% to 7% also includes any contingency or it is just a respite and even then you will be losing some money after 5% to 7% price increase?

B. Thiagarajan: 5% to 7% if we get, we are very adequately protected. You need to understand the cost of raw material might have gone up by 12%, prices need not. You got the point.

Kenin Jain: Right.

B. Thiagarajan: Because we have the labour and value addition profit, etc., building up to your price.

Kenin Jain: Right.

B. Thiagarajan: So, in the cost part of it, even though it has gone up by 15%, we are very safe, if we get 5% to 7%.

Kenin Jain: Sir, another question is that in the second part you told that there some escalation clauses exist, so what is the nature of that and what is the sum content or intent of the clause like? Is there is any rule that if the price rises, some percentage you get reimbursement or what is the understanding in that 500 crore?

B. Thiagarajan: See, as I mentioned, either there will be a price variation clause or there maybe a contingency, which we have provided. There will be a weightage for the labor, weightage for the material, weightage for the exchange rate and weightage for the wholesale price index. But, right now, the Refrigeration and Airconditioning Manufacturers' Association (RAMA) have resolved that they will implement a price variation formula called RAMA price variation formula, which is similar to that of IEEMA price variation formula. The IEEMA price variation formula is accepted by all State Electricity Boards and Central Power Agencies like NTPC, etc., and also by the DGSND or CPWD - universally within the country it is accepted. The RAMA price variation formula will take into account the steel, copper, labour, import, exchange rate, etc., and this formula is going to be adopted this month. So till now, the formulas have been company specific or customer specific.

Kenin Jain: Sir, just to understand this formula in a layman sense, say the prices of raw material increases by 20%, so if one puts this formula into action, how much price increase we get for the corresponding 20% increase in raw material?

B. Thiagarajan: It depends on the equipment; say for example RAMA will be adopting a formula for chiller, for air handlers or airside equipment, and another formula for probably the airside contracting work at site. So, let me take a simple example of a chiller. Chiller has got some copper, chiller has got some steel; chiller has got some amount of import content. So, what will happen in this formula is around 30% for copper, in a layman language I am telling you, 20% for steel, 10% the import content and 30% for labor - like that the weightages will be given. So normally, if you have to take the current steel prices, we plug-in and see, what it will mean is it depends on a base date. Let us take the base date as April and if you are to execute this order sometime in September, if the steel prices are like what it is, it will mean around 5%. The formula is being worked out exactly taking what is the material content of each of the components here and the formula provides for a base date, which is actually normally the month of finalization of the order and the month of execution and it will have a plus or minus ceiling.

Kenin Jain: Sir, one last thing from my side, that 8 to 10 days before we read one article in Business Standard that there is a huge inventory lined up for airconditioners with the dealers and the reason for the same is that nobody expected the rainy season to start early and that is the reason even some of the marquee companies are having lots of inventory at their place. So, what is the ramification of the same you understand on the pricing and on the volume growth in this quarter, especially post rainy reason, how the things would unfold?

B. Thiagarajan: Yes, actually for us, this particular article you are referring to is connected with room airconditioners.

Kenin Jain: Exactly sir.

B. Thiagarajan: In our case it is very small part of our business. We will be more worried about the chillers, air handlers and central/ packaged airconditioning systems. As far as the cooling products, where the room airconditioners are part of it, it is a fact that in the market close to two months' of sale of stocks are accumulated, the manufactures have met as a part of RAMA, which coordinates these issues and it is a combination of many things. One, is connected with un-seasonal rains in Northern region and two, is also the economic slowdown. Many consumer durables have seen the downward trend right from two-wheelers. So, I do not think it is connected with rain alone. Three, is that going by February and March, there was a very high optimism with the regard to the growth that is going to be witnessed and suddenly it all turned to a slower growth. Under the circumstances, the manufacturers' priority is to get rid of the stock or the inventories as early as possible. So, the price increase may not be effected immediately. My guess is that players like LG, Samsung, who are basically large consumer durable players selling through the retail segment, they will have to come forward and revise the price upwards or downwards. In any case, as far as Blue Star is concerned, we do not compete in that segment. We compete in the corporate and commercial segments where the decision-making is entirely different. Our products are differentiated. So, we are very clear that we will not be desperate to get rid of this stock by discounting and indeed our inventories are also at a higher level, probably, we would have around three weeks of inventory and we could have managed with two weeks of inventory. This is the update of this.

Kenin Jain: Fine sir. Sir, why the margins in our professional industrial equipment segment have dipped by 300 bps in this quarter as compared to last year?

B. Thiagarajan: You cannot compare quarter wise here because they started executing certain turnkey projects with imported equipment and in any case when the margin as a percentage also is a misnomer here because the top line is only the commission received and the domestic value addition. So, indeed it is low and it could have been better, but there is nothing to worry there.

Kenin Jain: But there is nothing one-off in that one?

B. Thiagarajan: No, there is nothing one-off.

Kenin Jain: Fine.

B. Thiagarajan: Certain billings of the domestic value additions, they were not carried out - that is what it means.

Kenin Jain: Okay, so that will be slipping over to the next quarter most of?

B. Thiagarajan: That is right.

Kenin Jain: Thanks a lot sir.

Moderator: Our next question comes from **Ms. Kirti Dalvi of Enam AMC.**

Kirti Dalvi: Yes. Good morning sir and congratulation on very good set of numbers.

B. Thiagarajan: Thank you.

Kirti Dalvi: Yes. Just if you could guide us the sales through what we have achieved - how much you would attribute to value growth and the volume growth, if you could give just a rough estimate about that?

B. Thiagarajan: In Q1, basically it will not be anything to do with - hardly half a percent would be due to the price increase. It will not be much. In Q2, it maybe much more significant. Otherwise, it is basically the volume growth.

Kirti Dalvi: Okay and would it be possible sir to get the cooling product mix in terms of your split and window airconditioners? Like say how much would be the split, I know it is majority the split, but still if you could put the number to it?

B. Thiagarajan: It has been increasing over the years. In our case, it is not an indication of the market at all. In our case, it is 70% split airconditioners, 30% is window airconditioners.

Kirti Dalvi: Would you like to put the numbers, absolute number?

B. Thiagarajan: No, we do not disclose the numbers here, but in any case I do not have it here. It should be in the order of, our total sales should be in the order of around 40,000, I think.

Kirti Dalvi: Okay and sir in terms of our order book, it entirely belongs to your electromechanical project or some part goes to the other two segments also?

B. Thiagarajan: Yes, very minimum, but predominantly the pending order book will be in central airconditioning.

Kirti Dalvi: Okay and sir would you specify how much would be the HVAC and MEP in that?

B. Thiagarajan: See, I have clarified these at many occasions. Actually, MEP is a virtual animal; there are customers who finalize the HVAC order and also an electrical package and also a plumbing package. In fact, HVAC package in many cases will comprise a chiller package, air-handler package, low-side package, warm shell package, like that. There maybe four different bits together. There is hardly any customer today in India, who gives one single MEP package. I suppose it will happen at some point of a time. So, in this particular result of HVAC, it contains the electrical, it contains some minor amount of plumbing and package airconditioning - all are declared as electromechanical and we have not been disclosing the individual figures of this at all. But I can broadly indicate to you the electrical business in this year is supposed to be doing somewhere around 175 crores of billing and we are on track.

Kirti Dalvi: Okay sir and would it possible to get exports figure for this quarter?

B. Thiagarajan: Very minimum it will be, I will just give it to you and it is predominantly in the product segment. You are asking for the billing figure?

Kirti Dalvi: Yes sir.

B. Thiagarajan: Yes, roughly around products and projects put together, we should have been doing around 25 crores.

Kirti Dalvi: Okay, and sir you just mentioned that and it's very well known that

B. Thiagarajan: I stand corrected it, it is not 50 crores it is 25 crores

Kirti Dalvi: Okay and sir we do import some of our equipment for our products, so we do get some kind of benefit in terms of our currency movement. Considering that the rupee is depreciating now, do we get impacted because of this on our OPMs to an extent?

B. Thiagarajan: Yes, definitely, obviously, whatever the imports, we are paying higher rupees, but despite that you have seen our margins have improved.

Kirti Dalvi: So, will we be able to maintain this margin going forward to 9% or 8½ to 9% for the whole year percent?

B. Thiagarajan: In fact, it is much more if you remove the one-time employee liability, the operating margin is around 10. We hope to, but I cannot say anything because the situation is dynamic, we have learnt to control costs. We are doing a lot of value engineering measures. We are trying to protect ourselves with the customers while accepting the orders. And as you have seen our track record, we have always focused on margins and the profitability rather than the topline growth. I hope, we will continue to do so, but the market conditions are pretty unclear, but if you ask me a question on what is our assessment, we feel we will be able to manage these margins.

Kirti Dalvi: Okay. So, will we be able to maintain the last year's margins as of today?

B. Thiagarajan: I think so.

Kirti Dalvi: Sir, the last question is what would be our average taxes for the whole year? Considering, I think last year, we had a higher utilization of Himachal Plant so, in last quarter, I think that has led to higher tax rate. So, could you guide us for the average tax rate what would we are going to do for FY09?

B. Thiagarajan: I think it will be in the order of around, anything above 25%. We are trying to get what best we can do. We know that it was higher last year. I think it will be above 25%.

Kirti Dalvi: Okay, but lower than?

B. Thiagarajan: As we progress, we will get to know. As of now, I think it will be in the order of around 28 or so.

Kirti Dalvi: Okay sir. Thank you very much sir and wish you good luck.

Moderator: Our next question comes from **Mr. H.R. Gala of Quest Investment Advisors.**

H. R. Gala: Hello, Mr. Thiagarajan, congratulations for a really good set of numbers.

B. Thiagarajan: Thank you Mr. Gala.

H. R. Gala: At times, when the economy looks down…Based on, whatever discourse you have given so far, do you believe that we will be able to maintain this tempo of growth of say around 36% for the rest of the year?

B. Thiagarajan: I think so, because as I have been telling many of you, indeed, very clearly, construction is slowing down, but at the same time there are many segments, which continue to grow. Nevertheless, we have not seen a major decrease in the enquiry inflow or the order finalization. In any case, globally - it is not true of India alone - the HVAC Industry or Electromechanical Projects Industry have a time lag of around 12 months from the construction slowing down and it is true of taking off also. So, when the construction was booming we were not taking off. It took 12 months for us to take off. So, as of now, if you ask me, this year, I think we will happily maintain. And, but we cannot say about the next year. Probably, in Q4 itself it might slowdown, we do not know and after all we are part of the whole eco-system right?

H. R. Gala: Right.

B. Thiagarajan: There are indeed many builders who have been deferring certain new projects since the fund allocations which were there for these projects, obviously, they have to now shell out something like 10% more because of the cost pressures.

H. R. Gala: True.

B. Thiagarajan: Three is, the interest rates have gone up definitely and they all depend on the bank loans and funding and stock market is doing not so favorably. So I have a feeling it will slowdown and it will never be in the order of some 50% 60%, everybody was announcing some project or other everyday and the good news is I think infrastructure-led projects basically the airports, metros, power, that sector, we do not see a slowdown. Even the large IT players are trying to consolidate their operations by moving into IT SEZ, that segment continues to offer a great opportunity. In hotels, construction still goes on because I think some players believe that this is the right time to go and build hotel rooms. When the economy revives, they will be in a position to reap the benefits. In healthcare, we are no where compared to the developed countries, so I think there will be a significant, like the retail revolution taking place; the healthcare revolution has to take place in a big way. Now, you see all types of hospitals, apartments converted into clinics - all these are going to change in a dramatic way, so lot of investments are taking place there and as a Company. Our focus is on what construction will take place in the next five years of time. So, one or two quarters if it doesn't, we are not really worried at all.

H. R. Gala: I agree with you. Okay, now in view of this scenario, which has slightly changed for some of these segments, how are we going ahead with our capital expenditure program what we had announced earlier?

B. Thiagarajan: As of now, we have not changed our plans. Our investments were in two major areas - manufacturing in Wada and ERP SAP implementation. On these two, we are not cutting back at all. We are going ahead. In any case, last year, we did not spent what we budgeted and there were lot of work in progress. We are not capital intensive and if you recollect last year and year before, we suffered for not having come on scene with certain expansion. We were up to our neck, so we took a decision not to cut back anything at all. Because, in any case, our growth will be definitely - that we are continuing to maintain- CAGR of 30%+. So, we will go ahead.

H. R. Gala: So, how much CAPEX we are planning in FY2009?

B. Thiagarajan: It should be… should exceed Rs.100 crores

H. R. Gala: How much sir, I did not get you?

B. Thiagarajan: It will exceed Rs.100 crores and when we get to September, we will have a much clearer picture.

H. R. Gala: Do you see any pressure on working capital build up as you said that probably your stock is slightly more. How is the position on receivable side?

B. Thiagarajan: In some segments, collection is becoming a problem. But, as of now it is not a very major concern. We will, however, be very careful. With builders in specifically class B towns, collection in India has always been a problem. In no other country, does any company spend so much time following up on payments. It is even more tougher now, but we have been monitoring our collection targets. It is more of is okay, that is, we used to collect Rs.100 crores, we are collecting at least Rs.98 crores, there is no major slowdown seen.

H. R. Gala: How much is our DSO as on 30th June?

B. Thiagarajan: Can u repeat the question please?

H. R. Gala: Yes, days sales outstanding. You know the ratio, which you normally discuss?

B. Thiagarajan: No, we have not been specifically disclosing these figures. Different businesses measure the outstanding in different ways and all that you need to know is the total capital employed to the billing. Our internal target to be above 7.5. In other words, if we put in Rs.100 crores, it should do at least Rs.750 crores and we have been out performing this ratio always and the individual business divisions are given that goal, that is, they should turn it around more than 7.5 times.

H. R. Gala: That is right.

B. Thiagarajan: And they are doing much better than that as of now.

H. R. Gala: Okay that is fine. Can you tell us something about Naseer Electrical performance sir and where are those numbers included in our sales?

B. Thiagarajan: It is included in Segment 1. They were a 100-crore company when we acquired that and our target is to do at least 175 crores of billing this year and we are on target. There is no problem in that. They used to book somewhere around 12 crores of orders every month. We are booking more than 20 crores as of now and the customer segment is one and the same. And they were focused on two cities Bangalore and Hyderabad and now we are rolling out to our customers in west and north as well. It is ahead of our expectations.

H. R. Gala: Do you see any improvement in their profit margin also since we have taken it over?

B. Thiagarajan: Too early to say, the margins from electrical business is almost same as our airconditioning contracting business. One difference in our contracting is along with contracting, we also supply our own manufactured equipments like chillers, air-handlers - that is not available in electrical. We do not manufacture anything at all.

H. R. Gala: True, it is only services.

B. Thiagarajan: To that extent, contracting of electrical is pure contracting. Margin-wise, it is same as airconditioning contracting.That business is indeed strategically important for us and we are happy with the way it is progressing.

H. R. Gala: Ok. Will you have to put in some more capital expenditure to expand the manpower, tools, etc., that might be required?

B. Thiagarajan: For electrical you are asking?

H. R. Gala: Yes, I am asking for electrical.

B. Thiagarajan: No, actually it is not capital intensive at all.

H. R. Gala: No, in terms of manpower or maybe offices or something like that?

B. Thiagarajan: In managerial terms, yes. For in the west, north, and east, we are going ahead and investing in office space. In fact, we hired a very large office for electrical business. It is going to be part of our office in Bangalore. The people are moving in now from the Naseer erstwhile premises. Our intention is to integrate the employees culturally in line with Blue Star values and Blue Star way of working. It was a small industry and a small company. Now, we want to make them feel a part of Blue Star and substantial investments are being made, that are not capital in nature, they are mainly revenue expenses. And the employees are integrated in the Blue Star employee policy or regulations, in the sense that they get paid as a Blue Star employee and they were somewhat, I would say, less productive compared to Blue Star. They had more employees for the same amount of work, but I suppose it is a question of management depth and the way it has to be driven and it is moving smoothly.

H. R. Gala: Okay, my last question. What was our total gross borrowing as on 30th June, long-term and short-term both put together?

B. Thiagarajan: I will let you have that. I do not have that figure.

H. R. Gala: Okay. No problem. I will talk to you later. Thank you very much and wish you all the best.

Moderator: Our next question comes from **Mr. Marco LoCascio of Equinox Partners.**

Marco LoCascio: Hi, good morning.

B. Thiagarajan: Hi, good morning.

Marco LoCascio: Well, I wanted to ask you about the revenue growth. Very candid answer earlier, so my only other question is on the extensive raw material price increases, maybe you can get me a ball-park figure of your major raw materials, where they are now versus a year ago?

B. Thiagarajan: So, in percentage terms, we are a very complex company manufacturing window airconditioners to large chillers. The raw material prices have been different or the content is different from different. I can tell you on the average, from last year June to this year June; raw material prices would have gone up by around 7.5% across the products.

Marco LoCascio: 7.5%?

B. Thiagarajan: Yes. Raw material cost increased, but that does not signify the price increase, price increase will be different because you have the value addition labor etc, etc.

Marco LoCascio: I understand.

B. Thiagarajan: So, it is roughly 7.5%, you can assume in some cases it is as high as 15% and in some cases low as 3%. On the average, for all the products manufactured by us, it will be 7.5.

Marco LoCascio: Great, thank you very much.

B. Thiagarajan: Thank you.

Moderator: Our next question comes from **Mr. Ravi Bhatia of Aviva Life Insurance.**

Ravi Bhatia: Good morning sir.

B. Thiagarajan: Good morning.

Ravi Bhatia: Sir, part of my question has been answered already; just want to know as far as Naseer Electrical is concerned, what would be the revenue that you would have booked from there in this quarter?

B. Thiagarajan: First of all, it is no longer Naseer Electrical; it is Electrical Projects Division of Blue Star Limited.

Ravi Bhatia: Absolutely.

B. Thiagarajan: Naseer Electricals Private Limited as an entity; we did the slump sale, so that entity may still be remaining as a shell company with the promoter of that company. Electrical Projects Division figures independently - we are not disclosing and all that I can tell you is that they were to grow by more than 75% than the previous year and we are on track. If you know Naseer Electrical, as a company, was doing around 100 crores and Electrical Projects Division is supposed to be doing 175 crores this year. We are on track on a pro rata basis is all I can tell you.

Ravi Bhatia: Ok.

B. Thiagarajan: And it is a small base. In any case, there is nothing to say that we have done exceptionally well because the potential is huge, that is, in three years' time we would like that to do around 500 crores.

Ravi Bhatia: Okay and would you say that, in terms of new orders that you have booked in the last few months, because of this Electrical Division getting added, you have been able to actually address and take on much larger orders than you would otherwise have, is that a case that you have already seeing now or?

B. Thiagarajan: In few cases, yes. A customer like HCL, order which we would have got for HVAC system would have been some 9 or 10 crores, but because it was including electrical, it became double. In fact, one order that we have booked is worth 30 crores from HCL which includes 19 crores of electrical and balance is HVAC. But at the same time, I would not say that it is true for some infrastructure projects, like for example, we did lose Delhi Airport order. In Delhi Airport, it was not a combined package, it was a HVAC package, electrical was different, equipment was different, many packages were there. Delhi Metro order, which we have booked in Q2 in July worth 100 crores was not at a MEP package. So it is not necessary or it is not necessarily true that all large value orders are bundled. It is still an evolving market. I think it will take sometime for India. But more certainly because we now have electrical, we think both HVAC market share as well as electrical market share will improve. Customers are definitely looking for one agency who will do the combined thing, and because you are already there, you are able to influence the customer to finalize the order.

Ravi Bhatia: Okay, thank you.

B. Thiagarajan: Thank you.

Moderator: Our next question comes from **Mr. Ankit Ladhani of Anvil Research.**

Ankit Ladhani: Hello.

B. Thiagarajan: Yes sir, good morning.

Ankit Ladhani: Yes, sir good morning. Sir, the order book for 1400 crores, sir what is the target completion time for the same?

B. Thiagarajan: No, it is very difficult to say. All that we can say is that at any point of time, we will have something like five to six months of orders in hand, that is all we can say, because some of these orders maybe 12 months, some of these orders maybe three months. We do not know at all, but on the average we should be having around five to six months of orders in hand.

Ankit Ladhani: Okay. And sir, this might be a repetition; the CAPEX is for 300 crores, right?

B. Thiagarajan: No, no, I said that for sure I think we will spend 100 crores this year in CAPEX for sure and only by September we will be able to indicate something.

Ankit Ladhani: Okay. And sir, we estimate of maintaining 36% growth rate for the year, the same, which we have for this quarter?

B. Thiagarajan: I am not saying that. All I am saying is that the outlook looks much better and we should be doing even better than this. We have been saying that a CAGR of 30 for sure we will be doing and we always exceed that target and as of now the situation looks much comfortable as you can see from the order inflow or the pending order book.

Ankit Ladhani: And sir the revenue from Naseer Electricals, which we had earlier it is included in which segment?

B. Thiagarajan: First segment, the electro mechanical projects.

Ankit Ladhani: Okay, that is all. Thank you sir.

Moderator: Our next question comes from **Mr. Nirmal Shah of Alchemy.**

Nirmal Shah: Good afternoon, Sir.

B. Thiagarajan: Good afternoon Nirmal.

Nirmal Shah: Sir just wanted the breakup of your order book in terms of just two sectors, one is the IT and one is non-IT in terms of telecom, shelter, and new infrastructure projects if you can give?

B. Thiagarajan: I think out of these pending orders, all that I can tell you is that IT maybe, you wanted IT and other separately right?

Nirmal Shah: Yes sir.

B. Thiagarajan: IT will be around 30 and 70 will be non-IT.

Nirmal Shah: Okay. And sir, out of the remaining 70 non-IT, how much would be the new infrastructure projects and the telecom shelter and the other, you mentioned about the new growth being witnessed in all this coming like power projects, telecom, shelter and other infrastructure projects, how much would be that out of the 70%, just put clubbed together. I do not want any specific percentage wise breakup for all these?

B. Thiagarajan: See, we have been, as I mentioned to you, it is honestly our desire from probably not this investor update, from the subsequent investor update, to give this indication. This is a long pending request of most of the analysts and fund managers, but the problem that we encounter is, it will be a builder who is building a hotel. And these guys get captured as the builder segment rather than the hotel segment. A builder could also be building a hospital, so we will end up giving some inaccurate data. But I can tell you that telecom as a segment is continuing to grow. But I think some telecom players are now trying to consolidate, look at different things and the first quarter honestly was not a great growth for a telecom.

Nirmal Shah: Okay.

B. Thiagarajan: Most of them, some were acquiring somebody, some were in the process of consolidation, somebody was making a infrastructure company and many things have been happening there, but in the long run, in the next nine months of time, I think telecom will continue to grow. I will, to tell you that out of the balance 70% of the orders comprise Retail mainly in class II cities. Second is hotel. Third is airports and power. So, all these will be more or less equal you can say.

Nirmal Shah: Okay. Thanks a lot.

B. Thiagarajan: Thank you.

Moderator: Our next question comes from **Mr. Mitul Mehta of Lucky Securities.**

Mitul Mehta: Yes, good afternoon sir. Congratulations on a good set of numbers.

B. Thiagarajan: Thank you Mr. Mehta.

Mitul Mehta: Sir, just a broad question. Historically Blue Star has been largely domestic growth driven company, so now is there any thought on the part of the management to look at markets like Middle East?

B. Thiagarajan: We have always stated this, that is, we want profitable growth and on an EVA basis. It should provide higher returns if you want to invest in some other market. We will look at the Middle East market or in Malaysia through the JV, only specific projects, which are highly profitable. Also in product exports, the differentiated products are not the normal standard products. So, if you ask me a question whether there is a renewed focus or a different focus in the Middle East, not exactly. We are same as what we were last year. The good thing about us or the bad thing about us is we want to be focussed on the profitability and the resources that we deploy there. So, because now the Middle East is booming, we will shift all our energy into Middle East as is expected by some of the analysts. I do not think so; we are not doing anything significantly different in these months to renew our focus in the Middle East, though we know Middle East is offering exceptional opportunity at this point of a time.

Mitul Mehta: Thank you very much sir.

B. Thiagarajan: Thank you.

Moderator: Our next question comes from **Ms. Bhavika Shah of Sushil Finance.**

Bhavika Shah: Hello sir. Good afternoon.

B. Thiagarajan: Yes, Bhavika.

Bhavika Shah: Sir, I would like to know what is the response on the VRF product in this quarter.

B. Thiagarajan: Very good, exceptional, we have grown by around 270% in the VRF.

Bhavika Shah: Okay, and sir what is the…?

B. Thiagarajan: It is highly accepted. It is now getting accepted as replacement to even a large central plant.

Bhavika Shah: Okay, and sir can you tell me what kind of revenues are included in this quarter from VRF itself?

B. Thiagarajan: No, it will become a selective disclosure and all that I can say is it has grown by 270%, and we are the only Indian manufacturer of digital scroll.

Bhavika Shah: Okay.

B. Thiagarajan: And this business will become very significant this year.

Bhavika Shah: Okay, and sir one more, what is the average cost?

B. Thiagarajan: So, you can say around Rs.30,000 per ton. By ton, I mean one and a half ton window air-conditioner roughly costs you around 15,000 rupees. A split air-conditioner of one and a half ton maybe costing you around 22,000.

Bhavika Shah: Okay.

B. Thiagarajan: A one and a half ton VRF system maybe costing you around Rs. 43,000 to Rs.44,000.

Bhavika Shah: Okay.

B. Thiagarajan: And a central air-conditioning system also will be costing you the same, which is chiller based. Packaged airconditioning system maybe costing you something like 30,000 in comparison to that of VRF.

Bhavika Shah: Okay.

B. Thiagarajan: But the energy savings are more than 25%, so in our life-cycle cost measurement, it will workout cheaper than central airconditioning. The time taken to install, there is no duct or anything, it is very fast. You do not need any false sealing. It is just a copper piping that is about all. So, in specific segments, of course, this is not a replacement for central airconditioning - in the sense, the airport or metro railway or a convention center or five star hotels cannot do with a VRF system.

Bhavika Shah: Okay.

B. Thiagarajan: But, let us say a 50-bed hospital can very well be a multi-zone kind of an application where you need different parts to be maintained at different temperatures or a small office of let us say around 10,000 square feet to 15,000 square feet, these will all I think switch over to VRF systems.

Bhavika Shah: Okay and sir one more question, what is the average cost of debt?

B. Thiagarajan: Average cost of VRF system?

Bhavika Shah: No, no average cost of debt, the annual?

B. Thiagarajan: Weighted? I will come back to you. Weighted cost of capital you are asking?

Bhavika Shah: Yes.

B. Thiagarajan: Yes, I will come back to you on that.

Bhavika Shah: Okay fine, thank you sir.

Moderator: Our next question comes from **Mr. Mehul Mehta of Standard Chartered Capital Market.**

Mehul Mehta: Good morning sir.

B. Thiagarajan: Good morning.

Mehul Mehta: This is with reference to Naseer Electricals. You said that order inflows are being booked at about 20 crores per month, run rate of 20 crores per month. Am I right?

B. Thiagarajan: That is right. Roughly, they are supposed to be so.

Mehul Mehta: Yes, sir if I look at like say order inflows for this quarter is about 950 odd crores.

B. Thiagarajan: Yes.

Mehul Mehta: And I take out those 60 crores then order inflow growth is to the tune of 30% to 31%? Because last year, we will not be having order inflows of Naseer, am I right?

B. Thiagarajan: Like-to-like basis roughly approximately you can do so.

Mehul Mehta: Yes. So, it is about like whatever if I take out this 20 crores run rate then like growth rate inflow, which I am calculating I am right in that?

B. Thiagarajan: Yes. We have; in fact, in our results also we have mentioned so. Though the exact figure you can roughly work out that manner if you want.

Mehul Mehta: Okay fine, thank you.

Moderator: I request the participants to press * and 1 for your questions.

Moderator: Our next question comes from **Mr. Arun Agarwal of Baroc Capital.**

Arun Agarwal: Hello.

B. Thiagarajan: Yes sir, good afternoon.

Arun Agarwal: Good afternoon, I just wanted to, if you can just comment a little bit on the competitive scenario. Do you see any increase in competitive activity and there are like you are trying to get into electrical, there are players like Sterling and Wilson who are trying to get into your HVAC space, if you can comment a little bit on that?

B. Thiagarajan: Yes, see I will take it as two parts; one is with regard to the general competitive scenario. Indeed, all of us are aware we have the access to the same set of information. There is inflation, there is the cost of capital going up, interest rates are up, money availability is likely to be lower, therefore, there is an impending slowdown in the new construction. If that is the case, there is going to be probably lesser number of enquiries where the players are going to compete for their pie. That is one part.

Two is, you need to increase the prices because the raw material prices. I told you it is necessary for all players to increase the prices between 5% to 7% definitely. It is a real cost increase due to the raw material as well as the exchange rate. The HVAC industry should be using steel and copper to the extent of around 50% of the total business they do, so there is a second reason second pressure, which is to increase the prices by 5% to 7%.

There is a third - the money availability is lower, interest cost is higher, so there is a cash flow you need to manage. So there is a larger pressure on collections and the payment terms. Now, this is a very complex situation for the businesses to manage. You want to maintain the market share, you want to increase the price and maintain the profitability, you want to maintain the working capital. So, this complex situation obviously will intensify the competition and it is the question of prudence, perseverance, certain bold decisions that is how it will be. So, we see the next nine months of time a tough going. You are to be selective in orders. Now you will be tempted to maintain growth, but you may end up losing margins. You maybe tempted to maintain the margins and end up losing the payment terms. So it calls for very high level of management techniques - the sales management techniques specifically. We will see the market being fiercely competitive, probably from October to March, as the enquiry levels, probably are likely to come down in terms of the number of orders to be finalized.

Second, the project when they were envisaged, let us say a hotel or a hospital or even an airport, the cost estimates do not provide for this 5% to 7% of cost increase at all. Like, let us say, telecom company, they have not budgeted for so many rupees. They would not have even budgeted a normal escalation that is what is our feedback. So, therefore, what they are going to do, they are going to be negotiating hard to bring down your price. Today, for them, it is to meet the budgetary estimate that they provided for. We do not see the competitive landscape substantially changing from what was last year or year before. In the sense, that in the contracting space, specifically central and packaged airconditioning, more competitors getting into the fray. We are not seeing and we do not foresee that to happen in the next 9 to 10 months of time. Sterling and Wilson have been competing… their strategy is to integrate and offer MEP. They are going ahead with their plans like we or other competitors trying to integrate electrical and plumbing into that. So, I do not feel a significant change in the competitive landscape at all. The fact is, Indian market is still not matured. It has got a long way to go. Our market size or the figures that we are talking about in this huge country, is still one tenth of what is supposed to be happening. Like, for example, in this huge economy, 175 crores of electrical contracting, is very negligible. It is minuscule compared to many other developed countries. So, for the given competition, all will be able to maintain their market share that is what we feel. Our interest is to grow our business at least CAGR of 30% plus and we will do so.

Arun Agarwal: Sure, thanks a lot. Just one more question, this quarter. There is a mention of 746 lakhs on reassessment, sir this entire thing is charged in this quarter?

B. Thiagarajan: That is right.

Arun Agarwal: And the entire thing is one-time in nature?

B. Thiagarajan: Most of it.

Arun Agarwal: Okay, can you explain what is this about?

B. Thiagarajan: See, I am not a chartered accountant or a financial expert. All that I know is that certain employee benefits like, for example, sick leave, long-term service awards such things we have been taking as an when it accrues and at this point of our time, the accounting standard guideline is that you should provide for it. So, we have provided for as a one-time.

Arun Agarwal: I mean you provide for it, but in future you will incur it right, and then you have to come into the provision?

B. Thiagarajan: Yes, that is right.

Arun Agarwal: To that extent, it is not really one-time it is just the timing is different from the actual incurrence of that?

B. Thiagarajan: Yes, to clarify, it is not every quarter 7 crore will be provided for.

Arun Agarwal: Okay, understood.

B. Thiagarajan: It is for all the past 65 years of existence of Blue Star, it might have been provided for.

Arun Agarwal: Okay understood.

B. Thiagarajan: So, it is the one-time in that sense.

Arun Agarwal: Okay, understood and one last question you earlier mentioned that for 500 crores of your order books, you may have no protection?

B. Thiagarajan: Yes, correct.

Arun Agarwal: So, on that part of the order book, what is the kind of hit you may take on that cumulative order book?

B. Thiagarajan: Very difficult to say. These are very different types of projects, different stages. Let us say in a project where chiller is already delivered or I have a back-to-back vendor who is going to supply the equipment. It is very difficult to calculate, but if you look at our margins for Q1.

Arun Agarwal: Right.

B. Thiagarajan: Though the raw material prices went up, and we have improved our margins, and so our estimate is we maybe probably able to maintain. In some cases, we are going back to the customers. In some cases, we are doing some value engineering and some cases, we will ask for alternative mix and so on. It is quite likely in one order we are taking a hit of 5%. In some order, we may be taking a hit of 2%. But overall we have to see. We are still confident of maintaining the margins.

Arun Agarwal: Okay, thanks a lot.

B. Thiagarajan: Thank you.

Arun Agarwal: Thank you very much.

Moderator: Our next question comes from **Mr. Mohit Mandhana of Fidelity Investments.**

Mohit Mandhana: Good afternoon sir.

B. Thiagarajan: Good afternoon Mohit.

Mohit Mandhana: Sir, my question is slightly repetitive; would it be possible for you to quickly repeat the main drivers of strong performance in packaged air-conditioning systems and cooling products?

B. Thiagarajan: Packaged air-conditioning is part of the first segment.

Mohit Mandhana: Yes. Okay maybe, maybe let me put it this way, probably main drivers of segment I and segment II.

B. Thiagarajan: Specifically, our business is related to the new construction, okay?

Mohit Agarwal: Yes.

B. Thiagarajan: And the construction, as well as MEP projects business always globally have a time lag of anything around one year, and so we are not seeing any slowdown in terms of the construction of new spaces at all. That is what is contributing to growth.

Mohit Mandhana: Yes.

B. Thiagarajan: Some segments we started seeing slowdown like retail in class I cities, but retail in class II cities continued to do well.

Mohit Mandhana: Yes.

B. Thiagarajan: Hotel as a segment is doing well, healthcare as a segment is doing well, and infrastructure-led projects, which is the airports, metro, as well as power is doing well. These investments we have not seen any slowdown at all. The second thing is that restaurant, eateries, small offices, or modernization of small offices in line with as the country evolves is happening. That is where actually many split airconditioners go. Here hardly you will see office, which is not air-conditioned today - that should be driving this. Hardly do you see a restaurant, which is not airconditioned and you do not see a bank, which is not airconditioned. You see many ATMs being opened. These are all the drivers of our cooling products business and specifically in the cold chain, agricultural, horticultural produce has been receiving more attention than we thought - in the production end or the agri end, so the integrated pack houses or seed-related cold storages is taking place, though in the retail end or as a chain, as a whole, it is not growing significantly. On the agri end, there are large investments that are taking place. I think the state governments and many other agencies are focussing their attention on that. So, these are the broad drivers. This will continue to exist over at least as I see for next six to nine months of time.

Mohit Mandhana: Yes, Yes. Thank you sir.

B. Thiagarajan: Thank you.

Moderator: Our next question comes from **Mr. Raunak Nagda of Value Quest Research.**

Raunak Nagda: Good afternoon sir.

B. Thiagarajan: Good afternoon.

Raunak Nagda: Congratulations on good set of numbers. I would just like to know how much, sir you won't be able to give me the guidance in number terms, but can you give me segmental break-up of what do you expect in the next year?

B. Thiagarajan: In terms of?

Raunak Nagda: Revenue.

B. Thiagarajan: Expected revenue?

Raunak Nagda: Yes.

B. Thiagarajan: No, I will not be able to.

Raunak Nagda: Sir, I would like the segmental break-up of expected revenue?

B. Thiagarajan: No, we cannot. I am not able to still follow. I say that we always tell you that CAGR of 30% we are confident of doing. If you go by the first quarter and the pending order book, we should be again having one good year and in terms of if you ask me that what percentage of, normally 65% of our revenue comes from segment one, which is electromechanical projects, 25% comes from cooling products, 10% comes from professional electronics and industrial systems.

Raunak Nagda: Okay, thank you sir and all the best.

B. Thiagarajan: One more question we will take?

Moderator: Sure sir. Our last question for the day comes from **Mr. Abhishek Trivedi of Motilal Oswal Securities.**

Abhishek Trivedi: Good afternoon sir.

Thiagarajan: Good afternoon Abhishek.

Abhishek Trivedi: Congratulations on the great set of numbers.

Abhishek Trivedi: Sir, I just need one clarification on this you talked about Accounting Standard 15 impact in this particular quarter to the extent of 7 odd crores. Was there any Accounting Standard 15 provision in the same quarter of last year?

B. Thiagarajan: Not exactly. It is honestly a one-time increase of around 7 crores.

Abhishek Trivedi: So, last year, which we had accounted for the Accounting Standard 15 would have come in the third or fourth quarter of last year?

B. Thiagarajan: No. We have, if you recollect the last couple of years, that is, to my frustration each of the time, there is something else new is happening. Like, for example, incentive provision for employees, we started making this provision. Earlier, we used to take it on accrual basis. As and when we paid, we used to book it. So, right now employee incentive provisions are taken care of, always we make for that particular quarter what is the provision that is payable. So, there is no change as far as the employee incentive is concerned, compared to June 07 and June 08. Honestly, we were thinking everything is now perfect, but at this point of time, a new thing came up, which is connected with certain benefits like sick leave. What used to happen is that every employee is eligible for sick leave and he earns some accumulated sick leave. The Accounting Standard, I believe, called for if there is there is a sick leave that has to be provided for. Then there is a second thing of a service award. For example, if somebody completes five years, somebody completes ten years, and somebody completes 15 years, we give a service award to the employee for having completed so many years of service. It is not gratuity. Gratuity or retirement benefit, we always provide for. This is nothing but a goodwill award that is given.

Abhishek Trivedi: It is a sort of incentive, right?

B. Thiagarajan: It is not an incentive. It is an award. It is recognition of having completed 10 years; he will be given some 10,000 rupees or 15,000 whatever it is. Now, that we always were accounting for as and when we paid the money. But it is supposed to be provided for. So, far all the 65 years of existence of Blue Star, as on date, the employees whatever they have as a sick leave or whatever service award potentially due to them is being provided for in advance. That incremental amount is somewhere closer to 7 crores of rupees. So, compared to Q1 last year, in Q1 this year, 7 more crores is the one-time additional liability we have picked up. It will not be same in the every quarter.

Abhishek Trivedi: Sir secondly, you talked about this RAMA price realization clause. Is it applicable to the entire range of products, which we are having as of now or is it related to some particular product only?

B. Thiagarajan: No. First, let me clarify that RAMA price variation clause has not come into effect. RAMA has decided that henceforth, unanimously ask for a price variation clause. The first formula is going to be for the large central plant equipment like chiller. One will be for the air handling unit, one will be for the ducted split unit or the packaged airconditioners and another for contracting, central airconditioning or HVAC contracting, and we will adopt this formula as an association and insist with all stakeholders that henceforth we will go only as per the formula because the volatile nature of metal prices and the exchange rate is going to be a way of life. So, as an industry, we will insist on a fair price variation formula, which is beneficial. It will be plus- minus. If it comes down also, the customer will get the credit.

Abhishek Trivedi: Just to get it right is it RAMA?

B. Thiagarajan: Yes, Refrigeration and Airconditioning Manufacturers' Association.

Abhishek Trivedi: Okay. And this would be coming into effect from this particular month, right, or next month or whatever?

B. Thiagarajan: Next month, most probably.

Abhishek Trivedi: Sir, seeing this and with implementation of this clause, do you foresee that the amount of projects which we are currently having no prices collection clause on, would tend to reduce in future?

B. Thiagarajan: 100%. The industry as a whole has not been proactive. See what was happening was, there was scale and there was a downward trend of prices last year and the year before. So, people were taking it for granted. All of a sudden they witnessed a huge inflation and surprisingly the rupee weakening is the other trend, which shocked everyone and I suppose this formula will make then think proactively and ensure that they are protected.

Abhishek Trivedi: Sir, but this won't be binding on the customer, this is just an industry practice which most of the players in this particular airconditioning…

B. Thiagarajan: The comparison is IEEMA price variation. If you go to Indian Electrical and Electronic Manufacturers Association, 25 years ago, they mastered this. They came together to say, because electrical industry again uses copper and steel very extensively - they made it very clear. So, any electrical contract other than what we buy in retail, will always have an IEEMA price variation formula.

Abhishek Trivedi: Okay sir. Thanks a lot and all the best.

Moderator: Now, I hand over the floor to Mr. Thiagarajan for closing comments.

B. Thiagarajan: Thank you very much for your interest and I suppose I answered most of your questions. On specific questions where I committed that I will come back to you, you will get an e-mail from me. Thank you very much for your interest. Thank you.

Moderator: Thank you sir. Ladies and gentlemen, this concludes your conference for today. Thank You for your participation and for using Door Sabha's Conference Call Service. You may disconnect your lines now. Thank you and have a pleasant day.

Note: 1. This document has been edited to improve readability.
2. Blanks in this transcript represent inaudible or incomprehensible words.