



## "Blue Star Limited Conference Call"

**November 3, 2009** 

Moderators: Mr. Vir Advani – President - Corporate Affairs &

SPECIAL PROJECTS, BLUE STAR LTD

Mr. B. Thiagarajan – President- Airconditioning &

REFRIGERATION PRODUCTS GROUP, BLUE STAR LTD



**Moderator:** 

Ladies and gentlemen, Good morning, this is Rochelle, the Chorus Call Conference Operator. Welcome to the Blue Star Ltd. quarterly results conference call. As a reminder for the duration of this presentation, all participant lines will be in the listen only mode and this conference is being recorded. After the presentation there will be an opportuinity for you to ask questions. If anyone should need assistance during the conference call they may signal an operator by pressing '\*' and then '0' on your touch-tone telephone. At this time I would like to hand the proceedings over to Mr. Vir Advani of Blue Star. Thank you, and over to Mr. Advani.

Vir Advani:

Good morning ladies and gentlemen, this is Vir Advani. I have with me Mr. B. Thiagarajan who has logged in from Chennai and we will be you an overview of the results for Blue Star Limited for the quarter ended September 30, 2009.

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The following are the financial highlights for the Company for the quarter-

- We reported a Total Income of Rs 563.52 crore for the quarter ended September 30, 2009, representing 13% decline over the corresponding quarter in the previous year.
- For the quarter, Gross Margin increased from 22.9% to 25.1%, due to softening of the raw material prices.
- Operating profit (PBIDT excluding Other Income) for the quarter was Rs 64.48 crore as compared to Rs 68.06 crore in Q2FY09. Operating Margin increased to 11.5% compared to 10.5% in Q2FY09 owing to tight control on operating costs and cost of sales.
- Net Profit at Rs 49.44 crore registered growth of 10% compared to 44.96 crore in Q2FY09.
- Earnings per share for the quarter (Face value of Rs 2.00) stood at Rs 5.50 vis-à-vis Rs 5.00 in the corresponding quarter of the previous year.



- Carry Forward Order Book as on September 30, 2009 increased to Rs 1,815 crore compared to Rs 1,555 crore as at September 30, 2008, representing a growth of 17%.
- Order Inflow during the quarter declined from Rs 798 crore in Q2FY09 to Rs 655 crore.

I will now spend some time on each of our lines of business and give you both financial as well as operating highlights for the quarter.

The central airconditioning and electrical contracting business, collectively called Electro Mechanical Projects and Packaged Airconditioning Systems, showed a 12% decline in the quarter, compared to the same period in the previous year. Segment results declined by 12% in the quarter compared to the corresponding quarter in the previous year. The Operating Margin of this business in Q2FY10 was 11.3%, same as that in Q2FY09.

During the quarter, the Company saw good prospects from the Government/PSU, infrastructure, healthcare, education and hospitality segments. The slowdown continued to adversely affect the IT/ITES and commercial segments.

In Q1FY10, the Company won a prestigious Rs 172 crore integrated MEP order for the proposed Delhi Airport Metro Express Line. This line is envisaged to be a 23 km long underground/at grade/elevated high speed rail corridor which will connect New Delhi International Airport to various stations. The rail corridor is being developed with state-of-the-art technology and will be comparable to the world's best airport link expresses such as the ones in Heathrow and Hong Kong. Blue Star's scope covers design, supply, fabrication, erection, testing, inspection and commissioning of HVAC, Electrical, Fire Fighting, Plumbing, Station Management System, Access System and Track Side Auxiliary System for the entire project. The project is expected to be completed by July 2010, before the 2010 Commonwealth Games.

During the quarter, the Company further strengthened its foothold in the healthcare segment with prestigious orders from ESI Hospital, Manesar; Narayan Hridalaya, Jaipur and Rukmani Devi Birla Hospital, Jaipur together valued at Rs.15 crore. The Company continued to aggressively pursue business from the Government of India and performed well in the education sector booking several orders.



In packaged/ducted airconditioning and small chillers, offices continued to be the major driver for growth. The Company introduced a new ducted split model of 17 TR to cater to the medium commercial segment. The Company also booked orders from power project companies such as Siemens and ABB for their airconditioning requirements. Blue Star's Precision Control Packaged Airconditioners (PCPA), which have been specially designed for the IT segment performed exceptionally well registering a growth of 75%. The rapid expansion of data centres in the country has resulted in significant demand for precision cooling airconditioning. The Company booked prestigious PCPA orders from IBM, Hewlett-Packard, Essar Steel and Tech Mahindra during the quarter.

The Company continued to sustain its leadership position in the telecom segment with its customized array of telepac airconditioners especially designed for the telecom industry. The electrical projects business also performed well. Apart from cross-selling its services to existing HVAC customers and booking integrated M&E/MEP orders, the Company bagged several standalone electrical contracting orders.

The cooling products business comprises room airconditioners and refrigeration products and systems. The Cooling Products segment declined by 14% in revenue. The segment results registered a modest increase of 8% during the quarter. The Operating Margin increased to 13.4% in Q2FY10 compared to 10.7% in Q2FY09, due to differentiated products resulting in higher price realizations.

The room airconditioner business performed well in the quarter with enhanced business from the education segment. Nearly a third of the institutional sales during the quarter were from the education segment - mainly from colleges in Andhra Pradesh, Tamil Nadu and Karnataka. Sales from the residential segment were also good, due to the extended summer and poor monsoon.

The refrigeration products business continued to perform well with growth from the ice cream and dairy segments which contributed to over two-thirds of the chest freezer sales. During the quarter, the Company launched an innovative cooling solution for seeds called Precision Climate Seed Storage (PCSS) System. Seeds are a precious resource and if stored in ambient conditions deteriorate rapidly. The Indian seed industry is estimated to be a Rs. 5700 crore market with an expected annual growth rate of 15%, well higher than the global average. Since seed consumption is not always immediate, the excess seeds, when not stored in controlled conditions, get wasted. Recognizing this need of the hour, Blue Star has introduced a seed storage system which ensures the storage of the seeds at precise temperatures and humidity levels thereby preserving them over



longer periods of time, reducing waste and increasing yield. Investments in Blue Star's PCSS will have an immediate and positive impact on the economic growth of the country.

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 manufacturers to that of a system integrator and value added reseller, thereby moving up the value chain. The Company executes several turnkey engineered projects in the areas of manufacturing, telecom, healthcare, defence, pharmaceuticals, banking and R&D. Given the nature of the business, quarterly performance is not an accurate indicator and the prospects of this business continue to be solid.

In conclusion, in spite of unexciting revenues due to the business slowdown, Blue Star produced good results. We maintained high operating margins by good supply chain management and controlled operating expenses. Finance costs are also substantially lower. There are some early signs that the worst of the economic slowdown is behind us, but it is too early to predict the speed of the recovery. Our carry forward order book is reasonably comfortable and the Company remains lean and efficient. We remain confident about our ability to capitalise on growth opportunities as they develop.

With that ladies and gentlemen, I am done with my opening remark. I would like to now pass it back to the moderator, who will open up the floor to questions. Between Thyag and I, we will try and answer as many questions as we can. To the extent we are unable to, we will get back to you all as well. With that, we are open for questions.

Moderator: Thank you very much Mr. Advani. Ladies and gentlemen we will now begin with the question and answer session. At this time participants who wish to ask questions may please press '\*' and then '1' on their touch-tone telephone. If your question has been answered and you wish to withdraw the question from the queue please press '\*' followed by '2'. You are requested to use handsets while asking a question. Our first question is from the line of Nirav Vasa of Gupta Equities. Please go ahead.

**Nirav Vasa:** Can you share the execution duration of the 1,815 crore order backlog?

**Vir Advani:** That is a little difficult to answer; I will try and answer it broadly. Until last year we were telling everyone that our average time in the order book was roughly 8 months or so. That of course has got significantly stretched,





which is why you see bookings growing but billings shrinking. So at this point in time my feeling is that it is probably closer to maybe 14 or 15 months, although as liquidity and demand for commercial real estate comes back, I feel that it will accelerate back to under 12 months.

**Nirav Vasa:** Okay. And sir what percentage of your existing order backlog would be fixed priced contracts?

Vir Advani: All our private sector contracts are not fixed priced and well certain government projects are fixed priced. I do not have that break up but I would estimate about 10% of our order book is fixed priced.

**Nirav Vasa:** And sir can you just repeat once again what was the order intake for this quarter, I had missed that number, please?

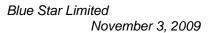
**Vir Advani:** The order inflow this quarter was 655 crore versus 798 Crore?

Nirav Vasa: Okay, thank you very much sir. I am done with my queries.

**Moderator:** Thank you Mr. Vasa. Our next question is from the line of **Kenin Jain of Voyager Investment.** Please go ahead.

**Kenin Jain:** Why has the performance been muted on the cooling products business if one compares sequentially, i.e. Q1FY10? We have seen substantial fall in activities on the base front and on the margins front, despite the better summer season in some of the other companies reporting better volumes, so could you substantiate that?

Vir Advani: Q2 for cooling products is always lower than Q1. Q4 and Q1 are the big quarters for cooling products generally. So Q2 being lower volume is not a surprise and Q3 will be lower as well. The difference with others, I am not sure which companies you are referring to, but it is quite possible that the difference will be muted in our case, because what we report as cooling products is both room air-conditioners as well as refrigeration. Refrigeration tends to be marginally less seasonal, not much less, but marginally less than room air-conditioners, but in spite of all of that this would be expected.





**Kenin Jain:** Other expenditure has decreased substantially vis-à-vis Q2FY09 and even sequentially, so what is that attributable to?

**Vir Advani:** We have been mentioning that, if you recall, when we saw things turning down around August/September of last year, we did a few things, so you are purely talking about the operating expenses not the gross margins?

**Kenin Jain:** No it is 29 crore like vis-à-vis 37 crore and 36 crore.

Vir Advani: Yes, so from August/September last year, we have significantly cut down on discretionary spends that includes advertising. It also includes general employee related expenses, travel and other discretionary expenses which we have cut down on account of lower volume of business as we are on a cost cutting drive. Thirdly, we have been talking for the last 6 or 7 quarters about an operational excellence program that we started 2 years ago. A lot of that program was focused on the gross margins, i.e. how to improve product cost and how to reduce that. About a third of the activities that we took up as part of that program, which we did with an external consultant, were focused at operational efficiency, supply chain related etc. which come below the line... we are talking about logistics and other cost items. So between, like I said, one is ad spend and the other is simple direct expenses like travel and others and the third one is specific cost cutting programs, operational efficiency programs, that we had started 2-3 years ago, have contributed to lower operating expense.

Kenin Jain: How are the inquiry levels, with respect to, from the realty side or from the commercial and the retail side on a business as a whole? Do you still believe that, it is a while before you see inquiries translating into a final confirmation of orders or still developers and end users are on a wait and watch mode. If you can throw some light on that aspect, especially the business trends, how the things are different now vis-à-vis say about 6 months before?

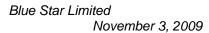
Vir Advani: Sure, so if you look at our order inflow over the last 3 to 4 quarters, you will see that December 2008 and March 2009 were very bad quarters for order inflow. Q1 was a good quarter, but we had qualified it in the last call, explaining that there were some one-offs that were there, we do not expect



it to be a trend. So this quarter, even though order inflow is of course lower than last year, 655 crore is a lot better than what it has been for the last few quarters. And our business at least from an order inflow perspective is mostly Electro Mechanical Projects which is not seasonal in nature. So the fact that it is up to 655 crore is somewhat encouraging, it is not very exciting but it is some what encouraging. However, I do not think Q3 is going to be much better because obviously we are in Q3 right now, so we have visibility, I am talking about inflow right now. There is of course talk about several projects getting finalized in Q4 that we are aware of, so it looks as though Q4 is going to be better because the inquiries that we are quoting for will be finalized in Q4. That, of course, is still a few months away, but I would say where we stand today based on the conversations we are having, is either Q4 or Q1 when we will see the inquiries converting to orders and order inflow improving. So, we are probably somewhere between 4 and 6 months away which is a lot better than it was 6 months ago.

**Kenin Jain:** And how is the power side of the business developing like, could you throw some light on the opportunity and how big it looks and how we are planning to look at it?

Vir Advani: Before I talk about power, just a quick input is that as far as inquiries, order booking are concerned we are seeing a lot more movement from projects and business from the steel industry incidentally. So as far as the industry is concerned steel is moving much faster than power. Obviously the potential opportunity for us as a company in power is significantly more than in steel. So, in power as we have mentioned earlier, we have a couple of players, one is, of course, the traditional air conditioning work that goes into a standard thermal power plant. That work continues. It is not at a very hectic pace, finalizations are happening but it is sort of going because NTPC is a main buyer there. The private power players have still not come to a point of finalizing air-conditioning. Obviously a lot of their plans are on paper right now, whether it is Adani or Reliance or some of the bigger private guys. I think it is another 6 to 8 months before our part of the contracts come up, but NTPC of course continues to buy. But it is no different than it was a year ago, it is the government organizations so it





moves at a certain pace. Other than air-conditioning, we see opportunities on the electrical side. We had mentioned that we are focused on the transformation and distribution part of the business and specifically in sub-stations. We obviously have capability in-house to execute sub-station work, so we are looking at that more seriously now as far as the utility side of power is concerned. I had mentioned that while we are doing a lot of business development and groundwork in this new sector this year, it would not be till next year before it translates into business. We still have not got our hands around the total opportunity for Blue Star in the power sector, but I hope by the end of this financial year we will have a better idea and we will be able to share 2-3 years plans with you on that.

**Kenin Jain:** Thank you sir.

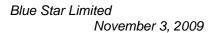
**Moderator:** Thank you Mr. Jain. Our next question is from the line of **Nirmal Shah of Alchemy**. Please go ahead.

**Nirmal Shah:** Sir, can you throw some light for capex figure for this year and how much of it has already been capitalized in the first half?

**Vir Advani:** I do not have how much is capitalized. I can get that for you. As far as the year is concerned, we are keeping it on a maintenance capex level so it will be under Rs 50 crore for this year.

**Nirmal Shah:** The debt on the balance sheet as on 30<sup>th</sup> September and the working capital cycle, if you can give some sense on that?

Vir Advani: Debt is very much under control. We do not give QoQ figures. But as far as working capital is concerned, you can see working capital is up compared to the year end. Of course, that pressure on receivables continues, collecting old debtors is an issue, customers are still sitting on money. And frankly what will happen is, you will see revenue and debtors move almost in tandem going forward. In the sense that as revenue goes up debtors will not go up, in fact if revenue goes up debtors will come down. And the reason is that both issues are linked to the same problems, i.e., it is a combination. Either a customer does not have money to continue with the project or he just has money in his balance sheet but he is sitting on





the project because he does not have customers to go and sell or lease the space to. And so it is our feeling that, as soon as that demand picks up or they change the application or the facility or whatever because a lot of that is going on as well. As projects get freed up as it were financially, we will see both revenue moving positively, as well as receivables coming down. So until the revenue picks up the receivables will not improve, that is the fact.

**Nirmal Shah:** Okay. And sir is it possible to share in terms of number of days or it is not possible?

**Vir Advani:** No, we do not give that right now, we give it annually. So you can probably figure it out from the numbers that is quite stretched right now.

Nirmal Shah: Okay, thanks a lot, sir.

Moderator: Thank you Mr. Shah. Our next question is from the line of Kirti Dalvi of Enam

Asset Management. Please go ahead.

**Kirti Dalvi:** Sir, we have de-grown 13.5% on our top-line for the 6 months, do we see that we will be able to match-up what we have done in FY2009 in terms of revenues?

**Vir Advani:** We are aiming to get to that level, that is the aim, of course. I think some of our divisions have seen some improvement over the last couple of months. If that continues, we should be able to reach FY2009 levels on the revenue basis.

**Kirti Dalvi:** Yes, because that will lead to 33% sequential growth and almost 13.5% again on a YoY basis growth?

Vir Advani: Yes, but you have to remember that December for example was a pretty bad quarter last year and March was actually better than what we thought but still it was on a low base.

**Kirti Dalvi:** Sir, in the worst case scenario what would be the situation sir?



**B. Thiagarajan:** In terms of top-line, in the worst case we will be in a position to reach less than -10% growth. It will be anything between 0 to -10.

**Kirti Dalvi:** Okay sir. And given that we have improved our operating margin significantly on the quarters as well as on 6 months basis, how much of that would you attribute to raw material scenario, the low raw material inventories that we must have used in this quarter?

must have used in this quarter:

Vir Advani: You can see that from the gross margin. There are various components attributable to gross margin improvement. There will be foreign exchange, there will be some redesign, value engineering, but I still say that a large amount of that is better procurement. This word raw material is misleading because as we have explained to you we do not buy lot of raw materials per se, it is a lot of component buying. So obviously when you strip down everything to its basic roots, lot of it becomes steel and copper. So, you can link it all back to that, but a lot of buying is procurement, it is component or system buying which in turn are linked to raw materials, but my point is that regardless of a raw material movement we are talking about better purchasing.

**Kirti Dalvi:** So, we feel that it would be sustainable for us in the next 6 months as well as in the next year?

Vir Advani: No, I think that we all are aware that prices are going up, raw material, finished goods or whatever. There is some debate on how much it will actually move up, because demand is recovering but it is not recovering to any levels of last couple of years. So one train of thought right now is that for India and China, these companies will do pricing because that is where the demand is and therefore prices may not move up as dramatically, as raw materials prices would. We have seen of course increase in input costs but nothing dramatic or scary right now. And so we are hoping that we should be able to ride out most of this year, sort of beneficialy but by Q4 we will see impact in our P&L.

**Kirti Dalvi:** So do you see that these are our peak margins?



Vir Advani:

Yes, these are pretty high margins that we are seeing right now. I think there was one quarter last year if I am not mistaken which was higher than this, I think it was 27% or something. So this year, this quarter it would be 25, I would say this is pretty good, this is as good as it gets.

Kirti Dalvi:

And sir, given that we are entering into this or rather we are looking at new areas and we would probably get some business in FY2011, do you foresee that Blue Star getting back again into that same growth trajectory of 15-20% plus growth or would it be possible to clock it immediately or you will see that it will again take 1-1.5 years time?

Vir Advani:

No, I think, that as you are aware, the mix of our business has changed quite a bit this year with electrical and plumbing also entering. We have consolidated our position and posted a decent electrical, plumbing business since is relatively new. We have probably taken our 6 to 8/9 months to do that. Out of the order inflow for electro mechanical projects for the first 6 months of this year, 40% of the order inflow was finalized as M&E or MEP which is quite substantial. It is higher than what we had anticipated. In all our internal projections we had always talked about 20-25%. That is 40% now and I do not know whether it will continue at 40. Let us see what happens, but my point is that a lot more projects are getting bundled. Now we are a much stronger player in electrical this year than last year and we will be even stronger next year. And similarly in plumbing. So, going by the number of projects, instead of just airconditioning, if in last financial year 100 projects were finalized because the first half of last year was fantastic as you remember, say about 60 projects are being finalized this year. I would say maybe 80 projects will get finalized next year, so the difference is that on these 80 projects being finalized next year, I will be bidding on a much larger rupee value. Now, while my success rate in electrical and plumbing maybe lower than air-conditioning where I would not have a 33% market share, but still that is all incremental business. So, we do see next year as a positive year, it necessarily needs to be. So even if the general real estate market does not recover to FY08-FY09 levels, we should still do better than that.

**Kirti Dalvi:** So can we assume 15-20% could be a band?



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Vir Advani: Yes, we do not do this, but certainly we are looking at double digit growth next

year.

Kirti Dalvi: Okay. And, could you guide us on effective tax rate for the current year because

for 6 months it is 24%?

**Vir Advani:** I think we should take, Thyag about 25-26%?

**B. Thiagarajan:** I think it should be 25%.

**Kirti Dalvi:** And it will be sustainable next year also or you think there could be a marginal

increase?

Vir Advani: I think there will be an increase, if I am not mistaken, Thyag one of our factories

is coming out next year or year after?

**B. Thiagarajan:** Right, so it will. Unless and until we work on something else, you should

take it as couple of percentage points more than this year, if you are

projecting.

**Kirti Dalvi:** Okay. And what is the share of VRF systems in our cooling products?

**B. Thiagarajan:** VRF is not part of cooling products, it is part of packaged air-conditioning

coming in segment 1.

**Kirti Dalvi:** Okay. And does that contribute a lot?

**B. Thiagarajan:** As of now it is not, but it is growing at the rate of around 30% in market

size. In other words, it is eating into the conventional packaged air-

conditioning and some part of the central air-conditioning.

**Kirti Dalvi:** Okay. And sir, do you see significant ramp-up happening in Q3, Q4 in packaged

air-conditioning business?

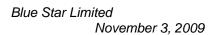
**B. Thiagarajan:** Yes, month after month we are seeing that. What is really happening is

that the residential segment had not slowed down at all; in fact residential

segment seems to be doing very well in room air-conditioners. Next

comes, light commercial which comprises shops, showrooms, boutiques

& restaurants - that is beginning to grow and is doing better month after





month. So, the packaged air-conditioning goes predominantly to these light commercial segments, as well as with large spaces. I do not see IT/ITeS or retail opening up in Q3 or Q4 in terms of billings at least. But shops, showrooms, boutiques etc., are looking up in Q3 as well as Q4.

**Kirti Dalvi:** Okay. And packaged air-conditioner does not form our order book?

**B. Thiagarajan:** Within a month if it is gets executed, maximum two months.

**Kirti Dalvi:** And, would it be possible to get order book break-up?

**B. Thiagarajan:** 90% of the order book belongs to segment 1.

**Kirti Dalvi:** Within that, if we want to break between IT/ITeS, hotels?

**B. Thiagarajan:** Pending order book predominantly will be infrastructure projects. I think,

we can clarify, IT/ITeS related orders will be very little.

Vir Advani: Yes, I think if I am not mistaken, IT/ITeS is down to about 25% of the order book

and like Thyag mentioned, infrastructure is the big part, hospitals, hotels,

education are also getting bigger.

**Kirti Dalvi:** Okay thanks a lot sir and wish you good luck.

Moderator: Thank you Ms. Dalvi. Our next question is from the line of **Prasoon Agarwal of** 

Fidelity International. Please go ahead.

Prasoon Agarwal: I just wanted to get a sense of the kind of liquidity that you are

maintaining on balance sheet including any unutilized bank lines or so?

**Vir Advani:** Unutilized, I do not think we have any.

**Prasoon Agarwal:** Okay and any sense that you can give me on the cost of funds that you are

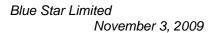
seeing right now and going forward?

Vir Advani: Cost of funds has not been an issue being in single digits. Availability and cost of

funds is not an issue for us. We do not consume a lot debt in any case, so

it is not a concern right now at least, our only concern is growing the

business right now, funding is available and cost effectively.





**Prasoon Agarwal:** Okay, thank you sir.

Moderator: Thank you Mr. Agarwal. Our next question is from the line of Madhuchanda

Dey of Kotak. Please go ahead.

**Madhuchanda Dey:** I have three questions, first is in terms of your project business, was there

any particular project, where you were facing an execution delay which is likely to be met up in the second half, or is this the trend that is likely to

continue for the rest of the quarters as well?

Vir Advani: There is no particular project. All projects are delayed across the board. There is

nothing exceptional, the only difference is that compared to the prior years, any new orders that have been booked, say if we were able to bill a new job within 4 months of booking it earlier, today it takes 6-7 months

before we can bill it, simply because projects get awarded and the entire

pace of execution is slow. So that is the only difference otherwise across

the board projects are slow.

**Madhuchanda Dey:** Are there any particular verticals where this trend is more visible?

Vir Advani: Like we mentioned, IT/ITeS, retail as usual. And where execution is okay but

billing is slow is because of the nature of the project, that would be

government projects, hotels, hospitals all of these tend to be much slower

billing even though the execution may not be significantly slowed down.

Madhuchanda Dey: And the deterioration and the working capital, any sectoral color on the

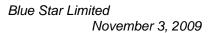
same or that is also across the board?

**Vir Advani:** You mean receivables.

Madhuchanda Dey: Yes.

Vir Advani: It is not much different from our order book per se, so my guess is that IT would

probably be lower than the order booking because whatever work we were doing, has been paid. It is not that global customers are sitting on money because they have always been cash rich. Money, I think broadly would be more tied up in government jobs, because the payment cycles are longer, also there will be certain builders where money is tied up because





of fund problems, but beyond that it would be general slowdown in payment.

**Madhuchanda Dey:** You have announced an order backlog of 1,815 crore, other than the electromechanical is there any other component?

Vir Advani: Yes first, like Thyag mentioned about 80-85% of that amount is electromechanical projects. There is a small amount which is outside that, which is related to certain cooling products or other businesses where the book-in bill may have spilled over from month to month but besides electromechanical projects there is no other major business.

**Madhuchanda Dey:** Refrigeration does not come under your order backlog?

**Vir Advani:** No, not particularly, most of it is modular cold rooms and stuff like that. There is a small projects business there, but not significantly.

Madhuchanda Dey: And my last question, you are guiding for a similar to a marginal decline in top-line YoY, which means there is going to be a significant execution in the second half. Having said that the pace of execution remains lack luster. Is there any new project that you are going to start or what is the basis of this kind of guidance?

Vir Advani: The basis is, there is about half a dozen large value jobs that have been slow where we know clients need delivery. These are infrastructure jobs, linked to certain national events that we know have to happen. Based on that assumption we have assumed that billing will be higher in the second half compared to the first. So there is some basis to it, but clearly some of this recovery also has to do with certain private customers coming forward as planned or promised. So there is an element which is why we are giving this range, flat to negative because some of those are binary.

**Madhuchanda Dey:** I would reckon that -10 is on the assumption of some guidelines and 0 would be on the assumption of these private parties coming into play?

Vir Advani: Yes, you are probably right.

**Madhuchanda Dey:** Yes thanks a lot.



Moderator: Thank you Ms. Dey. Our next question is from the line of Shefali Doshi of KJMC. Please go ahead.

**Shefali Doshi:** Sir, you mentioned that you have been undertaking various cost cutting measures and operational efficiency but in spite of that I am seeing that there is an increase in the percentage of staff cost to sales as well as other expenses to sales, like staff cost has grown to 8.42% from 6.53%, and purchases of trade and materials not on other expenses but purchase of traded goods as a percentage of sales has also increased to 5% as against 2.75%. Could you please throw some light on that?

Vir Advani: Yes, so there are obviously increments built in there, like I said, we were focused on cost of goods and we were focused on operating efficiency which is to do with things like logistics and other things. Employees while we have been reducing obviously, the cost of employees has gone up. We did rounds for the increments as we are supposed to, so to that extent, employee cost, you are right, is up. Thyag, are there any exceptional items here that are not comparable to the prior period?

**B. Thiagarajan:** No, not at all.

**Vir Advani:** So, the employee cost has gone up, but it has gone up by a lower percentage as compared to prior years if you trend it, because we were little cautious on those increments.

**Shefali Doshi:** So, we can say there were no increments given during the corresponding quarter of the last year and which were included for this quarter?

Vir Advani: No, this is not what I said. I meant that compared to last year employee cost this year is higher, because we gave increments this year since you are asking why it is high than last year.

**Shefali Doshi:** Okay. And your purchase of traded goods as a percentage of sales has gone up to 5% as against 3% in Q2FY09. Can you throw some light here?

**B. Thiagarajan:** No it all depends on the product mix. The question is that, in our business you have projects, sale of products & services. In projects, there will be our own manufactured goods, bought-out equipment. In case of





professional electronic division also there are certain projects, there are certain traded goods. This particular variation has got absolutely no correlation or meaning. It all depends on the type of projects you execute or the total product mix that you are in.

**Shefali Doshi:** Okay and another question is on the tax rate, as it was mentioned that it has gone down from 26% to 24% on the first half basis, so any specific reason for the decline in the tax rate?

B. Thiagarajan:

Basically our Himachal plant continues to enjoy some amount of tax benefits and also the other manufacturing units some residual benefits are there. As long as our own manufactured products business is growing, it will continue to have an impact and also if you take out our last year Q1 and Q2 results, you will know there was anomaly there. We had paid the excess amount and we got back later. So you will see the noting of the last year Q1, Q2 results and that is the reason there is a huge swing in the tax rate.

**Shefali Doshi:** No, but I had read somewhere that Haridwar plant is coming out of the tax benefit?

**B. Thiagarajan:** Himachal plant.

**Shefali Doshi:** Yes, Himachal plant so if it is coming out...?

**B. Thiagarajan:** It will reduce, it is not coming out. We will continue to enjoy the tax benefits out there, but at a reduced rate inline with the government

scheme.

**Shefali Doshi:** So earlier whatever benefits you were getting in terms of tax rate it will be at the reduced tax rate?

**B. Thiagarajan:** That is right.

Shefali Doshi: Okay thank you sir.

**Moderator:** Thank you Ms. Doshi. Our next question is from the line of **Vidhu Mehta of Lucky Securities**. Please go ahead.



Vidhu Mehta: Sir, you mentioned that several projects are going to get finalized in Q4 and subsequently in Q1 of next year, which part of the segment are these projects from? And, if you could also elaborate on the opportunity that exists for us on the metro side, lot of cities are going to get connected with metros and monorails so what is the air-conditioning opportunity for Blue Star?

Vir Advani: Sure, as far as Q4 and Q1 go, what we expect to happen is one there will be finalizations in metros; we will talk about that when I will give you a metro overview after this. Beyond that, hospitals, hotels, continue to get finalized, there are selective SEZs coming up now- these are being promoted by private organizations for part internal consumption and part business offering, so those we are seen picking up. And we are seeing some amount of interest even from the IT sector, at least the multinational IT companies. The large ones have reopened conversations on projects that they had held. I do not think the builders are jumping back into IT in any hurry or any time soon, but I can see that the large multinationals and possibly followed by the large Indian companies have come back for projects. So I would say that this would be the ones that should get finalized in the Q4, Q1 period.

As far as metros are concerned, you are right, several cities are planning metros; I was told by someone that as of today there are 17 cities planning metros. Of course, I do not know how much of that will fructify, but that is the number that I have been told. Of these, the ones that are the most active right now as we speak, there is Kolkata, Bangalore and Chennai Metro. There is also some talk that Hyderabad Metro will now come out of it funk because of the Maytas thing being resolved, although I have not heard much more on that, but certainly these ones are moving ahead. We expect Kolkata, Bangalore and Chennai should get finalized in the next 9 months. So sometime between January and July of next year these 3 major ones should be finalized which is a good sign. But it is important for you to understand that, with this order from the Delhi Airport Metro Express Line which is connecting Delhi Airport to the main Delhi Metro line, we have taken a turnkey project which is HVAC, electrical, plumbing, firefighting, station access, auxiliary system, the entire thing. And going



forward in all metros that we will be bidding for, it will be turnkey, so the opportunity is much broader than air-conditioning. Just to give you an idea, if I am not mistaken, out of this contract that we have received, only 30% of the value is actually air-conditioning. So what we would have been quoting at Rs.100, actually the opportunity is Rs.400. Each of these projects are specific and is being broken up under many packages and all of that good stuff. I would say that in each of these major cities Kolkata, Bangalore, Hyderabad, and Chennai - at least the MEP value should get finalized in the next 9-12 months and it should be at least about Rs 300-400 crore per metro. So, some Rs 1200 plus crore of MEP work will get finalized. I do not know in how many packages and in what permutation combination, we need to figure out, but that is the type of value that should get finalized across these three.

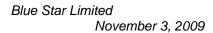
**Vidhu Mehta:** Would you also be bidding for the Monorail project which has started in the Mumbai city?

Vir Advani: Yes, just the difference between Mumbai and these others is that the others have significant underground pieces, whereas Mumbai is all above the ground. So to that extent, the main opportunity would be electrical work there. When Phase I was finalized, we were not ready because at that time we did not have an electrical or a plumbing business, of course today we do. So when Phase II comes up for bid, we will, but the value will be less by that factor.

**Vidhu Mehta:** And on the refrigeration, unitary cooling division, would you share what is our market share at this point of time?

B. Thiagarajan:

It comprises actually 2-3 different group of products. If you were to take room air-conditioners, I think our market share should be somewhere around 6% and within that if you have to take a window air-conditioner, ours will me much lesser at 2-3%. If it is a split air-conditioner we may be enjoying around 9%. And this is because we are predominantly a player only in the non-residential segment, which you know. If it is water coolers, I think it will be close to 30%. If it is bottled water dispenser it may be around 15%, if it is super market equipment it will be 10%, in cold storages we should enjoy close to around 20% of market share.





Vidhu Mehta: Okay. And do we have any exposure at this point of time on the real estate,

primarily to DLF, Unitech?

**Vir Advani:** I am sorry we have exposure to builders?

Vidhu Mehta: Yes builders.

Vir Advani: Yes of course builders are big part of our business, so whoever you named is

obviously a customer. So yes absolutely we do.

**Vidhu Mehta:** And are they paying on time?

Vir Advani: You want me to answer that question.....Well to be serious, obviously payments

are slow. You can see that reflected in our capital employed and I mentioned to a lady earlier that, out of all our segments where we are facing issues with payment, IT is not an issue, even though the amount of business has halved. The issues have been with slower payments from government jobs which is nothing new, we all know that. Secondly, builders are an issue, but still the difference is that these are all repeat customers and we have exposure to them on multiple projects. I do not think we have any single project with one builder, on which we are outside his door begging for money. So these are multiple projects across air-conditioning, electrical etc. And generally these are customers with whom at least we keep contact with, talking about new projects, existing

projects etc. So we are confident we will collect, it is just a matter of time.

**Vidhu Mehta:** And how much would be as a percentage of order book exposure to builder?

**Vir Advani:** You know that would have come down, my guess is it maybe about 30%.

Vidhu Mehta: Okay, thank you so much sir.

Moderator: Thank you Mr. Mehta. Our next question is from the line of Sanjeev Zarbade of

**Kotak**. Please go ahead.

Sanjeev Zarbade: Sir, I just wanted to understand the profitability in MEP projects as

compared to your central air-conditioning projects? Has the share of MEP

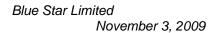


projects increased, would there be any change in the overall profitability in segment A?

Vir Advani:

What is happening, since we are going through a transition phase, is that you are either an air-conditioning contractor or an electrical contractor and you are trying to bundle, broadly one of your services is your strength and the other one is something you are building up, right. So customers are seeing commercial benefit in bundling. So I mentioned to you at one point that 40% of jobs in the first half have been bundled. I do not think there is some great technological change in the world that has lead to this. It is purely a commercial move. And even the vendors as well as the customers understand that the vendor needs to build up a capability, the customer knows that he can probably get some kind of commercial benefit out of that, so he is willing to take the risk because anyways the project is now going to move at lightening speed, so because of all of that what is actually happening on the ground is that margins on an MEP job are tending to be lower than standalone jobs.

However, this is in my opinion a transition period because one is that major commercial benefits to the client will reduce, because each of us is building up capability and therefore does not need to keep buying business as it were to build up a base, so one is our own pricing changes. The other is as the pace improves customers will want to ensure that they get the right quality. And the third most important thing is that there are inherent operating efficiencies in running and integrated turnkey projects as against the standalone projects. One is of course the pure manpower saving, you have 5 men team at site that can manage 40 crore of business instead of 15 crore of business that is obviously a benefit, but more than that, it is the amount of time and cost that you save in design and rework at site. So, you should be able to get out of an integrated project faster than you would a standalone project, simply because you are not coordinating with 3 other vendors, as the client rarely takes on the responsibility of coordination, he will leave it to the vendors to do so. So, what I am saying is that there is an operating cost benefit built in that will kick in. So, on a long term basis whatever information we have seen and understood from around the world and what has been done in the past in India and what we





expect, margins in MEP job should be the same or slightly higher, than a standalone job because in fact there should be a premium, because you push out the smaller vendors by doing turnkey. So to that extent your pricing should be safeguarded because you are then competing with fewer players. You get some operating efficiency kicking in and you save time. So all of that should lead to better margins, but to be frank in the short term right now we are not seeing that.

Sanjeev Zarbade: And Sir, I wanted to ask that would the execution cycle of projects come

down in FY11 based on the events in the metro that are happening?

**Vir Advani:** Are you asking whether they will come down?

Sanjeev Zarbade: Yes.

Vir Advani: Yes, that would be the basis on which this billing should be higher next year,

because as I mentioned to you I said that number of jobs that will be finalized next year even will not be as many as 2 years ago, I do not think that the recoveries will be that dramatic. However, because we are targeting a bigger chunk of the pie as well and as the pace of projects

improve, I think billing will improve.

**Sanjeev Zarbade:** Okay thank you and best of luck to both of you.

Moderator: Thank you Mr. Zarbade. A follow-up question is from the line of Kirti Dalvi of

Enam Asset Management. Please go ahead.

**Kirti Dalvi:** Sir, was there any kind of forex gain in this quarter?

**Vir Advani:** Kirti, we need to get back to you, I do not have that with me.

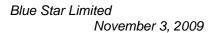
**Kirti Dalvi:** And if you can give us the exports figure for the quarter as well as for half year?

**B. Thiagarajan:** We do not disclose that Kirti, it is not a segment at all.

Vir Advani: But it is down from last year naturally. Our exports were also in the Middle East

as you know and that is actually down.

**Kirti Dalvi:** Okay sir, thanks a lot.





Moderator: Thank you Mr. Dalvi. Our last question is from the line of Mayur Parkeria of Wealth Managers. Please go ahead.

Mayur Parkeria:

Sir, if you look at Blue Star over the last 9-10 years, I know it is an elongated period I am talking of, we had a structural change from around 450 crore of top-line to 1,100 crore from 2000 to 2006 that was around 2.5 times and then from 1,100 crore to 2,500 crore in 3 years' time, half the time which we said. I understand the segment growth differs across the years. Barring 2010 which you say maybe flattish or negative when can we see another kind of structural change & over what period of time? I am not looking for a particular guidance but just your sense on the structural change, are we seeing from 2010 onwards and in what period?

Vir Advani:

Realistically I think we need to do that in 3 years again. I mean this year like you said is a plateau year, we are doing what we can internally and of course waiting for the market to turn. We think 2011 will be a positive year and based on our broader portfolio of both projects as well as products, we feel confident that we should be able to deliver a much more aggressive growth again from 2011 over a 3 year period.

Mayur Parkeria:

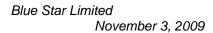
So 2011/2012/2013 so we are hopeful of maintaining 24% CAGR on that side?

Vir Advani:

Yes, absolutely that is the intention. I will just qualify that, by saying that we have a broader projects portfolio, we have a bigger product portfolio and the main point is that we are moving from a complete focus on the commercial real estate market. We are making a migration right now to broaden our portfolio or address the market to include commercial real estate, residential real estate, as well as industrial business and in industry we mean steel, power, oil & gas, petrochemicals etc., residential we mean it from 2 angles, one is of course from product perspective, as well as from the new project capabilities we have in electrical and plumbing and of course commercial market continues to be our main focus.

Mayur Parkeria:

Okay. Now this kind of breakup which you gave about industrial, residential and commercial, so this will mean a significant change across





the kind of segment which we report in and the growth which we will have. Because residential when you say right now is a product business.

Vir Advani: Yes.

Mayur Parkeria: So when you go towards more on projects won't it be under cooling

products or will it get combined in MEP segment which maybe right now

in central air-conditioning or something like that?

Vir Advani: Yes naturally, we do not report by customer segment, we report by business

segment of ours. I am just saying you should see residential, commercial

and industrial businesses in all our reported lines.

Mayur Parkeria: Right, so from our reporting perspective, if I have to just look at product

which is cooling products and projects which is central air-conditioning,

will that undergo significant change when we see the next cycle of

growth?

Vir Advani: I would presume that what we report as first segment as it stands today should

grow faster just because the address market we are going after is much

wider. But I do not think we are slowing down any time on our cooling

products business, because both the room air-conditioner business and the

cold storage business continue to grow well and so when the market

recovers it should do better. And of course it is of a much smaller base.

B. Thiagarajan: Of course, there could be a situation in about say 5 years' time; it is

anybody's guess, if the course in infrastructure is opening up in a very big

way, segment 2 also can dramatically grow. The fact that the room air-

conditioner business has been growing from where we were and where we

have come; there is a possibility that accelerates because basically the Tier

II and Tier III cities are also beginning to buy. And it is just that today we

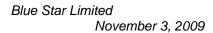
are not focused on residential nor we have any big plans to get into retail,

but at the same time we do supply to residential segment through the other

channels we have. We are not present in the retail channel that is about all.

So therefore, with the residential segment growing it is also possible room

air-conditioner business also grows.





Mayur Parkeria:

Okay. Sir last question, you have significantly reduced our import content over the last 2-3 years, and it is now a very small percentage if I am not wrong. But is there any material cost benefit to do with the forex import content which is there?

Vir Advani:

I do not think that imports are insignificant, they are quite significant. I am not sure where you got that information; I think our imports continue to grow both as far as components are concerned, as well as finished goods. So, to that extent our imports continue to be quite significant and in fact in today's global economy, given the situation of demand around the world, we are finding that what was cost prohibitive two years ago, to import it now is quite cost effective and so we are redirecting some of our purchasing in that manner.

Mayur Parkeria:

Okay sir sorry, I just saw my spread sheet on the reverse manner and I missed out on that. Yes, so you are right and around 500 crore, we had a significant portion of import. So, anything to do with the cost saving because of the forex conversion in this first half?

Vir Advani:

Yes another lady asked us, we do not have that information with us; we will get that for the next call probably.

Mayur Parkeria:

Okay, thank you very much sir.

**Moderator:** 

Thank you Mr. Parkeria. Ladies and gentlemen that was the last question. I will now handover the conference over to the management for their closing comments.

Vir Advani:

Thank you very much everyone for attending our call. And we look forward to addressing any unanswered questions you have and talking to you in 3 months from now. Thank you.

**Moderator:** 

Thank you Mr. Advani and thank you Mr. Thiagarajan. Ladies and gentlemen on behalf of Blue Star that concludes this conference call. Thank you for joining us on the Chorus Call Conferencing Service and you may now disconnect your lines. Thank you.