Transcript

Conference Call of Blue Star limited

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Presentation Session

Moderator: Good morning ladies and gentlemen. I'm Leela, moderator for this conference. Welcome to the conference call of Blue Star Limited. We have with us today Mr. Vir Advani, Vice President Corporate Affairs and 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 key pad. Please note this conference is recorded. I would now like to hand over the conference to Mr. Vir Advani.

Vir Advani: Good morning ladies and gentlemen, this is Vir Advani and I am accompanied by my colleague Mr. B. Thiagarajan. I will be giving an overview of the results for Blue Star Limited for the quarter ended September 30th 2007. Post this there will be a short overview of our businesses after which we will open up for questions. Either Mr. Thiagarajan or I would respond to those. So let me go ahead. The following are the financial highlights for the company. We have reported a total income of Rs.548.59 crores for the quarter ended September 30th 2007, representing 46% growth over the corresponding quarter in the previous year. Net sales for the quarter Rs.547.77 crores were also up by 46% over Q2 of FY07. So for the half year ended September 30th 2007 total income grew 47% to Rs.1010.91 crores compared to H1FY07. Net sales over the same period also grew 47% to 1010.02 crores. Operating profit or EBIDTA for the quarter was at Rs.68.4 crores, this was up by 108% as compared to the operating profit of Rs.32.8 crores earned in Q2 of FY07. Operating margin that's EBIDTA margin increased significantly to 12.5% in this quarter compared to 8.7% in Q2 of FY07. Other income for the quarter was 82 lakhs as against 81 lakhs in Q2 of FY07. Net profit for the quarter was Rs.45.97 crores up 150% over net profit of 18.4 crores for Q2 of FY07. The carried forward order book as on September 30th 2007 stood at a healthy 1031 crores compared to the order book of Rs.788 crores as of

September 30th 2006. This represents a 31% increase over the last year.

I will now spend sometime on each of our lines of business and give you both financial as well as operating highlights for the quarter. The central and packaged airconditioning business, which is the first line of business, continues to contribute significantly to the overall growth of the company. This division grew by 46% during the quarter to Rs.401 crores and represented 73% of the overall business. The operating profit grew a 115% to 57.1 crores during the quarter. Operating margins improved from 9.7% to 14.2% for the period. The construction boom continues to drive the demand for central and packaged airconditioning systems. During the quarter Blue Star booked two significant orders for airconditioning, the Ahmedabad and Trivandrum airports amounting to Rs.12 crores and 6 crores respectively. Blue Star's strong reputation and credentials enable it to maintain a leadership position in the central airconditioning business. Some other significant orders include orders from Cee Dee Yes Builders, (its an IT park occupied by Cognizant Technology in Coimbatore) - this was a Rs 18 crore order. Moser Baer based in Noida ,NCR placed an order of 19 crores, Z-Square mall in Kanpur, an order of 12 crores and Axis mall owned by Bengal Peerless in Calcutta of Rs.9 crores. These are amongst many other orders that we have had booked in the current quarter. The quarter under review also witnessed successful commissioning of the recently launched screw chillers with the eco friendly R134A refrigerant. These chillers have been very well received in the market and with this new range the company is confident of increasing its market share in screw chillers. Our second line of business, cooling products also performed exceedingly well in the quarter. This business grew 48% over Q2 of FY07. More importantly operating profits surged 300% to Rs.10.7 crores in the same period. Cooling products business performed extremely well with growth driven by split airconditioners as well as cold chain equipment. In the room airconditioner segment, which is one of the two segments within this line of business as you know, Blue Star continued to outperform the market. The focus remains on the corporate commercial and light commercial segments. Volumes of split airconditioners for the commercial market grew significantly during the quarter. For the cold chain, which is the second part of this business, Blue Star offers equipment right from pack houses at the farm end to supermarket refrigeration equipment for retail outlets. Blue Star's focus on the agricultural segment helped it win a significant order valued at Rs.16 crores from the Haryana State Agri Marketing Board for supply of cold chain equipment comprising cold storages, pre cooling chambers and ripening chambers across 9 locations in Haryana. While large corporate players like Reliance Retail and Heritage are setting up pack houses, small players at the village and town level are investing in ripening chambers, mainly bananas and mangoes. Blue Star has booked several ripening chamber orders from upcountry locations in Tamil Nadu, Punjab, and Gujarat. The third line of business, which is professional electronics and industrial systems also continued to perform well. While revenue grew by 37% over the corresponding period last year, PBIT grew marginally by 3%. Given the nature of this business quarterly performance is typically not a good indicator of the outlook of this business; in fact you may recall that in the last quarter which is Q1 of this year, segment profit of this business has zoomed by 386%. So the half year ended September 30th the business has registered solid segment profit growth of 46% as compared to the first half of FY07.

In conclusion, management remains confident about the future of the business. Our success is closely pegged to the growth in commercial construction. With the investments in real estate increasing Blue Star expects the momentum to continue. With that, I would like to end the quick brief of the quarter results and pass it back to you to open up any questions that you may have. Again Mr. Thiagarajan or I may respond depending on the question. So with that I will hand it back to the moderator. 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.

First question comes from Ms. Aparna of Sahara Mutual Fund.

Aparna: Good morning sir, very good set of numbers. Congratulations on that.

Vir Advani: Thank you.

Aparna: I am happy that the company spoke to us on the margins, is this visible now, from this quarter? Taking that forward sir I would like to understand what has contributed to our profitability and that will be my first question and second is your outlook on the segmental breakup going forward

Vir Advani: Okay I will take the two questions. First one is on margins, you see from the results that gross margin has improved by about 1 point something percent, I don't have the exact number in front me, but just over 1%, this has been driven by, there are some positive and some negative influences to that, so on the positive side the rupee has helped us a fair amount because we are a net importer, that is one and the second is the custom duties on components and finished goods have been reducing. We had talked about that in the first quarter results as well. That continues to be a permanent benefit that we will be getting. Also internally we have been focused on value engineering, on our products and our solutions and that has reduced the amount of materials cost. So that continues to be an ongoing internal effort that we have. On the flip side, the metal prices continues to be a concern area, they have gone up in the quarter but you would not have seen the impact of it because of some of the positives that I talked about earlier, that in terms we are getting better at managing the metal price increases. Obviously we don't have visibility beyond a certain period as to where they are going to land up and therefore - we do our planning based on some reasonable estimates. So that will continue to be a challenge, we feel, but value engineering will help us through that. In addition to that there is obviously general inflation in our costs, for example petroleum, raw material inputs, things like that have been under pressure, we are facing some issues, but again we managed to offset that with some of these other initiatives. So the gross margin like I said is improved just over 1%. The main benefit you would have seen is in the operating line, so you would have seen that as far as our lines of business are concerned, we have seen improvement across the board. I think the most important one is the central and packaged airconditioning systems business, which for the quarter has moved up from 9.7 to 14.2% operating result, whereas for the first half I think it is a little more relevant - we have gone up from 9.6 to 12.6%. That is something that we have been talking about for several quarters in the past, we have been talking about scales kicking in and we have been talking about our ability to grow the business without a commensurate or equivalent amount of expense growth. And that is what is converting into better operating margins for us. In addition to that you also see an improvement in our cooling products business, so a couple of things are happening there. One is we have talked about our room airconditioner business becoming more and more profitable. We have a very efficient plant in Himachal and that has really helped our margins tremendously in this business, we are also getting scale effects in room airconditioners especially in split airconditioners, which are helping margins and then equally on the cold storage side, on the cold chain side, we are seeing an increase in business there, that is a better margin business than our traditional room airconditioners and so overall you have seen an improvement for the first half, operating margins have improved from 6.7 to 10.4%. So, overall we are very positive on the margin movement. We think that our margins are sustainable and that is what we have been striving to do and as we have been talking in the past every year for the next several years, we have talked about a 1 percentage point improvement in margins year-on-year. We stick to that, so we don't look at margins very closely on a quarterly basis because business mix affects it as well, but certainly we are heading in the right direction. So that was the answer to the first question, I forget your second question. If you can…

Aparna: Yes, before that I have a follow on question on this first question. You mentioned about the inflation in cost of petroleum products and all that has been a concern for you. Going forward will you be able to pass it on to the customers by better realizations or do you feel that we will still have to handle that?

Vir Advani: On product line basis we have tried to pass on some of that to the customer. I don't think that we can expect to move all of that cost over to the customer. We are going to have to bear some of it, but with some of these other efforts that we are taking internally we'll be able to manage that. So while I say it's a concern area, I don't think we are forecasting reduction in gross margin any time soon.

Aparna: Okay. My second question was on the segmental outlook, 70% of central package and 23% of cooling, going forward how do you see this moving?

Vir Advani: So what's happening is that, traditionally like you said we have been around 70% in central around 20% in cooling, and 6 to 10% in professional electronics. Last year I think central airconditioning grew faster than cooling products. This year it looks as though our cooling products business is growing faster and therefore it is now- for the first half - 26% of the revenue. So I think that both are growing very well, it seems as though cooling products is growing faster more because its a much smaller base, but on a sustainable basis we still believe that our central airconditioning, package airconditioning systems business will contribute 70 to 75% of revenue, because we do anticipate the growth to be sustainable at that level. To the extent that the cold chain business scales up, it is obviously still a very small business. We forecast that in the next 2 to 3 years that business will become more and more significant, to that extent these percentages might vary a little bit, but for now we can see the central business staying at about 70 to 75%.

Aparna: Okay thanks a lot sir and all the best.

Vir Advani: Thank you.

Moderator: Next question comes from Mr. Amit of Lotus India AMC.

Amit: Good morning sir, very good set of numbers, congratulations on that.

Vir Advani: Thank you.

Amit: Sir one question. I was observing that your employee cost as a percentage of sales it has gone down from 9% to 7% for the quarter. Sir, are we actually seeing that operating leverage kicking in as in as scale is expanding?

Vir Advani: So what is your question I am sorry?

Amit: From margin expansion, one is the 1% reduction in the raw material cost for which the reasons can be the rupee appreciation and value engineering and all that. Another reason has been the employee cost as a percentage of sales actually going down, which means that the operating leverage impact has started kicking in that. As the scale expands as it is a very scaleable model, and more orders that you get and the more orders you execute your fixed cost obviously does not increase in the same proportion, right? So from this last two quarters are we seeing that actual operating leverage kicking in?

Vir Advani: Yes, absolutely. So that's why you see a 1% expansion in gross margin, but a significantly higher expansion in PBT, what you see for the half year is that employee cost grew around 27% whereas top line grew 46%.

Amit: No just wanted to understand that was that something extraordinary in last years employee cost?

Vir Advani: No, It is very much like to like and there is nothing extraordinary. It is in fact leverage that is kicking in. We had talked about this last year that we believe that the model doesn't need you to add a rupee of cost for every x rupees of revenue that you have. It's actually a more scalable model than that. Also you have to understand that cooling products has grown significantly and obviously it is a product business and therefore again you don't expect to see employee costs and things like that rising proportionally. So yes, it is definitely scale that is kicking in.

Amit: Okay thanks, thanks a lot sir.

Moderator: Next question comes from Mr. Shrinath of Motilal Oswal Securities.

Shrinath: Good morning Vir and Thiagarajan, great set of numbers as usual. A couple of questions. The first one is on the order book and the order inflow. We have been monitoring the order book for the last almost 12 quarters now and last quarter we began with the 48% YOY growth at about 974 crores or so. This time it is up about 31%, which is lower obviously than previous quarter and also the implicit order flow during the quarter seems to suggest a slight slowdown over the previous trend of 30 - 35%. The implicit order flow during the quarter could be something around 20 - 25% and if you juxtapose this with news flows such as some of the organized retail player facing resistance, and obviously some of the BPOs going back on their scale because of the rupee issues. Are there any initial signs of perhaps 5% to 10% points maybe slow down over the 30 - 35% growth that we have been kind of observing in the last so many quarters.

Vir Advani: So there are a couple of things there. We have been looking at this thing from a segment buying perspective and a few things are clear. One is that the organized retail, which is the front end of the entire chain. Clearly there are issues there from customers' growing perspective; you have all read everything in the newspapers. So it is in fact true that supermarkets are slowing down in terms of roll out. Now having said that, if you recall our business is divided between the front end and the back end. So the pack-houses and all of that are going on in the back end. Basically, if you look at it, you can broadly categorize our refrigeration business into Agri and Organized Retail. Agri part is growing by leaps and bounds. The retail piece is where the issues are. We obviously don't know when those are going to get resolved I think it will take some time. I think we have seen clearly buying by the organized supermarkets an issue. In the existing business which is where you are referring to the…

Shrinath: I am sorry you are breaking.

Vir Advani: Okay let me try again. I said in airconditioning, obviously supermarkets don't form a very significant part because there have been malls, multiplexes - that kind of retail is much more prevalent for airconditioning. There I think clearly everyone keeps reading about how there are too many malls and this and that, but we keep booking more and more mall orders. We still have not seen a slowdown in that segment, but maybe it will come; we don't know, we will see. So I don't think retail related to airconditioning is an issue as of now. In IT, BPO which is a significant segment for us, we have not seen any slowdown in buying of the large purchases. In our national accounts, for example, both in IT and BPO are buying significantly, as far as they are concerned they are facing more and more volume growth from their offshore business. I think some of the issues are creeping up in the smaller IT and smaller BPO companies where people are trying to tighten up and see how they can improve their productivity rather than going and buying more space. So there is a little bit of - I don't know if the word is slow down - but there is certainly questioning of the right thing and delay in closure of orders and things like that. So that is somewhat there but we are still not concerned. As far as our central airconditioning business goes, a lot of purchasing is now moving to the infrastructure segment. We have a large number of airport bids that are out. We have a large number of power sector bids that are out.

Shrinath: Is that happening, the power sector bids?

Vir Advani: Yes absolutely. There is large amount of growth in our telecom business, so I feel that in central airconditioning, lot of infrastructure buying is happening, and that may be probably offsetting some of this slow down or whatever that you have seen or you are reading about. Again in health care also we are not seeing any slow down in hospitals, so the way we are looking at is there may be by the end of the year as when we evaluate our buying for FY08 with…

Shrinath: Sorry you are breaking again.

Vir Advani: Okay I said that when you compare our buying of FY08 with FY07, at the end of the year we might see some shift in segment buy, but we are not so far seeing any slow down per se of any significance to worry about.

Shrinath: Okay that is one. The other one obviously was on margins. We had some time back said that we may be reaching double digit margins by FY09 may be whereas here it is not only double digit it is almost mid to double digit kind of thing. I mean slightly less than that, but mid 10 to 15% in this quarter alone. So would a half year kind of margin which is 10-1/2 be more realistic than the margins this quarter.

Vir Advani: Yeah please don't focus on the quarter. We stick to what we have talked about, which is double digit margins - we are getting there. You are right that we had talked about FY09, it looks as this is going to happen in FY08, which is fine, but we are not forecasting any high double digit margin. I think this is more to do with mix of business and things like that. Again by just the nature of our business quarterly reviews are very, very difficult. We prefer to do half year, full year, so please look at it from that angle.

Shrinath: And the next question is similar to the one, which was raised earlier - that of employee cost. Are we still continuing the AS15 rule of estimating incentives and charging it to revenue?

Thiagarajan: That is right, Shrinath. From this financial year onwards, we are providing for the incentives in that respective quarter itself. And also earlier we never used to provide for the gratuity and retirement benefit - that also we are doing now on a quarterly basis.

Shrinath: So which, if I am correct, was not there in the previous quarter right and a year ago; we were not doing that. So all of the AS15 actually came in the fourth quarter of last year.

Thiagarajan: That is right. When we declared the annual results, we did it and we took a double hit last year. Now this year onwards we have started making the provisions in the respective quarters itself.

Shrinath: So despite that, employee cost to sales is down from 8.8% in second quarter of last year to 6.8%.

Thiagarajan: That is true, that is basically because without adding additional manpower resources we have grown the top line. There are two reasons to that. One is with regards to the central airconditioning; the average size of the order is going up. And second, in case of packaged airconditioners, basically our distribution network is the model that we follow. So obviously the next question will be that how far we will sustain this? Yes, it appears this year we will be able to sustain like this. And in any case the top line growth will be far ahead of the employee cost growth.

Shrinath: Okay and just to conclude this employee issue point, in the second quarter of last year, do you think you would have paid the incentives for the previous year in the second quarter of the last year.

Thiagarajan: That is right so now September to September it is comparable now.

Shrinath: Yeah because last September you would have paid the incentives for '06 and this September we have actually provided for incentive payable this year. I mean likely to accrue for this year right.

Thiagarajan: That is right.

Shrinath: Yeah okay that closes the employees' part. One last question is on the tax front. Now we have two units in the low tax regime one is our Dadra unit if I am not mistaken. And the second is the Kala Amb unit in Himachal Pradesh.

Thiagarajan: That's right.

Shrinath: So the Dadra unit, when does the tax exemption on that expire, this is the last year I believe.

Thiagarajan: Yeah that is true.

Shrinath: So from FY09, Dadra unit will be under full tax.

Thiagarajan: Dadra will be at the fag end of this year. For one more year we will get a little more benefits. As far as Himachal is concerned, the benefits are available.

Shrinath: Yeah that's right for five years at least.

Thiagarajan: That is right - for 3 more years.

Shrinath: Okay and one last question again on the business, what are the developments on Blue Star design and engineering number one and two, our fifth new plant in Wada. How do you see that progressing?

Vir Advani: On Blue Star design and engineering, the business is significantly up for the first half. We are engaged in the UK, Middle East and in the US. We are looking at ways to scale that business further now and hope in the next 2 to 3 months to have a five year growth plan in place, so hopefully by the end of the financial year we will be able to talk about that more.

Shrinath: What is the head count here now?

Vir Advani: The head count is about 130 people or so.

Shrinath: It was about 100 a quarter ago.

Vir Advani: Yeah about a 100 or so. Correct. So things are going well there. On Wada, we are hoping to start production in January of 2008. It will be a limited production, because we have just put up a couple of lines; just to get business going and expect that probably by March/April we will be ready to move more production over. So we will be, like we just said, we are not moving any of the room airconditioner business there, so we are not as linked to meeting this summer requirements as we usually are. So this gives us a little bit of breathing room, but we hope to be up and running by January.

Shrinath: What are the initial products that are likely to role out from here?

Vir Advani: We actually haven't taken a decision yet. We have settled for the central airconditioning products - we stick to that. Now, which product lines within central airconditioning is a call that we will take over the next couple of months. Our manufacturing in general is highly flexible, so the factories don't need to be designed to a particular product line and so we will take that call over the next couple of months.

Shrinath: Yeah thank you very much. I may come back later.

Vir Advani: Thank you.

Moderator: Next question comes from Mr. Nirmal of Alchemy Shares.

Nirmal: Good afternoon sir.

Vir Advani: Good afternoon.

Nirmal: I just wanted to know, based on the current capacity and the manpower, how much more order intake can we take and second question, last time when we had met, you had mentioned to grow at around 35 to 40% CAGR would not be an issue, but to grow beyond 50% there will be aggregation challenge. Can you throw some light on these two issues?

Thiagarajan: One is the order inflow. We have shown in the past, even if the order inflow is somewhere around 40% or 45% we have managed to execute the orders well and sustain that with the existing manpower without significant increase. But at the same time, as a company, we need to plan out the next three years - how the market will develop and what are the segments that will grow, so obviously it is not the execution manpower. There will be several other manpower resources like planning, acquiring technology and training. The ballpark figure is that, if the growth is 30 to 35%, with this kind of manpower, we will be able to manage. And indeed, we will be allocating resources to many other developmental projects in the coming years. That is what you have to keep in mind. So you are basically trying to see how the top line growth without growing the expenses will be maintained. That must be your interest right?

Nirmal: No sir, right now the availability of manpower is an issue specifically in your industry - where more and more there is a shortage of engineers. So how are we tackling that kind of problem and considering the growth what we have done in the first half, how are we poised for that?

Thiagarajan: It is a valid point. As of now our attrition are well within our control. We have not been facing any undue or a galloping attrition rate. Two, obviously this industry is doing well. Suddenly people are seeing huge growth, since it is construction related. I think we will be able to attract more manpower than in the past. We have witnessed in the campus recruitments, both the degree holders and diploma holders, more and more are opting to be a part of the industries associated with the construction boom. So we have a clear plan for the next two years, how many people we have to recruit in what segments.

Nirmal: Sir just one last question you mentioned about this scale, you mentioned that the average order size is going up. Can you highlight what was the average order size same quarter last year and what it is right now.

Thiagarajan: Probably in the next quarter we will be able to share some structured data. All that I can say is that, in central airconditioning, projects used to be around 5 crores. It is now moving towards 7- 7.5 crore.

Nirmal: Okay, thanks a lot.

Thiagarajan: Thank you.

Moderator: Next question comes from Mr. Nishit of ABN Amro Broking.

Nishit: Good morning sir. Congratulations on the good set of numbers.

Vir Advani: Thank you.

Nishit: Sir all my questions have been answered, but this is regarding our quarterly results. Historically, we have seen that fourth quarter is almost 40% higher than the previous three quarters. Do we maintain that? Even in this year we would see the same trend?

Thiagarajan: See historical data will at some point of a time undergo a change because we see a market shift in many segments or the size of orders or the type of customer segments or the product mix that we have. At this point of time, we are not be able to extrapolate based on that 40%, and if you are attempting to forecast what will be the year end revenues, you have do it out of the data that is available - the pending order or order inflow rate and the billing that we have achieved.

Nishit: That I do agree, but again sir I just wanted to see whether the trend has shifted?

Thiagarajan: Probably this year and first half of next year may be defining that. As of now, it is very difficult to predict that.

Nishit: Ok sir.

Sonal: Good morning Vir, this is Sonal here. On the professional electronic side we have seen some margin dip, is there a drastic change in the product mix out there?

Vir Advani: You are saying that for the quarter right?

Sonal: Yeah.

Vir Advani: That has gone down from 25% to 19% or something. No, we maintain that professional electronics there are 5 or 6 very different lines of business within that, and each one has its own quarter to quarter buying situation. So attempting to extrapolate margins in professional electronics on a quarterly basis is very, very difficult. It really depends on which product lines hold in which quarter, so you are better off looking at the half year, because the half year margins were 19.5% last year, they are 18.6% this year. We don’t see any good reason why the year will not end at the same levels of last year, because I think to the extent that some more lines of business may do better this year. The other thing is that top line doesn't really correlate with bottom line because of high sea sales that happen in this line of business. So we are maintaining that we expect operating margins in the electronics division to be in and around 20%, even for this year.

Sonal: Okay and one more question on the cooling products side. Is it possible to share roughly out of the total what you have done in the first half, what is the share of the cold chain part?

Vir Advani: No, as you know we don't break out that information below the segment. It is growing, but it is still not significant, we know that.

Sonal: The room AC is still going at a faster pace than cold chain, within the portfolio?

Vir Advani: Yeah so for the half-year, room airconditioners have certainly grown faster, other than it has to do with what we talked about earlier, which is this organized retail, some delays in purchasing and what not. And also inherently our split airconditioner business is doing phenomenally well. So I think between those two, clearly room airconditioners have grown much faster than cold chain.

Sonal: On the gross margin trend sir if you could just, is it possible to quantify the extent of the gain that has been purely due to the rupee appreciation?

Vir Advani: No, we don't have that I am sure it could be worked out; we don't have that as of now.

Sonal: Ok. Thank you.

Moderator: Next question comes from Marco of Equinox Partners.

Marco: Hi, gentlemen, good morning.

Vir Advani: Good morning.

Marco: I know we have talked about margins already, but staying on the central airconditioning segments I was wondering if you could comment on going forward, how management would consider balancing the margins versus achieving a level of growth and whether the increase in airports, telecom and power sector is going to affect the consideration?

Vir Advani: Could you be clear, you are asking how the infrastructure segment is going to affect the revenue growth? Is that the question?

Marco: No, not the revenue growth, but are the margins for the individual segments different among the infrastructure versus the shopping malls or…

Vir Advani: Okay, so how is the business mix going to affect growth in margins is it?

Marco: Yes and how the management thinks about balancing margins versus the rate of growth of top line.

Thiagarajan: In a construction boom, obviously for the first time in the country we are witnessing shift in the segments. IT, ITES used to be 65% of our central airconditioning revenue, which is now shifting towards many kinds of segments. Say, for example, infrastructure related projects. Here again you have something promoted by the Government and something by the private sector. For the first time privatization is happening in a big way. There is retail. There is healthcare and you do have hotels and hospitality industry investing in a big way. As of now, we are seeing margins in infrastructure projects to be equivalent or in certain cases higher than even the regular ordinary airconditioning projects. Probably, we will be in a position to analyze this and share in a better manner in about a year's time because the shift is just now taking place. To further clarify infrastructure projects seem to be more profitable than the regular projects as we see it today.

Vir Advani: And part of this could be a result of the difference between winning a large order and a small order. In smaller orders you have a lot more competition and in larger orders the options to the customer also reduce. There are only so many vendors like us, who can deliver above a certain value, and with large value projects now coming up in the market, we hope to be able to improve the margins even on the larger jobs. So that's another thing that is happening.

Marco: So on a quarterly basis, margins will fluctuate if you capture one more or one less of these large airports or power sector projects?

Vir Advani: No, it shouldn't because as you see in the order book, it is now crossing Rs 1000 crores and as far as we can see for the next 12 to 18 months, although we are trying to correlate infrastructure, we haven't seen any significant greenfield infrastructure jobs coming up. So they are certainly larger than our traditional orders, but not 8 to 10 times larger. So I mean when Thyag said that in central airconditioning job values are inching up to 7.5 crores, it is a move from 5 crore. So we are still talking about 10 to 20 crores order values for the next 12 to 18 months. I think that will further undergo a change in the future, where it might start creeping up to Rs 40/50 crores, but that's still in the future. So when that happens, may be then you start to see these quarterly fluctuations, but for now I don't think these single orders are going to skew margins significantly.

Marco: Ok.

Vir Advani: Thank you.

Moderator: Next question comes from Mr. Rahul of Lucky Securities.

Rahul: Good morning sir and congratulations on a great set of numbers. My question pertains to your capabilities in delivering very large size turnkey solutions, say for example our Hyderabad airport or a revamp of the Delhi airport; do we have the capability to execute such large contracts?

Vir Advani: It depends how you look at it. For example, the Delhi airport, the entire job is being done by a general contractor. So if you ask the question are we able to deliver that, no because we are not a civil construction company, but if you ask the question more specifically are you able to deliver HVAC or airconditioning system solutions to a Delhi or a Hyderabad airport, the answer is absolutely yes. We continue to be, I think in the country we still have the largest jobs delivered whether it is RBI or any other large jobs like that. We have experience doing 50 crore plus jobs. So we are not seeing that as a significant issue, but however, having said that, you do know that some of these large jobs are being tendered and sold in different manners. So a general contractor doing an end-to-end job is something new in India. So to that extent, we maybe hampered like you are saying, but technical capability wise, there is no issue.

Rahul: Ok just to add on the point from what I understand the Hyderabad airport, which is under construction, the airconditioning is being handled by Voltas. So point number one, is my information correct, and secondly are we in a slightly negative position compared to Voltas in bidding for these really large sized contracts?

Vir Advani: Your information is correct about Hyderabad airport. We did bid on that, we walked away from it for commercial reasons, but that didn't stop us from technical bidding. Now I think where Voltas is obviously stronger, is that they have a large international business and I think working in the Middle East, the advantages that the job sizes are larger, so to that extent I am sure that they have a lot of capability to deliver. I don't have an opinion on which way they are structured and whether their Middle East operations will actually come back to India to deliver some of these because in India the large jobs are being done by both them and by us. So I think we will have to see how things unfold. We are obviously very cognizant of the fact that job sizes are increasing and that we need to keep moving up because that's how your margins improve. So having said that, we are highly focused and so if we have to let go of large jobs, which are not as profitable as what we want, or we may not do them. But I think it is still early days to form opinion on whether or not Hyderabad airport and things like that will necessarily go to only one bench or so any one else.

Rahul: Do you need to rejig your product offerings to get these kinds of orders or that is not really envisaged at the current point of time? Do you have to take on some more parts of the turnkey aspects or the civil construction part of it, or that's not necessary in your opinion?

Vir Advani: As far as turnkey goes, the word turnkey in our industry becomes restricted to what is known as building services, which is mechanical, which is basically the airconditioning and electrical. These are the two pieces that go together. It is very rare that civil goes along with electrical and mechanical because the skill set is completely different. Mechanical and electrical certainly go together simply because they occupy the same physical space above the false ceiling. So we started building an electrical business last year, we are booking orders in the electrical space. Certainly going forward over the next 3 to 5 years we would see more and more turnkey jobs coming into the market, and we are working on ways to bring up that electrical capability in the company up to the level of our airconditioning capability. To that extent, I think Voltas because they are operating in the Middle East has the electrical capability already, but I think that in the Indian market right now turnkey jobs are still not the norm. We have several years to go before that happens, so there is a move in the company to build the electrical skill.

Rahul: All right. Thank you very much and all the very best.

Vir Advani: Thank you.

Moderator: Next question comes from Mr. Siddharth of UTI Mutual Fund.

Siddharth: Hello sir I am Siddharth from UTI Mutual Fund.

Vir Advani: Yes, please.

Siddharth: Sir we have seen for the last six quarters - the order book has been between the 40 - 45% increase over the order book if you consider the last six quarters from June '06 to September '07 and for this quarter the order book size is around 30% growth. So is it because of the higher base or just a seasonal trend and we can see even 40% growth over the next order book also, because your base also is increasing largely.

Vir Advani: Yeah, I am trying to understand your question. So you are asking whether the carry forward order book growth is slowing down is it?

Siddharth: In absolute numbers it is as usual. Is it because of the higher base we are seeing degrowth or it is just the seasonal trend?

Vir Advani: No there are a couple of things. One is you will also understand that with the cooling products business growing faster, cooling products business tends to be more book and bill. We don't carry forward as much business in cooling products obviously. So even though you are seeing revenue growing, the order book growth you are seeing is not as fast, so that's one angle. The other angle is that like we have talked about, this organized retail which was growing faster last year we are facing some buying decision delays and things like that. But in general we remain optimistic that the order inflow will continue, because we are not seeing any significant slowing down. Also like we talked about, there may be some shift in segment buying when you are selling to government, airports and things like that. While the job sizes are larger, the turnaround time or the lead time on sales becomes longer. So there are some of those things. So while we are going through this transition from heavy IT buying to non-IT buying, there may be from quarter to quarter some, what appears to be order book not growing as fast, but we are not too concerned with that right now.

Siddharth: Okay, thank you sir, congratulations for excellent numbers.

Vir Advani: Thank you.

Moderator: Next question comes from Mr. Nilesh of Tata Mutual Fund.

Nilesh: Good morning sir. I just had one question. This was regarding when we speak to Voltas, what they indicate that gradually the order size is increasing. We were talking about the Hyderabad project. The total MEP size of the order is around 165 crores rupees out of which airconditioning forms around 40 crores, which is what they have won. Just wanted to understand that Voltas is taking steps going forward understanding that going forward more MEP projects would be given, which would be larger in size which would invariably improve margins. As a company, what are the steps that we are taking to see that we are technically capable of MEP projects which would be larger in size, which would invariably improve margins and give a small visibility of earnings going forward? What are the steps that we are taking and how do we see ourselves bidding for these kind of huge orders sir?

Vir Advani: *W*e are building that capability in-house like I mentioned right now. There are a few examples of turnkey projects like Hyderabad airport that you mentioned. They are few and far between, and that's simply because the industry is still not mature may be to that extent. It also has to do with the fact that there may not be too many matured MEP vendors available. So you don't know whether the chicken came before the egg or whatever. So it will happen. We are cognizant of it that it should happen in the next 3 to 4 years. There is a lead time to build the capability. I don't think that any one company at least in India today has a significant sort of a competitive advantage that we can't catch up to. As far as we are concerned, our business strategy is very clear, which is to engage with large corporate and commercial customers, to build our national account presence. We are still the largest vendor in India. We have the highest margins out of all publicly traded companies in this segment by a long shot if you review it. So we are obviously doing something right in the market we are serving. It is with the intention that as you build these large long term relationships with these customers, as the buying trend moves towards bundled or turnkey buying like you were talking about, we will be the natural vendor who gets that business. To that extent we need to spend time building that capability. We are obviously doing that, but I think that it is still early days in the market for it.

Nilesh: Ok you are saying complete MEP kind of projects coming into India would take another 3, 4 years and within that time you would have that capabilities because Voltas does have the capability and is executing MEP projects in the overseas markets, so you think within the 3 to 4 years by when MEP projects would start coming into India, you would have that capability. Is that the key understanding that I have got from what you said?

Vir Advani: Yes, so just to clarify, MEP jobs are happening as we speak right in Hyderabad airport in India and like that, there will be some more, but as a percentage of the total market I think it is few years before it becomes significant and so by the time it does, just to let you know, we are already booking and billing and executing electrical jobs. It's not as though we are not. It's just that we are not executing large MEP jobs like what Voltas talked about, but the strategies to build up the electrical capability as and when the MEP market becomes significant, we will have both HVAC and electrical capability in place.

Nilesh: No issues. That answered my question. Thanks a lot and congratulation on an awesome set of numbers. Thank you.

Vir Advani: Thank you.

Moderator: Next question comes from Munjal Shah of ICICI Prudential.

Munjal Shah: Sir just wanted to understand from these current levels of Rs 1600 crores sales in 2007, when are we targeting a billion dollar of revenue sir?

Vir Advani: It depends on what the dollar is going to be at.

Munjal Shah: Assuming 40.

Vir Advani: Assuming 40, I don't know that. I think we will be maintaining that we anticipate growing 30 to 35% top line for the next few years.

Munjal Shah: That few years would be 3 to 5 years or more than that?

Vir Advani: I don't think any one can see beyond that. So I will state three years just to be safe. We believe we are in a long term 10 year commercial construction up cycle, but I don't think anyone is forecasting 10 years, so I see the next three years

Munjal Shah: And you mentioned about five year plans which you would be formalizing by the year end or something.

Thiagarajan: Normally we do in the month of January.

Munjal Shah: January. So would it be shared with the general public or the investor?

Thiagarajan: Not exactly, but relevant information or direction we will continue to as a part of the analyst meet.

Munjal Shah: Okay and secondly are you looking at some inorganic growth opportunity or further tie-ups for your business, technical tie-up or something?

Thiagarajan: Technical tie-ups we continue to. In fact we keep pursuing many tie-ups like that. Agency businesses are representing foreign principals in India. We continue to evaluate many opportunities.

Munjal Shah: Yes, But is there anything in line, which should happen before March '08, or something.

Thiagarajan: Nothing as of now, if there is, we will share with you.

Munjal Shah: Okay fine, thank you very much sir.

Vir Advani: Thank you.

Moderator: Next question comes from Ms. Sarika of JM Mutual Fund.

Sarika: Hi, good morning sir. Sir I just want to understand what could be the driver for the professional electronic business of yours going ahead and if you could touch upon the different product profiles under this segment.

Thiagarajan: See professional electronics business is a mixture of many agency lines and many industrial products. In a manner of speaking, we can say it is an opportunity business that some segments are growing and we represent somebody. We grow that business; the principal may decide to come on their own in the country. So it has been going on like that. What is to be noted is, with the manufacturing and industrial growth, combined with overall economic growth that is happening, this business is booming. Be it testing machines, be it analytical instruments, be it projects. Of late what we are seeing is turnkey solutions as a system integrator, adding certain Indian products along with the imported products, testing and commissioning. There are several projects that we are executing. I think this trend is going to continue. So this business, though has nothing to do with airconditioning, except that the engineering is the common thing. We see the growth prospects or the outlook continuing.

Sarika: Okay how big could it grow, some numbers if you could talk upon.

Thiagarajan: We have been maintaining that all our segments will be growing between 30 to 35% in the next 2 to 3 years of time and that is the outlook for this division as well.

Sarika: Okay.

Thiagarajan: Anyway to repeat for your information, the top line here is the Indian part rupee billing plus the commissions that we received. Strictly speaking, the value of the equipment in high sea sales is not getting reflected. As of now that business will be close to Rs 700 - 800 crores top line. Because it is directly imported by the customer and we are only receiving an Indian agent's commission, it is not getting reflected in the top line.

Sarika: Okay fine thank you.

Moderator: Next question comes from Mr. Shalab of Sundaram BNP.

Shalab: Good afternoon sir.

Vir Advani: Good afternoon.

Shalab: Congratulations on the very good set of numbers.

Vir Advani: Thank you.

Shalab: Sir after all these questions I was more interested to know about the long term strategy of the company, what is the company thinking about the business next five years, may be when the construction boom slows down. What are the other growth areas that the company is looking at and probably working on those?

Vir Advani: Well the truth is like we said our main challenge is people management, manpower and so currently we are highly focused on the growth rate and managing the growth rate that we have in the businesses that we are in. We don't foresee adding any new lines of business or any unrelated lines of business in the foreseeable future simply because we are very focused on what we are doing, which is growing the revenue which is important for us more from the margin perspective and keeping track on the margins. What you will probably see over the next five years is that you would probably see a more international company that means that we will look outside India, but still we will be highly focused on the product lines and segments and customers that we serve. So as a company, we believe that our core competency is in handling commercial customers in the building segment. So that's the broad definition of what we believe our co-competence is, and it has been highly India focused and perhaps the one exception we will make to our current strategy is to try and make it more international. But, I don't think we have any intention in getting into a new or unrelated line of business.

Thiagarajan: Plus to add to that we are a manufacturer, we are a contractor, we are a service provider. So, all these three streams of revenue have been helping us to sustain in all types of periods. So, honestly if the construction boom is slowing down, something in service should be sustaining and broadly as of now as we had mentioned we are focused on this current growth than paying our attention to what will probably happen when the boom goes away.

Shalab: Okay sir on the MEP side, sorry to dwell more on that but has our foray into the international market being more restricted because of our capabilities in MEP, because we are more focused on HVAC and not the entire chain?

Thiagarajan: Not exactly. We have been present in Middle East. At some point of time when there was a slow down we pulled out of the Middle East. Then here, currently in the country the growth is happening in a big way though we still continue to bid for Middle East jobs depending on the profitability. It is the question of priorities that's about all. It is not to do with our inability to take up MEP jobs. As we mentioned, we are indeed bidding for MEP jobs within the country also.

Shalab: Sir just one more question on MEP, once we start bidding for these integrated projects where we do the entire mechanical and electrical part, just wanted to understand from the business point of view, the integrated margins would be lower or higher than what HVAC offers, because as I understand electrical part is a low value add business and the margin can be lower over there.

Thiagarajan: Not exactly, our understanding with the type of projects that we have currently in hand or from the industry information, electrical contracting business could be as profitable as or slightly more profitable than even HVAC.

Vir Advani: The only difference is that to clarify that we will not be an equipment manufacturer in the electrical space. So to that extent what Thyag is saying is easily understood - which is contracting margins should not be any different, the difference would be that in HVAC we will also be capturing manufacturing and service margin.

Shalab: Right, so it will be mostly in the bought out components in the electrical part.

Vir Advani: Yes, but when you compare the two contracting businesses side by side there is no good reason why one is better or worse than the other.

Shalab: Ok sir. What kind of CAPEX are you looking at in FY08 and the coming next few years?

Thiagarajan: See as of September '07 we have spent Rs.13 crores. Because many jobs are in work-in progress we have not capitalized with that. The year end it will be anything between 60 to 80 crores.

Shalab: And sir, going forward do we maintain this rate of 60 to 80 crores or as the business grows we will have to also pump in more money into the capital expenditure?

Thiagarajan: We intend reviewing this with the big growth that is happening and the profitability improvement that is available now. We want to review this some time in December or January. Most probably we are open to increasing our investments in manufacturing and as well as IT infrastructure. So we will have a concrete plan sometime in December or January.

Shalab: Okay but the 60 - 80 crores would include the entire CAPEX of the Wada plant?

Thiagarajan: Yes, definitely.

Shalab: Okay thank you sir and all the very best to you.

Vir Advani: Thank you. I think you can just take one more question and wrap up please.

Moderator: Sure sir. Last question comes from Mr. Milan of ASK Securities.

Milan: *H*i sir, I joined late, so I don't know if this question has been answered, just wanted to know the size of opportunity in India for MEP work over next five years possibly.

Vir Advani: Size of opportunity in MEP work over the next five years, so and I suppose you are talking about commercial buildings, right?

Milan: Yes, anything you think you can do over next 3 to 5 years.

Vir Advani: No you need to understand electrical goes into everything that stands, right? So it can go into power plants and it can go into ship etc.

Milan: But you won't be doing that.

Vir Advani: We are restricted to commercial buildings and not residential buildings and all of that. The electrical contracting business should be as large as the airconditioning business, because for every rupee that you invest in a building in airconditioning, you invest an equivalent amount in electrical. So as you build out the airconditioning business over the next five years, you will have an equivalent electrical opportunity. Now what is important to understand is that a percentage of that overall market will be MEP that means it is a turnkey bundled order. So that will be a percentage of the total market, it won't be the whole market. So you need to start dissecting to figure out where it will land up. So we feel that over the next 3 to 5 years may be about 25% of the market will be bundled MEP jobs. Not more than that.

Milan: Okay and so what would be the size in terms of absolute number? Any guess or any working you have done internally.

Vir Advani: No, we haven't actually, so you can probably do that. You can take - I think last year HVAC market size central airconditioning market size was 2800 crores, so if you extrapolate that out over 5 years you can probably figure out what the total market will be.

Milan: Right, I'll do it. Okay, thanks a lot and all the best.

Moderator: There are no further questions. Now I hand over the floor to Mr. Vir Advani for closing comments.

Vir Advani: Thank you very much everyone for getting on the call. We will be scheduling our next conference call at the end of the next quarter. So we will wait to hear from you then and we will also be sending out an investor update hopefully on Monday. We are just waiting to clear it by our Chairman. So probably Monday everyone will get the investor update and all of that will be up on the web site also by then. So you can access www.bluestarindia.com to get a copy in case we have not e-mailed it. With that, thank you very much and have a good day. Bye, bye.

Moderator: 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.