"Blue Star Limited Q1 FY19 Earnings Conference Call"

August 09, 2018

MANAGEMENT: MR. NEERAJ BASUR – CHIEF FINANCIAL OFFICER

Moderator: Good morning, Ladies and gentlemen. Welcome to Blue Start Limited Q1FY19 Earnings Conference Call. We have with us today from the Management Mr. Neeraj Basur – Chief Financial Officer. As a reminder, all participant lines will be in the listen only mode. and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Neeraj Basur. Thank you and over to you, sir.

Neeraj Basur: Thank you very much. Good evening, Ladies and gentlemen. This is Neeraj Basur. I will be providing you an overview of the results for Blue Star Limited for the Quarter Ended June 2018.

First I will talk about our Financial Highlights for Q1 FY19:

Effective April 1, 2018, the company adopted IndAS 115 and accordingly has realigned its revenue recognition policies appropriately. The accounting changes have been applied with retrospective effect to each of the prior reporting periods presented. The company has opted for a full retrospective approach in view of the seasonal nature of its business. The impact on revenue and profit was not material for the full year FY18.

Following are the financial highlights of the company for the quarter ended June 30, 2018 on a consolidated basis:

-Revenue from operations for Q1FY19 was Rs 1507.8 Cr, as compared to Rs 1519.9 Cr in Q1FY18. Comparable revenue from operations in Q1 FY 18 after adjusting the excise duty and other applicable input taxes was Rs 1405.1 Cr (growth of 7.3% in Q1FY19 over Q1FY18).

-EBIDTA (excluding other income and finance income) for Q1FY19 was Rs 136.7 Cr as compared to Rs 110.6Cr in Q1FY18, growth of 23.6%. EBIDTA (excluding other income and finance income) as a percentage of revenue improved to 9.1% in Q1FY19 from 7.3% in Q1FY18.

-PBT before exceptional items for Q1FY19was Rs 111.8 Cr as compared to Rs 101.9 Cr in Q1FY18, growth of 9.7%. PBT before exceptional items as a percentage of revenue improved to 7.4% in Q1FY19 from 6.7% in Q1FY18.

-Tax expense for Q1FY19 was Rs 32.5Cr (effective tax rate of 25.6%) as compared to Rs 25.9 Cr in Q1FY18 (effective tax rate of 25.4%).

-Consequently, consolidated net profit for Q1FY19 increased to Rs 91.6 Cr from Rs 76.2 Cr in Q1FY18, a growth of 20.2%.

-Carry-forward order book as at June30, 2018 was Rs 2121.6Cr as compared to Rs 1969.1Cr as at June30, 2017.

-Consolidated capital employed increased to Rs 1305.5 Cr as on June30, 2018 from Rs 843.4 Cr as on June30, 2017to support seasonal working capital requirements.

-Consequently, consolidated net borrowings increased to Rs 413.4 Cr as on June 30, 2018 from Rs 47.7 Cr as on June 30, 2017. Our debt to equity ratio was 0.5 as on June 30, 2018 as compared to 0.1 as on June 30, 2017.

I will now talk about business highlights for Q1 FY19:

First, I will talk about Segment-I: Electromechanical Projects and Packaged Air-Conditioning Systems. Segment I revenue was Rs 619.4 Cr in Q1FY19 as against Rs 599.1 Cr in Q1FY18, a growth of 3.4%. The segment results grew to Rs 39.7 Cr (6.4%) in Q1FY19 from Rs 24.3 Cr (4.1%) in Q1FY18. Order inflow in Q1FY19 was Rs622.8Cr as compared to Rs709.5Cr in Q1FY18.

On the Electromechanical Projects business, the market is showing signs of revival in terms of large number of enquiry inflows from private sector, largely office, hospitals and industrial segments, as well as from government driven infrastructure projects such as metros, airports and healthcare institutions. However, these enquiries have not yet translated into order finalization during the quarter. We expect the order booking momentum to pick up over the next three to five months.

Revenue growth in Q1FY19 was lower due to accelerated pace of supplies in Q1FY18, ahead of the introduction of GST last year. The strategy is to focus on profitable and healthier cash flow projects which would contribute to segment results. We continue to invest in smart systems and technology in line with our value proposition of superior project delivery through intelligent engineering, modern execution practices and committed teams.

We maintained leadership position in the electro mechanical space in India. Some major orders won during Q1FY19 included LuLu Mall by KEF infra at Lucknow, My Home Bhooja Hyderabad, Brigade OMR Bangalore, Tata Realty Chennai, Lotus greens Noida, Oracle Bangalore, Wipro Chennai, Sintex Factory Gujarat, L&T Realty Mumbai, Amara Hospital Tirupati and Apollo Hospital Bhubaneswar.

Carry-forward order book of the Electro Mechanical Projects business was Rs 1447.0 Cr as at June 30, 2018 as compared to Rs 1453.2 Cr as at June 30, 2017

Moving to Central and Packaged Air-Conditioning Systems business. In Q1FY19, Central and Packaged Air Conditioning Systems business registered a growth of 15.2%while the market grew at 13.0%. We continued to grow at a faster pace than market growth. The trend of growth is expected to continue in Q2FY19. New product variants launched in last financial year

gained good acceptance in market and helped to gain market share. Key segments that contributed to the business in Q1FY19 are government, retail, hotels, industrial and hospitals.

Major orders bagged in Q1FY19 were from Red fort Museum,,Rajeev Gandhi Hospital, MES (Military Engineer Service), Siemens Limited, Unichem Laboratories, Jinal Steel works and Emmar Properties. We would be launching an energy saving variant of chiller in FY19, which would widen our product range in the chiller market.

Talking about International business, our focus remained on expansion of the Blue Star product range and consolidation of growth in the different markets that we are present in. Our international business is present in 19 markets and we are currently focused on deepening the penetration in these markets. We also launched a range of Room Air Conditioners, Water Cooler, Bottle Water Dispensers and Water Tank Chillers, for the Saudi Arabian market, along with our authorized distributor Sands International in Saudi Arabia. With this partnership, we aim to cater to a large base of customers in Saudi Arabian market and provide them a world class consumer experience. A wholly owned subsidiary Blue Star Systems and Solutions LLC is being incorporated in the mainland UAE to support and expand the air-conditioning and service businesses in the country.

We received the prestigious EUROVENT Certification, for our Air Handling Units (AHUs). This is a critical accomplishment, which will help us offer a wider range of EUROVENT Certified range of AHUs in the international markets that we operate in.

During the quarter we continued to actively engage in product launches, seminars and press meets across the globe; to showcase our wide range of products, and provide our stakeholders, partners and customers the perfect platform for interaction. We continue our journey to strengthen our brand in select international markets. We have plans to selectively and profitably grow our international business and the overall business outlook remains positive.

I will now talk about Segment-II, Unitary Products. Revenue for this segment de-grew to Rs 830.8 Cr in Q1FY19 as against Rs 861.3 Cr in Q1FY18.The segment results were however flat at Rs 95.0 Cr (11.4%) in Q1FY19 as compared with Rs 95.3 Cr (11.1%) in Q1FY18. Better product mix and cost rationalization contributed to improved margins in Q1FY19.

Coming to room air conditioner business, unseasonal rains and soft summer conditions across the country, especially in the Southern part of the country affected Q1FY19 performance. The RAC industry de-grew by 13% in value terms. Our sales declined by 10% which is a matter of concern since we had planned for a growth of 20% and hence have inventory holding in excess of normal levels by around 60 days. We expect pricing and liquidation pressures to continue till the festive season.

The position was revived partly towards the quarter end, predominantly in the Northern Region. We performed better than the market in quarter end, primarily due to higher billing of

premium products and our market share improved from 11.4 % in Q1FY18to 11.7% in Q1FY19.

Major orders won in Q1FY19 were from Narayana Group of Institutions, Sri Chaitanya Group of Institutions, SKD Reality, VIT – Bhopal, Gujarat Gas, Ananda Residency, ECIL, PWD – Orissa, Rungta Mines, CPWD – Guwahati, Maruti Suzuki, Pernod Ricard, JIMS etc.

We expect competition to continue to intensify in the inverter air-conditioner segment with some competitors resorting to reducing / maintaining prices despite increase in input costs. In spite of a soft summer, we expect growth momentum to pick up in the rest of the year in the back drop of significant under penetration. We see good prospects from institutional segment.

Moving to commercial refrigeration business. In Q1FY19, Commercial Refrigeration business registered a growth of 8.2% while the market grew at 2.2%.We continued to grow at a faster pace than market growth. Our strong position among national and key account customers helped deep freezer category maintain a steady growth momentum. Bottled water dispensers gained modest growth. The new lines of business “Medical Refrigeration” and “Kitchen Refrigeration” had gained traction in the market. Our foray into Retail Refrigeration has evoked good response and this business should see results in the quarters ahead. Expansion plans of QSR (Quick Service Restaurants), Dairy and Ice Cream segments increased demand for modular cold room business. Overall the Commercial Refrigeration business is poised for scaling up with its strong and wide product range.

I will now talk about our Water Purifier business. Revenue from our water purifier business doubled in Q1FY19as compared to Q1FY18.

During the quarter, we launched stylish and differentiated range of residential water purifiers with RO, UV, RO+UV and RO+UV+UF technologies. The range comprises nine series, with price points varying from Rs 10,900 to Rs 44,900 in the RO and its variants range; and price points from Rs 7,900 to Rs 8,900 in the UV range. When we forayed into the business, it was with 13 models in limited price bands and the same has now been extended to 35 models (including colour variants) across various price points.

Select models offer an innovative and unique Immuno Boost Technology. We are also test marketing a range of commercial water purifiers, to cater to the growing demand of purified water in offices, restaurants, clinics, and other commercial establishments.

Our water purifiers are already available in 174 towns with over 250 channel distributors/dealers including ecommerce channels and modern trade in over 2400 retail points, and we target to increase the presence to over 3600 outlets in FY19. There are over 400 ‘Star Water Consultants’ across major outlets for demonstrations and lead generation that have been

appointed. We have launched a new TV commercial highlighting our Immuno Boost technology.

Our segment II results were impacted by around 140 bps during the quarter, due to investment in this product category primarily in marketing, brand building and R & D.

Since our entry into the residential water purifier business, we have made good progress in this segment with a wide range of product variants. We are committed to make significant investments and want this business to set a benchmark in terms of the quality of products as well as customer service. Our goal is to achieve revenue of around Rs 100 cr in FY19.

I will now talk about Segment-III, Professional Electronics and Industrial Systems. Segment III revenue was Rs 57.7 Cr in Q1FY19 as against Rs 59.5 Cr in Q1FY18.The segment results were Rs8.3 Cr (14.4%) in Q1FY19as compared with Rs 9.5 Cr (16.0%) in Q1FY18.

This segment witnessed improvement in enquires inflow. Revenue of health care business improved from supply of CT scanners to the heath department of the Government of Uttar Pradesh.

Growth potential of Indian digital payment sector and rising focus of enterprises on data security create a huge opportunity for this business. Expected growth in healthcare market also offers good opportunity to grow this business. The order booking inflow has grown over the past 2 quarters and we expect the momentum to sustain in the coming quarters too. We have added contemporary products to widen our reach in digital data security market.

Major orders bagged in Q1FY19 were UP – CT, Rajeev Diagnostics, Rajasthan, National Payments Corporation of India (NPCI), Thermit, Microlab, BHEL, National Bureau Of Plant Genetic Resources (NBPGR), Maharashtra Seamless, Timken Jayaswal Nicco, Suzuki,etc.

On business outlook, increased enquiries from private sector and prospects from infrastructure sector such as development of airports, healthcare and metro rail projects will open up opportunities for the electro mechanical projects business. In spite of a soft summer, market potential in the Unitary Products segment remains strong in the back drop of significant under penetration. We also expect the pace of order inflow in the Professional Electronics& Industrial segment to continue. We will continue to make investments in manufacturing, marketing, brand building, product development as well as human resources in the next few years in order to capitalize on the imminent growth opportunities.

With that ladies and gentlemen, I am done with the opening remarks. I would like to now pass it back to moderator, who will open up floor to questions. I will try and answer as many questions as I can. To the extent I am unable to, we will get back to you via e-mail.

With that, we are open for questions.

Moderator: Thank you. Ladies & gentlemen, we will now begin the question-and-answer session. We have the first question from the line of Renjith Sivaram from ICICI Securities. Please go ahead.

Renjith Sivaram: We have around 3% drop in the UCP revenues, but we had taken some price hikes also. So, in volume terms what will be the kind of decline in the UCP segment?

Neeraj Basur: The volume decline will be higher because the overall price realization has helped us to maintain de-growth at the current levels. Our focus on five star and inverter categories also helps higher average selling price realization.

Renjith Sivaram: So, as a follow-up, if you can help us how the percentage of inverters have moved?

Neeraj Basur: In the current quarter we had around 45% of our sales from inverter ACs, which was pretty much in line with the market. Last year it was closer to around 20% - 25% and this has steadily grown to around 45% now.

Renjith Sivaram: Also, unallocable expenditure had been low. Is it right to assume that the investment phase of the water purification systems is over and now they have started to give revenues or profits?

Neeraj Basur: The water purifier business has consistently been reported as part of Segment-II and the unallocated expenses have largely been a part of the common corporate expenses. It is not linked with investment in water purifier business. The overall reduction in unallocated expenses is part of our conscious focus to keep our common costs in tight control. There were certain onetime expenses last year which are not repeated this year.

Renjith Sivaram: So, in water purifiers, can you quantify what was the revenue and what are prospects you are seeing?

Neeraj Basur: We are aiming for Rs. 100 crores range revenue in FY19 and at that level we will have around 2.5% of the market. This will be the second year of our presence in this particular category. The impact on margin is about 140 basis point on Segment-II results in Q1 FY19.

Moderator: Our next question is from the line of Ankur Sharma from Motilal Oswal Securities.

Ankur Sharma: A couple of questions. One, when I look at your Q1FY19 and Q4FY18 segmental numbers, both for projects and more so for the unitary products business, there has been a significant restatement in these numbers. I remember you did mention this was more to do with the Ind AS 115, but if you could just tell us a little bit more on this, because I would have expected the impact on unitary business to be a lot lesser. We have not heard too much from your peers also on this. So, if you could just tell us what has really changed there which has brought in so much more of numbers into Q1FY19 and less into Q4FY18, if I understand it right.

Neeraj Basur: IndAS 115 has been implemented by us with full retrospective effect, primarily because we have a seasonal business. In the regulation 33 disclosure, we have given full year impact also

for FY18. For the full year FY18, the overall impact on the revenue, largely Segment-II is about Rs. 101 crores. On a reported revenue of some Rs. 4,600 crores of last year the restatement impact is about Rs. 101 crores. The full year impact on profit before tax is about Rs. 10.4 crores and a full year impact of profit after tax is Rs. 5.3 crores. Therefore, on a full year basis the impact is fairly negligible.

On your question why this impact is there in Segment-II, as you are aware, the major shift in Ind AS 115 in the products business is the move from a risk and reward based revenue recognition to delivery of goods and services in the hands of the customer. In that context the shift that we have had to make is for our products business where from a dispatch based revenue recognition we have moved on to a more delivery-based revenue. In addition, there are certain reclassification distribution expenses which earlier in the old Accounting Standard 9 were permitted to be reflected as a cost line. Now certain discounts, commissions, etc, need to be netted off from revenue. Those are the primary reasons, but I would reemphasize, while you will see the quarterly seasonal impact when we restate last year's numbers, when we report e the full year the impact is not going to be significant or material for FY18.

Ankur Sharma: Secondly, again on the Unitary Products, does this reported decline of approximately 4% is on a YoY basis? Could you talk about the like-to-like number for the segment and more importantly, with room air conditioning declining by about 10%, obviously the overall segment does not seem to have declined so much. We are trying to figure out why with the 10% decline in air conditioning, the overall decline in the segment numbers is much lesser?

Neeraj Basur: The main impact on Room AC this quarter was because of weak summer. We have seen industry de-grow by around 13%, I am sure you will have similar data points as well. Our sales has declined by around 10%. We have de-grown somewhat lower than the industry and in that context continue to maintain our better than market performance track record.

While the room ACs sales were challenged, the commercial refrigeration products, have seen some healthy traction. While the market grew at around 2% we were able to register 8% growth, fairly well across the deep freezer category. We have done well on our water dispensers and water coolers also. In the new commercial categories that we have been talking about now for a year, which is medical refrigeration and kitchen refrigeration, we have started showing some early traction. Water purifiers sales have doubled, though on a low base but it has made some contribution into Q1FY19 also. So, overall when we look at our Segment-II performance, some of the commercial products growth have helped us mitigate to some extent the de-growth from the domestic room air conditioner sales.

Moderator: Our next question is from the line of Nitin Arora from Axis Mutual Fund. Please go ahead.

Nitin Arora: Just continuing with Ankur's question, if I have to look at a like-to-like growth only in the AC segment, what would be that number?

Neeraj Basur: We have 10% de-growth in value terms on a like-to-like basis.

Nitin Arora: When we look at the margins, though Q1 remains higher for you, double-digit EBIT margin in the Segment-II, given that you will have guided now a Rs. 100 crores revenue in the water purifier business in FY19, is there any stance change in terms of guidance doing upwards or you still maintain what you have said in Q4? Would there be some pressure on margins because of the expenses in the water purifier?

Neeraj Basur: This continues to be an investment year for us in water purifiers. Last year which was the first year for this business, we achieved around 1% of the market more or less. However, most of what we invested last year helped us settle and stabilize, and learn enough about the product portfolio. We learnt about the distribution reach that we need to have, and we made several course corrections last year. A lot of that is going to help us achieve this full year revenue of around Rs. 100 crores-odd around 2.5% of the market.

However, this year again we need to continue to invest in brand and also distribution expansion and service network creation. Therefore for the full year what we have talked about in the past, we think there will be a negative impact on Segment-II margins of 150 basis points. In Q1FY19, we were pretty much within that limit, it is 140 basis point for quarter one. The segment as a whole, after absorbing water purifier investment should continue to be in the range of 9.5% to 10.5% for FY19.

Nitin Arora: Sorry, if I heard it correctly, you said 9.5% to 10.5%?

Neeraj Basur: Quarter one tends to be always healthier in segment 2, but quarter two and quarter three do see a decline in the margin profile. For the full year on a blended average basis it will come back to 9.5% to 10.5%.

Nitin Arora: How should we look at the inventory? Wanted to ask two questions, one on the inventory and second thing when you said the increase is support the seasonal working capital. So if you can talk a little bit about it, where it has actually gone? Also, if you can share the gross debt numbers.

Neeraj Basur: Capital employed and gross borrowings have gone up by about Rs. 400 crores. The increase can be divided into two parts, normally our capital employed would have anyway gone up in good summer season by around Rs. 200-odd crores, so it is roughly double that. We had planned for around 20% growth towards end of quarter four whereas we have ended up de-growing by about 10% by the time towards end of the quarter. We have at this point in time about 60 days excess inventory when we closed the quarter which will take us about four-odd months to liquidate and bring it back to the normalized level. We are not unduly worried on that account and it is not something which is a major issue or a major challenge. We believe that it will get absorbed by the time festival season starts.

Moderator: Thank you. Our next question is from the line of Abhineet Anand from SBICAP Securities.

Abhineet Anand: My first question is on the Segment I. I think you have been guiding for a rather muted margins. But last few quarters we have seen very strong margins. Can you throw some light and give us a sustainable margin range that you feel should be there?

Neeraj Basur: Yes, two things I would like to say there and you might have noticed in the opening remarks itself that after many quarters sequentially we do see some signs of market revival at this point in time in terms of orders pipeline in Segment I. It is not yet fully converted into booked orders, but it is a healthy sign. When we look at our booked order values, you will see them being flat year-on-year. We are quite optimistic that over the next three to five months a lot of these or some of these enquiries should start converting into confirmed orders which will help us. In this particular segment, we have seen some healthy traction on our central and packaged air-conditioning systems business which is basically the VRF packaged and ducted systems and our chiller business where we get an opportunity to not only execute the projects, but we also get the opportunity to sell our commercial cooling equipment. So, the healthy improvement in the margins that you have seen now for the last few quarters, which is now hovering in the range of 5.5% to 6%, is an outcome of that. This quarter it was 6.4%.

We have consciously in the last three to four years focused on large projects with a certain minimum threshold around profitability and cash flow margin visibility. We had been not accepting many orders, which were not in line with our overall internal commercial guidelines. Being selective in the large project segment has helped us, because whichever orders are getting executed and closed, most of them are quite healthy and they are helping us generate a steady state margin. To top that up further, we do see the central and packaged air conditioning equipment business also contributing consistently. When you put these two together we have a visibility of a steady state margins which are now looking to stabilize somewhere around 5.5% to 6%.

Moderator: Thank you. Our next question is from the line of Ambar Singhania from Edelweiss.

Ambar Singhania: Sir, wanted some clarification on the IndAS 115 which you mentioned. As you said that revenue recognition will happen when it is sold to the customer, so is it right that whatever inventory will be lying with the dealer will now reflect as your inventory instead of sales which used to be earlier?

Neeraj Basur: No. The revenue recognition earlier was also based on our sales to dealers and customers and it continues to be so. There is a subtle difference where earlier the old Indian Accounting Standard 9 allowed us to recognize revenue when the risk and rewards were substantially transferred on dispatch. Whereas Ind AS 115 requires the revenue recognition to be demonstrated with the transfer of control and therefore completion of delivery, so there is a subtle difference between these two accounting requirements. It does not change our position as far as our business transactions are concerned between us and the dealers, that is the reason

you see the full last year impact to be just about Rs. 100 crores on a Segment-II sale of around Rs. 2,500 crores. So, the answer to your question is that, inventory lying with dealers is not impacting our revenue recognition.

Ambar Singhania: But going forward when you will book things as revenue, will it be when the goods leave your factory, or will it be when the goods will be sold by the dealer to the customer?

Neeraj Basur: We do not have to wait for the goods to be sold by the dealer, that is not the requirement of this accounting standard. It is only a timing difference for a few days, because the goods have to be received by the dealer and that is the point of revenue recognition.

Ambar Singhania: So, basically this Rs 100 odd crores is whatever that was there in the transit

Neeraj Basur: Right, so that is the only part that needs to be restated. We have fully migrated in Q1 and all that had to be changed in terms of logistics and accounting has been done. Once the dealer physically acknowledges that they have received the shipment, our revenue recognition criteria is fulfilled because the performance obligation has been satisfied and thereafter it is their stock and as and when they sell they recognize their revenue. Our revenue recognition is not dependent at all on them selling their stock.

Ambar Singhania: Sir, just wanted to understand on the capital employed which had gone up from Rs. 135 crores to Rs. 505 crores in the unitary product segment. Can you give some idea about how much is because of the increase in inventory and how much is because of increase in debtors?

Neeraj Basur: Some of the increase will be receivables, but largely the impact is because of the inventory. What you need to compare is not Rs 135 crore to Rs 505 crore, because Rs 135 crore was as on June 2017. What you need to look at is our March 2018 end position which was Rs. 382 crores of capital employed which has gone up to Rs. 505 crores . Since the inventory buildup started somewhere in Q4 and in a normal summer condition this Rs 382 crore probably would have reduced to Rs 150 – Rs 175 crore which would have been close to last year's level. So, largely it is inventory and somewhat it is due to debtors also.

Moderator: Our next question is from the line of Srinidhi Karlekar from HSBC. Please go ahead.

Srinidhi Karlekar: My first question is on competitive intensity. You said that particularly in inverter category you are seeing increasing competition. Just wanted to understand this increase in competitive intensity is it just due to weak summer or are there any structural things that are happening? Whether MNCs have better cost economics in the inverter category?

Neeraj Basur: It is a combination of both. Obviously in a weather or a seasonal cycle where the external conditions are favorable the intensity takes a different connotation as far as competitors are concerned. In a weaker summer quarter obviously the competition intensifies, so that is anyway given. However, there has been no structural or fundamental change in quarter one as far as the competitive positions are concerned. Inverters sales were around 45% of the market

after the new energy labeling norms became applicable in January. That has clearly made the product portfolio choices sort of narrowed down around between 3 and 5-star inverter range. On the fixed speed products, as you are aware, the 5-star fixed speed is no longer a viable product for any player, so largely the competition is on the 3-star range of products. There is a band within which one can play in terms of pricing power. As a company we cannot go significantly higher than that band. We have always got a premium in terms of our pricing which ranges from 2% to 4%, depending on which product we talk about. In quarter one we continue to maintain that pricing lead over some other players, again, because we have always followed a balanced strategy of growth but we want to also equally focus on margins. As you can see from this quarter results as well, while we had various challenges and we made ourselves as competitive as we thought we needed to, we maintained a close focus on preserving our margins to the extent possible, which was also on the line of our sight. So, the answer to your question is, competition on pricing side continues to be quite stiff.

There is some surplus inventory in the market and most players would be carrying that inventory. We do not expect competitive pressures to reduce anytime soon in the next three to five months. Once the entire industry gets back on the normal cycle, say round Q3 or somewhere around that, probably more normalcy will be seen and we are quite hopeful because of the macro and structural penetration gaps that exists in this category, market revival should happen.

Srinidhi Karlekar: In this Unitary Product segment, would it be possible to quantify how much is the room AC part in that business? And within the room AC business how much is B2C and how much is institutional?

Neeraj Basur: We are maintaining a blended reporting structure for Segment-II, just to maintain the consistency in our reporting as well as some of these data points are considered to be competitive from a view point. We do therefore talk about the growth performance growth on the room AC side and the commercial product side separately, which I have already shared. Beyond that we will be constrained to share any further breakup.

Moderator: Our next question is from the line of Aditya Bhartia from Investec. Please go ahead.

Aditya Bhartia: Sir, you have spoken about competition intensifying in the room AC space and inventory is also on the higher side. However, while speaking about the margin guidance or margin indication you were expecting almost 9.5% to 10.5% margins in this segment vis-à-vis around 8.8% that we had done last year. So, what exactly is contributing to this margin uplift and is high energy efficient product significantly better profitable?

Neeraj Basur: Firstly, we maintained average realizations in Q1. Also we have a slightly higher margin realization as compared to some of our competitors. We maintain that and in quarter one again continued to do that. So, that is one variable. The other variable is of course as we grow in

scale we get better leverage in terms of our procurement efficiencies. We took price corrections in Q3, Q4 last year which are helping us maintain the margin profile so far.

We are focusing a lot on our own manufacturing and within our manufacturing there is great emphasis on backward integration. We want to gradually move as much of our component manufacturing in-house as much as we can. Just for an example, our indoor units we have now started producing for the last few months ourselves, which earlier used to be fully imported. Equally, we want to also start looking at the backward integration of some of the electronic components. Our belief is, while the selling prices will probably be determined or influenced or guided by the market forces the cost structures is what we can influence at our end which we try to do quite actively in order to keep our margin profile intact. In a tough quarter like what we have gone through, certain discretionary expenses like marketing spends, etc, also have been optimized in line with the prevailing external conditions. Wherever we have discretionary cost elements we try and balance them in line with the market scenario. It is a combination of many things, it is not one or two which we keep doing quite dynamically in our business.

Aditya Bhartia: You mentioned that unallocated cost last year had some part of one off cost. Even in FY17, I remember there was some IT related expense. If you could just tell us what the quantum could be and how should we be looking at unallocated cost going forward?

Neeraj Basur: We have done a little bit of course correction where we identified few more elements of cost which could be allocated. We have done that effective beginning of first quarter of last year and the unallocated costs post that correction for the last full year was about Rs. 95 crores which is pretty much in line with the benchmark unallocated cost as a percentage of revenue of about 1.5% - 2%. We continue to have certain consulting assignments or some one-off strategic cost spends which we cannot allocate which may or might not be there every year. So, you will continue to see in some quarters a little bit Rs. 2 crores or Rs. 3 crores here or there. Ballpark we expect unallocated cost to remain in Rs. 100-odd crores range on an annualized basis.

Aditya Bhartia: Wasn't it Rs. 121 crores last year?

Neeraj Basur: Last year we were not allocating all of our information technology cost, we were keeping that centrally into one pool. We have started identifying our IT spend in line with what each segment of our business consumes, that has been additionally done and in line with that, you see a further pruned down unallocated structure. But we have done it consistently over the quarters of last year also to make the results comparable.

Moderator: Our next question is from the line of Abhishek Puri from Deutsche Bank. Please go ahead.

Abhishek Puri: You mentioned that we are doing much more of backward integration. So, of the imported components in the cooling products which were about 60% to 70%, has that reduced in the quarter one? What is the expectation there?

Neeraj Basur: It would not show up in the current quarter. There will not also be a significant impact for full financial year 2019. Of our imports, indoor units is a fairly substantial portion followed by commodities like copper and so on. We continue to import compressors, though we have developed a few local sources as well. It will take us another three or four quarters before we get on full steam with our indoor unit manufacturing in-house. The proportion will continue to shift from imports to domestic. However, the import content will not become insignificant. It will continue to remain significant, though it will get reduced over the next few quarters.

Abhishek Puri: Looking at the IndAS 115 effect, the first quarter of last year has been restated higher by about Rs. 21-odd crores whereas the fourth quarter has gone down by about Rs. 100-odd crores. So, would that mean that the balance Rs 80 crores will be adjusted in Q2 and Q3 as well?

Neeraj Basur: That is not the way to read it. In that table that you see, Rs. 101.86 crores revenue from operation is for the full year. So, it is an aggregation of quarterly changes that the restatement changes that IndAS 115 has required us to do and the impact on profit is Rs. 10 crores for the full year.

Abhishek Puri: I am talking about the revenue and not profit. So, for the cooling products business full year revenue remains the same but quarterly there is a significant variation and specifically in the fourth quarter and if I adjust the first quarter and fourth quarter there is a balance of about Rs. 80 crores which needs to be adjusted as well.

Neeraj Basur: That will flow through on our comparative quarters through quarter two, three and four as we continue to report last year's numbers.

Abhishek Puri: So, they will become higher by Rs. 80 crores?

Neeraj Basur: Correct, because quarter one seasonally is always higher whereas quarter four, and quarter two and quarter three are seasonally lower. That is how you will see this number flow through. But the full year impact will be roughly about Rs. 100 crores.

Moderator: Our next question is from the line of Lokesh Garg from Credit Suisse. Please go ahead.

Lokesh Garg: When we had shared Q4FY18 results, our reported growth was maybe of the order of 5% but we had shared that our actual growth is higher because there are some GST related price revisions that were to be taken in consideration. Now, in Q1FY19,does it carry similar revision related effect because basically Q1 FY19 is not full anniversary of GST as yet. This quarter should have carried those revisions, does it or does it not?

Neeraj Basur: Technically it is not a revision, it is only a restatement to make it comparable. In last year first quarter was a pre-GST quarter, the reported revenue year did have the central excise and some indirect tax impact on the reported revenue numbers. On a comparable basis, last year first quarter revenue was Rs. 1,405 crores on a consolidated base as compared to Rs. 1,507 crores this year. So, the comparable growth is about 7%. But beyond that after that there will be no further comparability needed because quarter two last year was a GST quarter. Probably this is the last quarter we need to share with you such comparable numbers.

Lokesh Garg: Other question that I wanted to ask is if there is a timing revision related to accounting standard that has come in. It might have possibly lead to delay of revenue recognition, so in Q4FY18 the previous sale record that we had in cooling product segment is Rs. 692 crores and the in revised Q4FY18 we have Rs. 591 crores, so there is a Rs. 100 crores decline in revenue Is it because of timing gap?

Neeraj Basur: It is on a rolling basis. It is not just that quarter alone. So, when we implemented it retrospectively from Q1FY18, actually the entire restatement starts from Q4FY17. That is how we have calculated this full year impact. So, only one quarter will not give you the complete picture. The full year impact is what will flow into the current year's numbers, which is at Rs. 101 crores of last year's revenue from operations and Rs. 10 crores profit impact that will flow into FY19.

Lokesh Garg: So, FY19 turnover to that extent is overstated by Rs. 100 crores roughly, right?

Neeraj Basur: Over a period of time, it would not be in quarter one because quarter one will roll over into quarter two, so it will flow into the next four quarters. This Rs. 100 crores is for the four quarters of last year. So, this will flow into the current year on a quarterly rolling basis.

Moderator: Our next question is from the line of Chinmay Gandre from Future Generali. Please go ahead.

Chinmay Gandre: I wanted to understand how the absolute EBIT has changed post the restatement? If I look at the numbers, in Q1FY18 last time the EBIT was Rs 81 crores which has moved to Rs. 95 crores in the current quarter for Q1 FY18 itself. And also, if I look at the Q4 numbers it was Rs. 68 crores initially, now I see that number being like Rs. 40 crores. So, if you can help me understand like why the absolute EBIT has moved so much?

Neeraj Basur: There is a note number two in the results and in that in Q1FY18, there is a Rs. 17.7 crores of restatement related increase that we have talked about. This is exactly what I was explaining in response to the last question. When looking quarter-on-quarter because of seasonality, there will be some quarters where there will be an increase. Quarter one typically is a heavy quarter, there is an increase when we do the restatement, whereas in quarter four there is a decline because of this change. The full year will aggregate up to Rs. 101 crores in top-line and about Rs. 10 crores in profit. This is disclosed as note number two in our published results.

Chinmay Dandre: The top-line which you reported and the unitary products was Rs. 840 crores which has moved to Rs. 860 crores, so it is around Rs. 20 crores higher. But EBIT is up from Rs. 82 crores to Rs. 95 crores which is Rs. 13 crores higher?

Neeraj Basur: When I explained the Ind AS 115 components the timing of revenue in case of risk and reward to a control is one element, then there are certain cost lines which used to be earlier represented as a cost which has now to be netted off from revenues. So, the revenue number that you see is net of those cost lines which have been also restated, that is why it will not be comparable. If you try to do a percentage of restated revenue addition in last quarter one to the revenue, it will not show you the correct picture, because the revenue is restated net of cost reclassification. So, cost is just a reclassification element there.

Moderator: Our next question is from the line of Jai Kakkad from Haitong Securities. Please go ahead.

Jai Kakkad: You said that there is restatement of expenses you have to net off from revenues. But then why is EBIT getting impacted because it has been net off. So, why is EBIT for Q4FY18 impacted by Rs. 28 crores?

Neeraj Basur: This is because of the timing of revenue recognition. The timing of revenue recognition has moved from dispatch base to a delivery and receipt base. That causes the change in the revenue recognition which has a corresponding impact on profit. The full year impact of profit which has moved from FY18 into FY19 is about Rs. 10 crores which will move over the course of next few quarters, whereas the expense restatement is more of a grouping change, it has got no impact on EBIT.

Jai Kakkad: When you talk about the full year change, last year there is some revenue from previous year which also would have moved. So, the actual impact from the fourth quarter there will be some spill over into the first quarter this year and because the inventory increases so much, it should be higher?

Neeraj Basur: This is not going to be linear in that fashion the way you are trying to understand, because remember FY18 this restatement started for us from Q4 FY17. So, the impact that you see of quarter four is not purely a quarter four impact, it is the flow-through effect of previous three quarters which have also been restated in FY18. So, to that extent it is not a simple math that this quarter's number has gone into next quarter and so on, it does not flow like that. Again, we could have gone for a prospective restatement, in that case you would have only seen this Rs. 100 crores and the Rs. 10 crores number impact on profit would have got adjusted from our retained earnings.

However, we chose not to do that because of the seasonal nature of our business in order to make quarter one comparable with quarter one, quarter two comparable with quarter two of last year and so on. Otherwise we would have struggled to make the numbers comparable throughout this year which would have been a difficult thing for us. So, as we progressively

report our quarterly results we will keep sharing with you the restated numbers of last year. Current year Q1is Ind AS 115 compliant, so there is no restatement needed for the current year because Ind AS 115 became effective from April 2018. So, to maintain comparability what we have done this retrospective implementation. But since to make Q1FY18 comparable we have had to open up Q4FY17 also, that is why it would not be a simple mathematical addition.

Jai Kakkad: Percentage wise if you look at unitary cooling, if you net off Rs. 100 crores revenue adjustment versus a Rs. 28 crores EBIT adjustment then the margin of that shift is very high.

Neeraj Basur: That is not the correct way of understanding it because a Rs. 100 crores restatement is net of reclassification of the cost elements under Ind AS 115 that had to be reclassified from an expense line to revenue line netting off. So, that is a net revenue that you are looking at.

Jai Kakkar: Which are the significant expense items which are getting netting off?

Neeraj Basur: Cost elements like any quantity discount that was being offered to the dealers, trade discounts, travel schemes, if they qualify certain sales targets then they get certain incentives. Ind AS 115 requires any expense that we incur which is intended to help us generate revenue to be netted off from revenue. Under the old accounting standard we were allowed to reflect those as elements of cost which would have appeared in other expenses in regulation 33 format. Now they are needed to be netted off from revenue. The reported revenue impact that you see in the reported results is net of all these reclassifications.

Jai Kakkar: So, this also includes any dealer discounts you said?

Neeraj Basur: Yes, that is why it will be incorrect to just do a percentage of EBIT over the reported net revenue restatement. You will get an incorrect result.

Jai Kakkad: In terms of number of days which get postponed, is it fair to assume it could be in the range of 3 to 4 days, not more than that?

Neeraj Basur: No, it would not be, it is not a fixed number. If it is a local supply it is same day, slightly longer supply could be two to three day. But by and large it is not a very long lead time which needed to be recalibrated.

Jai Kakkad: Can you quantify the amount of expense which is getting net off in this?

Neeraj Basur: I am not sure whether that will be possible, because if we do that then there is a too much of Ind AS reconciliation that we start explaining. But broadly I have explained the concept, I have explained the background and I have also given you elements which have got impacted. More importantly, I will remind everyone that the full year impact on last year restatement is not a material amount which has been reviewed by our auditors as well.

Jai Kakkar: The problem only is that the full year impact last year also has element of previous year's flow through.

Neeraj Basur: But this is on a comparable basis. On a comparable basis, so we are comparing FY18 with FY19, so on a pure comparable basis the full year impact is about Rs. 100 crores. We are not restating FY17 and that is why I cannot give you what would have been full year impact of FY17, otherwise this becomes even more complicated. So, FY18 is what we are restricting our focus to. Rs. 100 odd crores on a full year revenue is not a very big number to worry too much about.

Moderator: Thank you. Ladies & gentlemen, that was the last question. I now hand the conference over to Mr. Neeraj Basur for his closing comments

Neeraj Basur: Thank you very much, ladies & gentlemen. With this we conclude this quarter's earnings call. Do feel free to revert to us in case any of your questions were not fully answered and we will be happy to provide you addition details by email or in person. Thank you very much.

Moderator: Thank you. Ladies & gentlemen, on behalf of Blue Star Limited, that concludes today's conference. Thank you for joining us. And you may now disconnect your lines. Thank you.