"Blue Star Limited Q2 & H1 FY'20 Earnings Conference Call

November 15, 2019

MANAGEMENT: MR. NEERAJ BASUR – GROUP CFO

Moderator: Good day, ladies and gentlemen and a very warm welcome to the Blue Star Limited Q2 & H1 FY'20 Earnings Conference Call. We have with us today from the management Mr. Neeraj Basur - Group CFO. 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 '0' on you touchstone phone. 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: Good morning ladies and gentlemen, this is Neeraj Basur. I am happy to share with you that Blue Star has been awarded the coveted "Golden Peacock Award for Excellence in Corporate Governance" for 2019. We at Blue Star have always endeavored to adopt and implement best-in-class governance policies and practices and this award recognizes our commitment in this regard.

I will now provide you an overview of the results for Blue Star Limited for the quarter ended September 2019.

Following are the financial highlights of the company for the quarter-ended September 30, 2019 on a consolidated basis:

-Revenue from operations for Q2FY20 was Rs 1249.47 cr as compared to Rs 1032.20 cr in Q2FY19, a growth of 21.0%.

-EBIDTA (excluding other income and finance income) for Q2FY20 was Rs 73.58 cr as compared to Rs 58.07 cr in Q2FY19, an increase of 26.7%.

-PBT before exceptional items was Rs 55.75 cr in Q2FY20 as compared to Rs 34.42 cr in Q2FY19, an increase of 62%.

-Tax expense for Q2FY20 was Rs 16.88 cr as compared to Rs 7.84 cr in Q2FY19. The Company has decided not to immediately opt for the lower rate of 22% corporate tax owing to the un-availed MAT credit to the tune of Rs 67 cr (consolidated). At the same time, we needed to account for higher tax expense during the quarter on account of increased profitability and unwinding of Deferred Tax Asset created in earlier years.

-Net profit for Q2FY20 was Rs 37.94 cr as compared to Rs 19.55 cr in Q2FY19, an increase of 94.1%.

-Carry-forward order book as at September 30, 2019 was Rs 2934.52 cr as compared to Rs 2216.63 cr as at September 30, 2018, an increase of 32.4%.

-Effective Working Capital Management enabled a significant reduction in our Capital employed to Rs 1063.49 cr as on September 30, 2019 from Rs 1267.88 cr as on September 30, 2018.

-Consequently, borrowings reduced to Rs 188.97 cr as on September 30, 2019 (debt equity ratio of 0.22) as compared to a net borrowing of Rs 463.47 cr as on September 30, 2018 (debt-equity ratio of 0.59).

Business Highlights for Q2 FY’20:

Segment I: Electro-Mechanical Projects & Commercial Air Conditioning Systems

Segment I revenue was Rs 783.54 cr in Q2FY20 as compared to Rs 630.97 cr in Q2FY19, a growth of 24.2%. Segment result was Rs 44.56 cr (5.7%) in Q2FY20 as against Rs 44.75 cr (7.1%) in Q2FY19. Order inflow during the quarter was higher by 11.2% at Rs 794.35 cr as compared to an inflow of Rs 714.31 cr in Q2FY19.

i) Electro-Mechanical Projects business:

In Q2FY20, order inflows from infrastructure sector continued to be impressive with the addition of Airport projects at Bangalore and Delhi. However, delays in new project approvals from financial institutions led to relatively lower order inflow in the buildings segment.

We continued to exercise caution on the pace of project execution in view of the continuing liquidity stress in the real estate and infrastructure sectors. We maintained our leadership in the Electro-Mechanical space in India.

Carried forward order book of the Electro Mechanical Projects business was Rs 2064 cr as on September 30, 2019 as compared to Rs 1512 cr as on September 30, 2018, an increase of 37%.

ii) Commercial Air Conditioning Systems

Our business registered an impressive revenue growth during Q2FY20. New product launches and increased operational reach in tier–3, 4 and 5 cities helped us to gain market share in Chillers and VRF categories during the quarter. We continued to grow faster than the market and improved our market share in all the product categories.

Our newly launched products such as the next generation Inverter Ducted, Water cooled VRF, Air cooled VFD Screw Chiller and Configured Oil Free Chiller gained good traction and market acceptance.

Key segments that contributed to billing during the quarter were Industrial, Hospitals and Educational Institutions.

Major orders bagged in Q2FY20 were from JSW Steel Ltd (Bellary), Safdarjung Hospital (Delhi) and ISRO Viewing Gallery (Sriharikota).

iii) International Business

Our continuous efforts to increase demand for unitary and applied products helped us bag good orders from the markets in the Middle East, Africa and SAARC countries.

With steady growth, we are also focusing on enhancing and improving our eco-friendly product standards and certifications. Our showroom in Dubai is playing a significant role in demonstrating our products lines and capabilities and help build confidence in potential customers.

Our international projects executed through the Joint Ventures at Qatar and Malaysia continued to do well.

We continued to invest in strengthening our brand in select international markets.

Segment II: Unitary Products

Segment II revenue was Rs 377.21 cr in Q2FY20 as compared to Rs 343.06 cr in Q2FY19, a growth of 10.0%. Segment result was Rs 11.96 cr (3.2%) in Q2FY20 as compared to Rs 8.20 cr (2.4%) in Q2FY19.

i) Room Air Conditioner business

After a very good Q1FY20 and late, but strong summer, Q2FY20 demand for Room Air Conditioners was good and market grew by 10%. We grew in line with the market and maintained our market share of 12.5%.

The demand was for low-end products with more than 60% emanating from tier-3, 4 and 5 markets. Further,40% of the sales was through the consumer finance route.

FY20 should be a normal growth year for the industry on the back of lower penetration. Our new brand initiatives have been well received by the trade and should support our growth plans for FY20 and the next summer season.

ii)Commercial Refrigeration business

Revenue growth in Q2FY20 was contributed by increased billing across all categories. We continued to perform well in the processed foods, ice cream, hospitality, and dairy segments and maintained leadership position across the product categories. Our new lines of businesses also started gaining good traction in the market with orders from several reputed brands.

Major orders bagged in Q2FY20 were from Shell, Swiggy, Hatsun and Havmor.

iii) Water Purifier business

We continued to grow in line with the market growth and maintained our market share. Total installed base of our Water Purifiers crossed one lakh units during the quarter. We will continue to make investments in branding and marketing initiatives both in the digital and print mediums to achieve the targeted growth and market share.

Segment III: Professional Electronics and Industrial Systems

Segment III revenue was Rs 88.72 cr in Q2FY20 as compared to Rs 58.17 cr in Q2FY19, a growth of 52.5%. Segment result was Rs 24.43 cr (27.5%) in Q2FY20 as compared to Rs 12.56 cr (21.6%) in Q2FY19.

Revenue and profit growth was majorly contributed by receipt of multiple high value orders of Data Security Solution and Non-Destructive Testing businesses. Growth potential in the Indian digital payment sector continues to offer growth opportunities for our Data Security Solutions business. On the other hand, automotive capex has been muted.

During the quarter, large orders were received from Honda Motorcycle and Scooter India and Welspun Corp Limited.

Business Outlook:

Though the order book is healthy, project execution pace has not picked up and credit flow in the real estate and infrastructure sectors remains a constraint. Low penetration coupled with increasing demand from Tier-3, 4 and 5 towns will continue to support growth in the products business.

We will stay focused on driving revenue growth and profitability with a close watch on margins, cash flow and capital employed.

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 and gentlemen we will now begin the question-and-answer session. The first question is from the line of Aditya Bhartia from Investec. Please go ahead.

Aditya Bhartia: Growth in Unitary Products segment for us appears to be weaker than what some of the peers have reported, as well as growth that we understand the industry has delivered in first half of this fiscal. What has that been on account of and have you seen competitive intensity increasing from private label brands and from some of the other players especially into that market?

Neeraj Basur: The industry and our growth in the Room AC category has been similar at around 10%. It has been a mixed quarter for different players. There are players who have done better than that and there are also players who have achieved lower growth. We are still awaiting final industry data. Our assessment is that bulk of the growth has been contributed by the entry level products in tier-3, 4, 5 markets and the online channel which e also caters to the entry level products. Blue Star has consistently maintained a mid-premium level market positioning, and in that context our growth of 10% is pretty much in line with what we were expecting for Q2.

Aditya Bhartia: But if we look at first half as well, our growth in the Unitary Products segment has been somewhat lower, around 10% vis-à-vis 30%-odd that industry appears to have grown. So even first quarter to that extent, growth was bit slower and what has really contributed to that?

Neeraj Basur: I need to remind you and others were on the call that our growth in Q1 in Room AC was around 25%. In Q1 we transitioned the old range of our commercial refrigeration products into a new range and so we were liquidating our existing inventory.. Our segment 2 overall growth in Q1 was impacted by the commercial refrigeration products whereas the Room AC sales was in fact ahead of the market. In Q1the market grew by around 22% and we grew at 25%.We have registered a 22% year-on-year growth in our Room AC business in H1.

Moderator: Thank you. The next question is from the line of Renjith Sivaram from ICICI Securities.

Renjith Sivaram: UCP margins have been bit of a worry for us. While it has been lower last year we can understand there were lot of inventories, so this quarter also it was low. Is it kind of we are unable to take any price increase or is it something to do with the investments into this water purifiers?

Neeraj Basur: If you look at the overall segment-II margin profile this year versus last year, this year we are at around 3.2% compared to 2.4% of last year. Last year Q1 was impacted because of the poor summer season led inventory problems and that spilled over to Q2 also. There was an overhang of inventory and the related inventory holding costs in Q2 last year, which are not there this year which is getting reflected in the margin improvement. Having said that, the pressure on prices continues and obviously that has an impact on the overall margin profile as well. We took a price increase in end of Q3 and beginning Q4 last year, after that we have not re-calibrated our prices significantly. We are mindful of the gap between our pricing and the competition and we have been trying to narrow that down as much as possible in order to catch up on the growth momentum which has helped us in H1 this year.

We have also consciously stepped up our branding and advertising expenses in the current year. You might have noticed we have recently signed Virat Kohli as the new Brand Ambassador to promote our products, more specifically our Air-Conditioners. That is one example of how we are stepping up our marketing and advertising spend because we do believe that the full financial year growth for the market should be good, and in that context we want to use Q3 and then Q4 when the summer starts, to ensure that our market growth rate keeps pace with our aspiration of market share and growth.

Therefore, while there have been savings as compared to last year in some of the inventory holding costs, we have stepped up advertising, and have not taken consciously, any price increases. In Q2 because of the overall volume and sale, margin tends to be lower. The same situation will be there in Q3 as well, but by Q4 we are expecting to come back on our expectations of 9% to 9.5% margin profile for the UCP segment.

Just to conclude this answer, in the current year we are on a reducing investment scale as far as Water Purifiers are concerned. The margin impact last year was 160 basis points on segment-II margins and we are expecting it to be anywhere between 90 and 100 basis points this year from our water purifiers category.

Renjith Sivaram: In Segment-I, when we look at the order intake and your peers, there is a stark difference. So have we lost out on any of the metro jobs?

Neeraj Basur: We had bagged an order of Rs.253 crores from Mumbai Metro in Q1. After that we have been bidding for some Metro and airport jobs and had bagged a couple of good airport projects. Our overall order book in fact has grown quite impressively this year at 32% plus.

Moderator: Thank you. The next question is from the line of Nitin Arora from Axis Mutual Fund.

Nitin Arora: First question on the UCP segment. We faced a decline because in the chillers part because we were going for a transition in a lot of products. Can you quantify how the growth was within this quarter and are these products back in the system because you were doing some high-rated inverter products there as well?

Neeraj Basur: In Q1 we had a de-growth situation in the commercial refrigeration products category. We were liquidating our inventory of old SKUs in Q1. In the current quarter, we have grown by around 6% in that category. The other products have given us rest of the growth.

Nitin Arora: For the full year, you are expecting a 10%, growth?

Neeraj Basur: No the growth for Q2 is 10% and 6% is the growth of commercial refrigeration products.

Nitin Arora: How do you look at this commercial refrigeration for this year and next year because that has almost like 30% of UCP going to come?

Neeraj Basur: I had clarified last quarter as well that, we expect to be able to neutralize the impact of de-growth in commercial refrigeration for Q1 during rest of the year. Our expectation is that we will be just about neutral or grow marginally for the full year in commercial refrigeration products and rest of the growth in Segment-II will be driven by Room ACs and the other products that we have in this segment.

Nitin Arora: There is a brand, who is pushing prices higher compared to what is available in the market by all the other brands. When we look at the wholesale numbers of quarter the whole thing was each brand in this quarter, I am talking about the volume part; we saw that it has relatively not able to push that wholesale because we still have lot of inventory in the system. Has that really held Blue Star also to gain the market share from him or you think it is a transition thing, so not really impacted, not able to gain by other players?

Neeraj Basur: We are still awaiting market share data for Q2. The early numbers we have indicate that there are two or three players who have grown quarter-on-quarter and there are players who may not have grown or in fact might have de-grown, and the overall market growth is about 10%. Q2 is a relatively low quarter to have any view on e shaping market positioning, and so will be the case in Q3. Greater clarity on market ranking will get established by Q4. The good news is that the inventory level across most players in the market is fairly normal relative to last year.

To that extent, since the excess inventory situation has completely got managed and resolved, there should not be pricing pressure because of that going forward. So, we are expecting a normal growth in FY20.

Moderator: Thank you. The next question is from the line of Aditya Bhartia from Investec.

Aditya Bhartia: Sir, my question is on Water Purifiers wherein you indicated that we have grown at the pace of the market. Given that we are a new entrant one would have imagined that Blue Star would be growing at a pace meaningfully faster than the market. So, what is your take on that and how will be progressing vis-à-vis the initial expectations that we have set?

Neeraj Basur: The rate of growth is normal as compared to market in the context of Room ACs. Coming to Water Purifier, we would be at around 2% or 2.5% market share. We are doing quite well as far as the entire product portfolio and the rest of product expectation that market has and what we are offering and the products are well received. We realigned the entire water purifier distribution with the Room ACs and that gave us access to a larger distributor base.

That part is also settled out, and so is the after-sales servicing in this space. The Water Purifiers market is a highly concentrated one where the top-three players between them have close to 70% to 75% market share. So, it does take time to penetrate deeper. We are reasonably comfortable with our 2% market share as of now. Of course, we could have done better and we can still do better is our overall view. We will steadily keep building on to the blocks which are in place and the overall burn or overall investments are reducing, and by next year we should be relatively in a better space as far as this particular category is concerned. It is taking us longer than what we had anticipated for sure, but we are pretty okay with the progress made so far.

Aditya Bhartia: At the breakeven, what is the kind of rough market share that we require?

Neeraj Basur: That number keeps changing. But overall it would not be significantly higher; we are at currently 2%. We need to do somewhat more and we will quantify that probably by next year. But, we will not be very far off from that level by the end of this year.

Aditya Bhartia: Last question is on Segment-III margins, wherein we have seen very strong margins in this particular quarter. What has that been on account of and how should we see margins in the segment going forward?

Neeraj Basur: Segment-III is a bit different as far as the product and solution portfolio is concerned. We have some very good solutions in the data security space and there is also an increase in the digital payment transaction volumes across the country. That opens up some interesting opportunities for us and that is what has happened in this current quarter. We got multiple orders which contributed nicely to the revenue as well as profit growth. In addition to that, we also had good orders from our non-destructive testing business. This gave us a nice push in terms of revenue as well as profit growth and also margin profile. But this business is subject to such quarters where it will have a bump-up and you will see these kinds of margins when these orders get fulfilled. Overall this segment is capable of generating 15% to 18% margin. So far this year has been good like last year when we got a big order for supplying the CT machines in the state of Uttar Pradesh. That had given us a good boost to the overall segment profits and revenue last year.

Since there are multiple lines of businesses, one business or the other will keep contributing and then there will be quarters when it kind of tapers down as well. On an overall basis, 15% to 18% margin is what we are quite comfortable with as far as this segment is concerned.

Moderator: Thank you. The next question is from the line of Manoj Gori from Equirus Securities.

Manoj Gori: We have been targeting North markets aggressively and we came out with different range of products at different pricing as compared to other geographies. So can we throw some more light like how we are targeting North markets and what could be the status maybe for the next season and how we are looking to ramp it up?

Neeraj Basur: We have not come out with any different product range for North market. What we had stated was that North is a large market and we were lagging in that market and South for us has been traditionally stronger. So over the last, 1.5 - 2 years, we have been consciously focusing on improving our distribution capabilities and outreach in the North and that is helping. And we do expect that over the next few years we will have a pretty much equitable contribution coming to us from South and North, probably followed by West and East in that order. So it has been more around distribution led initiative than anything else, which is helping us.

Manoj Gori: On the EMP side, so if we look at currently, there has been slow down, like you have already mentioned in the opening commentary. So can you throw some more light like how you look at like in the near future near to medium, like in terms of order inflows and execution?

Neeraj Basur: On the projects business we have a very healthy order book. So there's no problem as far as the orders are concerned, and with a carry forward order book of around Rs. 2,900 crores we are in a good space and equally, the sales funnel also is there, it is across the midsize and smaller projects which we service through own commercial air conditioning products. The order book is looking reasonably okay as far as that segment is concerned.

The challenge in the projects business which has been there now for a year and a half and continues to be there for real-estate and infrastructure customers is around the flow of liquidity and credit. So we are being watchful and I mentioned this in our last earnings call as well that our focus is to balance our overall billing growth with operating cash flow and working capital. The effect of that is visible in our working capital position. It was there at the end of quarter one, it is there end of quarter two as well, and that's how we have been able to achieve a substantial reduction in our borrowing quarter-on-quarter.

So we are being watchful and that does put a little pressure on the margins, because we continue to incur our overheads while we are still executing these orders. However, whenever we get a sense that some of these infrastructure customers are having a little bit of a stretch on their payment capability or the payments are coming slower compared to the terms of payment agreed with them, we are moderating the pace of our execution for this reason. Normally we would have executed much faster and with this kind of order book we would have accelerated the pace of execution. But because of the external market situation, we continue to exercise caution. Our sense is that we will continue to do that at least for next couple of quarters more and then take some judicious calls. Once the situation stabilizes on the banking and NBFC space, the order acquisition pace for those categories of customers will be back on track.

As far as the government customers are concerned, particularly from PSU customers and government customers, the execution is going on fine, though payments are tending to be delayed. At least we have a reasonable assurance of the payments will get realized even though with a delay. So it's that phase in this segment where one needs to continue to exercise caution and watchfulness and that's what exactly we are doing.

Manoj Gori: So it's more of an execution timing related concern?

Neeraj Basur: Yes, that's right. And that's linked with largely the liquidity and credit availability situation, which will stabilize at some stage. So once it stabilizes then we will step up the accelerator on execution as well.

Moderator: Thank you. The next question is from the line of Anupam Gupta from IIFL.

Anupam Gupta: On the product segment, while you said for 9%, 9.5% margin, but at the same time we haven't seen any price hike as you also said, and you said you are stepping up your advertisement and marketing expenses as well. Given that l is there a downside risk to that 9%- 9.5% margin in the balance half for this year?

Neeraj Basur: The downside risk could be only to the extent if summers in Q4 do not set in early enough. Summers normally start to set in somewhere in the middle of February and then March tends to be a good month. So it all boils down to the scale and overall pace of growth which is reasonably possible in Q4. So far, we are tracking fine in terms of our overall margin for H1 in this segment. Q3 will be again a low single-digit margin kind of quarter and Q4 is where actually we will be able to catch up and come closer to 9%- 9.5% overall for the year.

So the only downside risk will be the weather pattern and when and how strongly the summer sets-in in Q4. If the summer sets in strong, then as we have seen it many times, Q4 can be a bumper quarter.

Anupam Gupta: The slowdown which is impacting a lot of other segments which hasn't impacted AC so far, have you seen any signs of slowdown at all in any geography or region for AC?

Neeraj Basur: The real test of this theory is if summers are strong and yet AC sales do not happen, that is when we will get to exactly know whether there is a structural issue, and is there a slowdown issue. The availability of financing for the consumer at the store level is continuing to be normal in this quarter as well and we do not see any challenge so far in NBFCs who are financing consumer appliances, electrical appliances and so on.

A big part of the online sale is anyway funded using credit cards which is strictly speaking not consumer financing but an alternate way of paying for the equipment. So far we have not really seen in the room AC segment or in commercial range of refrigeration products any kind of rub-off effect of this perception of slowdown as of now. But again, we will wait till end of quarter three, beginning of quarter four to see whether it is all normal in terms of our overall expectations.

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

Abhineet Anand: First thing is the other income; is there any one off in this quarter?

Neeraj Basur: **W**e had some income tax refunds in this current quarter, and that is included. The other income of Rs. 10.6 crores includes Rs. 4.5 crores of interest on refunds that which in a manner of speaking may be one-time because we may not necessarily have income tax refunds every quarter. And rest of the other income of Rs. 5-odd crores would be normal income from other sources.

Abhineet Anand: Okay. Secondly the share of JV, etc., FY19 we had a loss of around Rs. 18-20 crores H1 looks to be good at around Rs. 2-odd crores, if you can throw some light what happened exactly and how this year will pan out?

Neeraj Basur: Our joint venture in Oman was at that point in time incurring losses. We had taken losses in quarter two of last year and in quarter three had taken a complete write down of the entire exposure. Since we already provided for that entire exposure last year itself and we initiated measures to exit that joint venture, that venture is no longer contributing to either profits or losses. So, the contribution is now from the other joint ventures that we have and they are performing quite well. These numbers will not impact significantly either way.

Abhineet Anand: And just last thing, this margin for the segment I, your earlier view has been that it will be around 5.5%, those numbers remain or is there any change to that?

Neeraj Basur: I have always been saying 4.5% to 5.5%, so that remains as a range and yes we should be okay in that range.

Moderator: Thank you. The next question is from the line of Ankur Sharma from HDFC Life Insurance.

Ankur Sharma: Just a question on the UCP segment margins. Now, given the fact that there have been no price hikes all this while, plus we have seen this doubling of custom duties on IDUs and ODUs. So I was just wondering, especially as we go into the next year, of course this year we had order inventory, how do you manage that transition? What's your plan in terms of in-sourcing production of these?

Neeraj Basur: Customs duty hike happened last year in September, and again after this year's budget on certain set of components, including compressors and now after the budget this year, even the indoor units were included. Of course, a part of that does have an impact on margins, because so far we have absorbed the impact and we have not passed it on. As far as our strategy going forward is concerned, we intend to insource in a big way the manufacturing of indoor unit which has already started last year.

In the current year, we are intending to manufacture at least 20% of our overall indoor unit consumption in our own factory in Himachal. Progressively, by next year we expect this 20% to increase to 70% or 80% and then over the next year and a half or two years, we should substantially reduce the dependence on imports of the indoor units.

As far as some of the other components are concerned, we are also exploring alternate sources of procurement other than China, and including some FTA countries which will to some extent have a mitigating effect on the customs duty profile.

Lastly, we will have to take a pricing view at some stage, we are just holding on for a little while longer and probably by end of Q3, beginning Q4, s when we launch our new product range for the next year and that is the time pricing decision is taken. With just few months left for the calendar year to end, it doesn't make sense to tinker around with prices too much in Q2 and Q3. We will take a pricing decision when we are ready to launch the new range of products for the new summer season and that's how we are planning to respond to the customs duty increase scenario.

Ankur Sharma: Sure, very helpful. Just the second question was on the overall demand for room ACs, typically we have seen September to November is the so called the second summer season, which really hasn't happened this year, given the extended monsoons. Despite that we do not here have too much of an inventory built up, or maybe I am wrong, and you can correct me here. So, just trying to kind of understand why despite such a high and extended monsoon we are not seeing any kind of inventory buildup, especially at the secondary level.

Neeraj Basur: In quarter one secondary sale and primary sales both were good which led to reasonable or substantial liquidation of stock at the distributor level. There are pockets where monsoon has got extended and extending into October as well, mainly in West. West is the market where the second summer happens. The impact is localized to West, and on an aggregate basis we don't see too much of an inventory problem, regardless of how the second summer or the extended monsoon played out in some pockets of the country. Of course things have normalized now and by the time we hit December, the stocking up will start in preparation for Q4.

Moderator: Thank you. The next question is from the line of Amber Singhania from Asian Market Securities.

Amber Singhania: Just couple of things. One, if you can give some color about how the other products are doing, like water cooler, air purifier and all, though it is small, but we had a significant impact on the margin because of the product also. What is the outlook in this?

Neeraj Basur: As far as water coolers are concerned, the major sales for water cooler happens in quarter one, and it was good, in line with the overall summer and then again it starts in Q4. So Q4 and Q1 are the two big quarters for water coolers and so far we are good. As far as air purifiers are concerned, it's a small market and the situation in NCR and northern parts of the country does give a bump up to the demand, which has happened in Q3. But since the overall market size is small, it will not make a very big impact on the numbers.

We are continuing to push up the distribution of air purifiers in these markets. We are also going to launch another range of air conditioners which will have an inbuilt air purifier just to converge somewhere the two products, because we believe that air purification and air conditioning will be quite convergent with each other.

Amber Singhania: Okay. Secondly, as we have hired Virat Kohli and also we are doing some higher advertising compared to last year, what kind of advertising budget we are keeping from this year versus last year? Whether it will be reflecting in unallocable expenditure or whether it will be part of you UCP?

Neeraj Basur: A clarification, we have not hired Virat Kohli; we have just tied up with him as a brand ambassador. It was planned and in the last year our brands spend was really muted because the weather and the season and the market were not great. We had in a way underspent, so we wanted to catch up, with the brand spending and this worked quite well and kind of reputation Virat Kohli has in that space plus the fan following that he has, the target customer segments, there's a good amount of alignment in people who follow him and people who follow Blue Star. The common thread between him and us being trust, so the kind of trustworthiness he demonstrates across all three categories of the game, we also are in the same league where we believe trust is one of our biggest USP as far as our brand is concerned, again, across all the three segments, whether it is residential, whether it is commercial, or the large projects. So, to that extent, there is a good amount of calibration in having him as a brand ambassador. So this was planned, and this is part of our overall planned spend and nothing more than what we have already budgeted for.

Amber Singhania: So around 2% of the sales?

Neeraj Basur: Well, we are yet to work out our exact spending structure for quarter four where a bulk of the next round of spending happens. We will talk more about it in Q4.

Amber Singhania: And it will part of unallocable expenditure, not the part of usual expenditure?

Neeraj Basur: No, it is all allocated. Our unallocated expense doesn't have any brand, marketing, advertising expenses.

Moderator: Thank you. The next question is from the line of Kunal Sheth from B&K Securities.

Kunal Sheth: My question is pertaining to the unitary cooling segment. Sir, you mentioned in your comment about the margins for the quarter that part of the reason why margins were lower because there is still pressure on pricing in the market. So, could you share your thoughts, in spite of such a strong growth in the room AC market this year, what is causing the pricing pressure in the market?

Neeraj Basur: The inventory in the market across different players and quarter one included, not all players are able to liquidate the hangover of inventory from FY19 in either Q4 of last year or Q1 of this year. While we had substantially liquidated inventory starting Q3 and Q4 itself and we didn't have that much of a challenge in Q1, there are players who did have residual problems left. So, quarter one and then quarter two, those pricing pressures remain. Even in quarter two there are possibly some players who had to take aggressive pricing positioning because of the inventory issue.

Our market assessment is that by September of this year most of the players do not have any excess inventory left whatsoever. By the time we get into Q4, pricing pressure arising from the impact of excess inventory should not be there. Now, of course, we don't know how some other external factors will play out, but then inventory should not be contributing to pricing pressures in Q4.

Kunal Sheth: So it is purely led by inventory, and you don't see too much of a competitive positioning in terms of new challenges that are causing pricing challenges, it's purely inventory driven?

Neeraj Basur: Sorry, in what sense?

Kunal Sheth: What I am trying to figure out is it, so this is purely due to excess inventory in the system and not necessarily some of the new players or private labels that are causing pricing pressure in the market?

Neeraj Basur: Yes, and that was largely there in quarter one, not as much in quarter two.

Moderator: Thank you. Next question is from the line of Amarjeet Maurya from Angel Broking.

Amarjeet Maurya: Sir, according to one of the domestic outsourced manufacturer, Flipkart and Amazon are coming aggressively in the entry level segments. So what's your thought on that and are you facing challenge in that segment?

Neeraj Basur: There are two sides to it. Firstly, using Flipkart, Amazon and the entire ecommerce, e-marketplace platform to sell is a reality, and we are very well aware and we are gearing up to be able to compete well in that entire category. The other part what you are asking is whether some of these players will launch their own branded machines and whether that will become a threat? They may launch or some of them do have their own branded products. There are some modern trade participants as well who are having their own, for example, Croma. So it's a leverage tactic, their positioning is more often leveraging their existing distribution infrastructure and platform more than in a real sense to become a serious player at least at this point in time. Those kind of competition will remain, and we will have to just respond to that. As of now, we do not really see that becoming a major threat.

Amarjeet Maurya: Sir, from total revenue of room AC, out of that how much is contribution from entry segment, middle segment and premium segment, can you give some split?

Neeraj Basur: We have never compiled a breakup of our sales in that manner, but we have always been conveying to you that more or less we are mid-premium segment, and that's our sweet spot.

Moderator: Thank you. We will take the next question from the line of Ravindra Naik from Sunidhi Securities.

Ravindra Naik: In UCP segment you mentioned that growth is driven by lower-end products and. So if at all the market will behave like that in the next coming years, and the second half of this year or in the AC season, what would be the strategy given that you have not taken a price increase? And also there is a cost pressure is also there, so what will be the strategy on the UCP sales and the pricing crunch?

Secondly, you mentioned that in your initial remarks that your margins have come down due to your ad expenditure. So why have other expenditure has gone down by around the Y-o-Y there is a 30% decline almost in other expenditure. Please confirm on these two things, the other expenditures decline and also marketing decline in base segment, and pricing part. Thank you so

Neeraj Basur: We are expecting the overall market growth for FY20 to be normal and that's what I had said in the opening remarks. Normal will mean anywhere between probably 10% to 12% and we would in that situation see ourselves growing anywhere between 15% to 18%. So that's the overall view as far as full year is concerned.

To your second question on other expenses, I am not able to relate because the other expenses are Rs. 120 crores in this current quarter as compared to Rs. 97 crores last year. So, if there's anything specific, you might just want to email the same to us and we will respond to that.

Moderator: Thank you. That was the last question. I now have the conference over to Mr. Neeraj Basur for closing comments.

Neeraj Basur: Thank you very much, Ladies and Gentlemen. With this, we conclude this quarter's earning 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 additional details by email or in person.

Moderator: Thank you. Ladies and gentlemen, that concludes this conference call for today. On behalf of Blue Star limited, thank you for joining us. And you may now disconnect your lines.