"Blue Star Limited Results Conference Call"

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Moderator Ladies and gentlemen, good day and welcome to the Q2 FY12 results conference call of Blue Star Limited. We have with us on the call today Mr. Vir Advani, President, Electro Mechanical Projects Group and Executive Director of Blue Star Limited and Mr. B. Thiagarajan, President, Air Conditioning and Refrigeration Products Group. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. If you should 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 would now like to hand the conference over to Mr. Vir Advani. Thank you and over to you sir.

Vir Advani: Good morning ladies and gentlemen, this is Vir Advani. I have with me Mr B Thiagarajan and we will be giving you an overview of the results for Blue Star Limited for the quarter ended September 30, 2011.

The following are the financial highlights of the Company for the *quarter (Q2FY12)*

- We reported a total Operating Income of Rs 604.65 crores for the quarter ended September 30, 2011, as compared to Rs 694.76 crores in Q2FY11, representing a decline of 13%.

- For the quarter, Gross Margin declined to 18.6% from 22.2% as compared to same period last year due to higher costs pertaining to increase in material costs and changes in the business mix.

- Operating profit (PBIDT excluding Other Income) for the quarter declined by 80% to Rs 13.62 crores. This was largely on account of lower business volume, reduction in the Gross Margin and increases in other expenses comprising investments in advertising, R&D and increases in logistics costs. The overall economic climate continued to deteriorate during the quarter due to slower GDP growth, high inflation, interest rate increases and weakening of the rupee. All the three business segments were adversely impacted. The contracting business was affected the most as input costs and general operating expenses increased resulting in lower margins in various projects.

- Financial expenses during the quarter increased substantially from Rs 3.28 crores to Rs 30.56 crores. This was due to:

    - Higher interest costs on account of increase in the capital employed in the business largely to fund inventories, pay down vendors to de-bottleneck operations and acquisition funding
    - A market related overall increase in the cost of financing
    - Unrealized foreign exchange losses on account of strengthening of the dollar vis-à-vis the Indian Rupee.

- As of September 30, 2011, we had a total foreign exchange exposure of US $ 72 million, primarily in the nature of buyer's credit for our product and component imports. Our normal practice is to hedge 35-55% of our foreign exposure on an on-going basis. The unexpected and rapid devaluation of the Rupee against the US $ in end-September, resulted in a marked to market loss of about Rs 20 crores on our un-hedged foreign exchange exposure.

- Consequently, there was a Net Loss of Rs 20.80 crores compared to Net Profit of Rs 38.65 crores in Q2FY11.

- Carry Forward Order Book as on September 30, 2011 increased to Rs 2162 crore compared to Rs 1999 crore as at September 30, 2010, representing a growth of 8%.

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

The Electro Mechanical Projects and Packaged Airconditioning business accounting for 64% of the total revenues in the quarter, declined by 19% while segment results fell sharply to a loss of Rs 3.41 crores as compared to a profit of Rs 43.37 crores during Q2FY11. The Operating Margin of this business in Q2FY12 was -0.9% compared to 9.2% in Q2FY11.

In the continuing uncertain environment, the pace of order inflow and execution remains sluggish. We continue to maintain our focus on managing the capital employed in the business and have closely synchronized our revenue velocity in line with requirements, and in some cases this has resulted in a slow-down in billing.

We have advanced or short closed a few more old jobs in this quarter, a practice we have rigorously pursued this financial year, and the resultant cost over-runs on these projects have been accounted for in this quarter thus pulling down operating margins for this segment. The major cost over-runs continue to be in Building Electricals, large infrastructure projects and commercial and residential projects for Builders and General Contractors.

As we have mentioned earlier, a large proportion of our order book is fixed price and the continuing inflationary trends and high commodity prices have adversely impacted the older jobs significantly. In the last couple of months we have seen a marginal “cooling-off” in commodity prices, however, they continue to be at much higher levels than those prevailing in mid 2010.

In spite of slowing revenue and execution, there has been an increase in the Capital Employed in the business. This is a result of slower than expected debtor collections as well as a conscious effort to pay out vendors over a three-month period and bring them into a regular cycle. With this decision, we expect to get better operating support from our vendors as we work to convert the WIP into certified and invoiced work. We expect the benefits to accrue in the coming three quarters.

The projects business will continue to face margin pressures for the next 4-5 quarters and we are focused on systematically purging the order book of the uneconomical contracts, a process we expect will last through the first quarter of FY13. We are working with our customers to try and recover some of this margin erosion through escalation claims and tighter enforcement of contract conditions.

As a management team we are focused on the following:

- Managing the capital employed in the business through expediting collections, commercially closing jobs and synchronizing delivery of materials and allocation of resources based strictly on requirements and payment trends
- Continuing to tighten our estimation, margin and terms of payment requirements for new orders
- Improving procurement efficiency and exploring possibilities of value engineering
- Improving productivity and optimizing all costs.

On the market side, in spite of sluggishness in market for new order finalizations & the liquidity crunch, the company continues to witness demand from the Hospitality (across the board) & Commercial Office Segments (in certain geographic pockets). During the Quarter, Blue Star won prestigious orders in these two segments namely Radisson Plaza, Mumbai, Marriott Courtyard, Pune,

Lalit Hotel, Chandigarh, NAR Indra Hotel, Lucknow, Oberoi Commerze II, Mumbai, Merlin Acropolis, Kolkata. The company's leadership position in healthcare continued with the award of Eternal Hospital, Jaipur, and Shekhar Hospital, Lucknow. Of these project wins, Radisson Plaza, Mumbai, Oberoi Commerz II, Mumbai and Merlin Acropolis, Kolkata are bundled MEP orders.

In Packaged/Ducted airconditioning and small chillers, the market is growing at a moderate pace. There was a good inflow of orders from the Industrial, software, hotels & restaurants and hospital segments. The 'Office' segment which contributes to 25% of the total pie remained flat. All others including retail, banks, developers etc have shown a decline in the current financial year.

In the VRF segment, the market is growing at a healthy 25%. The inflow of enquiries is steady with many consultants preferring VRF over Ducted systems for certain applications. However, the market has become crowded with as many as 13 players and has consequently become very price competitive. Our innovative products in this segment have received a good response in the market and we are confident of regaining our leadership position.

The outlook for the Telecom sector remains uncertain with most players carefully controlling expansion. However, some positive signals are emerging from the Data Centre market with MNCs like HP and IBM announcing expansion plans.

Moving on to Segment 2, the Cooling Products business comprising Room Air-conditioners and Refrigeration and Cold Storage Products and Systems, revenue registered an increase of 11% in the quarter. However, Segment results for the quarter compared to Q2FY11, declined by 45%. The Operating Margin declined from 11% in Q2FY11 to 5.4% in Q2FY12. This is on account of higher operating expenses on account of our expansion into the retail channel as well as higher supply chain costs. In addition, there were certain one time provision write-backs related to Warranty and Free Issue in Q2FY11, which are not accruing in Q2FY12.

Our focus on the retail channel to expand our presence in the residential air conditioning segment has helped us to grow revenues even in a declining market. We will focus on consolidating our position in the market through channel expansion and increasing our reach into tier 2, 3 and 4 markets which continue to grow.

The Refrigeration Products business performed well in the last quarter with good growth in the water cooler business, mainly from the Industrial, Government and Office segments. The Company also witnessed growth in the deep freezer business driven by the ice cream and dairy segments. Further, bottled water dispensers also did well and we bagged orders from both residential and industrial customers like Adani Power, Gujarat.

In the cold storage business, the Company has witnessed good inflow of orders in retail and food processing sector. During the quarter, major orders were booked from Metro Cash & Carry, Pepsico holdings etc.

The revenues of the Professional Electronics and Industrial Systems business (Segment 3) declined by 12%, while segment results increased by 2%. The Operating Margin increased from 25% in Q2FY11 to 29% in Q2FY12. All the businesses in this segment performed well. The increase in operating margin is largely on account of the change in business mix for the quarter and we expect margins for the current year to revert to our long term averages.

Outlook for H2FY12

At an overall Company level, while performance in second half of this financial year (H2FY12) will not be as good as second half of the last fiscal (H2FY11), we expect H2FY12 to be significantly better than first half of this fiscal (H1FY12).

Due to the prolonging Eurozone crisis, inflation and high interest rates, the investment climate continues to deteriorate. We expect the coming quarters to be challenging for the EMPG business (Segment 1) and while the revenue momentum will continue to be weak, we expect some recovery of margins progressively over the next 4-5 quarters through a combination of actions we indicated earlier in the call. Further, we expect the Capital Employed to come under control as stated earlier.

In Segment 2, we are confident that our strategy of channel expansion, focus on high growth markets and products, and our leadership position in the refrigeration products business will help us maintain the momentum displayed in H1FY12. We expect revenue to continue to grow, albeit at a marginally lower rate and for operating margins to be maintained at FY11 levels.

We are taking a number of actions to improve productivity, drive operational efficiencies and maintain tight control on items of discretionary expenditure to reign in costs and improve margins, an activity we are pursuing on a war footing.

We are hopeful that our efforts at managing the capital employed in the business, the number one priority for our organization in the current fiscal, will start yielding results towards the end of the current fiscal.

To sum up, while the commercial construction sector is witnessing a slowdown, small commercial businesses such as shops, showrooms, restaurants and the residential market continue to grow. On the other front, commodity prices are cooling-off. The strong foundation on which our businesses are built gives us the confidence that in 3-4 quarters we will significantly revive the operating performance and return to a growth path. In retrospect, while we had indicated a decline in performance in FY12, the actual performance is an aberration in the consistently good performance record of Blue Star. Therefore we intend to stay focused on our chosen markets and will endeavor to return our operating performance to long-term levels.

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

Moderator Thank you, sir. Ladies and gentlemen we will now begin with the question and answer session. The first question is from Nikita Gawandi from Quantum Asset Management. Please go ahead.

Nilesh Hi, this is Nilesh from Quantum Asset Management. Just wanted to understand in terms of the typical cost structure of the company, when we get orders do we enter into back-to-back contracts for raw materials or how is it?

Vir Advani Let me clarify, we do not buy too many raw materials per se, because we are system integrators we end up buying many components, products as well as, of course, certain materials which have a heavy raw material content like cables and transformers, etc. But we do not have an efficient way of protecting ourselves on the backend primarily because, steel is one

of the largest inputs into all our business and we are unable to hedge that effectively. We are, however, putting in place a new hedging desk for copper and aluminium. We have been working on that for about six months and we hope that in the next two quarters we would have productionized that, so that on a project by project basis, we will be able to at least hedge those two commodities.

Nilesh Within the consumption of raw materials how much of it would you say is exposed to open market prices and how much of it where we have some control over prices where we have not exposed to fluctuation in market price?

Vir Advani I have answered that already, the bulk of what we do on the project side is open to market price. In our equipment business, we are able to hedge our copper and, of course, we do hedge our foreign exchange to a certain degree, but there again, steel and other inputs are open. But again we are not buying a lot of raw material in raw form. It is primarily converted already and then passed on to us. So other than sheet metal for our equipment, GI sheet for our equipment, a limited amount of raw material we are buying.

Nilesh Just wanted to understand, when the client places a pure HVAC order vis-à-vis a MEP order, what does he look at when he decides later whether I want to have the MEP order through this builder or just purely CAC /HVAC order, but what takes the decision in either way?

Vir Advani What I see here are two things. One of course, price makes a difference in this market. It is a very price sensitive market right now. So whether you can deliver an MEP job where the sum of all is more competitive as compared to breaking up the contract depends on how you can share your overheads as an MEP contractor, but more than that these days, it is the application. The more complex the application, the more likely the customers will bundle. So if it is a hospital or a hotel or a large infrastructure project like the Metro, etc., they will tend to try and bundle that, whereas if it is simpler retail commercial building kind of application, they are still choosing to unbundle it.

Nilesh How much does the pie increase by? If were to win a MEP order vis-à-vis just a pure HVAC, how much does the size of the order increase there?

Vir Advani Roughly two-and-a-half times.

Moderator Thank you. The next question is from Pritesh Chheda from Emkay Global. Please go ahead.

Pritesh Chheda Just one slightly high level question, in the last six quarters we have seen significant change in Blue Star's performance versus what it was especially on the first segment size which is the projects and accompanying increase in loans. Just wanted to understand what has gone so wrong in this particular business for such a sharp deterioration or change in performance in the six quarters? If you could highlight the main aspects of the same?

Vir Advani I will repeat it, I think we have done it twice already. Essentially, what we are looking at is an increase in cost over this period. We all know what has happened to raw materials over this period. We have fixed price contracts on one hand and we are open on the procurement side. And so cost overruns had exceeded what we had anticipated. We have made an effort to close jobs that have been opened for three years and more and as we close those one by one, we update those costs and book the losses in those projects. While we are doing that, we are also re-evaluating the overall order book, because obviously as costs go up, one has to look at even the running jobs, as well as, the active and healthy ones and even there we are seeing erosion in margins. I had indicated in the last call that, the total quantum of erosion of margin would be in the tune of 3% to 5% of the carry forward. The overall impact is now probably closer to 5% in our estimates as as we execute this order book. Having said that, we are frontloading a lot of that cost of overrun because, as we identify them, we are booking those corrections to the extent that we may be able to recover part of what we are having to write off or take adjustments on. We will look through escalation clauses in our contracts as well, and also we are looking at the future commodity pricing and what positive impact that is going to have on the carry forward margin.

But looking back, over the last six quarters, I think the material usage content from an overall portfolio point of view, in our electrical business,

has grown significantly in the last two years. The copper and aluminium content of raw material there, is significantly higher than in the HVAC projects that we have. And so to the extent, the copper and aluminium prices have gone up significantly more than steel has, we have seen higher erosion in margins in the electrical business.

The other issue that we have been working on for the last four quarters now, is to try and bring down the capital employed through receivables management. Many of our customers who are builders as well as even corporate, are facing fund issues, so we were being a lot more liberal on the receivables front all the way until about three quarters ago, when we told you that we are going to change the strategy which we have, so as to not see runaway receivables anymore. I think that part is starting to come under control by this quarter over the last four months as we have indicated in the call. We have tried to pay out vendors at a faster pace in order to get the cooperation to convert our large WIP into the billable revenue. So the capital employed is going through a cycle right now. It will take us another two to three quarters to bring it under control.

So if one steps back and looks at it, the capital employed is the one thing we need to bring back under control. On the margin side clearly, tightening up order inflow is critical given what we are seeing on raw material prices, being so volatile, moving up and down. But fundamentally, as I mentioned in the call, I think we remain committed to that business. We believe that there is long term potential, we continue to be a leader in that business which is undergoing lot of stress in the market. We anticipate it will take us three to four quarters to bring back the business to the long-term operating performance levels that we were seeing for the last three to four years. I do not know if that answers part or whole of your question.

Pritesh Chheda One clarification here, 1) Have we compromised on the quality of client or the orders in the last three to four years because of which the cycles have got elongated versus generally what the execution was? 2) How does it reconcile with the ever increasing working capital cycle? And is there a fear or some of the debtors actually going bad?

Vir Advani On the first one which is customers, I will not say that we have compromised, the market has moved away quite significantly in the last

five years from corporate buyers to builders and general contractors. That is a trend that we have seen over the last four to five years. So if I have to guess, maybe about 20% of the business five years ago was driven by builders and contractors. Today that maybe as much as 40% to 45%. So to that extent if you want to be in the business, then you will be working with customers that are different from what you were working with, three to four years ago. So I do not think it is a conscious decision, it is more of market structure change. I think you have the second question on the capital employed. Could you ask that question again, I am not clear?

Pritesh Chheda In the last three years, on one side we saw the cycles increasing. Second side we saw the RMs increasing and third we saw an ever increasing working capital cycle. So I just want to reconcile with the quality of the customers and if any of that is bad in nature?

B. Thiagarajan I can add one small thing here, the question relates to quite a few quarters which we have crossed. Blue Star was on a high growth path. In almost all businesses, it grew very significantly. As Vir mentioned, there is a significant shift in the customer profile. The builders and developers and infrastructure projects came into picture, which means it is a long gestation time. Third thing is in line with the growth in the economy. Like we say the infrastructure has to improve in the country or many other things have to improve, one thing we are clearly witnessing is the legal and other measures to enforce contractual commitment on payment terms. It is a fact that the customers enjoy longer credit periods and lot of energy is being spent in collecting the payments and specifically in contracting business disproportionate time goes in speeding up the contracts and collecting the payments. The country has not come out as yet. Apart from the cheque dishonuor law which came into picture afterwards, we have not seen any kind of legal remedy that is available where a payment is stuck. So from the company's point of view that is the reality. If we want to be in business we have to deal with this particular situation. So we are very clear. In the opening remarks we have mentioned that a) Unless payment is available we are not going ahead with execution. This we have been practicing for at least four quarters and very significantly in the past two quarters. b) We are completing due diligence and credit worthiness of the customers and analyzing how the projects will move and then we are taking

a particular action.There are already improvements we are seeing in our speedy collection of payments. So we will get this under control.

Vir Advani And as far as bad debt is concerned, I think we are actively making provisions on a regular quarterly basis since the last financial year. So the provisions we are making adequately, cover any risk we have on the debtors.

Moderator Thank you. The next question is from Sundaram EA from M3 Investments. Please go ahead.

Sundaram EA You had mentioned that there were some write-offs in this quarter numbers because of some of the debtors, etc., which turned out to be unsustainable that you were writing off. Can you explain to us the extent of the write-offs in Rupee crores for Q1 and for Q2 that is there in your accounts?

Vir Advani I did not mention any write-offs. What I said is that, we are providing for debtors on the quarterly basis. What I said was, as we close projects we are updating our costs which are having an impact on the margins. So it is not a write-off as they are running projects that have to be closed. So these are not debtors that we are writing off. This is erosion in margins on account of cost overruns. So I have to just clarify on that.

Sundaram EA The erosion of margins that you have made provisions for, can you give a numerical number to it, in Quarter 2 as well as in Quarter 1.

Vir Advani It is difficult to put a number to it that way because you update the project, you close the project and whatever is the final margin on the job, it goes into it.

We bill about 150-200 projects a quarter and so we do not really track it like that. What I did indicate last time, I will repeat it and then I will tell you the update of that, is that when we looked at the order book last quarter we said that the margin erosion will be to the tune of 3% to 5% of that carry forward. The carry forward was about 1800 crores if I remember. That order book is more or less the same, maybe it is up by a little bit this quarter. What I am saying now is that, as we have got further into the reviews of our costs, we are saying that, the erosion is going to be closer to 5%. I am also saying that we are frontloading a lot of that 5% erosion in this financial year. So our Q1 was about closing projects, Q2 we continue to

close some projects and we also try to update running projects. Q3, Q4 we will completely update our costs and my view of that is that there will be a 5% erosion in Segment 1 margins on account of that. Once that adjustment is done then we go into the new year the carry forward has lower margins obviously but it is being refilled with projects which have higher margins plus on top of that there are two things that we are working on, one is in our control, the other is not. What is in our control is to go out and try and recover some of this erosion in margins from clients on projects which have been delayed beyond reasonable limits. So we go back and ask for cost escalations and price escalations and over stay, etc.

What is not in our control right now, but where we hope we will see some benefit in the carry forward margin, is on commodity prices, because copper has come off its highs of around $9500 a ton down to around $7000-7500 a ton. So while we have not seen the benefit of that yet, because there is a long lead time on ordering and delivery of our material, as earlier I mentioned to you that we do not buy raw material but we buy semi-finished or finished goods. Hence, we expect that if these levels of copper and aluminium holdup which all macroeconomic trends seems to convey they will, then we will start to see some improvement in the carry forward margin from the lower levels. So it may not come back to historical levels but we are certainly hopeful that it will be better than what we are realising currently.

Sundaram EA Speaking of historical levels, if you take the last seven to eight years average for operating margins for Blue Star, it has been around 9% on a company wise basis.

Vir Advani Correct.

Sundaram EA But in the last quarter it has fallen quite significantly, less than 2.5%. Do you think you can go back to 9%, what is your assessment?

Vir Advani See Segment 2, we think will continue to hold at this 11% plus level. So that should continue. Of course, the market is a little dull right now but in spite of that I think we should be able to manage those margin levels. Segment 3 margin levels continue to hold and I think for the foreseeable future will hold because there is no significant change in that business. Segment 1 is

obviously where the swing is. We know why the swing has happened now. We are explaining that. Until we bill out this order book, you will see Segment 1 margins significantly lower than where they have been which is around 8% to 9%. As we refill the order book and as we start to build those projects, we will certainly return to those levels because even though the order inflow in the first half of this year is certainly down, no doubt about that, it's a combination of the market being dull as well as our own interest in being more selective about projects we take. We are clearly seeing the ability to book new business, fresh business, at historical margins. So it's not as though there is a structural change in the margin of pricing level in the industry. I am being very clear about that. We have I think for the last 18 months, been booking business that we may not be looking at going forward. So there maybe a reduction in the order book as we get more selective but because customers are coming forth to give us these contracts, we presume that the market will return to these levels.

So how long will this 1800 crores take to execute, is where the big question is? I would say it's a combination of our own interest to slow it down until capital employed comes under control as well as there are a large number of projects we all know about, which are moving slowly because the demand has slowed. So my best guess of that is that, it will take us through most of FY13 to bill this out. So FY13 margins will not be at the levels that we would want but from then on we should see the improvement. In FY14 one should certainly go back to those historical levels. In FY13, the mix of the business will determine the overall company margin because if Segment 2 and Segment 3 continue to grow healthily like we expect them to, they will become a larger percentage of the overall business and to that extent even though Segment 1 margins will be lower than historical levels, the mix will be different so maybe at the company level you will see healthier FY13 margins.

Sundaram EA One more question about your capital employed. You had mentioned that your intention is to reduce the capital employed. If you see the long-term average for Blue Star it has been one of the most highly capital efficient company with revenues per capital employed was more than five times and debt-equity ratio of never more than 0.5. But recently it has substantially weakened. What is your target and on a sustainable basis where do you think these numbers will stabilize for Blue Star?

Vir Advani Our near-term target which is year end, is to bring down that capital employed that you are seeing there. We hope that if we do things right it will be by a couple of hundred crores based on the action we are taking. So you will see a short-term improvement but on a long-term basis I will say that it's going to take us a little longer to return to that lean balance sheet because obviously we do have this capital employed that we are working on. It is a combination like I mentioned just to remind you, there is some acquisition funding there, there are higher inventory levels on account of our room air conditioner business and then we have paid out our vendors. So if you look at our balance sheet for the first half you will notice that our current liabilities are down by 100 crores, on account of vendors being paid out ahead. So these are short term measures we needed to take to manage the business. But on a long-term basis we may not get back to five times capital turn but clearly this current level of two times is not acceptable to us. So given the nature of the business, there will be infrastructure business, there will be larger projects as we go forward, the average project value is increasing, the duration of the projects is increasing plus as we bill, we grow and we scale the product business, there will be a demand on capital for both capacity as well as inventory. So while there will be demand for capital for the foreseeable future we hope that we should return those capital turns, I think five would be quite an aggressive target for us but certainly around four times what we should be aiming for.

Moderator Thank you. The next question is from Avinash Nahata from Aditya Birla Money. Please go ahead.

Avinash Nahata My question is regards to the consumption of copper and aluminium. If you look at the Segment 2 of the product business of Blue Star, we are buying components made of copper and aluminium. If you could throw some light and just put a number to it, what if you can assume that copper was at 8500 and it comes down 15% on a like-to-like basis, there is no hedging and we keep on buying at different price points based on our consumption pattern. What savings it could lead to in our product business?

Vir Advani Let me try and explain this. First of all the copper price reduction has been coupled with the Forex move. So the net effect is to look at the net impact which is not as large as one would hope. But leaving that aside, which is just copper, I will mention again, in our projects business we don't buy any

raw material, we don't even buy pipes for example. The closest we come is cable, transformers, switchgear, control panels, etc., where there is an implied buying value of LME but none of our vendors are linking our purchase to the LME rate. So that comes on a negotiation as to how you can convert that lower LME rate into better pricing for your projects. Now because these are all specked-in engineered products that we are buying, there is a lead time on that which is a minimum of three to four months of lead time between placing an order and actually receiving the material. So to the extent of need of product at our project sites, February to March is when we have some flexibility on the pricing. So most of this year will go by without that benefit, because we have already placed orders that are being manufactured and delivered. On the equipment side, in our manufacturing business, lead times are around three months again where we have little bit more of direct control because we are buying pipes and things like that, so it's a little more connected. Overall for the company, we have been buying on an average over the last two years, approximately 300 crores of copper and aluminium annually. Of course, it goes up and down depending on seasonality. So if one does simple math, then you are talking of around 5-10-15% of 300 crores, as savings, of course, based on what I just explained to you. So that is a broad answer to that question.

Avinash Nahata You said 300 crores of consumption, would this comprise of both components as well as the pipes, etc., you had mentioned put together?

Vir Advani It is a mathematical number because it's an implied value of these two commodities, so we presume that a transformer has 'x' percent that kind of thing. We are not taking physical delivery of 300 crores of copper.

B. Thiagarajan To add to this, if we are talking about the margins in the cooling products business, there are three elements which can affect. One is the foreign-exchange itself. Two is the raw material prices. The third one, which is becoming significant, is the fuel prices resulting in higher logistics costs. Each one of them affect in a different time period and different lead times are involved there. That has what is to be kept in mind. Something like fuel it's immediate, in the next week itself it will affect. Something like copper or raw material has a lead time, both ways whether it's going up or it's going down. That is what I would like to add.

Moderator Thank you. The next question is from Ankit Babel from PINC Research. Please go ahead.

Ankit Babel My first query is that we understand that the current order book had margin pressures since there were fixed price in nature. Just wanted to know what about the new orders, are they also fixed price in nature or we have embedded escalation clauses?

Vir Advani They continue to be fixed price. As I mentioned in the past, the infrastructure and government contracts tend to have a built-in price variation clause. Private sector business continues to be without escalation clauses. However, what we are doing now is we are insisting that we agree on the price during the execution period of the contract. So obviously every contract has a execution time and what we are agreeing with clients selectively is that should there be delays in their projects on account of their delays, obviously if our performance is slow then that is to our cost, but if the projects are getting delayed on account of their issues and if the time of the contract is extended then at that time there will be a mutual renegotiation of the pricing and the rates. So to that extent it's not an official price variation clause which is what one wants to see, which is RBI linked, etc., but it's reducing the risk from an open-ended risk to a contract duration risk. And I think customers are coming around to understand the importance of that.

Ankit Babel But historically how has this performed? At the time of negotiation, were we able to get all the claims which were on account of delay in projects from customers' end? Were we able to regain all the 100% overruns of whatever it would have been from the customer?

Vir Advani No, if we had been able to do that, then we would not have had this margin erosion.

Ankit Babel Exactly sir, that is where I was coming in from. Why are we not insisting on escalation clauses then and why we continue to be vulnerable to fluctuations in commodity prices in foreign-exchange?

Vir Advani So that's the structure of the industry and it's not possible for one company to change that. So one has to build-in, you take inherent risks in the business and then you have to de-risk it.

Ankit Babel So it's from the customers and that they insist on fixed price contracts and not from our side?

Vir Advani Absolutely, yes.

Ankit Babel Then in the first half we had already witnessed a decline in the revenue growth for the company as a whole. Now you have indicated that the second half would be significantly better than the first half, that is on a sequential basis. So are we expecting any growth in revenue in FY12 as a whole as compared to FY11?

Vir Advani No, I don't think so.

Ankit Babel And also not in the project division because there….

Vir Advani Clearly not in the projects business because we are actually slowing it down.

Ankit Babel In the margin erosion in the project division in the first half is more than what you have guided of 5% erosion. Actually it's running into losses. Considering the first half performance are we going to make any money in this Segment in FY12?

Vir Advani Please understand what I am saying, I said of 5% erosion on the carry forward order book. I am not saying that it's 5% erosion on quarterly margin of the business.

Ankit Babel Normally it's like 9% kind of margins you do in the project division, right?

Vir Advani Right.

Ankit Babel Now the carry forward order book, I believe most of it would form part of the revenue for the current year, right?

Vir Advani No, that is not true because our order book is more than a year in volume, it's more like 18 months.

Ankit Babel I agree. That is the reason why I am saying is that most of the revenue for this year would be from that carry forward order book only because new orders will get executed, most of the revenues will start coming in from next year?

Vir Advani Correct.

Ankit Babel So what I am saying is that in the first half we have already witnessed negative margins.

Vir Advani Yes.

Ankit Babel What I presume is that for the year as a whole, we will still continue to be into negative territory for the project division. Now this is my assumption.

Vir Advani Correct.

Ankit Babel So the normal margins of 8% to 9% can be witnessed only in FY14?

Vir Advani Yes, that is what I told the earlier person, correct.

Ankit Babel So FY13 would also be a mix of a negative to on an average around 3% to 4% kind of margins.

Vir Advani Yes, we have not projected that but you are right, it will be a mix of the old and the new. So to that extent depending on what we bill and how much we are able to recover from the current, is what will determine the FY13

Ankit Babel So we can presume that the worst is over for the company and on a sequential basis there would be an improvement in the performance?

Vir Advani yes.

Ankit Babel Which can take another six to eight quarters to reach to the normal levels.

Vir Advani I agree with you.

Ankit Babel Second question is what was the order inflow in this particular quarter?

Vir Advani 677 crores.

Ankit Babel Since last two quarters there has been a slowdown in order inflows. This suggests that in FY13 in revenue we should not expect any growth, am I right?

Vir Advani Actually on the flip side, the order book is growing and so what I mentioned

Ankit Babel That is because you are purposefully delaying the execution.

Vir Advani Absolutely, so that is the point. You asked whether in FY13 there will be growth, over FY12 I presume there will be because FY12 will be a low revenue year.

Ankit Babel But it would be a single-digit kind of a thing or it could be a good double digit?

Vir Advani I am sorry. It is a little early to talk about FY13, we are still trying to get over FY12. So maybe by next quarter we will have a better view of the next year.

Ankit Babel Lastly, what could be the expected tax rate for FY12 and FY13 considering the higher R&D expenditures?

Vir Advani The tax rate in FY12 maybe around 25% to 27%.

Ankit Babel In FY13?

Vir Advani FY13 we will have to re-look again. It should be around 27% or so.

Ankit Babel Lastly just one thing that historically we have always enjoyed a debt free balance sheet. When can we expect a debt free balance sheet for Blue Star in the coming future? Will it take more than eight quarter, on a very broad basis?

Vir Advani I think it will take more than eight quarters. I have not yet looked out that far right now. I think once we have a clearer view of the order inflow into FY13 and the conversion of that. It also depends on the velocity of business improving because we need that growth to pay down the debt. So I think that probably starting FY13 we will have a better view of that.

Moderator Thank you. The next question is from Nitin Bhasin from Ambit Capital. Please go ahead.

Nitin Bhasin I have a couple of questions but the more dominant one if you can answer that is, the different ways in which we can slice your order book. One way could be looking at is, how is the order book presently and if we integrate it, and how much of it's the HVAC or plumbing or electrical? So if we could have a sense on that, that is a) part of the order book. The b) part of the order book if you can also slice it for us in terms of how much of it's infrastructure as such right now and how much of it's presently possibly commercial and government. The third way to possibly slice it would be in terms of time period. How much will be completed in 12 months, how many in 18 months, how much possible in 24 months or 30 months, because the weighted average is 18, hence there has to be some order book which is possibly at 24 or 30 months. So if you could just broadly spend some time on this. And alongside the competition, because we hear that people all the way from Schneider's of the world, or the L&T of the world, are also vying for big electrical jobs. So how are you dealing the competition with them? And also in terms of plumbing, has plumbing actually panned out the way that you thought of the acquisition?

Vir Advani Let me try and take some of this. So MEP to standalone I think it's about 30% of our order book is MEP, and when I say MEP is not all three services, its bundled. So it could be M&E, M&P, E&P, etc.

On infra, it's still 75:25, so about 25% of the carry forward his infrastructure, the rest is still commercial and a little bit of residential. As far as the other view of the order book, it's difficult at this stage to figure out duration because, like I mentioned where it's currently just choking the system. So even if one can deliver a project in the next eight months, we are actually not allowing that to happen until the capital employed at a project level comes under control. That means either the customer has to increase the velocity of payment or we have to convert what we have already delivered into invoiceable quantum. So I am unable at this stage to figure out the duration. What I had been saying is that at one time the carry forward used to be seven months of billing, then it became 12 months of billing, my best guess right now is about 18 months. So it will take and

you are right, the larger infra projects or hospital projects will spill into 24 months plus. So that is the mix.

It is very difficult right now to talk about that part. But on the quality of the order book as it stands today or as we view of it about 75% is commercial, of that may be about 35% would be for builders and other 10% for contractors, the rest would be for corporate commercial customers. The other Segments I think will not have too much change from the last couple of quarters. IT continues to be a lower percentage because demand is still not picking up. Hotels and hospitals continue to increase in the order book. We have a mixed opinion of that. Hospital business we like because it's more manageable business. The hotel business is not one of our most favorite businesses because of the nature of the project, a very time intensive project with very high expectations and typically significant overrun in time. But that is the Segment that is buying right now so we are selectively participating in that. So that is the flavor of the order book.

Going forward what we are seeing in terms of new orders coming in, we are still seeing a change. It's quite interesting. What we are seeing is larger orders getting finalized. So in fact smaller orders are getting delayed and larger orders are getting finalized so we may be expecting to have fewer but larger value orders in the order book going forward and that is already starting. So it's a combination of us choosing to our preference for MEP projects over standalone projects, so that automatically increases the size of the project but also even if I don't look at that even standalone orders for some reason larger projects seem to be getting funded and signed off rather than smaller ones.

Nitin Bhasin When you say large projects, is it the infra or it's still the building, hospital and hospitality kind of thing?

Vir Advani Yes, so it's both. So in infra there is some movement but I am talking about in the building business itself, there seems to be larger, if there is a 10 crores order and a 30 crores order to be finalized for some reason, the 30 crores one gets finalized faster than the 10 which is counterintuitive to what is going on from a funding point of view. The only other argument for that is that 30 crores project of that building is a priority building and is going to be funded by a larger investors, etc., and maybe, therefore, the

money is tied up. So I am not quite clear on that. I am way too far down in the cycle to comment on that. But that is what is happening on the carry forward basis. You had another question?

Nitin Bhasin The other question was in the Segment A only, we are hearing multiple kind of things that, the electrical, the Schneider's of the world and the L&T of the world, are also vying for products and projects. And in a way they are your product vendors also. So, how are you dealing with the competition because that is very different kind of an environment as compared to your HVAC where your HVAC vendors don't necessarily compete with you?

Vir Advani So I will just clarify, you are talking about the power sector electrical business.

Nitin Bhasin Yes.

Vir Advani Not really in the buildings, we still have not seen anyone competing significantly in buildings. There maybe some exceptions like you are saying of some Schneider or something who will take a job or two. But by and large the equipment suppliers tend to stay away from building business. In the power business, of course, there is a lot of competition from equipment suppliers. There our exposure is relatively low.

What we have said is we have booked some amount of business last year and we are executing it to understand and learn the business before we scale it. So in our current order book, that business isn't very large so we have not yet seen real competition from that point of view. In the eyes of the market and what we do in it is a big mismatch. But on the building side we obviously always keep our eyes open for new competition. My own sense is that the equipment guys, they may get tempted to try and execute a project once they get into it and they understand the complexity of the actual execution coupled with the financial implications of a projects business as compared to a clean equipment business and they tend to be very selective on what they do. So we will wait and watch to see, but we have not seen any significant change in the industry structure so far.

Nitin Bhasin The last one on the Segment 2 right now, it will break it into smaller parts of A and B. One is that, if we look at your margins of your Segment 2 this

quarter were closer to about 5%. And this is possibly one of the lowest in the cooling products business right now. And there has been a lot of talk about these Japanese coming into the Indian market, want to create market share for themselves, and bringing down their pricing points. How is the competitive dynamics playing out for your company right now in terms of the competition pressure on realizations and margins when the costs are simply not controllable because there is too much of volatility?

B. Thiagarajan See, in the Indian products business one thing which is significant is the fact that the market has not slowed down. While the summer was not as anticipated by the players it continues to grow anything between 15% to 20%. As far as we are concerned, we are able to manage that growth by different strategies in different Segments, like room air conditioners it's coming basically out of our network expansion into the retailers and also Tier-4 and Tier-5 markets. Because the restaurants or the food sector is doing well, the refrigeration products as well as the cold storage business continues to grow. Having said this, unlike our projects business, in the product business, the raw material prices immediately affecting the lead time, is not much. So all the players invariably increase their prices right from December-January onwards till March-April. And one more round of price increase is in the offing now basically because of the Rupee weakening. Now what is preventing from the market to do that is because all others have to liquidate our stocks before December, new energy labels are coming into play, as far as the room air conditioners are concerned. Refrigeration products, refrigeration systems price increase has been affected. We have taken the lead, we have announced anything between 3% to 5% increase already and room air conditioners, the players have to liquidate their stocks and at the same time cope with the Rupee weakening scenario. The good news is that these inventories came in much later, I wouldn't know some players would have already paid off or somebody maybe having buyers credit, somebody might have hedged, but the fact of the matter is the price is not going to increase in room air conditioners.

On the whole I do not see there is huge undercutting, it will happen when 10 to 15 players are there in the marketplace. It's happening during this Diwali season we are witnessing that but all will revert to moderate pricing.

Bottom line is this particular business, room air conditioners or deep freezers or water coolers, I see some kind of growth happening in the market place, not much of margin erosion in the coming 3 to 4 quarters. From our side our significant challenge at this moment is basically what do we plan for next summer, in terms of inventory levels because always the guess work goes on, market will grow by 25% to 30%, so we may have to be taking a balanced decision. Second is with the diesel prices going up in this manner, per unit logistics cost are as high as the margin itself. The warehousing and transportation, a very huge expenditure we are incurring. We are trying to bring about certain changes there in the methodologies that we will follow. So, therefore, the outlook for this business is good.

Nitin Bhasin But the 5% margin, because somewhere in the call you mentioned that we are expecting 11% margin back. So this 5% was an aberration do you think and it will be very soon recovered back to 10-11%?

B. Thiagarajan For sure.

Nitin Bhasin The smaller part to this question was one thing, historically you have been focusing on commercial and commercial there was a lot of AMC revenues also. And the profitability, hence, of the cooling products business was much better than so many other players out there in the market. Now you are looking at the residential market and the residential market not having the entry side of revenues. How do you see this profitability pressure from increasing trends into the residential market, because naturally you can grow volumes, you can grow revenues, but the AMC revenues will not come from the residential market?

B. Thiagarajan One strong difference is never we had huge revenue of service even in commercial for the room air conditioners. It is an insignificant part of it. See, our conversion rates in AMC for room air conditioners even when we were focused to only on commercial sector is only 10%. So it’s not going to make a difference. Our complete retail strategy is to grow the volumes while staying focused on the commercial and corporate Segment. That’s about it. So far it’s going good. It looks good. We will see. It’s founded on the premises that Blue Star as a brand can sell the machines at a much higher price than the consumer durable players and so far we are able to

sell, though our products are more expensive than the consumer durable players.

Nitin Bhasin How much is the order book from Segment 2 and Segment 3 of the total order book?

B. Thiagarajan Order book will be insignificant. If you see the pending order book here it will be what is 2 weeks-3 weeks only will be there.

Nitin Bhasin So it's maximum about three to four weeks for the Segment 2 and Segment 3 as an order book at any given point in time?

B. Thiagarajan Except there may be some cold storage projects which go on for three to six months of our time. Otherwise it's always book and bill…..

Nitin Bhasin So basically out of the present 2000 crores kind of an order book right now, 2100-2200 crores order book, your orders ….

B. Thiagarajan It is predominantly Segment 1 related. Something of Segment 3 maybe there.

Nitin Bhasin So basically 90% you can say of Segment 1?

B. Thiagarajan Vir, can you clarify that?

Vir Advani Yes, that is correct 90%.

Moderator That was the last question, sir. Would you like to add a few closing comments?

Vir Advani Thank you very much everyone for attending our conference call. If there are any more pending questions that you need answers please send them across to us and we will try our best to respond to you. Thanks again and talk to you in three months. Bye.

Moderator Thank you very much. On behalf of Blue Star Limited this concludes this conference call. Thank you for joining us and you may now disconnect your lines.