



"Blue Star Limited Q2FY18 Earnings Conference Call"

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MANAGEMENT: MR. NEERAJ BASUR - CHIEF FINANCIAL OFFICER – BLUE STAR LIMITED

Moderator: Ladies and gentlemen, good day and welcome to the Blue Star Limited's Q2 FY18 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" and then "0" on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Neeraj Basur, Chief Financial Officer. Thank you and over to you Sir!

Neeraj Basur: Good morning ladies and gentlemen, this is Neeraj Basur and I will be providing you an overview of the results of Blue Star Limited for the quarter ended September 2017.

GST roll out from July 1, 2017 had a profound impact on business operations across all our segments. We have explained impact of this transition in the relevant segment result discussion section. Prior to GST going live, revenue for previous periods included excise duty and other applicable input taxes. Comparable revenue and EBITDA margins in this update have been computed by adjusting excise duty and other applicable input taxes from the revenue of respective previous periods, on a like-to-like basis. There is no impact of this on the profit before tax and profit after tax figures.

Now I will talk about financial highlights of Q2FY18. Following are comparable financial highlights of the company's performance for the quarter ended September 30, 2017 on a consolidated basis.

Our revenue from operations for Q2FY18 was Rs.835.71 Crore, which reduced marginally as compared to Rs.847.84 Crore in Q2FY17. EBITDA excluding other income and finance income for Q2FY18 was Rs.45.91 Crore as compared to Rs.40.19 Crore in Q2FY17, a growth of 14%. EBITDA has a percentage of revenue increased to 5.5% in Q2FY18 from 4.7% in Q2FY17. Profit before tax was Rs.28.78 Crore in Q2FY18 as compared to Rs.26.66 Crore in Q2FY17, a growth of 8%. Tax expense for Q2FY18 was Rs.8.42 Crore as compared to Rs.7.34 Crore in Q2FY17.

Effective tax rate for Q2FY18 was 29% as compared to 28% for Q2FY17. Consequently consolidated net profit for Q2FY18 increased to Rs.20.78 Crore from Rs.20.01 Crore in Q2FY17, a growth of 4%. Carry forward order book as on September 30, 2017 increased by 15% to Rs.2120 Crore as compared to Rs.1840 Crore as on September 30, 2016.

On a standalone basis, Blue Star had net borrowing of Rs.252 Crore as of September 30, 2017 as compared with Rs.263 Crore as on September 30, 2016.

Net borrowings of our fully owned subsidiary Blue Star Engineering and Electronics Limited decreased to Rs.45 Crore as on September 30, 2017 from Rs.56 Crore as of September 30, 2016. Our consolidated capital employed increased marginally to Rs.757 Crore as of September 30, 2017 from Rs.705 Crore as on September 30, 2016.

Now I will talk about business highlights for all the three segments for Q2FY18.

In segment I, Electro-Mechanical Projects and Packaged Air Conditioning Systems, unfulfilled customer orders needed to be individually realigned under the GST structure. This turned out to be a slow and arduous process and consequently led to a slowdown in project execution and therefore billing. The comparable revenue for the segment was Rs.501.82 Crore in Q2FY18 as against Rs.538.67 Crore in Q2FY17. The segment results grew to Rs.38.3 Crore, which was 7.63% of segment revenue from, Rs.28.56 Crore, which was 5.3% of segment revenue in Q2FY17. Closure of certain projects having higher profitability particularly in Q2FY18 resulted in better margin realization. Order inflow in Q2FY18 was Rs.582 Crore as compared to Rs.560 Crore in Q2FY17, a modest growth of 4%.

For our electro-mechanical projects business, the overall market demand slowed down in Q2 due to business and operational uncertainty post introduction of GST and sluggish demand from private investments as corporates continue to adopt 'wait and watch' approach. Spending was largely driven by Government in various infrastructure projects like metro

and healthcare. Our sales prospects base remained static with a drop in the office segment and some growth in the residential space mostly for fire, ventilation, electrical and plumbing services. New order booking from heavy industrial and factory segments continued to be muted.

Select large value investments from Government and a few corporate are going the super bundled route through general contractors. Further, customer preference for single vendor for multi services is gradually on the rise. Our share of multi service mechanical, electrical and plumbing systems in building and industrial projects continues to be higher than the industry.

The strategy to focus selectively on profitable and healthier cash flow projects has started to show results. Blue Star continues to invest in smart systems and technology in line with our value proposition of superior project delivery through intelligent engineering, modern execution practices and committed teams. Blue Star maintains its dominant leadership position in the electro mechanical space in India. Some major orders won during Q2FY18 included Cube Constructions, DLF Cyber park, Sintex Corporate office, Ford, Deloitte, Smitha Hospital and MRF.

In Central and Packaged Air Conditioning Systems business, overall market for the central plant equipment business also experienced a slowdown in Q2 due to the implementation of GST. Billing cycle got delayed due to lack of sufficient clarity and interpretation of new GST rules. Bookings however showed some signs of recovery in the month of September.

In spite of the slowdown reported in this quarter, our VRF product range continued to record good growth rates. Our fifth generation VRF and the new configured series chillers have gained good acceptance in the market. There is also a good momentum amongst the dealer for the sales of our inverter ducted systems. Major orders booked during the quarter were JSW Cement, Samhi Hotel, Theni Anantham Silks, NTPC, Jindal India and Greenply Industries.

On the international business front, Blue Star continued its focus on expanding its product exports. Healthy order inflow continued for water coolers, room air conditioners and other applied products such as VRF, AHU and chillers from various distributors and OEM customers. However strengthening of Rupee against US dollar in Q2 impacted our export billing.

Blue Star conducted a number of distributors and consultant interactions as part of confidence building measures and also participated in a number of exhibitions across Sri Lanka, Qatar, Iran and Maldives. Blue Star's stall in the 'SIVAR expo' in Sri Lanka was adjudged as the best stall by the exhibitors. As reported earlier, our exports business has presence in 19 international markets and we are currently focused on deepening with the penetration in these markets. On the economic outlook, emerging markets of the Gulf Cooperation Council (GCC) countries and Africa remained under pressure. The ongoing sanctions on Qatar by GCC countries have impacted both order inflows and cash flows.

Blue star continues its journey to strengthen its brand in select international markets. Blue Star has an aggressive plan to selectively and profitably grow its international business and the overall business outlook remains positive.

Moving to Segment II, Unitary Products. Towards the middle of Q1 this year, dealers and distributors started to destock their inventory in anticipation of GST migration. In addition, post GST going live, business supply chain had to undertake a short shut down during the month of July in order to revalue the stock of unsold finished goods to establish transition credits under GST.

Comparable revenue for this segment was Rs.294.38 Crore in Q2FY18 as against Rs.262.83 Crore in Q2FY17, a growth of 12%. Segment results reduced to Rs.15.66 Crore, which is 5.32% of segment revenue in Q2FY18 as compared with Rs.19.79 Crore, which was 7.53% of segment revenue, in Q2FY17. Drop in segment results is due to higher commodity prices and

planned investments in our new product categories such as water purifiers, air purifiers and air coolers.

Our Room Air Conditioner business, as I just explained, overall the remained subdued in Q2 primarily due to GST transition. The secondary movement and restocking has commenced from September onwards. Consequently during Q2, our room AC business grew by 5% in value terms and in line with the market growth.

Our market share remains steady at 11% in Q2FY18 as compared with the same period last year. The company continued to perform better in the high energy efficient product such as 5 Star and inverter ACs. With growing volumes in tier 3, 4 and 5 markets, more customers prefer availing consumer financing schemes now.

In our Commercial Refrigeration business, the overall market for these products also experienced a slowdown due to GST implementation. In spite of the GST impact, Blue Star grew faster than the industry during Q2FY18. The growth was seen across all our product lines. The quarter was good for Deep Freezers, Bottle Water Dispensers and Modular Cold Rooms. Modular Cold Room business saw an increased traction with major contribution from dairy, ice cream and food processing segment. Our new lines of business Kitchen Refrigeration and Medical Refrigeration also witnessed good acceptance in the market with increase in secondary sales.

Blue Star continued to strengthen its product offerings catering to the needs of constantly growing Dairy, Ice cream and Food processing segment and also continued to be a dominant player in the Commercial Refrigeration Space.

Our Water Purifier business continued the growth momentum in Q2FY18. The products have been well received in the market and overall the business outlook remains positive. While the industry grew in line with the expectations, price realization continued to be under stress due to disruptive pricing strategies used by few large market players. Blue Star

water purifiers are now available in 110 towns with over 450 channel partners and 1700 retail points.

Plans are on anvil to increase the water purifier distribution network further in FY18. The entire service delivery process was made IT and app-enabled and is now fully supported by a call centre. Investments in brand building continued with advertisements, campaigns across various TV, print and digital channels, and the campaign received great visibility. We expect segment results to be impacted by 120 to 150 basis points for the current financial year due to continued investments in this product category primarily in distribution, R&D and brand building.

Segment three, Professional Electronics and Industrial Systems, revenue declined by 15% in Q2FY18 to Rs.39.51 Crore from Rs.46.34 Crore in Q2FY17. Segment results also de-grew to Rs.2.85 Crore, which was 7.21% of revenue in Q2FY18 as compared with Rs.8.08 Crore, which was 17.44% during the same period last year. Revenue in Q2 was lower due to continued softness in industrial Capex and general uncertainties arriving from GST migration. Margins in this segment were impacted by low demand coupled with lower realization due to sluggish market conditions. Plans are on the anvil to rejig and renew the product portfolio in order to improve profitability and at the same time the demand is expected to also revive in the last quarter of the current financial year.

Revenue in Q2 was lower due to continued softness in industrial Capex and general uncertainties arising from GST migration. Margins in this segment were impacted by low demand coupled with lower realization due to sluggish market conditions. Plans are on the anvil to rejig and renew the product portfolio in order to improve profitability and at the same time, the demand is expected to also revive in the last quarter of the current financial year.

During the quarter, large orders were received from Karnataka Institute of Medical Science, Institute of Nephro Urology, Reliance Jio, Axis Bank,

Ordinance Factory, Jindal Steel, Hindustan Aeronautics Limited and GB Springs.

Our business outlook; Over the long term we anticipate a positive impact of GST transition for our Company and industry. The procedural transition of GST for Blue Star was pretty much in line with our plan. Our billing and procurement activities were reinitiated in the GST environment with minimal downtime. However, the markets that we serve have not yet fully stabilized and regained momentum. While Q3 is expected to be better in terms of market potential, we anticipate some impact to continue during Q3 as well. Once the external environment stabilizes, the Company is confident of regaining its growth momentum.

The Company intends to continue to make investments in manufacturing, marketing, brand building, product development as well as human resources over the next few quarters in order to capitalize on the imminent growth opportunities.

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 the floor to your 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 now open for questions.

Moderator: Thank you very much Sir! Ladies and gentlemen, we will now begin the question and answer session. We will take first question from the line of Renjith Sivaram from ICICI Securities. Please go ahead.

Renjith Sivaram: Good performance in a challenging quarter. In room ACs segment, we get to hear that Videocon has exited the market. Due to that, did we see any increase in our market share?

Neeraj Basur: Renjith we would not be able to comment on Videocon's strategy. Coming to your question on market share, you are aware that the dealers and distributors had started the destocking actions in Q1 at least 45 days

ahead of GST going live. The restocking action did not quite happen in Q2. Even the festival period, as I explained in my opening remarks, which started somewhere in September, did not see much traction in terms of the secondary sales. So Q2 was pretty much impacted for everyone including us. The market grew by about 5% and our growth also was in line at around 4.5% - 5%. We have been able to maintain our market share in Q2 and H1 as compared to last year despite this major disruption and GST transition.

Renjith Sivaram: There was lot of permutation and combination regarding the GST pricing. With its transition, do we now you have some clarity? As in, was there any price increase or decrease due to GST?

Neeraj Basur: The GST impact has been neutral as far as the overall MRP impact is concerned and has not resulted in any price change impact per se. However, there is surely an upward bias from commodity prices which have increased by around 8% to 10% during the last six months. So far we have not taken any decision to revise our product prices consequent to that. We are waiting for some more stability to come back in the market and will relook at the portfolio over the next two to three months along with the market pricing trends and decide appropriately.

Renjith Sivaram: In the last concall, you had mentioned that for full year you expect room AC growth around 15%. Do we still stand by that guidance or planning to change that?

Neeraj Basur: This year is going to be a challenging year for sure. Substantial part of Q1, which is actually the peak quarter and then of course Q2 as I explained, was impacted by GST and we do expect the GST impact to continue in Q3 as well. Notwithstanding that, of course by Q4, we expect things to start coming back to normalcy. We think the market will grow in the range of 10% to 12% this year. Our overall growth should be pretty much in line with the market. We do not expect us to be significantly better or below market growth.

Moderator: Thank you. We will take the next question from the line of Nitin Arora of Aviva Life. Please go ahead.

Nitin Arora: Neeraj you mentioned that there was no market share gain for us. Can you attribute few reasons for it?

Neeraj Basur: This was a challenging quarter for us. We maintained our market share because our growth has been in line with the market growth. The market has also faced same challenges post GST scenario and hence the same needs to be looked at from that perspective. Once we get back to external normalcy, our stated aspiration is to go up to around 12% market share for FY18 and we hold onto that aspiration despite current GST uncertainties.

Nitin Arora: For the VRF segment, what was the growth rate for us and the market?

Neeraj Basur: VRF market grew by 10% in Q2 and during H1 it grew by around 12%. We have been doing quite well in this segment. We launched two new products. One product was launched last year, which is VRF IV plus and the fifth generation of that VRF called VRF V plus was launched recently. The product has received good acceptance from the customers. So our growth in Q2 as a result of this push was around 30% and for H1, we maintained that growth rate over last year.

Nitin Arora: In terms of the water purifier, are we now in a position to give some guidance? Overall what could be that size, in terms of our revenue, let us say for the next half or even for FY2019? How should we read your unallocable expenses now with respect to the expenses you are incurring on distribution or let us say the ad spends?

Neeraj Basur: As far as water purifier category is concerned, Nitin, I have mentioned about this in my earlier discussions also. This is a developmental year for us as we launched just about a year ago. We are in the process of refining and fine tuning our products and the entire SKU portfolio strategy. We are also in the process of assessing across which markets and how should we optimally expand our distribution footprint. We are already present in

about 110 odd cities across some 700 odd distribution points. We will prepare a detail strategic plan for this business by Q4 and when we come back to you with Q1 results next year, we should be in a position to give you some more specific data points on our aspirational market position, market share and so on. We want to use the current year experience as a learning to sharpen our strategic plans. In addition to that, we have also talked about the fact that this year we should expect an impact of around 120 to 150 basis points on segment II margins because of our continued investment in the water purifier category.

As far as the question on the unallocable expenses are concerned, earlier we used to have some common brand-related spends included as a part of our unallocable expenses. Starting Q1FY18, we have been allocating those to the respective segments. So what you see as unallocable expenses in Q2 and H1 and previous year does not have any marketing or any brand related spends. These are purely corporate expenses, IT expenses and some common expenses on a R&D, etc. Other than that, unallocable expenses do not have any other items.

Nitin Arora: Got it. Thank you Neeraj, all the best.

Moderator: Thank you. We will take the next question from the line of Abhishek Puri from Deutsche Bank. Please go ahead.

Abhishek Puri: On the room AC market, you said that Q3 could still be impacted by GST and you expect recovery in Q4. So just wanted your sense on A) Price adjustment due to the increase in raw material prices and B) From January onwards, we have the energy efficiency norms changing. This will again require some price increase as you need to phase out the lower model and have some product in that pricing category. Hence either you take price hike or the margins get impacted. So if you increase the price, do you foresee any impact on the demand? I am just trying to understand the growth versus margin impact coming in especially from the energy efficiency change and from the raw material price increase.

Neeraj Basur: Abhishek the raw material prices in the current financial year have already firmed up by around 8% to 10% across various key components. So far we have been absorbing the impact. Like I said short while ago, we did not want to destabilize the pricing given the fact that anyway there is so much of GST transition related uncertainty going on externally.

We first want the external market to stabilize a bit more.. You are right that from January 1, 2018, the energy labeling norms are changing. As a consequence of that the current range of five star rated machines will be labeled as a three star rated machines. Besides, the inverters will also get rated now. Our own sense is that from January 1, 2018 viz. Q4 onwards, higher energy efficient models and inverters will grow disproportionately. Already across the sector, we see the inverters sale now on the rise and we expect that trend to continue over the next couple of years.. There will be an optical price increase for the customers who on a like-to-like basis would have paid almost a similar price for five star rated machine pre January 1, 2018 ..

In H1, a combination of inverter and five star split ACs accounted for around 40% of our overall sales. Hence as far as Blue Star is concerned, we see ourselves in a reasonably competitive space because our current focus continues to be higher energy efficient machines. This has been our key focus since past few quarters and hence we do not need to make a substantial portfolio change. We continue to realign ourselves in the new labeling environment along with the market.

Finally like I said, a view on the combined impact of the commodity price hardening and the label change will be taken somewhere in December before we get onto the new labeling regime in order to realign our entire SKU portfolio and prices. Some realignment will happen but we do not know by how much and to what extent at this point in time. Probably when we declare our Q3 results, we can share some of this data with you; as in how much price adjustment consequent to commodity and the labeling changes had to be impacted because by that time we would know

our new portfolio composition and the pricing norms a little bit more clearly.

Just to conclude this answer, in Q3 it is unlikely that we will take significant pricing change. To whatever extent, pricing impact will have to be reconsidered, it will be in Q4.

Abhishek Puri: Thank you for the detailed answer. My second question is again on the room AC market. You have reasonable portfolio of the inverter products. Do you think that this 40% of sales can grow to 60% or may be 70% in the new energy efficiency market? Secondly, the consumer will see a vacancy of space that Rs.18000 - Rs.20000 product or a three star AC one ton small one will go out of the market. So is there a possibility of new product launches in that category or for the same five star there will be reduction in prices and or will there be a three star at that same price point of Rs.20,000 or so?

Neeraj Basur: It will be a unviable Abhishek for us to offer the same five star machine at a three star price. Now of course, whenever these kinds of shifts happen there will be some price readjustment which will happen. To what extent, we do not know yet. But it is unlikely that a five star will be sold at a three star price and then correspondingly the downward spiral will get arrested. Going forward clearly this will assess the growth of inverters range of products. To your question whether this can grow further, currently it is about roughly about 25% to 30% in terms of inverters for the industry and it is likely to grow to around 50% in the next two years.

Abhishek Puri: Thank you and all the best Sir!

Moderator: Thank you. The next question is from the line of Ravi Swaminathan from Spark Capital. Please go ahead.

Ravi Swaminathan: Sir thanks for taking my question. First question is on the EMP segment. You mentioned that you are witnessing some traction in the metro orders. Can you highlight the opportunity which is there as of now in pipeline?

Neeraj Basur: We do give a breakup of our order book once a year in terms of various sub-segments. But broadly, the segments that are reasonably doing well in this overall EMP segment one is definitely metro and the other one is the Government funded projects. These are the two main drivers of order growth in this particular segment as of now.

We have been doing some work for Delhi and Bengaluru metros besides few other orders in the pipeline which are getting executed at this point in time.

Ravi Swaminathan: Regarding the quality of orders and their margin profile, we have been hearing that couple of players who used to be large earlier or no longer present in the market. Hence is their improvement in the margin profile of new EMP projects coming in or it is just a function of execution that determines the margins for you?

Neeraj Basur: Even in this segment the commodity price does play a key role and does have a huge impact on margins. As of now, we are not witnessing any board improvement in margins across the segment. Our overall assessment for this segment for the year continues to be same. We expect margins in the range of 4.5% to 5% though this quarter was relatively better as we closed some higher margin jobs. But again in this segment because of GST transition there has been slow progress as we had to revert back to all our customers to seek an amendment in the unfulfilled orders in order to realign the commercial structure in line with GST. In addition to that, the private sector Capex in particular has just not started. There are not too many players in the market offering gamut of services. May be when there is revival in the external market, we could see some margin impact. At this point of time, as the market is not growing, we have been able to achieve our growth primarily because of two reasons. One: we have further strengthened and reinforced our multiservice proposition. That has given us some incremental access to customers who would have otherwise gone to regional players. Secondly: we had the benefit of demonstrating the ability of executing and closing contracts in the desire time. The quality and cost of our work has also helped us gain

market share from some existing players. In reality, we have been garnering market share rather than market growth helping us grow. At this point in time, clearly margins are under stress even in this particular segment.

Ravi Swaminathan: In terms of VRF, how big is that business out of your overall EMP segment and is the margin in this business better than the entire project business?

Neeraj Basur: VRF margins are included in segment 1 results.

Ravi Swaminathan: Margin wise is it better than air conditioner?

Neeraj Basur: Ravi, you are aware that we have consistently shared segment level margins only and not given a split because of competitive reasons.

Ravi Swaminathan: My last question on the input cost increase. Has this been fully reflected in this year's numbers or is it likely to impact next year purchases?

Neeraj Basur: The input price started increasing way back in Q4FY17 and Q1FY18. So there has been an impact in Q2 as well and the same is expected to remain in Q3 as well as Q4. For next year procurement also, we see an upward bias and hence margin pressure.

Ravi Swaminathan: Thanks a lot.

Moderator: Thank you. The next question is from the line of Ankur Sharma from Motilal Oswal Securities. Please go ahead.

Ankur Sharma: Good morning Sir and thanks for the opportunity. First question on the room air-con business. Your comment that Q3 could again be a soft quarter given the base of restocking which implies that you do not expect any significant revival in Q3. I am just wondering, because historically, every time there has been a rating change, you typically see some pre-buy happening because of prices going up post that. So I just wanted your views on that?

Neeraj Basur: Ankur, clearly October and November is where we do foresee continued impact of supply chain because of GST, though it is improving. Having said that, of course every successive month is better than the previous month in terms of the traction, but it is certainly still not at our baseline which used to be in terms of momentum previously. We are not there yet.

Now on your second point whether in context of labeling changes from January, could there be some positive buying behavior somewhere in November and December. Possibly yes, because we are also cognizant of the fact that Q4 again has to be replanned in the context of the new norms. So to whatever extent we will be able to push our sales in Q3, we will do that. But the new variable, GST, is preventing us from giving you a very confident response. If it had been a normal labeling change, then you are absolutely right, there would have been some positive buying. As we are yet to experience it in the GST scenario, we will wait and see.

Ankur Sharma: Just a followup on this would be, would it be pure inverters for you or do you intend to have a mix of both fixed and inverter?

Neeraj Basur: We will continue to serve both categories, though our focus will be more towards inverters. We do not believe that five star category will be viable from overall costing point of view. I believe that an inverter machine is better positioned and like I said short while ago as a result of that we do anticipate inverters to hit 50% levels overall sale by the next financial year. We should be pretty much in line with that.

Ankur Sharma: And just last question would be on the water purifier business. Just to get a sense of where we are on the sales and the margins ex-water purifier business, would it be possible for you to share either the sales numbers for Q2 or the margin excluding the water purifier business?

Neeraj Basur: I did explain this short while ago. As far as full year margin impact for segment II is concerned, it is going to be somewhere around 120 to 150 basis points. As we are still in the process of stabilizing this business and once we do our strategic planning next year, by Q1 next year we will start sharing some insights on the water purifier business.

Ankur Sharma: What would be your margin guidance for the UCP segment for FY18?

Neeraj Basur: Without considering the impact of water purifier, broadly we should be in the range of 9% to 10%. Like I said, water purifier will require investments and therein the impact will be about 120 to 150 basis points. Hence net of these, 7.5% is what we expect. We do not want to position this as guidance but it is just an expectation at this point in time. And like I said, the uncertainty of GST still remains.

Ankur Sharma: That is very helpful and best of luck Sir!

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

Amber Singhania: If I see the first half versus last March, our debt has gone up significantly. What was the main reason for that? Also, how will the Capex plan pan out for us, both for greenfield as well as brownfield expansion? It will be great if you can share the number for FY2018 and FY2019.

Neeraj Basur: There is a cyclical impact of payables on this business. Amber, you would be aware that when we generally make procurement decisions for Q4 and Q1, which is now and between December, by the time these payables come up for payment it is usually in Q1 and Q2. So in Q4, the payables due for payment are at a lowest level whereas they are at the highest levels towards the end of Q2 as they are paid off during this time. Hence it is more important to look at YoY borrowing number. Last year in September, we were at Rs.320 Crore on a consolidated basis as against around Rs.295 Crore this year. In Q1, if you recall, we were actually at the lowest level ever at around Rs.48 Crore for the group as a whole end of Q1 this year. This is purely because of the procurement cycle and payable seasonality. Again in Q3 and Q4, we expect this to reduce. We have been consistently improving our debt equity profile. Hence we do not see this as a concern at all. The other point I would want to make here is that despite the GST transition, we have been able to actually reduce our borrowing levels despite the fact that lot of orders and customer buying were delayed. Wherever buying did happen, the customers were also going

through the same pain of transition and their cash flows were also under stress in Q2. Despite that, we have been able to hold on and improve our borrowing from the same point last year.

To answer your question on Capex, for FY18 do not expect any unusual Capex. For the full year, it will be around Rs.100 Crore odd. We have five manufacturing plants wherein this Capex will be incurred as we continue to rebalance capacity and replacement of existing machines. In addition to that, we have stepped up our IT Capex quite a bit in the last two to three years to support technology and digitization initiative. We continue to also invest on R&D as well. So these three areas put together, we will spend about Rs.100 Crore which is pretty much in line with last year.

Amber Singhania: For 2019?

Neeraj Basur: We have not made out of Capex plan yet for FY2019.

Amber Singhania: You mentioned that you have already taken the decision for the next season during this period. So how do you see the next summer season, which is Q4 and Q1, as in your estimates in terms of market growth and our plans? Secondly, by now you will be freezing the prices for the new product which will come in the next season. In the wake of uncertainty of whether the industry will be passing on to the customers or not, how are you planning to pass on the cost? Will it have some more impact on the margins?

Neeraj Basur: Right now we are only restricting our visibility to Q4 because Q1 is a little bit far. In Q4, we expect things to return to normalcy because most of this GST transition should be over and done by Q3. Of course the new element is rating table change, which may cause some disruption and we do not know exactly how the market will behave at this point in time. But then notwithstanding, we do expect the Q4 to resume to as close to normalcy as possible which will help the market to grow by around 10% as compared to last year. As explained short while ago, we are holding onto any pricing decision at this point in time for at least another couple of months. We want to club that with our entire portfolio revisiting decision in

Q4 and then at that stage we will take a look at our pricing. Hence I guess Q4 is when we will be able to share with you on what we have decided on a pricing.

Amber Singhania: Just one clarification wanted on your unallocated expenditure. So I see in the annual report the unallocated is around Rs.133 Crore whereas on the GST reporting for FY2017, it is roughly around Rs.95 Crore. So is that the difference, which you are mentioning which has been transferred to the respective segments or something more to the run rate?

Neeraj Basur: This is what has been additionally allocated out.

Amber Singhania: Going forward, should we take that this GST reporting in Q2 for FY2017 as the base on that, right?

Neeraj Basur: Yes.

Amber Singhania: And isn't this Rs.95 Crore still pretty high given that corporate Capex, corporate expenditure and the new product launches not there?

Neeraj Basur: Like I explained, it has a mix of two or three elements. We have corporate expenses. As I mentioned, IT is one area wherein we consciously wanted to spend more, both on Capex as well as the Opex side. The same is also included in that. To some extent, the R&D initiatives which we take across the entire organization, is also included in that. Hence it is a mix of all these. We have benchmarked unallocated expenses in the range of 2.5% to 3% of our revenue. The same has been done after considering how much our peers and comparable companies are spending just to see whether we are in that range or we are out of space. At this point in time, we do believe that we should pretty much be in sync with the industry.

Amber Singhania: Is there no scope of this coming down or will it continue to be the range as mentioned by you?

Neeraj Basur: Like I said, there are two key central cost elements, IT and R&D. We are consciously stepping up our spends over there because these are the areas

which we think will help us to scale up our revenues. If you would have seen our growth in the last two to three years, we consciously do not want it to be a manpower dependent growth. If you see our employee cost ratios, you will see some improvement there. But then in order to maintain and support the processes, you need to step up technology, which we have been doing. We do not expect this to go up disproportionately. Saying that, we will continue our focus on supporting IT, R&D and of course our central corporate expenses.

Moderator: Thank you. We will take the next question from the line of Atul Mehra from Motilal Oswal Portfolio Management. Please go ahead.

Atul Mehra: Good afternoon and thanks for the opportunity. We have observed in case of some other durables that have declared their numbers, Whirlpool, etc., that the growth has been very robust, upwards of 25% whereas AC at least for you has been flattish for the quarter. So in terms of market place, do you see any differential growth trends between the categories?

Neeraj Basur: I am not sure whether we compare ourselves with the pure consumer durable companies because 50% of our business mix is into projects.

Atul Mehra: No, I am just talking about your cooling products.

Neeraj Basur: In the cooling products, we have grown by about 12% in H1 whereas comparable growth for Q2 is close to about 6.5% to 7%. We do think in terms of the category focus our growth is in line with the market growth. Beyond the room air conditioner, we are not sure how other products in consumer durable category have performed. Hence we will not be able to answer that.

Atul Mehra: I am asking this question because the trend is clearly visible. Even Q1 was pretty robust for them and so was Q2. My question only was when you talk to the market place and channel, do you see that durables as a category being much stronger than ACs for the first half?

Neeraj Basur: Our conversation with them is actually not in the context of entire range. When we do our benchmarking, it is only in the context of the room AC product category and not the entire range. Having said that, what has happened in the room AC secondary purchases is that a lot of buying got advanced to May and June for reasons we all know. While all of us did expect some revival to happen during the festival time period of August and September, largely September, however, it does appear that the tertiary demand has not returned to that extent. Again I am talking about room AC. So to that extent, we have underestimated the potential revival of demand in Q2. We all expected that market should start reverting to normalcy but what we found was only about 5% odd growth across the market. Another factor what we need to bear in mind is cyclicity. AC's typically witness highest sale during Q1 and Q4 while Q2 and Q3 are traditionally our lower sale quarters..

Atul Mehra: And secondly my question is in terms of GST transition. As we speak, are most of the channels now completely in sync with GST or are they still in some transitory kind at this point in time?

Neeraj Basur: The procedural aspects I guess have been handled across the supply chain, not just the customers but even the suppliers and vendors. So everyone is in sync with the procedural aspect of the filing, etc. all that which were issues few months ago is behind us. Their ability to buy from us or our ability to buy from them is now happening. But I guess, the momentum is still not there. So to that extent, people will take some time to completely get aligned or the same should happen once the season turns back. I guess things will be much better than what they are right now.

Atul Mehra: Has there been any kind of loss of dealers or retail outlets due to the GST transition?

Neeraj Basur: None that we have encountered. All our key dealers, distributors, suppliers and vendors have successfully transited.

Atul Mehra: Great. That is it from my end. Wish you all the best. Thanks.

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

Abhineet Anand: Thanks for the opportunity. For FY18, you are saying that there will be an impact of 120 to 150 basis points. Given the progress in water purifier business, will that have an impact on our UCP margins in FY19?

Neeraj Basur: Our initial experience and response in the market has been quite encouraging. We have been growing sequentially and month-on-month, of course on a very small base. As I explained, we now have presence in more than 100 towns through 450 channel partners and 700 retail points. Our current year (FY18) focus is to set up this business and make sure that we have presence across the relevant cities. Our servicing network is up because in this category it is equally important, if not more as compared to distribution, is the ability to service with very stringent turnaround and response times. That needs to be set up and we are in the process of doing. As a result of all these initiatives and of course like I said sales, though in a very small base, are growing every month which is encouraging. The customer resonance to a range of product SKUs is also quite positive. You will be aware that this is one category where creating a confidence and trust takes lot of time for any new entrant. This can be done by demonstrating that they are going to be serious and a long term player and will stay. Right now we are in the process of building that confidence with the retailers and distributors. As a result of all these initiatives, we have been guiding 120 to 150-basis points impact on our UCP segment margins in FY18. FY19 like I said short while ago, we will draw our long term strategy for this category in Q4. We will share more specifics with you on our planned progress and our goal post for water purifier probably after Q1 results next year.

Abhineet Anand: One last thing, so we added water purifiers and some of the other products. Do we intend or is there strategy to add a few more going forward in FY19 and FY20 as well?

Neeraj Basur: This has to be a continuous process beyond FY18. I guess when we are closer to Q4 and when we internally have clarity on our strategic plans for FY19 and FY20, mostly FY19, we will certainly talk about at that point in time.

Abhineet Anand: Thanks a lot.

Moderator: Thank you. Ladies and gentlemen that was the last question. I now hand the floor back to Mr. Basur for closing comments. Over to you Sir!

Neeraj Basur: Thank you very much ladies and gentlemen. With this we conclude this quarter's earnings call. Do feel free to revert to us in case you have any more questions or any of your unanswered questions. We will be happy to provide you additional details by e-mail or in person. Thank you very much and have a good day.

Moderator: Thank you. Ladies and gentlemen on behalf of Blue Star Limited that concludes this conference. Thank you for joining us. You may now disconnect your lines.