



Blue Star Limited

Q1 FY'21 Earnings Conference Call

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MANAGEMENT: MR. B. THIAGARAJAN – MANAGING DIRECTOR

MR. NEERAJ BASUR – GROUP CHIEF FINANCIAL OFFICER

Moderator: Ladies and gentlemen, good day and welcome to Blue Star Limited Q1FY'21 Earnings Conference Call. We have with us today from the management Mr. B. Thiagarajan -- Managing Director and Mr. Neeraj Basur -- Group CFO. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Neeraj Basur. Thank you. And over to you, sir.

Neeraj Basur: Thank you. Good morning, ladies and gentlemen. This is Neeraj Basur. We also have on the call today, our Managing Director -- Mr. B Thiagarajan. I will be providing you an overview of the results for Blue Star Limited for the quarter ended June 2020.

I. FINANCIAL HIGHLIGHTS FOR Q1FY21

The current financial year commenced in the backdrop of an unprecedented economic disruption. As a socially responsible organization, during the initial phase of the lockdown, apart from donating rations to the needy and personal protective equipment to the frontline social workers, we were at the forefront attending to the emergency equipment servicing needs of our customers such as Kasturba Hospital, Mumbai, Chitradurga District Hospital, Karnataka and Torrent Power, Sabarmati in their efforts to keep the essential services operational.

The financial performance for the quarter needs to be viewed in the context of it being a challenging period for the economy as a whole, and the HVAC&R industry in particular due to the on-going pandemic. Most part of the summer season was lost and project sites were shut. It was in the third week of May economic activities started opening up. Even as we speak, partial lockdowns are in place and various restrictions continue.

Therefore, the results for Q1FY21 are not comparable with that of Q1FY20.

Financial highlights for the quarter ended June 30, 2020 on a consolidated basis, are summarized below:

-Revenue from operations for Q1FY21 was Rs 626.02 cr as compared to Rs 1575.45 cr in Q1FY20, a de-growth of 60.3%.

-EBIDTA (excluding other income and finance income) for Q1FY21 was Rs 1.36 cr as compared to Rs 114.85 cr in Q1FY20.

-In Q1FY21, there was a loss of Rs 29.47 cr before Exceptional Items as compared to a profit of Rs 107.96 cr in Q1FY20.

-Net loss was Rs 19.66 cr in Q1FY21 compared to a net profit of Rs 76.84 cr in Q1FY20.

-Carried-forward order book increased marginally to Rs 2923.06 cr as on June 30, 2020 compared to Rs 2841.10 cr as on June 30, 2019.

-Capital Employed increased to Rs 1193.83 cr as on June 30, 2020 from Rs 949.20 cr as on June 30, 2019 due to higher inventory levels on account of revenue de-growth.

-We raised Rs 350 cr during the quarter through issuance of non-convertible debentures to fund working capital and to build sufficient liquidity on the Balance Sheet. Consequently, net borrowings increased to Rs 428.53 cr as on June 30, 2020 (Debt Equity ratio of 0.56) as compared to a net cash balance of Rs 0.74 cr as on June 30, 2019.

II. BUSINESS HIGHLIGHTS FOR Q1FY21

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

Segment I revenue was Rs 312.44 cr in Q1FY21 as compared to Rs 623.94 cr in Q1FY20, a decline of 49.9%. Reduction in scale caused the margin to shrink significantly. In view of the financial and operational stress faced by a few customer segments, we have prudently made provisions for doubtful receivables and potential credit loss. These factors resulted in the segment reporting a negative margin of Rs 10.53 cr in Q1FY21 as against a margin of Rs 33.53 cr in Q1FY20.

Order inflow during the quarter was impacted due to lockdown and reduced to Rs 266.78 cr as compared to Rs 966.90 cr in Q1FY20, a de-growth of 72.4%.

1. Electro-Mechanical Projects business

The lockdown during the quarter severely impacted bookings and had a major impact on the revenue. Only around 10% of the project sites were operational during the quarter.

We prioritized and focused on jobs based on the customer credit profile and collections. Going forward, the same principles of cash management will be followed as far as this segment is concerned.

As economic recovery post COVID will be slow, the commercial buildings sector which contributes a major part of our revenue is expected to take longer to recover. Infrastructure and industrial sectors are expected to recover relatively faster.

Carried-forward order book of the Electro-Mechanical Projects business was Rs 2040 cr as on June 30, 2020 as compared to Rs 2013 cr as on June 30, 2019, an increase of 1.4%.

2. Commercial Air Conditioning Systems

With the segments such as light commercial, medium-sized offices, educational institutions, entertainment and banquet halls severely impacted, both new order booking and billing were lower during the quarter.

Consequently we registered a de-growth of 66% in billing.

However, order inflow from BFSI, Healthcare, Pharma and Government sectors are encouraging.

Major orders bagged in Q1FY21 were from Patna Medical College, ThyssenKrupp (Nagpur) and MMRCL COVID Hospital (Mumbai).

3. International Business

The international markets in which we operate were also impacted by the pandemic. However, easing of restrictions in some of the major markets enabled pick-up in revenue in June.

Revenue and profitability of the projects executed through our Joint ventures at Qatar & Malaysia were also impacted due to the pandemic, though the operations slowly started to normalize from June.

Our focus remained on the expansion of the Blue Star product range and building brand awareness in the different markets that we are present in. We have also increased our marketing across Digital Media platforms, to build awareness and brand visibility across key markets.

Segment II: Unitary Products

Segment II revenue was Rs 274.85 cr in Q1FY21 as compared to Rs 906.89 cr in Q1FY20, a decline of 69.7%. Inability to sell during a substantial part of the peak selling summer season combined with additional burden of demurrage and detention charges due to the lockdown resulted in erosion of margins. Consequently, the segment result was a loss of Rs 3.76 cr in Q1FY21 compared with a profit of Rs 98.91 cr in Q1FY20.

1. Room Air Conditioner business

In Room Air conditioner business, our estimate is that the market shrunk by almost 65% during the quarter with the conventional retail outlets and non-essential e-commerce sales shut till the third week of May. Our de-growth was also in line with the market. Even after the markets began opening up the footfalls were lower and the priority was to liquidate the inventory lying with the channels since March.

Sale through the e-commerce channel including our own web store gained traction and share of revenue through this channel improved to 12% this quarter.

2. Commercial Refrigeration business

Revenue of this business was impacted significantly due to loss of sales to the ice-cream manufacturing segment and complete shutdown of commercial establishments and educational institutions which contribute a major share of revenue from storage water coolers and bottled water dispensers. The loss of revenue from these segments was partially compensated by increased revenue from customers in the essential services segments such as processed foods, healthcare and pharma.

Major orders were bagged in Q1FY21 from Odisha State Medical Services Corporation, Royal Cold Chain (Azadpur Mandi), and Indian Immunologicals Limited.

Healthcare, pharma, food delivery and processed food segments will continue to offer attractive growth potential for this business in the new normal.

3. Water Purifier business

Impact of the pandemic on our water purifier business was relatively moderate. E-commerce channel continued to contribute to a major share of revenue for water purifiers.

We continue to stay focused on establishing our brand as a trusted one in the category, with well-engineered and the reliable products including the ones that offer alkaline water for boosting immunity, backed by superior service.

Given the growing concerns on health and immunity, the demand for water purifiers is set to grow and we have set ourselves a market share target of 2.5% in FY21. The business is poised to break even this year.

Segment III: Professional Electronics and Industrial Systems

Segment III revenue was Rs 38.73 cr in Q1FY21 as compared to Rs 44.62 cr in Q1FY20. Segment result grew to Rs 10.18 cr (26.3%) in Q1FY21 from Rs 4.42 cr (9.9%) in Q1FY20.

Data Security Systems business continued to do well on the back of digitization initiatives in the BFSI sector. Demand for Healthcare products picked up in the latter part of the quarter.

While corporate capex is likely to be selective, we expect the Indian digital payment sector and healthcare sector to grow further in the current scenario and continue to offer opportunities.

With the wide portfolio of products and solutions forming part of our offerings, the prospects for this business segment is positive.

III. BUSINESS OUTLOOK

We have taken swift actions to restore business operations with adequate focus on safety and well-being of our employees, channel partners, business associates and vendors. Manufacturing and supply chain operations are fully operational.

We have cut the operating costs in line with the potential revenue loss and infused capital though long- term debt to strengthen the resilience of our Balance Sheet. We will continue to prioritize project execution based on cash flow. The Room Air conditioners and Commercial Refrigeration businesses are expected to gain traction gradually and our expectation is that the market will get back to normal by Q4FY21. Healthcare, pharma and processed foods segments will continue to offer good opportunities for the Commercial Refrigeration business in the new normal. Increased awareness on building immunity will offer good prospects for the Water Purifiers business. Digitization and Healthcare initiatives offer good prospects for the Professional Electronics and Industrial Systems segment.

We will endeavor to overcome this challenging phase in a balanced and agile manner with focus on prudent management of working capital and operating costs, while ramping up revenue.

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

With that, we are open for questions.

Moderator: Thank you very much. I will now begin the question-and-answer session. The first question is from the line of Ravi Swaminathan from Spark Capital.

Ravi Swaminathan: My first question is with respect to the Room Air Conditioning business. If you can give a flavor on how the secondary sales has been in the month of July, how many dealers offices are completely open and also the kind of inventory levels which are there with the dealer currently?

B. Thiagarajan: As far as room air conditioners business is concerned, our sales were at 70% of the previous year's level in June and at 77% of previous year's level in July. Given the fact that we are maintaining the market share, the industry also should have recovered to anywhere between 77% and 80% in July. This is in terms of secondary sales. This includes e-commerce as well. Our estimate that inventory is in excess of normal levels by around 30 days. It is not an unmanageable level since there was no production in in the second half of March or April. In Q2, we expect the revenue should be at 80% of the previous years' level as the market is likely to settle down and some part of the festival season such as Onam falls in second quarter itself.

Ravi Swaminathan: My second question is with respect to the debt we have raised recently. Is it due to abundant caution with which we have raised the debt, or do we see some sizable deterioration in the working capital cycle for either or both segments?

Neeraj Basur: We have been through a compressed liquidity cycle and therefore we wanted to adequately mitigate financing and refinancing risk on the balance sheet in the short duration. We wanted to make sure that there is sufficient liquidity with us for a mid to slightly longer duration in view of the pandemic created uncertainty. We also want to make sure that we have sufficient working capital financing available so that business growth gets supported adequately.

Ravi Swaminathan: What is the composition of your order book among commercial real estate, industrial, if you can give a breakup?

B. Thiagarajan: We do not look at commercial real estate orders alone. We do not think, for example, health care is impacted at all. It is the segments such as offices, malls, hotels where execution may be postponed due to liquidity crisis which we are conscious of and we continuously evaluate the credit risk profile and do not execute unless our cash flow is protected. Such segments constitute 30% of the order book in the segment for both electromechanical projects and the commercial air conditioning systems. We are generally the last in the project execution chain and may execute the project provided there is no credit risk.

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

Renjith Sivaram: Just wanted to understand this new Atmanirbhar theme which the government is trying to play. So, what percentage of our imports are from China? We know that China has scale and that gives cost advantages. So when we move that to India, logically the cost should increase and that will impact our margins unless and until we pass on the price hike. So, how do you see this and what is your strategy to address this issue?

B. Thiagarajan: We are a part of the high powered committee, which is engaged with the government and the DPIIT in this matter. There is a phased manufacturing program announced under Atmanirbhar. There are certain sectors which are prioritized under Atmanirbhar Bharat such as air conditioners, furniture, leather, shoes etc. The Government is chalking out a road map to achieve this.

However, the Atmanirbhar focus has got nothing to do with China. It concerns import from all countries and not China alone. The government introduced non-tariff barriers long before Atmanirbhar Bharat was announced. A non-tariff barrier called Quality Control Order or QCO was introduced a couple of years ago by which the Bureau of Indian standards will define the standards and the testing procedures and clear every component or finished goods that are getting imported from any country. Blue Star's own risk management framework called for reducing dependence on imports, particularly China, and we had a target to reduce it to a level of 15% including components by 2023 but we are expediting that. In the finished goods category, our dependence is be not strategic but tactical, depending on the volume of a SKU. A

few SKUs that are not economical to be manufactured by us or by an OEM manufacturer may be imported.

There is a likelihood that the import license regime may be introduced and customs duty may be enhanced. Keeping this in mind we have stopped importing finished goods unless it is a small quantity not economical to manufacture locally as previously mentioned. The key point is that under Atmanirbhar Bharat, the Government wants all the components to be manufactured within the country. Now, that is a level playing field. Any player in India whether it is a Japanese, Korean or American, all of them get their components from China. Koreans get it from their Chinese factories. India does not have scale for compressors or motors or drives or for Copper Therefore, it will not impact Blue Star alone; it will impact the entire industry. There is a consensus among the industry players that if there is an Indian manufacturer, we do not mind buying from that Indian manufacturer. They should allow Chinese manufacturers to set up facilities in India because their costs are lower. They have already committed investments, like for example, world's largest compressor manufacturer known as GMCC has set up a facility here. They could not complete the commissioning due to the current pandemic caused disruption. Similarly, Magmet which is the largest manufacturer of drives is also almost ready with its manufacturing set-up in India. The key initiative is to grow the market, then only India will be competitive in terms of components. Otherwise, all of us are going to incur more costs in terms of components and in the process, the customer will end up paying more. So, the government has notified a draft phased manufacturing program similar to that of mobile phones, where over a five-year period customs duty will go up as the indigenization efforts will increase. Simultaneously, with many Indian parties, who have potential interest in manufacturing components, discussions are on. For aluminum, fins for heat exchangers, Hindalco has been approached by the government. The AC industry players have explained to the government what they need. For instance, a TVS group company is being talked to for setting up motor manufacturing facilities and so on and so forth. The government has fully understood this program, they know every aspect of it and therefore it is being planned systematically.

Renjith Sivaram: How do you see the growth of Room AC this year?

B. Thiagarajan: The room air conditioners revenue is likely to be around 80% of last year level in Q2, 90% in Q3 come back to last year level in Q4.If the COVID-19 pandemic gets behind us by Q3, we can even look at a 5% to 10% market growth.

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

Ankur Sharma: My questions are again on the Room Air Conditioner industry. So, in your opening remarks, you mentioned that the industry shrunk by about 65% in Q1. All I was trying to understand was, how about the north versus the southern regions has fared given the fact that the lockdowns were in April and may be beginning May which are the bigger seasons for the south, but then you had a relatively better selling time right all the way till June for the

Northern markets. So, would it be fair to assume that the southern parts would have been worse off both in terms of absolute volumes and in terms of inventory at this point?

B. Thiagarajan: The showrooms in the in the South opened around the last week of May with restrictions such as alternate day, limited hours etc.,. By then, the summer season was over in Kerala except for a little bit of Andhra Pradesh where again there were a quite a few restrictions. Therefore, the sales came predominantly from the northern and western regions. Even Gujarat and upcountry Maharashtra did reasonably well during that period. The overall recovery was 71% in June and North would have been higher at around 85%.

Ankur Sharma: Is it fair to assume that inventory levels also would be slightly better off on the northern side versus the south, is that correct with dealers?

B. Thiagarajan: We are not sure about the industry. As far as we are concerned, , the inventory level in the south is relatively higher. The real issue is not inventory this time. We do not think that the industry or even Blue Star anticipated recovery to 70% in June or 77% in July. Therefore, the price levels had dropped earlier. Inventory is not an issue at all.

Ankur Sharma: On the pricing front, despite inventory not being an issue, you think that still it is a problem?

B. Thiagarajan: Yes, since the market has shrunk, all players would like to see their revenue recovering and convert inventory into cash and hence the price levels are dropping. Across the board the price levels we did witness a drop in the order of around 10% to 12%.

Ankur Sharma: How is the labor availability on the projectsites, how is the execution? I think you said about 10% of sites are open if I remember the number correctly.

B. Thiagarajan: Prior to lockdown we would have had around 10,500 people and around 150 active sites operating. Right now, it is reduced to around 50 sites, which in the normal course, we would have operated with around 3,500 people, but what we are having today is somewhere around 1,500 people which is at 50% level. It is not only due to non-availability of labor, but also to take care of safety aspects, restrictions on the number of people who will work etc.. We are also clear unless and until we get paid for the work done and the payments that are due are settled, we would not mobilize resources to a site. In the projects business, we would be more focused on cash realization than market share.

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

Nitin Arora: One question I had on the scheme which you were talking about, so let us say, so compressors, as you rightly said, the scale and let us say even **GMCC and Highly are** there, and the balance sheets they have, they can really expand. But coming to ODU and IDU, given whatever the domestic EMS company we have in India, they themselves are so much dependent on the supplies in abroad. But if the PLI scheme comes in, let us say for an IDU or an ODU, supposedly IDU should be more given that we import a lot. As a brand, would you be

interested in applying in that PLI Scheme, do you think taking advantage of that PLI Scheme, can we really help in getting some exports or can really lower the cost for the domestic market, is there something on that level?

B. Thiagarajan:

We do not depend on China for IDUs. We have been importing some parts from China, but our indigenization program started a couple of years back. In FY21, we would have completed most of the indigenization of IDUs. We are not very sure if the government is thinking of any incentives for IDU manufacturing. Under the phased manufacturing program, they are not providing any incentive. Directionally, they will keep increasing the customs duty every year and nudge to indigenize. We are supposed to create our value chain which is perfectly fine. However, given that the Indian market size is some 7 million compared to 110 million in China, the Chinese manufacturers will be competitive. It is likely that they will reduce the price if customs duty is increased as they have excess capacity.

Why did we indigenize IDUs? We figured out that we can make it despite the small volume of Indian market and our own market share by designing it in a better way. So, there must be innovation. We adopted the same philosophy for 300-litre deep freezer and VRF. For innovation to be successful, we must invest into R&D, including hiring experts from Japan or China to support us in design. We are requesting the government to incentivize R&D under Atmanirbhar Bharat as we cannot become globally competitive without adequate investments in R&D. We are also emphasizing the importance of growing the domestic market. So at least for five star or four star air-conditioners, make the GST 18%, then the domestic market will grow, then you can go ahead and ensure you are globally competitive. So, a self-reliant India should come together along with global competitiveness, not pinching the pockets of Indian consumers. These aspects have been well understood by the Government and we believe that the Atmanirbhar Bharat programme will factor these.

Nitin Arora:

Lastly, if that is the case and you are insourcing IDU supply chain, if I look at the higher component because the components and the whole IDU is highly imported, in the longer run as a company does it make sense to really in-house what you are doing or you think I have to depend on a domestic vendor who can get the IDU?

B. Thiagarajan:

It depends on case-to-case. For instance, Blue Star is not going to get into manufacture of all components. For the foreseeable future, we are not interested in manufacturing compressors, we are not going to manufacture motors, and we are not going to manufacture drives in-house. While the IP of the drive is ours, we will get it manufactured by a third-party either in India or any other country. If any manufacturer can go ahead and develop facilities for manufacturing of motors, we will encourage and commit our quantities to them. We must help the government to crack this problem but otherwise all manufacturers will end up increasing the prices by procuring motors at higher prices. The real reason for us to get into IDU manufacturing is to avoid uncertainties, this year was a lockdown, a couple of years ago a bad summer etc. If we are dependent on China, we end up committing the quantities in December itself and it would be challenging to go back on the committed quantities.. We are emphasizing

with government to factor that we cannot make the customer pay more in order to Make in India.

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

Amber Singhania: Just two small questions: One, if you can give some color on the quantum of provision you have taken in segment-I and the quantum of demurrage in detention in segment-II? Secondly, when we are saying that water purifier business, we are seeing a break even, even this year. So would it be fair to assume that the margin compromises we have done earlier of 1-1.5% during the launch of this product will come back to the segment-II from next year onwards?

B. Thiagarajan: We will take the second question on water purifier margin impact first. It was 1.5% in FY'19. It came down to 0.6% in FY20, and would be nil in FY21. In fact, it would have been nil in FY20 itself had March gone on well. It will no longer impact our profitability. The focus now is to grow the market share from 2.5% to 3-3.5%. On your first question, we have taken provisions of around Rs.15 crores. We are concerned that if some projects get delayed beyond a year, some extra claims may not be settled and therefore have considered provisions prudently as we had done in Q4FY20. Rs.8 crores is the demurrage and detention charges of containers in segment-II.

Amber Singhania: Any further provision or demurrages is there to be booked in quarters from here?

B. Thiagarajan: There is not likely to be any further demurrage and detention charges which were incurred during the lockdown period. This impacted the entire industry.

Amber Singhania: If you can give some color on Air Purifier and Water Cooler business?

B. Thiagarajan: The season for Water Cooler is over. We continue to have a 34% market share. Air Purifier is disappointing because we expected higher traction due to the coronavirus, but it did not pick up as expected. The whole market size is not even Rs.250 crores. So we are not overly concerned about that.

Moderator: Thank you. The next question is from the line of Charanjit Singh from DSP Mutual Fund.

Charanjit Singh: If you can just help us understand on this inventory part in the Room AC space, because by the end of March, everybody was worried in terms of the supply side from China. So, there was a huge inventory buildup in the industry and then we have lost one and a half month of sales. So, we are now talking about only one month of extra inventory whereas we have been earlier having two to three months of extra inventory. So, if you can just tell us like what is the level of inventory in the channel and what is the level of inventory at your end and if it is only one month of inventory, then why does 10% to 12% of price cut and when was this price cut initiated in the market in the room AC space?

B. Thiagarajan: As far as we are concerned, there was no production in the last 10 days of March and for the entire month in April. In fact the room air-conditioner factories commenced operations

sometime in June second week only. So there was no additional inventory build-up. The concern in February and March was whether there will be a shortage of material for the summer season. So, we set up a war room, we were following up with the vendors at China to dispatch as much as possible.

Since the materials were not getting dispatched from China in desired volumes in the month of February and in the first half of March and we ended up canceling quite a few orders when the lockdown was announced, therefore the current inventory level is not unmanageable. When the activities picked up in June, all of us were interested in liquidating the inventory and in that context, the prices had started dropping.

Charanjit Singh: On the commercial refrigeration, if you can highlight how is the market right now, what is the kind of dip in the volumes that you would have seen and going forward how we see this market taking off?

B. Thiagarajan: We are very optimistic about that part of the business and we saw recovery in July, though the first quarter was bad due to reduced sale of both water coolers and deep freezers. Deep freezer segment is driven by ice-cream sales. As you are all aware ice cream was not classified as essential goods and therefore while the milk and butter, cheese was getting distributed, ice cream was not. Add to that people consuming ice cream also substantially dropped because of the fear of cold, cough, etc., so the ice cream industry had collapsed. In the normal course, ice cream industry would have revived in August, September and October with the marriage season. However, as the marriages are going to be conducted with a restriction of 50 people or so, sale of deep freezers to the ice-cream industry may not revive even in Q2. We feel it will revive only in Q3 as far as deep freezers are concerned. With the workforce not being there in full strength in the factories and the health concerns around, sales of water coolers are also likely to be subdued till Q3. Processed food and pharmaceutical sectors have been supporting growth and quite a few significant orders that have come in. The food delivery segment should support sales of cold storages or deep freezers.

Moderator: Thank you. The next question is from the line of Bhavin Vithlani from SBI Mutual Fund.

Bhavin Vithlani: Three questions: First is on the cost side, we have seen 40% lower employee cost and 50% lower other expenses. What part of this is sustainable and what part of it will come back as the volume comes back? The second question is if you can give us any color on the energy rating change that was expected in 2021, what are the new timelines that the industry is expecting? The third question is if you can give us a color on the cash flow from the operating activities and how should one expect for the year as a whole?

B. Thiagarajan: All elements of employee cost such as fixed pay, variable pay and the headcount and new recruitment are controlled and therefore should be sustainable for the full financial year. The other costs such as warehousing, logistics, advertising etc. are variable in nature. Depending on the market demand and the situation, we will take a call on advertising. Right now we are live with a campaign on water purifiers with immunity protection. In the festival season we will

end up advertising for air conditioner specifically with the COVID deactivating filter. So therefore that expense is dependent on the market recovery. Out of the total reduction, around 50% will be sustainable and the balance 50% will depend on the volume. While employee costs and other expenses have been managed well proactively, finance cost is higher at this point of time.

Neeraj Basur:

Cash flow from operating activities is a high priority item on our radar and as mentioned earlier, even in the project business, the reason we are prioritizing cash flow over growth is with that objective in mind. We expect the inventory to get progressively liquidated and release the operating cash flows into the system. We are doing reasonably well on our collection from customers and are not seeing a stress build up over there. We are taking very prudent steps on that count as well and we are using significant part of our free cash flows to ensure that we catch back on the overdue payments to some of our suppliers which will also be settled within the month of August. Thereafter, we will start applying our operating cash flows to reduce the level of our gross borrowings so that by the end of the year, we reach to a level of net borrowings anywhere in the range of Rs.350 crores to Rs.400 crores.

B. Thiagarajan:

Energy level change should have taken place from 1st January 2021. That is getting postponed. It is very likely that it will be from 1st July 2021. We have requested it to be deferred to 2022 as inventory management in the peak summer season will be challenging to handle with a label change.

Moderator:

Thank you. The next question is from the line of Bhoomika Nair from IDFC.

Bhoomika Nair:

You spoke about the phased manufacturing program for the component part of it. There will not be any price reduction by the Chinese vendors. So, what kind of increase in component cost would be there if import duties were to be levied over the next five years?

B. Thiagarajan:

All the Chinese manufacturers started investing in India when the QCO was introduced as they saw that the Japanese market had achieved penetration and India is a growing market with only 7% penetration. The investment plans of GMCC, Midea, Haier etc, are huge even Gree was evaluating options to enter India. The first clarity that needs to be provided is what is going to happen to those investments. We do not think we should prevent a direct investment if they are going to follow the law, if they are going to generate employment, if they are going to bring down the costs. Under the phased manufacturing program, customs duty will be going up year after year. However, the Chinese can bring down the price year after year in which case there would not be any impact at all.

There is not likely to be a compressor manufacturer who will be competitive in India on his own. They cannot match the Chinese prices. Do we have other sources? We do have vendors for deep freezers from Spain, France etc., but even they are importing the components from China. Hence the dependency is very high on China. The crankshaft of a compressor manufactured in other geographies gets sourced from China. Ironically we have some electronics coming from Japan and during this period, we find that Japan is not able to deliver

because they are dependent on China for the chips. In our view, if a Chinese manufacturer is going to invest in India and fully manufacture, not assemble, we should encourage them to do so. At the end of the day, the affordability of the consumer is important, our own domestic market growth is important.

Bhoomika Nair: The second question is on EMP segment. You said that we will be more cautious in terms of where the cash visibility is there. Where do you see that kind of stabilizing and how quickly do you see the scale up there and do you see further provisions that like you made in the current quarter? I think you mentioned Rs.15 crores provision in the current quarter that you made.

B. Thiagarajan: We cannot comment on the future provisions as of now. We follow a prudent principle of providing for potential doubtful receivables. We will keep assessing the debtors' realisability as we move forward. There are contradictory signals on when it is likely to stabilize. For instance, we are executing a very large project in Bangalore where there is a hotel and mall involved which we thought may not take off for the next one year but the customer wants us to complete it. We are also executing three airports like Bangalore, Chennai and Delhi. We thought now airports will go slow but there is a huge pressure to expedite these jobs. As far as scaling up is concerned, as mentioned earlier, we are not after market share in this segment but profitable growth with high cash flow collection visibility. The risk is very high in this business, so, therefore, we are consciously selective. Our focus continues to be good projects with good cash flow either in the buildings, factories or the infra projects where the funding is issued through JICA or any other development agency. Perhaps we will review our scale up plans next year.

Moderator: The next question is from the line of Sandeep Tulsian from JM Financial. Please go ahead.

Sandeep Tulsian: My first question is on a comment that you had made in the previous call that the price gap between Blue Star and the more affordable ACs is reducing gradually and the company is okay to sacrificing margins to come in that affordable product range. So where are we on that journey – have we further cut prices, has that gap reduced further from say last two -three quarters?

B. Thiagarajan: It is a strategic initiative to make Blue Star products available in the affordable premium category. We had plans to manufacture around 60% of our products in that range. Our product launch in January addressed that and we will continue to pursue that initiative to take it up even higher to around 80% of the sales. We expect sales from tier- 3, 4, 5 to go up to 75% because the rural and other tier- 3, 4 towns seem to be growing faster even during June and July. Therefore, production of affordable premium range of products will need to be enhanced.

This is a moving target. We had assumed a certain level of prices, but the market forces had forced the prices to come down further during this period. But we believe it is ephemeral in nature. So, price realization should come back once the situation normalizes as none of the players will be running the business at a loss or reduced level of profit. Having said that, we

are conscious of the fact that the future growth in our B2C portfolio is going to be driven by middle class and tier-3, 4, 5 towns. In B2B products, it is going to be driven by MSMEs and the large industrial or corporate customers. That is making us to invest more time, energy, effort into product optimization without compromising on our image as a superior product and solution provider.

Sandeep Tulsian:

I had another question on the e-commerce side. You did mention it is about 12% of your overall sales now. In terms of market share, are you better off on e-commerce versus your offline sales or worse off? Secondly, how does it fare in terms of profitability because a lot of channel costs are not existing in the e-commerce space?

B. Thiagarajan:

We think this is a wrong period to be passing a judgment on e-commerce. The dealers had higher inventory and e-commerce had also non-essential sales prohibited and when they were permitted to sell non-essentials like air-conditioners, the offline channel had objections. It was stopped again and then they restarted so that they have a level playing field. In June and July there was not a big price difference between e-commerce and the regular channels. So, therefore, it may be a wrong period to be judging. There is a big sale this week. During the past three or four months, we did not witness any sale events of e-commerce which pushes up the volumes heavily. Now, market share of ours in e-commerce is lower than the industry standards. For example, the industry share of e-commerce in Q1 was 17% i.e. if industry sold 100, 17 was through e-commerce. So, e our market share is not in line with the industry share. So therefore, that is by design because we will not compete in a price bracket. What is our way forward? We would like our share in e-commerce to be equivalent to that of industry. However, that would not be by compromising margins, but by developing products which will be able to compete.

Moderator:

Thank you. Ladies and gentlemen, I now hand the conference over to the management for closing comments.

Neeraj Basur:

Thank you very much, Ladies and Gentlemen. With this, we conclude this quarter's earning call. Do feel free to revert to us in case any of your questions were not fully answered and we will be happy to provide you additional details by email or in person.

Moderator:

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