"Blue Star Limited Q3 FY16 Earnings Conference Call"

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MANAGEMENT:	**MR. VIR ADVANI – EXECUTIVE DIRECTOR AND PRESIDENT, ELECTROMECHANICAL PROJECTS BUSINESS** **MR. B. THIAGARAJAN – EXECUTIVE DIRECTOR AND PRESIDENT, AIR CONDITIONING AND REFRIGERATION PRODUCTS BUSINESS**

Moderator: Ladies and gentlemen, good day and welcome to the Blue Star Limited Q3 FY16 Earnings Conference Call. We have with us today from the management, Mr. Vir Advani – ED and President – Electromechanical Projects Business and Mr. B. Thiagarajan – ED and President, Air Conditioning and Refrigeration Products Business. 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 this conference call, please signal an operator by pressing '*' then '0' on your touch tone 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: Thank you. Good afternoon 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 December 31, 2015.

The following are the financial highlights of the Company for the quarter (Q3FY16) on a standalone basis:

- The Company reported Total Operating Income of Rs 685.76 crore for the quarter ended December 31, 2015, as compared to Rs 595.57 crore in Q3FY15, representing an increase of 15%.

- Operating Profit (PBIDT excluding Exceptional Items and Other Non Operating Income) for the quarter was Rs 27.89 crore as compared to Rs 8.78 crore in Q3FY15 mainly due to increase in sales, tighter control on operating costs and lower provisions.

- During the quarter, Other Income was Rs 1.36 crore as compared to Rs 2.14 crore during the same period last year.

- Financial Expenses for the quarter declined by 14% to Rs 9.05 crore from Rs 10.51 crore in Q3FY15 owing to a reduction in the cost of funds and robust management of the borrowing mix.

- There was an exceptional loss of Rs 1.95 crore during the quarter as compared to an exceptional gain of Rs 18.33 crore during Q3FY15. While the exceptional gain in Q3FY15 was mainly due to profit on sale of assets, the exceptional loss in Q3FY16 was due to bonus expenses for earlier years pursuant to retrospective amendment in statute.

- Consequently, there was a Net Profit of Rs 4.80 crore as compared to a Net Profit of Rs 6.30 crore in Q3FY15.

- Carry Forward Order Book as on December 31, 2015 increased by 14% to Rs 1605 crore compared to Rs 1412 crore as at December 31, 2014.

- The Total Capital Employed of the Company stood at Rs 1046 crore on December 31, 2015 as compared to Rs 975 crore on December 31, 2014. The net borrowings of 333 crore as on December 31, 2015 were lower as compared to Rs 390 crore on December 31, 2014.

Segment-wise results for Q3FY16 are as follows:

- The revenues of the Electro Mechanical Projects and Packaged Airconditioning Systems business, increased by 22%, while segment results registered a significant growth to Rs 25.68 crore from Rs 2.90 crore mainly due to enhanced billing and tighter control on costs.

- Cooling Products registered a growth of 21%, while segment results recorded a significant 67% growth at Rs 16.90 crore. This enhanced result is attributed primarily to the expansion of the dealer network supported by various sales and marketing initiatives of the Company.

- The Professional Electronics and Industrial Systems business has been transferred to its subsidiary, Blue Star E&E Ltd with effect from April 1, 2015. The segment revenue and results reported in the Blue Star Limited standalone figures relate to some specific orders that were part of the order pipeline booked in the last financial year and necessitated execution by only Blue Star. The quantum of billing from such orders has been reducing progressively. Thus, the revenues and profit for this business during the quarter were split between the parent Company and its subsidiary. On a combined basis, the revenue declined by 5%, while the results were lower by 30% to Rs 4.90 crore, mainly due to lower demand. These combined figures are based on management accounts, and have not been subjected to audit or a limited review by the auditors.

The following are the financial highlights of the Company for the quarter (Q3FY16) on a consolidated basis which has not been subjected to audit or a limited review by the auditors:

- The Total Operating Income was Rs 736.53 crore for the quarter ended December 31, 2015, as compared to Rs 611.80 crore over the same period in the previous year, representing an increase of 20%.

- Profit before Tax and Exceptional Items increased from a loss of Rs 12.05 crore in Q3FY15 to Rs 10.61 crore during the quarter under review.

- Net Profit increased to Rs 6.58 crore from Rs 5.36 crore in Q3FY15 representing an increase of 23%.

The following are the financial highlights of the Company for the 9-month period ended Dec 31, 2015 (Cumulative Q3FY16) on a standalone basis:

- For the 9-month period ended December 31, 2015, the Total Operating Income grew by 11% to Rs 2311.00 crore, as compared to Rs 2075.42 crore over the same period in the previous year.

- Operating Profit (PBIDT excluding Other Non Operating Income) increased by 16% to Rs 120.63 crore from Rs 104.44 crore.

- Net Profit at Rs 38.05 crore declined by 18% as compared to Rs 46.36 crore in the same period as the previous year.

I would like to elaborate on our plans to set up two new manufacturing facilities:

We had embarked on a manufacturing footprint redesign programme with the help of KPMG. Consequent to that exercise, we have closed down our Thane and Bharuch plants. The room airconditioners and commercial refrigeration business is growing at a CAGR of 15% and keeping in mind the future capacity over the next 10 years, the Company is planning to invest in setting up two modern, state-of-the-art factories at Jammu and Sri City. The Company will invest about Rs 200 crore over the next 3-4 years in these facilities. The CENVAT exemption at the Himachal Plant ceased from June 2015 and the proposed new plant at Jammu will have a CENVAT exemption for 10 years from the date of commissioning.

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.

Segment I (Electro Mechanical Projects & Packaged Airconditioning Systems)

During Q3FY16, this segment registered a revenue growth of 22% to Rs 439.09 crore, while the segment results grew eight-fold to Rs 25.68 crore. This resulted in a segment margin of 5.8% as compared to 0.8% during the same period last year. Enhanced billings and improved cash-flow led to better cover of fixed costs in the electro mechanical projects business resulting in an increase in profitability. In addition, there were far lower provisions as compared to the same period last year. Further, the VRF business performed well owing to the positive response to the newly launched next generation VRF IV Plus product range. Despite continued efforts, the Company was unable to close legacy jobs during the quarter due to inability of the customers to close such projects and the Company intends to aggressively target closure of these in Q4. The Capital Employed in this segment decreased from Rs 514 crore as on December 31, 2014 to Rs 430 crore as on December 31, 2015.

The order inflow in Q3FY16 for this segment grew 62% to Rs 431 crore as compared to Rs 266 crore during the same period last year. The carry-forward order book stood at Rs 1545 crore as at December 31, 2015 as compared to Rs 1319 crore as at December 31, 2014, an increase of 17%.

In the electro mechanical projects business, the commercial segment gained some momentum in select metros such as Chennai, Bengaluru, Delhi NCR & Hyderabad. However, the overall market remained muted with investments in the industrial and infrastructure segment not witnessing any improvement. Though the market sentiments are positive, active prospects for finalization are still at low levels and purchase is taking place in a limited manner. During the quarter, retail malls, light industrial factories, high rise residential towers (mainly in Mumbai) and some Government- funded healthcare and education projects contributed to growth.

In the central plant equipment segment, the market continued to remain stagnant except for a marginal improvement in enquiry inflow from West and North India. Segments such as quick specialty restaurants, healthcare and hospitality showed enhanced demand, while commercial spaces, IT/ITeS and developer segments continued to be adversely affected. Tamil Nadu witnessed a significant dip in enquiries in the month of December due to the recent floods. During the quarter, the VRF segment recorded the fastest growth rate amongst all the categories for the combination of flexibility and energy efficiency. The Company made deep inroads in the VRF segment with its latest offering, VRF IV Plus, which has met with a positive response in the market place. Product launches were conducted in Mumbai and Delhi during the quarter amongst customers, architects and consultants.

Segment II (Cooling Products)

During the quarter, the Cooling Products segment of the Company registered a 21% increase in revenues to Rs 237.69 crore. Segment results increased substantially by 67% to Rs 16.90 crore. Segment margins increased from 5.1% to 7.1% attributed to a healthy festive season as well as enhanced channel penetration. The Capital Employed as on December 31, 2015 was Rs 186 crore, as compared to Rs 193 crore as on December 31, 2014.

Festival buying and aggressive promotions by retailers including e-commerce players helped the Room AC industry post a healthy growth of 12% during the quarter. However, the higher than normal inventory levels in the industry also created stress in the system which led to discounts in order liquidate the excess inventory ahead of the launch of the new models planned for 2016. The sluggishness in the rural markets continued. Further, Tamil Nadu was adversely affected due to the flood situation in Chennai.

The Room AC business of the Company during the quarter continued to perform faster than the market growing at 22%. There is a rising preference for inverter ACs and this category now accounts for about 10% of the sales of the industry. Also, the 0% Finance options by the NBFCs and Credit Card EMIs by the banks are now reaching a sizable 25% of the secondary sales values.

During the quarter, the Company also forayed into allied products such as air coolers and air purifiers to leverage its equity in the residential segment. It launched 5 models of air purifiers including models with HEPA filter with ionizer technology, plasma technology as well as HEPA filter with nano e-technology for spaces varying from 200 sq ft to 400 sq ft. Though the market of air purifiers is nascent at about Rs 200 crore, given the rising concern of air quality in the country, this category is expected to grow three-fold over the next 5 years. As regards to air coolers, the Company has launched 3 models catering to price conscious customers in non-humid areas of North and Central India for spaces ranging from 100 sq ft to 300 sq ft. The current market size of air coolers is at about Rs 2600 crore, with the organized segment at about Rs 1600 crore, and this market is set to nearly double over the next 5 years. The Company intends to ride on its existing channel network for distributing these new products launched.

In the commercial refrigeration products business, the deep freezer market has been sluggish with lower demand for hard top chest frezeers. However, glass top freezers continue to grow with the expansion of frozen products and ice cream outlets. The water cooler business has witnessed marginal growth with a surge in demand for water coolers with inbuilt purification. Bottle water dispensers have been growing significantly due to expansion into modern retail chain space. The modular cold rooms business has been encouraging with Company making deep inroads into the fast growing QSR segment. The demand from pharmaceutical, dairy and ice cream segment is also on the rise. Introduction of eco-friendly cyclopentane panels have met with an encouraging response and this trend is likely to continue in the future.

Segment III (Professional Electronics and Industrial Systems)

As mentioned earlier, the revenues and profit for this business during the quarter were split between the parent Company and its subsidiary, Blue Star E&E Ltd. On a combined basis, the business recorded lower revenues of 5% to Rs 35.97 crore, while the results declined 30% to Rs 4.90 crore. Segment margins decreased from 18.5% to 13.6% during the quarter. The decrease in demand due to the sharp appreciation of the dollar coupled with lower capex spends in the industrial segment caused the decline in the business. These combined figures are based on management accounts, and have not been subjected to audit or a limited review by the auditors.

During the quarter, the data communications business won a large order from Indian Air Force for a video surveillance project which comprises very high-end cameras to monitor the fleet take-off and landing at one of their air base stations. In the healthcare systems business, the Company launched a surgical diathermy unit. The test and measuring instruments business is focusing mainly on oscillographic recorders and RF-over-fiber and anticipates significant opportunities in these areas. The business has added new principals to expand the business including Freedom Communications, USA and Tel Instruments, USA.

International Business

In view of the oil prices falling to record lows, the governments in GCC countries are revising their spending plans and are addressing the drop in oil revenues mainly by making cuts in public spending and by reducing energy subsidies. While the real estate market in the Middle East has performed well in the recent past, the oil price slump may adversely affect the construction boom. Retail and hospitality continue to perform reasonably well with enhanced tourism.

During the quarter, there was good order inflow for various categories of unitary products such as water coolers, room airconditioners and refrigeration units from various distributors and OEM customers. The Company has introduced room airconditioners with eco-friendly refrigerant R410A and with high energy efficiency in line with new UAE regulation which met with an encouraging response in the market place. Other than the unitary products, there is increased focus on central airconditioning equipment in UAE, Oman, Qatar, Bahrain and Iran where distributors are being appointed for enhancing penetration. The Company also participated in the Big 5 show, which is amongst the largest events in the Middle East for architecture and construction-related products and supplies, showcasing its entire range of offerings.

The Company continued to make deep inroads in SAARC countries such as Bangladesh, Sri Lanka, Maldives, Nepal and Bhutan. On the other hand, Africa, mainly Kenya and Nigeria, are adversely impacted due to currency depreciation and the business is muted in these markets.

In conclusion, the electro mechanical projects business is showing definite signs of picking up and is expected to keep improving in the near future. The cooling products segment continues to perform well owing to the Company's growing range of products, enhanced distribution and strong brand equity. The Company has also broadened its product line in related areas such as air coolers and air purifiers and is confident of sustaining the growth momentum in the last quarter of the year.

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 via e-mail. With that, we are open for questions.

Moderator: Thank you. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Narayan Ravindranath from Kotak Securities. Please go ahead.

Narayan Ravindranath: Sir, can you give us a segmental break-up of the Rs.1,600 crore order book that we have?

Vir Advani: We share that break-up once a year i.e. at the end of the financial year. However, just to give you a rough idea, 20% is from government and infra while the remaining 80% is evenly divided between IT, hospital and light industrial.

Narayan Ravindranath: As mentioned earlier, will our EMP margins continue to be around 5%?

Vir Advani: No, what I mentioned in the opening remarks is that we have been trying to close set of legacy orders. We have been trying to do it since last three quarters and have met with limited success. As these are infrastructure and some large commercial projects, where clients do not want to take delivery because there is slowdown in the market. Hence we have been struggling to close. We are going to take some practical calls in Q4 on that legacy carry forward which we were to close in March'15. So to that extent, I think in Q4 we may have to correct some of this but yes, that is our intention.

Narayan Ravindranath: So broadly, on the rest of the order book there will be EBIT margins of around 6%-7%?

Vir Advani: So there is couple of aspects. One is the legacy orders. We all know about that the quantum of it and as I said we will take a practical call in March. Other than that, we have a fixed cost. It is not manufacturing capacity but it is essentially people and technological capability which is in place. We bill at a pace that the cash flow is available in the market. For this current quarter you saw, what I will call normal billing, which is the cash movement in the market and therefore we billed at reasonably decent amount. When we cover that fixed cost, then we are able to see the operating margins of 5% to 6%. If these billings continue to improve, which is what we expect, then that margin tends to go slightly higher. So we are out of that area of being below breakeven as far as the running job.

Moderator: Thank you. The next question is from the line of Salil Utagi from Systematix Shares. Please go ahead.

Salil Utagi: My question is regarding the growth of industry volumes during the quarter in room AC and how has been the performance of inverter ACs?

B. Thiagarajan: It is roughly around 10% to 12% for the industry and we would have grown around 20%.

Salil Utagi: So is this mainly because of the adverse weather in the western and other parts of the country before Diwali or overall there has been surge in demand across India? I mean what has been the main reason behind that?

B. Thiagarajan: Overall it has been surge in demand. Actually, the sign of improvement in demand was there at the beginning of the festival season itself. It was not due to weather at all. I think this particular durable tops the demand list of a consumer as of now. As I had mentioned earlier, it comes even after the four-wheeler. To say, in India the demand for mixer grinder, refrigerator, washing machine and television is much ahead. Then comes the four-wheeler and then air conditioners. Also, we are witnessing signs of single AC owners trying to buy the second AC. So the demand has been good and I think it will continue to be so.

Answering your question on inverter ACs, the inverter industry is around 10% and for us it is at 13% of total AC sales. Our market share is somewhere around 10.5% now. In inverter, we should be much higher, around 12.5%.

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

Nitin Bhasin: On the room air conditioner market, Vir mentioned in the beginning that the sales are growing because of the expanding distribution. So could you just take us through three things on the room AC business? One, in the last 18 months, how has your distribution expanded, in terms of number of cities, states and point of sales? Second, the supply chain that you are building, as you are gaining the market share, in terms of what components would you manufacture and what you would not? And number three, of the entire cooling products business in the last nine months, how much is the revenue share of room AC business?

B. Thiagarajan: To answer your last question, it will become selective disclosure. Hence at this point of time, we do not want to get into that but when we say the market share, you will be in a position to figure out the number. For the first question, in the beginning of the year, we had stated our intention to grow market share in the northern region, predominantly, where our network was poor. The reason being we were not able to match the prices that were prevailing in price sensitive markets. Also, in quite a few markets in northern India, for window air conditioners, we did not have a complete range during the previous year. So this has led to expansion of our market share in the North. In terms of dealer network, we would have added somewhere around 650 outlets this year. But the point is not actually the network expansion. I keep telling the analyst that the real network expansion is not a big thing to do, the share from each outlet is the figure that it is very important for us and that is growing at around 20% in north India market.

Nitin Bhasin: Sure. Besides the newly added 650 outlets, we also know that you follow a lot of sole selling dealer selling model because of your earlier focus on the commercial. So can we get a sense, as in how much you are servicing from the regular retail points in the SSD network?

B. Thiagarajan: Then you have to look at three types of channels. In the SSD, there are exclusive sales and service and there is multi brand sales and service. There are aircon dealers who are dedicated to Blue Star and there are aircon dealers who are dedicated to aircon but handle other many brands also. So today around 50% will be from retail outlets and balance 50% is from sales and service dealers.

Nitin Bhasin: Okay, thanks for this one. Coming back to the EMP business, you mentioned that after long things are looking very good and the recovery should be much better from here on. Which segment is actually giving you this sort of good signs? Also, when can we see possibly Blue Star go back to 8% or 10% sort of EMP margins?

Vir Advani: What I meant was that the things are far from great. They are just a little better than they were earlier. I think the overall market the MEP market has not grown in the current year and to my knowledge, it has been flat or a little lower than last year. It is primarily because the infra and heavy industrial MEP market is dead. In the commercial and light industrial, there is ongoing sort of business that is coming. I think Blue Star has done a better job of gaining more market share this year than we did last year and it reflects in our order book, which is improving. So that is positive for us but there are two challenges which continue. One is the legacy orders, which we have been trying to close for nine months and are still struggling to close. Other thing that concerns me right now is that even the newer jobs, while they are moving, they are moving much slower than expected. It has been after quite a while that we have seen billing at a reasonable level in a single quarter. But I am a little concern that this may not be a trend because we need to see this billing improve for two or three quarters in a row. I am little cautious right now on that because after doing reasonably good billing in Q3, we have issues of dollar movement and concerns over Chinese economy outside due to which I am already seeing private sector customers coming back and putting the brakes on job execution. So we are not out of the woods yet as far the market is concerned. As far as Blue Star is concerned, like I have been saying, cash flow has improved, order inflow is now improving and we are now waiting for the billing to turn stable and grow. So maybe we are still a few quarters away from that and we have this last round of this legacy thing to deal with. I say next year will be a mixed year and probably by the end of next year things should look bright.

Nitin Bhasin: Within this e-commerce space, that possibly is driving some inflows, what is the size of these locations, because we hear the news about commercial picking-up?

Vir Advani: Yes, absolutely. I did not mention e-commerce though. At least in the projects business, we do some warehousing around the country. But it is not significant at all as this tends to be smaller projects. Most of our new orders have come from the light industrial market. Bengaluru is doing well as a market and so is Pune. These are couple of places where we are seeing some commercial build but there is no real trend that has emerged. There is no, I do not think there is any structural change in the market at all. Like I said, I think we are just doing better compared to last year.

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

Ravi Swaminathan: Just wanted to know about the segments other than commercial real estate, say for instance, Infrastructure and industrial segments etc. How are things panning out over there? Are we seeing any traction for large ticket size orders from Metro, rail, airports?

Vir Advani: In my opening remarks, I mentioned that there are no enquiries from Infrastructure, airports, metro, power plants and power transmission. In distribution, yes enquiries are there. Power Grid is building and so that is probably the only part of Infrastructure where there is some enquiry level. In heavy industries like steel, oil & gas, there is practically nothing. There is little bit of enquiry in petrochem, etc., but our volume of business is quite small. As it applies to Blue Star, there is practically no enquiry level finalizations and that is fairly significant part of the overall pie which is absent in the current year.

Ravi Swaminathan: So does that mean that our focus would only be on commercial going forward or would we look at orders even in these? And what would be the sense of margin profile or working capital in the commercial infra or industrial?

Vir Advani: Where we are getting our business from is commercial and light industrial or what we call factories. So in these two segments of the market, there are still some spends and as I said it is flat or slightly lower than last year. We are winning more market share and therefore our order inflow is better. In commercial and light industrial, our commercial terms are very clear and with our standards, we have no challenge on the same. We are able to book business at 10%-12% margins. We are also able to close them at reasonably good margins. Of course commodity price is helping us and we are able to take advantage of that. The issue we have is that even though our carry forward orders and our new orders are of good quality, even with these good quality projects we are seeing significant delays, latest on account of this China and dollar moment. Every six months a year, new thing comes and gets our customers and their execution cycle goes for a toss. So therefore I am not able to give anyone a good outlook for these businesses for the near term. Until the Infrastructure and heavy industrial kicks-in, in terms of enquires, and until the commercial and light industrial market gives us consistent billing and completions, we continue the struggle to manage and grow.

Ravi Swaminathan: Okay. Can you give us sense on the competition? In my sense, the top four players will be Blue Star, Voltas, ETA and Sterling Wilson. Apart from that, compared to last cycle, has there been any new entrant and has the competition level increased considerably? Any change in the ways of ordering?

Vir Advani: I have mentioned in the past that we are competing with civil contractors who are doing turnkey general construction job. So that is a new type of competition. On the lower end, there are smaller dealers, of course they are not in the MEP market but they are there in the standalone services market. In that band, between the two, which is the market where we are focused on, there is no new competition per se. I think we are doing a little better than everyone else but that is just relatively until the market picks-up. I think we are all struggling.

Moderator: Thank you. The next question is from the line of Mahesh Bendre from Way2Wealth. Please go ahead.

Mahesh Bendre: Sir, during the last eight quarters, the cooling product business has been growing at 20% plus. So do we think that we will able to maintain this kind of growth next year as well?

B. Thiagarajan: We are planning to.

Mahesh Bendre: Okay. And Sir, in your opening remarks, you have mentioned that we are setting up two manufacturing facilities. Is it possible to share more details? What will be capacity? When they are going to be operational, CAPEX and so on?

B. Thiagarajan: These facilities will be up in Jammu and Sri City in Andhra Pradesh. Total investment will be around Rs.200 crore over a period of four years. The facilities are basically meant for unitary products to begin with which are room air conditioners, deep freezers and water coolers. We intend availing the excise duty benefit in Jammu for the next 10 years. South Indian plant is because we have more than 50% of the business coming from there. So logistics and warehousing closer to the port drives that decision. Now the land acquisition process is on and hopefully we should be able to commission one plant in FY18 and another in FY19.

Mahesh Bendre: What will be the capacity in terms of room air conditioners?

B. Thiagarajan: The total capacity will be around 7.5 lakh units of room air conditioners and balance deep freezers and water coolers. It is highly flexible.

Moderator: Thank you. The next question is from the line of Atul Mehra from Motilal Oswal Asset Management. Please go ahead.

Atul Mehra: Sir, you mentioned that in case of room AC business on a per outlet basis, you have been doing exceptionally well in terms of (+20%) growth. So is there a sense on what would be our market share in the existing outlets that we will be present in?

B. Thiagarajan: Which outlets you are talking about?

Atul Mehra: In case of retail outlets for room ACs.

B. Thiagarajan: It will be same as our average market share. I do not think that from the retail outlet we have different share than the sales and service dealers. Of course, there must be a difference which you can imagine. Say there are certain Tier-III, Tier-IV, Tier-V towns where the sales and service dealers, due to his equity, will be having market share in access of 20%. For instance, Vizag is dominated by sales and service exclusive dealers of Blue Star where we will have something like 16% market share. But all India if you take, it will average out the same.

Atul Mehra: And in terms of modern retail perspective, how strong will it be as against traditional?

B. Thiagarajan: Again, modern retail sells more of five star and inverters which is the category wherein we do well. So, the five star and inverters put together, the industry is around 30% and in that pie we are around 40%. The modern retail generally sells these five star in inverter units also. We do very well there also.

Atul Mehra: And how are we addressing e-commerce as a distribution platform?

B. Thiagarajan: I would say that we have begun to address it reasonably well given the situation that we are in. You are aware that their value proposition seems to be low price which we do not subscribe to; I do not think that we are in that game of increasing the numbers by discounting. But at the same time, we know in the long run it will be an important channel. Therefore we are maintaining our price positioning with almost all the players. Also, we have the tie-up with the payment gateways as well and our market share has been significant. We enjoy around 10% market share on e-commerce portals as well. We have created the delivery mechanism and installation service mechanism also. So this festival season our growth came because of e-commerce channels as well.

Atul Mehra: What would be contribution at this point in time?

B. Thiagarajan: We enjoy market share of 10%. You can calculate based on that. On an annualized basis, our estimate is that 5% of the total sales should go through e-commerce on a 4 million units.

Atul Mehra: In terms of air coolers, that you have launched this quarter, how relevant and important is the contribution from the same? Could you talk in terms of timelines? Also in terms of the market itself, going by the numbers of the leader, this is one of the categories which have got the highest margin. Do we see very high margins as well in this category or what could be our entry strategy over here? Would it be price-based entry competition or how could that be?

B. Thiagarajan: The entry barriers are very poor. 50% of the market is still unorganized. But most importantly, this is not the case for entire Indian market. There are pockets in North India and some Central India which buy air coolers. The air conditioner itself is seasonal business and air cooler is very highly seasonal. It is a question of some three months window that the entire sales take place. Our intention is not building market share and volumes. At the end of the day, we have to maintain our operating margin and we are not going to focus on air coolers alone. We will be a large air conditioning or the comfort provider. Given that, we will position of our brand like that only. It will be a premium offering. Therefore, we will target only the high-end consumers. Our goal is something like 15% market share in three to four years of time. The market size, as I told you, is somewhere around Rs. 1,500 crore or so in the organized sector. And will probably double in three to four years.

Moderator: Thank you. The next question is from the line of Renjith Sivaram from Antique Stock Broking. Please go ahead.

Renjith Sivaram: Sir, the cooling products have done phenomenally well every quarter. So what are your expectations for next year? Also, was there any impact because of Chennai floods?

B. Thiagarajan: In Chennai, there was problem in Q3. But I think it should recover in the summer season. In terms of growth and margins, we should be able to sustain pace. We do not foresee a problem.

Renjith Sivaram: Even at this high base, what kind of market share are we looking at?

B. Thiagarajan: Our goal for next year is at least 12% market share.

Renjith Sivaram: Okay. And was there any price cuts this quarter?

B. Thiagarajan: Yes, extensive price cuts were there in Q3 because it always happens as in January people launch new model, including us. So there will be desperation in the market to get rid of the old model.

Renjith Sivaram: So roughly, should it be around 5% to 10% or more than that?

B. Thiagarajan: Post summer, the prices came down something like 15% for some of the brands. But the commodity prices have been low and the other thing was that the rupee went up. So while improving the margins in the industry, they diluted the savings which were not retained by many players.

Renjith Sivaram: So in a sense that if you read it correctly, EBITDA margins should have improved had this price cut were not there?

B. Thiagarajan: Correct, at least it should have improved by 100 basis points.

Renjith Sivaram: And lastly regarding the order intake, how do you see the full year order intake and order book? Given the environment, our order intake and order book have been very good. So will this space continue or can we read that next year can be a very good growth year once these orders gets executed?

Vir Advani: As I mentioned, the order inflow is encouraging and we hope to close the year on a reasonable note. With regards to the challenges in the execution time of this order book, we started seeing signs of improvement in middle of the year but is now looking little uncomfortable given the overseas macroeconomic conditions. At this stage, it is difficult to say how next year is going to look. We continue to be selective about the orders we book and careful with the customers whom we are choosing. So we hope to ride out next year but a lot of it depends on what happens outside the country and at the macro level.

Renjith Sivaram: So this Rs.400 - Rs.500 crore of order run rate will continue in the next quarter also?

Vir Advani: We expect that.

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

Anupam Gupta: Sir, just a small query on the tax rate. The tax rate is down this quarter also. What will be the full year tax rate for FY16?

Vir Advani: About 21%.

Anupam Gupta: And what is driving that lower tax rate?

Vir Advani: We still have some benefits from Himachal.

Anupam Gupta: So that would end in FY16 and FY17 should be at normal tax rate?

Vir Advani: FY17, I think we will be about 22%. We have some more benefits in HP left. We lost the CENVAT benefit but we are availing income tax benefit there.

Moderator: Thank you. The next question is from the line of Kapil Agarwal from Max Life Insurance. Please go ahead.

Kapil Agarwal: Sir, as 3Q was pretty good on volume front for most of the players, how do you see the inventory in the system for yourself and the competitors?

B. Thiagarajan: I think most of them would have liquidated. I do not think that any inventories are lying with them. Now the inventory build-up is happening. Hence you have to see what is going to happen March.

Kapil Agarwal: How do you see the competition on pricing? We heard some players were cutting prices in 3Q as well.

B. Thiagarajan: In Q3, there was massive price cut. I do not think that they will do the same thing in Q4. They will wait for summer. If there are rains or something like that or if summer is not picking up, it will start again. But honestly, this happens every year.

Kapil Agarwal: Right. And Sir, lastly, your modern pipeline is fairly strong. Do you see the same for competitors?

B. Thiagarajan: Yes, definitely.

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

Nitin Bhasin: If you could give us on the Projects business, roughly dependence on ducted business as of now and have you seen a decline in that segment given the shift to VRF?

B. Thiagarajan: There is no decline, it is stagnant. It should have grown but it has not.

Nitin Bhasin: VRF market share.

B. Thiagarajan: We are around 10% as against 8% last year.

Nitin Bhasin: And looking at the financials that you have reported, the capital employed is up from 573 roughly to 663. And if you look at your debt, it is down by about Rs.60 crore or so. Can you take us through where is the capital employed reduction for the business coming off? I am not able to tally this right now. Probably that entire Rs.90 crore increase in your capital employed and yet a Rs.60 crore decrease in line of your debt.

Vir Advani: We will ask Mr. Neeraj Basur, our CFO, he will explain to you how this whole thing is computed, it comes from another line call, unallocable corporate assets less liabilities. Over the phone you would not understand that.

Nitin Bhasin: Yes. Because first time after a long time period of time I am seeing that the unallocable capital employed has gone up materially so, I thought just ask you that in terms of what is this un-allocable, I will ask Neeraj.

B. Thiagarajan: He will separately call you. The thing is that it has been there for quite some time this particular line, do not go on any conclusion, it is simple, he will explain to you.

Vir Advani: And probably we will send out a clarification to everyone at the year end so that, that clarity is there.

Nitin Bhasin: And the Room Air Cooler business, you are not going to manufacture. Let us say, definitely your manufacturing will have to be little different than what people are otherwise using, in terms of complete outsourcing. So how do you plan to build a supply chain for this product? Could you just help us understand that?

B. Thiagarajan: So obviously, as of now the plan is to outsource. We will own the fair shares and perhaps the controls. We have to see as we go forward how these volumes will build-up. So you are right in the conclusion that we are not going to be in the low end at all. We are going to play in the high end of that market and we will accordingly figure out what kind of IPs we will own while manufacturing outside.

Moderator: Thank you. Ladies and gentlemen that was the last question. I would now like to hand the conference over to Mr. Vir Advani for closing comments.

Vir Advani: Thank you very much, everyone for getting on this call. We will be in touch in the next three months once the year is ended thank you.

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