



"Blue Star Limited Q3 FY17 Earnings Conference Call"

January 30, 2017



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

Moderator: Ladies and Gentlemen, Good Day and Welcome to Blue Star Limited Q3 FY17 Earnings Conference Call. We have with us today from the Management – Mr. Neeraj Basur – CFO, Blue Star Limited. 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 – CFO, Blue Star Limited. Thank you and over to you, sir.

Neeraj Basur: Thank you. Good evening ladies and gentlemen, this is Neeraj Basur and I will be providing you an overview of the results for Blue Star Limited for the quarter ended December 31, 2016.

Third quarter of this fiscal year was impacted by multiple externally driven events that contributed to several business challenges. Demonetization of high denomination currency notes, outcome of US Presidential elections, firming commodity and crude prices coupled with high volatility in the forex markets contributed to uncertainties during the quarter.

Blue Star resolved to mitigate these external challenges by maintaining strong focus on the growth momentum. Accordingly, in our products business, limited impact of demonetization initiative has been experienced so far. However, our projects business experienced sluggish pace of order bookings primarily because investments and capex by corporate, real estate and light commercial customer segments have significantly slowed down post demonetization.

You will recall that last year, we had completed implementation of a complex set of corporate restructuring transactions involving the merger of Blue Star Infotech with Blue Star and separately had also merged two of our wholly owned subsidiaries. Consequently, previous year's numbers have been restated to give effect to the restructuring. Therefore, our Q3 reported performance this year is not comparable with previous year's numbers. We would provide you necessary

details, wherever relevant, to enable a meaningful analysis of our quarterly performance.

Following are financial highlights of the Company for Q3 FY'17 on a consolidated basis:

- Total Operating Income for Q3 FY'17 was Rs. 926.47 Cr as compared to Rs. 733.55 Cr in Q3 FY'16 (excluding BSIL's operating income of Rs. 61.46 Cr), representing a growth of 26%.
- PBIDTA (Before other income) for Q3 FY'17 was Rs. 35.08 Cr as compared to Rs. 23.55 Cr in Q3 FY'16 (excluding BSIL's PBIDTA of Rs. 11.65 Cr), a growth of 49%.
- Profit before Tax (before exceptional items) was Rs. 15.71 Cr in Q3 FY'17 as compared to Rs. 5.98 Cr in Q3 FY'16 (excluding BSIL's PBT of Rs. 10.97 Cr), a growth of 163%.
- Tax expense for Q3 FY'17 was Rs. 1.53 Cr as compared to Rs. 1.09 Cr in Q3 FY'16. Effective tax rate for FY'17 is expected to be 22%.
- Exceptional Items in Q3 FY'16 relates to expenses of Rs. 6.59 Cr towards goodwill charge arising from BSIL's amalgamation and bonus expenses relating to earlier years. There were no Exceptional Items in Q3 FY'17.
- Consequently, consolidated net profit for the current quarter increased to Rs. 14.50 Cr from Rs 9.00 Cr in Q3 FY16.
- Order inflow during Q3 FY'17 increased by 14% to Rs. 787 Cr from Rs 688 Cr over the same period last year.
- Carry-forward order book as at December 31, 2016 increased by 12% to Rs 1794 Cr as compared to Rs 1605 Cr as at December 31, 2015.
- Blue Star's standalone net borrowings decreased to Rs. 209 Cr as on December 31, 2016 from Rs. 243 Cr as on March 31, 2016

- Net borrowings for our 100% subsidiary, Blue Star Engineering & Electronics Limited reduced to Rs. 59 Cr as on December 31, 2016 from Rs. 60 Cr as on March 31, 2016.
- Consolidated capital employed increased to Rs. 723 Cr as on December 31, 2016 from Rs. 630 Cr as on March 31, 2016 in line with business volume growth.

BUSINESS HIGHLIGHTS FOR Q3 FY'17

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

Segment I revenue increased to Rs. 554.55 Cr in Q3 FY'17 from Rs 458.30 Cr in Q3 FY'16, a growth of 21.0%. The segment generated profits of Rs. 28.70 Cr (5.2%) in Q3 FY'17 as compared with Rs. 25.58 Cr (5.6%) in Q3 FY'16.

1. Electro-Mechanical Projects business

In the Electro-Mechanical Projects business, order inflow in Q3 FY'17 saw a modest growth at Rs. 471 Cr as compared to Rs. 433 Cr during same period last year.

Overall, the market remained sluggish, impacting growth prospects. Quarterly consumption continued to be driven mostly by government investments in infrastructure projects such as metro rail, hospitals and educational institutions.

Project execution remained slow as customers phased out their requirements based on available funds thereby deferring overall project completion timelines. Increase in fuel and commodity prices increased the input cost at the project sites and created additional stress on profit margins. Cash flow also continued to remain a challenge across several customers.

Contrary to our earlier expectations, the market has not yet fully revived both in terms of new order finalization as well as execution speed. Further, as I mentioned in my opening remarks,

demonetization event also adversely impacted real estate segment and investment sentiments amongst the corporate customers.

Some major orders won by Blue Star during Q3 FY'17 included Amazon (Hyderabad), Thapar University (Patiala), Sea Valley (Vizag), Hotel Cidade de Goa, and Ascendas (Delhi).

Carry-forward order book was Rs 1753 Cr as at December 31, 2016 as compared to Rs. 1545 Cr as at December 31, 2015, an increase of 13%.

2. Central and Packaged Air Conditioning Systems business

Some signs of early market recovery emerged for this segment. Hospitals, hotels, restaurants, industrial and educational institutes were major contributors in Q3. Blue Star performed well in VRF and Chiller product categories.

We maintained our strong hold as a market leader in the ducted systems category. The new configured water cooled screw chillers introduced in the market has also gained good acceptance.

In Q3, orders were received from Vibrant Academy, Amity International School, HDFC Bank, Grasim Industries, JSW Steel Limited.

During Q3, Blue Star's remote monitoring centre called 'rView' won the "Excellence in Operations" award from IDC Insights, an international knowledge agency.

3. International Business

The company continued focus on expansion of its products export business. There was good order inflow for water coolers, room air conditioners and for applied products such as VRF, AHU & chillers from various distributors and OEM customers.

Blue Star continues its journey on brand building in select international markets. Blue Star participated in multiple major trade

shows such as Climate Abu Dhabi Expo, UAE and Big 5 Exhibition in Dubai, UAE with largest ever display stall.

On the economic outlook, emerging markets of the Gulf Cooperation Council (GCC) countries and Africa are expected to remain under pressure during 2017. New geographies have been identified for expansion.

Segment II: Unitary Products

This segment registered revenue growth of 34%, from Rs 237.66 Cr in Q3 FY'16 to Rs. 318.41 Cr in Q3 FY'17. The segment results showed reduction by 10% from Rs. 16.08 Cr (6.8%) in Q3 FY'16 to Rs. 14.54 Cr (4.6%) in Q3 FY'17. Our continued focus on maintaining growth trajectory enabled us to perform better than our expectations in this segment. Results of this segment in the current year include expenditure incurred to launch water purifier products, air-coolers and air-purifiers.

1. Room Air Conditioner business

During Q3, our room AC business grew by 47% against the estimated market growth of 25% during the same period. Product penetration among the existing dealer / retailers coupled with better product range, aggressive sales promotion and widening of distribution footprint contributed to our growth.

The Company continued to perform better in the high energy efficient products such as inverter ACs. With growing volumes in tier 3/4/5 markets, more customers prefer availing consumer finance schemes. During the quarter, close to 16% of the ACs sold were through consumer finance schemes.

2. Commercial Refrigeration business

Commercial refrigeration products business slowed down in the current quarter, impacted by demonetization. Retail sales as well as sales at dealer stores especially in Tier 3, 4 and 5 towns were impacted. We expect the situation to improve in Q4 of FY'17 for these products.

3. Water Purifier business

Water Purifier business was formally launched in Q3 FY'17 with 13 models (including colour variants) with price points varying from Rs 15,000 to Rs 45,000. The value proposition has been identified as 'Choose Purity' which received exceptional feedback on social media.

In the first phase, the Company plans to offer contemporary range of electric water purifiers. The products will be initially available in Mumbai, Delhi NCR, Bengaluru, Secunderabad, Chennai, Pune, Ahmedabad, Nagpur and Chandigarh. The distribution would be subsequently ramped up in all states in the South, Maharashtra, Gujarat and Northern region by March 2017.

Segment III: Professional Electronics and Industrial Systems

Billing of this segment grew by 42% in Q3 FY'17 to Rs. 53.51 Cr from Rs. 37.56 Cr in Q3 FY'16. Growth in billing was driven by a few large surveillance projects billed during the current quarter. Segment result grew to Rs. 7.32 Cr (13.7%) in Q3 FY'17 as compared with Rs. 6.34 Cr (16.9%) during the same period last year.

During the quarter, large orders were received from Sun Diagnostic (Cuttack), Steel Plant Hospital (Bhilai), Karnataka Police, Defence Labs (Panagarh), Lalbaba Seamless (Kolkata) and Divine Cylinders (Gujarat).

BUSINESS OUTLOOK

The residential and light commercial segments demonstrated healthy growth and are expected to continue the growth trend with enhanced spending by consumers. The electro-mechanical business environment is expected to continue to remain sluggish even during Q4 FY'17. The Company intends to continue to make investments in manufacturing, marketing, brand building, product development as well as human resources in the next few quarters in order to capitalize on the imminent growth opportunities.

The Company is currently evaluating guidelines and regulatory updates on GST in terms of transition preparation. We are in a state of high readiness to migrate to the new tax regime as and when the new law gets enacted. Impact assessment will be taken up once the regulations and related rules get formulated.

With that, Ladies and Gentlemen, I am done with my opening remarks. I would now like to pass it back to the moderator who will open up the floor to questions. I will try and answer as many questions as I can. To the extent if I am unable to, we will get back to you via email. With that, we are now open for questions.

Moderator: Thank you. Ladies and Gentlemen, we will now begin the question-and-answer session. We will take the first question from the line of Renjith Sivaram from Antique Stock Broking. Please go ahead.

Renjith Sivaram: Sir, one major worry in this result was the UCP margins. So it will be really helpful if you can quantify what was that additional investment that we had to do for air coolers, water purifiers and air purifiers. We can then get some idea with regards to normalized UCP margins. And my second question will be on the capital employed under UCP. What has led to a growth of around 28%? Is it largely inventory or debtors and is that something to worry about?

Neeraj Basur: As I mentioned earlier, the results of unitary product segment also includes the expenditure and investment that we are making in to launch our water purifiers range of products. In the current quarter we have spent close to Rs. 10 crores in terms of these initiatives, largely to support the brand building and launch related cost for this particular segment. Because of this conscious investment decision, the margins have been impacted. If this investment was not made, then our margins for the quarter would have been 7.7% for this particular segment as compared to 4.6% that we have reported and as compared to last year margins of 6.8%.

And to answer your second question on the increase in working capital for his particular segment, that is largely driven by the increased scale and there is nothing to worry about in terms of either inventory or debtors, it is pretty much in control.

Renjith Sivaram: So because of demonetization there is no debtor increase or inventory stuffing into the dealers. Just the basic idea is whether the primary sales is similar to the secondary sales in the market?

Neeraj Basur: Primary sales generally tend to follow a lag and so far till end of December, in fact, we had pretty robust experience during the New Year as well as Christmas period even followed up during the Pongal sales in early January. And so far, we have not witnessed any significant reduction in the secondary sales pattern as well.

Renjith Sivaram: So that means we have not taken any price cuts and increased our market share. Hence is it correct to assume that it was largely driven by our push and our penetration strategy?

Neeraj Basur: That is correct.

Moderator: Thank you. We have the next question from the line of Sujit Jain from Yes Securities. Please go ahead.

Sujit Jain: Sir, if you could help us with our AC market share, the market value growth vis-à-vis 34% growth in UCP segment, the VRF segment growth vis-à-vis the market, the inverter sales growth vis-à-vis the market and the EMP margin guidance.

Neeraj Basur: So let us go one by one. Overall our room air conditioner market share at the end of December was 11.5%, up 90 basis point compared to last year. We expect to maintain this level for the full year. As we have stated, we want to continue to steadily grow our market share by about 100 basis points a year and we expect to be on that trajectory.

As far as VRF market share is concerned, our overall VRF share was roughly round 12% to 13%, that is overall market share in that particular segment.

In inverters, overall if I look at the nine months so far, our sales from inverters have been more or less around 15% as compared to industry trend of around 12%. And we have been maintaining this trajectory as well.

Your last question on EMPG, or Segment-I, as we have mentioned at the beginning of the year, there are two factors to be borne in mind. Demonetization has impacted real-estate sector and there has been a slowdown in private sector capital expenditure commitment as well as investments. The government projects continue to be in line with our expectations. So we do see some impact in quarter four as well on that segment. Having said that our estimation of net margin in the range of 4.5% to 5.5%, more or less seems to be online.

Sujit Jain: To understand QoQ AC market share has dropped from 12% to 11.5%, is that understanding correct?

Neeraj Basur: No, in fact if you look at quarter three, it was alone at 14%. The 11.5% which I mentioned earlier was YTD.

Sujit Jain: And one last question is, if I were to reconcile the numbers minus the IT business, the EBITDA margin is 3.8% versus 3.2%. But if I look at segmental data, all three segments the PBIT margin has come down. So how does one reconcile both these numbers?

Neeraj Basur: So, last year the numbers that I have spoken include the profit from the IT business which was amalgamated with Blue Star which is around Rs. 11 crores. So if you remove that, then the PBIT comparison will appear normalized.

Moderator: Thank you. We have the next question from the line of Madan Gopal from Sundaram Mutual Funds. Please go ahead.

Madan Gopal: My first question is on that launch expense of Rs. 10 crores that you incurred for the current quarter. How does it move for the next quarter? Is it one-off and is it done or you think we will be continuing to incur some portion of it moving forward also?

Neeraj Basur: The formal launch took place during the quarter, pretty much end of October. We do intend to continue the thrust for this particular product category in quarter four as well. We do have our plans drawn up in line with those and you will see some more investments happening on water purifiers in quarter four as well.

Madan Gopal: And this broadly would be done this year or you think even in FY18 or even in H1 of next year some bit of these expenses would continue?

Neeraj Basur: It is at least 18 months investment cycle which has just started. We estimate that at least till first half of next year we will continue to support and invest in this particular product.

Madan Gopal: Of similar number, right?

Neeraj Basur: We are in the process of firming up a quarter-over-quarter spends number and as and when we do we will continue to share every detail.

Madan Gopal: And second, you gave a number, 15% of inverters in our mix, right?

Neeraj Basur: That is right and it is a year-to-date number.

Madan Gopal: And 12% for the industry?

Neeraj Basur: Yes.

Madan Gopal: Is our market share also around 15%?

- Neeraj Basur:** No, our market share is 11.5% overall.
- Madan Gopal:** No, I am asking for the inverter alone.
- Neeraj Basur:** As you are aware, we do not measure separately or track the inverter market share.
- Madan Gopal:** And you are talking about the market share in Q3 moving to 14%?
- Neeraj Basur:** Yes.
- Madan Gopal:** This is primarily coming on the back of what, the more sales from the distribution reach that we are creating or how is it coming to that? It seems to be a sharp increase in this quarter.
- Neeraj Basur:** So, it is a mix of both. It has been driven by increase in our overall distribution base, number of stores that we have on our network as well as growth happening from the same stores as compared to previous year.
- Madan Gopal:** So basically, it looks more sustainable, that is the filler that I wanted, is this 14% not just a quarter thing, it has kind of sustained here?
- Neeraj Basur:** So, 14% is definitely for the quarter. For the full year, like I mentioned short while ago, we expect the market share to be also in the range of 11.5% or so which will be about 100 basis points better than last year.
- Moderator:** Thank you. We have the next question from the line of Nitin Arora from Aviva Life. Please go ahead.
- Nitin Arora:** Just wanted to know, I think you have given us the numbers, but sorry I am not able to recollect the same. By how much did the market grow in room ACs and VRF segments vis-à-vis us?

Neeraj Basur: As far as the room AC segment is concerned, our estimate is that the market grew by 25% and Blue Star's growth was 47%. As far as the VRF is concerned, market grew by about 12% and our growth was roughly about 50% in this particular quarter.

Nitin Arora: Sir, then is it fair to assume that the impact of demonetization, wherein the thought process was it would be impacted because of the cash sales, has not impacted industry growth numbers?

Neeraj Basur: We should be bit cautious on this subject and need to watch out for at least one more quarter. As far as Q3 is concerned, by the time demonetization event took place, the festival sale, Diwali and the October end, Onam, etc., period was already over. We did see a good response towards the end of December again, during the Christmas and New Year time period. We would like to believe that while as of now we do not see much impact of demonetization, but then for the full effect, if there is a lag effect at all, we would like to watch out and wait for another two months or so. However, having said that, by the time February comes to an end, we should get an idea about next season's weather pattern and if that really is helpful, if the summer happens again like last year quarter four, if early summers do tend to set in sometime in February or early March, then it is quite possible that the residual lag effect might also not have so much of an impact. But we will wait and watch for one more quarter.

Nitin Arora: In the last call which happened immediately after demonetization, you shared some numbers of 30% of sales taking place through consumer finance and 30% dealer sales by cash. How do you see that numbers changing now?

Neeraj Basur: It has not changed much in quarter three alone. Overall, we continue to have around 20%- 25% of all our sales through the consumer finance schemes.

Moderator: Thank you. We have the next question from the line of Ashish from Goldman Sachs. Please go ahead.

Ashish: Sir, just wanted to understand one thing. Considering the strong room AC sales growth numbers and as you mentioned that there has not been any buildup at the dealer's end, can we attribute this strong growth, some part of this growth, to pre-buying of goods? And does it mean that Q4 could be a bit softer?

Neeraj Basur: So, Ashish, in the last call I had mentioned that our own research shows that 75% of the buyers of room air conditioners are genuine first time buyers. We have typically experienced that this is not a category which is linked with necessarily the need to spend in cash. So we do not think that there is an element of advance purchase of any sort in this category.

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

Ravi Swaminathan: Sir, these YTD numbers that you had given for Blue Star, is it volume or value growth, the 29% that you had?

Neeraj Basur: Value growth.

Ravi Swaminathan: Can you give the corresponding volume growth also for Blue Star?

Neeraj Basur: We do not track volume growth for the industry and hence it will be difficult to give that to you.

Ravi Swaminathan: And the split between split-ACs and window-ACs, if you can give for Blue Star?

Neeraj Basur: The overall breakup between window-AC and split-AC: roughly 80% is split and about 20% windows.

Ravi Swaminathan: And Sir, one question on the input cost. Commodity prices across the globe have increased. Have you started seeing the impact of that in our margins or when we are purchasing, I mean, will it happen with a lag effect? What is your view on that?

Neeraj Basur: It will happen with a lag effect. You would be aware that pretty much the procurement season starts for us, let's say for Q4 the procurement typically starts somewhere in September – October. Increase in commodity prices whether it is copper, steel, even crude to some extent and then of course resultant impact on FOREX exchange rate etc, it is pretty much last 45 - 60 days phenomena. We have been able to commit to our purchases for the next four - five months. So we will need to fit again and work out our strategy for this particular mitigation of commodity forming up the impact probably more for quarter of next year and not as much for the quarter four of current fiscal.

Ravi Swaminathan: Given the fact that next year the BEE norms are also likely to change and there will be a price increase across ratings. And with our negotiation with suppliers there would be kind of a revision in price input cost. Will it affect our ability to pass on the prices to end customer?

Neeraj Basur: As you are aware that pricing is to a large extent driven by market forces. First we will look at the entire thing and product portfolio for next year and take an appropriate call on the pricing levels. We will definitely try to manage the cost within the desired margin levels. So, this will be more of a next season's strategic call that we will take in due course, not impacting us as much as quarter four.

Ravi Swaminathan: There has also been recent news that LG is planning to vacate the fixed speed air-conditioners. Will we take this as an opportunity to gain market share?

Neeraj Basur: Yes, so we are aware of this announcement that LG has made. In fact we look at it as a positive move because if at all this should help expand and grow the market further. Now that is one aspect. As far as we are concerned, again, consistently we have talked about this that we are unlikely to get into a pricing or price matching strategy. We may choose to mitigate or counter measure or match this impact through some other means but not necessarily through price reduction or anything of those sorts. Of course, we have to watch out very closely the impact of this move over the next few months. But overall we feel that this will only help expand and strengthen the market growth.

Ravi Swaminathan: In EMP segment, there is lot of opportunities which are there in the pipeline, are we bidding for it?

Neeraj Basur: Blue Star is pretty much a consistent player in the metro rail segment. We have executed quite a few orders for Delhi and Bangalore metros. Next year we do see quite a few of these orders getting completed and awarded to the range of some Rs. 1,000-odd crores, that is our overall sense. We will participate in these orders or in these contracts based on our past track record as well as the credentials that we have. Yes, this will be an important segment for us.

Moderator: Thank you. We have the next question from the line of Mayur Patel from DSP Blackrock. Please go ahead.

Mayur Patel: Just have two questions. One on the margin profile which you explained very well, that 7.7% would have been the margin if there was no marketing and advertisement expense of Rs. 10 crore in water purifiers. Given that, we have seen during last few years, we have steadily maintained 10% to 11% margin profile in the cooling products business. Going forward also is that the strategy given the new products which we have? Also in the inverter ACs, one of the competitors is behaving slightly more aggressive and based on news

article it shows that they are plying to have a big cut in price and offer inverter ACs closer to the fixed speed compressors air conditioning. So given these factors, our endeavor would be to maintain margins around 10% - 11% or are you are flexible?

Neeraj Basur:

Mayur, just one clarification. Firstly, we did not have the water purifier initiative as a separate product during FY16. Hence we would be maintaining the margins in the range of 9.5% to 10.5% as far as the room air conditioners are concerned. However as I mentioned short while ago, for the next 18 months we do also expect to continue investing in the water purifier segment. So the segment result as a whole, which is Unitary product, we should expect some impact till the time we are in an investment mode. Then of course the margins will normalize in that segment also.

The other question you asked about responding to competition. It is unlikely that we will get into a price matching initiative. We do see that as a good opportunity, market will expand and it should expand. We will maintain our consistent position in terms of a premium player as well as a player who will continue to focus on high energy efficient and better quality products.

Moderator:

Thank you. We have the next question from the line of Nitin Bhasin from Ambit Capital. Please go ahead.

Nitin Bhasin:

Quickly, one question on the room AC business. Can you just give us a sense in terms of how much of your UCP business is room AC for this quarter and the first nine months? And historically you have not spent such amount of money on the promotion. Let's say, an air cooler or an air purifier, why such a difference in the strategy?

Neeraj Basur:

Nitin you are aware that the company doesn't share the break-up of each product category and hence we would like to maintain that consistency even now. The only reason we are separately calling out

water purifiers because this is a new product and a new initiative. So for some time probably it is important for us to share the impact of those initiatives.

As far as the second question goes, you might again recall that last year when we had carried out the restructuring and as a resultant corpus of substantial order was generated. It has been a stated objective which we had shared that we do want to invest a part of that corpus into expansion but invest that corpus into brand building as historically we have been under spending on it. I would not say we have not been spending but not spending enough, that is the view we have had internally on brand building. We said we want to invest part of the corpus in new capability building including new and adjacent products which we have done and also invest in capabilities like research and development and human resources. So it is all part of a very well thought through strategy which is now getting executed and pretty much in line with what was started about a year ago.

Nitin Bhasin: So, we would not see similar expenditure on room air coolers or air purifiers do not require such a brand building initiative that is required in water purifier? Is that one way to look at it?

Neeraj Basur: In a way yes, but then even those categories will need some support. But you are right. Water purifiers do need investments in brand building of a different magnitude and size which will be definitely more than some other products.

Nitin Bhasin: What is the product sourcing strategy of water purifiers as you are putting funds in this business? What is the product sourcing or product manufacturing strategy?

Neeraj Basur: So, at this point in time we have not really gotten into fine tuning that part because firstly we want to make sure that we understand the customer needs and segments well, understand the distribution, set

up the distribution network properly, set up the entire servicing network comprehensively because this is a category where the quality of services is a very important success driver. We want to get that right first which would be followed by the sourcing strategy.

Moderator: Thank you. We have the next question from the line of Saurabh Kataria from BOI AXA Mutual Fund. Please go ahead.

Saurabh Kataria: Most of the questions have been answered. Just a couple of small things. So, you said that in our MEP segment, there can be some impact due to demonetization. So do you expect that during next couple of quarter the capital employed in the business going up? And the other question is on the competitiveness or the competitive scenario. You have seen the inventory buildup, in terms of, how the inventory buildups have been in the overall market, dealers and all, versus competition. Thanks.

Neeraj Basur: To answer your first question on Segment-I, overall we do not expect capital employed to get adversely impacted for a very simple reason that we follow a very disciplined approach about executing projects and managing our exposure. The reason we are sharing our experience on demonetization is because of the impact on real-estate wherein we are seeing some slowdown. Then there is little sluggishness in closing new orders because obviously that will impact the project execution and our overall revenue and billing. Of course, it puts pressure on cash flows but at the same time we do not permit the overall capital employed in this segment to go beyond a certain risk appetite and exposure appetite that we carry. We are confident that we will be able to maintain that discipline around the next quarter as well.

Answering your second question, our understanding is that pretty much by the end of December, there is no excess inventory in the industry as far as the room ACs are concerned.

Saurabh Kataria: One last question, on the EMP segment. You said that we will not go beyond a threshold limit. Is there a percentage of sales or anything which we can track to understand?

Neeraj Basur: It will be difficult to understand because we do it on a project basis. This is a norm we have for projects of different size and it is more internal to us but then we do follow any particular criteria.

Moderator: Thank you. We have the next question from the line of Charanjit Singh from B&K Securities. Please go ahead.

Charanjit Singh: Sir, we have been highlighting about channel expansion especially for our AC business and now we are also expanding the channel for these new products. So if you can just highlight where exactly we are on the channel expansion versus our target and how do we see the channel for these kinds of new product categories which we have added like water purifier and build up over the next couple of quarters?

Neeraj Basur: So, as far as our AC business is concerned we have roughly **1500 dealer points** as of now and across the country we have close to 4,000 stores who will be selling our products. We added about 30 new dealers and about 130 distributors in Q3. So, this is a normal process and there is nothing aggressive that we have done here. So as far as our channel strategy is concerned, we continue to add new distribution points pretty much in preparation for the summer season's sale.

As far as our water purifier business is concerned, we have plans of having our presence across 100 towns over a period of next few quarters and establish our products in close to 1,000 outlets.

Charanjit Singh: And you also mentioned that we have a certain portion of sales definitely coming from Tier-III and Tier-IV and we are also expanding the network over there. So what proportion of sales for us is coming

from Tier-I, Tier-II and Tier-III, Tier-IV versus what would be the industry standard?

Neeraj Basur: So, Charanjit, we do not have a ready answer for this question, probably we will revert back to you.

Charanjit Singh: Last question from my side is on the pricing environment right now. How has been the pricing if we look at the different regions and competition? Going forward in Q4, could we see some marginal pricing pressure?

Neeraj Basur: Q3 we did not see pricing pressure in a significant way and we hold the same expectation for Q4 as well. But of course, as the summer season starts and also because of the impact of commodity prices, we may see some impact on pricing. Saying that, we will have to just wait and watch and then plan our strategy in line with what we see around us as far as competition is concerned.

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

Ankur Sharma: My questions are on the room AC segment. You recently launched new models for the upcoming summer season. What I wanted to know was whether you have taken any significant price hikes or price cuts on these models? The reason I am asking this is because, and I refer to an earlier question, LG has obviously cut their inverter prices by as much as 30%. So in that scenario, where you do not change prices for your models, how competitive would Blue Star be going into CY17?

Neeraj Basur: So, Ankur, as I mentioned, so firstly we are at this point in time and this reference is to quarter four we will have to assess and again reassess our position for Q1 separately. But for Q4, we do not intend to fiddle around too much with our prices. That has been Blue Star's consistent approach. Rather than that, we will focus more on the

value proposition for the customer. Having said that, we will also closely look at how other players are reacting or they are responding to this particular move. But our focus, again, consistently will continue on high end and more energy efficient range of products for which there is a certain price point. At this point in time, we feel reasonably confident that we will be able to manage the impact of such competitive changes at least for one more quarter.

Ankur Sharma: Secondly, this very strong sales of almost 47% in Q3, was it driven by any region or more by southern India or was it spread out more evenly?

Neeraj Basur: It is pretty much in line with the earlier trends where we are stronger in South, followed by the West, North and East. However, of late we have started witnessing some encouraging signs of improvement in North relative to other regions. But overall composition has not changed yet.

Moderator: Thank you. We have the next question from the line of Krish Kolhi from Edelweiss. Please go ahead.

Krish Kholi: Basically I wanted to know the breakup of fixed price contracts versus variable price contracts in the EMP segment.

Neeraj Basur: We do not share this kind of a breakup for purely competitive reasons.

Moderator: Thank you. We have the next question from the line of Priyank Singhal from HDFC Life Insurance. Please go ahead.

Priyank Singhal: I just wanted to once again sort of understand LGs move. It seems to be again a reinforcement actually to our strategy where you have been focusing on inverter and energy efficient ACs. So given that we have a higher market share in that segment, how do you view this move by one of your competitors? And secondly, is it likely to result in any meaningful pricing related pressures or is it that with economies

of scale over a period of time, the cost of inverter ACs themselves would come down meaningfully and therefore margins should be aided from that phenomenon itself?

Neeraj Basur: Priyank, you are absolutely right. This is in a way again a reinforcement of our stated strategy of focusing on inverter and high energy efficient models. So we are glad that other players are now focusing equally as we have been doing pretty much for the last few years. As I mentioned earlier, we expect this to actually expand the market for inverters. Clearly our brand positioning is a bit premium but then clearly in the same segment. Therefore, we do see this as an opportunity and we believe that the consistency of our play will help us manage the overall competitive pressure. You are also right that over a period of time as the volumes grow, probably the economy may help rationalize the overall without necessarily compromising too much on the margins, rationalize the overall selling prices and the overall cost composition in a balanced manner.

Priyank Singhal: But from a sourcing point of view, is there a difference between inverter and a non-inverter ACs?

Neeraj Basur: As far as the overall manufacturing versus outsourcing strategy is concerned, we have been following a blend of roughly 60:40 where 60% of what we sell has always been manufactured by us. We do not expect to alter this strategy. The strategy is unlikely to be different in case of inverter and a non-inverter ACs.

Priyank Singhal: And second question was with respect to the water purifier segment. You mentioned that the investments will continue for a few more quarters. But in terms of some breakeven point, are you in a situation to provide some visibility on when the EBITDA breakeven is likely to be achieved for that segment?

Neeraj Basur: Not at this point in time because like I said as of now we are in a very, very nascent for this particular segment. We are just getting to learn a little bit better about distribution, customer preferences as well as the entire servicing network. Over the next few months, I guess we will have a much better visibility as well as clarity around the fine tune approach that we need in terms of go-to-market as well as turning the overall business in terms of profitability. But clearly our approach has been, like we have done in the room-AC segment, to learn when we are small and then grow and realize the benefits of scale, etc. So we will follow the similar approach here as well.

Priyank Singhal: And a related point on this, just from a supply chain and distribution synergy with our rest of our business including the UCP segment, is it the same supply chain or we have a completely different set of dealers and service network for this business?

Neeraj Basur: There are some distribution points which do overlap. However it is a slightly different product, though an adjacent product, which needs a specialized distribution as well as servicing network. It is exactly what we are in the process of establishing at this point in time.

Priyank Singhal: But the model is not a direct selling model like Eureka Forbes. It is more to do with retail selling model like a Kent kind of a model?

Neeraj Basur: Yes, it will be a retail selling through the stores but not necessarily the same stores which are selling room air-conditioners.

Moderator: Thank you. Ladies and Gentlemen, that was the last question. I would now like to hand the conference over to Mr. Neeraj Basur for his closing comments.

Neeraj Basur: Thanks very much, Ladies and Gentlemen. With this, we conclude this quarter's earnings 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. Thank you very much.



*Blue Star Limited
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Moderator: Thank you. Ladies and Gentlemen, on behalf of Blue Star Limited that concludes today's conference. Thank you for joining us. And you for joining us and you may now disconnect your lines.