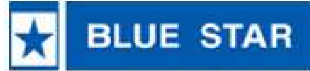

"Blue Star Limited Q3 FY12 Earnings Conference Call"

January 31, 2012

MODERATORS: MR. VIR ADVANI – PRESIDENT, ELECTRO MECHANICAL PROJECTS GROUP & EXECUTIVE DIRECTOR, BLUE STAR LIMITED
MR. B. THIAGARAJAN – PRESIDENT, AIR CONDITIONING & REFRIGERATION PRODUCTS GROUP, BLUE STAR LIMITED

Moderator Ladies and gentlemen, good day and welcome to the Blue Star Limited Q3 FY12 earnings conference call. From the management end we have Mr. Vir Advani, President, Electro Mechanical Projects Group and Executive Director and Mr. B Thiagarajan, President - Air-conditioning & Refrigeration Products Group. As a reminder for the duration of this conference, all participant lines will be in the listen only mode and there will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during this conference call, please signal an operator by pressing "*" and then "0" on your touchtone telephone. Please note that this conference is being recorded. At this time I would like to hand the conference over to Mr. Vir Advani. Thank you and over to you sir.

Vir Advani Thank you. Good morning ladies and gentlemen. This is Vir Advani and 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 31st, 2011. The following are the financial highlights of the company for the quarter which is Q3 FY12.

- Blue Star Limited reported Total Operating Revenue of Rs 589.69 crores for the quarter ended December 31, 2011, as compared to Rs 613.41 crores in Q3FY11,representing a decline of 4%.
- For the quarter, Gross Margin declined to 16.7% from 23.5% as compared to same period last year due to higher costs pertaining to increase in material costs and changes in the business mix
- Operating loss (PBIDT excluding Other Income) for the quarter was Rs 3.14 crores compared to Operating profit of Rs 48.30 crores during the same period last year. Unprecedented input cost increases have impacted all business segments of the Company. As seen in the earlier quarters of this financial year, the Electro Mechanical Projects business has been particularly impacted largely due to the fixed price nature of the contracts. We will provide more details later in the

opening remarks

- Financial expenses during the quarter increased from Rs 8.92 crores to Rs 22.10 crores. This was due to foreign exchange losses on account of the strengthening of the dollar and higher interest costs
- Our total foreign exchange exposure at any point in time is about US $70-75 million and our normal policy is to hedge 35-55% of the net foreign exchange exposure on an on-going basis. To reduce our exposure to foreign exchange volatility, we have increased amount hedged. Due to the sharp depreciation of the Rupee in December, our foreign exchange losses for the quarter were about Rs 13.78 crores of which about Rs 6 crores is the unrealized loss
- Consequently, there was a Net Loss of Rs 32.76 crores compared to Net Profit after tax of Rs 22.36 crores in Q3FY11.
- Carry Forward Order Book as on December 31, 2011 increased to Rs 2160 crore compared to Rs 2072 crore as at December 31, 2010, representing a growth of 4%.

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

The Electro Mechanical Projects and Packaged Airconditioning business accounting for 63% of the total revenues in the quarter, declined by 15% while segment results fell sharply to a loss of Rs 15.18 crores as compared to a profit of Rs 29.13 crores during Q3FY11.

In this quarter we have continued the process of advancing and short-closing old jobs. Of the total order book of about Rs 1800 crores (as of April 1, 2011), spread over 900 plus open jobs, we have reviewed the costs, planned revenues and expected cost to complete for about 600 odd jobs. Based on the extensive review of these jobs, which account for about Rs 1000 crores of our order book, we have been adjusting the planned revenues and revised the planned costs to reflect the most current prices of equipment and materials. The consolidated impact

on the cost over-runs on a YTD December 2011 for these jobs is a margin erosion of about 7% on the Rs 1000 crores reviewed order book. We expect to complete the review of the remaining jobs, subject to their advancement to appropriate milestones, by the end of Q4. As indicated earlier, the overall margin erosion will be in the range of 5-6% of the segment order-book and we anticipate that the process will be largely complete in this financial year. Our observation, based on the review of these jobs, is that the impact is most pronounced in the Building Electricals segment, long gestation infrastructure projects and some projects being executed for Builders and General Contractors.

Our priority has been to manage the capital employed in this business and I am happy to say that we have made reasonable progress on this front. The Capital Employed in this segment is currently about Rs 498 crores (down from Rs 637 crores as of end September 2011). We will continue our focus on managing the capital engagement in this business through synchronizing material delivery and execution with payment, expediting measurement and payment certification, and aggressive debtor collections.

The new management team has taken a number of steps to contain the margin erosion including:

- Retrieving and re-allocating excess/ non immediately required material, lodging escalation claims where feasible, short closing/ re negotiating hugely delayed projects
- Being much more selective in order booking – the focus being on large, bundled MEP projects, where we can maintain a differentiated position. We have reduced our exposure to the long gestation residential segments, particularly for the electrical and plumbing business

- Strengthening our estimation, project management and review mechanisms to operate in a more volatile environment
- Incorporating price variation clauses, where feasible, to reduce risk in our largely fixed price contracts
- Focus on improving productivity and efficiencies across the board.

The projects business will continue to face challenges for the next few quarters, however, we expect to bring the business back to long term trend levels in FY14.

On the market side, despite market sluggishness, delayed order finalizations and our selective approach to order booking, the company continues to witness demand from the IT/ITeS, Retail, Hospitality and Industrial segments. During the Quarter, Blue Star won prestigious orders in the above segments namely, Tata Realty Infrastructure Ltd - Chennai, Capgemini-Pune, Boomerang IT Campus - Mumbai, Wipro –Data Centre- Greater Noida, JW Marriot-Mumbai, Acropolis Mall-Kolkata, DLF Mall of India - Noida, Emaar MGF - Gurgaon, BHEL Bokaro Thermal Power Station- Bokaro, Solvay R & D Centre - Ankleshwar.

The company maintained its leadership position in healthcare by winning projects such as New Rise Hospital -Gurgaon, Jawahar lal Nehru hospital & medical college -AMU Aligarh, ESIC hospital-Hyderabad, G.M.M.H hospital - New Delhi, Q.R.G hospital - Faridabad. Of these project wins, New Rise hospital, JLN Hospital & Medical College, JW Marriot Hotel are MEP orders.

In Packaged/Ducted air-conditioning and small chillers, the market is growing at a steady pace. There was a good inflow of orders from Commercial Complexes, Industrial, Retail, Hotels & Restaurants and Education segments. The Office and hospitals segments remained flat.

All others including banks, developers etc have shown a decline in the current financial year.

In the VRF segment, the inflow of enquiries is steady with many consultants preferring VRF over Ducted systems for certain applications. Despite stiff competition, the company has been able to do well in segments of Hotels, Offices, Residences and Hospitals. Some of the prestigious orders won by us are namely, Hotel Rathinam Regency - Madurai, KDJ Hotels & Resorts - Jodhpur, Vaibhav Empire Pvt. Ltd - Vizag, GSFC Ltd - Vadodara, Mother & Child Hospital - Hyderabad. In line with the depressed sentiment in the telecom business, our telecom airconditioning business continues to be under volume and margin pressures.

Moving on to Segment 2, the Cooling Products revenue registered an increase of 28% in the quarter. However, Segment results declined by 30% to a profit of Rs 7.15 crores from Rs 10.22 crores in Q3FY11, due to cost pressures.

The growth in this quarter in the Room Airconditioner business, has come due to our continued efforts to expand in the residential segment, channel expansion to cover the tier3/4/5 markets, and product portfolio enhancements to provide a much wider and contemporary range. While the demand for residential air-conditioners has declined, small offices, showrooms, restaurants, marriage halls etc – where we have a leadership position, continue to grow robustly. In a scenario where the industry has de-grown, we have showed good growth and increased market share by about 2%.

The Refrigeration Products business showed steady growth this quarter. Bottled water dispensers and water coolers grew on the back of commercial and residential demand, Chest freezer business grew

well driven by growth in ice-cream, dairy and small retail segments. In the cold storage business, the Company has witnessed good inflow of orders in retail and food processing sector. Some of prestigious orders won by the company are Bharati agro, MSAMB , Metro Cash and Carry - Jaipur & Mumbai Haldiram. Dominos has awarded Blue Star with "Best business partner 2011" cold rooms in this quarter.

Margins in segment 2 were impacted due to significant increases in input costs particularly imported units and components, logistics and freight cost and increases in sales and distribution costs to support the channel expansion. We import a number of components and sub-assemblies for our products business – ranging from ~ 100% for IVRF products to 20-40% for some of the refrigeration and air-conditioning products. The costs of these imports have increased substantially in the last 6 months and while we have affected price increases, they have not fully compensated the increases in costs. Though we have increased prices ranging from 5-15% across our range of products, however, competitive activity and our desire to maintain a market leadership position in a high growth segment has limited our ability to fully recover the unprecedented cost increases. We are looking at all options for cost reduction including sourcing, value engineering and supply chain and logistics cost reduction.

To support the growth of the Refrigeration Products, we have recently set up a small factory in Ahmedabad which is expected to come on stream by the end of February, subject to clearances. This will be our second factory in Gujarat and we have earmarked about Rs 15 crores of capex for this expansion. When fully operational, this factory will add another 100,000 units thus doubling capacity for our range of water coolers and panels. Our MCHX line, which will help reduce our overall dependence on Copper, is ramping up well and we expect

that the benefits will accrue in the next fiscal. We are closely watching the evolving situation and will judiciously vary various elements of the marketing mix to maintain good growth without compromising margins, a process we believe will take 2-3 quarters to stabilize.

The revenues of the Professional Electronics and Industrial Systems business, i.e. Segment 3, increased by 16%, while Segment results were flat at Rs 11.68 crores compared to Rs 11.66 crores in Q3FY11. Order inflow into this segment has been moderate, however, there are promising prospects particularly in the Industrial Projects business which is geared to the Steel and Petro-chemical sectors.

Outlook

As communicated earlier, the Company expects the next few quarters to be challenging on account of the uncertain economic environment. Segment 1 margins will continue to be at depressed levels in the near term. We are confident that our on-going efforts to reduce the capital employed in this business, improve the quality of the order book and focus on high quality, timely and efficient execution will enable us to bring this business back on track in the coming quarters. We are focused on completing the review of our projects order book by the end of Q4 and we will provide you an update at the end of the next quarter in terms of the impact and the outlook.

We believe our market and product expansion efforts will help us to grow at a healthy rate in the cooling products segment (Segment 2). Margin pressure continues to be a concern in this segment 2 as well, and the Company has initiated several actions including price increases as well as value engineering and product cost reduction

efforts that should yield results in early FY13. At an overall level, the Company will exercise prudent financial management measures in order to contain the decline in profitability.

The Company has been through several challenging periods in its seven-decade history and has been able to adapt well to the circumstances. The underlying demand for its products and services driven by increasing urbanization, rising incomes and infrastructure investment is robust and with its market leadership position, the Company is well placed to capture the tremendous opportunities in the near future. The Company will endeavour to return to the growth path in the next financial year, and is focused on returning to profitability on a stand-alone basis early in FY13.

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. Between Thiag 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. With that we are open to questions.

Moderator Thank you very much. We will now begin with the question and answer session. The first question is from the line of Ruchi Vora from UBS. Please go ahead.

Ruchi Vora My first question is on your order book. What is your old order book like? Could you highlight in detail where there is a margin issue? Has it been taken at old prices and what is part where you are comfortable with? And you have a normalized margin of 5 to 7%. Could you split your order book into two parts?

Vir Advani We have a total order book of around Rs1800 crore. There has been order inflow of a certain amount in the current financial year. The major problems are with the orders booked in FY10 as well as FY11. We have reviewed Rs1000 crore out of Rs1800 crore already, where

we have to update the plan cost by up to 7%. We have taken jobs in our electrical & infrastructure business first. So a lot of that has been covered in that Rs1000 crore. On the remaining Rs800 crore, while we will be updating the cost, we anticipate that the adjustment will be lower than the first Rs1000 crore. This is why we feel that on an overall order book, we will have about 5 to 6% total erosion. So we are about 55% through and have taken about 70 to 75% of the correction already. We have another 40% of the order book to go on which there may be another 25%. That is the kind of break up.

Ruchi Vora So just to elaborate on this a little bit, out of the Rs1000 crore of order book that you have reviewed how much have we executed till Q3 FY12?

Vir Advani What we do is as soon as we update the cost, we make the impact immediately and it's the entire impact on both whatever has been recognized as revenue till date as well as the eminent loss on the remaining execution. So that loss has already been taken upfront.

Ruchi Vora If I understand this correctly, out of your Rs1800 crore order book, first of all does your current margins, say over the last 2 to 3 quarters, only reflect the cost to the extent of the revenues that you have executed?

Vir Advani No, it will reflect the margin erosion on the jobs which we have reviewed and on the entire job even if there is left over execution. But as I mentioned to you, we started Q1 and Q2 with jobs that were 80-90-95% complete. So those in any case, the bulk of the revenue had already been recognized. When we got to Q3 and now as we move into Q4, these are jobs which are earlier in their execution cycle. But even on those jobs when we identify cost overruns on a project, even as 60-70% executed, we will still take 100% of the potential loss immediately. And like we have mentioned, while they are making these adjustments in the current year there are several efforts on whether it is claiming, escalation claims from clients and various other

actions that are on, to try and recover a part or all of this, which will begin to flow-in in Q1 or Q2 of next year. So we will be adding that to our margins next year because there is a gestation period and a cycle to recover some of these erosions.

Ruchi Vora I think what we are really trying to get is when will Segment-1 turn profitable? I do appreciate it is a very difficult operating environment. But we do want some color in terms of when does the problem order book really get over and when can we really move on with the newer projects?

Vir Advani I mentioned to you starting June-July of this year, even though the inflow of orders has been much lower than prior year, down by about 25%, but the quality of the orders coming in is at historical level and quality. The orders that are getting finalized in the current financial year are jobs that are active and that are being executed. Because we think in FY10 and FY11, customers were awarding contracts and then sitting on the jobs for 6-9 months because they wanted to lock in a price and then they wanted to keep everyone hanging. That is not happening right now. So jobs are getting finalized and need to be executed. We are expecting a lot of the jobs which we are booking in the current financial year to be executed and billed next year. That will contribute favorably to the margins. We would have also taken, like I mentioned to you, endeavor to take a 100% of whatever erosion in margin there is on the overall order book by Q4 itself so that we enter the new year cleaned up. The difficulty in answering your question is unrelated to this, which is that we have choked the delivery of material and revenue recognition in the business. We have been mentioning to you that we are focused on reducing the capital employed. Now what that does is while it helps your capital employed and while it helps you manage the business tighter, we have a certain fixed cost that is sitting in that segment and that fixed cost has to be covered. Now we are unable to say at this point whether in Q1 or Q2 of next year we will

cover that fixed cost adequately. Because until we get the capital employed tightly under control we are not going to ease up on revenue recognition. So to that extent while the gross margin, we anticipate will be much higher levels in Q1 and Q2, the operating margin of Segment-1 we are unable to comment right now, whether we will be able to show a profit or whether there will be a marginal loss in Segment-1 in the first half of next year.

Ruchi Vora So the worst case scenario you are saying by H2 FY13, we should see some improvement?

Vir Advani Yes, absolutely.

Moderator Thank you. The next question is from the line of Pritesh Chedda from Emkay Global. Please go ahead.

Pritesh Chedda Just a question on the working capital side on a Q-o-Q basis, what has changed? Have we started receiving from the debtors or it's any other item which has actually contributed to the reduction in the working capital? What is your take going ahead?

Vir Advani The capital employed has improved on three counts. One is we have managed to get our inventory down considerably. Second is, our debtor position has improved. The third one is, as we mentioned to you in Q2, that we had reduced our payables considerably because we needed to get vendors to come forward to close out the jobs that we needed to close. Having paid out a large amount in Q2, we were able to control some of that in Q3. But the main benefit has come from inventory and debtors.

Pritesh Chedda Can you tell us what is the net working capital cycle is for the company now? What you see this number in the incremental quarters how it should be now?

Vir Advani If we look at our projects business, we are still operating at about 180 days or so. That has to be brought down to about 100 days. Of course, it is down from over 200 days, so we are making progress. I think in Q4 we will see significant progress and as we enter into the year, you will see quarter-on-quarter improvement once we get down to about 100 days.

Pritesh Chedda What is the inventory that we are carrying on the books from the raw material side? And second, I just want to match this with a question, we have taken corrections in the costing for projects.

Vir Advani Yes.

Pritesh Chedda Now if the raw material from here on goes down, does it make room for improvement in margins on those same projects because the losses and costings would have been pre-booked?

Vir Advani In our projects business we do not keep inventory. If it is project based inventory we call it WIP, it will be sitting at the project waiting to be billed but that will be a very small amount because we don't have large warehouses at site. So that is relatively small compared to the balance sheet. In the projects business, you are right to say that we may see some commodity price reduction going into the new year and that will be a positive contribution to our profitability. For us, in the projects business steel is the largest input and copper is a largest input projects business. Steel as well as copper in our electrical, these are both large. Steel, it does not seem to be moving and copper has again started rising. Given the dollar impact and the fact that all these are imports; we are not really seeing any benefit coming in on raw materials.

Pritesh Chedda But it is safe to assess that while you guys did your costing you would have extrapolated the current costing and just checked whether I am off the project or I am in the money in the project?

Vir Advani That is right.

Pritesh Chedda My last question. Do we have FX loan on the balance sheet? And second the $75 million is a hedge exposure against our payables and receivables?

Vir Advani We do not have any Dollar borrowings. This $75 million is the net exposure we have, net of export and import. This is largely around our equipment business where we I have mentioned we are importer both components as well as sub-assemblies and some finished goods that is the exposure.

Pritesh Chedda And out of that, 30% is hedged?

Vir Advani Out of that now we have increased our hedge to about 70%. What I mentioned of the call is that our old policy was between 35 and 55% which is what we had kept it up to in Q2 and then that is when the Dollar started running the way it did. So we slowly have managed to increase that to 70, because the cost of covering has also gone up, so we are at about 70%.

Pritesh Chedda This should be net import for us?

Vir Advani We are a net importer.

Pritesh Chedda What is the Rupee-Dollar at which we have hedged?

Vir Advani Average it would be around Rs49-50.

Pritesh Chedda Many thanks to you and all the best.

Vir Advani Thank you.

Moderator Thank you. The next question is from the line of Amit Dalal from Tata Investment Corporation. Please go ahead.

Amit Dalal Volatility in raw materials perhaps has taken place much more in the period say, 2006-2009 than what has been experienced in the last year. Obviously there is some lesson that perhaps has to be learnt from this order booking exercise that you all have done last year and the problems which have come in. What would you enumerate as the two or three sectors of projects which you took up last year which really created problems for you and perhaps you would like to avoid going forward from here?

Vir Advani There are three problem areas. One is there were about 15 or 20 old jobs, and when I say old these go back to 2007-2008, so these are running jobs for 3-5 years. These jobs were actually smattering across the board, but largely with builders of lower repute, guys who ran out of money mid-cycle we had the material stuck there unable to move out and unable to bill and collect. So one lesson is to be careful about the builder community, whom we work with. Also we need to have the right terms of payment. Because really what went double whammy was prices collapsed as well as terms of payment got much worse. So we ended up accepting 60%-70% on delivery which is fine if it is a running job. But if the jobs get stalled for a year or two then you begin to see what happens to your balance sheet and that is where we are in. So that is one segment. The next one is in our electrical business especially in our south electrical business which we acquired about three-and-a-half or four years ago. Actually there was nothing wrong with the order book we inherited. Infact we found that the problem is in the orders booked subsequent to the acquisition. I think it is over 60% odd of our problems. I think we should have been much more mature about our costing. We perhaps underestimated the gestation period. Over and above that copper did move dramatically between 2008 and 2011.Copper is a very large content in our electrical business. So it is a combination of experience as well as copper really playing havoc with us. In the third segment that we did enter as a result of getting into the electrical and plumbing businesses, has been the residential

segment. Taking electrical, plumbing, fire fighting contracts in the residential building market has turned out to be a lesson we learnt. These are jobs very long gestation, very heavy labor content, big risk of theft because you are working in multiple tens and hundreds of flats at a time and you are unable to manage the security across such a wide spread project. So I think that is a segment that we have decided to take on very selectively. We will work with customers only with whom we have a running relationship that we are comfortable with. In case of infra projects, like metros, power & airports, we have been relatively okay with metros. But power and airports is where we have been facing some problems. These jobs for which original contract period was 12-15 months and even after 36- 44 months we are still nowhere close to completion. So I would say these are some of the learning's which we have taken in already starting June. So we clearly see a change going forward.

Amit Dalal Two other questions, one is you mentioned that you have improved your working capital, your total capital employed. So can you tell me what is the total outstanding debt of the company as on 31st December?

Vir Advani Rs460 crore which is down from Rs620 or so in September.

Amit Dalal Last but not the least you have made an announcement in expanding into the retailing segment for your unitary cooling. What type of a capital employed do you see taking place over there?

B Thiagarajan It is very impressive. The debtors is approximately 31 days. It all operates on post dated cheques of 30 days. I think the real question there is the inventory basically because you plan for the summer and do it. As you know last summer the whole industry anticipated more than 35% growth. That is how the inventory was built and for the nine months we had to carry that inventory because the summer was not severe. The market had actually de-grown. We had grown by 29%.

Despite growing by 29% April, we carried lot of inventory in May & June and subsequently it got liquidated by December.

Amit Dalal Right now, for instance in that business you would have a capital employed of Rs100 crore?

B Thiagarajan Much lesser. It will be around Rs70-80 crore. I am talking about the working capital not total capital employed, which is more relevant.

Amit Dalal Mr. Vir, you mentioned another thing that you have changed the management in your electrical business or the project business because you felt that there was a different focus required. Were these the same people who were running it from 2006 to 2009 or was it some different team? Because obviously it is the order booking which has really created a problem for you in 2010-2011.

Vir Advani It was the team that has been in the business for the last 5 to 6 years and so we had to make some changes there because we realized that the direction was clearly not right and so those changes were made. They were made at about June-July of this year.

Moderator Thank you very much. The next question is from the line of Sanjeev from Kotak Securities. Please go ahead.

Sanjeev Wanted to know the breakeven level at which our central air conditioner business could be profitable?

B Thiagarajan The cost of that particular business on an annualized basis next year will be somewhere around Rs110 crore. So assuming that it is a 10% margin, that business should do around Rs1100 crore of turnover.

Sanjeev Basically what you are saying is that at Rs1100 crore revenue level….

B Thiagarajan Assuming at today's cost level, but let us say if only 1000 crore is possible, the expenses have to be cut because the cost includes the manpower. And you need to cut down the month or also the working capital will come down.

Vir Advani And, therefore, our interest costs will come down.

B Thiagarajan Our guess is that, even in this situation anywhere between Rs800-1000 crore of business can be done. At around 12% margin it may be possible.

Sanjeev Is it possible to throw some light on the steady state fixed cost as a percentage of jobs sales at current revenue level?

Vir Advani Like I mentioned this is a contracting business so it is not fixed in the sense that we do not have factories and CapEx. I think fixed is really about the manpower and the teams that we have deployed as well as the capital employed in the business. So there is a cycle time to reduce those costs. There is also currently a large amount of work to be done to close out the jobs that we want to close, which I mentioned to you. Our main focus right now is to close a large number of jobs between now and April-May. So as we close out jobs, we free up capital and we free up manpower and we free up teams and that is how you reduce that fixed cost I am calling it, it is perhaps the wrong accounting language. But that fixed cost as it were begins to fall from Q1 and then we will make sure that we keep that cost at a level that can afford the revenue that we are able to process. The issue right now is not the carry forward order book. For this segment I think it is some Rs1900 crore right now out of total Rs2100. So actually the order book is not a problem, it is the pace of the order book that we want to control which is the issue. We are literally watching it month-to-month and we will free up manpower, etc., if required.

Sanjeev On the execution cycle, we have had problems with some projects which have actually turned out to have much longer cycle. So are we now working on having lower execution cycle time?

Vir Advani Actually, that is not what we are doing. In fact as I mentioned to you, our focus is now on MEP projects where we are differentiators & do not have small contractors playing around with prices and terms of payment. Larger MEP projects by definition will be longer gestation. So our strategy going forward is to reduce the number of projects we will be executing, there will be larger value and hence will be able to manage much more tightly. But since a consequence of that will be a longer gestation.

Moderator Thank you very much. The next question is from the line of Hardik Doshi from First Voyager. Please go ahead.

Hardik Doshi My first question was actually on segment 1. Of the Rs1800 crore order book, we are expecting an overall a 5% or 6% hit. So that works out to roughly around Rs100 crore.

Vir Advani Yes.

Hardik Doshi Now we have taken 7% hit on Rs1000 crore; we have already taken about Rs70 crore through our P&L and another Rs30 crore we expect to flow through in the 4th Quarter?

Vir Advani Yes.

Hardik Doshi Now after this is done and excluding the impact of these stalling of projects that you talked about, what is the normalized margins that we are assuming after these cost revisions?

Vir Advani So there they carry forward that is still needs to be executed which will be at a lower margin. So FY13 I do not think we would see any dramatic improvement to historical levels. Historically Segment-1 has

been operating at about 10% or so in our operating level. Currently it is obviously at a negative. It is our sense that next year we will be somewhere in between. We will be in the 5% range and it is only in FY14 where you will begin to see it going back to 8-10%. It is too early to talk whether it will be 8 or 10 but next year that slide will be in the range of about 5%.

Hardik Doshi What you are saying is even after these costs revisions that we are taking on and the cost hits that we are taking in FY12, the normalized margins are still around 5%. On this Rs1800 crore book that is there?

Vir Advani Yes, that is right.

Hardik Doshi Can you just give an update on your demand environment? I think the last time we spoke to you, you were talking about demand for the industry being down about 30% year-over-year and we were actually being more selective.

Vir Advani Yes.

Hardik Doshi So how is that tending and how is the competitive landscape, any changes out there over the last month or so?

Vir Advani No changes, market continues to be challenging. Market is down about 25-30% as is our inflow of orders. I think we also have slowly customers moving to MEP. So it is time you will see a lot of more MEP projects getting finalized. To that extent maybe our addressable market has improved but on the flip side like I had mentioned, we are staying away from certain segments of the market. So net-net addressable market stays roughly the same and it is sluggish. I am not seeing anything changing in Q4 and from what I have been told from customers we will be going into the new financial year, there is going to be no significant change in that. So we all have to just get used to a lower volume of business until the next cycle kicks in.

Hardik Doshi The competitive intensity, obviously we are holding back on orders until we get the margins as we want.

Vir Advani Yes.

Hardik Doshi But how is the competitive intensity otherwise?

Vir Advani I think the organized players are all following similar strategies. We have not seen any ridiculous pricing in the market right now. But on the flip side we are seeing smaller contractors, sub-50 crore volume and size of contractors who are getting aggressive in the smaller jobs. My sense is that there will be a 12 to 18 months cycle before they hit a wall and problems come. But for now in the smaller jobs, they seem to be very aggressive. So we are staying very far away from that segment of the market.

Hardik Doshi Then my second question is on the Segment-B where our margins are below 5% now. You mentioned when you took a price increase of somewhere between 5 to 15%. How much more pricing action can we take currently? And second is, any localization initiatives or anything else that there is that will get us back to the normal margin levels that we were at?

Vir Advani I will just refer to the margins and I will hand over to Thiag to give some color around it. Essentially if you look at the numbers for the quarter we had segment result of under 5%. YTD it is about 8%. Last year it was about 11.8% full year. We are anticipating this current financial year,FY12 we will end at about the YTD level of 8%, so there has been an erosion over last year. So that is how the current year will end. There is very little you can do right now to affect JFM margins. So we hope to manage at about 8%. Going into the New Year I will ask Thiag to just give us some source on margins for the whole year.

B Thiagarajan The import content on various products are different. Actually there are room air-conditioners or the refrigeration products such as deep freezers and water coolers. Basically the initial part of the year was impacted by copper and other commodities, the later part due to the exchange rate. Right now in January around 5% average price increase has been implemented. In room air conditioners from February it will go up by an additional 10%. So overall, we will get back to the YTD margin levels in cooling products segment in Q4. And I think in Q1 the same level of margin will profile.

Moderator Thank you. The next question is from the line of Kashyap Pujara from Enam Securities. Please go ahead.

Kashyap Pujara Basically I wanted to ask, if you can give us some color on the margins that you are bidding fresh orders at on the MEP front?

Vir Advani So we are back to around 12%, which is where we have been historically

Kashyap Pujara What is the kind of traction we are seeing on the domestic front in terms of fresh orders?

Vir Advani Like I mentioned to the earlier call also, our order inflow is round about 25%. My sense is the market is also down about that much. We are focused on existing customers and we are focused on balancing our order book right now. So literally we are down to deciding how many hotels, how many hospitals, how many offices, how many retail malls we are willing to take. We want a balanced book. We do not want overexposure in any one segment which is something that we made a mistake last time around. So that is how we are progressing. The one part of the market that is completely quiet is the infrastructure market. I think the one and only job we really focused here was Bangalore Metro and unfortunately there has been nothing really finalized currently. They are settling to start finalizing airports and some metros

starting Q1. We have no sign of that right now. That is a troubling sight. Other than that what I am seeing is that jobs are getting delayed for finalization. So what you expect to get finalized in a quarter again is delayed 3 to 6 months. But they finalized an order; fortunately they want to start the site work immediately so at least you have visibility in your costs so that is the other advantages. The project starts within three months of booking a job, you have a chance to lock in your pricing immediately, let us say for the execution which is something that did not happen over the last two years where you are booking a job in one month and then it took up to 6 to 8 months to even start before engineering was finalized and unless our engineering is finalized you cannot place orders and if you cannot place orders in nine months then any estimated cost that you got from vendors at the time of booking are no longer valid. So for us frankly we are better off booking smaller amounts in business currently rather than just jacking up the order book. But then quickly moving to engineering and procurement, finalizing pricing and then the next process is to control delivery. We will purely base it on the cash flow on the projects and if cash is moving we will deliver to the extent it is not remote.

Kashyap Pujara In terms of your peer group, like say your key competitors in terms of your domestic MEP business, is the margin profile overall returning to normalcy? Like say be it Sterling Wilson or be it Voltas, all of you all are bidding at the similar site level margins now or is there undercutting yet prevalent in the market like it was few months back?

Vir Advani We tend to walk away fairly quickly, so I am not sure where they finally land up. So wherever we sense that there is such movement we feel we just walk away from projects. So I cannot comment on what they are doing from their margins. But by and large I have not seen any irrational behavior over the last 3 to 4 months.

Kashyap Pujara Lastly from your overall order book of Rs1800 crore that you are giving, how much would be the quantum of orders that would have been won this year carrying say a profile of 12%.

Vir Advani It will be about Rs400-500 crore.

Kashyap Pujara So which means that as you completely take the correction in your current order book on the past, you will be hopefully returning back to normalcy in the next fiscal, at least second half?

Vir Advani Yes.

Kashyap Pujara Just a last question, and that is about the cooling products, typically the air-conditioning division. You had correctly mentioned that the industry was anticipating a stellar growth and there was reasonable inventory and after that we have seen the market slide. Demand and cost factors both have worked out to be unfavorable because we had on one side cost pressures, so we increased the price and demand was also coming down. So you had a double whammy of the sorts. Now going forward, considering that it is a seasonal business, 60% to 70% off air conditioning sales happen in the Q4 and the Q1 and right now we are seeing a severe winter. Coupled with that, you are having star ratings that are changing from this January. So are we going to see a situation where actually the dealer would tend to give away too much discounts and there would be a pressure to de-stock?

B Thiagarajan Two corrections, one is that though the industry de-grew by 15% we had grown by 29%. It is basically because of the retail entry. Our problem was with regards to carrying inventory for a large part of the period. The second part as far as the severe winter or the normal summer, there is no correlation. If you see a 50-year data also, summer can be severe, it is unpredictable. Assuming that there will be a normal summer the price levels in the market will be indeed higher. Now going by the penetration, going by what happened during the

festival season which is October, November, December, the market has not been bad. Those three months were very good for the industry. So we all anticipate somewhere around 15% growth in the summer. And as far as discounting is concerned, I do not know, dealers have the power to discount it at all. If he discounts, it is on the dealer price he is going to discount. It is not going to affect my margins at all.

Moderator Thank you. The last question is from the line of E. A. Sundaram from M3 Ivestments. Please go ahead.

E. A. Sundaram **In the segmental results there is one element where I need some clarification. In the last item it says 'unallocable corporate liabilities'. Your total capital employed has come down in segments. But if you see the unallocable cost of liabilities they have also come down. So the total capital employed really has not come down between September to December. So can you please explain what goes into the calculation of this cycle? It has come down from Rs420 crore to Rs269 crore.**

Vir Advani **You are right.**

E. A. Sundaram **What really is it? And the last item is total capital employed in the company has fallen only from 562 to 529.**

Vir Advani **Can I do one thing, can I revert to all of you all on that. I have been explained that it is on account of our bank borrowings having reduced and therefore been shown but I need to get into that and revert to you. What important, however is, I will just repeat what we are clear about is that the Segment-1 capital employed has actually reduced in the business to the extent that we have shown, to that extent that there is this unallocable amount is also reduced, I will revert to all of you all in writing.**

E. A. Sundaram When answering one of the earlier questions you mentioned that the net working capital cycle has fallen from 200 plus days to about 180 days and your target is to reach about 100 days. But if I see the average of the last decade except the last year, the inventory days as average between 35-40 days of Blue Star and the debtor days has ranged between 65-70 days. So will the 100 plus days become the new norm?

Vir Advani Again I was referring purely to the projects part of the business, not even Segment-1 and all that. In that particular business the capital employed was hovering around 200 days, that is how under 180 and we are bringing it down to about 100.

E. A. Sundaram In the projects business, related question is, what was it earlier? If it is your target to keeping it to 100 now, what was it earlier before the trouble started?

Vir Advani Around 50 days. I am not able to see 50 days returning any time soon. I think 50 comes when the market is on an upswing. Because you have very fast velocity in projects which is what helps you in reducing the capital employed, to that level. But I think at the current level, for us at least it is unmanageable. Therefore we decided to reduce it significantly. I think a 100 days is what is manageable in the current scenario. I feel that when the next cycle of growth comes which will be around FY14, you will see that 100 days drop down to 50 days again.

E. A. Sundaram My final question Mr. Advani is, just like in the power projects, is there any aggressive competition from Chinese in your business, especially in the EMP business. Are they bidding at much lower levels compared to the Indian competitors? What is your experience there?

Vir Advani We have not seen from China anywhere close. We have seen Japanese contractors coming into the market because of all the FDI coming in from Japan. But they work in different models. They work

like the Koreans where they will take a turnkey contract but then they will come to a company like us to actually handle the MEP. So frankly we have not seen any new competition enter the EMPG market.

Moderator Thank you very much. I would now like to hand the conference over to Mr. Vir Advani for closing comments please

Vir Advani Thank you very much everyone for attending this call. If there are any questions that remain unanswered, do send us in writing and we will try our best to respond as soon as we can. We look forward to our next call at the end of the year.

Moderator Thank you very much, sir. On behalf of Blue Star Limited, that concludes this conference.