

Blue Star Limited

Conference Call Transcript

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Blue Star Limited

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PRESENTATION

Good morning, ladies and gentlemen, I'm Sulogna, the moderator for this conference. Welcome to the conference call of Blue Star Limited hosted by Motilal Oswal Securities Limited. We have with us Mr. Srinath Mithanthya, Senior Vice-President (Mid Cap Research) from Motilal

Oswal Securities Limited as your call leader today, and we also have Mr. Vir Advani, Head-Investor Relations from Blue Star limited. For the duration of the presentation, all participants' lines will be in the listen-only mode. After the presentation, the question and answer session will be conducted for the participants in the conference. Now I hand over the call to Mr. Srinath Mithanthya. Thank you and over to you Mr. Mithanthya

Srinath Mithanthya Senior - Vice-President - Motilal Oswal Securities Ltd.

Yes, good morning, friends. This is Srinath from Motilal Oswal Securities. I am pleased to introduce to you Vir Advani, who is head Investor Relations and he also handles the CEO portfolio for Blue Star Design and Engineering, and along with him, we have B. Thiagarajan, who is Executive Vice President. The two will be handling the call from Blue Star's end, and without any further delay, I hand over the floor to Vir. Vir, please take over.

Vir Advani, Head - Investor Relations - Blue Star Limited.

Thanks Srinath. Good morning, ladies and gentlemen. This is Vir Advani, and I am accompanied

Blue Star Limited

by my colleague, Mr. Thiagarajan. We will be giving you an overview of the results for Blue Star Limited for the period ended September 30, 2006. I will then open up the floor for questions. So, feel free to ask me at that time.

The following are the financial highlights of the company. We have reported a total income of Rs. 376.7 crore for the quarter ended September 30, 2006, which represents a 32% growth over the corresponding quarter in the previous year. Net sales for the quarter at Rs. 375.9 crore up by 33% over Q2 of FY2006. For the half year ended September 30, 2006, total income grew 34% to Rs.689.5 crore compared to the first half of FY2006. Net sales over the same period also grew 34% to 512 crore. Our operating profit, which is EBITDA excluding other income to the quarter was at Rs. 32.8 crore. That was up 67% as compared to EBITA of Rs. 19.6 crore earned in Q2 of FY 2006. Owing to prudent value engineering measures as well as better price realization, the operating margins increased significantly to 8.7% in the second quarter of FY2007 compared to 6.9% in Q2 of FY2006. I will talk a little bit more about margins later. Other income for the quarter was at Rs. 81 lakh as against Rs 200 lakh in the same quarter of last year. Net profit for the quarter was Rs. 18.4 crore, up 59% over

net profit of Rs. 11.6 crore for Q2 of FY2006. On the order inflow side, for the period April to September 30 2006, new order inflow was at Rs 925 crore representing a 46% increase over Rs 633 crore in the same period last year. As a result, the carried forward order book as of September 30, 2006, stood at Rs 788 crore compared to the order book of Rs 540 crore as at September 30, 2005. This also represents a 46% increase over the last year.

That is as far as the overall company numbers go. 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 half-year. I have chosen to review the half-year as quarterly results have limited meaning for most of our business. However, once I am done, if you have any specific questions on lines of business in the quarter, please feel free to ask me those questions. Starting with the first line of business, that's our central air conditioning business, this business continued to contribute significantly to the overall growth of the company. This division grew by 34% during the first half of FY2007, Rs. 461 crore in revenue, and represented 67% of the overall business for this period. The operating profit grew 43% Rs. 42.9 crore during this time. The operating margin improved from

8.7% to 9.3% for the first half. Operating margins in this business have improved in spite of increasing raw material pressure. While the gross margins have been maintained at last year's levels as a result of better price realization and volume growth, the operating margins have improved as a result of operating efficiency and tight control over variable costs. The domestic IT, ITES, and retail sectors continued to fuel the demand for central air conditioning during this period. In addition to these markets, some emerging segments like telecom and airports contributed to the healthy order booking in this time. The company bagged a significant order to air condition over 2000 cellular sites from a leading network operator, as an example. The airport side, although a small start, the company won the HVAC contract for Nagpur International Airport and expects to win several more projects in this sector in the coming 9 to 12 months. We are also seeing investments in the power generation sector, which should come on line towards the end of this financial year and contribute towards next year's revenue.

On the international front, as we had explained at the analysts' meet in May 2006, we are in the process of formalizing our re-entry into the Middle East projects market. We are expected to

commence operations in Qatar in Q4 of this year. As far as product exports are concerned, progress is very encouraging and we are targeting a billing of close to Rs. 100 crore for this financial year. For the first half incidentally export billings stood at Rs. 44 crore.

Moving on to our second line of business, i.e., cooling products, cooling products also performed well for the first half, growing 34% during this period. Operating profit grew 46% to Rs. 10.8 crore in the same period. The majority of the growth in the segment was the result of substantial room air conditioner volume growth during the first half. Within these product segments, split air conditioners witnessed the highest growth. The commercial refrigeration business, which is also a part of cooling products had a respectable first half; however, with large investments expected in the food, retail, and supermarket segments toward the end of the current financial year, and into the next year, the future of this business looks very encouraging. I am sure many of you would have questions about the cold chain that I will be happy to answer specifically when we break out for questions, but as far as the first half goes, to summarize commercial refrigeration had a good first half but nothing exceptional simply because many of the

announced investments will only start to materialize into orders toward the end of this year and the beginning of next year as I have already mentioned to some of you in the past. However, having said that, the company is formally tied up with ISA from Italy in the second quarter to provide refrigeration technologies and solutions. This tie-up provides Blue Star an access to world-class solutions and is expected to make the company a formidable player in the supermarket refrigeration segment.

Finally, the third line of business, which is the professional electronics and industrial equipment business. It performed exceptionally well in the first half as you can see. Our revenues grew a significant 43% over the first half of FY2006 to Rs. 45.7 crore, PBIT grew 112% to 9.5 crore. This is essentially on the back, as I mentioned before, of our growth across the segments we serve, whether it is telecom, banking, industrial, process industry, etc. As an example, the company bagged a repeat order valued at Rs. 12 crore from Tata Steel, which is related to overhead yard utility type work around the pumps and valves that we supply to them. So, that is just an example of the type of new projects that this group is starting to engage in. So, with that, I have come to an end of summary of each of the businesses.

As far as the outlook for the company goes, I will, of course, answer the questions, but as far as the general outlook goes, we remain optimistic about the rest of this year, and into the New Year. We stick to our earlier direction that we anticipate to grow by at least 25% a year both on the top-line and the bottom-line. Obviously, the first half has shown that we are doing better than that plan, but having said that we do continue to see raw material pricing pressure and therefore have to be a little careful on how we manage the growth going forward, but on a general basis remain very optimistic for all our three lines of businesses. With that I would like to break now and open the floor for any questions that you all might have. Thank you.

Sulogna - Moderator

Thank you very much, sir. We will now begin the question and answer interactive session for the conference participants connected to Airtel audio conference service. Participants who wish to ask questions, may please press "*" "1" on their touchtone-enabled telephone keypad. On pressing "*" "1", participants will get a chance to present their questions on a first-in-line basis. To ask a question, please press "*" "1" now. The first

Blue Star Limited

question comes from Mr. Ankit from Birla Mutual Funds, Mumbai. Mr. Ankit, you may ask your question, now.

Ankit - Birla Mutual Funds - Mumbai

Hi sir. A couple of questions... You mentioned that order inflow, during first half was 935-odd crore. Can you throw some light on what was the big order? You mentioned that 2000 cellular site AC order was received, how much was the value of HVAC and how much was the value of the whole?

Vir Advani, Head - Investor Relations - Blue Star Limited

I don't have specific values of each of the projects that we won during the year. As an example, the telecom order that I talked about was valued at about Rs 26 crore. The airport that I talked about was about Rs 10 crore, but these are not necessarily large or small orders. They were just representative of some of the new areas or industries or segments that are opening up for us. In general, our average order values and central air conditioning range from as low as two or three crore to as high as 30 or 35 crore, and so that 925 would have a fair amount of jobs in the

10 to 25 crore range, which we consider to be a fair value. I do not have right now the specific values against some names.

Ankit - Birla Mutual Funds - Mumbai

Sure sir. So the average ticket size is around 10 to 15-odd crore for your order?

Vir Advani, Head - Investor Relations - Blue Star Limited

No, I didn't say that. Actually I said it ranges from 3 to as high as 30. So, we haven't actually calculated the average, but it is probably in single digits.

Ankit - Birla Mutual Funds - Mumbai

Okay. Second, you have mentioned about good pricing environment. Can you throw some more light on the sales, and rising raw material prices, how do you see margins going ahead?

Vir Advani, Head - Investor Relations - Blue Star Limited

Coming back as I am sure other people will ask the same question, what I was conveying is that if you compare our gross

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margins for the first half of last year to first half of this year, you will see that they are flat. Now, that is in spite of raw material price increase, specifically around copper, aluminum and steel. Hence, how we have been able to manage this increased raw material cost is largely due to two things. One is pricing like I mentioned, so let's talk about that. In general, Blue Star is never L1 as they call. L1 is industry terminology for lowest price. We do not sell on price. We sell on various other platforms. So, typically, we are able to command a premium price in the industry over our competitors and we have shown that right through this year as well. It is not a tremendous or dramatic price premium, but it is there and it allows us to maintain our gross margins in spite of these raw material increases. The other way we have been able to control gross margin, is by doing better purchasing. With higher volume, as you can see coming in, we are able to purchase more effectively, and therefore we have stated in the last year or so consistently that volume growth is very critical for us to maintain an improved margin. So, you are able to see that in this half as well. So, higher volume leads to better purchasing power, which leads to better margins. So as we go into the next year, if raw material prices, which of course we have no control over, if we are able to

see some improvement on raw material pricing, you will also see some margin improvement as well.. Finally, as you can see, we are able to grow the order book by 45%-46%. You are seeing revenue growing by about 35% in central air conditioning. Frankly, we are letting go of a fair number of projects and business that we find have low margins and we are able to do that given the positive environment around us. So, that's another contributor to us being able to command a higher price in the market.

Ankit - Birla Mutual Funds - Mumbai

I was looking at couple of quarterly results. Generally, we reach a turnover of some 380-390 crore specifically in the fourth quarter, which is the highest quarter for us. In the current quarter, which is September 2006, we have seen a turnover close to reaching 380-odd crore. So you can see that things are improving very dramatically, in that sense that revenue is growing much faster? Probably, March 2007, we can see a turnover of, say, 450 to 500-odd crore in a quarter?

Vir Advani, Head - Investor Relations - Blue Star Limited

Blue Star Limited

In general, Q4 is our biggest quarter. So as you can see most of the profit comes in that quarter, therefore we do not anticipate anything different in this financial year. So whatever you worked out for the last few years, there is no change in buying pattern or revenue recognition or anything that would lead to any other situation in this financial year.

Ankit - Birla Mutual Funds - Mumbai

So generally first half is around 44-45% of full year sales?

Vir Advani, Head - Investor Relations - Blue Star Limited

Yes. If you calculated that and telling me that, I will say yes. I have not calculated that.

Ankit - Birla Mutual Funds - Mumbai

Any special reason why professional electronics division's revenues were up by close to 100% during this quarter.

Vir Advani, Head - Investor Relations - Blue Star Limited

I will hand over to Mr. Thiagarajan he will be able to throw some light on that.

Thiagarajan- Executive Vice President - Blue Star Limited

In the electronics division we are basically agents for many multinationals who are dealers in the field, be it medical, be it data equipment, etc. They keep losing the agency and they keep gaining new agencies. There are two reasons now for this huge growth (1) there is increased activity in the market as far as the process industries or heavy industries are concerned. So, there is a positive environment, which is contributing to this growth, as far as the revenue is concerned and order book is considered, TISCO order is also contributing to this growth. Incidentally as Mr. Vir Advani mentioned, you must remember here that the top line is not significant as far as this business is concerned because here we do quite a bit of our sales on high seas basis. So only the Indian agent's commission will get booked in the bottom line.

Ankit - Birla Mutual Funds - Mumbai

Because I was thinking in the first quarter the margins were quite

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low in this segment and second quarter the margins have significantly improved.

Thiagarajan - Executive Vice President - Blue Star Limited

You cannot compute the margins on revenue to bottom line. Here the top line will include only the domestic portion whereas the bottom line will include the commissions received. So that will actually misguide. So we generally do not compare margin percentage in electronic division alone because it is predominantly an agency business receiving commission from the principal. See, roughly if I tell you that business that you are seeing as top line in real value will be equivalent to something like 400 crore or so and majority of the billing would not be reflected because it is the principal who is billing it on the consumer.

Ankit - Birla Mutual Funds - Mumbai

OK sir. That is all from my side.

Thiagarajan- Executive Vice President - Blue Star Limited

Thank you.

Sulogna - Moderator

Thank you very much sir. The next question comes from Mr. Rabindra Nayak from IDBI Capital, Mumbai. Mr. Nayak you may ask your question now.

Rabindra Nayak - IDBI Capital - Mumbai

Good morning sir. Congratulations for good results. I want to know this in professional electronics and industrial equipment can you please get me the break up in which industry you are targeting percentage wise and how it has changed from last year, and can you throw some light on the cold chain basis and also throw some light on the your recent entry into the power business. You just mentioned in your note recently from your initial talk.

Vir Advani, Head - Investor Relations - Blue Star Limited

All right. I will try and answer the three questions. The first one is related to electronics. We do not actually go down into industry segments and try and work that way. We have five lines of business within that division and they range from medical electronics and analytical

Blue Star Limited

instruments, which typically will go into hospitals, healthcare, pharmaceuticals etc. So that is on one side of the spectrum. Then we have a line of business, which is communication equipment, which goes into the high-tech as well as the banking segment. So that is a whole another segment there. Then the third set of products, which are called non-destructive testing machines and that go in defense applications as well as certain process industries and then finally you have pumps and valves, which are typically going to industrial applications. So, it is actually a wide variety of products as well as industries that they serve. We have about 45-50 principals as we call them. So actually from your perspective it will be difficult to sort of map how we do against the industries we serve. For this year for the first half I can tell you that a lot of growth has come from our testing machines as well as from our industrial products, that is the pumps and the valves and the type of work we are doing for TISCO for example, but that is not to say that the banking industry products or the pharma, health care products are not doing well. They have actually all been growing. So just to close up on this line of business I know you have seen much higher operating profit for this quarter, please do not look at the quarterly profit for this business.

We have been saying that in general the business should produce an operating profit close to 20% on an annual basis, which is what it has been doing historically and we do not see any significant change on an annual basis against that number. So whoever wants to work around how this business is going to fare, I think 20% operating margins are fair.

Rabindra Nayak - IDBI Capital - Mumbai

So you mean to say this medical and banking business is actually maintaining its pace, but your test of measurement particularly the telecom sector, the exposure has improved, increased. You mean to say that?

Vir Advani - Head-Investor Relations - Blue Star Limited

It is not only telecom, it also goes into industrial application, it goes into defense applications. Each of our lines of business is doing well.

Rabindra Nayak - IDBI Capital - Mumbai

Can you please throw some light on the cold chain business where

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you see the potential in the domestic market immediately or in the overseas market, and what kind of growth are you expecting going forward?

Vir Advani - Head-Investor Relations - Blue Star Limited

As far as cold chain goes it is a new subject altogether as we all know. It has only got lot of press coverage and a lot of noise in the first half of this year. We have what we call as commercial refrigeration business, which in the last financial year was about roughly 50% of what we call the cooling products line of business.

So if you look at last year's numbers we are talking about somewhere around 100 – 120 crore of commercial refrigeration that we had last year. Now that is not real cold chain as they define it today. There are more cold rooms as well as certain applications that go into smaller stores. Now what is happening is we know that there is a whole supermarket food retail built-out that is going on. You are talking about hypermarkets, supermarkets, convenience stores, I believe over the next two-and-a-half years we are talking about a total market size of some 5000 stores that are going to be built out. Yes we have to keep in mind that each of these stores has both an air-conditioning

opportunity as well as a refrigeration opportunity.

What we have estimated using our own back-of-the-envelope numbers is that over the next two-and-a-half years, assuming that these 5000 stores are built out by Reliance or Bharti or whoever else, there is a total potential for air-conditioning and refrigeration together of about 2800 crore. So the air-conditioning and refrigeration revenue/billing potential over the next two-and-a-half years in the food retail segment is as much as 2800 crore. Now this of course is our own calculation, I am sure in the next six to nine to twelve months, there will be a host of market information available and we will be participating in those, but this is back of the envelope. We would like to garner as much of this potential opportunity as possible.

Rabindra Nayak - IDBI Capital - Mumbai

Sir regarding this power business, can you please throw some light on this electric energy you have just mentioned it in your initial note.

Vir Advani - Head-Investor Relations - Blue Star Limited

Blue Star Limited

Let me clarify just so that there is no misunderstanding. I mentioned that there are new segments that are opening up for our air-conditioning business. I mentioned telecom as one, so all the cellular sites that are being built out in the country over the next five years.

Similarly I mentioned power generation, so to be clear Blue Star is not getting into power generation, we are not getting into electrical power plants or anything like that. I am talking about doing the air-conditioning for power generation industry. So it is a new market opportunity for us because as the investment in power generation increases over the next few years, each of these power plants require significant air-conditioning and we will be participating in that new segment of the market. My colleague Thiagarajan would like to add on something to that.

Rabindra Nayak - IDBI Capital - Mumbai

Okay.

Thiagarajan- Executive Vice President - Blue Star Limited

See Rohit, if you would have looked till 1990, air-conditioning was as predominantly in the

industrial segment like 70% used to be industrial air-conditioning, 30% used to comfort air-conditioning. Between 1990 and till now, it significantly changed and now actually 80% is comfort air-conditioning and less than 20% is industrial air-conditioning.

All the manufacturers stay away because industry was not offering any great opportunity. Now with industry opening up, industry includes actually power generation plants where there will be turbine rooms or for that matter switch gear rooms, control rooms, etc., and the market is also opening up and a only few players are experienced in handling that kind of projects. So apart from comfort air-condition, which are actually IT, ITES, retail, hospital, hotels, etc., industrial also is opening up. That is what it is. So the power generation industry will also offer air-conditioning opportunities.

Rabindra Nayak - IDBI Capital - Mumbai

Thank you very much sir.

Sulogna - Moderator

Thank you very much sir. The next question comes from Mr. Vinod from Prodigy Investment,

Blue Star Limited

Mumbai. Mr. Vinod you may ask your question now.

Mumbai. Mr. Bendre you may ask your question now.

Vinod - Prodigy Investment - Mumbai

Mahesh Bendre - IL&FS Investsmart - Mumbai

Okay. Sir what kind of opportunity you are seeing in the agri supply chain, that is for the fruits, vegetables and dairy products carried from the farms to the stores basically? Is there any opportunity you see?

Sir just wanted to know how this competitive scenario is shaping up. You have improved your margins based on your operating efficiency, is there any pressure on the top-line as well as EBITDA level due to competition?

Vir Advani - Head-Investor Relations - Blue Star Limited

Vir Advani - Head-Investor Relations - Blue Star Limited

That is why I answered the earlier question around the cold chain and I mentioned that the total air-conditioning and refrigeration opportunity was about 2800 crore, of that about a 1000 crore would be in what you are talking about, which is bringing it from the farm to the retail store and I am not including the transportation refrigeration there, because we are not a player in the transportation refrigeration market.

No, actually we have been gaining market share. I am now talking about our central air-conditioning business obviously. We have been gaining market share in the first half as well, we had gained market share last year. There is of course I mentioned to you that we are letting go off a number of projects that we do not think are profitable so there is to some degree competition trying to underbid and win some volume, but so far we have not faced any problems either at the volume level or at the EBITDA level as a result of this. Having said that, we will see competition coming in as the market expands. We promote healthy competition, of course we have two other significant players in the market and they

Sulogna - Moderator

Well I guess his line has got disconnected. We will proceed to the next question. The next question comes from Mr. Mahesh Bendre from IL&FS Investsmart,

Blue Star Limited

are also doing fairly well as you can see. So as far as we can see right now because of the overall market growth, we have not had a problem on this front.

Mahesh Bendre - IL&FS Investsmart - Mumbai

Regarding your 30% growth for this quarter, how much has come through the volume and how much has come through the average realization improvement?

Vir Advani - Head-Investor Relations - Blue Star Limited

The bulk of the revenue growth is from volumes. The price realization I told you would be only to the extent of trying to offset the gross margin erosion due to raw material price increase, so it is not very significant.

Mahesh Bendre - IL&FS Investsmart - Mumbai

Sir, what is the CapEx plan for '2007 and '2008 probably on whole year basis?

Vir Advani - Head-Investor Relations - Blue Star Limited

We intend to continue the current level of investment. I believe this year we will spend about 25 odd crore. That will be a combination of new CapEx and maintenance CapEx and into next year we should maintain the same level.

Mahesh Bendre - IL&FS Investsmart - Mumbai

Regarding the order book, you said you have order book around 1200 crore. What will be the execution period for this?

Vir Advani - Head-Investor Relations - Blue Star Limited

So just to clarify I said that the order book as of September 30, 2006 was 788 crore and not 1200, and the average life of our order book is about seven months, so that is roughly what it is.

Mahesh Bendre - IL&FS Investsmart - Mumbai

Okay. Thank you so much.

Vir Advani - Head-Investor Relations - Blue Star Limited

Yes.

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Sulogna – Moderator

Thank you very much sir. The next question comes from Mr. Vinod from Prodigy Investment Management, Mumbai. Mr. Vinod you may ask your question now.

Vinod - Prodigy Investment Management – Mumbai

Yes, hello sir. I think I missed this part. You were speaking about your different platforms that gives you a competitive edge over your competitors, can you just brief on that which allows you to have a better pricing advantage over your peers?

Vir Advani - Head-Investor Relations - Blue Star Limited

Sure. I will ask Thiagarajan to answer that for you please.

Thiagarajan- Executive Vice President – Blue Star Limited

In central air-conditioning and commercial refrigeration we are a turnkey solution provider that I think is setting us apart, in the sense that we are a designer, we are a manufacturer, we are a contractor, and we are a service provider. This end-to-end solutions offering is there from

Blue Star. This is one of the important parts. The second part is of course around 40% of our orders are actually repeat orders. Lastly our main platform is on the energy saving and of course hassle-free execution that is people trust and hand over their jobs to us. This helps us to be the preferred vendor for most of the major accounts, be it IT, ITES or builders.

Vinod - Prodigy Investment Management – Mumbai

Thank you, sir.

Thiagarajan- Executive Vice President – Blue Star Limited

Thank you.

Sulogna – Moderator

Thank you very much sir. The next question comes from Mr. Rabindra Nayak from IDBI Capital, Mumbai. Mr. Naik you may ask your question now.

Rabindra Nayak – IDBI Capital – Mumbai

Sir, you mentioned about entering into the Middle-East market again. Although your exposure to this market is very

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limited right now, what are the challenges you are facing currently to enter this market and what opportunity do you see. Can you please throw some light on that?

Vir Advani - Head-Investor Relations - Blue Star Limited

Yes sure, a couple of clarifications. We say it a re-entry because Blue Star has executed several projects in the Middle East and Africa right through the 80's and 90's. We were in Abu Dhabi until the early 90's and then came back to India when the Middle East turned sour. We have international operations through a joint venture in the Far East, it is based out of Malaysia and it covers Malaysia, Singapore, and Vietnam.

So we have of course international projects experience; however, what we are trying to do now in the Middle East is basically just enter in the right way because there is of course a very large opportunity in that market. Having said that you need to identify the right markets to enter within the Middle East because, of course, Dubai is the most famous Emirate, but that is not necessarily the best market to enter.

So we have spent some time figuring out the right market, we

have selected Qatar as the starting point, where the Asian Games are expected later. Also we have identified Bahrain as the second market. Having identified the markets we now need to figure out our entry style. That means that you need a local partner there. We have in the process of that. We don't see any specific challenges per se. Frankly, we have been very busy in the Indian market growth, we have been very busy in controlling our gross margins, improving our operating margins for a core domestic business and you are seeing the results of that. Having stabilized that and having brought it up to a fairly healthy revenue growth as well as operating margin improvement we can now allocate managerial and manpower time to the international operations. So we will have gotten going in Q4 of this year and you will start to see returns of that in the next year.

Rabindra Nayak - IDBI Capital - Mumbai

Okay. Thank you very much.

Sulogna - Moderator

Thank you very much sir. Participants who wish to ask questions may please press "*" "1". The next question comes

Blue Star Limited

from Mr. Mehul Mehta from Dolat Capital Limited, Mumbai. Mr. Mehta, you may ask your question now.

Mehul Mehta - Dolat Capital Limited - Mumbai

Good morning Mr. Advani.

Vir Advani - Head-Investor Relations - Blue Star Limited

Hi Mehul.

Mehul Mehta - Dolat Capital Limited - Mumbai

Hello. This is in connection with staff cost, a clarification that there is a performance incentive worth 38 million. So what I want to know is, is it for the quarter, or first half how is it like?

Vir Advani - Head-Investor Relations - Blue Star Limited

I will answer that and then Thiagarajan can clarify further. It is an annual incentive that gets paid out to a lot of our employees as it says in any company that you know, I think the point of that note, if I am correct, is that in this financial year that pay-out was done in the second quarter whereas in

the last financial year it was done in the third quarter because we pay either in September or October. So last year we paid out in October so it showed up in Q3. This year we paid in September so it showed up in Q2.

So to that extent the point of the note was that to look at the staff cost increases on a like-like basis you would have to adjust for that incentive.

Thiagarajan- Executive Vice President - Blue Star Limited

This incentive is a performance-linked incentive. It is a growth where one compared to previous year, how the growth has been and also based on the corporate profits and the performance rating for the financial year. It also includes the customer satisfaction index. We do have somewhat a complicated formula for computation of these incentives.

Mehul Mehta - Dolat Capital Limited - Mumbai

So if I understand it correctly for the year it is done, like for FY '2007, Right?

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**Thiagarajan- Executive Vice
President – Blue Star Limited**

FY '2006 it was booked in the month of September and therefore for the current year, which will end in March '2007, it should get paid out in August, September when we complete the performance appraisal and the customer satisfaction index etc., etc.

**Mehul Mehta – Dolat Capital
Limited – Mumbai**

So that will get reflected in FY '2008 I believe?

**Thiagarajan- Executive Vice
President – Blue Star Limited**

That is right. That is right. The only change as Mr. Vir Advani mentioned is last year it was paid out in the month of October or November. This year it has got paid out in the month of September itself.

**Mehul Mehta – Dolat Capital
Limited – Mumbai**

Great, thank you. And one more question is on room air-conditioner business. Can I have volume growth in that and value growth?

**Thiagarajan- Executive Vice
President – Blue Star Limited**

It is roughly in excess of around 55%.

**Mehul Mehta – Dolat Capital
Limited – Mumbai**

Room air-conditioners volume growth?

**Thiagarajan- Executive Vice
President – Blue Star Limited**

Room air conditioners. If you are within that there are three product categories. One is the window air-conditioner, or the bedroom air-conditioner, another is the split air-conditioner, another is the (indiscernible) air-conditioner. So the split air-conditioner growth is in the excess of 70%.

**Mehul Mehta – Dolat Capital
Limited – Mumbai**

But this you are giving me volume numbers?

**Thiagarajan- Executive Vice
President – Blue Star Limited**

Volume as well as the value, because there has not been any significant price difference.

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Mehul Mehta - Dolat Capital Limited - Mumbai

Okay. Thank you.

Sulogna - Moderator

Thank you very much sir. Participants who wish to ask questions may please press "*" "1".

Srinath Mithanthy Senior - Vice-President - Motilal Oswal Securities Ltd.

Vir, I have a couple of questions rather. Firstly, if we could provide a breakup of our orders by segment if any. That's number one. Also by national accounts and new accounts that could be another possible breakup. The second question would be the status of our tie-ups, I mean we just talked about ISA, but I believe during the quarter we also entered into tie-ups with Danforth, Food Control Equipment and Bitzer. So what is the status of those tie-ups and what is the potential from these tie-ups?

Vir Advani - Head-Investor Relations - Blue Star Limited

So we will just answer one by one on the order book that you asked about. About 80% of that order book is central air-conditioning, probably another 12% or 14% would be cooling products and the remainder would be professional electronics and that has typically been the ratio.

Within central air-conditioning about 45%-50% of the orders booked would be in the IT, ITES retail segment. All right. So that is one view of it. I do not have on this call breakup of new business verses our repeat orders verses what we call national accounts.

National accounts is for other people's clarification are essentially captive accounts where Blue Star as we enter into annual contracts with them and basically they give us a 100% of their business regardless of the geography that they are in, so it is a kind of a repeat order, retention, customer satisfaction, model that we run.

Approximately 30% of our overall business is through national accounts in general, but I do not have as far as the order book goes for the first half what is that percentage, but I can estimate that will be about 30%. We will try and start providing that on a quarterly basis as well, and fill you in on the progress of that. What is most important is that the national account strategy is

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working very successfully and it is obviously more profitable for us from a customer management perspective. As far as the other relationships go outside ISA let me ask Thiagarajan to give you a couple offerings from those.

Thiagarajan- Executive Vice President – Blue Star Limited

See, far as the ISA Italy is concerned after the MOU we have progressed well on training of sales and service personnel and we are on a parallel basis working on what kind of ancillary equipment can be indigenized, and we have also started bidding for many jobs. We have started receiving some orders including a few orders from Reliance or Café Day or Momma Mia etc., etc., and this I think in Q4 it will start yielding bigger results.

This is a period where there is lot of learning is happening from both sides. Incidentally, if you would know even the customers are in the process of learning. I do not think as we see in the marketplace the big format retailing, as it has happened in the US or Europe is not likely to take place in India because of the high real estate costs. The smaller formats are taking the lead, retailing in smaller towns like Vijayawada, Hyderabad, that kind of stuff. So we will have to align also ISA Italy to capture that

kind of format. You are seeing now the Sarkari Bandar turning into Reliance and this kind of smaller convenience stores format seem to be taking off in a big way than the mega stores. It is engineering, detailing, and our interest will be to standardize the equipment, we have the prime mover advantage now and that we would like to build upon.

Srinath Mithanthya Senior - Vice-President - Motilal Oswal Securities Ltd

Just to clarify, correct me if I am wrong? ISA is largely into display equipment with various designs etc., right. Attractively designed display equipment.

Thiagarajan- Executive Vice President – Blue Star Limited

Yes, a wide range including ice-cream dispenser or islands, they can cater to the retail and supermarkets.

Srinath Mithanthya Senior - Vice-President - Motilal Oswal Securities Ltd

Is this only a distribution agreement or is there eventually technology transfer and local production agreement?

**Thiagarajan- Executive Vice
President – Blue Star Limited**

As of now it is distribution but they are open to consider. See their interest will be to sell their core equipment. And I suppose as we foresee in India it may need some other customization. This is open. Someone else also had separately asked a question with regard to Bitzer, what will happen. In Bitzer, again, it is meant for the cold storages modeler as well as the form in the equipment. Here again, we are trying to build the refrigeration equipment locally at our factory. All our partnerships are like this, in the sense that if we enter by importing, whatever could be indigenized, if the other party is willing we go ahead and indigenize. At the end of the day, it is a competitive market. People look for equipment that is affordable, and incidentally it also depends on what is the custom duty or the free trade agreement. In some cases, it may make sense to import it unless the scale is going to be available.

**Srinath Mithanthya Senior - Vice-
President - Motilal Oswal
Securities Ltd**

Yes. You have touched upon Bitzer, What about food control equipment? Is that...

**Thiagarajan- Executive Vice
President – Blue Star Limited**

I would be frank in telling you we have not progressed much on that. It is our intention to be there, but clearly our focus is to scale up ISA and the Bitzer part of it. The food control thing is, basically, it is called controlled atmosphere storage. It is for life extension of fruits and vegetables. You have to prioritize. Today, we are having far too many things to do. So that is somewhat a low priority. I do not think even in the next quarter, we will progress on that front anything significant.

**Srinath Mithanthya - Senior Vice-
President - Motilal Oswal
Securities Ltd**

And the tie-up with Danforth is high end chillers?

**Thiagarajan- Executive Vice
President – Blue Star Limited**

Danforth is refrigeration air-conditioning component supplier in many respects. One is we buy compressors from them. We buy control equipment like walls from them but the tie-up that you are talking about is with regard to the

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variable frequency drives. These drives are used for reducing the power consumption in air-conditioning, which can bring down the energy consumption by around 25% on the average. So, we tied up with them for this product and we have progressed very significantly. Our energy efficiency related programs, be it in our products or in projects or in energy management services that we render, we are promoting Danforth variable frequency drives.

Srinath Mithanthya - Senior Vice-President - Motilal Oswal Securities Ltd

Yes. One final question is on interest and working capital. Interest has significantly increased and one of the criteria of our bidding for orders is also the payment term. So, the interest costs seem to suggest that are we going a little bit lax on the payment terms or overall how are we managing working capital?

Vir Advani - Head-Investor Relations - Blue Star Limited

To answer that, we have been talking about working capital for the last two or three quarters. So the bottom line is that our working capital is not worse than a year ago, that is the good news. The

bad news is that they are not better than they were last year. So, we have not been able to improve it over last year, but I can say it has not gotten worse. So what is really happening is that the volume of the business is growing substantially. We have also made additional capital investment in factories. So all this is leading to higher debt and therefore higher interest. Having said that, I do not think we are going to be able to significantly reduce the working capital, but we will certainly be able to tighten up some aspects of it. So, we have yet not managed to tighten up those things. We will be doing that. But the reality is that our working capital needs have gone up. We are doing some forward investing into areas like refrigeration and all of those areas as well. So, you will see some of this stretch for some time, but we are certainly cognizant of it and we will try and reduce the overall base outstanding because that is one aspect that we can control. It is not that payment terms from customers have gotten any worse. It is just that we need a little more control over that. So, we will put that in place.

Srinath Mithanthya - Senior Vice-President - Motilal Oswal Securities Ltd

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And you touched up on bulk purchasing some time back. That also has contributed to slightly higher working capital requirement?

Vir Advani - Head-Investor Relations - Blue Star Limited

Maybe I can explain that. There are couple of things. On the one hand, what I meant is centralized purchasing means that we buy as one organization from a particular vendor, that is one aspect which obviously does not affect working capital, but I think you picked up another point which I probably forgot is that because of some of the raw material price increases that had been forecasted, there was a certain amount of forward buying that we did on certain critical materials so to that extent there is some of that there, but again it is not significant enough to sort of skew this working capital significantly, but it is certainly there.

Srinath Mithanthya - Senior Vice-President - Motilal Oswal Securities Ltd

Also are you seeing an increase the average cost of borrowing itself in line with the higher interest rate or what?

Vir Advani - Head-Investor Relations - Blue Star Limited

It has not gone up significantly, no. I again will be able to get that rate for you and send it out to whoever is interested, our average borrowing rate, but as far as I know it has not gone up significantly over the last year.

Srinath Mithanthya - Senior Vice-President - Motilal Oswal Securities Ltd

Okay thanks a lot.

Sulogna - Moderator

MR. Mithanthaya as there are no further questions from the participants you may go ahead with the final remarks.

Srinath Mithanthaya - Head, Investor Relations- Motilal Oswal Securities Ltd.

Yes sir, please.

Vir Advani - Head-Investor Relations - Blue Star Limited

All right so I think we are done on our end. Thank you very much for the time. I just want to reiterate that the outlook for this year looks

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very encouraging. We have talked about some of the challenges we have around raw materials, increase and of course controlling costs but we have been able to demonstrate now in the first half that we can manage this. The challenge now for us going forward is to convert some of these new opportunities like the retail situation opportunity as well as national projects opportunity and convert that revenue. Like we said we hope Q4 will have some more refrigeration revenue in there although we have to wait for the next financial year to see as how our projects are contributing. We do remain very optimistic about our product export opportunities that are going to cross 100 crore this year and we hope to scale that further next year and that will also contribute favorably to the overall operations of the company for the next financial year. With that I would like to conclude the call. Thanks Srinath and Motilal for organizing this.

You may now disconnect your lines. Thank you for connecting to Airtel audio conference service and have a pleasant day.

Srinath Mithanthaya – Head,
Investor Relations- Motilal Oswal
Securities Ltd.

Thank you.

Sulogna – Moderator

Ladies and gentlemen, this concludes the conference call.