BLUE STAR

PLATINUM JUBILEE

Blue Star Limited
Band Box House, 4th Floor,
254 D, Dr Annie Besant Road,
Worli, Mumbai 400 030, India.
T : +91 22 6654 4000
F : +91 22 6654 4001
www.bluestarindia.com

February 7, 2020

BSE Limited Phiroze Jeejeebhoy Towers, Dalal Street, Mumbai - 400 001	**National Stock Exchange of India Limited** Exchange Plaza, C-1, Block G, Bandra Kurla Complex, Bandra (East), Mumbai - 400 051
BSE Scrip Code: 500067	**NSE Symbol: BLUESTARCO**

Dear Sir/Ma'am,

Sub: Earnings Call Transcript – Q3FY20

With reference to our letter dated January 28, 2020, and pursuant to Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, we are enclosing herewith the Earnings Call Transcript pertaining to Q3FY20 Financial Results of the Company.

The aforesaid information is also being made available on the website of the Company www.bluestarindia.com

Thanking you,
Yours faithfully,
For **Blue Star Limited**

Vijay Devadiga
Company Secretary

BLUE STAR LIMITED MUMBAI

Encl: a/a

\\172.16.31.16\Legal and Secretarial Documents\(01) Blue Star Limited\2019-20\Stock Exchange Compliances\Regulation 30 - Information and Updates\Earnings Transcript\Q3

"Blue Star Limited Q3 FY20 Earnings Conference Call"

January 31, 2020

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

Moderator: Good day, ladies and gentlemen and welcome to the Q3 FY20 Earnings Conference Call of Blue Star Limited. We have with us today from the management, Mr. Neeraj Basur – Group Chief Financial Officer of Blue Star Limited. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference call, please signal an operator by pressing * then 0 on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Neeraj Basur - Group Chief Financial Officer. Thank you and over to you, sir.

Neeraj Basur: Good morning ladies and gentlemen, this is Neeraj Basur. I am happy to share with you that Blue Star has won two more prestigious recognitions during Q3FY20, namely; "Golden Peacock Award for Corporate Ethics" for 2019 and was adjudged "Best Governed Company" [Listed Company: Medium Category] at the 19th edition of The Institute of Company Secretaries' National Awards for Excellence in Corporate governance. We at Blue Star have always endeavored to adopt and implement best-in-class governance policies and practices and these awards reaffirm our commitment to following the highest standard of professionalism and business ethics. I will now provide you an overview of the results for Blue Star Limited for the quarter ended December 2019.

I. Financial highlights for Q3FY20:

Following are the financial highlights of the company for the quarter ended December 31, 2019, on a consolidated basis.

- Revenue from operations for Q3FY20 was Rs 1235.91 cr as compared to Rs 1098.97 cr in Q3FY19, a growth of 12.5%.
- EBIDTA (excluding other income and finance income) for Q3FY20 was Rs 57.03 cr as compared to Rs 42.37 cr in Q3FY19, an increase of 34.6%.
- PBT before exceptional items was Rs 33.24 cr in Q3FY20 as compared to Rs 21.39 cr in Q3FY19, an increase of 55.4%.
- Tax expense for Q3FY20 was Rs 11.97 cr as compared to Rs 0.99 cr in Q3FY19. Effective tax rate in Q3FY20 was 37.8% as against 7.0% in Q3FY19 due to reversal of Deferred Tax Asset created in FY19, arising from higher profitability in Blue Star Engineering and Electronics.
- Net profit for Q3FY20 was Rs 19.70 cr as compared to Rs 13.23 cr in Q3FY19.
- Carry-forward order book as at December 31, 2019 was Rs 2812.40 cr as compared to Rs 2277.43 cr as at December 31, 2018, an increase of 23.5%.
- Tight management of inventories and receivables resulted in the reduction of Capital Employed to Rs 1020.52 cr as on December 31, 2019 from Rs 1173.53 cr as on December 31, 2018.

- Consequently, borrowings reduced to Rs 127.62 cr as on December 31, 2019 (debt equity ratio of 0.15) as compared to a net borrowing of Rs 375.94 cr as on December 31, 2018 (debt-equity ratio of 0.47).

II. Business Highlights for Q3 FY20

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

Segment I revenue was Rs 758.80 cr in Q3FY20 as compared to Rs 655.47 cr in Q3FY19, a growth of 15.8%. Segment result was Rs 39.00 cr (5.1%) in Q3FY20 as against Rs 30.11 cr (4.6%) in Q3FY19. Order inflow during the quarter was at Rs 550.49 cr as compared to an inflow of Rs 684.71 cr in Q3FY19.

1. Electro-Mechanical Projects business

We were selective in bidding and booking new orders in view of the continuing liquidity stress in the real estate and infrastructure sectors which slowed down the pace of order inflow in Q3FY20. The focus continues to be on cash flow and profitability, and faster execution was witnessed in a few select jobs, resulting in good revenue growth.

We maintained our leadership in integrated MEP projects in India.

Some major orders won during Q3FY20 were from, Phoenix Market City (Indore), Chalet Hotels (Bangalore) and Manyata Promoters Pvt. Ltd. (Bangalore).

Carried forward order book of the Electro Mechanical Projects business was Rs 1941 cr as on December 31, 2019 as compared to Rs 1573 cr as on December 31, 2018, an increase of 23.4%.

2. Commercial Air Conditioning Systems:

The commercial air conditioning market, which witnessed phenomenal growth in the first six months of the financial year slowed down during Q3FY20 in terms of billing. However, order inflows continue to be good. We continue to improve our market share in VRFs and Chillers, while maintaining leadership in Ducted Systems.

Key segments that contributed to billing during the quarter were Government, Hospitals, Builders and Educational Institutions.

Major orders bagged in Q3FY20 were from Ambuja Cement Ltd (Jaipur), Telangana State Industrial Infrastructure Corporation (Hyderabad), ISRO (Sriharikota) and Police Headquarters (Mumbai).

3.International Business:

Our international business continues to focus on growth in the Middle East, Africa and SAARC countries. We continued to grow steadily in these markets. Our showroom in Dubai is playing a significant role in demonstrating our products lines and capabilities and helping in securing projects and maintenance jobs.

Our Joint venture in Qatar that executes MEP projects continued to do well. However, order inflow and pace of execution were impacted in Malaysia due to politico economic conditions.

We continued to invest in strengthening our brand in select international markets.

Segment II: Unitary Products:

Segment II revenue was Rs 420.23 cr in Q3FY20 as compared to Rs 391.52 cr in Q3FY19, a growth of 7.3%. Segment result was Rs 7.65 cr (1.8%) in Q3FY20 as compared to Rs 9.39 cr (2.4%) in Q3FY19.

Higher advertisement expenses during festival season impacted the margin.

1.Room Air Conditioner business:

After a slow start to the quarter due to muted festival demand, growth picked up in December 19 and we grew by 10% in Q3FY20 as against the estimated market growth of 5%, thus sustaining our pursuit to improve market share.

In line with the trend observed in the first two quarters, demand continued to be for affordable range of models. Further, close to 36% of the sales was through consumer finance schemes.

Lower penetration coupled with higher demand from Tier 3, 4 and 5 markets should continue to support growth.

2. Commercial Refrigeration business:

Good growth in the processed food, ice cream and hospitality segments contributed to the revenue growth. We maintained leadership position across major product categories such as Deep Freezers, Storage Water Coolers and Cold Rooms.

Our new product categories, namely, Commercial Kitchen, Healthcare and Retail Refrigeration products gained good traction in the market. We continued to invest in brand building and business development to promote our new product range.

Major orders bagged in Q3FY20 were from Reliance Retail, Top and Town, Dairy Fun, Rebel Foods, and Jubilant Foodworks.

3. Water Purifier business:

While the competition is intensifying, we are staying focused on establishing our brand as a trusted one in the category, with well-engineered and the reliable products backed by superior service. With over 1,10,000 Blue Star water purifiers already in the market, the service revenue has begun to flow in. We have established ourselves as one of the leading brands in the e–commerce channels, and on course to break even in the next financial year.

Segment III: Professional Electronics and Industrial Systems:

Segment III revenue was Rs 56.88 cr in Q3FY20 as compared to Rs 51.98 cr in Q3FY19, a growth of 9.4%. Segment result was Rs 17.99 cr (31.6%) in Q3FY20 as compared to Rs 6.86 cr (13.2%) in Q3FY19.

Revenue growth was driven by certain high value orders from Data Security solutions, Healthcare and Non-Destructive Testing business. Regulatory requirements on data localization and increased thrust on digital payments solutions created good short opportunities for Data Security Solutions business. The government's programs for affordable healthcare are also creating various opportunities for the Healthcare business. With the wide portfolio of products and solutions forming part of our offerings, the prospects for this business segment is positive.

III. Business Outlook:

Though the order book is healthy, pace of order inflow slowed down from the real estate and infrastructure sectors due to continued challenges on flow of credit to these sectors. Low penetration coupled with increasing demand from Tier-3, 4 and 5 towns will continue to support growth in the products business.

We will continue to stay focused on driving revenue growth and profitability with a close watch on margins, cash flow and capital employed.

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

With that, we are open for questions.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Renjith Shivram from ICICI Securities. Please go ahead.

Renjith Shivram: Just wanted to understand this unallocable expenditure is higher this quarter, so what is that pertaining to and where do you see that going forward?

Neeraj Basur: Last year's unallocable expenses of Rs 12 crores was net of interest on certain income tax refunds of around Rs 8 crores. In the current quarter, we have incurred certain expenses on office renovation across the country. Broadly, we maintain a run rate of Rs 22-24 crores a quarter, that is about Rs 80-90 crores a year and we will be pretty much on that trajectory for the full year.

Renjith Shivram: And in terms of room AC, last call you told that this year we are expecting around 9.5% kind of margins, so this quarter the margins were low vis-à-vis last quarter where we had this whole issue of inventories and other things, we have to take a pricing thing but despite being a better quarter compared to last year same quarter, why the margins are still not improved?

Neeraj Basur: We had announced in Q2 that we have tied up with Virat Kohli as our brand ambassador and that was done with a conscious intent to further strengthen our brand and in preparation for the summer season. The endorsement with Virat was signed towards the beginning of this quarter and the related expenses that we have incurred have been fully been charged off in the current quarter. This is also a non-seasonal quarter from a sales point of view, so that is getting reflected in the overall margins. That explains why the margins are little subdued, not significantly though despite the charge that we have taken to support Virat's brand ambassadorship.

We expect the margins in segment II to be somewhere in the range of 8.5 to 9%.

Renjith Shivram: How is the overall room AC market growth in FY20 the full year because there is only one couple of months remaining, so how do you see that panning out? How is the summer related stocking up from the dealers?

Neeraj Basur: It is a little early to comment. January is a lean month. The existing indications are that summer is likely to set in as per the normal pattern somewhere towards the end of February and we don't see any reason for a concern.

Moderator: Thank you. The next question is from the line of Sandeep Tulsiyan from JM Financial.

Sandeep Tulsiyan: My first question is pertaining to the unitary products segment. I want to understand two aspects over here. One is, are you seeing any divergent trend between the ACs which are at entry level and which are at a mid to premium level where Blue Star is placed, have you seen a divergent growth?

Neeraj Basur: What do you mean by divergent growth?

Sandeep Tulsiyan: It is one segment growing significantly faster or slower than the other and second aspect that I want to understand is the whole issue in China, is it creating any sort of sourcing issues for Blue Star?

Neeraj Basur: Let me address the first one first. Blue Star's whole focus continues to be mass premium which is the sweet spot for the range of products that we have. We really don't see any change or a shift in the demand pattern for that particular segment because inherent demand remains quite strong. There is indeed a market for the entry level as well which is catered to by us as well as other players, but our predominant focus remains on the mid premium range because that goes in line with the products and the quality position that we have maintained over several years. With overall penetration levels being what they are, there is enough and more room for that segment to continue to grow. The biggest driver remains the intensity of summer season. Once the summer season sets in and continues all the way through till May-June, we don't see a reason why market should not grow and in that context, our endeavor to grow as well in line with our plans.

Coming to the second question, the current ongoing issue in China is around Corona virus. The usual pattern for procurement in our industry is to start placing the orders towards the middle or end of Q3 which is November-December when our POs are released because usually the Chinese New Year which sets in toward end Jan - beginning Feb tends to bring some disruption in supplies. We usually try to stock up a little in advance in the normal course which we have done in the current year as well. So as far as Q4 supplies are concerned, we have either received the raw material or some materials are in transit and we expect the shipments to be received within February and early March. As it stands, the indications are that there will be an additional 10-day shut down across various factories in China where currently there is impact or assessed impact and we will get to know more about the situation towards middle of February and if it tends to be a very short-term phenomena, then probably everything will get caught up and we are not at this point of time visualizing significant impact in Quarter 4.

Sandeep Tulsiyan: My second question is on the EMP segment that I wanted to understand, we do understand these liquidity issues were pertaining in first half also, but growth from few selected segments like railways and government related spends were driving inflows which have been fairly strong in first half. So incrementally if you could highlight which specific segments other than the real estate and infra that you mentioned has seen a very sharp dip or is there probably some sort of a big curve from the government side to restrict ordering in the near term and how does this change your order inflow outlook for the next year that is FY21?

Neeraj Basur: As far as Segment I is concerned, we have been maintaining that we are watching the current liquidity situation and the market very closely, our particular concern being real estate and infrastructure sectors, and not as much government customers. The government segment has a different challenge of not being able to collect as per schedule. Within those constraints and with a very clear eye on the working capital as you can see from our balance sheet as well as the borrowings, we are selectively booking and closing orders. We have to continue to be on this mode until such time there is easing out of market conditions in the customer segments that we operate in because we do not want to take on exposures which we feel may be excessive in the current market context. There is indeed a sense of slowdown in the last few months. It could be in anticipation of the budget and probably once the budget is released, we will know better what measures get announced. Companies are taking time to launch new projects.

Our order book is quite healthy. We got some big orders earlier in Q1 such as Mumbai Metro. The order book has grown quite reasonably and we are quite satisfied with the orders that we have booked. On the pace of execution, we continue to closely watch on how much we should execute with a balance between billing margins and cash flow. We are trying to balance and as and when market conditions improve, we will have the capability to accelerate growth in segment I.

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

Nitin Arora: Two questions from my side. The first one is, you said about AC growth was about 10%, how much did you grow in the other 30% of your business in the segment II?

Neeraj Basur: The growth in room AC business is about to 10% and the other businesses would have grown close to around 6% to 7% and on a blended basis, we have grown 7.5%.

Nitin Arora: Correct me if I am wrong, you are talking about AC from a secondary perspective?

Neeraj Basur: Primary.

Nitin Arora: Why I am asking is that if you are talking about 10% growth in primary in the season where generally primary goes or some of the players or some of the competitors are just pushing primary in this quarter because you have new two players coming next season talking about the Samsung or the other one or two regional players, is it deliberate move not to push primary in this quarter or it is more of a function of an old inventory which is what channel tells us that it is not a product of festive, but still the inventory is there?

Neeraj Basur: The festival season was a bit muted and despite everyone’s expectation didn’t really start as expected and the sales actually picked up towards the end November - beginning December. In anticipation of new product portfolio launch which we have done now in January, there are always some end-of-the-life products which we liquidate through the channel with some discounts and some schemes. In that context, the way the quarter started and the way quarter ended, we are fairly satisfied with the 10% primary growth which is somewhat higher than the market. It is the lowest quarter for the year and in that context, it doesn’t really make any material impact on the full year’s revenue growth. Regardless of that we are quite satisfied with how the quarter ended and of course the channel stocking will determine what happens in Q4.

Nitin Arora: We generally enter into a business, for example, a water purifier, we lost the margins, we got Virat Kohli and we got an impact to end margin. The other companies also get the ambassadors and all but doesn’t get impacted on the margins, so just wanted to understand given a season where lot of new players are coming and pushing the inventory very hard where the market pricing itself in last 2 to 3 years has not gone up, does it concern you in terms of the way strategy is getting driven? Also if you can quantify the 9 months and the quarter 3 water purifier business?

Neeraj Basur: In the last year, the summer season was extraordinarily subdued and everyone including us had cut down on advertising. In the current year's 9 months, not just Q3, we have stepped up on advertising spend as compared to last year, both ATL and BTL. On top of that Blue Star signed up with a brand ambassador after a long time, which has its own commercial consequences which we have consciously absorbed and that in itself an indication about the positive sentiment we have on the market potential and the normalized growth which the market should be able to realize. So these are tactical moves to reap a longer term impact on the category in general. Of course, there will always be competitive pressures from different players that would impact and pricing.

We on our part try to mitigate the pricing pressures by continuing to identify the cost side optimization opportunities that are possible right from increasing the share of our own manufactured products and components relative to fully imported ones and then managing the overhead structure in a manner where the margins remain preserved to the extent possible. However, there will be quarters where due to the timing of certain expenses that we may choose to incur like this quarter as a case in point, we may see that short-term impact but for the full year to date margin performance was a tad below at 7.0% compared to 7.2% last year. For the full year we should tracking at 8.5 to 9% which is lower than our initial guidance because of the additional spend on advertising through the year.. The big determinant of growth and margins in this category will be how the season plays out, so we will just wait and watch.

As far as water purifier is concerned, we are likely to close the full year with around Rs 60 crores of revenue for FY20 with around 2% market share and it is lower than our own expectations. We would have been happy with Rs 80 - 90 crores revenue for the current year and we will be below that by around Rs 20-25 crores. That is fine because it is a process of setting up a new category. Market share will be in the range of 2 to 2.5% for the full year. Next year our expectation is that we should turn breakeven. We have an impact of close to 80 basis points in the segment margins which next year should get neutralized fully.

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

Ankur Sharma: Can you remind us of your guidance for FY20 on both sales and margins for the projects business as also for the unitary cooling products business, please?

Neeraj Basur: Broadly the growth expectation continues to be around 10% to 12% in Segment I and around 15% in Segment II. Margin profile for segment I should hover in the range of around 5% for the full year and in segment II, 8.5% to 9% is our expectation.

Ankur Sharma: The second question would be on the kind of competition you are seeing on the room AC side and I think Nitin also mentioned about Samsung coming in and we heard a lot of media articles also talking about Samsung refocusing on the room AC business, cutting prices, etc., so I don't know if you can talk about a specific competitor or if you can talk about the industry as a whole, what are the pricing trends that you are seeing at this point and how are we versus say the last couple of quarters?

Neeraj Basur: As far as the market is concerned, the pricing continues to be quite competitive. There is no let down on pricing competitiveness regardless of Samsung's positioning. The real test will be what happens in Q4.Not everyone has announced their prices for the product range for the new season, so we have to wait and see. . We are however not expecting any let down on pricing pressures. and are not anticipating any great price correction. If we are able to hold down to the current level of pricing, I guess we will consider ourselves fairly lucky because that is the nature of the market as of now, but this changes very quickly when the summer intensity picks up. A few weeks of high intensity summer and some course correction on discounts and incentives can suddenly change course on the overall pricing and margin realization or a combination of the two. We are being nimble enough to course correct as required in the context. The good news from the market point of view is there is no significant inventory overhang as far as our understanding goes which was the case till two quarters ago. With inventory not being a problem for most players, you can expect some degree of rational decision making on pricing in Q4.

Moderator: Thank you. The next question is from the line of Aditya Bhartia from Investec.

Aditya Bhartia: You mentioned 8.5% to 9% UCP segment margins for the year, but that would imply over 12% margins for fourth quarter, I mean these kind of margins we haven't done for a while, so what gives you the confidence that there can be such a sharp jump in margins?

Neeraj Basur: Quarter 4 is usually quite good because of the overall sales volume and typically there is an element of catch-up in quarters one and four. We are optimistic on that front as there is a basket of products. On a blended basis we think we should be able to do around that range I had just talked about.

Aditya Bhatia: If I remember correctly, you had initially pointed out that you will be looking for somewhere around 10% market share in water purifiers by FY21 and it is around that time that you will be breaking even, so now it appears that we have 2-2.5% market share currently, may be next year we inch it up to 3.5-4%, even at 4% market share breakeven looks possible?

Neeraj Basur: We are somewhat behind our own plans as far as the scaling up of water purifier is concerned but that again it is part of the learning and growing and continuing to improve. Since there has been a little bit of a trajectory correction on our own expectation of growth, we have taken numerous steps to realign the entire operating structure of this business and we had spoken about this in quarter 2 where we are now getting our extended room AC selling force to also sell the water purifier which is resulting in cost efficiencies and as a consequence at around 3% or 3.5% market share, we should be able to breakeven.

We are fairly confident now that the brand is well established, product portfolio is doing well, distribution is spread over 1000 stores with almost 200 cities. We are now in a good place to start scaling up. That is another reason why we have done this reorganization and little bit of rejigging in our own plans. We continue to be quite supportive, optimistic and bullish on this category, it is just taking slightly longer than our own plans.

Aditya Bhatia: This is regarding the competitive intensity again on the room AC side, given that some of your competitors have reduced pricing or maintaining similar pricing as last season and given that growth is coming more from the affordable category, do you see that there could be a risk of getting out priced or there is risk of you being required to cut down on pricing?

Neeraj Basur: It is a bit speculative at this point in time to consider that. We will be better position to have a view on this sometime towards end February beginning March, so a little premature to decide any which way at this point in time.

Moderator: Thank you. The next question is from the line of Shrinidhi Karlekar from HSBC.

Shrinidhi Karlekar: I want to understand the supply chain from China a bit more. So you said, we ordered typically in the middle of Q3 that is around November and December and would it be fair to say that the pricing of those contract would be based on prevailing copper cost or a commodity cost and if that is correct, would it be fair to say that the dollar cost of those purchase goods are coming down over last two years?

Neeraj Basur: Firstly, we are comfortably positioned as far as the current levels of inventories are concerned, raw materials, components and finished goods.

On the component side, the copper prices have been fairly stable. Secondly, INR has also been fairly range bound barring instances of very short-term volatility. Of late we see copper prices firming up a little. But again we will watch out for a quarter because by the time we complete quarter four, the inventory for quarter one will start building up. For now we are good as far as the overall component pricing is concerned we don't see a reason to worry too much on that front.

Shrinidhi Karlekar: I guess you would be planning for almost entire summer and you would be placing order in somewhere in November and December. So the copper prices that goes into those products would be largely freeze based on prices which are prevailing in October and November and the price rise that happens through say November to February shouldn't largely affect it should come in the next cycle of purchases. Is that correct largely?

Neeraj Basur: To some extent not entirely, because this would be true if we commit to the offtake volumes in advance for probably six months which we don't do. We enter into rate contracts which are valid for three to four months at that point in time and then we reserve the right to keep moderating the quantum and the volume offtake over the course of next three or four months. We persuade the suppliers not to resort to any immediate price corrections. But if the volatility is high then probably some renegotiations do happen. So it holds true both ways if there's a price dip then also we can renegotiate. By and large, we don't see this to be a problem or a challenge for the next three, four months.

Analyst: Typically we do 70% of business in the first half of calendar year and 30% in the second half of a calendar year and our margins are typically 6% point different in first half versus second half in a calendar year. So apart from the scale of business, which is very different, are there any other reasons why what explains this margin difference in terms of business mix as well as the net realization that you get from the product?

Neeraj Basur: It's purely in scale. Q2 and Q3 are the lowest, and Q3 is the lowest amongst all four. It is largely scale driven and nothing beyond that.

Moderator: Thank you. The next question is from the line of Arafat Saiyed from Reliance Securities.

Arafat Saiyed: My first question is on ad spend, can you quantify what amount you spend on Q3 and in the nine month FY20 versus last year?

Neeraj Basur: We usually do not give that as a public disclosure.

Arafat Saiyed: Okay, so can you just spread some light on that how it has changed versus last year?

Neeraj Basur: Last year because the summer season was quite below normal and we also had a huge amount of inventory pressures so we had to be on a cost containment mode. So both ATL and BTL spends were fairly well rationed last year. This year started on a very positive note with a fairly intense summer. So we have resumed on a normal trajectory of advertising spend.

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

Amber Singhania: Just wanted to understand, by and large the industry imports around 50% of the requirement from China be it on a complete unit or be it on a component basis, compressor completely comes from there. Now, as you mentioned that Q3 mid that is November, December you place an order so the supply must be coming throughout the Q4 or rather four months of the calendar year as such till March, April. Now, if this virus issue prolongs for longer time but how do we see the supply impacting for the industry and the company. Do we see any such things happening, do we have sufficient inventory in the system to produce more units which will be consumed in next three months?

Neeraj Basur: As far as our quarter four selling plan is concerned, both what we need to import in terms of raw material components and our own production lines, we have sufficient raw material and finished goods to cater to the overall supplies that are needed to fulfill sale for quarter four, so we don't see a concern there and equally because this entire thing has happened when the China normally would have stayed close because of their New Year. As of now, this is looking like an extension of that New Year closure by about 10 days. The indications we are getting so far from our Chinese suppliers is that by 10th of February they expect to open up. We have to wait and watch. For now, we are good for Q4. As of now we are not clear on what happens beyond let's say it's a very long or very short or medium term, I think it will be a bit speculative. We will be able to take a view once there is more clarity towards middle of February.

Amber Singhania: Would this be more or less similar for the industry as well?

Neeraj Basur: It should be because for example, everyone imports compressors, most players import copper, though the degree would vary. One good thing is that we have started manufacturing indoor units from last year. To that extent there is a little reduction in that pressure. About 45% to 50% of our IDU requirement this year is going to be in-house manufactured. That does reduce the dependence to some extent but it is a general mixed bag at this point in time.

Amber Singhania: Just wanted to your sense on the overall costing and pricing front as we know that given the competitive intensity it is difficult to increase the prices in the market as such, and we are also seeing that inverter which used to be at a significant premium earlier is now available at a significant competitive priced in the market as such across the brands. Is there any further scope for cost reduction on inverter given we have already crossed 65% kind of penetration as industry. Where do we see the cost efficiency is possible to bring in for the industry as well as for the company on that part in the event that it is difficult to increase the prices?

Neeraj Basur: Four years ago inverters used to be only 15% of the overall market. They are now around 55-60% and as the volumes grow there are some procurement efficiencies and overall economies that can be expected. This gets translated back as price corrections as far as the overall selling prices are concerned. So, some of that is also happening, which is not a concern because of the corresponding material cost savings as well. The pressures on pricing arose as some players have certain short term or tactical reasons could be because of inventory levels, could be because of market share that they may be wanting to achieve, if there is a little extra push to course correct on prices that does put pressure on everyone in terms of price realization.

That is also a usual phenomenon in this particular category and we need to continue to moderate the course of our pricing and discounting pretty much on a monthly basis. That's what we do, because we don't want to compromise on growth or growth opportunities at the same time we want to make sure that a reasonably stable margin profile is maintained again the biggest determinant being the summer intensity. If that tends to be normal, then pretty much we see what we saw in quarter one of this year or years before last. I don't expect it to be any different even going forward.

Amber Singhania: But costing side we have captured more or less whatever was possible barring a few basis point more?

Neeraj Basur: Not really because that's a continuous exercise first one the procurement side, as you procure more you gain from economies of scale. If commodity prices remain stable then of course there are procurement efficiencies that can be realized steadily.

We also have opportunities to continuously do value engineering in our factories and push for a higher proportion of backward integration of example, IDU production is a major initiative in that context. So, when we do more of that, then there are further conversion cost efficiencies that can be expected. So we always alongside our sales plan, also carry cost management plans on the principle of TCM. Which in a way to some extent do help us to mitigate the pricing pressures, not entirely at times, but then one has to look at that pretty much in parallel. Otherwise, it will be a one sided challenge.

Moderator: Thank you. The next question is from the line of Neerav Vasa from Anand Rathi.

Neerav Vasa: I have a broad strategic question with regards to room air conditioners. Considering the fact that the competitive intensity is not slowing down and it is not even expected to slow down. How do we intend to rebalance our supply chain with regards to own manufacturing, contract manufacturing and imports? My second question would be pertaining to the tax rate that we can take for FY20 considering the MAT credit we have?

Neeraj Basur: As far as owned versus contract manufacturing versus import, there is no change in terms of our strategy. A substantial part of what we sell is in the range of 60% is own manufactured. We are looking at deepening the extent of backward integration and the related value that we will capture through the value chain. Our second port of call always is contract manufacturer, the SKUs where volumes do not justify us manufacturing it in-house get contracted out by us. We are pretty agnostic to whether we manufacture those ourselves or through contract manufacturer, wherever we get better economy and the residual fulfillment happens through the CBU import route. That's the structure we follow.

This structure gives us a fair degree of flexibility in terms of optimizing on capacity utilization. It gives us flexibilities around the entire cost structures as well that need to be optimized from time to time. We will be on the same trajectory for some more time. Of course, IDUs for example next year instead of 60% this year will be about 70-75% own manufactured. So, that proportion will go up. Similarly, there could be some other components which we will manufacture in-house.

As far as tax rate is concerned this year, there is a onetime impact of a deferred tax asset reversal which is non-cash. In quarter four of last year we had taken a deferred tax credit because of certain tax loss benefits we had in a wholly owned subsidiary. The good news is, the subsidiary is earning accelerated profits which are visible in segment III results. As a consequence, the deferred tax asset which would have reversed over two or three years is getting reversed in a shorter time span. That's more of an accounting entry than anything else. As far as the normalized expected tax rates are concerned we should be in the range of 27% to 28%. Once we come out of this DTR unwinding and once the MAT assets are fully consumed then of course we will migrate to the lower tax rate, but that's probably a year away.

Neerav Vasa: So, what would be the pending MAT credit that we have at the end of third quarter?

Neeraj Basur: On a consolidated basis we have close to Rs 70 crore.

Neerav Vasa: My last question is pertaining to the water purifier business. Sir, as we are increasing the scale and size of operation, how do we intend to go about manufacturing of it? Would that be on a contract outsource model, in-house manufacturing or imports?

Neeraj Basur: At this point in time, we don't intend to manufacture water purifiers because we are going step by step. Having launched the product portfolioand after having made deep inroads on the distribution and post-sale servicing, we are now prioritizing the economics of this category. The next will be of course to scale it up. So, unless we hit a scale where we believe that it makes economic sense to manufacture in-house we will continue with the contract manufacturing model.

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

Nitin Bhasin: Two questions, one is on the segment I which is the entire MEP business could you give us some sense on in terms of what's happening because we hear a lot about commercial real estate launches being very strong. So while that is good, but also we hear about the government projects being very slow. So if you could give a sense in terms of how is the order book pickup, inquiries of tenders looking like right now and because of this private equity backed retail space or real estate space is there finally an integration of MEP happening or no, so that's the first question?

Neeraj Basur: As far as integrating MEP is concerned, pretty much that's been our differentiator for some years now and that's helped us gain traction on our order booking. We will be amongst very, very few players in the country offering a comprehensive integrated HVAC, electrical, plumbing, ventilation services under one roof. So that anyway is a very firm differentiator and we are doing well on that count. As far as your question on what's happening in the market, yes there are deals which are backed up by private equity players and we do participate whenever possible.

While there is the intent to launch projects, , there is a degree of lag after announcing a project and by the time the project is ready for MEP works. So we have to just wait and see once they achieve finance closure and whether it's going on track and then how the civil part moves before MEP can step in. So there will be a lag even once the market revives in terms of order growth. On the government projects, your comment is absolutely on the dot. While the overall opportunity size looks good, there is indeed a pressure on collections. We don't run a credit risk, but there is a delay risk as far as the government collections are concerned. So one needs to be watchful as far as government projects are concerned. So this segment has its own challenges and unless you keep an eye on the various parameters, it can spin out of control fairly quickly. So that's what we are doing at this point in time.

Nitin Bhasin: So it's largely a muddle through segment in terms of 5%-8% growth and the margins where they are they remain there?

Neeraj Basur: I would not say it will be a muddle, this is a fairly important segment. We have been going through an external environment which has remained challenged for a very long period of time. Having said that, at some point in time whether it's the banking, NBFC, the economy has to come out of the current set of challenges because the country will need to grow. So once the growth resumes this can be a very rewarding segment to be in. I guess we are getting tested out for our resilience in a challenged environment. We are always seen as a fairly stable player and probably that will come to our advantage.

Nitin Bhasin: So second bit in this was, you are a very strong player when it comes to small and medium enterprises and ducted packaged air conditioning system and you are one of the leaders over there. So, and we hear a lot of stress on the SME right now. So do you think that this segment actually can go become more weaker in the next one or two quarters if the SME stress remains?

Neeraj Basur: Well, it's not as much about SME. These are small sized projects where it could be a boutique store, a shop, a showroom, a small restaurant, a hospital. These are not necessarily SMEs, but they are also impacted by the liquidity concerns. So far it has been reasonably good barring quarter three where there is a degree of slowdown. However, probably this sub segment will be the fastest to rebound when the external environment starts to look better.

Moderator: Thank you. Ladies and gentlemen, due to time constraint that was the last question. I now hand the conference over to Mr. Neeraj Basur for closing comments.

Neeraj Basur: Thank you very much ladies and gentlemen, with this we conclude this quarter's earnings call. Do feel free to revert to us in case any of your questions were not fully answered and we will be happy to provide you additional details by email or in person. Thank you.