BLUE STAR

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August 9, 2023

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

Dear Sir/Madam,

Sub: <u>Intimation under Regulation 30 of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (the 'Listing Regulations') - Earnings Call Transcript for the First Quarter ended June 30, 2023</u>

With reference to our letter dated July 24, 2023, and pursuant to Regulation 30(6) read with Part A of Schedule III of the Listing Regulations, we are enclosing herewith the Earnings Call Transcript pertaining to the Financial Results for the First Quarter ended June 30, 2023, of the Company.

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

Kindly take the same on record.

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

RAJESH DIGAMBAR PARTE

Digitally signed by RAJESH DIGAMBAR PARTE
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BLUE STAR LIMITED

Rajesh Parte
Company Secretary & Compliance Officer
Encl: a/a

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"Blue Star Limited's
Q1 FY24 Earnings Conference Call"

August 04, 2023

MANAGEMENT: MR. B. THIAGARAJAN – MANAGING DIRECTOR
MR. NIKHIL SOHONI – GROUP CHIEF FINANCIAL OFFICER

Moderator: Ladies and gentlemen, good day and welcome to the Blue Star Limited's Q1 FY24 Earnings Conference Call. We have with us today, from the Management, Mr. B. Thiagarajan – Managing Director, Blue Star Limited and Mr. Nikhil Sohoni – Group Chief Financial Officer, Blue Star Limited.

As a reminder, all participants' lines will be in listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the 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. B. Thiagarajan. Thank you, and over to you, sir.

B. Thiagarajan: Good morning, ladies and gentlemen. Thank you for joining this call. We had the opportunity to meet many of you on May 5th at the physical meet at Hotel Four Seasons. We had announced the results for FY23.

You may be aware in that conference and subsequently in many interactions including television interviews, the concerns about the unseasonal rains during summer season and therefore, possible impact on room air conditioner sales and how or what we are doing had been raised.

We had said that this was not expected, but we will figure out how we go forward and if we are in the room air conditioner business, we have to cope with these kinds of uncertainties. When it rains, the industry can get impacted. We were also impacted to an extent.

I had always maintained that given the penetration levels in the room air conditioner segment, the long-term prospects for that business will continue to be good and we had gone on to project that for the industry and individually for Blue Star for the financial year FY24, the growth will be at least 10% and the 15% respectively. That had been the direction with which we have been working.

The important thing was, there was a huge build up to the summer because the IMD forecast indicated a very favorable summer season for companies such as ours. Fortunately, unlike the earlier years where one will end up building inventory through the import route, we are relatively better off because of the component ecosystem that has evolved, and the finished goods manufacturing happens locally in a much bigger way than what used to be in the past.

Therefore, there has not been an inventory pressure which could have led to dilution of prices and would have taken a longer time to recover when the festival season sets in.

The second part is Blue Star's own business model where we are not entirely dependent on B2C businesses alone. We have a strong b2b portfolio as well. Fortunately, for us the other businesses, such as electromechanical projects and commercial air-conditioning and Commercial Refrigeration had risen to occasion and these businesses have delivered and partially compensated for the shortfall in the room air conditioner business.

The good news was that the month of June was far better than the month of May, and we are hopeful that in the balance part of the year, even the room air conditioner business, should come back to deliver higher growth than the previous year.

You have seen the Results, and I will hand it over to Mr. Nikhil Sohoni who will take you through the highlights for the quarter. Post that, we will answer your questions, including the announcement that we will raise additional capital. And I suppose many of you will have questions related to that. Thank you very much.

Nikhil Sohoni: Thank you, Mr. Thiagarajan. So, good morning, ladies and gentlemen. This is Nikhil Sohoni, and I will be providing you an overview of the results of the company. We entered Q1FY24 on a strong note on the heels of an exceptional Q4FY23 performance with a record carried forward order book and a promising summer season. While the projects business continued to do well in the quarter, unseasonal rains across the country resulted in muted demand for unitary products. The Company swiftly took necessary corrective actions, and thanks to its diversified B2B business portfolio, delivered good results for the quarter.

1) **Financial highlights for the quarter ended June 30, 2023, on a consolidated basis, are summarized as follows:**

- Revenue from operations for Q1FY24 grew 12.6% to Rs. 2,226.00 Cr as compared to Rs. 1,977.03 Cr in Q1FY23.
- EBIDTA (excluding other income) for Q1FY24 improved to Rs. 145.00 Cr (EBITDA margin 6.5% of revenue) as compared to Rs. 123.31 Cr (EBITDA margin 6.2% of revenue) in Q1FY23 due to scale and better realizations.
- PBT before exceptional items grew 12.8% to Rs. 113.61 Cr in Q1FY24 as compared to Rs. 100.69 Cr in Q1FY23.
- Tax expense for Q1FY24 was Rs. 30.24 Cr as compared to Rs. 26.34 Cr in Q1FY23.
- Net profit for Q1FY24 grew to Rs. 83.37 Cr as compared to Rs. 74.35 Cr in Q1FY23.
- Carried-forward order book as of June 30, 2023, grew by 37.4% to Rs. 5,359.05 Cr, as compared to Rs. 3,901.48 Cr as of June 30, 2022. Carried-forward order book as of March 31, 2023, stood at Rs. 5,042.27 Cr.
- As reported earlier, the company continues to invest in manufacturing capacity expansion as a part of its growth plans and to improve profitability through localization. . Consequently, the capital employed as of June 30, 2023, increased to Rs 1700.00 cr as compared to Rs 1018.38 cr as of June 30, 2022. We also continue to invest in and expand our R&D portfolio.
- Thus, we ended the quarter with a net borrowing of Rs. 283.46 Cr (debt equity ratio of 0.20 on a net basis) as compared to a net cash position of Rs. 81.03 Cr as of June 30, 2022.

- Considering the growth plans and the ensuing capex requirements of the company, the board has approved raising of funds by way of QIP to ensure a balanced and optimum capital structure.

2) Business Highlights for Q1FY24

<u>Segment-I: Electro-Mechanical Projects and Commercial Air-Conditioning Systems:</u>

Segment I revenue grew 19.1% to Rs. 949.12 Cr in Q1FY24, as compared to Rs. 796.76 Cr in Q1FY23. Segment result was Rs. 66.62 Cr (7.0% of revenue) in Q1FY24 as compared to Rs. 45.17 Cr (5.7% of revenue) in Q1FY23.

Order inflow for the quarter was Rs. 1,224.65 Cr as compared to Rs. 1,365.90 Cr in Q1FY23.

1. Electro-Mechanical Projects business:

While there were fewer than anticipated orders from the commercial buildings sector, we continued to witness healthy bookings from the factories and data center sectors driven by the continued thrust of the Government in encouraging manufacturing investments. We also witnessed an uptick in enquiries from the healthcare and hospitality sectors.

Additionally, inflow of enquiries and tenders in the railway electrification and metro railway sectors remained buoyant throughout the quarter.

Major orders were received from Induslnd Bank (Chennai), Maruti Suzuki, etc. to name a few.

Carried-forward order book of the Electro-Mechanical Projects business was at Rs. 4,038.14 Cr as on June 30, 2023, as compared to Rs. 2,777.45 Cr as on June 30, 2022, a growth of 45.4%.

2. Commercial Air-Conditioning Systems:

Continued traction from the government, industrial and healthcare sectors coupled with increasing demand from the education and retail sectors enabled growth in revenue during the quarter.

Demand from tier 3, 4 and 5 cities continued to be encouraging with significant and high value orders from these towns.

We continued to maintain our number 1 position in Conventional and Inverter Ducted Air Conditioning Systems as well as Scroll Chillers and second position in VRFs and Screw Chillers.

We also received many significant orders for the recently launched centrifugal chillers.

Some of the major orders received during the quarter were from Foxconn Technology (Bangalore), IOCL (Baroda), Mindspace Business Parks (Thane), etc. to name a few.

3. International Business:

Business and economic activities in the Middle East markets continued to remain upbeat. With significant growth plans and ensuing policies by the Saudi government, there have been huge investments in the region. Consequently, we witnessed strong demand for our B2B products across territories. Despite delayed summers, we also witnessed a growth in demand for our room air conditioners as compared to last year.

The pace of enquiries and order inflows at Qatar continued to remain moderate with economic activities in the country yet to pick up after the FIFA World Cup. The operations of the joint venture at Malaysia is slowly bouncing back after a prolonged slowdown and weak macroeconomic conditions in the country. We are also in the process of developing advanced products and solutions for North America and Europe.

Segment-II, Unitary Products:

Segment II revenue grew 6.3% to Rs. 1,198.45 Cr in Q1FY24 as compared to Rs 1,127.59 Cr in Q1FY23. Segment result was Rs. 89.34 Cr (7.5% of revenue) in Q1FY24 as compared to Rs. 91.13 Cr (8.1% of revenue) in Q1FY23.

1. Cooling and Purification Products business:

Due to unseasonal rains, demand for room air conditioners remained flat. Our growth was modest, and the market share was maintained at 13.5%.
Margins for the quarter remained flat on account of subdued demand.
We continue to invest in expanding our distribution footprint across the country.

2. **Commercial Refrigeration business:**

The commercial refrigeration business witnessed traction across all segments with an uptick in demand from the hospitality, pharma, and processed food sectors. With the opening up of educational institutions and commercial establishments such as malls, we witnessed strong demand growth for our storage water coolers.

Additionally, with significant investments in infrastructure for the warehousing and logistics segment, we witnessed growth in the modular cold rooms category.

We also witnessed increased traction for our kitchen refrigeration equipment, driven by the growth of QSRs and the hospitality sector.

We continued to maintain our leadership position in Deep Freezers, Storage Water Coolers and Modular Cold Rooms.

Some of the major orders received during the quarter were from the New Parliament House (New Delhi), DHL (Chennai), and Nestle India to name a few.

Segment-III: Professional Electronics and Industrial Systems:

Segment III revenue grew 48.9% to Rs. 78.43 Cr in Q1FY24 as compared to Rs. 52.68 cr in Q1FY23. Segment result was Rs 10.49 Cr (13.4% of revenue) in Q1FY24 as compared to Rs. 5.89 Cr (11.2% of revenue) in Q1FY23.

With a steady rise in corporate capex across segments, we witnessed growth across all lines of business. The non-destructive testing business continued to gain momentum. Increased penetration and investments in the healthcare segment by both the public and private sector continued to create opportunities for the healthcare business.

Major orders were received from Tirumala Hospitals, FIS Payment Solutions, Bhushan Power and Steel, Bank of Baroda to name a few.

3) Business outlook:

With continued investments in the infrastructure sector and with the capital investment cycle playing out in a significant manner in many sectors including manufacturing, the demand for our B2B products and solutions is expected to be robust. The demand for commercial refrigeration products continued to grow at a healthy pace. While the summer season impacted the room air conditioners category, given the penetration levels, we hope that the demand will revive in the festive season. As in the past, we will remain agile and implement necessary course correction strategies. We are optimistic about the prospects for the rest of the year.

With that, ladies and gentlemen, I am done with my opening remarks. I would like to now pass it back to the moderator who will open the floor to questions. We will try to answer as many questions as we can. To the extent we are unable to, we will get back to you via email. 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 Bhoomika Nair from DAM Capital. Please go ahead.

Bhoomika Nair: Sir, my first question is on the unitary product segment. We have seen about a 6-7% kind of a growth and if I can get some color of how the actual RAC and the other Commercial Refrigeration bit of the business has done, because we understand the market has seen a bit of a decline and you mentioned that our market share has been fairly steady. So, is it possible to get some color on the breakup of revenue growth or how the two parts of the business have performed within the segment?

B. Thiagarajan: You are wanting to know whether room air conditioners degrew and that is compensated by Commercial Refrigeration. Is that your question?

Bhoomika Nair: Yes, sir.

B. Thiagarajan: That would be a selective disclosure. You are not aware of what it was last year also. Our estimate is that the industry would have degrown by 10% in the room air conditioner business. We would have degrown less as for us larger share comes from the institutions business.

Bhoomika Nair: So, is it fair to say that means that we have gained market share? Because we have obviously not degrown that much as the industry.

B. Thiagarajan: Very, very marginally. The other aspect in the market share data is value-based v/s volume based. Quite a few data that will be available in the public domain is based on the volumes.

There had been an energy label change and there had been a repositioning of our products itself. Our average price realization per unit would have come down because we are into affordable segment as well. Therefore, it is a challenge to figure out accurate data. We want to be transparent to the extent possible without violating any of the regulations. In that context, though our volume would have grown, in value terms, we wouldn't have gained market share. It would have remained the same is our assessment.

Bhoomika Nair: Sir, my second question is related to the fundraise that was brought up. You know, what is the requirement for this? Where are we looking to kind of utilize these cash flows? And would it be entirely through equity, or given that we are largely debt free, there would be a mix of debt and equity as well?

B. Thiagarajan: Since many of you will have question around fund raise, Nikhil will elaborately answer this question so that the others can use their opportunity for other questions.

Nikhil Sohoni: The intention of the fundraise is to ensure that the company always has an optimum capital structure. This raise will be primarily equity. The net debt level was Rs. 283 Cr this June compared to a Rs. 81 Cr cash position in June 2022. At a gross level, the debt is at around Rs. 600 Cr.

As we grow, we have had a substantial CAPEX in last two years, which have primarily been funded by internal accruals. While that will continue to fund CAPEX going forward, we also want to ensure that we have sufficient net worth available, should the growth capital be raised by way of debt going forward.

There will be CAPEX, over next three years which we need to fund. We have to ensure that we have sufficient balance sheet strength to raise debt going forward. All of that requires us to have a very strong balance sheet, which this equity raise will enable, and that's why this fund infusion has been thought about.

While we are targeting to raise equity, the approval of the Board is by way of QIP giving flexibility to raise through debt or equity, but our primary intent is to raise equity.

Bhoomika Nair: And the use of funds, for what will we, I mean, we have started our Sri City facility. So, where will this CAPEX be utilized towards?

Nikhil Sohoni: CAPEX investment is a continuing process. In the current year, we are also investing in sub 300-litre capacity at Wada in addition to the investments in Sri City. In Sri City, we presently have a capacity of 300,000 ACs per annum, which will go up to 600,000 as we go forward. As we scale up, the volumes go up, in value terms, even the working capital requirements would increase. This being a seasonal industry, inventory level at June is perhaps the lowest level of the inventory and as we go forward, working capital also has to be built up to support the scale. We will also explore the option of retiring some high-cost debt in the books. The usage would be a combination of all these including working capital, CAPEX and general corporate purposes.

B. Thiagarajan: I will elaborate on plans for Sri City. There are three phases there. In the first phase which is under commercial production, the capacity is 300,000 units. Total planned capacity is 1.2 million units. There are two more phases planned in Sri City.

In the meanwhile, the other information is also in public domain that the current factory is around 20 acres. We have bought 40 more acres of land in Sri City, which internally we call it as Sri City 2. That is meant for commercial air conditioning products, both for domestic and export markets. And after completing phase three, we will commence the construction of the Sri City 2 plant.

As Nikhil mentioned, the fund raise is basically for the capacity expansion in line with our growth plan, and it is also coming at a time when we had postponed these investments for many, many years. As you may recollect, it was in 2011-12 we started with Jammu and Sri City land itself was bought, and we waited and waited for us to get the confidence that yes, these capacities are required. And so, primarily, this is a reason for our raising capital.

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

Ravi Swaminathan: My first question is with respect to the ordering environment regarding the first segment. This quarter we had seen roughly around Rs 1,200 crores of order inflow, and it was more or less kind of flattish compared to corresponding quarter last year. And after many quarters of successful growth, there has been some kind of a pause. Do you think this is temporary? What are the factors that are likely to drive the growth further going forward, if you can elaborate on that? Are there any large infrastructure orders which are in the pipeline which can drive this growth? If you can talk more about this, it will be really great. And also, the quality of those orders in terms of profitability, is it improving, at the same place, or probably even declining? So, if you can talk about that?

B. Thiagarajan: Mr. Ravi, thank you for the question. The simple answer is the construction cycle is on and there is a healthy enquiry pipeline. Quite a few orders are under finalization. We had always maintained that we are not building a market share in that business. We are interested in profitable growth and free cash flows. That is the principle as far as that business is concerned.

We would also want to maintain our differentiation on superior projects delivery. The huge order inflow, which was beyond our expectations, required us to beef up our design execution team. Projects business is not like a factory where everything is in a controlled environment. We have to mobilize manpower and execute the project without losing focus on commercial controls.

To answer your questions, any order that had been booked in H2 of last year or this particular quarter or in the next few quarters will be of very high quality. That is strictly reviewed by the Risk Committee under the Enterprise Risk Management framework. Much more than anyone else, you are aware of this business history, what the industry went through, what we had gone through. So, we are very clear about our priorities.

In a particular quarter, there could be loss of orders due to competitive intensity. There are quite a few segments which are doing extremely well in terms of enquiries and order finalization. These are manufacturing, followed by data center, healthcare.

We are beginning to see the hospitality sector coming in. Quite a few airport enquiries are going to be floated, and in the package air conditioning segment, Tier-3, 4, 5 towns are doing extremely well. There again, you are seeing small hotels or educational institutions or marriage halls and so on and so forth.

Looking at segment wise opportunities, we think office space consumption has slowed down compared with last few quarters. However, we have also diversified into segments other than office buildings. Hope I answered all your questions.

Ravi Swaminathan: Yes, thanks a lot for the detailed explanation. Are the drivers for the third segment very similar to the first segment or there are differences there? Are there structural growth triggers there too?

B. Thiagarajan: Distinctly different. The driver for the third segment is manufacturing related CAPEX and the banking financial institutions related CAPEX. The healthcare part of it is not dependent on other segments. It is a segment which continues to grow.

Ravi Swaminathan: And last question. What would be the CAPEX plans for the next two years? That is FY24-25.

B. Thiagarajan: In the AGM, this was a similar question. My rough estimate is somewhere around Rs. 750 Cr over the next three years. Much of it may happen in FY24 and FY25. FY26 will be lower. This is our rough estimate.

Moderator: Thank you. The next question is from the line of Rahul Gajare from Haitong Securities. Please go ahead.

Rahul Gajare: Sir, I have two questions. You know, the first one is on the UCP business basically. Given that we have seen a 6% growth in the segment and, you know, the industry has seen a decline and even the room air conditioning has seen a decline, is it possible you can throw some light on how the regional sales have been for you? How the growth or decline has been across the region? So, that is the first question.

B. Thiagarajan: I think we did well in Tamil Nadu in April and the first half of May. There was a similar pattern in Andhra Pradesh as well. East and Northeast regions did extremely well throughout the season. Gujarat did well and Mumbai was one location where it was March and April, followed by first 10 days in May, after that, it didn't pick up at all. Northern Region did not do well.

Rahul Gajare: Sir, is it possible you could actually quantify how the growth generally was in the South for the quarter and how bad was it in the North and so on?

B. Thiagarajan: I presume you are comparing with the last year. I don't think that data is going to be very relevant.

We are of the view as also emphasized with the government or policymakers that the overall market size for room air conditioners was 8 million units. That 8 million units should have moved up to 10 million in FY24. So, we should be worrying about whether it would move up to 10 million units or not. The market size is supposed move up to 13 million units by FY25.

All the PLI schemes, the government working, projections, everything is built on that particular assumption. The manufacturing capacity expansion of various companies also will be broadly based on these numbers. So, we would be focusing on growth in the overall market size rather than focusing on select locations. There is a possibility still that 8 million units will become 10 million units this year. And Blue Star will grow to at least 10 lakh units compared to the 8 lakh units that we did last year.

Our view is that the festival season should do better than last year. Looking back at history, whenever summer has failed, festival season has always been good.

Another aspect is that the data ecosystem is yet to mature in this industry. Therefore, we would like to focus on 8 lakh units growing to 10 lakh units The data published by the Bureau of Energy Efficiency is the license fee they collected for the BEE labeling, which is not published brand-wise, but for the estimates of the government and the policy, they do share that data in a limited way.

Rahul Gajare: Sir, my second question is on the project business. You know, we have a strong order backlog now. You did indicate during the Analyst meet of your intention to go, you know, North American market, European market. Is it possible you could split this order backlog that you have right now, you know, between domestic and international and the kind of profitability that you have in both these markets? That's my last question.

B. Thiagarajan: Segment-I comprises the Electro-Mechanical Projects and the packaged air conditioning. The commercial air conditioning is part and parcel of that. Our export presence today is in the Middle East and South Asia and North Africa markets.

The annual report discloses what is our export revenue. We are a minuscule player there. There is a demand for our products in European market and the North American Market. Therefore, we want to pursue these opportunities. We have set up wholly owned subsidiaries in Europe as well as North America.

As explained in the May meeting, the product specifications are different in the export market. For example, United States the frequency itself is different, it's a 60 hertz product. It has to meet their energy efficiency norms, refrigerant norms and the brands to whom you want to sell, you have to get required approvals. So, the R&D testing for all of this has to happen over a 12-to-18-month period.

There will be some trial orders that will be given to produce, and they are to validate the product, and we want to be satisfied because we won't enter United States market with a product which is half baked because our interest and ambition is much bigger there.

It may take 5 - 10 years, but we want to build it in right way as we have no plans to get into refrigerators, washing machines etc. We aspire to be a global player in air conditioning and refrigeration.

In the revenue for the quarter or in the order book, there is nothing that is significant from United States or Europe. It will be some trial orders, in the region of around USD 2 - 3 million. When we have significant order wins, we will be happy to report that this is the win that we have got. So, right now the pending order book comprises substantially Electro-mechanical projects business and Commercial Air Conditioning business, which are ducted systems, inverter ducted and VRF.

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

Ankur Sharma: Thanks for your time as always. Not sure if this question was answered, but if you could talk about the channel inventory given the fact that you know, as you said, the companies and the channels were preparing for a good summer and clearly, you know, the unseasonal rainfalls. So, one was on channel inventory, how is that? And more importantly, we have heard there would be some price cuts, in fact, to clear out inventory as well. So, if you could just talk about what have you been hearing, what is the competition doing, etc?

B. Thiagarajan: For us the inventory is not high as it used to happen 3-4 years ago, because we are able to quickly moderate the inventory level. So, it may only be slightly higher.

In fact, if we are to look at the working capital deployment July of this year versus July of last year, there is no significant change. It is more or less the same. Working capital turns had remained unaltered. There could be some pockets where inventory could be higher. The channel did not buy as expected, they were also regulating their cash flows. Whomsoever had bought in May, they could buy only after clearing out their inventory. The channel also has been very prudent.

On the whole, there may be pockets and some brands that may be carrying inventory. In our view, the industry has come to terms with the fact that it is a bad summer season and we need to move on. There are no reactions such as pleas to reduce the GST and so on and so forth We have come to terms with that. There may be some additional inventory. However, it is not something impacting the industry in a big way, and definitely not Blue Star.

Ankur Sharma: And just the second question on your guidance for the full year in terms of sales growth and margins for the UCP segment, any changes there?

B. Thiagarajan: In January, I felt that FY24 should see 20% growth for the industry and Blue Star should grow by 25%. Somewhere in April, I had said that it should grow by 15%, and we should be growing by 20%. And I think it will be somewhere around between 10% to 15% is my latest estimate, and Blue Star also should be growing in the same way.

Ankur Sharma: And margin, sir?

B. Thiagarajan: If we want to maintain the EBIT projections which we have said, it will be for a full-year basis, it is 8% to 8.5%.

Ankur Sharma: So, it is sticking to the margin largely around 8% to 8.5%.

B. Thiagarajan: Blue Star will always be concerned about that. You know, if you are falling in margin one quarter it is finel, but we are very clear that on a full year basis, we should be aiming to earn a 8% to 8.5% margin on a steady basis. Again, this also I had clarified that three years ago prior to COVID, prior to PLI scheme, we always felt that it would be 9.5% to 10% or at least 9% to 9.5%. We are no longer saying this. I think with the capacity expansion that is happening and the new competitive landscape, one should be happy if it is 8% to 8.5%.

Moderator: Thank you. The next question is from the line of Pankaj Tibrewal from Kotak Mutual Fund. Please go ahead.

Pankaj Tibrewal: I want to dwell a little more on the capital raise plans, though Nikhil ji alluded on that, the balance sheet strengthening is the primary cause. But when I look at all the parameters today and the fact that we have done Rs. 600 Cr of CAPEX in the last two years and the next two years will not be that substantial, I am still not able to understand why to raise capital unless there is a big plan on some investment? Because the DNA of the organization is quite disciplined on the working capital side, whether it be Project business or UCP business. So, just wanted to understand more where is this money going to be. Or is it the experience of COVID where we at one point were a little bit, you know, in a bit of a precarious situation, is that leading to a raise of capital? Just that will help because equity comes with its own cost.

B. Thiagarajan: Thank you for that question. It's good that you asked that question. First of all, this is a different question, you know, that in my 10 interactions, seven used to ask why you are not raising capital? How are you going to be funding this CAPEX growth?

The argument used to be around our being very conservative. We have not been aggressive in expanding the capacity. And you know very well, we were the first one to commission a room air conditioner plant under the PLI scheme in the industry and in Sri City.

We have been very clear that as a corporate core competence, manufacturing value addition is very important and for margin improvement given our past margin profile, we felt that it is important for us to go ahead and invest in manufacturing.

The other important aspect is the seasonality of the room air conditioner business, where you start building inventory from December. In the earlier conversations, that you would have heard of, in a bad summer like this, we would have been stuck with huge inventory because the orders would have been placed and the LCs would have been opened.

In the COVID year 2020, we had more than Rs. 450 Cr of inventory and more than 900 containers all coming in. As you would recall, we paid Rs. 8 Cr of demurrage charges for holding those containers. Now, it is important in this business that you have that flexibility of moderating the inventory build-up and manufacturing is important for that.

In the Commercial Refrigeration business, more than 60% of the products we sold were sourced from China. Deep Freezer is a voluminous and low-cost product. Around 7% of the cost is in packaging and then the ocean freight and the transportation all put together was huge all together adding up to 16% or 17%. Then you have the exchange rate going up. So, that business you will not be able to justify importing anymore. You have to make it here. Therefore, we invested in developing capability, how you will develop that product at a Chinese cost, and we reached a conclusion year before last that we will be able to do that. That's how the deep freezer investment came in.

Now the ice cream industry is growing, and when they are reaching Tier-3, 4, 5 or processed food, it is calling for lesser capacity Deep Freezers of, 250 litres, 200 litres, 150 litres etc., which are even more competitive, every Rs. 10, Rs. 20 will matter there. So, we developed that capability and we are investing there to go ahead and manufacture those smaller capacities.

Coming to room air conditioners, we are very clear that this market will continue to grow. We are now talking about some 10 million units against the domestic market size of 90 million units in China or a total manufacturing capacity of 130 million. The domestic market size of 10 million units will grow to 20 million units within three years and to 40 million units within another three years. There could be a bad summer season in between, but the direction is very clear. Therefore, that capacity is required.

Having decided that we will be only an air conditioning and refrigeration company, we would like to explore export opportunities. And we believe that we have the right to win business in Europe and in United States of America. There is absolutely no doubt about it because we hold those IPs whether it is a VRF system, whether it is the inverter, we have mastered that.

We can't import from somewhere and trade. Our calculation clearly shows that it is not necessary for us to set up a manufacturing unit overseas. It is not at all necessary for Europe or United States markets and in that context, we need capacity. So, it is mainly meant for capacity expansion.

Now, it is not to do with whether there will be another COVID. I think that's what you implied, that we want some resilience capital in hand if another COVID comes on, something like that. It may as well happen, but this plan is not connected with that.

The question is when we have become Rs 8,000 Cr company and grow to Rs 10,000 Cr, to Rs 12,000 Cr there would also be requirement of working capital. And our balance sheet had been thin. The very question of yours has the answer. How with this net worth you will be able to fund for the growth? And this is the background. Nikhil, over to you.

Nikhil Sohoni: Just to elaborate, like you said, while there was a Rs. 500 Cr CAPEX in the past, the guidance that we have given now is around Rs. 750 Cr over next three years, of which also, large part of which will happen in FY24 and FY25. So, that's the primary reason for the fundraise.

Pankaj Tibrewal: No, I understand the entire argument on that. My only point was that Net debt to trailing 12 months EBITDA is still half a time, and some debt is always good from a discipline perspective from a corporate side.

Nikhil Sohoni: The proposed fundraise will not make us debt free because working capital financing will continue by way of debt. And it is up to Rs. 1,000 Cr. So, we are trying to bring in that optimum capital structure which is required. We have taken an approval of up to Rs 1,000 cr from the Board. Depending on our requirements over the next two to three years is what we are going to plan out.

Moderator: Thank you. The next question is from the line of Bhavin Vithlani from SBI Mutual Fund. Please go ahead.

Bhavin Vithlani: Just one question from my side. Your peers have invested in captive compressor facilities giving the reason that technology changes will be rapid and that will give them a competitive edge. Well, Blue Star has both the commercial refs and the room AC, why would you believe it will not be a competitive disadvantage for you?

B. Thiagarajan: Thank you for that question. The commercial air conditioner has huge varieties of compressors. India is a growing market and is yet to reach optimal size. In commercial AC we are a minuscule country when we look at consumption. Now, the overall market size is small.

Within that, you will have some 60 to 70 types of compressors. So, it is impossible for India to be manufacturing that.

Globally, there are commercial air conditioning, Commercial Refrigeration compressor companies. There are plenty of them, and it is prudent for you to depend on them. There is no reason for you to be going captive. When you don't have the scale. There is some 300, 200, 100 compressors. You cannot set up a facility at all. These compressors are distinctly different applications.

Coming to the room air conditioners. The compressor is a high technology product and as I had clarified a number of times, Blue Star is no longer concerned about technological capabilities. Yes, it is a difficult job. We will have our own learning curve to be developing a particular product at a particular price for a particular margin that we have to realize. I am not undermining the challenge, but it is not impossible for Blue Star to do. Our concern is connected with what is the break-even volume that you should have.

Now, if Blue Star is making compressors, you can imagine, I cannot sell that to any other manufacturer because quite a few multinational have their own compressors coming from abroad. They are not going to buy from us. Our competitors will not buy because there are compressor manufacturers outside and why should they be buying from a competitive product?

Mr. Piyush Goyal at the time of PLI had tried this, whether Indian companies can come together to set up a compressor manufacturing venture? Calculation showed that for this scale, it is really not possible. My view is that if Blue Star wants to look at it it should when it reaches 2 million units in room air conditioners, this year, hopefully, we will be doing 1 million. So, when we reach 2 million, you can evaluate whether at that cost it is viable for you. And as of now with this 1 million or 1.2 next year, 1.5 third year, I don't think it is prudent for us to get into compressors.

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

Aditya Bhartia: Sir, my question is again on the fundraising plan. Now, even if you are spending, let's say, Rs. 300- 350 Cr annually over the next two years, we should be generating EBIT which is going to be higher than that, actually significantly higher than that, which should take care of your CAPEX requirements as well as working capital requirements. So, even if the net debt goes up, it will go up by a fairly minuscule number. So, just unable to understand why exactly are we going for an equity raise?

Nikhil Sohoni: Our gross debt currently is around Rs. 600 Cr and net debt is around Rs. 283 Cr. As the company increases its scale, the requirements are bound to go up.

The CAPEX plan which the company has, till now we have continuously funded from internal accruals. Going forward, as we said, we want to continue with this backward integration journey with the increase of product portfolio also, which will require investments in R&D. All of these investments will require us to spend around Rs. 750 Cr.

Now, if we have to use that kind of money over the next year or two, then we need to have a leverage capacity, which will be available to us because that will not be the end of it. So, we have to see that the balance sheet is ready for our future growth. We have to see on a long-term basis.

As we said that we have invested in Sri City in one more land, which will be a Sri City 2, where we will look at expanding the commercial air conditioning after a year or two. So, it is with the long-term intent that this planning has been done for the balance sheet funding. It's not something which is only for next one year.

Aditya Bhartia: Is it true, sir, that you don't want to have much debt on the balance sheet and at least on a net gearing basis you want to be net cash positive at almost all times? Is that how you think?

Nikhil Sohoni: We want to be prudent as far as debt is concerned. We would never like to overleverage ourselves.

Aditya Bhartia: And when you say overleverage, up to what level of debt are you comfortable? And when I am speaking about debt, I am basically referring to net debt levels?

Nikhil Sohoni: So, see, I would say that a net debt position anywhere above 0.2, 0.25 to 0.3 makes us very uncomfortable, one thing we have to understand is in terms of rating in terms of balance sheet strength, all of that, it becomes very important. You know, this is a seasonal business. So, you need to ensure that your debt position is right through the seasons also. Suppose the season is bad, and you are influenced by high debt levels at that point of time. To avoid such instances, you have to have that optimum balance for the capital structure. You can't be, you know, overleveraged and then suddenly be faced with a problem.

Aditya Bhartia: And sir, my last question is on the export potential, while what you are doing in North America, Europe sounds very encouraging, just wanted to understand what are the kind of internal targets that you are having? How do you think of these markets shaping up? And can they become a meaningful part of the business, let's say, over a 5-6 years' timeframe?

Nikhil Sohoni: It is still just a beginning with US and Europe. We have communicated that we will come out with the strategy in six months' time. We have got some anchor customers with whom we are in talks. We are already present in the Middle East and in those markets we are in touch with few of these customers. The markets, of course, are promising, and that is why we have formed a subsidiary over there. At present as we speak, we are connected with a few of the customers and exploring opportunities, and we feel that this market does hold good promise. There is immense potential there. Of course, we have to deliver on that potential, and we are confident we will, which makes us kind of very positive for this entire whatever start we have done in those geographies.

Moderator: Thank you very much. We will take that as the last question. I would now like to hand the conference back to Mr. Nikhil Sohoni for closing comments.

Nikhil Sohoni: So, thank you very much, ladies and gentlemen. With this, we conclude this quarter's earning 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 with additional details by email or in person Thank you.

Moderator: Thank you very much. On behalf of Blue Star Limited, that concludes this conference. Thank you for joining us, ladies and gentlemen. You may now disconnect your lines.