

Q3 2011 Earnings Call - Blue Star

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Operator

Ladies and gentlemen, good day and welcome to the Blue Star Limited Q3 FY11 Results Conference Call. We have with us on the call today Mr. Vir Advani, Executive Director; and Mr. B. Thiagarajan, Airconditioning and Refrigeration Products Group President, Blue Star Limited. As a reminder for the duration of this conference, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions at the end of today's presentation. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Vir Advani, Executive Director, Blue Star Limited. Thank you, I hand over to you sir.

Vir S. Advani, Executive Director

Thank you. Good morning, ladies and gentlemen. This is Vir Advani. I have with me Mr. Thiagarajan, and we will be giving you an overview of the results for Blue Star Limited for the quarter ended 31 December, 2010.

The following are the financial highlights of the company for the quarter. We reported total operating income of Rs. 606.83 crores for the quarter ended December 31, 2010, as compared to Rs. 586.19 crores in Q3 of last year, a marginal increase of 4%.

For the quarter, gross margin was maintained at 23.5% compared to 23.4% in the same period last year. Operating profit, that's PBIDT, excluding other income, for the quarter declined by 18% to Rs. 47.28 crores. This was mainly on account of lower than expected revenue and higher operating expenses.

Further, Q3 FY10 had a write-back of incentive provisions pertaining to FY09, amounting to Rs. 4.56 crores. More information on these will be provided in the segment reviews.

Financial expenses stood at Rs. 7.91 crores versus 2.27 crores in Q3 of FY10 on account of working capital increase and higher interest rates as well as funding related to the D.S. Gupta acquisition.

Net profit was lower by 47% at 22.36 crores compared to 42.34 crores in the same period last year. Q3 FY10 had an exceptional earning of Rs. 8.73 crores while there was no exceptional item in Q3 of this year.

Earnings per share for the quarter on a face value of Rs. 2, stood at Rs. 0.49 versus Rs. 4.71 in the corresponding quarter of the previous year. Carry Forward Order Book as on December 31, 2010 increased to Rs. 2,073 crores compared to Rs. 1890 crores at December 31, 2009, representing a growth of 10%. Order inflow during the quarter increased marginally from Rs. 660 crores in Q3 FY10 to Rs. 682 crores in the current year quarter.

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

The Electro Mechanical Projects and Packaged Airconditioning business accounted for 72% of total revenue in the quarter. This declined by 5%. Segment results declined by 41%. The operating margin of this business in Q3 FY11 declined to 6.7% compared to 10.8% last year same quarter.

As you may recall, we have been predicting an improvement in the commercial real estate market in H2 of this year. However, after a slight pick up in August and September, order finalizations have been delayed, infrastructure projects are moving slower than anticipated, the telecom industry has not returned the capital spending, and the IT sector recovery seems to be delayed by another two quarters. As a result the expected booking growth of 15 to 20% in H2 has not materialized in this quarter.

On the billing front, we had consciously decided to be cautious about aggressive project completions in light of the debtor position not improving. Billing was marginally lower than the same period last year.

Finally, we had taken certain capability building and productivity improvement investment decisions at the beginning of the year for this business. These costs are largely revealed to manpower, consultants and modernizing our work practices. These programs will have a long-term impact even while we are bearing the higher costs in the current period. This has resulted in operating costs being higher than last year.

As a result of lower billing and the fixed operating costs in the business as well as the additional operating expenses described above, operating profit has been negatively impacted in the quarter.

Going forward, we are seeing some recovery in the retail sector, further recruitment figures of IT companies is encouraging, and we expect several metro-rail projects to get finalized in the coming six months.

Now, going a little deeper, in the central airconditioning business the company continued to witness good prospects from the healthcare and power segments, in addition to a moderate revival in the IT segment.

During Q3 FY11, Blue Star won two prestigious orders in the power sector from Indu Projects for their 500 megawatt thermal power plant being setup for Chhattisgarh Power Generation Company and from Reliance Infrastructure for two, 300 megawatt captive units at MIDC, Butibori, for Vidarbha Industries Power Limited.

These, in addition to the significant orders won in the power sector in the previous year have enabled the company to gain a dominant position in the fast growing and robust power sector segment. I'd just clarify this is all for airconditioning and ventilation work.

During the quarter, the company also won a prestigious integrated MEP order from the Godrej Group for their green building project coming up at Chandigarh. The company also witnessed some good repeat orders from national account customers including Infosys, DLF, HCL, Volkswagen and Hindalco.

The electrical projects business caters to both the commercial building market as well as the power sector. As in the case of the central airconditioning business, order inflow from commercial building has been muted. However, the residential tower and power segments continue to show promise.

We won a significant order from logic house in Noida for residential housing project. In the power sector, prestigious orders were won from Madhya Pradesh as well as OPTCL in Bhubaneswar. It was -- it also won a highway lighting

order for a toll plaza in Uttar Pradesh.

In packaged, ducted airconditioning and small chillers, segments that contributed to growth, included the office segment along with commercial segments such as retail showrooms, hotels, restaurants and marriage and function halls. There was also good demand from the industrial manufacturing segment. However demand from mid-sized IT and ITES, the largest buyer of this part of our business has yet to recover. This coupled with input costs increases has resulted in the business under performing in the quarter.

While the company sustained its dominant position in the telecom segment with its customized array of telepack airconditioners, the telecom infrastructure roll-out continued to be adversely affected. The forecast for tower roll-out in FY11 were reduced from 50,000 to 20,000 and has now been pruned down to a meager 10,000 sites. This has had a severe impact on the business. The tower roll-outs are expected to gain momentum sometime in the next financial year. And the company is well positioned to leverage on the opportunities that will emerge in this sector in the next fiscal. The outlook for this business in the last quarter of FY11 is not encouraging.

Moving onto the second segment. In the Cooling Product segment, revenues registered a healthy increase of 35% in the quarter, driven mainly by higher room airconditioner sales. Segment results increased by 23%. The operating margin declined marginally from 8.7 % in Q3 of FY10 to 7.9% in Q3 of FY11.

Input costs continued to be a concern in this business. Our decision to raise prices in September 2010 was timely and has helped arrest the margin decline in this business.

In the room airconditioner business, growth has driven -- was driven by sales from both the commercial segment as well as the residential segment.

In January 2011, the company has announced its foray into the residential segment, with a wide range of room airconditioners. Blue Star has been selling room airconditioners mainly catering to the corporate and commercial segment over the last couple of years the company has witnessed a significant demand from the residential segment given the higher disposable income and growing middle class. The company has significantly altered its marketing mix to focus on the residential segment.

On the product front it has launched a new contemporary and stylish range of split airconditioners to appeal to home consumers. As regards to the distribution, the company is planning to offer these products through some reputed retail channels in select cities in addition to the current 700 sales and service dealers. It is also building up a strong installation and service franchise network to support the retailers. In terms of advertising and brand communication, the company has plans to increase its advertising spend in the forthcoming summer season.

The differentiated value proposition to the residential audience has been identified as, 'Get office-like cooling at home', which

leverages Blue Star's expertise in cooling offices and communicates that one can get the very same expertise at home.

In the refrigeration product segment, storage water coolers, chest freezers and coolers recorded substantial growth in the quarter, while government institutions and the educational segment contributed to growth in water coolers, enhanced demand from ice cream and dairy segments resulted in growth of freezers and coolers.

Finally in segment three, the Professional Electronics and Industrial Systems business, revenues grew by 29% while segment results registered a significant increase of 33%. During the quarter, all the businesses in this segment performed well.

In the non-destructive testing business, significant orders were booked from Oil Country Tubular, NTPC, Central Glass and Ceramic Research Institute and BHEL in Hyderabad. Based on its competitive advantage in analytical applications desired in metallurgical research, the analytical instruments business won an order from National Metallurgical Lab, Jamshedpur for Field Emission Electron Microscopes.

In the data communications business, significant orders were won for the government project of MPIC which is a multipurpose identity card and for additional handheld terminals for warehouse applications.

In conclusion, after two quarters of reasonable revenue growth, the Q3 slowdown is somewhat unexpected, largely due to sluggish progress in Electro Mechanical Projects, and the slump in telecom airconditioning. This has impacted profits and cash flow to some extent. However management believes that decisions taken three months ago on bringing the capital employed under control and improving the quality of new orders booked are appropriate and will yield the desired results in the medium-term.

Looking ahead to the main summer season, the picture looks better. Sales of air conditioners and refrigeration products have been healthy and continue to show robust growth prospects.

The chief areas of concern in this business are rising input costs due to a higher inflation of key raw materials, which keep profit margins under pressure. We will continue to work on the same.

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 up the floor to questions. As we, Thiag and me, we will try and answer as many questions as we can. To the extent we are unable to, we will get back to you via e-mail. With that, we are open for question. Thank you.

Questions And Answers

Operator

Thank you, sir. Ladies and gentlemen, we will now begin the question-and-answer session. [Operator Instructions]. The first question is from the line of Aditya Bhartia from CLSA. Please go ahead.

Aditya Bhartia

Hello sir. Just wanted to get an idea, which are the sectors wherein you are seeing execution being slow?

Vir S. Advani, Executive Director

I am sorry. You have to repeat. Execution delays or -- I missed that.

Aditya Bhartia

Yeah, sir. As you mentioned that revenue booking in the EMP business has been lower this quarter because of delays in execution.

Vir S. Advani, Executive Director

Yes.

Aditya Bhartia

So which are the particular sectors or segments wherein you are seeing execution being slow?

Vir S. Advani, Executive Director

Alright. We are seeing, so execution is moving in hotels and hospitals. Progress is slow in our infrastructure business, which is metro as well as power. And also, there was a pick up in commercial real estate projects. So these are standard

office buildings, both IT as well as non-IT. Those projects again have slowed down I think probably because builders or owners are seeing a drop in demand on their end and therefore are slowing down projects.

Aditya Bhartia

Okay. So what is the kind of execution period that you'll be looking at for your orderbook now?

Vir S. Advani, Executive Director

So, well, it hasn't change too much. This is, essentially what we are doing is, we had said it's around 14 months. So there are two aspects here, one is, we have slowed down certain projects and work. As I had mention to manage our capital employed situation, the debtor position, plus there is some certain market segments that are pushing it from their end.

So I would guess that maybe it will get stretched by another month or 45 days, I mean we haven't done the calculation, but we can probably get back to you all by the end of the year.

Aditya Bhartia

Okay. And sir secondly, how are the pricing trends in the EMP business shaping up? Are you seeing bidding getting incrementally more aggressive?

Vir S. Advani, Executive Director

Yeah. So we had talked about that in the last conference call which is why we had taken a decision to -- so in projects you can't raise prices, right, because it's a deal-by-deal basis. So what we had decided to do is, raise our minimum margins that we accept business on, as well as raise, improve the terms of payment that we accept for projects.

So both of those, we implemented on, in October. Now that's on one side. The market itself is continuing to be very aggressive on pricing, but I -- we feel that after we have made the move, I think it will be a few more months and then I think our competitors will follow. And so we are expecting that pricing will not remain at these very aggressive and very low levels for much longer.

Aditya Bhartia

Okay. And what will be your margin expectations be like, given in this kind of a pricing environment?

Vir S. Advani, Executive Director

You are talking about for the company?

Aditya Bhartia

For the company.

Vir S. Advani, Executive Director

So we are -- you've seen after couple of quarters of reducing margins. If you look at Q2 to Q3, you will see gross margins holding. We think that the same will hold in Q4 and we are expecting to keep that kind of margin level into the next year. So we are taking kind of a six month view right now and we think that margins will hold for that period.

Aditya Bhartia

Okay, fair enough. Thank you, sir.

Vir S. Advani, Executive Director

Thank you.

Operator

Thank you. [Operator Instructions]. The next question is from the line of Mansi Sajeja from SBI Mutual Fund. Please go ahead.

Analyst

Yeah, good morning sir. Sir I just wanted to know, what is the gross and net-debt position as on December 2010? And how much of it was added due to the D.S. Gupta acquisition that you did in the first quarter?

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

Capital employed.

Vir S. Advani, Executive Director

Yeah. Are you asking about the capital employed?

Analyst

Yeah. Actually the gross debt and net-debt position as of now?

Vir S. Advani, Executive Director

Gross debt. No, we don't disclose debt positions on a quarterly basis, but what we had mentioned in our acquisition note to everyone is that we paid a total of 80 crores for that business.

Analyst

Okay.

Vir S. Advani, Executive Director

And that will be funded largely by debt.

Analyst

Okay. So as of June it was about 344 crore of gross debt. As of 30th of September balance sheet?

Vir S. Advani, Executive Director

Yeah.

Analyst

That we have as a...

Vir S. Advani, Executive Director

Right.

Analyst

So that was reported for that.

Vir S. Advani, Executive Director

That's right.

Analyst

So it should be similar considering...

Vir S. Advani, Executive Director

It would be at the same levels, yeah.

Analyst

Okay. Thank you, sir.

Vir S. Advani, Executive Director

Thank you.

Operator

Thank you. The next question is from the line of Madhuchanda Dey from Kotak. Please go ahead.

Analyst

Hello.

Vir S. Advani, Executive Director

Yeah.

Analyst

Yeah. I first have a housekeeping question.

Vir S. Advani, Executive Director

Yes.

Analyst

Which is, what is the end of the December order book and what kind of orders did you add in the quarter? And then I have another question, which I will come back.

Vir S. Advani, Executive Director

Sure. I think in the opening remarks which you may have missed.

Analyst

Yeah, I did.

Vir S. Advani, Executive Director

Yeah. So I'll just tell you the number and then as far as project goes, it's all in the transcript, you will read that in about an hour. But for the quarter, order inflow was 682 crores for the quarter, which was up from 660 in Q3 of last year and that takes our Carry Forward Order Book to 2,073 crores.

Analyst

Yeah. And my second question is, you had been mentioning in the previous calls that, this year things were not so good and the margin pressure was owing to the orders that you took in a period which was not very hospitable for investment.

Vir S. Advani, Executive Director

Yes.

Analyst

But you expect things to change rapidly and FY12, we were getting this indication that FY12 should be a decent year in terms of order booking and general business momentum. But in the last three months we have seen quite a bit of macro headwinds developing, right. So can you give us your assessment of the situation and how do you see your business in this context?

Vir S. Advani, Executive Director

Yeah. So the projects business, what we had said is that pricing is under tremendous pressure, input costs are going up. We need to do something to address our margin concerns. So as said in the last call, starting October, we improved the margins that we are accepting business at as well as terms of payment. So that has slowed down the order inflow a little bit.

But like I had just mentioned earlier, we think that it will take a few months, but our competitors will hopefully follow us. And we expect to move -- that at least order inflow will improve with better terms, going into the next year, that's the expectation. We have to see how that pans out.

Our equipment business, there the -- and of course, in the projects business, our capital employed continues to be a concern. So we said that we are going to tighten up on execution as well as on terms of payment of new jobs. We have done both of that, so you are seeing some of that impact in the revenue. But again, I think that they will ease up because this is the first quarter of having implemented it.

So, we tend to be aggressive when we do that and then customers come around, money starts to flow, projects start to move. So it's not -- we are not forecasting that this type of situation will continue into the next year, as far as revenue is concerned because the carry forward is still very healthy.

Moving onto equipment, the concern there is not capital employed, concern there is margins. We have raised prices once, we may raise prices again. There is a little impact on the demand or revenue on account of that, but it is not substantial.

Having said that, the raw material price -- costs continue to increase. So we had expected that there be easing off of input cost increase in Q4 that usually happens; copper, steel usually drop in Q4. Frankly, there is no turn back on that in fact both prices I think are higher in Q4 than they were in Q3.

So we are all watching that in the entire industry as well as the auto industry and various other industries are faced with the same problem, we are not different.

Having said that, we at least in certain part of our business, our equipment business demand is still quite strong, that's in room airconditioners and commercial refrigeration products demand continues to be strong.

In our central airconditioning equipment business demand has still not picked up because it's largely linked to the project. So it's a mixed bag there. So going forward into next year, we are working very hard to maintain our margins at the current level. We are spending a little bit more on the operating level like I mentioned in investments that we feel are important for the long-term. So we will continue that, we don't have any intention of cutting those investments or manpower. So we just have to ride out the next few quarters.

Analyst

Just if you may permit me to ask one last question.

Vir S. Advani, Executive Director

Yeah.

Analyst

Do you see the investment climate generally improving or deteriorating or remaining at the same level?

Vir S. Advani, Executive Director

So like I said, last -- we had expected H2 investment climate to improve, not only in IT, but across the board. After showing some uptick in August-September, even into October, there has been a precipitous fall in November-December moving into Jan as far -- and then the way we look at it is inquiries had come in as well as finalizations, orders that get finalized that has slowed down. And I think that's on account of macro trends that you guys know better than I do. And so there is a clear slowdown from that point of view.

Having said that, like I had mentioned, there are certain projects that have been in the funnel for a long time. Those need to get cleared because they have now been pushed beyond reasonable limits of time. So we are expecting finalizations to happen in Q4 as well as in Q1. But there is a clear change in the sentiment in the market.

Analyst

Just taking cue from this question.

Vir S. Advani, Executive Director

I am sorry.

Analyst

Okay. I'll come back again.

Vir S. Advani, Executive Director

Thank you.

Analyst

Yeah.

Operator

Thank you. The next question is from the line of Chirag Setalvad from HDFC Mutual fund. Please go ahead.

Chirag Setalvad

Hi. Two questions actually; one was, you mentioned your gross margins have sustained this quarter compared to the second quarter, but operating margins have come under pressure. So if you could comment a little bit on that, in terms

of whether this was -- how much of this was or to what extent did the delay in orders or postponement in orders impact you and if you could possibly quantify that? What other factors as you mentioned, the employee costs. So the impact on operating margins was first question. Then the second was the looking forward to next year, what kind of growth could you expect in EMP?

Vir S. Advani, Executive Director

Sure. So the -- for the quarter, the bulk of the operating margin erosion is on account of lower billing, lower revenue. It's actually very simple math. We should have done an additional 100 crores of revenue in projects, which did not happen. We slowed down things in November-December ourselves, plus some customers slowed down as well on their end. So that resulted in the bulk of the drop in operating margin.

Having said that, we have had some additional costs come in at the operating line. We were making investments in people, in technology, in consultants, in work practices which are from outside the country that we are implementing here which initially are more expensive, but then they start to yield results in the long-term. So there is a small amount of that as well. It is not dramatic, it's nothing very large, but there is an additional cost there.

So, but really in simple English it is, we have a sitting cost in that business, which is basically manpower, material, sites, mobilized, site offices running. So that sitting cost is there. There is a fine line you have to draw between your debtor position and your billing position. We took some decisions this quarter that has squeezed the revenue. Like I said, I think that probably, when you start doing something like this, it tends to be a lot more dramatic as you tend to settle down with your clients and as you tend to move ahead, revenue will grow again. It's not like that order book is not going to move.

So we think that starting Q4 itself, obviously Q4 is always a larger quarter. So what we are expecting is that Q4 will be largely inline with last year, which means that from a top-line basis we see roughly what we did last year. Our gross margin will stay at around 23.5%, which is where we are this quarter. And if you do the math you will see that therefore the operating margin will improve almost immediately.

So going into next year that was your second question. I think that, we've seen so Electro Mechanical Projects specifically. We will see growth in revenue. Two things; one is of course that the electrical and plumbing businesses will grow faster than the airconditioning business because of the market shares that we have, lower compared to airconditioning. So we -- and there's this Carry Forward Order Book that we are taking into the new year.

So I think that next year for the Electro Mechanical Projects business one should see at least 15% growth. Order inflow is a bit uncertain right now more because last two months has, like I mentioned to the lady earlier. Sentiment has changed quite a bit. And so we are just, we need to watch and see how many of these projects get finalized.

Chirag Setalvad

Just a follow-up on this. As you mentioned that 100 crores was partly a conscious decision by the company, partly by customers. And you mentioned the fourth quarter will be flat. Would you not think that because of the delay in the third quarter the fourth quarter would get the benefit of that, some of these orders would get completed in the fourth quarter.

Vir S. Advani, Executive Director

But as you know we run -- we have a 5 to 600 projects running, not all of them get build-out in a quarter, not all of them have movement in a quarter. So we would have taken certain steps on some projects this quarter. We'll continue to do that next quarter and the quarter after. So what I am saying is that over the next few quarters, there will be new projects that we'll be slowing down or customers may slowdown. So that's why we are not expecting a very large growth in Q4.

Chirag Setalvad

Great. Thank you very much.

Vir S. Advani, Executive Director

Thanks.

Operator

Thank you. Your next question is from the line of Rahul Baijal from Voyager Capital. Please go ahead.

Analyst

Yeah. Most of my questions have been answered. Just a follow-up. One, in terms of the change in the external environment that you mentioned. Is it coming mainly from commercial real estate and construction linked projects or you are seeing -- because you mentioned initially that in hotels and hospitals and retail and metro and rail at least things seem to be okay. So I am just inquiring whether it's more linked to the commercial real estate sector or is it, do you think it's more broad-based in terms of decision-making getting postponed?

Vir S. Advani, Executive Director

Yeah. So there's booking and there's billing, right? So first talking about booking.

Analyst

I am looking to booking.

Vir S. Advani, Executive Director

Yeah. So in booking we are still seeing hotels, hospitals and retail, booking is going ahead. I don't think there's been any change in the last three months.

Metro rail, I mentioned, there is slowdown in billing on that front which is infrastructure projects for us right? But bookings, I think they will move now because as you know there are three or four large metros that have been delayed for a year. And those finalizations will happen between March and June. So that's why I was saying.

So while there is no new metros rushing to be finalized, at least these three that we all know about will be done. So that's as far as on the booking, where there is -- so there are two things then on bookings, two things will happen. One is we had predicted a improvement in the IT sector in H2 itself right?

Analyst

Right.

Vir S. Advani, Executive Director

But that has not happened. There is very selective buying going on by the top three or four IT companies. Beyond that there is really nothing happening. So that affects us in multiple businesses. So that's one. So there is a delay there, and then change in sentiment will be in the commercial real estate market, right. So there's three types of situation then.

So in commercial real estate which is office buildings and the like, there I can see that after August-September number of customers coming forward to want to finalize in October to December, those finalization are just getting pushed. So if you have a corporate office, you are building, you are pushing that out. If you are a builder in Bandra-Kurla who's got land, you are pushing that out. In NCR, you are doing the same. That's the situation.

Analyst

Okay. So it seems mainly linked to commercial real estate as of now in terms of booking?

Vir S. Advani, Executive Director

And IT, right?

Analyst

And IT as well.

Vir S. Advani, Executive Director

A lot of our booking growth estimates were based on IT recovery, which is just not happening.

Analyst

Okay. But contrary to at least in the IT companies whose results have come out and whom we talk to, I mean, they seem to still projecting a robust environment for hiring.

Vir S. Advani, Executive Director

Yeah.

Analyst

And even their tone, on the -- on what they are hearing from their clients abroad seems to have improved. So I am little surprised as to how they seem to have kind of slowed down in terms of what their plans in India were?

Vir S. Advani, Executive Director

No. So I'll just clarify, they are -- they have announced plans to increase head count which is obviously the first starting point, so that's a good sign. The issue is that in many of these markets there is already an overhang of real estate, one.

Second is, they themselves had a number of SEZs that they had slowed down. So there is some -- so what's happening is that there will be some completion of jobs, when I am talking about new jobs being booked that was supposed to start in October, November, December which has not yet started. So that's why we are saying that next year things will

be better because if they are announcing 150,000 additional head count that needs to be recruited, that does translate into projects for us in the next year.

Analyst

Okay. And secondly, in terms of, you mentioned that you'd probably increase your threshold level for margins as well as terms and conditions on receivables going forward. But at the same time you are sounding a little concerned on the order inflow. So do you think such a strategy would work in a slowdown kind of environment or you need loosen up more on both these terms.

Vir S. Advani, Executive Director

Yeah. No, we took the decision three months ago, we are sticking to it. I don't think we have a choice because at some point doing this business that the margins and terms that were available last year it doesn't make business sense. And, so we have realized that, we expect our competitors to realize that, which will then translate into customers understanding that.

So, I don't think it, while there maybe a slowdown in demand that doesn't -- because we are -- I think until we took that decision certain large number of projects being finalized in the market at terms and conditions that were unprofitable, unmanageable. So I think that that change has to happen and I think it will.

Analyst

Okay. And lastly, you mentioned that there could have been about 100 crores miss in terms of delaying in the quarter linked to some sort of a client linked slowdown and plus a conscious slowdown from your side. Is it possible to quantify how much came from what 50-50 or can you give us some flavor on that?

Vir S. Advani, Executive Director

I'd stop by. I don't really know, but yeah, 50-50 sounds like a good number. But I don't have any basis for that right now.

Analyst

Okay. Thank you very much.

Vir S. Advani, Executive Director

Thank you.

Operator

Thank you. The next question is from the line of Mayur Patel from Spark Capital. Please go ahead.

Mayur Patel, Spark Capital

Thank you sir for taking my questions. Most of them are answered. Just on D.S. Gupta what is the outlook for FY11, what are you targeting from the top-line and bottom-line perspective or any direction if you can give?

Vir S. Advani, Executive Director

Yeah, well what we are expecting is, I think we had mentioned that we had a Carry Forward Order Book that we inherited of 250 crores in the current year. So that order book is being executed now. Now we're about four months into taking over the operation. We have -- we are successfully integrating the business.

Order inflow there continues to be strong, so we feel quite optimistic about the plumbing business, going into the New Year. So the carry forward itself will be quite healthy. And we are also expecting, because it is off a small market share, we should also do well next year.

So we are projecting I think a growth, I don't have that number with me. But I think we should be projecting about 25% growth next year.

Analyst

Sir what was the FY10 revenue and profit numbers?

Vir S. Advani, Executive Director

FY10, I don't have that piece of paper here.

Analyst

Thank you, sir. No issues. I will take this offline.

Vir S. Advani, Executive Director

Yeah, please.

Analyst

Sir just one small query. Any possibility of our effective tax rates coming down, maybe any plans on new CapEx index, shelters or something like that?

Vir S. Advani, Executive Director

No, there's no plan. We are doing some small capacity expansion in a couple of places where we need to, but that's not going to change the tax rate dramatically.

Analyst

Okay. And sir last one. As you told, debt levels are almost similar to what around 344 crores which were reported last quarter and our interest costs have increased both because of the increase in debt levels and the rising interest costs. And so going forward, what at a -- what should we expect in terms of debt levels either coming down or what are the

company's plan on this?

Vir S. Advani, Executive Director

Yeah, I think that, see we are working on the capital employed as we said. So to that extent if we are able to improve the debtor position, you will see some improvement on the debt level. However on the flip side, we still expect business to grow next year.

So what I'd probably say is that we will keep this level of debt on a higher revenue base, if the revenue base doesn't come in, then the debt levels would be lower because we will certainly have tied the capital employed issue a little better. Yeah.

Analyst

Fine, last question, just housekeeping question. Is it right that normally in Q4 we have some annual incentives on bonus given out to employees at -- I am just looking at the employee cost from a quarterly perspective?

Vir S. Advani, Executive Director

No, there is nothing in Q4 that is exceptional or one-time from an employee cost point of view.

Analyst

So it should be on, absolute business should be similar to other quarters, like Q3 or Q2?

Vir S. Advani, Executive Director

Yes.

Analyst

Okay. Fine sir. Thanks for taking my question.

Vir S. Advani, Executive Director

Thank you.

Operator

Thank you. The next question is from the line of Nirav Vasa from SBICAP Securities. Please go ahead.

Analyst

Hello.

Vir S. Advani, Executive Director

Yeah.

Analyst

Thank you for taking my question, sir. My question pertains to the pledge of shares that you have. Would it possible for you to give some details as to why these shares are pledged and with whom they are pledged?

Vir S. Advani, Executive Director

Fine. I don't know. I will get back to everyone on that. I am not aware of that. Let me look into and get back to you?

Analyst

Sure. And would it be possible for you to share with us the order backlog that you have in D.S. Gupta as of now? Last quarter it was 250 crores. This quarter any addition in that?

Vir S. Advani, Executive Director

There would have been, again because I don't -- we don't consolidate. There would have been order inflow as well as billing. My guess is with off the cuff -- without having looked in the numbers in detail I think that order inflow to billing would have been about one to one, which means that the carry forward will be around 250.

Analyst

Can you throw some light on you operations of Nasser Electronics please?

Vir S. Advani, Executive Director

Nasser Electricals is our electrical projects business, so it's, as you know it's integrated in the company, it is not standalone. There I have made the mention that, so the business is doing rather well, we have I think for the year between the commercial sector and the power sector, bookings will be up about 20 plus percent, billing will be up about 25% in that business. So the business is, yeah, it's doing well as of now.

Analyst

My last question pertains to the price hike that if you are -- are you considering any new price hike before the start of full fledged summer season in the cooling business?

Vir S. Advani, Executive Director

I'll ask Thiag to answer that please.

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

Yeah, yes we are planning to.

Analyst

Can you broad range in terms, as to what would be the price hike in percentage terms?

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

It is not like-to-like for the simple reason, the product portfolio is completely changing from February end, one. So it will be, the new models get launched. Second reason is February 28 is the Union Budget. We wouldn't know the implication of that, and roughly the prices are expected to go up by 2 to 2.5% in the industry.

Analyst

This price hike will be post-budget or pre-budget?

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

Post-budget.

Analyst

Okay sir. Thank you very much. My queries have been answered.

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

Thanks.

Operator

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

Pritesh Chedda

Good morning, Mr. Advani and Mr. Thiagaraj. A couple of questions.

On your initial outlook side, you said the billing largely in the commercial side of the business was weaker, and because of which the numbers were impacted. If you could just give a broad idea in terms of what is the mix in the order backlog currently? The mix of the order backlog which could help us kind of preempt or project, the type of future billing, that's one.

Second on the gross margins front specially, if you could share your outlook, both for the near term and slightly longer term into FY12, considering the current state of raw material, the current pricing in the projects and across the business and whatever inventory management policy that we have at this juncture.

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

Okay. I'll try and answer the first one. There is, so you are asking what percentage of our order book is made up of segments or sectors that have -- had slowed down right, in terms of execution?

Pritesh Chedda

Sure.

Vir S. Advani, Executive Director

So the reality is that, almost like we have always said, more than 80% of our carry forward is in the commercial market. There is out of that maybe about 30% is hotel, hospitals which are moving, the other 50% of that 80 would be IT office buildings, etcetera, where there is a slowdown. The remaining 20% out of 100 would be infra projects. I said that there that has been -- so the infra side is not an issue of capital employed or us slowing down or anything, it is more I think these large projects being, getting slowed down at a macro level.

So, I'd say that maybe 70% of the order book is theoretically impacted by either us slowing things down or the client slowing things down. But again, I don't want to -- I want to be clear that the slowdown in the quarter is not something that we are projecting for the next 12 months. Like I said there will be an ease up in the revenue flow. Carrying an order book, we know we can execute it. It's just about getting clear with our debtor position, with our customers and then moving forward. So I think you will see a improvement as we get into the next financial year.

Pritesh Chedda

Is there a chance for any doubtful receivables or doubtful projects which could later on come into provisions in any of these orders that you are executing at this juncture?

Vir S. Advani, Executive Director

No, I don't think so. We are providing now on a quarterly basis as you know, it's a change in accounting policy. So we are -- so we review our debtor position now on a quarterly basis and then take some decisions. So vis-à-vis last year there is no, there is nothing dramatically different and one doesn't expect it to. I think it's just about, which -- and part of the thing is that by taking these commercial decisions that we are, about slowing down projects, part of the reason is that, right, you don't want to bill out and then have to write-off. So we are just making sure that we bill at the appropriate base.

Pritesh Chedda

Okay.

Vir S. Advani, Executive Director

Then forgot your second question?

Pritesh Chedda

On the gross margin side, and at least if I see for the first three quarters there is absolutely no impact on the gross margin. So is the inventory management policy where current prices would impact your gross margins in the

forthcoming quarter or should we read it differently?

Vir S. Advani, Executive Director

I think you would see -- because you are seeing -- you are seeing more or less flat.

Pritesh Chedda

Yeah.

Vir S. Advani, Executive Director

So it's a little difficult to look at a company level gross margin. I know that's all you can see because the business mix changes quarter-to-quarter, right. So there is a business mix impact to the gross margin as well as the raw material. So let's not worry about the business mix because that's adjust itself in the year, right. So by the end of the year, there is no dramatic change in business mix in FY11 or FY10.

So what we are saying is that the gross margin, so input costs have been rising every quarter. They are largely impacting the equipment business of ours, the product business which is between segment one and two. We took price hike decision in September which offset some of the input cost increase that would have otherwise seen in Q3 which would have reduced gross margin, but it did not because of the price increase. You heard Thiag few minutes ago, we are going to see what the Union Budget does and then take a further decision.

But, like you know, copper and steel are now at their highs. And there doesn't appear to be a cooling-off. I think that that seems to -- I think now the prognosis is that will continue for some time longer. So we are going to have to pass on part of that to our customers. I don't think the industry can actually bear that full cost.

So what we are saying is that we are going to do our best to maintain gross margins at the current levels even in the next year, in spite of the input costs, and that's on the equipment business. In the projects business, as you know, they are -we don't have input cost protection there. So there is going to be some impact but because it's projects and we are buying out finished goods, we are able to negotiate better; we have better ways of, we have options for sourcing, so procurement has obviously become a very critical component of that business, much more than last year. And we'll be spending even more time and effort on that going forward.

So the endeavor is to maintain the margins in next year. It's going to be tough given the input costs issue, but we are -and that's partially, I had mentioned that we have taken some decisions to invest and spend money which is now being reflected in our operating costs going up. But some of these investments are related to these subjects, like procurement, like R&D, R&D investment increase is quite dramatic for us, which will hopefully lead to better value engineering and reducing cost of product.

So these are all the investments we are making currently; we don't want to stop making them. So there is some -- there is a temporary impact on the company's performance. But we hope that it will yield these kind of results going forward.

Pritesh Chedda

Okay.

Vir S. Advani, Executive Director

Yeah.

Pritesh Chedda

So far the impact, if I understand clearly is not because we have taken judicious price increase and we have gone ahead for productivity improvement. And that's the reason why gross margins are not impacted by the material price.

Vir S. Advani, Executive Director

That's in gross margin, correct.

Pritesh Chedda

Okay. What is the extent of price increase that we have taken so far? And considering the current material prices and current raw material inventory, if we do not take a price increase further, means the gross margins get impacted in forthcoming quarters in such a scene?

Vir S. Advani, Executive Director

Yes.

Pritesh Chedda

Okay. And what is the total price increase that we have taken at a blended level, if you can give an idea. Is it...

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

Yeah, product-to-product, it will vary, it will be around 2.8%.

Pritesh Chedda

Okay. So that is the blended price increase taken at about 2.8%.

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

Yeah, all products put together.

Pritesh Chedda

Okay. Lastly, if you could share an outlook as to FY11, what kind of an order inflow would you expect that in the EMP business? And what kind of backlog will you close at in the EMP business?

Vir S. Advani, Executive Director

Yeah, it's very difficult to answer FY11 right now. Like I said, I think, you are asking FY11, I am sorry. Not FY12, right?

Pritesh Chedda

No sir, FY11.

Vir S. Advani, Executive Director

FY11, the order backlog will be roughly where it is right now. Because we are expecting billing and booking to be a little better in Q4. Yeah, so we should enter the New Year with this level of order book, around 2100 or so.

Pritesh Chedda

Okay. And you expect the billing also to pick up in quarter four versus quarter three?

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

Yeah.

Vir S. Advani, Executive Director

Yeah. That always happens, but versus Q4 of last year, there probably will not be a growth.

Pritesh Chedda

There won't be a growth.

Vir S. Advani, Executive Director

Versus Q4 of last year.

Pritesh Chedda

Okay.

Vir S. Advani, Executive Director

I am sorry. I am going to have to -- if you get back in line.

Pritesh Chedda

Okay. I am sorry. All the best to you, sir.

Vir S. Advani, Executive Director

Thank you.

Pritesh Chedda

Thank you.

Operator

The next question is from the line of Aditya Khemani from HSBC Mutual Fund. Please go ahead.

Aditya Khemani

Good morning, sir.

Vir S. Advani, Executive Director

Good morning.

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

Good morning.

Aditya Khemani

Sir you mentioned that this quarter order inflow was 682 crores. Could you sir, quantify what was the total bids we participated in this quarter?

Vir S. Advani, Executive Director

I am sorry. We don't track that, but I think that we'd have probably participated, round number around...

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

One-third is our...

Vir S. Advani, Executive Director

Yeah, 2,000 crores.

Aditya Khemani

2,000 crore.

Vir S. Advani, Executive Director

Yeah. But that's a round number.

Aditya Khemani

Sir what I want to understand is how much would -- the market would have shrunk this quarter? Have we lost market share or how has the market come down? Broadly, do you track market share, sir?

Vir S. Advani, Executive Director

Yeah. Absolutely, we do. Very difficult to say though, because it's a tough -- especially on a quarterly basis, it's almost impossible, but on an annual basis we do that. Whatever we understand, so far on an annualized basis, our market share is sustained. We are not giving up market share anywhere actually, I don't think any equipment or project business. If anything, we have increased our market share in a couple of new businesses of ours. So from a market position point of view, we remain confident.

Aditya Khemani

Sir could you quantify that our market share in the product and project business and who would be the main competitors and...?

Vir S. Advani, Executive Director

I am sorry for a quarterly call, this may not be the right place. So if you can maybe send us an email or something, we'll be happy to answer that.

Aditya Khemani

Okay sir. And sir the second question like, the mix of 80% commercial and 20% infra. How do the operating margins and working capital cycle differ in both?

Vir S. Advani, Executive Director

The margins are like-to-like, the capital employed, so there is probably, again I don't have that off the cuff. But I'd say that there is probably it's about 15% higher capital employed relative, one to the other.

Aditya Khemani

In infra. But the margins would remain same?

Vir S. Advani, Executive Director

The margins will remain same, yeah.

Aditya Khemani

So on a ROC basis, infra would be lower than commercial.

Vir S. Advani, Executive Director

That's right, yes.

Aditya Khemani

But sir how would this mix, you expect this mix to change over the next three, four years? I mean would we be more proactive in increasing the share of infrastructure in the total book?

Vir S. Advani, Executive Director

So we are looking at not only infrastructure what we've seen, what I have said is that infra, power, residential, these are all new sectors or segment -- industrial, all new sectors for us as compared to commercial. We hope that these three or four new sectors such that infra, power, residential and industrial together in about three years from now should constitute about 14% of our order book.

Aditya Khemani

Okay.

Vir S. Advani, Executive Director

Okay, yeah.

Aditya Khemani

Okay sir. Thanks. Thank you sir.

Operator

Thank you. The next question is from the line of Lavina Quadros from Enam Securities. Please go ahead.

Analyst

Hi, I would just like to ask this question on behalf of Lavina, this is Munjal. There has been lot of talks on this cold storage side actually again. And recently there was some article with regards to subsidy also on the CapEx on the cold storage side, subject to some terms and conditions and none better than you to answer on this side. Could you just take us through that cold storage, what will happen and now it will happen at a faster pace?

Vir S. Advani, Executive Director

Sure, I will ask Thiag to answer that.

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

See cold storage industry is growing at about 35%. It is both from horticultural side as well as pharmaceutical and food processing industries. The -- but the base is very, very small, it is estimated at around 900 crores. We continue to be the market leader. And the story is that this 900 crore market should grow to around 10,000 crore in about five year's time. That five years continues to get shifted.

No major investment from private sector is taking place. The investment is driven either by government or in the case of pharmaceutical and the food processing industry by the private sector. The fruits and vegetables is the major driver. So we believe that modern retail, only when it takes off, the large investments will take place and then market will explode. Probably, that market size should be higher than even airconditioning market only.

Having said that, the subsidy level is to the extent of around 40%. In some cases, it even exceeds that. That is basically to attract private sector investors. But the investment is very poor except in case of certain commodities. Say for example, apple and banana, which are large consumed fruits and the value addition that it gives can compensate for the cold storage cost. Other than that, we do not see any major things happening in fruits and vegetables.

But we are there. We serve not only fruits and vegetables, pharma, ice creams and poultry, floriculture and sericulture, aquaculture, all that. And we are the market leaders there and when the market grows we keep growing at around 30%.

Analyst

So is it true that banks are offering some subsidized loan also?

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

Plenty are there. Strictly speaking, you can get hundreds of subsidies, many financial packages, but whether the returns will be there is the question mark.

Analyst

Okay. And any new competition that you have witnessed in this cold storage segment?

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

All of them are waiting for the FDI in retail to happen. So once it happens, they all will come in. But our positioning is completely different. We are a turnkey solution provider. We are not an equipment manufacturer and the market they are alone. We manufacture some equipments that is used in a turnkey project. Where...

Analyst

And we have...

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

Whereas the multinational chains which will come, will be for the storefront equipment what we call it. It is...

Analyst

We had some tie-up with some Italian company, right, for this?

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

Yeah. We do have many tie-ups. So we will operate that as an agency business but that is not our focus. Our focus is the back-end cold storage infrastructure.

Analyst

Okay. Thank you very much.

Vir S. Advani, Executive Director

If we can just have one last question, please?

Operator

Sure, sir. Thank you. The last question is from the line of Kirti Dalvi from Enam AMC. Please go ahead.

Analyst

Good afternoon sir. Few question from my side. There was write-back of provision of almost 15 odd crores in the first half. Is there something in this quarter?

Vir S. Advani, Executive Director

Sorry there was?

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

No.

Vir S. Advani, Executive Director

No.

Analyst

There was nothing like that. And sir, there is some purchase of traded goods of almost 45 odd crores in this quarter; that pertains to primarily to which segment, sir?

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

It primarily deals with segment two, Cooling Products and very little of segment one.

Analyst

And this is sir primarily our components or something which we have imported because on a Y-o-Y it has shown a tremendous growth?

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

We import certain plastic components for the room airconditioners.

Analyst

Okay. And sir, you did mention that your -- probably our Q4 numbers would be, in terms of top-line would be similar to that of last year. But do you see the margins also to the extent of similar levels, what we achieved in Q4 FY10?

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

What we achieved in Q3 probably...

Analyst

So the margins you are seeing...

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

Gross margin...

Analyst

No, I am sir, talking about the operating margins sir.

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

Operating margin should be more or less like last year.

Analyst

So Q4 FY10 also will be to the extent similar in this year as well, in Q4?

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

That is right.

Analyst

And sir in your initial commentary, you did mention that there were some one-time 4.5 crores or something the expenditure we incurred. Could you just elaborate? I am sorry but I have missed out on that.

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

No, the employee cost comparison of Q3-to-Q3, it is looking like a huge increase has happened in employee cost. Basically employee cost if you will take out the Q3 FY10 result, employee cost had negatively grown in that quarter, basically because certain credits had been taken. So that is the difference actually, around Rs. 4 crores.

Analyst

Okay.

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

So you have to refer to Q3 FY10 results, you will see employee cost growing negatively in the quarter. That is basically because certain write-backs were there at that point of a time. So on a like-to-like basis, the employee cost wouldn't have gone up by such percentage in this quarter, it would have gone up only by 12% or so.

Analyst

Sure. And sir the last question on Cooling Products. We have seen the robust growth in this year, in the first nine months as well as in Q3. Do you think this demand would be sustainable going forward as well?

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

Yeah as of now, it looks, it will continue to be there for quite sometime.

Analyst

And since we are spending and entering into the residential segment, probably, and given our ad spends and other cost related to that. Do you think the margins we would be able to achieve what we achieved in the past or do you think that will be under pressure at least in the initial one or two years or one year at least?

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

Yeah, the margin won't be under pressure. The volume if we are able to manage around 50% growth, the scale gives you certain cost reductions as well. So it should be more or less balanced. We do not see any problem in operating margins in that segment.

Analyst

Okay. So this 20, 25% growth would be possible or you think higher than that could be possible in Cooling Products?

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

No, we are growing; we are planning to grow at more than 35%.

Analyst

In Cooling Products?

B. Thiagarajan, President, Airconditioning & Refrigeration Products Group

That is right.

Analyst

Thank you, thank you very much and wish you good luck, sir.

Vir S. Advani, Executive Director

Thank you.

Operator

Thank you.

Vir S. Advani, Executive Director

Thank you very much, everyone. Conclude the call now.

Operator

Thank you, Mr. Advani. Thank you, Mr. Thiagarajan. Ladies and gentlemen, on the behalf of Blue Star Limited, that concludes the conference. Thank you for joining us. You may now disconnect your lines. Thank you.