

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Thank you. Good afternoon, ladies and gentlemen. This is Vir Advani. I have with me Mr. B Thiagarajan, and we will be giving you an overview of the results of Blue Star Limited for the quarter ended December 31, 2012. The following are the financial highlights of the company for the quarter, which is Q3 FY13. Total operating income stood at INR598.80 crores for the quarter ended December 31, 2012 as compared to INR584.01 crores in Q3 FY12 representing an increase of 2.5%.

Operating profit, which is PBIDT, excluding other income for the quarter increased to INR25.43 crores from a loss of INR8.81 crores in Q3 FY12. Financial expenses for the quarter decreased by 38% to INR13.72 crores from INR22.10 crores in Q3 FY12. Provision for taxation for the quarter was nil, same as that in Q3 FY12. Although the company is required to make a provision for MAT, due to the set off of the carry forward business loss of the previous year, there's no taxable income for the year and hence no provision is required for tax.

Consequently, net profit is INR5.37 crores as compared to a net loss of INR32.76 crores during the same quarter of the previous year. Earnings per share for the quarter on a face value of INR2, so that put INR0.60 vis-a-vis a negative of INR3.64 in the corresponding quarter of the previous year. Carry forward order book as on December 31, 2012 reduced to INR1628 crores, that's 1628 crores compared to INR1678 crores as on September 30th, 2012, due to slower new order booking as well as a concerted effort to improve the quality of new orders won.

I'll now go through the general outlook of each segment that we are operating in followed by specifics of our performance in each of these segments. So, first, the general outlook for the segments.

For segment one, overall the electromechanical projects market continues to be sluggish with demand slowing across sectors. Though enquiries are getting floated, the finalization of jobs continues to be slow because of political uncertainty, cash flow problems of builders, high interest rates, et cetera.

There's, however, some positive movement in enquiry flow lately in segments like hospitals, IT/ITES, industrials, mixed use development, educational institutions and commercial complexes. At an aggregate level, the central airconditioning equipment market continues to grow marginally. The central plant market is roughly flat, the ducted AC market is growing at 5% this year and the market for VRF continues to grow at 12% to 15% with demand coming primarily from industrial, offices and the retail segments.

The general outlook for segment two, the room airconditioner industry went through one more quarter of de-growth in Q3 FY13. According to our estimates, the market would have de-grown by around 10% over last year. The reason being lower than expected festival business across the country, increased power tariffs and decreased power availability in a few states. The demand in the commercial refrigeration business is robust with demand for water coolers coming from educational institutions, industry and government segments, while freezers witnessed a good demand from the ice cream and dairy segments.

However, the competition is increasing in the market and price realization is expected to be under pressure as we enter the summer season. In cold storage products, the traditional segments of pharma, fast food and restaurants, ice cream, banana ripening, and fruits and vegetable storage continues to fetch good business opportunities. The general outlook for segment three, demand for hi-technology imported equipment has been flat over last year owing to the adverse foreign exchange position.

Government, Scientific, education segments, et cetera, have been cautious in adding new equipment. Demand for destructive and non-destructive testing machines continues to be reasonable with the light and medium industrial segments continuing to make incremental capital investments.

There has been a significant slowdown and deferment of CapEx finalization in core industrial segments, particularly steel, mines and metals, and oil and gas for the entire year. This has impacted our industrial projects business quite substantially.

I'll now move on to the overall performance of each of the segments. So our performance in segment one, the electro mechanical projects and packaged airconditioning business accounting for 66% of the total revenue in the quarter has grown by 7.6% to INR396.02 crores. Segment results grew to INR22.94 crores in Q3 FY13 compared to a loss of INR15.18 crores in Q3 FY12. The operating margin of this business in Q3 FY13 increased to 5.79% compared to minus 4.13% in Q3 FY12, mainly due to better gross margins and focus on business from profitable segments.

As indicated in our last call, the segment operating margin has dropped from 7.03% in Q2 FY13 to 5.79% in Q3 FY13. This drop is primarily due to lower billing as project execution continues to be slow.

The capital employed in the business as at end December 2012 was 477 crores, which was higher than INR423 crores at the end of September '12. The increase in this quarter is primarily on account of a substantial drop in our collection of advances and new orders booked, selectively paying down vendors and business associates, increase in inventory levels in our equipment business, and the overall tight liquidity in the market. This is also becoming increasingly challenging to improve the capital employed levels due to low collections and creditors needing to be paid out quickly.

The company has witnessed a shrinkage in order inflow in Q3 FY13 as well, because -- this is because we continue to be selective in booking orders with better terms of payment and other commercial terms. Besides we have been aggressively pursuing existing customers for price escalations and variations.

Moving on to the central airconditioning equipment business in segment one, despite facing challenges like aggressive pricing in the market by competition, customers preferring other solutions like VRF, et cetera, the company is confident of achieving growth by expanding the product range, furthering our reach, and also by developing good relationships with consultants and customers.

The company is also closely monitoring the new trends emerging in the market like demand for water cooled ducted split ACs, eco-friendly gas-based ducted systems, and is geared up well to cater to our customers changing needs and thereby achieve good growth in this segment despite stiff competition from multinationals.

Some of the major orders won by Blue Star during the quarter in segment one are under Electro Mechanical Projects, we booked Q.R.G hospital in Faridabad; Shankara Cancer Hospital in Bangalore; Capital Greens in Delhi; Pearl City Walk in Bathinda; Wells Fargo in Hyderabad and Bangalore; and JSW Toshiba in Chennai.

In Packaged Airconditioning Systems, POSCO in Pune; HCL Technologies, Chennai; Lafarge, Chittorgarh; Laxmi Diamonds in Surat; Volkswagen in Mumbai. And for central airconditioning products; Gift City in Ahmedabad; SKF headquarters in Pune; Sai Fertilizers, Mumbai; Infosys, Bangalore; CPWD projects, et cetera.

Moving on to segment two, the operating performance in the quarter. In the Cooling Products segment, revenue registered a decline of 5% in the quarter as compared to the same quarter last year, while segment results declined by 47% to INR3.78 crores. Quarter three is generally a lean season for this business.

Blue Star had a de-growth in the room airconditioner business this quarter as compared to the same quarter last year. Last year, there was an additional trigger of a BEE, that's the Bureau of Energy Efficiency, table change resulting in panic buying by customers in December 2012 -- I'm sorry, December 2011 in anticipation of steep price increases by manufacturers, which is not there in this year. Our de-growth, however, was slightly lower than the market de-growth.

The company also witnessed an impact of erosion in margins in Q3 FY13. This is due to multiple reasons, namely the first reason is sales volume drop in the room airconditioner category for reasons explained above. Second reason is on account of losses in the business of sourcing and selling of installation accessories such as copper pipes, refrigerant and insulation material, which has been subjected to high commodity price fluctuations. This has adversely affected segment results. As explained last quarter, this business is expected to be wound up by March 2013.

Third reason for erosion in margins in segment two, dropping operating margins in the refrigeration products business. You may be aware that we had invested in a new factory in Ahmedabad in H1 FY13, excess manufacturing capacity and its related overheads have resulted in lower operating profits in this business, especially given the lean season. This is expected to be reversed as we sequentially load the factory for the upcoming summer.

Overall, the capital employed in segment two reduced from INR237 crores as on September 30th, 2012, to INR216, that's 216 crores as on December 31, 2012.

Going forward, the company expects the budget stimulants, its plans of channel expansion and a focus on the light commercial segment to help it achieve a slender growth in FY13.

Some of the major orders won by Blue Star during the quarter in segment two are room airconditioners, SRM University in Delhi; ISV in Hyderabad; IL&FS, Hyderabad; Shriram Housing in Vizag; Infosys in Bangalore; and Hindalco in Raipur.

For refrigeration systems and products, Dr. Reddy's, Biocon, Mylan Pharma, Domino's, Yum International, McDonald's, Amul, Vadilal, Mother Dairy, et cetera.

Moving on to segment three, in the Professional Electronics and Industrial Systems segment, the revenues reduced by 9%, while segment results declined 18% to INR9.56 crores in the quarter when compared to the same quarter last year, owing to the unfavorable business climate and declining demand in the capital goods sector.

As you're aware, segment three consists mainly of three components; the first one being the agency business, the second one being a system integration business, and the third one being an industrial projects business.

As explained earlier, the agency business in Q3 FY13 continued to be lower vis-a-vis Q3 FY12 due to the impact of a strengthening dollar. We have de-grown by about 10% in this part of the business.

The second component, which is a system integration business is doing reasonably well and continues to show some modest growth.

And finally, the third part, Industrial Projects, the order inflow for the Industrial Projects business has reduced significantly on account of bleak demand in coal, metallurgical, oil and gas, and power generation industries. This has led to lower billing and with sitting costs remaining intact, the profitability is substantially down. Unfortunately, the situation is expected to continue for the next two to three quarters.

However, the company is confident that with its good customer base namely SAIL, RINL, JSPL, Tata Steel, et cetera, and with the industrial CapEx cycle improving by Q3 FY14, the Industrial Projects business should see better business and profitability in H2 of next year.

Some of the prestigious orders won by Blue Star in this segment in Q3 FY13 were Indian Space Research Organization in Bangalore; IIT, Guwahati; Wipro in Mumbai; Specialise Instruments in Mumbai; Volkswagen, Pune; HDFC Bank, Mumbai, et cetera.

In closing, the external environment looks extremely sluggish. In some volatile -- in such volatile market conditions, the company is making concerted effort to grow the business profitably by focusing on our equipment business, executing select big projects with better margins, quickly closing non-profitable legacy jobs, improving sourcing and operational efficiency, carrying out value engineering and cost control measures, and bringing down capital employed to desired levels.

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

With that we are open for questions. Thank you.

Questions And Answers

Operator

Thank you very much, sir. We will now begin the question-and-answer session. (Operator Instructions) The first question is from the line of Praneet Shivram [ph] from BNK Securities. Please go ahead.

Unidentified Participant

Good evening, sir. I would like to get some clarity regarding like what is the order intake figure for this quarter? And if possible, if you can help me in terms of like how much of that is from central AC and how much is from package and chillers?

And also the order book breakup in terms of mix of low margin jobs and -- which are close to zero percent margins and high margin jobs, have it improved from last quarter?

And finally, like if you can quantify the impact of the product segment sourcing and selling installation accessories which we had held off, if you can quantify that, and if you can help us know the adjusted margins in that segment? That's from my side.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

I'll try and break it down. As far as order inflow is concerned, I don't have that number off-hand. What I do know is that order inflow in the current quarter has been lower than Q2, which was expected, but has been at roughly the same level as Q3 of last year, which is not to say much, but it is what it is. That's the first point.

Second point you asked about was the carry forward order book of segment one. I've updated you all I think in the last quarter. Quarter-to-quarter with this level of billing that we're talking about, there will be very minor changes, substantial changes in the overall margin of the order book. I think by the end of the year and in any case we were unable, given the number of jobs in the order book is difficult to keep track of that aggregate number month-to-month, so what we do is we look at it twice a year. So I

mentioned you at the half year what the mix was, we look at it again at the end of the year.

The objective, as I mentioned to you is, to bring down the number of jobs with zero margin to the extent we can by billing them out in the current year. I'd say that we've done about 70% kind of conversion of that in the sense that against our target of 100, we maybe will achieve about 70. Out of 100 of those jobs to be billed in the current year. So we will still be carrying part of it on.

The low margin jobs, again, maybe about 50% to 60% success rate of converting them to closure. The running jobs obviously while they're not moving at a great pace, probably moving relatively the fastest.

So I'd say at an aggregate level, when we end this current FY13, we'll have cleaned up maybe 60% to 70% of what we set out to do at the beginning of the year. Okay, so that's on that. And that just to remind all of you is largely on account of customer willingness to allow us to close these jobs, which basically means finishing up all the work at site to snags, technical handover, commissioning of the systems and establishing the final contract value, raising our final bill and exiting the project.

We are still on track to close approximately 600 projects in the current financial year. I'll have a final number by the time we end the year in March. But that progress is adequate, it's not as good as we would want, but it is better than what is happening in the market.

Finally, you had asked a third question, which is what is the impact of our spare parts marketing business that we have decided to shut down. Thiag, do have a sense of that? Could you maybe pitch in and help me with that? Oh, I'm sorry, Thiag is in -- he's actually in Chennai today, so maybe he's not on. So let me address that.

B Thiagarajan, President, Airconditioning & Refrigeration Products Group

I will tell you where it is, around 1.6 crores of loss we booked this quarter.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah.

B Thiagarajan, President, Airconditioning & Refrigeration Products Group

Cumulative so far it would have been around 5 crores, primarily out of copper pipes, insulation material, as well as refrigerators.

Unidentified Participant

And is there anything remaining in the fourth quarter or is it completely off?

B Thiagarajan, President, Airconditioning & Refrigeration Products Group

Probably around 75 lakhs to 1 crore, maybe at the worst case scenario.

Unidentified Participant

Okay, okay. And just a follow-up on that previous question, that 600 projects if we quantify into value, how much it will be, sir?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Based on the contract value of these jobs, we amount to about 1,200 crores to 1,300 crores of contract value.

Unidentified Participant

Okay. And if I get you correctly, around 70% of the closure of these jobs is our target?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah, about 75%, correct.

Unidentified Participant

Okay, okay, thanks. Thank you. I'll come back for later.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Thanks.

Operator

Thank you. The next question is from the line of Anantha Narayanan from Kotak Mahindra. Please go ahead.

Anantha Narayanan, Analyst

Good evening, sir. Just a couple of questions. What will be the debt levels like presently? It was around 418 crores I think on September?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah, so as of December the debt is up by about 40 crores to 50 crores.

Anantha Narayanan, Analyst

So it will be at around 450 crores, 460 crores?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

I believe so, and we had -- I think in the middle of the year, we had talked about bringing the debt down to about 350 crores by March, which was the same level as March of 2012, while the internal target continues to be that, I think we're selling more closer to around 400 crores by year-end.

Anantha Narayanan, Analyst

400 crores?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah.

Anantha Narayanan, Analyst

And sir, how is the performance of the subsidiary Blue Star Electro Mechanical, if you can give us some numbers?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah, I don't have those numbers here, but essentially it is running in line with the parent business. We have -- like I mentioned to you, we had got to that order book after we had finished the parent company order book. And so what we are seeing is margin reversals in that business similar to the ones we had seen in the parent company over the last few quarters.

So we will have another year of loss in that business in FY13. We'll have a better handle of it by the end of the year. We're expecting that once we do this, from next year we will breakeven and be positive.

Anantha Narayanan, Analyst

Got any plans to merge Blue Star Electro Mechanical into Blue Star?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

No, we have no such plans.

Anantha Narayanan, Analyst

No such plans?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

No.

Anantha Narayanan, Analyst

And sir, just one last question. What is the hedging policy presently? Do we hedge 100%?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah. No, so we have a policy and then we have what we're actually doing right now. So our policy calls for a minimum hedge of 50%.

Anantha Narayanan, Analyst

Okay.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

And also has an upper limit of the amount of dollars one can have unhedged.

Anantha Narayanan, Analyst

Okay.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

But what we are running at right now is about 80% to 85% cover.

Anantha Narayanan, Analyst

Of imports?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah, that's right. Of our net exposure.

Anantha Narayanan, Analyst

Net FX exposure?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Correct, correct.

Anantha Narayanan, Analyst

Okay. Thanks, sir.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Thank you.

Operator

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

Prerna Jhavar, Analyst

Hello, sir. Good evening. Sir, could you -- is there any FX component in the interest costs?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

In the -- you mean in the finance cost?

Prerna Jhavar, Analyst

Yes.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah. So the finance cost line has both interest cost as well as the impact on our foreign exchange borrowing. It's a summation of the two typically and that's how it usually is. So -- and about 50% of the finance cost will be borrowing interest cost and about 50% of it will be the exchange difference on our borrowings.

Prerna Jhavar, Analyst

And how was that in H1, sir?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

How was that in H1? So you're asking our finance cost? So you're -- which number you --

Prerna Jhavar, Analyst

The same split for the finance costs.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Okay, one sec. So on a YTD basis, let me try and answer this. On a YTD basis, our interest cost as compared to -- I want to make sure I get this right. Half year our total -- our finance costs were about 24 crores, about 13 crores of it was interest and about 11 crores was the exchange difference on borrowing. And in this current quarter, out of this 14, about 7 crores is interest and bank charges and another 7 is the exchange difference. So it's running roughly the same.

Perna Jhavar, Analyst

All right, sir. And sir, just wanted to know of the spare parts business which are winding up, what was the revenue that we recorded YTD?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Thiag, again, can you help me with that?

B Thiagarajan, President, Airconditioning & Refrigeration Products Group

Can you please repeat the question, please?

Perna Jhavar, Analyst

Sir, what is the revenue that you've recorded so far in the nine-month period in the spare parts business, spares marketing business?

B Thiagarajan, President, Airconditioning & Refrigeration Products Group

Roughly around 35 crores.

Perna Jhavar, Analyst

Roughly around 35 crores. And how was this in FY12?

B Thiagarajan, President, Airconditioning & Refrigeration Products Group

It was much larger. It would have been roughly double last year.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

All right, sir. Many thanks, sir.

B Thiagarajan, President, Airconditioning & Refrigeration Products Group

Thank you.

Perna Jhavar, Analyst

Thank you. (Operator Instructions) The next question is from the line of Prashant Talwar from SAIF Partners. Please go ahead.

Prashant Talwar, Analyst

Thank you, sir. Wanted to know from you, the split of segment one order book in terms of site margins less than 5%, 5% to 7% and greater than 7%? And also, if you could, give me a split of margins between segment two, between commercial airconditioning, room airconditioning and other cooling products?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Sorry, I don't think we break up all of this like this, what I had been explaining is the carry forward margin on segment one, which I'll maybe try and repeat for your benefit, segment two to break it up into margins is difficult, but let me try and go back to this carry forward of the segment one.

So we had -- I think, I think we're talking about last year's clean order inflow was about 900 crores, and this year we're running at a

lower rate. I think if I'm not -- if I'm correct about 100 crores will be of -- it would be zero margin business. About 300 crores to 400 crores would be at about 5%, and the remaining would be between 7% and 12% depending on nature of business and when it was booked.

So, that ratio is changing as we execute this order book, what I mentioned is, we're aiming to get down to -- our aim was to get to zero business carry forward at zero percent margin by March '13. We may -- I mean, we will be a little short of that, but we'll get pretty close to that.

Next is, we wanted to bring down that 300 crores to 400 crores of 5% business at a much faster pace, that we have not been able to do as successfully because of the capital employed impact associated with it, because these are sort of slow moving, non-moving jobs.

So, that, we will still be carrying forward into next year, some amount of that. As far as the clean business is concerned, we had hoped to build much faster, as you know, you can see from the results that we're struggling to build at the rate we want and more importantly, the capital employed is actually increasing in segment one, quarter-on-quarter is primarily because the inflow of cash has been slow in spite of say, executing the running job.

So we're having to, we're continuing to manage the billing in line with the capital employed and Q4 intention is to bring down segment one capital employed quite substantially, and therefore there will be some impact on the overall billing for the quarter. So that's what I can tell you on the segment one carry forward.

I think in the half-year I had mentioned to you that our aim was to close about 650 jobs. I think we had closed about 270 jobs mid-year. I'm revising that 650 to about 600 jobs for the year, which I just mentioned to the other gentlemen, we are on track to do that. And, so we should get to about 600 jobs this year. Yeah?

Prashant Talwar, Analyst

Sure. Sir, any guidance on margins of segment two between room airconditioners and the commercial airconditioners?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

No, no. So we don't -- I think first of all, segment two is made up of two types of businesses. There's a room airconditioner business and there's a refrigeration products business. And those two together make up the segment. We actually don't break out the margins separately for each of the businesses.

So -- but what I explained to you is that the -- one is, Q3 itself is always a slow quarter, so that goes without saying. But really this quarter we had a lower than expected operating margin, largely on account the room airconditioner business. I'll repeat, one reason is that in December 2011, which was last year, there was a big push out of room airconditioners into the market because there was a BEE table change that came into effect on 1st of January.

So we did quite a bit of billing in December, which of 2011, which we did not do in December 2012, because the table does not change this year. So it's -- obviously you'll understand that the lower the billing in that business, the lower will be the operating margin. So that was one reason.

The other reason for the lower operating profit in segment two, again, we explained was the spare parts marketing business where we had, I think, 1.5 crore to 2 crore correction in the margin in this quarter, which was not there in December 2011.

The refrigeration products business continues to do relatively well. Margins seem to be on track and there doesn't seem to be any significant issue in that business other than there is an increasing amount of competition in that business with new multinationals coming in, and price realization is going to be a challenge for us going forward.

So as we enter the summer season, we're going to be watching our refrigeration products business margins quite carefully because we have to stay competitive in the market.

So, still early, but on an overall basis for the quarter, it was a room airconditioner volume push and it was the spare parts marketing business both that led to this lower than expected contribution.

Prashant Talwar, Analyst

Sure. Thank you, sir.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Thank you.

Operator

Thank you. The next question is from Chirag Setalvad from HDFC Mutual Fund. Please go ahead.

Chirag Setalvad, Analyst

Hi, good afternoon. You mentioned in the past that in the projects business, you are bidding at 12% site level margins and 7% at about EBIT margins. And I wanted to understand, does that include the services component in this business or does it exclude it?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah, yeah. So when we say site margins, we are typically talking about the sale margin, which will include site margin plus any equipment margins associated with that project to the extent that there are any pre-negotiated service contracts that are finalized at the time of bidding or finalization, to that extent, the service margins will be included, but those are sort of one in ten contracts will get finalized with pre-negotiated rates. And so, by and large, it does not include the service component.

Chirag Setalvad, Analyst

And it would exclude the services, the historical services component?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah, yeah, it would definitely.

Chirag Setalvad, Analyst

Right. And approximately, what will be the break-up of this 1,600 order book between projects and products?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Projects and products, so projects is about 80%.

Chirag Setalvad, Analyst

Okay.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

And about 20% would be the products.

Chirag Setalvad, Analyst

Great. Thank you.

Operator

Thank you. (Operator Instructions). The next question is from line of Nitin B from Ambit Capital. Please go ahead.

Nitin Bhasin, Analyst

Hi. Good afternoon, sir. If I look at your segment one revenues, marginally up from the last year, and your margins have also

improved materially now when you look at the three quarters now. And given that you're saying that you're choosing projects very selectively, and where do we see the next 12 months, let's say, FY '14, can they be relatively on trend wise, better margins from what you have booked till now?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah. So, well, the issue is a little different. So, the margins, the gross margins are definitely higher, which is reflected. The problem for us is the operating margin, which right now is looking better than last year obviously, but it's not like-to-like comparison. On a standalone basis for the segment one margins to be at this 4%, 5% is obviously not acceptable to us given the capital levels that are required for the business.

Nitin Bhasin, Analyst

Yeah.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

So, really the challenge for us going into next year is, how do we cut our cost substantially in segment one such that, because I'm not expecting significant revenue growth at all. So you can see from the carry-forward order book, there's no real improvement.

I still am a little hopeful that in Q4 we are successful on some large business, but again, it's a touch and go, it could spill into Q1 of next year just as easily. So, while I continue to be hopeful that some business will get finalized, you can see from the order book levels that the order book will not support revenue growth in one. And so if I presume that revenue is going to be flat, and we have to do better than we're doing currently, we're going to have to cut cost substantially, if we don't cut cost then actually we'll end up happening is that the operating margin in segment one will drop next year versus current year. And obviously, even the current year levels are not acceptable to us.

Nitin Bhasin, Analyst

Just staying on this, I get your point that it's not acceptable because considering the very good past, whether it's FY11, FY10, and let's say, you're able to -- how much will be cost reduction? Because at one point in time you said that you want to reduce your cost by about closer to 20%, but you were seeing a better visibility in the systems, you held back little bit of cost cutbacks, now again you're saying that the visibility is not that great.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Right.

Nitin Bhasin, Analyst

Yeah. So, just assuming that the top line remains broadly here and there in terms of plus minus 5%.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah.

Nitin Bhasin, Analyst

And you're able to achieve because you are cognizant of the fact that there is issue in the system, you'll be cutting down some costs. So on a trend level, it is 5.5%, which we see in the nine months till now. It will definitely look closer to 100 bps at least better, because, see, you are executing the orders of past, which are poor, and you're now booking purpose in gross margins as you said and we also.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah.

Nitin Bhasin, Analyst

So, definitely the trend you're saying we are upwards.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah.

Nitin Bhasin, Analyst

The intensity of the trend could be very different from here on, intensity because it's very sharp, minus 2.5% to 5% is very good, but from 5.5% to going to 9% is difficult, but 5.5% to 7% is possible. Is that right way to summarize it that you can closer to be 6.5% to 7% if system remains what it is today?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah, so I'll just clarify, we've been signaling that segment one operating margin will be in that 4% range. I know YTD is still looking better than that, but I'm still cautious about the year-end figures because you remember, I'm still trying to close out some zero margin business very aggressively that I'm not being able to, well I want to. And so should that happen, should we be able to do that, there will be a dip in the year-end margin.

Nitin Bhasin, Analyst

Yeah, I get that point.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

So, keeping that in mind, I would say that whatever we close this year at, you should see an improvement next year between cost cutting and the general improvement in the gross margin, certainly, but it's very far to see 7% and 9% and all as of now, we'll have to work on that.

Nitin Bhasin, Analyst

But, definitely better.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah.

Nitin Bhasin, Analyst

That's one thing. Okay. The other thing is, in the second segment business, in one of the press articles, it was mentioned by Mr. Thiagarajan that they're expecting that the if market grows up 15%, you're expecting kind of a 9% market share, if you can add some color on that, how do you intent to achieve that?

Second, there was a comment also in the same article he said, market is witnessing a growth of 15% to 17% recently, whereas early in the call you said that the market is declining by closer to 5%, 10%, so if you could just have some sense on this?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah. We have with a trend for the two consecutive years. When the market was growing a year before, we grew around 5% more than the market. This time when the market has de-grown by around 5% or so, we have our decline in March, when we end the

year, wouldn't be that much at all.

So as far as the next year is concerned, it is dependent on actually two important aspects. One is how severe the summer will be. Two, the power situation across the country which as of now is very pathetic.

Nitin Bhasin, Analyst

True.

B Thiagarajan, President, Airconditioning & Refrigeration Products Group

But the industry, as a whole, agree on around 15% growth because it has bottomed out the feeling that we have still around 3.4 million. To give you a sense, China's market size is 50 million. So 3.4 million to 50 million, you can imagine, both the countries more or less keep in pace with each other in terms of the market growth. In this category, there is a huge penetration gap.

As far as we're concerned, the products are ready, range is complete, distribution network expansion is happening and we are investing in other marketing activities including advertising, and we should grow if the market is growing by 15%. So this is the context of that announcement.

Nitin Bhasin, Analyst

Okay, sir. If the market grows 15%, you expect to grow at 20% to 25%?

B Thiagarajan, President, Airconditioning & Refrigeration Products Group

May not be. As of now all that we are saying is that we will grow in line with the market, okay. I'm not committing about it because as we've mentioned some time ago, see, this game is all about that four month performance determine the rest of the year. You have a very little room for correcting it later.

The price points must be low. So what actually happens is that if the market is not going to open up, the people will become desperate and discount. Then you should be able to alter the prices and this is the game actually.

So, right now I will not commit that we will grow better than the market. Our growth should be in line with the market.

Nitin Bhasin, Analyst

And sir, same article, sir. You said that the market is witnessing a growth. Is there any kind of a growth in the December month or any other time and --

B Thiagarajan, President, Airconditioning & Refrigeration Products Group

The festival season has been reasonably good, but not like last year. So the confusion is this, right, why it is not growing like last year? Last year is a different thing altogether. That is December, you have to get rid of all the stuff, all the manufacturers, so it will be a primary movement that will be taking place in the market.

Nitin Bhasin, Analyst

Okay.

B Thiagarajan, President, Airconditioning & Refrigeration Products Group

So, right now, the festival season, it has been good. I would say among all the segments like we generally divide as the large commercial space than medium space like shops, showrooms, boutiques and the third one is residential, residential is doing reasonably well despite this economy.

Nitin Bhasin, Analyst

Okay. And just going into the last question is the segment number three. There was margin uptick in the revenues per EBIT margin on sequential basis, went up really sharply. So, if you could say that, you just help us understand that on even a lower scale of business, which is today, can these margins be repeated or there was something else and one should say that they are also at risk?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Let me try and take that. You are asking sequential margin, right, in segment three?

Nitin Bhasin, Analyst

I'll just come again, segment three, typically you've done a margin in excess of 20% in the EBIT level, only one quarter, which was 2Q, earlier in September quarter, you did a very poor margin of about 7.8.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah.

Nitin Bhasin, Analyst

Now you've come back again to 20% or slow on a reduced scale of business as well, which is -- so do you think this margin is kind of going to stable at this level now, those one-off thing, which was in 2Q, and hence you lost margins over there on a reduced scale of business also. Because you mentioned earlier in the call that third quarter is where you see some inflows now.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

I understand, okay, sure. Let me try and take that. So first of all, we believe that a steady state margin in segment three is north of 25%.

Nitin Bhasin, Analyst

Okay.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Okay. The entire year, we've had lower than that. I think it was 22% in Q4 of last year, 23% in Q1, it dropped to 7.5% in Q2, and it's up to 20.3% in Q3. This is all below what it needs to be now, it's on account of a few things. So, Q2 itself was a one-off event, we explained this to you saying that it was in the industrial projects business where we had an issue. That has been taken care of.

Q3 and Q4 will continue to have -- there are three parts of this business as the agency business, there is system integration business, there is a projects business. The agency business in FY13 is running about 10% lower than the prior year's because there's dollar moved up and all the budgets, as you know, were finalized at the beginning of the year at a different dollar rate and today it's running at different dollar rate.

There's still lot of scrambling going on to get reissued all of that. The system integration business, which is mid-sized CapEx investment for industrial customers is growing at single-digit type of volume. The industrial projects business, which is about a third of this business is severely impacted. So, what you are seeing in Q3 at about 20% is a muted industrial projects business and a minus 10 to zero sort of growth in the other parts of business. As we pickup order inflow in the projects business, by H2 of next year, you'll see the margins in this business climbing back to 25% plus.

So in the interim, we are going to have this level of margin on 20% or so, because we are catching up on that, but you're not going to see it, it's unlikely that it will drop to this 7%, 10%, 15% that we saw last quarter. That's the one-off event.

Nitin Bhasin, Analyst

Okay. Thanks a lot for the detailed answer. But just one thing, you mentioned that third quarter is where you expect good pickup in orders. How do you count that in terms of where do you see third quarter of FY14? Thank you.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

You're asking about the industrial projects business?

Nitin Bhasin, Analyst

Yes, yes.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

I honestly just a way -- a year out, I don't have any better sense is that we have -- it's just like the commercial business, we are continuing to have enquiries, we're bidding on, bids are in, they need to be opened, opening is getting delayed in the steel, oil and gas, petrochem industry. I don't know when it's going to lift. We feel it's a year out, but it could be shorter, it could be longer. I don't think we have clued in, and asking to that market to really have clear judgment on that.

Nitin Bhasin, Analyst

So the overall company in terms of growth direction is going to be, again, single digits to very early double digits unless and until something mean fully changes for segment one during the course of the year?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Correct.

Nitin Bhasin, Analyst

Thank you.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Thank you.

Operator

Thank you. The next question is from the line of Salvin Shah from Edelweiss Securities. Please go ahead.

Salvin Shah, Analyst

Good afternoon, sir. Just wanted to know the status on Utkal coal block in terms of approvals and signing off mining lease and all?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

I'm sorry, I don't a clue what you're talking about.

Salvin Shah, Analyst

Hello.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah. I'm sorry, I don't have a clue what you're talking about.

Salvin Shah, Analyst

Just wanted to know the status on Utkal and I --

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

I think you may be on the wrong call. This is a call for Blue Star Limited. Thank you.

Salvin Shah, Analyst

Thank you. Okay.

Operator

The next question is from the line of Mahesh Bendre from Quantum Securities. Please go ahead.

Mahesh Bendre, Analyst

Hi, sir. Just want to understand what is your outlook on order booking next year? Will it be better than this year or maybe still situation is too tight to --

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

I appreciate you're asking a question about next year and not next quarter, but even though I like the question, I have even less of an answer for you. We don't have a clue what's going to happen. I think we're just forecasting projects business, order inflow will continue to be at this kind of level which is quite low. And we're still hopeful that the equipment business, we will continue to see some marginal growth, but we really don't have a good sense.

All I know is that our enquiry levels are as high as they were a year ago, and as high as they were six months ago, but that don't seem to translate into order inflow. And so it's very difficult to judge what's going to happen next year.

Mahesh Bendre, Analyst

Okay, okay. And sir, I mean as a company do you think worst is behind us in terms of execution, new order booking and margin?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

I think the worst is behind us for you said execution and margins, I believe. Order inflow, I'm still a little cautious because this year our order inflow will perhaps be the lowest it has been in maybe four years and we are not changing our strategy on order inflow. And so if the conditions continue like this or get worse, then we may see further pressure going into next year on order inflow. So that's the only metric I'm not sure where it will end.

Mahesh Bendre, Analyst

Sure. And sir, the order book we have that is 1,600 crores, what portion will be get executed over next 12 to 15 months?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Typically this order book is about a two-year cycle. And so I suppose about half of it will get executed next year.

Mahesh Bendre, Analyst

Sure, okay. Thank you, sir.

Operator

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

Nirav Dhanraj Vasa, Analyst

Good afternoon, sir.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Good afternoon.

Nirav Dhanraj Vasa, Analyst

Sir, I just wanted to know one thing that now that you're targeting to get orders with minimum 12% site margin. So what are the competitive levels that you're seeing right now in the industry per se, because what my understanding is that there are many regional players in this business who are ready to work at lower margins.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah.

Nirav Dhanraj Vasa, Analyst

Now are they still ready to work at lower margins or they're also are bidding with higher prices?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

No, there are definitely small contractors, regional and even present in certain cities that are usually willing to work at lower margins and on different commercial terms, et cetera. So I don't think that's going away any time. I don't think they're raising their prices necessarily.

What we're seeing is that there is a certain size of project above which the customer doesn't want to take a risk with a small contractor, so they will not consider those contractors in such projects or there may be cases where customers do give larger projects to these contractors in which case we have little choice but to wait out the execution of the contract and let the customer experience the difference between a small contractor and an organized contractor.

So, I'd say that they're very much there. They continue to be a threat. That's part of the reason why order inflow is slow and -- but we have to live with them. I think our only way forward is to differentiate on engineering, on execution which is what we're doing.

Nirav Dhanraj Vasa, Analyst

So effectively if I take this conversation forward and what my understanding is that, going forward in the next year, the order inflow which is expected to come, it would be mainly from the quality orders where the ticket rates would be higher where the competition of the smaller players should be limited?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

That's right. You're absolutely right.

Nirav Dhanraj Vasa, Analyst

So you're trying to reduce your project sites and concentrate more on high value projects?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Absolutely. Correct.

Nirav Dhanraj Vasa, Analyst

Yeah. Sir, if you're concentrating in these high value projects, then the competition from the mid-tier segment players would be equally that ferocious as per my understanding, because they also have burned their fingers in your project business because of delays and commodity hikes. So, are you sensing that competition to, from strong this mid-sized players has to be equally intensive?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah. Well, you know what we've been saying is that, so we're booking business, it's not that we're booking nothing. So, the fact that we are booking business albeit at a lower volume implies that this kind of pricing, there are customers who want to give you this kind of pricing, and there are also competitors who are taking business away from us at similar level of pricing. So I'll have to imagine that the larger MEP players are quoting more reasonable rates just like we are, and maybe there is some -- I think definitely over the last 15 months or so, there has been some kind of rationalization of pricing in the market, of course above a certain value, below a certain value, it's like we mentioned, smaller players operating at different cost base and competing.

Nirav Dhanraj Vasa, Analyst

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

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Thank you.

Operator

Thank you. The next question is from the line of Sachin Maniar [ph] from CIMB.

Unidentified Participant

Hello?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Yeah, go ahead.

Unidentified Participant

Yeah. Hi, sir. Harish from CIMB. My question is on segment one and two. Given the issues whatever we've seen in the last 1.5 to 2 years, can you highlight some of the cyclical issues which you're facing at this point in time or near-term issues, and some issues which are structural in nature?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

So, from a cyclical point of view, we're in the middle of a building cycle that we're stuck in commercial real estate, at a certain point in most markets. When that cycle will turn and when business will pick up again, we keep guessing and anticipating, and unfortunately, I have never been able to judge it, I always get it wrong. So, I'm not in position to really focus out what's going to happen.

So commercial real estate is clearly in a particular cycle as it is. Structurally, I think also commodity pricing is in somewhat of a cycle

we've seen, we've seen for the last six to eight months some stabilization of commodity pricing, of course, the dollar has misbehaved, but commodities have largely behaved.

Again, I don't know what is going to happen with commodities as we go forward. So as a business, we have two cycles we're dealing with, one is the commercial real estate demand cycle and the other is the commodity price cycle. So those are the two challenges for us. From a structural point of view, on the project side, two clear differences; one is we've moved into the electro mechanical space instead of just the HVAC space. So we have some of our competitors, and so there are certain number of MEP contractors in the market that are competing for mid-sized, large-sized projects, which in turn has created a space for smaller local contractors to operate in single service smaller projects. And so that is a structural change that we're not anticipating will go away anywhere anytime soon. So maybe it's created some more space for these smaller contractors who are willing to work on terms and conditions that some of us are not willing to work on. That's on the project side.

On the equipment side, different challenges. Segment two, large structural change is the entry of multinationals into the business continuing to be -- to increasing. So we've got large number of players, formidable players, Japanese, American, European, not just Chinese, Korean which typically we've been able to manage. These are technology heavy weights who are competing very aggressively in the market, whether it's our room airconditioner business or our refrigeration products business, et cetera.

So that is a definite structural change. Many of these markets had between five to 10 competitors some time ago. Today, there are 15 plus competitors in each of these markets. So it has a different set of challenges for the company. The other structural change in that business has been the energy efficiency and the refrigeration related changes. These are all permanent in nature. Energy efficiency norms will keep getting more stringent. Refrigerants that are anti-environment will keep getting faced out.

And so, for structural changes that unless you own your own technology, your own R&D, your own ability to bring products to the market, there's very little place for you in this market. And so we've been gearing for that for the last three or four years and quite confident of addressing this structural change in the industry.

So it's a big question that I've tried to answer very quickly, but I hope you get a sense of it.

Unidentified Participant

Okay. Another question could be in terms of your advances from customers or your working capital requirement. Advances have gone down, working capital have increased and looks like some of -- this is structural in nature rather than cyclical. Can you concur on this particular fact? One. And secondly, in your annual report, you had highlighted the clear focus on cash flow and how it is going to trend in FY13. If you can talk a little bit about cash flow and how it will happen, how it will shape up by FY13 and going forward in FY14?

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

So, yeah, so the working capital requirements are not structural in our opinion, they are cyclical. Advances being lower is hopefully cyclical and not permanent. If it's permanent, then we don't really have a business.

So I'm presuming that as the market picks up, we will see advances improving, but advances only contribute partially to your working capital, it's not a big component. Real issue with working capital is collecting your money, that's due rightfully, legally due by from your customers.

And I again, I'm an optimist, so I presume that the interest rate issue in the country will not last forever. I, therefore, presume that the liquidity crunch that exist in this market today will not continue. And so, contractually, we're due large sums of money. Practically it is not payable by customers for reasons we all know. I continue to believe it's a cyclical issue and not a structural issue.

Obviously finding the right clients to work with and working with them properly and tightening up our own ship and all that is very critical and we're doing that. But other than that I think the issue is cyclical. So that's point one.

The other one you asked is on the capital employed for the company. We continue to obsess about capital employed. Unfortunately, quarter-to-quarter, the capital employed in the company is actually deteriorating instead of improving.

Our intention like I had mentioned is, was actually to land up at the same level as the end of last year, which I'm now revising marginally and saying that we may not achieve that goal, it may be about 50 crores higher than last year.

We, of course, still intent to trying it to last year level if we can. But like I said, there's a trade-off between billing and capital employed and we feel that with the quality of customers improving slowly that your capital being with better quality customers, there's some risk we have to take. So we are taking that risk carefully.

But I think for the year, it will continue to be a challenge. I'm hoping that there will be some changes that will be announced over the next year or next couple of months between now in the budget that will help ease some of this liquidity. And if it does, then you will see this capital employed come down.

And maybe what we've choose to then do is strategically build some more, because if it is with safe customers and we rather be billing and collecting our money after sometime and keeping it in the bank. So that's where we are on the capital employed. All right.

Unidentified Participant

Okay, sir. Thank you so much.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Thank you.

Operator

Thank you. Ladies and gentlemen, due to time constraints, no further questions can be taken. I would now like to hand over the floor back to Mr. Vir Advani for closing comments.

Vir S Advani, President, Electro Mechanical Projects Group and Executive Director

Thank you very much. Thanks for taking the time to sit in on this call. We will be -- if there are any question we are unable to answer, please send us an e-mail and we'll do our best to respond. Otherwise, we will be speaking to you at the end of the year once the financial results are out. Thanks again. Bye-bye.

Operator

Thank you. On behalf of Blue Star, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.