“Voltas Limited Q1 FY18
Earnings Conference Call”

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Moderator: Ladies and gentlemen, good day and welcome to the Voltas Limited Q1 FY18 Earnings Conference Call hosted by Motilal Oswal Securities. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Ankur Sharma from Motilal Oswal Securities. Thank you and over to you Sir!

Ankur Sharma: Thanks Raymond. Good afternoon ladies and gentlemen and welcome to the Q1 2018 Post Results Conference Call of Voltas Limited. With us today we have the senior management team at Voltas represented by Mr. Anil George, President - Corporate Affairs & CFO, Mr. Abhijit Gajendragadkar, Executive Vice President - Finance; Mr. Utsav Shah, Head Corporate finance, and Ms. Asawari Sathaye, Corporate Communications & Investor Relations. We shall have the opening remarks from the management and then have a Q&A session. Over to you Sir for the opening remarks.

Asawari Sathaye: Good afternoon everybody and I will start with the analysis of results quarter ended June 30, 2017. Central Bank the world over led by the US Federal Reserve is preparing to rollback easy credit policies as their economy is recover. More recently Canada interest rate for the first time since 2010 joining US and seven other major countries in doing so. The European Central Bank and The Bank of England too have entered into the need to tighten their monitory policy. Meanwhile IMF in its latest economic update continues to estimate global GDP at 3.5% for 2017. Growth for the Chinese economy appears to be inching up after decelerating for six consecutive years. Middle East economy has remained hampered by low oil prices. Lot to speak of other geopolitical concerns particularly following the stand of situation between Qatar and certain other Arab nations.

On the domestic front demonetisation and the ambiguity over the actual impact of the Goods and Services Tax or the GST ways and across quarterly results of corporates. GST filing now awaits assessing and navigating the many forms that prove challenging. Industrial growth in May slowed down to a three-month low due to adjustments in factory production ahead of July 1, 2017 rollout of GST. Owing to demand and supply mismatches, consumer prices rose by just 1.5% in June well below the RBI's forecast range of 2% to 3.5%, at the same time data on fresh investments and capacity utilization also indicate a weak demand environment. Monsoon arrived earlier than usual with most parts of India receiving above normal rain while some of the southern states experienced scarcity. In general, there is an increasing expectation of a stronger rural economy this year. Given these factors, RBI has lately reduced the repo rate by 25 basis points falling somewhat short of industry expectations. However the overall sentiment remains positive with the Sensex on a record breaking run. Estimates from the government as well as those from various independent agencies indicate a GDP growth of over 7% for the current year. The consolidated sales and income from operations for the quarter ended June 30, 2017 was higher by 6% at Rs.1962 Crores as compared to Rs.1845 Crores in the corresponding quarter last year. Profit before tax increased by 16% to Rs.261 Crores, profit after tax simultaneously improved by 18% to Rs.188 Crores, a delta of Rs.28 Crores over the previous year. Earnings per share, the face value per share of Rs.1 not annualized as of June 30, 2017 moved up to Rs.5.61 better than Rs.4.76 last year. Other comprehensive income recognized as per IndAS mainly includes notional mark-to-market revaluation gains or losses on various longer-term investments. Total comprehensive income for the quarter stands at Rs.234 Crores as compared to Rs.186 Crores in the corresponding quarter last year. Despite environmental headwinds diligent financial planning has ensured the continued robustness of our balance sheet with low debt, lower working capital and a comfortable cash position.

Analysis by segment:

Segment A: Electromechanical projects and services. Segment revenue for the quarter was higher at Rs.661 Crores as compared to Rs.580 Crores in the corresponding quarter last year. Segment result was also higher at Rs.35 Crores reflecting a higher result revenue margin of 5% coming from better quality carry forward orders and efficient execution. Order book of the segment stood higher at Rs.4906 Crores as of June 30, 2017 as compared to Rs.4417 Crores in the corresponding quarter last year.

International Operations: Despite the benefits of an uptake in the global economy the growth in GCC economy faced structural limitations due to the reliance on commodity export, the stronger US dollar and lack of readiness with the exception of the UAE to operate as trading hub. The much awaited spending related to the mega event, which is Expo2020 and FIFA 2022 has now started picking up with projects being awarded to main contractors. We continue to see inflow of suitably risk mitigated orders leading to a more comfortable order backlog of Rs.1972 Crores. Orders booked during the quarter include Rs.359 Crores for MEP work of a commercial building in UAE and Rs.137 Crores Voltas share for a museum in Oman. Learning from the past a number of internal initiatives have been undertaken to enhance labour productivity, strengthening commercials and build execution capabilities. Meanwhile given lower carry forward order book and slow pickup in execution at the newer project side turnover for the quarter was lower than last year; however, profitability was better than last year owing to better quality projects under execution. The situation in Qatar is being monitored on a regular basis and steps have been taken to mitigate likely delays in the event of a prolonged debt lock.

Domestic Projects: Performance in the domestic project business was encouraging with over Rs.700 Crores worth of new orders booked during the current quarter. This includes Rs.490 Crores for electrification project backed by central government sponsored scheme. Enquiries particularly for infrastructure projects such as metros, airports and water treatment have picked up. As mentioned in earlier con call, our strategic shift in focus to government projects or externally funded investments has started bearing fruit. We have an increased order backlog of Rs.2934 Crores as compared to Rs.2018 Crores last year, various process improvements and restructuring activities done over the last few years provide us greater comfort on internal efficiency reflecting in better profitability. The implementation of GST all positive in the long run led to some disruptions in the quarter particularly in the run up to the transition rate.

Segment B: Engineering Products and Services: Segment revenue and results for the quarter was higher at Rs.90 Crores and Rs.26 Crores as compared to Rs.69 Crores and Rs.19 Crores respectively in the corresponding quarter last year. Performance of this segment has improved mainly due to higher capital machinery sales in the current quarter. As seen from the widespread protest across the country owing to perceived ineffective GST the sentiments in the textile industry were muted. While subsidy driven spending particularly in the western part of the country continued, the later part of the quarter met with very weak demand as well as reduced activity level. In mining and construction equipment, Mozambique operations continue to smartly contribute to the divisions performance, meanwhile continued government spending on road infrastructure in India bodes well for the sales of crushing and screening equipment. Meanwhile mining activities remains subdued with some of the re-auction mines yet to commence operations.

Segment C: Unitary Cooling Products: Despite the high base of last year segment revenue improved to Rs.1212 Crores as compared to Rs.1196 Crores in the corresponding quarter last year. While the quarter started off well led by hot weather and strong demand, growth in the later month was impacted due to unseasonal rains in Southern India and most significantly due to the many uncertainties surrounding GST. Particularly in the month of June the lack of clarity on GST transitional provisions led to a great reluctance on the part of dealers to pickup fresh inventories. At the same time in many parts of the country dealers resorted to heavily discounted pre-GST sales in a bid to minimize their own stock levels at the time of transitions.

Despite these uncertainties, the Voltas brand sustained its number one position in the room air conditioner market at multi-brand outlet with an increased market share of 22.2% as at end June 2017 and the QTD of 21.6%. The new advertisement campaign combined with promotional offers and trade support measures met with an encouraging response. While segment result for the quarter was marginally lower at Rs.171 Crores as compared to Rs.178 Crores in the corresponding quarter margin remains strong at 14% notwithstanding higher selling expenses.

To sum up, the room air conditioning business is weather reliant and we would like the rest of the industry look forward to the second summer and the upcoming festive season to maximize sales volume. Depleted inventory in the channel provides reasonable opportunity to players across industry while we expect the effective GST to gradually win. Over the next few quarters we anticipate the continuation of strong government led investments to offset the subdued nature of private capex sentiment. Our focus continues to remain on securing good quality, reasonably risk mitigated orders with better margins and balanced commercial terms. Meanwhile we have to be suitably cautious of the emerging political and economic situation for our international business. Our balance sheet continues to remain robust with low debt and a comfortable cash position indicator of appropriate resilience. Thank you and we can now move on to Q&A.

Moderator: Thank you very much. We will now begin with the question and answer session. The first question is from the line of Manish Agrawal from Bernstein. Please go ahead.

Manish Agrawal: Firstly on a launch of new products is it on track for a pre-Diwali launch and have you decided on the number of refrigerators and geographies where we are going to launch the project and also if you could give some colour on the brand building strategy for these new products going ahead?

Anil George: In terms of the launch of new products we have a clear-cut market entry strategy, which is currently getting revalidated and I think it will be too premature for us to actually talk in terms of the specific products and what will really differentiate us from the competition. All that I can say at this point of time that both Arcelik team as well as the Voltas team are putting in their heads together visiting markets, doing various things that will give us the sufficient market information and heads to be able to launch refrigerators in the first scope followed through by washing machines, the microwaves, etc., so I do not think I can really comment anything beyond that because it will be giving away our entry strategy to our deterrents.

Manish Agrawal: Sir at least on a timeline?

Anil George: Timeline we are looking at being ready before the launch of summer so around January we expect to be able to launch.

Manish Agrawal: Sir secondly on the cooling product side, which are sourcing at lower pricing getting over and now the new procurement being at a higher commodity prices so what is the strategy on pricing going ahead?

Anil George: As of the moment we have had the impact of GST on us and maybe anticipating a question that might come us later. We have actually corrected the price of air coolers downwards by about 5% to 6%. As far as the air conditioners are concerned, we do not see a need to do a correction except in certain brands according to the products that are made, so GST is not impacting that. You know the strategy that we have been following always is that we offer good quality products at the right price to the consumer and that is what has held us in good strength and depending upon the various situations in the market some competitor doing something extraordinary, as a market leader we might need to respond and that is what we will do. The best answer to your question is really in terms of the proof to the pudding be in the eating if you look at our end of June market shares we have actually improved our shares to 22.2% so that says at all in terms of whether you are getting your pricing right and whether you are getting your product quality right and everything else that goes along with it.

Manish Agrawal: But is not your sourcing cost going up so, want to know the impacts margin going ahead?

Anil George: There are various things that go up, there are various things that come down, so it is a very flexible kind of an environment. If you look at one year back you might say that yes the prices of copper has gone up a little bit, etc., but at this particular point of time the commodity prices are largely stable. China consumption story is also starting off so there is a little bit of a pressure there, but then we are also volume buyers and we are also volume processors, so we expect to be able to retain our margin from the air conditioning segment at the 11% to 12% come what may.

Manish Agrawal: That is it from my side. Thanks a lot.

Moderator: Thank you. The next question is from the line of Atul Mehra from Motilal Oswal Securities. Please go ahead.

Atul Mehra: Thanks for the opportunity. Sir just couple of questions, one is in terms of the season that went by what is your sense in terms of how would inverter as a segment have penetrated in the market and while our market share has improved have we also seen market share improvement in the inverter category for us or it was in the fixed speed kind of category where it was catered by say LG and others?

Anil George: The season you already commented on the market share so I would not go there. Certain manufacturers or competitors decided to go heavily into inverters. You might recall Atul that at certain point of time one of our competitors got out of windows completely, at that point of time also we saw strategy as being twofold, one tactical and one long-term, the tactical one told us that there is still money to be made in windows and we stayed there that did not stop us from investing heavily into the split air conditioners and making that a success story too. Here again we see that the climb of inverters will take place, but it is not like a switch that is turned off and on it will take some time and the meantime there is enough space for the fixed speed to coexist side-by-side with inverters. At this point of time, we certainly do not have the leading market share position in inverters, but that is also a position that we will aspire to in due course, we have the products and we will be able to get that in due course of time.

Atul Mehra: Secondly Sir there was some media reports doing the rounds that we could be perhaps interested in a facility, which shop I think has recently closed down so is this only an assembly facility if at all we are looking at it all otherwise to, would it be purely assembly or is there any technology or any kind of inverter technology that they have over there or is it something of those sort or it is just purely assembly that is…

Anil George: Atul and any company just as you look at lots of companies to say that should this be in your portfolio, should this not be in your portfolio we as a company also look at all competitors, we look at various things available in the market, etc., etc., so it is an ongoing process we explore various opportunities to keep abreast of market trends and developments and we want to confirm that no proposal has been approved by the Board of Directors of Voltas Limited in this regard.

Atul Mehra: No Sir just a clarification only thing I am asking here is…

Anil George: No, I do not know enough of whichever company you are talking about to be able to come in turn.

Atul Mehra: Sure Sir! That is it and wish you all the best.

Moderator: Thank you. The next question is from the line of Fatima Pacha from ICICI Prudential. Please go ahead.

Fatima Pacha: Sir I want to know in this entire LG exit Five Star AC as a percentage of sales drop or what we able to convince the customer the Five Star AC is much more value for the bucks than the inverter AC because the pricing side I think of LG had quite converse the Five Star price?

Anil George: Just so that you understand when you say that inverters are certainly more energy efficient. Fatima what also happens is that in our country people first of all do not use an air conditioner 24x7 and that they use it for six hours, eight hours maybe in more affluent situations and very often they use it for two to three hours maybe and in certain seasons only during the year, so the alluded cost benefit and energy savings comes up when you use for 24x7, 365 days, etc., etc., so that extra premium to be able to absorb needs a certain kind of a consumer to be able to derive those full benefit. So that is one thing that I leave with you. The second part of it is that there is a price differential that LG very smartly so, they reduced their price when they made an entry, but that is an entry strategy, after that our understanding is that they blocked the prices back into what is now reasonable territory and we will be able to compete very well and incidentally we too are in inverters and we are able to have products that can be priced at the right level to compete.

Fatima Pacha: So would you have said that the five star as a percentage would have dropped this quarter?

Anil George: The market is always a little fluid, so it depends upon what is available when LG puts in so many number of AC suddenly as a new model and there obviously some bit of thing would come down, but then for us together with whatever inventor ACs that we have sold along with the steady speed ones we have been able to get a market share.

Fatima Pacha: Second question what is strategy entering next year because it is going to be quite an open for all market right because you could have even sell an inverter you can sell a fixed piece, but you just have to I think that IFC are waiting right?

Anil George: Yes.

Fatima Pacha: So would you think in that sense you would have to change our procurement strategy you would have to tweak the business model in some way or you think would…

Anil George: We are even with a fixed speed we are fully in compliance with whatever ER restrictions are required there is no problem at all.

Fatima Pacha: Even for next year you are saying there is no issue.

Anil George: There is no problem we look at some of these things well ahead of time and we do not come to the end of the day they realized that tomorrow something has to be done differently no there is a very conscious strategy and procurement planning that goes forward and we are well catered for that. As far as inverters are concerned, yes we do recognize that this will be the longer-term trend because most of the developed countries are going that way and also as a company we would like to be socially conscious and community friendly so we would look at inverter seriously and we have no hassles about admitting that over a period of time inverters will gradually increase, increase, increase, but the important thing is that it is not as is that fixed speed is going to go out tomorrow itself.

Fatima Pacha: You do not think that DEE rating change will cause a big thing because over there that IHER rating to get if you are not an inverter might be very difficult?

Anil George: No, not a problem as far as we are concerned.

Fatima Pacha: Thank you so much Sir and all the best.

Moderator: Thank you. The next question is from the line of Ranjeet Sivaram from ICICI Securities. Please go ahead.

Ranjeet Sivaram: As a continuation of the previous question as per what we understand in that rating change the current five star will become a three star and three star will become one star, so there can be a likely increase in prices so two things wanted to understand one what will be our strategy that we will be focusing more on fixed speed rather than inverters there and also will there be a big pre-buying because the prices will increase from January so can we see a huge pre-buying in the third quarter?

Anil George: See as far as the change in rating is concerned as I said it is well planned, it is well announced. We also know what is going to cause in terms of machine per unit, etc., and when we are looking at it going ahead the strategy will be in terms of mixing and matching both. India is a very large country and there are parts that particularly in the metros, which can take inverters and which can go along with that and the growth there can be higher, but in the rest of the country where the power is fluctuating it might not be a very smart idea to sell inverters large scale because the circuitry board is very susceptible to blow up the quality of power is not good, so people who are offering warrantees where the quality of power is not good or cannot be assessed might be at risk, so we let both of this continue with a sensible well balanced manner and we will change our designs and our product portfolio according to what the market really demands.

Ranjeet Sivaram: So how much can be the likely price increase because of this shift in because five star will become a three star and three star to a one star?

Anil George: Estimated is about Rs.500 per machine, but then there are also when we are a large scale manufacturer like us there are also efficiencies in production and efficiencies in procurement that set in so it is not just one thing to say that yes now all the machines are going to cost 500 no, it will be selectively increase in certain things, in certain other products it might not.

Ranjeet Sivaram: And will there be any pre-buying in the third quarter because of this increase in prices because generally we see this trend whenever it able to shift?

Anil George: I do not think that there is going to be a massive pre-buying just because of a price increase of Rs.500 or so I do not think, there will be some bit of pre-buying, but not massively.

Ranjeet Sivaram: Thank you I will join for further.

Moderator: Thank you. The next question is from the line of Sandeep Tulsian from JM Financial. Please go ahead.

Sandeep Tulsian: Sir my first question is regarding the difference between the primary and secondary sales that we have seen as an industry in 1Q, obviously on the secondary side we have catered out the market share, so it should be closer to the industry levels, but what was the industry growth levels if you can share some?

Anil George: In terms of if you are looking at that the total growth in the first quarter was kind of subdued fundamentally because the April was a very good month across the board because there was hot summer we gained, everyone has gained, in fact industry estimated that there was almost about a 25% kind of growth in the month of April, but May unseasonal rains hit particularly in the southern state and in June it was a complete washout most people took a decline of something like about 10% to 15% in on an average because of this GST issue. Now I am talking in terms of primary sales. Secondary sales at the same time got an added impetus because of the fact that given the GST the traders does not want to hold the stocks because of transition issues and their own concerns about whether they would get the credit, etc., so as you are well aware there was a math of discounts being offered and at this point of time what has happened is that at the end of June the stocks got completely decimated at the stockist and the distributors and now they are slowly pitching back and filling it, but the intensity of that filling will not be as sharp as it was a summer season or whatever.

Sandeep Tulsian: So sir for the overall quarter what was the growth numbers in primary and secondary for the industry you can share, you said April was 25% growth, but May was a decline, but combined for April to June how was it?

Anil George: See for the primary growth was generally and in most people had something like about 1% or flattish that was a kind of thing. The secondary growth as according to us what we understand is about 15% to 17%.

Sandeep Tulsian: 15% to 17%?

Anil George: Secondary.

Sandeep Tulsian: So even if there is slow replenishment of inventory one should assume gradually these numbers should…

Anil George: But the distributors are also smart they will not stock up too much in terms of this month.

Sandeep Tulsian: Not this month, but I am saying…

Utsav Shah: One should also remember that historically Q2 is a fairly quite month in terms of retail sales weather dependent.

Sandeep Tulsian: From the perspective of next onset of next summer subsequently this 15% has to flow through the system right?

Anil George: Should come through yes.

Sandeep Tulsian: Alright Sir! Thank you so much.

Moderator: Thank you. The next question is from the line of Lokesh Garg from Credit Suisse. Please go ahead.

Lokesh Garg: Sir just wanted to get your comment on air cooler as a business how much did you do in this season, how did you place relative to market in terms of share?

Utsav Shah: Lokesh basically the air cooler market was very flattish in this quarter as compared to last year and reasons were primarily as Mr. George already explained erratic monsoons and the GST uncertainty about transition provisions, but we have done marginally better than what we had done last year.

Lokesh Garg: Any numbers that you can share in terms of units or anything.

Anil George: No I do not want to give quarter-by-quarter numbers Lokesh.

Lokesh Garg: Sure and although this got discussed earlier in some questions, but you are essentially saying that you can meet a three star rating of the new standard starting January 2018 with a fixed speed AC also.

Anil George: Yes.

Lokesh Garg: Another question is a little broader. Basically as a strategy at group level particularly do we see a little bit more focus on Voltas and aim to make it a larger consumer business spanning multiple product categories extending the brand do you see that push coming from group level also or is that something that we are unnecessarily conjoining?

Anil George: That group operate is that each company has its own independent identity, has its own board, has its own management, of course there are non-independent directors who operate on our board and they represent Tata front, so generally the group as you have read from the paper are looking at certain sectors with greater interest and we are happy to be part of the group, part of that strategy, we will have to see how things evolve, but irrespective whatever is the push that comes from Tata group or not I think the company is very focused and its Board of Directors is focused on making sure that growth comes quarter-after-quarter and that we keep winning in the market place.

Lokesh Garg: Sure thanks Sir!

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

Aditya Bhatia: Sir is it possible to estimate the impact of revenue loss on account of GST-related destocking?

Anil George: Revenue loss because of destocking?

Aditya Bhatia: Yes, is it possible to estimate that, how much it could have been in quarter one?

Anil George: Quarter one as I told you generally if you look at the month of June, which is essentially because of the GST purchase is not getting GST being there and stock is not picking up, generally the industry has lost anywhere between 10% to 15%, but this is a temporary blip, this is in terms of the primary sales, the secondary sales are going on very well incidentally.

Aditya Bhatia: So Sir conversely by when should we be expecting restocking to commence, are you expecting that trend to play out over the next two quarters or will it basically move to fourth quarter of this year?

Anil George: Because the distributors in this game to make money and when he sees an opportunity of the second summer coming up he will also restock, but at the same time what happens is when his money has been released so he is also looking at opportunities for various products, etc., that sell better on the season, so towards that we get in to a second summer people will stock up quite aggressively.

Aditya Bhatia: In the conference call earlier you indicated that Voltas has taken certain price cut in room ACs as well as coolers, so given that commodity prices have been going up is it in response to intense competition or are we having certain sourcing synergies or scale advantages because of which we are taking these price cuts?

Anil George: The price cut is coming in the air cooler there is unjust enrichments in the way that the government would define it because of the change in the tax and we have decided as a responsible corporate citizen we have decided that we will pass the prices benefit to the ultimate consumer. In the air conditioner business if you recall the rate of about actually something like about 26.4 or something like that for the effective rate, which went to 28, so there is no benefit from that, but at the same time there are certain other things that come in so all said it get balances itself out and we do not see a need for any kind of a drastic price change in the air conditioning sector.

Aditya Bhatia: And lastly in response to LG's strategy what impact is it having on the market is it resulting in market share gains for other players or is it resulting in more intense pricing competition?

Anil George: I do not wish to comment upon our competitors specifically, I think what has happened is that the market is fearfully fought and there are some low price people there are other people who have been locking in the background who is also coming up so the order of who are number one, number two, number three, number four those have got juggled a little bit and those percentages has gone up and down. As I have told you we have picked up some market share, other people have also picked up some market share, this is a way of it, but we still have a clear 900 basis points plus difference between us in the nearest competitor.

Aditya Bhatia: 900 basis points you mentioned right?

Anil George: Yes.

Aditya Bhatia: Perfect Sir! Thanks a lot.

Moderator: Thank you. The next question is from the line of Venkatesh Balasubramaniam from Citi Research. Please go ahead.

Venkatesh B: Sir my questions are on the electromechanical projects division. It is very heartening to see this 14% topline growth. In the past electromechanical projects were actually growing in fits and starts you would see a quarter of growth and then you would again see it pulling back, now can we take this as a nearly indication that electromechanical revenues can on a sustainable basis grow at 10% to 15% for the next few years that is the first question Sir?

Anil George: I think the ambition of every business is to make every division and every product and everything that we deal and grow quarter-after-quarter, but as you rightly alluded to the project business is a little bit of a strange animal in the sense of it is susceptible to cash availability, susceptible to political issues, it is susceptible to various other things, but what I have been consistently saying right from the beginning is that we have worked at the legacy projects, got rid of bulk of them except one or two of things, which are still in arbitration and we are concentrating on getting our act right, we have consciously taken only those kind of projects where there is a greater assurance of profitability and not only profitability, but the definite assurance of cash being received at the end of the project so that is the way that we have strategized and therefore we have not gone after growing our topline, neither have we taken aggressive stances in terms of order book we have done it sedately and my own belief is and as I told you earlier also that we said that when we were struggling and we were looking at the thing I said we expect to reach something like 4% to 5% kind of margin over a period of time and that is where we have reached now and looking further I think this business needs to grow and we need to get something like 7% to 8% to be become sustainable and that is our direction and that is where we will go over the years.

Venkatesh B: Just a followup. If you could give us a flavour of what exactly is happening on the ground in Qatar are there problems or is your business facing any problems or if it is not facing why it is not facing because we have had another company for example L&T, which has got quite a few orders, which is having some amount of delays in Qatar, so if you could give us some flavour and finally any changes to that 6% expectation for the current year in terms of margins?

Anil George: I do not as a rule I do not give forward looking guidance in terms of margins, so you will have to wait and see how this evolve. As far as Qatar is concerned, one is that if it is going to be a prolonged client of a stalemate then obviously the answer to your question is yes we will also be impacted, others will also be impacted and economies that are based on Qatar yes will also be affected, but at this particular point of time all those stalemate is continuing, Qatar government is making sure that there is sufficient amount of supplies coming in from friendly Arab nations through different routes, but it might mean a certain amount of delay, a certain amount of cost, we do not see a big problem, a substantial problem at this point of time, but if it goes on for another two, three months, etc., at this way and nothing is, more sanctions come up then obviously there will be something. We are watching the situation very carefully and we are making sure that all our projects are protected to the best extent possible.

Venkatesh B: Thank you very much Sir!

Moderator: Thank you. The next question is from the line of Shriharsh Singh from Bank of America. Please go ahead.

Shriharsh Singh: Sir first question is on the AC segment the UCP segment, what percent of your 1Q primary sales in June on average if you could give me a figure?

Utsav Shah: Typically around 70% of the volume happened during the period February to June.

Shriharsh Singh: So particularly in June as a percent of 1Q sales?

Anil George: Yes that is very, very weather reliant yes.

Shriharsh Singh: On average if you just take an average let us say whatever like 5 to 10 year average would it be one third of this quarterly sale or would it be 20%, 25% or something like that?

Anil George: Yes about 30% is what should be, but it is again I hasten to add that is very weather dependent depending upon the intensity of the summer, depending upon the onset of monsoons and all these things, so it is not this is a weather dependent business and answer to your same question if you were to look at kind of growth that you had industry has had year-after-year. In times when the weather has been extremely hot and rains have been slow to come in whole industry has experienced as it happened a couple of years back a 30% growth, but within the last five years also we have had situation where it has gone negative.

Shriharsh Singh: True Sir so obviously it would vary from year-to-year, but broad range 20% to 30% of 1Q primary sales occur in June and so assuming this number so this number has declined, this June sales declined at 15% versus an average growth because of GST versus an average growth of 15% for the industry that could have happened of GST had not happened?

Anil George: Yes, but I am not talking about 15% was in June specifically in terms of primary sales across the industry 10% to 15% was the impact.

Shriharsh Singh: For the full year 1Q number?

Anil George: Full year numbers we have given last time, this we have not taken the full year.

Shriharsh Singh: Sorry so the 1Q number as a whole declined by 15%?

Anil George: No, not 1Q June.

Shriharsh Singh: June declined by 15% got it Sir!

Anil George: Please turn to my segment results you will see that we have grown by something like 3% in terms of turnover 1% had gone up in terms of 1196 versus 1212 right?

Shriharsh Singh: Yes Sir!

Anil George: That is 1% growth that we have got.

Shriharsh Singh: And my second question is related to MEP what percent of your order book is from Qatar if you have that number?

Anil George: Qatar at this particular point of time is we have an exposure of roughly around 600 odd Crores.

Shriharsh Singh: And so far there has not been an execution challenge?

Anil George: There is a little bit of slowness, but I think the question that is being answered is that is it something that is so dramatic. In the project business there are always ups and downs. By and large the Qatar government is making sure that their projects do not suffer they may opening up alternate channels, etc., so material is coming, some bit of delays will take place just like a shorter situation at some point of time, but if the issue prolongs for a very long time then of course the implications will be deeper.

Shriharsh Singh: Why your international order backlog has declined for something 2400 Crores to 1900 Crores, is that decline deliberate with your strategy of being cautious?

Anil George: Deliberate with our strategy of being cautious. At this point of time, if I were just to announce that I have picked up orders of let us say 5000 Crores, which would be pretty easy for us to do as Voltas, you would be very immune to the quality of those orders and the fact that we are turning around business and are able to get 5%, which if you look at any of the international players many of whom are in public arena you will know what I am talking about, so we have not gone for glory in terms of the topline, but we are doing it in a conscious basis, any order that we pickup as twice going into it properly reviewed for cost commercial conditions and the possibility of cash being received without strain, we only do our risk mitigation very, very carefully before we accept any order. In this project business, L1 means that it is a fixed price and once you take a contract you cannot exit because there are performance bank guarantees, etc., and predict rules put a tremendous onus of cost on you if you take up a project and then try to exit without completing it.

Shriharsh Singh: Got it Sir! That is it from my side thanks.

Moderator: Thank you. The next question is from the line of Abhishek Puri from Deutsche Bank. Please go ahead.

Abhishek Puri: Congratulations for a good set of results in a tough environment. I wanted to tell only the point of the energy efficiency norms, which are changing so just to understand it a little better you said the costing will increase by about Rs.500 per machine?

Anil George: Yes, Abhishek I am not giving a technical answer on that, but in our own management discussions with all the things considered, etc., with other things they are saying that it would be roughly cost impact about Rs.500, but that is not to say that there will not be other cost efficiencies introduced somewhere else or some pricing changes here or there it is an evolving thing, all that I was trying to answer very clearly is that we are conscious of what is coming ahead, we have planned for it and we know that we can get there with a minimum amount of expenditure involved in technologically upgrading our products.

Abhishek Puri: Fair point. My question was from a consumer point of view your five star AC today is about say 35000, 36000 and three star AC is about 29000, 30000, which is about 16%, 17% price differential, so from a consumer point of view that five star becomes a three star so he will have to face a 16%, 17% price increase is that correct or will we see a decline in prices overall in the system as a whole?

Anil George: No, I do not think that you will be seeing a massive decline in the prices, etc., it will be at any rate the pricing of any product is not just based in terms of the costing it is based on what the product is and what is the kind of consumers that goes behind it. So in general what I would say is that I do not see an opportunity for reduction of prices, but I do see that prices will either be maintained or they will need to be increased a little bit, given all the things that are taking place, but again if the competition is going in one direction we as market leaders will not be left behind we will also do whatever is required to make sure that our market shares are maintained.

Abhishek Puri: Let me rephrase my questions for the industry to maintain the same margins will it need to take about 14%, 15% price increase?

Anil George: No, because one of those products are going out of those things, so the bottom end is going out.

Abhishek Puri: But three will become one, five will become three from a consumer point of view it does not matter?

Anil George: New product that is still in the five star or equivalent of that in your inverters.

Abhishek Puri: But from a consumer point of view will he face a massive increase in price?

Anil George: No, I do not understand the logic too much.

Abhishek Puri: What I am trying to understand is that for me as a consumer instead of December 31, 2016 or January 1, 2017 the five star AC becomes a three star AC, so on January 31, 2017 three star AC price for me is Rs.30000 will it become Rs.35000 for me on January 1, 2017?

Anil George: There might be some bit of increase and readjustment that takes place between models, but what we are talking about is a mixture of so many other things that goes in through, so it is not a straight if add so much reduct so much it does not work that way.

Abhishek Puri: We will take it separately Sir! Secondly on the restocking I think in the primary quarter Q1 we have grown by 1% overall industry has probably declined because you have gained market shares what will be the overall guidance in terms of for this year we are seeing one more disruption in terms of energy efficiency coming in Q4, which is again one of the peak quarters, so what is the kind of industry growth that you expect for the current year?

Anil George: I am not able to actually forecast what the kind of industry growth it is very, very weather susceptible, it is susceptible to various things as we have learned to demonetisation, to GST and all these kind of things and I cannot give you forward guidance properly. Over a longer-term the term period the reason why we are in this AC business and why we are very, very strong about is that we see the penetration levels are low and we see that there is a prospect of growth at the rate of about 10% to 15% year-after-year for many years ahead. Weather dependencies ups and downs being taken, that is the way that we see it. Now each time there will be something that will come in a new regulation, but that is a game of business and we welcome it, but we are not going to be specifically targeted in anyway whatever happens, happens with the rest of the industry so we will manage.

Abhishek Puri: Thank you.

Moderator: Thank you. The next question is from the line of Snigda Sharma from Axis Capital. Please go ahead.

Snigda Sharma: Thanks for taking my question. I wanted to ask about the UCP segment margins held rather well in an environment where raw material cost are rising and we had negative operating leverage, we were also running an advertising campaign so can we sort of talk a little bit in detail about the puts and takes on margins in this quarter in the UCP segment?

Anil George: Margin that you see in the segment is a mix of what is a kind of volume that goes, what is the proportion of advertising spend that has been incurred in that quarter, what is the kind of promotions that you have done, etc., so volume makes a lot of difference and in this particular quarter we have had to spend a little more in terms of selling expenses so that we are able to retain given the kind of competition that we face and given the GST issue and the general reluctance of the trade to push up, so you are right that last year at this time we had something like about a 15% kind of a margin that has gone down to 14%, but the positive thing for me is that we have been able to grow our market shares and still be able to maintain a very decent margin, which has not seen elsewhere in the industry and that is context of many things including sourcing strategy, including volumes, including the appropriate pricing, including the right kind of perception of the product and the brand value equation to the consumer, so lot of these things mixing together. In general we expect that competition will get tough, but we are a cash rich company, have the volumes and we will make sure that our market shares are protected as best as possible. It needs to be a little more that needs to be done in terms of margins yes we might be fair to do that, so it is a kind of a daily situation that we keep monitoring and looking at how we need to respond to the things that happen in the market place.

Snigda Sharma: Sure Sir and what was our advertising expense during the quarter?

Anil George: No, I will not be able to comment on advertising expenses you are our friend I supposed yes so we will not, that is not the full annual advertising expenses can be seen from our balance sheet.

Snigda Sharma: No problem and can we take a 14% sort of a sustainable margin from hereon?

Anil George: I have never given 14% from hereon that would be very silly of us to assume that. This is the competition that needs to move, but what I have tried to say in the past and which I still maintain is that we are able to see that given the current situation unless something really goes very haywire in the market around 11% to 12% is the kind of thing that we would see as sustainable certainly for this category.

Snigda Sharma: I am sorry why I am hopping on this point is because this was rather tough quarter and we are seeing a lot of headwinds on margins and still we have been able to hold margins at 14%, which is why sort of want to understand what will be the incremental headwind that can take it from current levels of 14% to like a 12% are we expecting any significant increase in advertising expense or I know it vary from quarter-on-quarter, but just directionally how do we see it?

Anil George: Directionally the competition will get tougher. As I said that we might if for example our nearest competitor spends a lot of money or certainly there are states and some part of it where a small player comes in and decides to drop prices or give discounts in disproportionate nature we will also need to respond, so it is almost week-to-week kind of a game that goes on in the market place, do not think I can really comment on that except to say that we see 11% to 12% kind of margin as sustainable and really the margins every quarter are also reflection of what is the carry forward inventory that we have brought in and what did we pay for those that factor also needs to be taken into consideration because you are not selling inventory that you are not a trading company, we are actually manufacturing so there would be inventory that is carry forward for the summer season for example you start manufacturing and keeping it four months, five months, six months ahead in time, so that you have enough stocks in your hand, so it is all of that, that gets in to the cost of goods sold and then of course margins drops from there.

Snigda Sharma: Great Sir! Thank you and congratulations for a great quarter.

Moderator: Thank you. Due to time constraints we will be able to take one last question. Last question is from the line of Shrinidhi Karlekar from HSBC. Please go ahead.

Shrinidhi Karlekar: Thanks for the opportunity. Sir I wanted to understand what is typical replacement cycle for air conditioner products in your view and how much percentage of annual sales that happen in India could be from the replacement market?

Anil George: At this point of time, generally if you look at a really developed kind of economy you would say that the replacement takes place earlier. In India generally it will be at least 10 years so there is not so much of a replacement opportunity at this particular point of time, but as family and household gets more and more affluent they expand their needs as the new models come in, the aesthetic change people are looking at, at a replacement market. So at this particular point of time I would not hazard a guess on how much of the sales is actually replacement, the only thing that I can say is that in terms of exchange schemes that you see you would possibly find something like about 4% to 5% kind of exchange coming up across the countries what I would guess.

Srinidhi Karlekar: The second one is for inverter AC products I wanted to understand how much is the bill of material like the material that goes in to inverter AC is different from a non-inverter AC really what I am trying to understand here is we have economy of scale in fixed speed AC market can that be complementary in inverter AC product as well?

Anil George: Exactly the main cost of an inverter AC in terms of a new PCB that you put in and that PCB regulates the speed and the flow of the compressor and the blower that attached to it, so that PCB is a fairly expensive piece and that is what add to the question and my understanding is that it is roughly around 3500 to 4000 kind of thing if you do a very large bulk purchase kind of PCB. Over a period of time it might come down, but at this point of time that is the kind of expenditure that is there.

Srinidhi Karlekar: If I understand correctly so we have this fixed AC on top of that we need this PCB, so in general we have economy of scale and price there is competition in the rest part of the market, so if even in the inverter AC market Voltas as a company should be competitive right because we are just adding one more product, which overall cost may not be material?

Anil George: Not as simple as that it is not just that you just put one PCB into it and everything else is the same no, there are certain other changes that also need to take place in terms of machinery, construction, etc., I was giving an overall because you are asking what is the bill of materials cost I just said giving an example of how it pans out, but the later part of your question, which is more interesting one is are we at Voltas able to manufacture inverter AC at a price that can be competitive with other competitors in the market and the answer to that is a resounding yes.

Srinidhi Karlekar: Yes Sir I wanted to hear that only and Sir last one if I may the 11% to 12% margin you typically guide is it comparable to 14% that we reported during quarter or it is a different number we relate to just want a confirmation on that?

Anil George: The segment is a marginal segment. What I am saying is this quarter we have got 14%, which is in the context of the volume for the cost of goods that went into making those products, the advertising spend that we did and the various expenses that was incurred and what someone asked me earlier saying that how do I really see this going ahead and I said that we certainly expect the intensity of competition to go up. We expect various other changes in the market place to take place, but at the same time we do not know how much we will need to spend, but one determination that we have is that we must protect our market share and in doing so if we need to sacrifice a point or two of margins that is something that we will gladly do.

Srinidhi Karlekar: Fair enough Sir! That is helpful. Thank you.

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

Anil George: Voltas management wishes to thank all the investors for participating in the Q1 analysis of results. For any questions, feedback or anything you may kindly get in touch with Asawari Sathaye or Utsav Shah at any point of time. Thank you.

Moderator: Thank you very much. On behalf of Motilal Oswal Securities that concludes this conference. Thank you for joining us ladies and gentlemen. You may now disconnect your lines.