



BLUE STAR

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BLUE STAR LIMITED
Annual Report 2006 - 2007

The Corporate Purpose

We are a leading Indian engineering company with substantial competence in, and revenues from 3 streams of businesses:

- Airconditioning
- Commercial Refrigeration
- Professional Electronics and Applied Industrial Systems

As of now, our footprint is mainly Indian. However, we wish to progressively build a sizeable presence in chosen international markets over the next few years.

We are a customer-focused organisation, deliberately tuned to deliver a world-class experience to corporate and commercial customers. As specialists, we serve our customers with differentiated products, expert solutions and value-added services.

Technical, engineering and contracting expertise give us our competitive edge, and technical manpower constitutes our key resource. We will continue to recruit and retain employees and business partners who relate to our customer-oriented, specialist/expert culture. We will make Blue Star the employer of choice in our industry for we recognise that happy employees make happy customers.

A set of 12 Guiding Corporate Values and Beliefs defines our responsibilities to our stakeholders: customers, employees, shareholders, business partners and society. Delivering a world-class experience and adhering to our Corporate Values constitute the two pillars of the Blue Star Way. We will make conscious efforts to align our employees and business partners with this Blue Star Way.

We will strive to win the trust and admiration of all our stakeholders by sharing with them the fruits of business success.

BOARD OF DIRECTORS

Ashok M Advani
Chairman & Managing Director

Suneel M Advani
Vice Chairman & Managing Director

T G S Babu
Deputy Managing Director
(w.e.f. July 1, 2007)

Satish Jamdar
Deputy Managing Director
(w.e.f. July 1, 2007)

Shailesh Haribhakti

Pradeep Mallick

Gurdeep Singh

Suresh N Talwar

CORPORATE MANAGEMENT

Ashok M Advani
Chairman & Managing Director

Suneel M Advani
Vice Chairman & Managing Director

T G S Babu
Deputy Managing Director
(w.e.f. July 1, 2007)

Satish Jamdar
Deputy Managing Director
(w.e.f. July 1, 2007)

Arun Khorana
Executive Vice President

Avinash Pandit
Executive Vice President

H Rajaram
Executive Vice President

BThiagarajan
Executive Vice President

R Aravindan
Vice President - Packaged Airconditioning Division

J M Bhambure
Vice President - R&D

R G Devnani
Vice President - Dadra Plant

Michael Fernandes
Vice President - Human Resources & Quality

A Rakesh Rao
Vice President - Airconditioning & Projects Division (North)

P Venkat Rao
Vice President - Room Airconditioners & Refrigeration Products Division

COMPANY SECRETARY

K P T Kutty

BANKERS

The Hongkong & Shanghai Banking Corporation Ltd
State Bank of India
Oriental Bank of Commerce
ABN - AMRO Bank
BNP Paribas

AUDITORS

K S Aiyar & Company, Mumbai

BRANCH AUDITORS

R Venkatarama Aiyar & Company, Kolkata
Fraser & Ross, Chennai
Mohinder Puri & Company, New Delhi

REGISTRARS & SHARE TRANSFER AGENTS

Intime Spectrum Registry Ltd
C-13, Pannalal Silk Mills Compound
L B S Marg, Bhandup (West)
Mumbai 400 078.
Telephone: 91-22-2596 3838
Fax: 91-22-2594 6969

REGISTERED OFFICE

Kasturi Buildings
Mohan T Advani Chowk
Jamshedji Tata Road
Mumbai 400 020.
Telephone: 91-22-6665 4000
Fax: 91-22-6665 4151
www.bluestarindia.com

Guiding Values and Beliefs of Blue Star

- Pursue the Corporate Vision: Provide a world-class customer experience.
- Focus on profitable Company growth.
- Be a company that is a pleasure to do business with.
- Work in a boundary-less manner between divisions to provide the best solutions to customers.
- Win our people's hearts and minds.
- Place the Company's interests above one's own.
- Encourage innovation, creativity and experimentation in what we do.
- Build an extended organization of committed business partners.
- Be a good corporate citizen.
- Honour all personal and corporate commitments.
- Maintain personal integrity.
- Ensure high standards of corporate governance.

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Letter from the Chairman



Ashok M Advani, *Chairman & Managing Director*

DEAR SHAREHOLDER,

2006-07 was the fourth successive year of exceptional growth for Blue Star. With a strong leadership position in most of our core businesses, we were well positioned to capitalise on rapidly expanding market opportunities. The overall

results were impressive: a 36% increase in Total Income and a 46% jump in Profit After Tax. These growth rates have set new records for the Company and are comparable to those in the booming information technology industry.

The financial performance of the Company is summarized in the Annexure to this letter. Most growth and profitability ratios showed a healthy improvement from levels that were already good in the previous year. One cause for some concern was a small reduction in gross margin due to the sharp increase in input costs like copper and steel. This could have been worse but the impact of inflationary cost increases was softened by a concerted value engineering drive coupled with limited price increases.

A deeper analysis of the financial performance needs some explanation. The audited accounts for the year were prepared after adopting the revision in the Accounting Standard on "Employee Benefits" as explained in the Other Notes to the Accounts. This one time accounting changeover had a major financial impact that increased the expenditure on Employee Remuneration & Benefits by Rs.14.86 crores (See Note 9). As a result, the Operating Profit reduced by the same amount. This, in turn, adversely affected other financial and profitability ratios. Therefore, the Audited figures present a view that is not really comparable with the previous year's figures which were in accordance with the accounting standard requirements that existed earlier.

Had the Audited Accounts been prepared on the same basis as the previous year, the financial performance would have been significantly better. The third column, "2006-07 Restated" has been added to provide such a like-to-like comparison. This reveals a very gratifying picture. Restated profit growth was even higher than the Audited Accounts indicate, while the restated Operating Margin actually improved perceptibly instead of showing a marginal decline.

Restating the figures may seem to be a somewhat

academic exercise but it serves two useful purposes: It makes possible a meaningful comparison of last year's performance vis-à-vis the previous year; and it provides useful information to discerning investors that even though there was a one-time accounting 'hit' in the year of transition, the Company absorbed the impact comfortably and still reported very good results. This is a reassuring confirmation that in the current year, when no such non-recurring charge is expected, we are well positioned in terms of cost structure and financial capability, to maintain our profitable growth path.

Turning to the business segmentwise performance, once again, all 3 segments showed very good revenue growth: 37% each in Central Airconditioning Systems and Cooling Products and 30% in Professional Electronics & Industrial Systems. Business growth was evenly distributed across the segments and was at least as good as the overall market growth. Clearly, the Blue Star brand continues to enjoy a strong customer preference in markets that we operate in.

The audited profitability increase in Central Airconditioning was 28%, a big 78% in Cooling Products and 35% in Professional Electronics. And these results have been achieved despite the adverse impact of the accounting changes discussed above.

Historically, Blue Star's growth has usually been financed by a combination of internally generated funds and proportional borrowings. This approach worked well in the era of moderate growth even permitting a generous dividend policy while maintaining a strong balance sheet without excessive borrowings. Since our business does not require large investments in fixed assets, one of the keys to good financial performance is efficient use of

working capital. Last year, we turned over the total capital 5.32 times which is very good and required only a modest increase in borrowings.

How sustainable is this when business growth has accelerated? The last few years of high growth have required substantially more funds to run the business. Working capital needs have been growing fast. Manufacturing capacity has also been expanding rapidly while simultaneously being upgraded. Last year, our financial model delivered the resources reasonably well; availability of funds was not a constraint and the debt/equity ratio actually improved slightly. Yet we cannot afford to be complacent. We will continue to keep a firm grip on the balance sheet.

Another crucial test to judge overall financial performance is profitability measured in terms of Return on Capital Employed and Return on Shareholders' Funds. Both these ratios look very healthy at 32.1% and 33.4% respectively. And this is despite a moderate operating margin. I have often said that Blue Star is not a company that is easy to understand. We are different from most other companies

so we do not fit a more conventional business model. Despite low margins that are inherent in the highly competitive central airconditioning business, we have devised a successful financial structure that produces excellent profitability through efficient use of capital.

Blue Star has reached a very interesting and challenging stage in its corporate development. The achievements of the last few years have built a feeling of pride in the Company and a degree of confidence throughout the organisation. In that spirit, we have developed aggressive plans to sustain the high levels of profitable growth over the next few years.

Of course, much depends on external macro-economic developments and the overall business environment. So far this year, business conditions continue to look very positive. While there is no guarantee on how long this favourable trend will continue, I am confident that regardless of external developments, Blue Star will be ready.

ASHOK M ADVANI

Mumbai : May 19, 2007 Chairman & Managing Director

Annexure to Letter from the Chairman

BLUE STAR FINANCIAL PERFORMANCE

(Rs. in crores)

	2006-07 Restated	2006-07 Audited	2005-06 Audited
Total Income	1607.41	1607.41	1178.62
Growth over Previous Year	+ 36%	+ 36%	+ 27%
Operating Profit (PBDITA) excl. Non-Operating Income	131.78	116.92	86.68
Growth over Previous Year	+ 52%	+ 35%	+ 50%
Profit Before Tax	107.46	92.60	69.09
Growth over Previous Year	+ 56%	+ 34%	+ 32%
Profit After Tax	81.04	71.18	48.90
Growth over Previous Year	+ 66%	+ 46%	+ 25%
Shareholders' Funds	222.83	212.97	172.71
Borrowings	89.05	89.05	75.87
Capital Employed	311.88	302.02	248.58
Operating Cash Flow	60.12	60.12	18.36

KEY RATIOS

	2006-07 Restated	2006-07 Audited	2005-06 Audited
Gross Margin (excl. Non-Operating Income)	22.4%	22.4%	22.8%
Operating Margin (excl. Non-Operating Income)	8.2%	7.3%	7.4%
Return on Capital Employed	35.8%	32.1%	30.1%
Return on Shareholders' Funds	36.4%	33.4%	28.3%
Earnings Per Share (Rs.)	9.01	7.91	5.44
Dividend Per Share (Rs.)	3.00	3.00	2.40
Capital Turnover	5.11	5.32	4.74
Debt/Equity	0.40	0.42	0.44
Inventory Turnover	6.61	6.61	6.06
Receivables (Days Billings Outstanding)	80	80	74



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Board of Directors

| T G S Babu

| Gurdeep Singh

| Shailesh Haribhakti

| Ashok M Advani

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