"Escorts Q3FY17 Earnings Conference Call"

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MODERATOR:	**MR. CHINTAN MODI – SR. MANAGER - INSTITUTIONAL RESEARCH-MOTILAL OSWAL SECURITIES LTD**

Moderator: Ladies and Gentlemen, Good Day, and Welcome to the Escorts Q3FY17 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. Chintan Modi from Motilal Oswal Securities. Thank you and over to you, sir.

Chintan Modi: Good Evening, everyone. On behalf of Motilal Oswal Securities, I welcome you all for the Escorts Limited Q3FY17 Results Conference Call. I also take this opportunity to welcome the management team from Escorts Limited. Today, we have with us Mr. Bharat Madan – CFO; Mr. Shenu Agarwal – Chief Sales and Marketing Officer, Escorts Agri Machinery; Mr. Ajay Mandahr – CEO, Escorts Construction Equipment; Mr. Dipankar Ghosh – CEO, Railway Equipment Division; Ms. Jyoti Khatuka -- Head, Treasury, along with the Investor Relations Team at Escorts Limited.

We would start the call with the brief opening remarks from the management followed by an interactive Q&A session. Before we start, I would like to add that some of the statements that we make today in today's discussion will be forward-looking in nature. At this point, I will request Mr. Madan to make his opening remarks. Over to you, sir.

Bharat Madan: Thank you, Chintan. Ladies and gentlemen, a very good evening to you all. Thank you for joining us on the Third Quarter Earning Call for Financial Year 2017.

A snapshot of company's quarterly performance from continuing operations is as follows: Turnover at Rs.1,093 crores against Rs.891.3 crores last year, up by 22.6%, led by volume growth in both Tractor as well as Construction Equipment businesses. Tractor volumes up by 27.4% to 16,963 Tractors as against 13,319 Tractors last year same quarter. Construction Equipment volumes up by 16.8% to 815 machines against 698 machines last year same quarter. Material cost down by 85 basis points, stands at 69.3% against 70.1% last year same quarter. EBIDTA at Rs.91.5 crores against Rs.40.9 crores last year, up by 123.5%; EBIDTA margin now stands at 8.4% versus 4.6% last year same quarter ended December '15.

Finance cost went down by Rs.1.5 crores to Rs.4.9 crores as compared to quarter ended September '16. The total debt outstanding as of December '16 is Rs.255 crores, down from Rs.360 crores in March '16 because of reduced working capital during the season. PBT from continuing operations and before exceptional items stands at Rs.77.7 crores, up by 158% against Rs.30.1 crores last year same quarter. There is an exceptional item of approximately Rs.2 crores in the quarter on account of VRS of 13 employees. Company absorbed one-time loss net of tax from discontinued operations of Rs.30.8 crores on account of order parts business divestment. Post that PAT for quarter is up by 11.3% at Rs.22.7 crores as against Rs.20.4 crores last year same quarter. EPS is reported at Rs.1.90 against Rs.1.71 last year same quarter.

Moving on to Segmental Business Performance: Starting with the Agri Machinery business, domestic tractor industry volumes grew by 18% to 1.64 lakh tractors as compared to 1.4 lakh tractors last year same quarter. Our domestic volumes went up by 25% at 16,600 tractors against 13,250 tractors last year. Industry in our strong market in all the centers India grew by 16% whereas industry grew by 20% in the opportunity markets of south and west. We have gained market share across all major states; market share in strong markets up by 105 basis points and in an opportunity market is up by 30 basis points during the quarter resulting in overall domestic market share at 10.1% against 9.5% last year same quarter. EBIT margin in EAM stands at 10.4%, up by 345 basis points against 7% last year primarily due to material cost reduction initiative and higher volumes. The market response for the newly introduced models under Powertrac and Farmtrac brands have been positive and encouraging. Our market share increased from 10.5% to 11.3% in 41 to 50 HP category in first nine months of this fiscal. We expect domestic tractor industry to grow by 18-20% in current fiscal, we will grow in line with the industry.

Coming to the Construction Equipment business, industry grew by 27% in Q3FY'17 with respect to Q3FY'16. All major segments like earth moving, material handling, road construction, have seen a positive movement. Our served industry which is Backhoe Loaders, Pick n Cranes and Compactors went up by 32% in the third quarter. Backhoe loader have been the biggest gainer in Q3 with growth of 34% followed by Compactors that grew by 26% and Kiln grew by 23%. Our total volumes manufactured as well as traded products went up by 17% to 815 machines in quarter ended December '16 against 698 machines last year same quarter. A positive swing of 219 bps on quarter-on-quarter basis is seen in EBIT margin in Q3. The market response for the newly introduced Jungli Backhoe Loaders has been positive. In Q3, we have introduced Hydra 14 EX Plus Crane with advanced features for mining activities and more fuel efficiency as compared to peers. Going forward, we expect that our Construction Equipment industry will continue to grow at 10-12% CAGR growth for next 2-3-years and we will be launching new innovative products cater to this growth.

Coming to the Railways division, revenue stand at Rs.58 crores in quarter ended December '16, is up by 2.6% against that of last year same quarter. The EBIT margin stands at 11%. This quarter margin is affected primarily due to higher new product contribution and also inflation in the commodity prices. Order book for this division stands at approximately Rs.130 crores which will get executed in the next 6-7-months. Bogey Mounted Brake System Fitment order of 689 quantities executed in first nine months of this fiscal and for axle mounted disc brakes 167 have been executed.

Lastly coming to the Auto Parts Division: We have completed the divestment of OEM and Export business of order product division to Badve Engineering Limited, Pune as part of the planned strategy reorientation of the business during this quarter and the company has absorbed one-time loss net of tax of Rs.30.8 crores on account of this divestment.

Now, I request the moderator to open the floor for Q&A Session.

Moderator: Thank you very much. We will now begin the Question-and-Answer Session. The first question is from the line of Raghu Nandan from Quant Capital. Please go ahead.

Raghu Nandan: Can you throw some light on reasons for reduction when capital employed for Tractors and Construction Equipment segments? Also, why was there an increase in the capital employed for unallocated segment?

Bharat Madan: In the Agri business, actually it is working capital reduction which has happened. So I think in terms of overall inventory days, we have gone down from 35-days last year to about 33-days now and receivable also we are down there and the trade payable is up from 90-days to 104-days. So overall there is a reduction in the working capital which has actually led to this capital employed reduction on the Agri business side. To your second question, actually, what we are reporting here is not the capital employed figure, if you look at this more totally showing liabilities and total segment assets which are getting reported, and segment liabilities include the borrowing part, so it keeps fluctuating. So as a result the fluctuation is actually getting reported here in the Construction Equipment business.

Raghu Nandan: Because I was looking at the net figure and taking it as assets minus liabilities was Rs.60 crores for the current quarter and last quarter it was Rs.102 crores, a reduction of about Rs.43 crores?

Bharat Madan: So if you compare this, last year was Rs.45 crores. It was essentially on account of borrowing. Because earlier we used to report capital employed figure in the results. Now because of change of format, now the segment assets and liabilities is being reported separately. So in our earlier figures of capital employed, in the liabilities, we never used to take the borrowings. So now in these numbers which are getting reported in the segment liabilities, we are also including borrowings now. So as a result the fluctuation is happening on that account. There is no major change really in the working capital front on the fixed assets front. It is essentially the change in borrowings which is happening. That is more intra division within the reserve.

Raghu Nandan: On the unallocated segment, as part of Auto Ancillary asset or liability got reclassified into unallocated because there seems to be an increase there?

Bharat Madan: Yes, right.

Raghu Nandan: Sir, my second question was on raw material cost to sales. That has increased by about 130 basis points QoQ. Is this increase due to higher commodity prices and is there a further increase expected in March quarter, any price hikes taken to offset the same?

Bharat Madan: There was the pressure for the inflation on the commodity prices. So we did take a price increase in Q3 also in the Tractor business which was taken with some lag and same thing happened in the Construction Equipment business also. In Railways we were not able to take the price increase because it is a fixed price contract there. So whatever tenders were there, we cannot pass it on. So yes, to some extent, it is 1% impact is coming because of the inability to pass on 100% price increase to the market. There is pressure which is still on. We think the inflation is still continuing. We have seen the steel prices moving up even in Q4. From January we are again seeing the impact that will happen. Rubber prices also moving up. So we will see probably the next quarter as well as we will see the pressure on inflation continuing on the commodity side. So there is one price increase we have taken and probably we will have to take another price increase in this quarter, so we will review the market and take a call accordingly.

Raghu Nandan: Can you quantify the price hike?

Bharat Madan: Till end of last quarter the price increase was about 1.25% on the Tractor segment cumulative.

Raghu Nandan: How much impacted in the current quarter?

Bharat Madan: Probably something similar.

Raghu Nandan: Can we expect a breakeven for the Construction Equipment division in the March quarter? Just to reconfirm break even volumes are at 900 units, right, sir?

Bharat Madan: Yes, but the challenge again which we face is because the inflation treading in, so our inability to pass on the entire inflation to the market has led to this slightly slowness, otherwise we were seeing the better margin in this quarter also if the inflation was not duly treading in. So that is one challenge I think which we are facing but still we are hopeful we will be able to at least reach EBITDA breakeven in Q4 and if possible maybe the volume support us maybe even at EBIT level, we will be able to reach the breakeven.

Raghu Nandan: Sir, debt reduced due to divestment of Auto Products division?

Bharat Madan: No, the debt remains with us. What we did is actually an asset sale agreement with the company. So the debt is still on the book of the company and which based on the cash flow we will pay it off. There is more working capital related debt. There is no term debt which was there for that.

Raghu Nandan: What was the inflows for the sale of the assets which we did?

Bharat Madan: Total asset sale which was done was about Rs.17-odd crores plus taxes. So I think to-date some of the fixed asset is essentially the machinery, gets transferred. So essentially the fixed assets and the mower machinery which got transferred and some part of the inventory for which the customer order got transferred to them. So roughly Rs.17-18 crores total value was the consideration which we got from the asset sale.

Raghu Nandan: Which will be utilized towards VRS and other activities?

Bharat Madan: That is right. So our liabilities are still retained by us and all the old receivables are still with us. So I think as and when the payment gets realized, so those liabilities will be taken care. We look at the total segment of assets and liabilities. They are more or less snatching now on the order parts.

Moderator: Thank you. The next question is from the line of Dhawal Doshi from Phillip Capital. Please go ahead.

Dhawal Doshi: Sir, first on the demonetization part. So Tractor volumes clearly does not have any impact on account of the demonetization. But we supposedly had seen some impact on the spare sales. I guess this is one of the reasons for bit lower margins compared to what was estimated earlier for the Agri business. So has that impact weighted?

Bharat Madan: I think the margin impact is not coming from demonetization but there was some impact definitely because of demonetization because we saw in November industry was going down after the announcement of this move and in December some recovery happened, and January did face some issue on the collection front because of the demonetization. But overall the margin reduction like I mentioned earlier was more on account of the inflation setting in which we have not been able to pass on as and when it happens. So there is some lag which we did the price increase which has actually impacted the margin and now the pressure is still continuing in Q4 and probably in Q1 of next year also we are seeing the cranes which are looking like, the commodity price will continue to move up. So obviously that pressure will remain. So let us see how we are able to pass on the price increases to the market. That will depend on how the competition behaves and how the external environment is.

Dhawal Doshi: On the second hand market, so that still continues to be an issue, can that spill over as a problem for the fresh Tractor sales?

Shenu Agarwal: Certainly, we are facing some impact of demonetization in the second hand market. So the old tractor inventory is slightly piling up at the dealerships right now because of the cash availability situation.

Dhawal Doshi: So is it expected to spill over in terms of sales problems for us or that is still manageable?

Shenu Agarwal: As Bharat just said, the industry in November and December was much lower than the growth rates we were experiencing in the earlier part of the year. In fact, the effect is diminishing every month and we are hoping that by another two or three weeks we will come to almost a normal situation.

Dhawal Doshi: So what is the outlook for the Tractor industry growth for the next year as well as how do you expect it to close this year?

Shenu Agarwal: This year we are expecting Tractor industry to close at around 17-18% growth and next year also it depends on a lot of factors which could be clearer in the times to come, for example, the prediction on the monsoon, etc., But I think the fundamentals are looking solid right now in terms of the sowing that has happened for the wheat crop and also the crop prices. So we are expecting a positive industry. I think the range could be anywhere between 6-8% in our estimates.

Dhawal Doshi: How would that be for us both this year as well as for the next year?

Bharat Madan: Like I said I think obviously our expectation will grow with the industry but this year like we said we already improved our market share. So in nine months we have seen the improvement of about 0.3% in market share and this particular quarter the improvement was about 0.6% and again it will depend on how the growth pattern is between the stronger markets which we are operating and the weaker markets, specifically the southern and western markets. So our expectation is now probably you will see the swing happening in the growth pattern probably the northern market will start doing well. So that should be favorable for the company.

Dhawal Doshi: So you would continue to see market share gain, so we will basically continue to exceed the industry growth?

Bharat Madan: Let us see.

Dhawal Doshi: Sir, just coming on to the export piece of the business for Tractors. So while the exports are growing quite good but we were expecting some decent numbers coming in on account of the institutional orders. So when is that expected and any update on the same?

Bharat Madan: Institutional order which was expected this year has not really happened, so at least delayed as of now. So we do not have any visibility as of now and also timing when it will happen. So whatever growth you are seeing is actually coming more in the retail operations of exports which are actually picking up. So we hope this momentum will continue.

Dhawal Doshi: So what is the expectations or what is the company budgeting in terms of the overall volumes, 2500 units was mentioned in the last quarter's call, am I right?

Bharat Madan: It will be around that range only. So I think this year we are likely to add plus 1000 tractors on exports and hopefully next year we are looking at somewhere around 2000 plus tractors.

Moderator: Thank you. The next question is from the line of Viraj Kataria from Securities Investment Management. Please go ahead.

Viraj Kataria: Can you just provide some update on the sub-30 HP Tractor volumes we have done in the first nine months, the arrangement which we have with Amol Industries?

Shenu Agarwal: I do not know the exact numbers right now, but I think we have grown almost by 60-70% in the first nine months of this year as compared to the same period last year and it is still a small volume because we are relatively a new player in this segment and therefore the opportunity is pretty large for us to grow.

Viraj Kataria: So the product which we offer right now is it like 20 HP tractor if you could just provide some clarity?

Shenu Agarwal: This is a sub-20 HP segment and our product is in the range of 10-15 HP and most of the products in the market are in that HP range.

Viraj Kataria: Are they also sold through our network, is that the eventual plan to… ?

Shenu Agarwal: The network is common for steel plant as well as other products.

Viraj Kataria: You also highlighted some plans on launching other Agri Equipments. So if you can just provide some update on where we are with respect to that?

Bharat Madan: As of now, there is no plan on the implements part. So there is something which we are still exploring. I think probably as and when some opportunity comes up, obviously we will come back to you and update you on that. But as of now there is no development on that front.

Moderator: Thank you. The next question is from the line of Prashant Biyani from JHP Securities. Please go ahead.

Prashant Biyani: Sir, there has been some initial commenting from the Australian weather forecasting agency that there are signs of El Nino surfacing this year again. So just wanted your views on that, have you heard anything like that?

Bharat Madan: It is all guess work as of now. So I think we will have to be clearer as we approach that monsoon season. So if the things really turn out to be better fully you see a good season coming in next year also and if the things really turn out bad monsoon, then obviously things slightly go around. So second half may actually see pressure.

Prashant Biyani: Regarding this Railways segment margin, couple of quarters back you had said that this indigenization of some of the imported products might be complete by December. So has that been achieved?

Bharat Madan: No, we could not complete the indigenization part. We will take still another one or two quarters to fully complete that indigenization. But it is not only the indigenization, the Railways prices are fixed price contracts, so because of the commodity price increase we could not push back the price. That is one of the reasons why the margins were down. But we are confident Q4 we should be able to come back with our usual margin what we have.

Prashant Biyani: We are not in a position to pass on the price hike?

Bharat Madan: In Railways, it is government, so it is basically a tender based business. So once you have a tender, it is a fixed price contract, we usually do not have the price variation clause in the government tenders. So that way we have a difficulty of passing on that particular price variation within the period of the tender. But for future tenders, we hope the government to take up the price. But in any fixed price contract, it is not possible to pass on.

Prashant Biyani: So in that case, there might be some pressure in the Q4 also for the Railways segment. Is that correct way to look at that?

Bharat Madan: No, we have already factored in all those stuff once we had done that. So we do not see much of pressure in Q4 and we also have a very good product mix what we have planned for in Q4. So we hope to be back to our 12-13% remaining on EBIDTA.

Moderator: Thank you. The next question is from the line of Mitul Shah from Karvy Stock Broking. Please go ahead.

Mitul Shah: I have a question on Auto Ancillary segment. So what is the debt over there?

Bharat Madan: The working capital debt was close to Rs.50-odd crores.

Mitul Shah: You said that now more or less the assets and liabilities are matching. So that is including this debt part or it is totally working capital related?

Bharat Madan: It is purely working capital related.

Mitul Shah: This debt is additional liability, right?

Bharat Madan: Yes, debt was in any case more of the past losses which was there, so the debt has been now part of the un-allocable segment liabilities, it will be a case from there.

Mitul Shah: Next question is on the strategic initiative post this hive off Auto Ancillary segment, the vacant premises, any strategic planning for utilization of that?

Bharat Madan: There are some projects in the pipeline, I think which we are still debating. So I think April period time we will come back, but as of now since the divestment is just completed, so the arrangement with the buyer is they will continue to use the specialty for certain time and once they vacate the specialty, only after that the land building will be available to us for further use. So as of now it is still being used by them. So maybe it will take a few months more by the time they vacated and then probably we will look at the other options which are available with us and which one is the best thing to do that.

Mitul Shah: Sir, any plan to expand through Agri Implements segment which has been a growing significantly industry?

Bharat Madan: Like I said earlier also, so as of now we do not have any visibility in terms of entering into this Implements area. But if something crops up in between which is a good opportunity for us, then definably we will look at that.

Mitul Shah: On Railways segment, there is Rs.132 crores order. By when we wish to complete?

Bharat Madan: We wish to complete in this Q4 and Q1.

Mitul Shah: Sometime back promoter has guided for around Rs.1000 crores kind of revenue from this segment over next two-three years. Any clarity on that?

Bharat Madan: We do have clarity. So at an appropriate point of time we will come back and say because there are a lot of new products which have been introduced in the holiday stage. Once we cover that, we will come back with that.

Moderator: Thank you. The next question is from the line of Mayur Milak from Anand Rathi. Please go ahead.

Mayur Milak: Just a quick thing on the VRS. So the plan to rest the 500 employees over the next two years stays and what is the progress on that?

Bharat Madan: Recently we entered into the settlement with the union now. So I think the plan for the next three years we said we will take the major VRS. So I think we will start working on that now. Now it is premature, I think maybe next fiscal we will have to see and review the situation on how much we can do.

Mayur Milak: But should we expect that we will be seriously looking at sizeable number of retirements in the next two years?

Bharat Madan: We have about 450-odd employees getting retired in the next three years. On top of that is something which we are looking at exploring the VRS options of reducing further 400-500 employees. I think a few thousand odd employees over the next three years' period should get reduced. So that is the plan which we have. So let us see, again, timing wise we cannot really confirm as of now, but obviously we will have to watch it more closely and then come back to you into the finer time plans.

Mayur Milak: On the raw material front, we have seen significant reduction in the cost; we came down from 72% to almost 68% and now we are again seeing a jump in the steel price and all. So are we and the entire industry in a phase where we could actually pass on that entire thing or you think that something of it could really add pressure to the margins?

Bharat Madan: We expect the industry will pass it on. Obviously, there was 1.5-years of deflation period for the commodity prices. So obviously anybody who is waiting and watching till the time the deflation benefit gets neutralized, it was not everything got passed on to that time. So till the time that benefit gets neutralized, I think the industry will probably hold it back. But at the end of the day ultimately we will have to pass it on, nobody can absorb this sort of price increases on the cognitive side. So I think it is a question of time.

Mayur Milak: Is there really a difference in pricing between let us say North India and South India in terms of the same product or it is across regions the same price?

Bharat Madan: Our policy is we have the same price across all regions.

Moderator: Thank you. The next question is from the line of Sameer Deshpande from Fairdeal Investments. Please go ahead.

Sameer Deshpande: I had two questions; now we continue to have some sales in Auto Ancillary, we have reported Rs.15-16-odd crores and reported some loss also. So now after discontinuing this, do we expect to have sales continuing in next quarter also?

Bharat Madan: This sale which reported actually was for the pre-transition period. So our transition got concluded on 6th of December. So the sale likely was either prior to that period or there is some sale of inventory which was actually turned to the new buyer which is getting deflected here. So after this quarter there will not be any further sale. Maybe some disposal or some inventory which was not usable, maybe some scrap items which would be there. But very minor amount will really get reported, otherwise no significant numbers will get reported on this segment.

Sameer Deshpande: Now, we have already reported the loss also, no, Rs.31 crores hit which we have taken, do you not expect anything further on that?

Bharat Madan: No, we do not expect. Maybe some upside possible, like I said, if we dispose off some old obsolete inventory, maybe some scrapping, something may come as income. Depending on the disposal value, so there can be some income coming.

Sameer Deshpande: Construction Equipment, our expectation is that we will break even in Q4. So do we see the trend better because in this quarter, we have not groomed with the industry, we are lagging the growth in the industry. So what is the expectation for Q4 and going forward EBIDTA positive when we are likely to achieve?

Ajay Mandahr: We are operating in a segment in the served markets, almost 80% of that is Backhoe which is dominated by peers. So generally you will tend to find the growth rates much lesser as compared to the industry because industry is dominated by that growth. We are expecting to be EBIDTA-positive by this quarter end and volumes are looking to be alright, the market is positive and so are we.

Sameer Deshpande: So basically on this business, the next year we will definitely see contribution to the profitability because this year we have lost almost Rs.18-19-20 crores?

Bharat Madan: Sure, we try.

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

Chintan Modi: On the market share basically, on the weak and the strong markets, how things have shaped on YoY basis if you can highlight that?

Shenu Agarwal: In the last nine months we have grown almost in all the markets of the country, whether strong or weak, of course, our growth of market share in the strong markets is little bit higher than in the weak markets and the reason for that is in the weak markets since our market shares are low, it we take a little bit more time for us to get the fundamentals in position and then expect a higher growth. So we are working on that.

Chintan Modi: If you can just throw some light on Andhra Pradesh has been a key area in the south for us where we have been growing very strongly. So do you think that the growth rate is maintained in that space and which are the other regions which are really picking up well for Escorts?

Shenu Agarwal: The highest market share increases we have seen are in Haryana, UP, Madhya Pradesh, even Jharkhand, Chhattisgarh, those kind of states and as I said we have grown even in the weak markets, Andhra Pradesh also we have a positive growth in the first nine months, West Bengal, we have positive growth, Odisha we have positive growth. So I think there is momentum in all the markets, whether strong or weak. As I said, the effort required in the weak markets is of course more than in the strong and therefore the higher growth rates will come probably with a small lag.

Chintan Modi: In terms of employees what is our current strength if you can divide it between the blue collar and the white collar?

Bharat Madan: Blue collar regular work force we have got close to 2200 employees as of now and the white collar will be close to 1600.

Chintan Modi: How was the scenario last year same time?

Bharat Madan: Last settlement when we did, number of workers which we settled was 3000 plus workers. In the last three years we have been able to reduce the blue collar number by about 1000 employees. So now we are down to about 2100-2200 people and if you look at the next 3-3.5 years like we talked about is another 450 people getting retired. So in the normal course, we should end up by around 1600-1700 blue collar workers without VRS. So if we also go ahead with the VRS which we are looking at, another 400-500 people, so maybe 1100-1200 numbers which we are looking at which will be ending at the end of the next three years.

Moderator: Thank you. The next question is from the line of Kasturi Rangan from J Matrix Investments. Please go ahead.

Kasturi Rangan: Recently, the focus for the tractor segment has been shifted to the higher HP segment which is likely there is indication of losing the market share in the medium HP of tractors. So can you just throw some light on that?

Shenu Agarwal: Yes, you are right, the growth in the relatively higher HP segment has been higher this year as has been the trend for the last few years. So Tractor industry in 50 and above 50 HP is growing relatively better than the small tractor industry. We had launched as you are aware some new products in the segment, both in our Farmtrac and Powertrac brands in the last year and a half and both of these products in both the brands are doing fantastically well for us. So our share of market increases actually better in 40 HP and above than in the smaller segment also where the market is also growing. So that is helping us.

Moderator: Thank you. The next question is from the line of Rakesh Jhunjhunwala from Rare Enterprise. Please go ahead.

Rakesh Jhunjhunwala: I wanted to know about these workers. What is the average cost of the blue-collar worker to the company and white collar?

Bharat Madan: Average cost today is about Rs.55,000 per worker per month. White collar varies because from the lower grade it will be even lower than the blue collar employee today; Rs.40,000 average for the lower grade employee and for the higher grade overall average will be much-much higher and it depends on, variation is very huge.

Rakesh Jhunjhunwala: Therefore, you feel that 450 employees who are returning and 500 employees who can afford to give VRS, you should be able to work the company without 950 employees?

Bharat Madan: That is right.

Rakesh Jhunjhunwala: That means you are saving the cost is about Rs.60,000 per month, Rs.7 lakhs per year, so that means you can see Rs.70 crores reduction in labor cost?

Bharat Madan: Yes, but like we said, we also done a long-term settlement with the union now, normally all these things are also taken into account when the settlements are done. So both on account of productivity improvement as well as on the retirement saving which are getting there, so after that also there will be some minor increase which will be there which we are trying to neutralize. So net-net after taking into account all the retirement cost and the productivity benefit, we should be able to neutralize the entire increase of the settlement which we have with labor. So essentially we are saying no increase in the labor cost on the clientele level in the next three years will happen. If we brought early, we will see further VRS, and if we do VRS then obviously we needs some saving which can sit in.

Rakesh Jhunjhunwala: That means the productivity improvement has to be done and non-replacement you will be able to keep the labor cost in absolute terms at the same level or in percentage terms?

Bharat Madan: In absolute terms.

Rakesh Jhunjhunwala: So if your volumes go up, then the labor cost will go down?

Bharat Madan: That is right.

Rakesh Jhunjhunwala: This year volume?

Bharat Madan: This year we are expecting it will be about 63,000-64,000 Tractors total.

Rakesh Jhunjhunwala: If you are able to do productivity improvement and with the retirement, volume is 64,000, labor cost will remain the same, but if the volume go up, the percentage will come down.

Bharat Madan: Definitely, as a percentage, the cost will come down, not only for blue, but it will also come down for white collar.

Rakesh Jhunjhunwala: If you further reduce the workers through VRS, and you do not plan any VRS in the white collar?

Bharat Madan: Yes, so that will also benefit if we are able to do that.

Rakesh Jhunjhunwala: What is the problem in VRS – liquidity of the company or there is a big additional labor?

Bharat Madan: Like we mentioned, because we had this settlement due with the union which was actually being negotiated for the last six months and we recently concluded on that. So that was one of the hindrance actually because we were not able to offer that VRS scheme during this period, but nobody would have taken it even if we had offered the scheme. Now the settlement is done and now we are in the process of implementing the settlement which will take maybe another month or two and after that we should be ready with launching the VRS scheme.

Rakesh Jhunjhunwala: Mr. Madan, what I am asking is that if we offer VRS scheme, will the employees take it?

Bharat Madan: It is not necessary, it is a voluntary scheme, so obviously it will depend on what I want is being offered. So based on that I think people can take. Also we do not want to offer VRS to the employees who in any case going to get retired in the next three years which has already taken care of in the entire settlement negotiation. So anything which will be offered for the people who will be retiring after these three years and there again with the larger tenor for the higher employees are higher is the payout which is required. So today our average payback is 3.5-4-years with the settlement which we have done. Actually, we would have to take that call accordingly based on how much is the cash requirement for that and how many people will likely go for it.

Rakesh Jhunjhunwala: So substantial scope of reduction in labor cost?

Bharat Madan: That is right.

Moderator: Thank you. The next question is from the line of Raghu Nandan from Quant Capital. Please go ahead.

Raghu Nandan: Sir, one of our new products which was Euro 50 had been doing extremely well. So because of that would Powertrac share in our overall tractor mix have increased, would you be able to give some color on the mix between Farmtrac and Powertrac?

Shenu Agarwal: Euro 50 has been a very good success especially with the 40-50 HP market growing like it is, this has proved to be quite a boon for us and also it has helped us to add market share of the Powertrac; the Powertrac for the nine months' period has grown from 5.4% to about 6.1% market share and I will say about half of that is contributed through this product Euro 50.

Raghu Nandan: With reference to new product launches in tractors, can you throw some colors as to what can be the products one can expect going ahead? Earlier there was one talk of strengthening the Haulage segment and launching more products under the ALT Series 5000 something like that. Can you throw some color it will really be helpful?

Shenu Agarwal: Yes, Haulage segment is something that we look at as a very big growth opportunity for us because we are not as strong in Haulage segment right now as we are in the Agri segment and therefore we do have plans to launch more products in the Haulage segment like ALT 5000 and those products are under advanced stages of design and development and I think within the next fiscal year we are going to launch ALT 5000 and some other additional products in the Haulage segment as well.

Raghu Nandan: Due to demonetization, there was impact on used vehicle market. Is there any improvement there?

Shenu Agarwal: As I said, the cash flow in the rural markets is improving every day. So what we faced in November is nowhere close to what the situation is right now. I think we will be returning to normalcy in about another three to four weeks.

Raghu Nandan: In the Construction Equipment division, our growth seems to be lower than that of the industry growth. How can we bridge that gap, your thoughts and strategies there?

Ajay Mandahar: If you see the industry, served industry that we talk about, 80% is accounted by Backhoe Loaders and Backhoe Loaders our market share as of now is 2%, though we have grown by 30% further but market has grown by 40% and on a lower base the growth is not that substantial. So going forward, we have a plan for it, we will gradually improve our market share in Backhoe. It needs a lot of network, dealer developments, new dealer appointments so that we are doing now. In all other segments, we were close to the market growth.

Raghu Nandan: In the Railways division, assuming our revenue of about Rs.60-65 crores in the fourth quarter, we would end the full year with the growth of about 10-11%. Is that a kind of growth we should be working with for the next two-three years or do you expect an improvement in growth?

Dipankar Ghosh: We expect much more improvement of growth because as our new products kick in, so we expect around (+20%) growth next year and on CAGR level we should be expecting somewhere in the range of at least 20% CAGR.

Raghu Nandan: On the margin side, would you see an improvement going towards mid-teens in the Railways segment?

Dipankar Ghosh: We are already somewhere in the range of 11-12%. So for the coming two years since the new products kick in, we would be maintaining in the same range and as the new products become operational, then only gain the EBIDTA margin with improved localization and all other benefits what you have when you supply in volumes that will also kick in.

Raghu Nandan: VRS expenses, what is that estimated for next year?

Bharat Madan: I think it will depend on the number of workers who take this VRS we will work it out, but average VRS amount for worker will range anywhere between 20 lakhs to 22 lakhs.

Moderator: Thank you. The next question is a follow up question from the line of Dhawal Doshi from Phillip Capital. Please go ahead.

Dhawal Doshi: Just coming back on the Tractors price hike which is discussed at the start of the call, you mentioned that the price hikes are lagging the overall cost increase which is impacting the margins and a similar thing is expected in Q4 as well. So assuming we need to maintain the margins, what is the extent of price hike that is required?

Bharat Madan: Like we mentioned in the last quarter, we have taken close to 1%, so total cumulative increase in the last nine months is about 1.25% on the selling price and the way we are looking at inflation in this Q4, we expect that we will have to really do similar amount of price increase of 1.25%. So total overall during the year will be about 2.5% with neutralized inflation.

Dhawal Doshi: So 1.25% price hike will be good enough to offset the overall inflation, right?

Bharat Madan: Yes, 1.25%, over and above we have already done.

Dhawal Doshi: On the Railways division, as far as the margins are concerned, probably sometime back we were looking at much healthy margins in the range of around 14-15% going ahead whereas currently we are looking at a bit lower number as Mr. Ghosh has mentioned. What has been the specific reason for lowering the overall margin estimate for the Railways division?

Bharat Madan: Two reasons; one obviously was this inflation which we had not factored in because this is something like we mentioned this is a fixed price contract and most of the tendering in this year also had happened in the first quarter. So we got the orders which are getting executed, on which we are not able to pass on any cost increases to the government. So this is one of the reasons actually which led to the slight drop in the margin in this quarter, some impact may be there in the next quarter as well because the new tender which we are participating in also we will be quoting with the revised cost structure but if the inflation continues like this obviously different hedging strategy we will have to really work out for the Railways. Second, it also depends on the kind of product mix which we sell. Like we mentioned this quarter the mix was not really good at fair level but next quarter we expect the mix will also improve. So we will see some improvement in margin happening.

Dhawal Doshi: Correct me if I am wrong, Mr. Ghosh mentioned 11-12% margin range for the next two years or next two quarters I am sorry?

Bharat Madan: So this will vary in the range of 12-13% overall EBIT margin. So he mentioned about EBIDTA but the kind of mix which we are looking at in terms of the order book we expect 12-13% EBIT margins are possible even in the current situation also.

Dhawal Doshi: Any updates on the inorganic plans we did have some for the Railways business as well, right?

Bharat Madan: Still work in process, so nothing has been finalized, so I think once we get to something concrete, we will definitely come back to you.

Dhawal Doshi: What is the budget that the company is looking at in terms of the overall acquisition size?

Bharat Madan: No budget as such, it depends on the opportunity in the market. So as of now there is nothing been set aside for this particular purpose but as we did indicate total CAPEX will be required to be in the region of number of 80-100 crores of opt line for this business in the next four to five years which was anyway between 100-150 crores. It depends at what point of time and what opportunities available to us and at what valuation.

Dhawal Doshi: So it would not significantly change the balance sheet structure per se, right?

Bharat Madan: I do not think so.

Moderator: Thank you. The next question is from the line of Kasturi Rangan from J Matrix Investments. Please go ahead.

Kasturi Rangan: I have two questions; one is that recently you guys have collaborated with Porsche and Euro for the design of the Tractors and you guys are releasing different Tractors in European markets. So just wanted to know how the European markets for these tractors are doing and what does differentiate for that? The second question would be slightly very different from that. I just wanted to know the government subsidy on the tractors that will be given because what I heard is we have 20 HP, subsidy will be given for only those tractors. So I just want to know the impact on subsidy of a government plan and going to do?

Shenu Agarwal: Let me first clarify that collaboration or arrangement that we have with Porsche was not only for the European markets but it was to create a global product for us. So that product is still on the anvil and we are going to launch it in sometime in the future, we are still working on it. So that was one. The other was that subsidy, it is not exactly correct that government provides subsidy only on small tractors, in most of the states the subsidies are available in different forms but on all kinds of tractors and implements also. In some of the states, like let me say, Gujarat, subsidies are focused more on the smaller tractors because of a particular reason but subsidies are available from the government right now as they were in the past.

Moderator: Thank you very much. That was the last question. As there are no further questions, I would like to hand the conference back to Mr. Chintan Modi from Motilal Oswal for closing comments.

Chintan Modi: On behalf of Motilal Oswal, I would like to thank the management and the participants for taking out time for attending the call. I would like to give the call to Mr. Madan for any closing remarks.

Bharat Madan: Thank you, ladies and gentlemen for being present on this call. For any feedback and queries, please feel free to write into us at investorrelation@escorts.co.in.You can also log on to a website, www.escortsgroup.com for our earnings releases as well as other details and this transcript will be available on our website after some time. You can visit our social media pages for the latest company news, development, etc., we will meet again next quarter. Thank you very much.

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.