"Escorts Limited Q3 FY 2018 Earnings Conference Call"

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MODERATOR:	**MR. HITESH GOEL -- KOTAK INSTITUTIONAL EQUITIES**

Moderator: Ladies and Gentlemen, Good Day, and Welcome to the Escorts Limited Q3 FY 2018 Earning Conference Call hosted by Kotak Institutional Equities. 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 would now like to hand the conference over to Mr. Hitesh Goel from Kotak Institutional Equities. Thank you and over to you, sir!

Hitesh Goel: Thank you. Good Evening and on behalf of Kotak Institutional Equities, I welcome you all for the Escorts Limited Third Quarter FY 2018 Result Conference Call. I also take this opportunity to welcome the management team from Escorts Limited.

Today we have with us, Mr. Bharat Madan -- Group's Chief Financial Officer; Mr. Shenu Agarwal -- Chief Sales and Marketing Officer of Escorts Agri Machinery; Mr. Ajay Mandahr -- CEO of Escorts Construction Equipment; Mr. Dipankar Ghosh -- CEO of Railway Equipment Division; and other management along with Investor Relations team at Escorts Limited

We would like to start the call with brief opening remarks from the management followed by an interactive Q&A session.

At this point, I would request Mr. Madan to take over and make his opening remarks. Over to you, sir!

Bharat Madan: Thank you, Hitesh. Ladies and Gentlemen, A Very Good Evening to You All. Thank you for joining us on the Third Quarter Earnings Call for the Financial Year 2018.

A snapshot of Company's quarter performance is as follows: Turnover is up by 10.3% at Rs. 1,205 crores as against Rs. 1,093 crores last year, led by volume growth across all three businesses.

Tractor volume is up by 11.6% to 18,930 tractors, as against 16,963 tractors last year same quarter. Construction Equipment volumes are up by 33.4% to 1,087 machines against 815 machines last year same quarter.

EBITDA at Rs. 145 crores against Rs. 91.5 crores last year is up by 58.5%. EBITDA margin now stands at 12.04% versus 8.4% last year same quarter ended December 2016.

PBT from continuing operations at Rs. 129.5 crores, up by 71.1% as against Rs. 75.7 crores last year same quarter. The company reported a PAT of Rs. 92 crores versus Rs. 22.7 crores last year up by 305%. PAT margin now stands at 7.6% versus 2.1% last year in the quarter ended December 2016. EPS is reported at 7.70% against Rs. 1.92 last year same quarter.

Now, moving on to segmental business performance, starting with the Agri Machinery business, domestic tractor industry volumes grew up 7.9% to 1.77 lakh tractors as compared to 1.66 lakhs tractors in last year same quarter.

Our domestic volume went up by 11% at 18,480 tractors against 16,600 numbers in the quarter ended December.

Industry in our strong market in all its centers grew by 6.1% whereas industry grew by 10.3% in opportunity markets of South and West.

Our domestic market share stands at 10.4% in the quarter ended December 2017 is up 30 basis points as against last year same quarter. EBIT margins in EAM in the Agri business stands at 14.6%, up by 421 basis points against 10.4% last year primarily due to operating leverages and the cost reduction initiative taken by the company.

The market response to the higher HP models introduced in the Powertrac and Farmtrac brand has been positive encouraging. Our market share increased from 6.6% to 8.1% in 50 HP plus category in first-half of this fiscal.

In the Powertrac brand, we launched new models with highly advance Hydraulic Lift Technology called **Sensi 1** Lift, in our stronger markets. In current quarter we had launched new compact tractors range called the Farmtrac Adam Series for orchard and vineyard applications in the domestic market.

Going forward we are launching new Farmtrac Four-Wheel Drive especially designed for potato farmers. We expect domestic tractor industry to grow by 15% to 16% in current fiscal.

Coming to the Construction Equipment Business, our served industry grew by 21.9% in Q3 FY 2018 with respect to last year. Material handling has been the biggest gainer in Q3 FY 2018 with the growth of 70% followed by Compactors with 17% and Backhoe Loaders segment by 16%.

Our total volumes manufactured, and traded products went up by 33.4% to 1,087 machines in the quarter ended December 2017 against 815 machines last year same quarter.

EBIT margin for quarter three ended December 2017 at 2.2% is up by 462 basis points as against negative margin of 2.4% in the same quarter of previous fiscal.

Going forward we expect that our served Construction Equipment industry will continue grow at 18% to 20% range for FY 2018.

Coming to the Railways division, the revenues at Rs. 72.03 crores in the quarter ended December 2017 is up by 24.2% as that of Rs. 58 crores last year same quarter. EBIT margins up by 202 basis points to 13% as against 11% last year second quarter. The order book for this division stood at approximately Rs. 330 crores as of 31st December 2017 which will get executed by next fiscal.

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

Moderator: Thank you very much, sir. Ladies and Gentlemen, we will now begin the Question-and-Answer Session. We take the first question from the line of Nitesh Sharma from Phillip Capital. Please go ahead.

Nitesh Sharma: Sir, we have seen tractor segment margins improving sequentially despite RM pressures and 7% drop in volumes quarter-on-quarter. So, what has really worked for us? Is it the mix, cost control, something else? And do you see further cost reductions scope which is achievable in this next financial year in the tractor segment?

Bharat Madan: I should say a combination of all the factor, the company has been working on the cost initiative for the last two years - three years and that initiative are on as of now. So obviously on the growth on the manpower cost as well as on the material cost side, I think the work is happening now and we expect the momentum will continue maybe we will see some further saving happening in next year too. And obviously, another reason is the leverage operating leveraging we will be getting with the higher volumes coming in this year. So, the similar thing which has helped us in getting the overall improvement in the margin. And secondly, if you compare with the last quarter also, in the last quarter because the GST transition we have some one-off impacts which were factored in. so if we had removed those impact the margins should have been quite significant in last quarter also. So, there is not really a major change compared to the last year. But yes, 100 basis points to 150 basis points improvement has been there around better cost initiatives in this quarter.

Nitesh Sharma: And sir, we have taken any price hike during the course of the quarter?

Bharat Madan: So, we have taken a price increase in last quarter in Q2. So, in Q3, there was no price increase. So, there is another one which we have taken is in Q4.

Nitesh Sharma: And what would be the quantum for the same?

Bharat Madan: So roughly on a full year basis this will be about 2% - 2.5% sort of price increase has been taken

Nitesh Sharma: Okay, got it, sir. And any color on how is the demand on the ground for the industry and what is the outlook for FY 2019 that you are looking internally?

Bharat Madan: For the full year we expect the industry should deliver about 15% - 16% growth and Q4 probably will deliver a better growth number now so we are looking at aggressive growth may be could be anywhere between 20% to 30% growth may happen in Q4.

Nitesh Sharma: 15% to 16% for FY 2018, correct?

Bharat Madan: Yes, for the full year.

Nitesh Sharma: Okay. And for FY 2019, what you guys are looking at?

Bharat Madan: So, FY 2019 probably it will be somewhere between 7% to 8% what we are looking as of now. But lot will depend on how the things really move and all the Government policy initiatives are taken and how is the monsoon going forward in next year, so what we expect till having FY 2019 will be another peak year for the industry.

Nitesh Sharma: Okay, got it. Sir, secondly on the Railways segment what is the current order book and where do you see this heading?

Bharat Madan: So, as I mentioned the order book size as of 31st December about Rs. 330 crores which will get executed and next 12 months or so.

Nitesh Sharma: Okay. And our program as far as localization of content for AMBS**,** BMBS where do we stand on that?

Dipankar Ghosh: I mean we are on that process of localization and that is why you see a regulator continuous improvement of the margin or the EBITDA margin and we are introducing few new products also which will be announced in the coming quarter.

Moderator: Thank you. We take the next question from the line of Jatin Chawla from Credit Suisse. Please go ahead.

Jatin Chawla: First question is on the tractor side, I look at average realizations and they have gone up almost 2% on a quarter-on-quarter basis. Is this largely a function of the price hike or is there some mix changes also in there?

Bharat Madan: So, like you said there are two reasons so actually one obviously was a one-off impact which we have taken in the last quarter so that it still was probably about Rs. 12,000 to Rs. 13,000 per tractor, so roughly 25% the one-off impact which was built in the last quarter number so that is one of the reasons why this time we are looking at a slightly increased number. Then also at the overall revenue, there is a non-tractor revenue which has also moved up compared to last quarter, which normally is about roughly 8% to 9% sort of level. So, this quarter the number is slightly higher than the last quarter. So that is another reason of about 5,000 to 6,000 realization getting additional because of that. And obviously third is the price increase which we have taken in Q2. So, there is a full quarter impacting coming into this quarter so that is another reason for the improvement and the realization of tractor revenues.

Jatin Chawla: In terms of market share we have not really seen any significant improvement in the nine months period so far, how do you see that shaping up in the next quarter and in FY 2019?

Shenu Agarwal: Okay, yes, that is true. I mean our market share for the nine months is pretty much flat. But if you look at Q3 there was a slight improvement. The market share for Q3 stands at 10.4 as against 10.1 same quarter last year. And we have a detailed plan to increase market share to our aspired level. So, we are working towards that.

Jatin Chawla: Any target numbers you would like to share?

Shenu Agarwal: I mean from four years to five years' time frame our aspiration to touch 15% market share as we have been saying earlier. So, our plans are tailored according to that goal.

Jatin Chawla: Okay. And on the tractor EBIT margin side, last two quarters have been very strong. And it seems we will very easily exceed the guidance that we had at the start of the year of 100 bps - 150 bps increase we might actually end up a lot more than 200. So where do you see margins going? Do you think that these margins in the last two quarters there has been some GST kind of benefits that the industry has had and over a period of time this will be shared with the consumers or do you think this is sustainable and we can build on top of this with the cost initiatives that we are taking?

Bharat Madan: So, like we mentioned, we have the guidance of roughly 150 bps improvement in the margin in this year and on top of that because of GST, so it is not a real gain which is there but because of GST rate is going up. So, the top line has gone down by roughly 7% from 1st of July. Now that has led to some numerator, denominator adjustment based on which our margin has improved by 70 basis points. There is no actual gain which is flowing in but surely a notional adjustment which has happened. So, if you combine the two, so roughly 220 basis points - 230 basis points improvement is something which management had given the guidance for. So yes, if anything happens beyond that then there will be a positive surprise for us. But as of now, we look at the number will be in that range only.

Jatin Chawla: And on the Railways side this increase in the order book that we are seeing from the previous quarter to this quarter, anything that has come from the additional product or we are still out of the seven products only three have been kind of approved and where we are getting orders?

Dipankar Ghosh: I mean the present orders are from the existing products which are under approval. The new products which are in the validation phase, we have only the developmental order. So, all the 334 of order is primarily of the products which have already been approved.

Jatin Chawla: And for the new products when do we start expecting?

Dipankar Ghosh: We have developmental orders they are under validation period, so we should be another one quarter or two quarters, we should be ready with those products also to get fully commercial in those products.

Moderator: Thank you. We take the next question from the line of Hitesh Goel from Kotak Institutional Equities. Please go ahead.

Hitesh Goel: Sir, the first question is basically if I can look at Railways EBIT margin it has declined by 300 basis points on a Q-on-Q basis. But if I look at the revenues it has not changed much. So, can you just share light on that? And, if I look at the employee cost on sequential basis gone down by 9%. So, can you throw some color on that as well?

Bharat Madan: Yes. So, on Railways side one is obviously the issue on the product mix side so otherwise we will look on a full year basis I think the numbers will be somewhere between maybe somewhere around 14% - 15% sort of EBIT range. So, since this lot depends on what sort of product which is getting sold in these quarters. So, in the fourth quarter, we had lower margin and then with the 16% then 13% in this quarter it will be back to 15% - 16% level again in Q4. So, I think on an overall basis it will still be in the range of 14% - 15% sort of margins for Railways. Now coming to the manpower cost, we have been working on the cost initiative with our consulting firm and this is one of the key areas of concern which we had compared to the competition and does benchmarking in the profitability gaps. So, this remains our focus concern area for future also. And we will continue to work on the utilization of the manpower of the manpower. So we have been able to achieve 0.5% reduction in this quarter and we hope to fairly improve it further going forward I think in the next year.

Hitesh Goel: Sir, but can you share more light on this raw cost reductions because raw material per se is going up. So are you consolidating the suppliers per se or there is a big VA/VE program which is going on because in the quarter reduction of around 0.5% looks too much. So, can you just shed some light on that how are you achieving this, what is the process going ahead?

Bharat Madan: Yes, so the company is like I said, VA/VE initiative is still on so that is something which we feel there is some juice left now even after doing the major project in the last two years and that effort again is continuing and we expect that will continue. So, our entire target if we can beat inflation with the kind of cost savings which we are able to do through VA/VE initiative as that is something which is a good challenge to take. So that is what the company is looking at internally in terms of the future reduction exercises.

Hitesh Goel: So once the scale of tractor business volumes if it comes down the industry goes through a bad phase that at least in gross margin we should not see much deterioration because these are more sustainable gross margins, am I right on that?

Bharat Madan: Well, like I said our internal target was that even when the industry remains constant in the next three years - four years, we should be able to sustain double-digit margin in tractor business. So that is the target what the company has taken and working in that direction only.

Moderator: Thank you. We take the next question from the line of Mitul Shah from Quant Broking. Please go ahead.

Mitul Shah: Sir I have a question on construction equipment. Sir, can you give more details on new product launches and second thing on the margin side in terms of visibility on the FY 2019 as well as Q4?

Bharat Madan: Ajay, can you take that question?

Ajay Mandahr: The earning calls you can take but as talking about new products we have launched a couple of new products last year and last quarter as well and a number of variants that we have launched within the product. So today as of now we see 23% contribution coming from the new product segment or in the product that we have launched last quarter.

Bharat Madan: So, on the margin front Mitul, I think this year like you said we had given an indication that we will be breaking even and maybe slightly positive on the bidding margin side which is what I think we are looking at now look at the numbers for the current quarter and next quarter also we look like strong quarter. So on a full year basis, it will be a slightly positive number on operating margin. And next year maybe you can look at somewhere around 3% - 4% sort of EBITDA margin on this business.

Mitul Shah: Is there any possibility going further up or anything major we are doing to increase the margin to 5% plus higher single-digit?

Bharat Madan: So, it will be so like you said the same cost initiative what we have done in the tractor business also. So, team are working on the prescription side. We integrate the back end now for both the businesses and they are working on this cost initiative again on the material cost front and construction equipment too and that benefit obviously will start following in but it may not happen in next year alone but yes, like you said our long-term target is to be in the range of 7% - 8% sort of EBITDA margin in construction equipment business. So maybe in another two years - three years' time we should be able to reach that.

Mitul Shah: Second question on the tractor side. You said 7% to 9% growth for the next year. Within this or which region do you expect to outperform strongly from where you are seeing positivity?

Shenu Agarwal: Yes. So, see, this year so far it is pretty much this growth has been very widespread and very equitable. But in the current let us say in the current few months like last month and following month South will grow a little bit faster than the North. I think, for the next year it will be also more equitable. So, growth will happen North, South, East, and West the growth will be more or less same.

Moderator: Thank you. We take the next question from the line of Raghu Nandan from Emkay Global. Please go ahead.

Raghu Nandan: Sir, on the new products and tractors could you throw some light on the potential for these products be it on the compact tractor side or the specialized tractors you are looking at in terms of for paddy applications?

Shenu Agarwal: Yes. As Bharat had explained we have launched or in the process of launching three new products in this quarter. So, one this compact tractor, there is growing market for this kind of tractor, this is roughly like 20 horsepower to 30 horsepower, four wheel drives small size tractors. The market is essentially in the South and some hilly areas but Maharashtra is a big market and we have been absent in this market so far and therefore, we really think that this product will give us better coverage, not just in market share but also in terms of our channel strength in these markets like Maharashtra. So that is one. The other product that we have just launched or in the process of launching is also rice special, this tractor is a 45-horsepower four-wheel drive tractor, it is a unique tractor in the sense that it is the right combination of the weight and the power. So, this tractor is also going to address white spaces for us. We never had such kind of tractor. And then again there is another model which we are going to launch very-very soon is a 45-horsepower tractor in a Powertrac range which we had never had a tractor in that segment also. Right? So, all these tractors are covering white spaces and therefore, should give us additional volume and market share.

Raghu Nandan: So how do you see the penetration happening in the Southern markets and what is the aspirations there on the market share in the medium-term?

Shenu Agarwal: Yes. See, the aspiration for the Southern markets is you know a few years ago we were at between 2% to 4% market share in most of the southern market and this includes markets in West and East also where we have been a traditional weak. And good thing is that in the last two years we have grown in every or let us say most of the Southern and Western markets which is like A. P., Telangana, Gujarat, Maharashtra, Jharkhand, West Bengal, Chhattisgarh, Odisha (Orissa), etc. right? So, there is a good momentum. There is a more fundamental hygiene level of what we must do which means creating a brand presence and creating a strong channel which takes a little bit of time. But the good thing is we are continuously increasing market share in almost every quarter in these markets.

Raghu Nandan: And can you also comment on how things are ramping up on the exports market and how these new products will be rolled out and how you expect things to ramp-up over the next few years?

Bharat Madan: So our export like you said this year we are looking at roughly touching 2,000 tractors mark and next year we are again looking at targeting about 3,000 plus tractors. So, in the long-term vision is to really reach in terms of numbers 8,000 tractors to 10,000 tractors in export in four years to five years' timeframe. So that plan is very much on. So, I think we are working in that direction only. So whatever new markets need to be opened to do that they are being implemented. So, with a margin like the Brazil and Mexico, U. S., Europe, the market in the Middle East, sorry in the Turkey and Nigeria and the South-East Asia which is the focused market for us. So, these markets I think penetrated now and, we are expanding the portfolio while there is a product charge coming under the portfolio. So, like compact tractors is a very good market. So that will be another volume booster for the export segment. So that will give us help us.

Raghu Nandan: Thank you, sir. One query on the construction equipment side, this year the industry is growing at 20% we might do better than the industry. How do you see the growth panning out for the next year?

Bharat Madan: We still expect the construction should continue to grow at the same. So maybe 15 odd percent something which we think is sustainable number looking at the kind of public spending which is likely to happen with this Government and the kind of Infra the Government is commenting itself to. So, if that continues so maybe 15 odd percent growth will continue.

Moderator: Thank you. We take the next question from the line of Bharat Gianani from Sharekhan. Please go ahead.

Bharat Gianani: My question was basically your earlier comment highlighted that FY 2019 I mean you expected the industry to be the peak for the tractor industry. So like if we see ground factors like last 1 year to 1.5 years there has been a considerable increase in the MSP prices two years the crop acreage is also good and the rural income is higher side. So, what makes you think that like FY 2020 the industry may witness a downturn. I mean I just wanted to get a sense of that. So, if you can just throw some light on that?

Bharat Madan: See, one obviously like you said this we know last two years the industry has been growing. Last year its growth was 18% and this year we again look 15% - 16% growth happening in the industry. So, I was sitting on a very high base in the industry slightly. And normally if you look at the monsoon trend also normally every two years - three years you see a cycle getting reverse. So again, we see a good chance that probably next year the monsoon may not be good. So, I think that will be one indication that will be there but also because the election year a lot of subsidy programs are coming from the Government in next year and this year also we are seeing that demand increase happening on the ground because of these reasons. So the policy led initiative which normally comes in this year will need a lot of preponement the demand in FY 2019 so that is why we see the preponement happen. So normally you see post-election there will be some correction which is going to happen. And it is too early too talk about in terms of the growth for the sector for next year but a lot will depend on how the early rains happen or how the monsoon spread on all India basis. But our indication is since we are seeing the good pace now in the two years the growth has been growth and this year already the industry is touch a new peak. so we expect the growth momentum will be slightly lower next year and maybe FY 2020 onwards we will see some traction sort of happening in the industry.

Bharat Gianani: Okay. The second question is any update you can provide on the inorganic growth areas that you know highlighted for the Railway business so any update on that would you like to comment on at this point of time.

Bharat Madan: On the organic side?

Bharat Gianani: Inorganic side because we indicated that we had sold some treasury shares in the last two months - three months for inorganic growth opportunities in I guess in the Railways segment. Can you provide any update on that at this moment?

Bharat Madan: We have some deals on the table which are getting evaluated so maybe I think we expect to close one of them maybe in the next three months to four months' timeframe. So fairly we will come back to the market when the deal is finalized and closed.

Bharat Gianani: Okay. So, can you just give an indication whether it will be on a product which is high margin compared to the product currently we are having just any rough indication you can give on that?

Bharat Madan: I think, it is too early for us to talk about that because we do not know which one will get closed obviously. But yes, what we are looking at is since there is a good opportunity in the segment in the Railway business itself the segment has high margin. So obviously whatever category we go into obviously it will be high margin category only.

Bharat Gianani: Okay. And sir, my last question is that if we assume that FY 2020 may probably be a flattish or kind of negative slightly negative year for the industry and may be consequently for Escorts as well. So, in that event do we still stand by the guidance or you know attaining a 13% to 15% kind of an EBIT margin because I think that was the target that we shared in this quarter we are very close to the target. So, like in the event if FY 2020 turns out not be good for flattish. So still we will be able to keep that 14% - 15% kind of range or do you expect some pressure with the volume remains flat or slightly negative that would be my last question. Thank you.

Bharat Madan: Well I think like I responded the earlier question of this, the target is if the industry really goes down so our internal target was even at FY 2017 sort of industry volume numbers we should be able to maintain double-digit margin for the tractor business and we stand by that guidance that is what the company is working on for. So even after three years FY 2020 - FY 2021 if you see decline happening in the market our target will still maintain double-digit margin in this tractor business. May not be 13% - 15% but I think it will be still double-digit.

Moderator: Thank you. We take the next question from the line of Mayur Milak from India Nivesh. Please go ahead.

Mayur Milak: I was just looking at your staff cost so between Q1, Q2, and Q3 we move from Rs. 115 crores to Rs. 130 crores and then now we are down to Rs. 105 crores. So, any specific reason why this quarter has the staff cost at such a low amount.

Bharat Madan: So, like I said there some initiative that company had taken for the rationalization of the manpower. So, some benefit has started accruing from this quarter onwards. And there is also in the Q2 normally all the increments for the white-collar staff really gets implemented from second quarter from the 1st of July so that is why we saw some spike happening in the Q2 numbers. But in Q3 numbers the rationalization impact has started coming in and we expect this should be the number which will be the run rate for the company going forward too.

Mayur Milak: Okay. So, this basically the kind of number that we are looking at regular without really having any specific one-offs into this.

Bharat Madan: That is right.

Mayur Milak: Got it. And VRS plan was put to some halt, do we see any revival into that?

Bharat Madan: So not immediately because we recently controlled on that and we did not get much response in September when it was launched. So that is why I think from another year or year and a half we do not think we will be really coming out with another scheme. But yes, maybe in FY 2019 or FY 2020 probably at that time we will reframe the scheme and see whether we can actually launch it and really get a good number at that point in time but not in the next few quarters.

Mayur Milak: Okay. And so, lastly, just wanted to understand. So, while on one hand, we are saying that FY 2020 maybe flattish to negative. Do we then expect our cost initiatives to really be strong enough to make up for that decline that will gradually happen in the top-line because I assume if operating efficiencies might also come to a kind of impact with lower sales so will we to continue the run rate?

Bharat Madan: Well that is what the company is working on. So as the management I think the target is that only entirely. But I think, it is too early to say whether it will not but yes, I think I think our internal goal post is that only. So even if there is a correction in the industry we should be able to maintain the double-digit margin for the business. But yes, like you rightly said so the operating efficiency probably will reach its peak maybe next year so we do not expect there will be margin expansion possibility happening beyond FY 2019. So, if the industry unless the operating leverage comes from the high volumes the industry shows further growth. But if it does not show further growth probably you will see a peak happening on the margin next year.

Mayur Milak: Okay. On this input hike have we really been able to pass on all the increase in the raw material prices or there is still left and with this hike that we have taken in Q4, have we been able to pass on the entire hike?

Bharat Madan: So far till YTD numbers till December could pass on the increase but obviously the pressure on the commodity side continues. So, steel prices are further going up. So honestly, we will have to relook at the numbers again and depending on how the competition reacts to the price increases, we will take a call and passing it on to the market. But so far, we have been able to do that.

Moderator: Thank you. We take the next question from the line of Amyn Pirani from Deutsche Bank. Please go ahead.

Amyn Pirani: Sir, my question is on the tractor growth, during the last upcycle in tractors we had seen that the share of non-farm usage had increased materially and now that we are two years into the upcycle and hopefully we will have another year of the uptrend., has the share of non-farm increased and how would it compare versus the last upcycle that we had seen four years - five years ago?

Shenu Agarwal: Yes. See the share of non-farm is gradually increasing and it is increasing at a faster rate than the share of agri and I think it will continue to be so for next few years because there is a lot of latent demand there in the non-farm segments.

Amyn Pirani: Okay. So, I mean broadly speaking what would be the replacement cycle if a tractor is used purely in agri or a tractor is used for dual use both agri and non-agri, is there a significant difference in the replacement cycle then?

Shenu Agarwal: Yes, small difference. In agri, it uses to be about 12 years to 15 years earlier but now it has dropped down to about seven years or eight years and in non-agri, it use to be about eight years to nine years but now it is about five years.

Amyn Pirani: Okay. So, if the non-agri continuous and even beyond FY 2019 we could have some trigger for growth even if say monsoon's and other things are not favorable. Would that be the correct thing to look at?

Shenu Agarwal: Yes, if non-agri continues to grow, it does help in the downturn of the agri cycle. It does help to kind of create some cushion against the de-growth.

Moderator: Thank you. We take the next question from the line of Chirag Shah from Edelweiss. Please go ahead.

Chirag Shah: Sir, missed the point on the price hikes that you indicated that you have taken in Q4.

Bharat Madan: Yes, what do you want to know on that?

Chirag Shah: The price hikes that we have done in Q3 versus Q4.

Bharat Madan: So, in Q3 we have not taken any price increase but we have taken it in Q2. So, our cumulative price will be so far in say roughly 2%.

Chirag Shah: And it includes even Q4 price increase, right, sir?

Bharat Madan: Yes, including Q4.

Chirag Shah: Okay. And sir, is the commodity cost pressure already felt in the P&L or not yet?

Bharat Madan: No. What happens is normally and we take a price hike in the commodity and that gets pass on to the market with a lag. So that lag is a period where you actually get an impact on the P&L side. So that is something which is a concern, so in inflationary condition that remains a challenge for us to manage.

Chirag Shah: No, sir. Because what I was trying to understand is, sequentially your gross margin is largely flattish. So, does this reflect commodity cost pressures or not really the recent uptick in the steel prices that we have seen in Q3 and some part of Q2 have they reflected in our P&L?

Bharat Madan: So, like you said in the Q2 we already taken a price increase so that effect is already coming in Q3. So sequentially the material cost price if you look at there is hardly any change so that is why the gross margin has been more or less in line. But yes, there was some one-off impact which was there in Q2 which has led to better margin this time. So the GST transition impact which was built into sales line in Q2 so that obviously has not come in Q3 which has led to a higher better realization looking at in the Q3 numbers which is leading to this increase in the margin.

Chirag Shah: Fair point, sir. And the trend is likely to continue.

Bharat Madan: The trend of the higher commodity prices or the flattish gross margin?

Chirag Shah: On the margin front, how do you look at it? Can it improve for yourself gross margins or the cost pressure, the commodity cost pressure is far severed in Q4 versus what we have seen?

Bharat Madan: So, I think since we are coming over the new product category which are in the lower HP segment like you said with a lot of compact tractors range which is sub-30 HP segment which normally is a lower contribution item. So, we expect that whatever saving we do on the cost side but it will get offset with the slightly adverse product mix which will happen because of these new products. So overall, we do not expect it to be a major change in the gross margin side going forward.

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

Sameer Deshpande: And particularly on the margin front and everywhere the growth has been very healthy. I wanted to know the treasury stock was sold in December 2017 some 36 lakh odd shares were sold off a company that is the benefits trust. So, you are having this Rs. 250 odd crores in cash with the company now at this point?

Bharat Madan: Yes. So, the cash is very much with the company. So, like you said the purpose of the sale of shares was to fund the inorganic opportunities which the company is evaluating as of now and which probably will get materialized over the next few months. So, the cash will definitely remain in the company till the time and purposely, intentionally used only for looking at the growth opportunities going forward.

Sameer Deshpande: Yes, sir. And definitely, it will help us because we do not need to take any debt on the books. So current year also I think we are debt neutral, we do not have any net debt.

Bharat Madan: Yes, so net debt basis in the last five quarters we have been net debt and negative, so that situation continues to be so and the debt has further come down in December quarter and probably in March quarter net debt will be going down further. So, I think that is maybe somewhere in next year probably will be debt-free lending.

Sameer Deshpande: Yes. And this Rs. 250 odd amount and money can be used for the acquisition that will be helpful?

Bharat Madan: That is right.

Sameer Deshpande: Yes. And regarding this VRS, you mentioned that it is not likely to happen in next year or so?

Bharat Madan: Yes, because we recently concluded one VRS scheme which was not very successful, so the acceptance levels were very low. So that is why we want to give a break in between. So maybe another 1.5 years - 2 years sort of break is required before which we come with this another scheme.

Sameer Deshpande: And in Q4 also we expect the tractor sales also to grow by about 15% - 16%?

Bharat Madan: So Q4 we are looking at the slightly higher number. So maybe we are looking at anywhere between 20% to 30% growth possibility remains for Q4 partly because the preponement of the festive season so Navratras are falling in why this time is normally used to be a split between March and April so this time everything is happening in March. So, as you see pretty good number happening in this quarter.

Moderator: Thank you. We take the next question from the line of Ankush Agarwal an Individual Investor. Please go ahead.

Ankush Agarwal: Sir, my question is regarding railway equipment division, with this order book of Rs. 330 crores what is the approximate timeline for execution of this order and another question is where do we see this revenue for railway equipment division and construction equipment in next couple of years or so?

Dipankar Ghosh: This Rs. 330 crores are the initial order booking what we have now. We should be executing it in the next maybe two quarters to three quarters and we are hopeful that obviously, our order book would be in this quarter and the coming quarters. So that is the response to the first question while for the second question why do we want to see, we have taken up quite a leapfrog effect that we will be multiplying few times in the coming three years - four years, we see product profile what we have. I will not be able to give you exact numbers. But we are pretty hopeful and we are pretty confident that we would be growing in few multiples of our present top-line in the coming years for Railways.

Ankush Agarwal: Okay. And same for construction equipment?

Bharat Madan: Yes, so construction also like we mentioned so we expect fairly 15% sort of growth will happen likely have to happen next year too and if the same momentum continues from the Government side on public spending especially on the infra side so probably that sector will continue to perform better.

Moderator: Thank you. Next question is from the line of Nitesh Sharma from PhillipCapital. Please go ahead.

Nitesh Sharma: Continuing with Railways. Sir, what proportion of revenues during the quarter would be through new products and what would be through our traditional products if you could help us with the number?

Dipankar Ghosh: I mean you are talking about the coming Q4?

Nitesh Sharma: No, Q3.

Dipankar Ghosh: Q3 around only 10% to 15% I would say would be from the new products rest is still from the conventional products. Q4 it will be higher and in the next fiscal year, we are confident that it should be still higher than maybe 30%.

Nitesh Sharma: Okay. And what would be the localization content for the new products currently?

Dipankar Ghosh: In the new product except for the Axel Mounted Disk Brakes we have the majority of the new product like the BMBS and the new coupling systems and the new suspension system these are all our in-house development. So obviously, every one of them are already localizing for the Axel Mounted Disk Brake we are working with Railways for the localization, we already have put down all the plans for localization. So, we are waiting for the localization approval plans from the Railways, which should be clear in the next two quarters.

Nitesh Sharma: Okay, got it. Sir. And Mr. Mandahr, if you could help us understand in the construction equipment industry we are seeing consistent strong improvement in terms of volumes. So, has it led to an increase in the pricing power? How our various players playing around with the pricing, is it easier to take price hikes and hence, next year could be a big surprise as far as margin goes led by pricing power for the industry coming back?

Ajay Mandahr: In fact, entering into this quarter we have done a price increase. There was a slight price increase that we did on all the product range. But the problem is the majority of the markets or the competitions they are still waiting and watching for the right demand to come so that their capacities are filled, and they are able to pass on the price increases. We are optimistic that most of the players would start increasing their prices as the inflation pressures are very-very heavy now, so we expect towards the end of this quarter some price increases are going to happen. Nevertheless, we are going ahead with our price increase, we have already done one price increase in January and I think as we go along probably we have to we have to because this industry cannot bear that brunt of inflation. Inflation is too very heavy now.

Moderator: Thank you. We take the next question from the line of Sangam Iyer from Subhkam Ventures. Please go ahead.

Sangam Iyer: Actually I miss the early part of the call. Can you give me the timelines in terms of the couple of two new products that we were looking to launch early next year when are the timelines that you are looking for that rice sector and the other one as well?

Shenu Agarwal: Tractors, okay. So, we have actually launched two new products already, we were a little bit ahead of time. So, in the last few weeks, we have launched two new products, so one is a compact tractor which is basically a specialized tractor for orchards and vineyards and also find some application in row crop farming. So, this is a four-wheel drive 26 horsepower tractor, this use to be a whitespace for us, we never had a tractor here and the industry is growing quite a bit in some of the markets in India. Also, this will help us in exports in a lot of countries. The other was of paddy special tractor that has been also launched in few limited quantities right now and of course, this is a very unique tractor which is not available in India from any manufacturer, this is a lightweight 45 horsepower tractor, it is a good combination of weight and power, right. So, both the products are already in the market.

Sangam Iyer: Great. So, sir, in terms of the volume growth for the agri business for next financial year when we are giving the guidance I mean what is the kind of growth because I missed that part of the statement.

Shenu Agarwal: The industry growth is looking like we are estimating about 7% to 8% for the next year and this year we will close probably around 15% - 16% over previous year. We are already sitting at a high and we are projecting another like peak next year.

Sangam Iyer: So, given that we are entering in to new spaces which we are not present. Should we be growing at a much higher pace maybe 1.3x or 1.4x like what we did this time around in terms of the volume growth?

Shenu Agarwal: Yes, the plan is to grow at a higher rate than the market with the help of new products and other initiatives that we have.

Sangam Iyer: Sir, just one more question. I mean during the quarter we saw that the realizations are much better as compared to sequential basis. So, was there a change in the product mix and how do we see this going into the Q4 when volumes come back?

Bharat Madan: I think since in the last quarter there was one-off impact which was coming from the transition to the GST scenario on the tractor side so there is a one-time compensation which was given on the stock side to the dealers or the channel partners, so that impact has been negated on this quarter. So that itself has an effect of roughly Rs. 13,000 to Rs. 14,000 per tractor in this quarter volumes and then there is also a non-tractor sale revenue which has gone up. So, compared to last quarter, so this quarter the number of tractors sold are less than the last quarter in Q3 but the non-tractor revenue has gone up. So, there is another Rs. 5,000 - Rs. 6,000 impact which is there. And third is the price increase which we have taken in Q2 so the full effct of which is now coming in Q3. So, all three factors put together led to a higher realization and this is the run rate which we expect will continue going forward too.

Sangam Iyer: Great, sir. And on the margin front, should we be expecting a better margin profile given that now we will have a full year improvement in the construction business margin as well because what we saw in Q3 a full year impact would come in the next financial year and given that we are moving into better realization products with the two new launches that are coming into the system.

Bharat Madan: Yes, so like we said earlier again same thing I am repeating. So, we had given a guidance of further margin expansion of roughly 100 basis points for next year over current year. So that probably should be the peak which will be touched next year with all three businesses doing well.

Moderator: Thank you. We take the next question from the line of Kaushik Dani from Reliance Wealth. Please go ahead.

Kaushik Dani: Basically, what I see in the Presentation is that currently promoters plus trust is roughly 40% of the holding, right?

Bharat Madan: Yes.

Kaushik Dani: So out of this post-sale of shares of the trust, now how much does the trust holds in terms of percentage?

Bharat Madan: Roughly 27% is still with the trust.

Kaushik Dani: Okay. So typically, I think it is a good thing that we have been using this as an opportunity to do some acquisitions. So, let us say in the case in future some more opportunities come into the space, can we continue to use the trust shares in a similar fashion. What sort of thought process we have?

Bharat Madan: It will depend, we are also looking at good profitability and better cash flows from the operations. So, depending on yes, if there is a very good opportunity and there is a requirement so we will definitely use it. But as of now since we already sold 3% block and we are still sitting on that cash so on the balance sheet and we are looking at next two years - three years resulting very good cash flow internally also from the internal accruals. So, we do not expect there will be really a need to do that but like I said if something really come exicitng for us so definitely we can look at that option.

Kaushik Dani: Yes. So, is there some sort of minimum threshold mark which you would want to have you do not want the holding to go below x percentage or something like that?

Bharat Madan: The holding this is company's shares and nothing to do with the holding. So, promoter's holding is different from stock with the company's holding. So, unless like you said the regulator comes with the new guideline which restricts the companies to hold its own share unless we are forced to sell it in the market otherwise unless some good opportunity really comes our way only then we will be using this also acquiring those company.

Kaushik Dani: Right. The last question was with regards to the construction equipment. I believe from my calculations I think 300 units to 350 units per month is a breakeven scenario and as we see that let us say the economy improves and things start becoming better and that is one of the reasons as to why now we have EBIT positive and now I believe for nine months I think it is just break even as well as for three months it is 2.2%, right? So, assuming 20% industry growth rate that has been suggested can we come back or let us say reach levels of around 5% to 7% in next two years?

Bharat Madan: So, like we mentioned earlier, so again I am repeating, so we had mentioned that in next three years to four years we are looking at EBIT margin going to 7% to 8% level on construction basis. We are working on many cost initiatives again on that side. So, with the volume also going up the industry doing better and we give 15% guidance for the industry there. If that continues to happen then definitely we are looking at reaching those numbers in three years - four years' time.

Kaushik Dani: Yes. We all know that construction equipment is basically it is a very diverse industry, right? So, but then also just for the sake of theoretical what sort of market share we have?

Bharat Madan: So, market share it varies like we got a leadership position in Pick-n-Carry Cranes which is (+40%) market share which we enjoy and the other two categorize is Compactors and Backhoe Loaders, Backhoe Loaders is very insignificant player less than 2% or 2.5% sort of market share. On the Compactor side, we are ranging between 10% to 12% sort of market share.

Moderator: Thank you. We take the next question from the line of Nitin Kapoor an Individual Investor. Please go ahead.

Nitin Kapoor: Sir, just wanted to know what are your projections for the next four years to five years in terms of revenues and EBITDA margins overall?

Bharat Madan: So, the company in the process of working out the five years plan, so we are hosting our Investor Day on 7th of February in Delhi NCR so I think at that time we will be unveiling these plans for next four years. If you are interested then definitely you can join in and we will be able to share those numbers with you.

Nitin Kapoor: Okay, great. That is wonderful. But any ballpark in terms of margins?

Bharat Madan: Let us keep something for the Investor Day too.

Moderator: Thank you. We take the next question from the line of Ankush Agarwal an Individual Investor. Please go ahead.

Ankush Agarwal: Sir, my question is on the tractor side, I wanted to know if you can give a high-level break-up on the revenue share region wise for the tractors and another question is I see some initiative in the electric tractors and some driverless tractor if you can share your view and where industry is in terms of when we can see some commercial uptick in that area?

Shenu Agarwal: Okay. So, it is quite difficult. I mean we divide our markets into 28 different regions, it is quite difficult to give you that thing, maybe if you are really interested we can send you that separately and by electric tractor as you know we have launched it as a concept a few months back and our team is working now on the commercialization part. It is difficult to give an exact date, but we have taken the kind of an estimate of about 12 months to 18 months to launch it commercially at that time.

Ankush Agarwal: Okay. And so, is there any initiative on driverless tractors or do you see any viability commercially for that?

Shenu Agarwal: Not exactly driverless but yes, we are working on some more disruptive ideas around agri machinery and also tractors but it is difficult to divulge those right now.

Moderator: Thank you. We take the next question from the line of Rakesh Jhunjhunwala from Rare Enterprises. Please go ahead.

Rakesh Jhunjhunwala: On this Railway, I think 300 crores is the largest book we have had no?

Bharat Madan: Yes. So, I think if you look at last six quarters, we used to have a normal order book of Rs. 45 crores - Rs. 50 crores. So, this is the largest order book size I think which we are carrying on the Railway.

Rakesh Jhunjhunwala: That should give you a good turnover in next quarter?

Bharat Madan: So next quarter again I think it will continue the momentum we expected 20%-odd growth will continue in Railway business but this Rs. 330 crores will get executed really in the next fiscal. So definitely it gives us a lot more visibility to the next year's number.

Rakesh Jhunjhunwala: You will get further orders for next year also?

Bharat Madan: Yes, so that is what we are hoping. So, if we finish this order book in next two quarters to three quarters then definitely there is further opportunity to grow.

Rakesh Jhunjhunwala: And this good turnaround in the heavy construction, is continuing in this quarter?

Bharat Madan: Yes, so normally H2 is the strongest season for the construction equipment machinery normally Q4 is again one of the strongest quarter. So, we expect the similar growth probably will continue in this quarter too.

Moderator: Thank you. Ladies and Gentlemen, that was the last question. I would now like to hand the conference over to Mr. Hitesh Goel for closing comments. Mr. Goel, please unmute the line from your side.

Hitesh Goel: I would like to thank everyone for joining this Conference Call. Thank you. t

Moderator: Thank you very much, sir. Ladies and Gentlemen, on behalf of Kotak Institutional Equities, that concludes this conference. Thank you for joining us and you may now disconnect your lines.