



Escorts Limited Q1 FY16 Earnings Conference Call

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MR. SUNIL SAKSENA – CHIEF EXECUTIVE OFFICER,
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MR. BHARAT MADAN – GROUP FINANCIAL
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MS. JYOTI KHATUKA – HEAD, TREASURY
INVESTOR RELATIONS TEAM, ESCORTS LTD.**



Raghavendra Jaipuria:

Thank you Rochelle. Good evening and Thank you for joining us on Escorts Limited Q1 FY16 Results Conference Call. For today's call the management would be represented by Mr. S. Sridhar – CEO, Escorts Agri Machinery, Mr. Sunil Saksena – CEO, Escorts Construction Equipment, Mr. Dipankar Ghosh – CEO, Escorts Auto and Railway Products, Mr. Bharat Madan – Group Financial Controller, and Ms. Jyoti Khatuka – Head, Treasury & Investor Relations Team at Escorts Limited.

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

Bharat Madan:

Thank you, Raghavendra. Ladies and gentlemen, a very good evening to you all. Thank you for joining us on the first quarter earnings call for financial year 2016. A snapshot of company's quarterly performance is as follows:

Turnover at Rs.978 crores against Rs.1,129 crores last year, down by 13.4%. This is primarily due to drop in both tractor volumes and construction equipment volumes. Tractor volumes went down 16.6% to 14,887 tractors as against 17,849 tractors last year. Construction equipment volumes went down by 29% to 508 machines against 719 machines last year in the quarter ended June '14.

EBITDA at Rs.57.5 crores against Rs.56.9 crores last year, up by 1.2%. EBITDA margins now stand at 5.9% versus 5% last year in quarter ended June '14. The major reason for the increase in EBITDA margin is the 310 basis points reduction in the material cost which is down from 72.2% to 69% in this quarter.

Finance cost went down by Rs.2.2 crores to Rs.13.7 crores as compared to quarter ended March '15, the total debt outstanding as on June 15 is Rs.287 crores, down from Rs.481 crores in March '15 because of reduced working capital.

The company reported a PAT of Rs.36.3 crores versus Rs.34.1 crores last year, up by 6.3%. PAT margins now stand at 3.7% versus 3% last year in quarter ended June 14. EPS is reported at Rs.3.04 against Rs.2.86 last year.

Now moving on to segmental business performance:

Starting with the agri machinery business, domestic tractor industry volumes went down by 16.5% to 1.42 lakhs tractors as compared to 1.7 lakhs tractors last year in same quarter. The agriculture sector struggled with the untimely rainfall across multiple states. The standing crop was damaged and the crop yield reduced by 15% to 20% along with the delayed harvesting cycle. Additionally, the crop prices remained lower against last year. In terms of region, our strong markets de-grew by 18.7% while our weak markets de-grew by 12.6%. Our domestic volumes also went down in line with the industry, however our domestic market share grew



marginally from 10.1% to 10.2% in the quarter ended June 15. In the first quarter our export volumes stood at 338 tractors.

Continuing with our strategy to offer innovative products, we have launched Classis Series under the Farmtrac brand in 40 HP to 50 HP category delivering the never before driving comfort in tractors, the modern inside classic outside Farmtrac Classic series comes equipped with best in class combination of modern design, stunning looks and world-class technologies. The market response to all the newly introduced models has been very positive. The new models are creating product pull base market demand amongst the perspective buyers. Going forward in the current fiscal we shall continue to bring new products.

EBIT margins in EM went up by 78 basis points to 9%, against 8.3% last year despite the fall in volumes. This is primarily due to the savings in the material cost. We are on track and our projected material cost and better margins are expected once the industry turns the corner.

Now coming to the construction equipment business, the industry is continuing its decline in the fifth year now, served industry volume for the quarter went down by approximately 6%, the Pick n Carry crane industry saw the steepest decline to the tune of 28%. Our total volumes both manufactured and traded products went down by 29% to 580 machines against 719 machines in last year same quarter. Our volumes declined in line with the industry in the Pick n Carry and compactor segment, however, we have lost market share in the backhoe loader segment from 3.2% to 2.3% because of increase competitive intensity and the price discounts. We have not participated in any price discounts.

Revenue has correspondingly gone down by 23% from Rs.121 crores to Rs.93 crores, EBIT losses also have correspondingly increased from Rs.8.9 crores to Rs.11.2 crores. In order to stem the losses we have taken the following actions in Q1:

We affected price increase of approximately 1% across all product categories. We have shown significant 53% growth in exports with added footprint in Africa, Asia, and Middle East. We increase our channel outreach and tied up with new retail financiers. Going forward, we expect that our served construction equipment industry will continue to face challenges as no other industry in the Indian context has seen such a prolonged decline, any recovery is only expected to happen from large policy initiatives getting implemented on the ground. Therefore the industry revival is expected to take time and maybe push to the next year.

Coming to the railway division, revenues are up at Rs.48.8 crores as against Rs.42.7 crores last year. The EBIT margins are also up by 914 basis points and 13% against 3.8% last year. This is primarily due to favorable product mix and reduction in fixed cost. Order book for this division stood at approximately Rs.59 crores which will get executed in the next three to four months. Given the Government's focus on revitalizing the Indian Railways we are very excited on the future outlook of this business. To capture the opportunity our endeavor is to expand our product range either through in-house development or through technology partnerships. We got the



development order for axel mounted disc brakes recently and which shall be executed in coming quarters.

Lastly, the auto division achieved a revenue of Rs.29 crores against Rs.22.9 crores, up by 26.3% in last year same quarter. EBIT losses have also gone down from Rs.9.2 crores to Rs.4.3 crores correspondingly. This is achieved mainly due to cost savings in VRS, margin expansion due to sales portfolio rationalization and improvement in operations in EAP. Going forward, our focus will be to increase the sales in high margin segment which is exports and replacement market.

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

Moderator: Thank you very much sir. Ladies and Gentlemen, we will now begin with the Q&A session. Our first question is from the line of Sonal Gupta from UBS. Please go ahead.

Sonal Gupta: Just on the construction equipment side, what are the applications for which construction equipment is used, if you could just talk about that? And there has been clearly a lot of talk about road construction picking up, so are you seeing any improvement there or nothing?

Sunil Saxena: There is a lot of talk in various segments in terms of pick up in the government spending on particularly the road construction. However, what really is happening is on ground the projects are yet to take off, in fact what really is happening is the PPP projects which were actually stalled have in some way seen some kind of revival, there are large contractors who have either exited the earlier commitments through paying some penalties which the government has helped and the new ones are coming in, so it is a kind of handover, takeover situation where the projects which were stalled are now starting to see some kind of movement. We don't see in hurry a large increase in terms of the machine and the equipment taking off because the existing inventory which was actually lying mostly as NPA will first get utilized. So in short, the decline that you still see despite of announcements is a result of that.

In terms of the application of equipment's, there are various sectors in which Escorts operates, we are primarily market leaders in the material handling segment which is the Pick n Carry crane where we maintain our leadership even in the period where there are declines. The unfortunate thing is this particular segment has declined very-very steeply, almost 29% because there is less cargo to handle in terms of intermediary handling. The earth moving sector largely comprises of the backhoes and excavators, within that the excavator segment is seeing a kind of steady number but that is also not seen a growth as such, the backhoes is seeing a very steady decline almost for last consecutive four years, this is the fifth year in a row. So whatever is happening, the same number of players are really vying for the spot and on the backhoe the application largely is earth moving which essentially means it will help somewhere where the excavator which is a stationary application is not needed, which means some amount of complementary earth moving around the route building or wherever let's say canals are made, roads are made, there is a lot of work that happens in terms of stone quarries and various materials that get moved.



Sonal Gupta: Right, thanks for that. Again coming back to this question, you mentioned that there is a lot of existing inventory which is lying mostly as NPAs, so when do you really see players like you really starting to see that benefit, so is it going to be sometime next year or as of now are you already seeing some uptake of the existing inventory, I mean where is the situation headed?

Sunil Saksena: No, when I said NPAs, I meant the NPAs of the contractors who have bought equipment from financiers and therefore the NPA belongs actually to the financier community per se and the equipment lies underutilized, it is not an NPA with Escorts.

Sonal Gupta: Right, I am not attributing it to you or that sort, I am just saying that like you mentioned that there is a sort of excess capacity in this system right now and that will need to be absorbed first before really fresh purchases get made, so are you seeing some pickup on that front or you think that even that is yet to happen and really even for the tenders which the Government has floated etc last year you have not really seen ordering activity or work really getting started?

Sunil Saksena: Yes, largely while there have been very noble intentions and good announcements, on ground in terms of the money coming in the whole process is not backed up by enough money in the system. For example, today itself there is an announcement, you can read in papers, almost Rs.20,000 crores would be spent by the Government, the initiative would be from the Government and not from the funding institutions or from the contractors to apply their equipment. Largely this is coming out on the fact that all the announcements that has been made since the private sector and the financiers have not come forward the government will have to initiate that and unless this money flows into the system it would not see a very quick revival. Normally also what happens is the Q1 and Q2 is a low kind of volume, low performance months, also the rainy season really all these activities take a low head. So what one expects is from Q3 we could see some amount of raise but overall one was anticipating that with all the announcements that took place in the first half we could see a 5% improvement whereas what we are actually seeing is there is almost 6% kind of decline. So we are off as an industry by almost 12% vis-à-vis estimates that the entire industry is made as such. And therefore even if there is some amount of improvement in H2, that is Q3 and Q4, overall the year is really heading towards a flat year.

Moderator: Thank you very much. Our next question is from the line of Rakesh Jhunjhunwala from Rare Enterprises. Please go ahead.

Rakesh Jhunjhunwala: Good evening management. My question is to Mr. Sridhar, sir you have guided for flat volumes for the current year, after four months what are the expenses you see on the ground I mean you stick to that prediction or you improve it or decline it, what do you think?

S. Sridhar: See, I think our forecast situation remains the same and there is no change in the situation. Just to give the perspective very briefly, I think last year/s almost seven months were flat months, first six months were flat and the seventh month was 20% less. When we compare to the last year the first six months were almost flat year, the second six months were a negative year and within the second six months the last five months were almost like 30% negative that is what

gave us a shock to the entire system. With that background, we said that the quarter one itself will become a little better quarter and we expected that to be something like 15% to 18% and it has happened around 16.5%. So quarter one was not a surprise. We also expected quarter two should be little better but that will not reflect in terms of number because the secondary sales situation will become better and given that July again our impression is it will happen that way. But when you look at the wholesale number or the release numbers, what being put out by the companies to the stock exchanges it will still show a lot of negative for one reason, the month of September which is preparatory month for the season and this time this entire season is pushed into October end and the November middle, that means the Dussehra and Deepavali will happen between 28th and 15th of November, so the preparations will be split between September and October. That means the released numbers for the month of September will be very-very average, that in turn the quarter two average numbers will look negative, the negative range again our guesstimate is it should be something like 14% to 20% for overall industry depending on how the various players will play out in the month of September. But having said that, we expect from quarter three onwards you will see sentiment revival in terms of base effect from marginal growth, quarter four will become better and in our own internal planning I think next year should be one of the very good years of our agriculture, this is the kind of forecast what we had and this is what we have shared and we are sticking to our forecast.

Rakesh Jhunjhunwala: So what kind of growth you see next year, 15% to 20%?

S. Sridhar: Yes, exactly, it can be even 15% to 25% we said. So as of now we are not in a position to further narrow this kind of range but it can be anywhere between 15% to 25%, I think maybe by Jan-Feb will give us a better idea whether it is on the 15% of the side or on the 25% of the side.

Rakesh Jhunjhunwala: Right. I have another question sir, as I understand you have made a new strategy in terms of the HP which you are introducing tractors, you are introducing different type of tractors and you are also trying to push both the range the Farmtrac range and the other range. So how satisfied you are with the changing strategy, are you seeing result from the ground?

S. Sridhar: I will just share the philosophy behind these two approaches. See if you fundamentally look at it we have two brands Farmtrac and Powertrac, big problem for us, if I have to define that means historically or after 10 or 15 years the Farmtrac is the brand which has been falling over a period of time which was at one time very high and then falling behind year-after-year for simple reason, this is the premium brand which was giving us a lot of money and obviously it becomes a source of attack for many more companies and multinationals were at the forefront of taking away our market share so we need to improve this. So what we have done is a two pronged approach, first and foremost we have taken the bold step of even technology as well as sailing correction and that we have taken it in the last quarter four and then the corrections were underway and between April to June we have completed it. So this is a very-very important step because the decline arrest of Farmtrac is one of our internal priorities to grow our share. So those actions are complete, I think quarter three onwards you will see a positive performance.



Another important action what we have taken in Powertrac is, Powertrac is a very-very homogenous product and if you look at it some of the brands within the tractor industry if I am to tell you precisely only two or three brands were growing and the growth is triggered by the haulage shift what has happened to the industry in last five to seven years. Unfortunately Escorts did not have a participation in the haulage segment per say and this is why we created a brand called ALT which is called Anti-Lift Tractor abbreviated as ALT which become a brand for this tractor. We launched in the month of December, made available to the customer from January onwards. I think in the quarter one we have sold something like 550 on an average every month which is considered as very good for any product launch. So likewise what happens is the corrections whatever we are proposing I should say by the quarter four of this year this will be completed to the extent of 95%, so some of this quarter two also is undergoing some correction because some 45HP category of Powertrac are on pipeline for quarter three. So it has some space creation, something manure is happening, since it is strategic, it has also got praise positioning, I am not in a position to discuss beyond that what we are undergoing in quarter two actually.

Rakesh Jhunjhunwala:

Mr. Sridhar I have another question, see your margins have been better in this quarter, so do you think there is still lot of taste to improve the margins or only the improvement in margins is just because of a temporary cause of a blip in the raw material prices or there is lot of operational improvements because leaders margins are 16%, 17% Mahindra & Mahindra. So you see yourself going to what kind of margins you think you can go to if you have volumes?

S. Sridhar:

See, I think 15% is the margin we will target as the target margin for us, this is where we take it as our reference margin and this is the target we have set out I think 1.5 years back saying that this is the number we would like to achieve, conservatively in three years, maximum in four years kind of a target we have set out two years back. I think we are sticking to our kind of a plan what we have said in advance. Now having said that, I think what is enabling us is deflation in material cost, certainly it is enabling us and also whenever deflation is happening we should also expect the consequences much more discount in the market place. So that is also prevalent which we are not participating. So this is the temporary enabled, but most important cost compression activity is the material cost reduction by design, a lot of value engineering, value analysis which including R&D many- many people are involved on this and think this will reach the peak in another two to three quarter and then that will become sustainable for long. Then the choice is with us whether we want to hold it or we want to aggressively price it, it is a call which the management will take maybe after two or three quarter whenever it becomes appropriate.

Now the volumes is another area which can enable us in terms of increasing our EBITDA margin, certainly another scope of 1.5%, 2% is there. Now if you look at it as a cost compression activity, whatever we started it has almost started delivering now that means this is also a time where the company also started preparing itself for market share growth. If you look at it I think we are stagnating around 10% and first 6%, possible we should look at it something like 11% plus from the second six months. So this also calls for a certain corrections, so quarter two may not look like a great month but the point is I think the direction whatever we have set out couple of years back we are firmly on it, something enabling like deflation, but other than that we are



on our path. I think whatever we are discussing is an achievable path only, it is nothing surprising if you ask me in a large way.

Rakesh Jhunjhunwala: Another thing also about is that this automotive division, sir you lost cumulative around Rs.50 crores in the last few years, now how can we go to keep bearing this loss? I know we keep bearing this loss if there is some hope of great recovery in profitability I think which is not there, so do you not think it would be more in tune to sell that very division rather than keep incurring losses? Maybe roads I agree, that eventually volumes will come in and we will make money, so we can lose money but do you not think the automotive division should just be very close and sold away?

Dipankar Ghosh: Actually, if you see from the last year we have significantly reduced the losses and we are confident that in this particular quarter Q2 we should be able to pair out the losses and Q3, Q4 should be positive for us, whether we finally take a call of what we do with the division that we will see once we make it back. So our primary objective as of now is Q3, Q4 to make it positive and make it back and then we take a call how do we take it forward.

Rakesh Jhunjhunwala: You can also breakeven in the current quarter?

Dipankar Ghosh: Yes, I mean not current quarter, I am saying Q3 we will be black, Q2 we have reduced, you will see later the Q2 numbers also that there will be significant reduction of losses.

Rakesh Jhunjhunwala: And sir this railway equipment division, do you think there is prospects of big growth? Because see last year your turnover in the railway equipment business was about Rs.183 crores.

Dipankar Ghosh: Yes, Rs.183 crores, yes we see a prospect of growth at least this financial year we feel it should be at least 20%, 25% more growth and we are confident that year-on-year we will be growing in the railway business.

Rakesh Jhunjhunwala: But sir if you grow by 20%, 25% then last year EBIT margin was 10%, would your EBIT margin go to 15%, 16%?

Dipankar Ghosh: Since we are introducing new products, the EBIT margin will not shoot up in the proportional rate but yes we will be able to maintain the EBITDA margin what we had last year.

Rakesh Jhunjhunwala: Okay, thank you sir. You see big growth prospect for railway business over the next three, four years?

Dipankar Ghosh: Yes, we see and we are very excited about the railway business and we see a huge growth prospect for the railway business in the coming three, four years.

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



Raghu Nandan:

Sir just wanted to understand like how is the performance of tractor segment across various regions and various horsepower categories for the industry as well as for the company?

S. Sridhar:

The company performance in terms of market share is flat, so it is almost like 10.1 versus 10.2, so market share wise it is growth. I think in terms of region, I think all the regions had a similar performance but if you are to categories the way we categories like where we are strong and we already said that weaker market has the decline is much lesser versus the stronger ones, stronger one had where we operate, 60% of the market is where we operate and that market has bigger decline. But these things do happen, I think the most important action is not about the market, the most important action is what do we do? The way I have already answered is the two different brands Farmtrac and Powertrac we have lot of actions on the pipeline, at one product category we have almost completed the corrections, the other product category it is half way through the correction. Maybe in two more, three more quarter we will complete those kind of correction, that will set us ready for both the EBITDA growth and as well as the market share growth. So we are half way through in terms of major action plans which I have already explained.

Raghu Nandan:

And how is the performance across various horsepower categories sir, any trends you are seeing there?

S. Sridhar:

No, not much because generally it happened on the same way everywhere, some seasonality has some blips. Overall on the higher horsepower category if I look at it over a period of year I think that has a tendency to grow, 15HP and above and then some of this 20HP and below will also continue to grow till last year a year before. And the higher horsepower is one of our focus category and this is where I think from something like 1% market share four year back versus we achieved something like close to 9.7% last year and this is the category we also target for further growth, a lot of actions are on the card. We will have an ambitious target of something like 18% market share we would like to achieve in another couple of years.

Raghu Nandan:

Sure sir. And sir like what are the thoughts on the long-term growth for the tractor segment, when do you expect this industry to see a saturation?

S. Sridhar:

See, I think on the foreseeable future we do not see such saturation, it is like a TV and this is like a cost, this is like the bike, what happens is the penetration goes through, our TVs black white and becomes color, color becomes LED, LCD. See the technologies undergo, things become redundant but the purchasing keep happening. Even the most penetrated states are not showing those kinds of signs, so India has got many many packets where the penetration levels are low. So to give you the data point I think the CAGR of something like 6% to 8% what we have seen in the history, in our view it will continue for another 10 more years. So in the foreseeable future I don't think we have a need to worry. What may happen if the tractor which are getting sold in one form may reappear in a different form and different horsepower category and different purposes, those kind of a new categories may emerge. So, so far what is getting sold as a general utility tractor being used for all kind of purposes slowly will become a specialized tractor and Escorts is in the forefront of creating those kind of specialties and creating that special purposes actually, this is the way we see the tractor industry in the last year.



- Raghu Nandan:** Thank you sir. And sir on the raw material cost to sales there was close to 200 bps reduction on a QoQ basis, how much would you attribute to the commodity cost and how much to the cost reduction initiatives which we are taking?
- Bharat Madan:** See in this quarter roughly 1% you can attribute to deflation in commodity prices and we are looking at this trend continuing in Q2 also but from Q3 onwards probably the things will get reversed. So overall I think for the year maybe we will be more or less flattish on the inflation and deflation side, but this time this is EBITDA percent which is visible on the material cost front.
- Raghu Nandan:** Sure sir, so 1% would be because of the cost reduction efforts which we are taking on?
- Bharat Madan:** That's right.
- Moderator:** Our next question is from the line of Mitul Shah from Karvy Stock Broking. Please go ahead.
- Mitul Shah:** Sir again question on the raw material side, sir anything one time or any delay in the vendor compensation or anything which has benefitted us?
- Bharat Madan:** Delay in vendor compensation?
- Mitul Shah:** Anything one time?
- Bharat Madan:** There is no one time, so like we said the deflation is something which is a non-recurring item so obviously this will depend on the market demand and supply situation and in Q4 we have seen the 1% improvement which has happened on material cost and Q2 we are seeing this continuing in Q2, probably it has been better but Q3 onwards we expect this deflation will likely stop so items like sheet metal we expect the rate pressure will start coming in with the demand going up. So overall for the year we do not expect this material benefit in terms of price changes will be really visible on the P&L side on a full year basis, on quarter-to-quarter this will continue.
- Mitul Shah:** Again second question is on the other expenses side which has grown by 13% on a QoQ basis as compared to revenue growth of around 20%. So there is again benefit coming from the sequential improvement in the volume so out of this roughly 100 basis improvement how much due to cost engineering and how much is operating benefit?
- Bharat Madan:** No, other expenses mostly increase, is you look on quarter-on-quarter it is basically volume led, so there is a big change in the volume 20% growth coming in the volume so it is likely led to the other cost more or less otherwise there is no major change in the other expenses side category.
- Mitul Shah:** Nothing related to the cost engineering benefit started coming in as of now?
- Bharat Madan:** There are some consulting cost which is there obviously so there is a one-time nonrecurring cost which we talked about, so all those projects which we are doing on the cost side with various consultant, so that cost is obviously built in there in the other expenses which was also there in



the last quarter. So that is why if you compare quarter-to-quarter the cost impact may not be visible, but yes in terms of overall structure this cost is built in which will be probably discontinuing from next year onwards.

Mitul Shah: And sir last question is on the construction equipment side, considering the VRS and cost engineering measure is there our breakeven point from earlier guidance of around 750 units per quarter has come down or still it remains the same?

Sunil Saxena: No, it remains at about 750, in fact on construction equipment barring we had to do in terms of VRS was already done.

Moderator: Thank you Mr. Shah. Our next question is from the line of Hitesh Goel from Kotak Institutional Equities. Please go ahead.

Hitesh Goel: Yes, first question is on the consultant cost that you have pointed out, so how much approximately do you think that cost will be in the P&L which will get reversed from next year onwards, can you share that with us?

Bharat Madan: This will be close to let's say Rs.4 crores to Rs.5 crores a quarter.

Hitesh Goel: Rs.4 crores to Rs.5 crores a quarter?

Sunil Saxena: Yes, so this will continue till June of next year. I think from July onwards from next year probably this to us will go down.

Hitesh Goel: Okay. And my next question is on the material cost benefit, so you had said 100 basis points of the material cost benefit has come through VAV and the design changes that you have done, how much more can come through even if volumes remain flat from these levels?

Bharat Madan: So like we have indicated our target is to become a best benchmark in the industry on the material cost front, so we started the journey with about 72% material cost and target is to take it to a level of close to 68%. So today we are still sitting at 69% with deflation factored on, so if we will remove the deflation it will still be at 70%. So I think still 2% to 3% journey is there for us to really go through till the time we complete this project.

Hitesh Goel: So that should be done by the year end, I mean fourth quarter of this year because your consultant cost will also go away?

Bharat Madan: So the mandate was till the June of next year so by that time the project will be over, however the full impact we will be seen coming in from FY17 onwards. July onwards our impact will come in FY16.

Hitesh Goel: Can you just tell us one or two points, big improvements that have been done on the design side which has resulted in this improvement so that we can understand sustainable thing, just to give a sense.



S. Sridhar: No, but we just cannot share those kind of technology details but what we should understand is this is not price lead issue, this is a major design lead issue, if I have to give you an idea there are 20 engineers and R&D has worked on this almost for six months, so this is a lot of huge effort, that net result is what any case we have been doing, we analyze at x level, now the benefits are expected at 3x level. So three times effort has happened and also there is a something like industry going through a reduction, there is also offices made available, their free times are available so there are team of engineers who formed from operations, supply chain as well as R&D all teamed up together has generated. But to put out on precisely one or two examples I think I will be exceeding the brief actually, I will not be in a position to disclose that.

Hitesh Goel: Okay. And sir, my last question is basically on the HP side, so if you look at your HP based market share actually the maximum reduction has happened in the 40 HP to 50 HP range, so like you pointed out you are going to bring in new products in this range and going to target this market in a big way, can you just share your plans in this segment what you are going to do in terms of product plans?

S. Sridhar: See, I think three-four years back what we started off, we said the way forward is create the image segment leadership and the image segment, that is why 50HP and above he said from almost like 1% market share we said something like 17% to 18% was some market share, references were kept for three year to five year timeframe. I think now we are almost 10%, I think we will go towards that kind of direction in couple of years. But having said that that only constitutes something like 7% to 8% is that segment contributes only so much. The benefit of that segment is once we create those kind of an area immediate action will happen around 45HP to 50HP segment, this is where another 26% of the volume sits, and there is the big money is also there. This is the category which is under our thrust and focus, lot of actions what we are talking about Powertrac 45HP or 50HP or the Farmtrac whatever we are talking about all those actions are targeted towards 45HP or 50HP. The largest benefit of this action will be seen in two to three quarters from now, not the transition is happening, the dealers have lot of stocks, we are all building so things are getting depleted. Normally it takes three to four months for all to completely wipe out the old stocks and bring out the new model to the customers 100%. So the transition is on, almost we are 50% crossed, another 50% cross will happen in quarter two, that is one of the reasons quarter two will not be a significant quarter and the benefit along with Q3 recovery will remain as a very big benefit for Q3.

Moderator: Thank you very much. Our next question is from the line of Ashish Nigam from Axis Capital. Please go ahead.

Ashish Nigam: My question was on tractor dealer inventory, how does this stand at the moment and how has it trended in the last few months?

S. Sridhar: See, I think the tractor dealer stocks are on the levels of how it was possibly last year, but what has happened is industry is going down to the extent of 30%, the inventory also need to go down to the extent of not 30% it has to go down to the extent of 40% to 50%. So that when you look at the number of days of inventory holding now currently looks high, now how do we correct is



a challenge that we correct over a period of time. So the last quarter itself is some changes we brought in, even quarter four itself we corrected, some more corrections we have done, I think with quarter two a little more correction will do in quarter two with a recovery in quarter three, I think it should be a smooth transition. It is difficult, I don't say it is a big challenge but we are facing it, I think we will come out of it actually.

Ashish Nigam: So in terms of number of days could you share some number of how it is right now?

S. Sridhar: No, difficult to, I just do not want to put out those kind of figures in public, I assume along with you my competitors also will be listening though actually. Let me tell you one thing, I think this is not an acute issue and not only for my sake we also believe that it may not be an acute issue even for industry. People are conscious about it, I think overall this is difficult but still manageable situation. These are assumptions where we are operating it.

Ashish Nigam: Okay. And how has discounting been, how has that trended?

S. Sridhar: Yes, of course when the industry has got a lot of excess capacity and then the industry goes down like 30%, the immediate action is huge discounted work and that will prevail, it is happening, I think people finding their own ways, I think we find our own way of survival, rather I would say we are all getting used to. I think most important from our own point of view in this kind of a recessionary situations are preparations of our next, so there are a lot of internal challenges in terms of creating new product, creating position, dealer stock management in terms of existing versus new products, we concentrate more on that. As far as we are concerned we are pretty much used to this kind of situation, it is nothing new actually.

Ashish Nigam: Okay. You mentioned 15% target margin in three, four years, just want to clarify that EBITDA margin or EBIT margin? Is it around 2%?

S. Sridhar: Yes, EBITDA margin.

Ashish Nigam: And that you are expecting in three to four years?

S. Sridhar: That's right.

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

Viraj Kajaria: I just had couple of questions, one is, you are seeing increased number of NBFC is pulling back on new tractor financing, given such a low RM cost scenario are we seeing any further subvention schemes or any further increase in discounting to push sales?

S. Sridhar: See, answer is yes, NBFCs are finding it difficult, so discounting also happens and subvention is also happening. See these are all various dimensions of discount, so whenever this kind of a situation happens it happens at this kind of a format. The reality is it is happening that way and



the solution is also on the overall recovery, when the recovery happens this kind of disease also vanishes. For your question, this disease are prevailing even today, it is very much there.

Viraj Kajaria: So incrementally has the discounting subvention increased because everyone is hitting the RM benefits, are we seeing that?

S. Sridhar: I will say yes, these things are bound to happen it is happening.

Viraj Kajaria: Okay. And second question was, if we look previous recessionary cycle like the ones in 2002-2003, the whole recovery for us hinges on the fact that monsoon for August-September even with slightly below normal, still we should expect a recovery because of the base effect, but if deficit were to accrue, how different or similar the situation can be from an industry perspective?

S. Sridhar: See monsoon is one thing, if you look at it the conditions what you are looking at is prevailing for almost like 18 to 24 months now. The best time what we have looked at it is 2013-14, the 2013-14 has created the highest ever, otherwise if you look at overall a particular volume is prevailing, something like lakh and 50 is kind of a quarter is what we will be seeing every time. The moment the fundamentals are in place and also some price recovery, inflation and food related inflation and price appreciation for the crops when it happens, we see the recovery also happening very fast. But I think, this we have already shared, when it comes to this kind of attractive industry our own learning is it can happen in a short notice, very difficult to predict how exactly it will happen, when it will happen. The most important parameter what we can control is make yourself frugal, make yourself flexible, keep anticipating all the good signs. As far as we are concerned the sentiment recovery is also playing a very important role, in our view quarter three onwards the sentiment recovery chances are very-very high. Possibly by April onwards if there is an untimely rain the way it happened in February 2014 the quantity of rain being 10% or 12% below, prices still remains better, the chances of recovery is very high but the extent of recovery is what we should recover and that as I said is what we will know close to January-February is the time, where we will be in a position to much more clearly see how the future will pan out. But as of now we are preparing ourselves to be frugal, nimble, correcting the prices, correcting the brand, everything is separate, in-house, anticipating for the good time to come and our assumption is it will come maybe from four to five months from now.

Viraj Kajaria: Sir just a follow-up on that, since we also see a muted demand from summer side, are we seeing any signs of down trading to a low HP tractor, any signs of that, I mean are you seeing the sub-20, sub-30 HP growing in this kind of market scenario, what is your sense at the moment?

S. Sridhar: See the point is, if you have to look at it we have to just look at a three or four category, less than 20HP, something up to 40HP, 40HP to 50HP and 50HP and above. The less than 20HP is generally a subsidy driven program, if there is a Government program per say there is one particular packet does very well, so the growth is driven through certain incentive structure that does not give you a true reflection of it. The true reflection happens at the high end, 50HP and above is certainly growing, even though the segment is slow, the rest depends overall on both



the agri sector, as well as overall activity happening with the tractor. Thus, we need to wait and watch actually.

Viraj Kajaria:

But the subsidy it on time right?

S. Sridhar:

No, this is about 20HP, about some packets like Gujarat which keep giving on and off, such kind of a thing really does not matter, we do not participate nor no big money is there, it is not a very important segment. Most important segment is the 50HP which are growing, 45HP to 50HP are growing, and certainly haulage segments are growing too. So when there are patterns in the growing segment we are participating to what extent we are encashing. So most important is how we prepare ourselves actually, thus we concentrate more on inside rather than what will happen outside.

Moderator:

Thank you. Our next question is from the line of Kapil Singh from Nomura Securities. Please go ahead.

Kapil Singh:

Sir you referred something about different growth rates in your high growth and low growth markets, so could you give some more color on which are those market and how has been the geographical growth rates?

S. Sridhar:

See generally in South and West the decline rate for the quarter one is much lesser, it maybe something like 12% or 13% types. The North and the regions where we operate, there the decline rate was much more. But these things are normal and it happens in that way actually. The area where we do not operate, the low growth rate is the market where our market share are something like 3.5% types, so this is where we are. Where we operate we do have a market share which is anywhere around 14%, 15%, some areas are even 17% to 18%. So it has got a very different challenges. That is it actually, beyond that I do not know what more I can explain to you.

Kapil Singh:

Yes, that is what I was looking for. And in terms of the drivers for these markets, any color you could give like what is different that is happening in South and West compared to say North and East?

S. Sridhar:

Generally in South and West if I have to give you a very brief understanding, it is a little bit low penetrated State when it comes to tractor, but at the same time they also operate on a higher horsepower range. And also this is largely rain fed, it has got much more linkages with rains. And at the same time the ability to create cash crops is very high, the prosperity level, the boom bust levels are much more unlike little but stability area of North. These are all the structural differences, but we need different-different plans for different-different regions, there is more of academic importance for us, I really do not know whether I can explain you more and we will be taking everybody's time much more if I will speak on this.

Kapil Singh:

Maybe I will discuss it offline with you sir. Thanks.

Moderator:

Thank you Mr. Singh. Our next question is from the line of Nilesh M from Catamaran Ventures. Please go ahead.



- Nilesh M:** We are trying to increase our penetration in the South and the West if I look at your investor presentation, so what are the steps we are taking to increase the penetration in South and West, are we focusing on any particular State or we will be focusing fully on all the States?
- S. Sridhar:** No, strictly not on all the States, I think one State yes, Andhra Pradesh is one State we are doing some initiative, that initiative also we are not going on full thrust. In the recessionary situation we cannot put in those kind of money in those kind of market because the level of competition is very-very high, spending a lot of money on market development is not a very prudent step so some of this South and West development is on a slow path which at appropriate time we will speed up. Right now we are only perfecting our kind of formula, beyond that we do not spend money. Today our thrust is on wherever we do very well can we do much better, there are variety of actions which are prioritized around that, not on developing what we consider difficult markets to crack or the breakthrough markets to crack. So when the time comes we will start putting money, putting effort but as of now many things are on hold.
- Nilesh M:** Okay. So how much percentage of the total tractor revenue will be coming from South and West?
- S. Sridhar:** 40%, almost 60% is from strong market and another 40% is from our weak market.
- Moderator:** Thank you. Our next question is from the line of Sameer Deshpande from Fairdeal Investments. Please go ahead.
- Sameer Deshpande:** As you mentioned North and East which are our major markets for tractor which constitute around 60% of sales, this time I think have received better rains compared to the South and West, so how is it going to affect us going forward? And interest cost has not fallen in the way it should have fallen and the loans have come down by about Rs.115 crores - Rs.120 crores, so can we expect the interest cost to fall going forward in the next quarter onwards?
- S. Sridhar:** Okay. As far as the monsoon is concerned it is too difficult to arrive at a conclusion of its favorable or unfavorable, for example Eastern UP and Central UP is under scanty category so it is one of our top market. I think when it comes to monsoon still I would like to be an observer rather than passing judgments on how the monsoon will pan out in the future. So for monsoon I think I have no comments, when it comes to the interest rates, today I think somebody has also asked this kind of a question, the money availability is bigger issue rather than the interest, many NBFCs have got a lot of difficulties and are facing some challenges. Thus their level of involvement is also coming down. Today the issue is not about interest, it is a question of is the money being made available for customer. So the challenges are on a different levels, interest does not really matter.
- Sameer Deshpande:** No actually my question was relating to the loans of our company which have come down from Rs.412 crores to Rs.287 crores.
- S. Sridhar:** Okay, I am sorry Sameer. I think I will ask Bharat to answer.



- Bharat Madan:** See, the borrowing has come down specially in June, so if you look at the average borrowing for the quarter they were in Rs.400 crores plus range, but in June since the cash flow was pretty good, being a good season you have seen the volume number 6000 plus which we did, so cash situation was pretty good only in the month of June. Thus in June end we exited the quarter with a lower borrowings but overall average borrowing continues to be Rs.400 crores plus, which is why you are seeing the interest cost is not reflecting that sort of comfort, it is a number. And going forward Q2 normally is not really a good season month and the quarter will be actually under pressure, so liquidity wise also not supposed to be a very good quarter compared to Q1 and Q3, Q3 is supposed to be the best quarter in terms of cash flows. So in Q2 will also you will see the interest cost will continue, it will probably slightly go up from this range.
- Sameer Deshpande:** But Q3 onwards you may see an impact?
- Bharat Madan:** Q3 onwards yes, the impact really starts coming in from Q3 which is a bigger quarter.
- Sameer Deshpande:** But good you have reduced the loans that is a better.
- Bharat Madan:** Yes, so any surplus which we get first we will go to reduce the loan.
- Moderator:** Thank you. Our next question is from the line of Ritin Shah from JHP Securities. Please go ahead.
- Ritin Shah:** Sir, actually how are you looking at the export front, the company is doing very good on the export side, so going forward is it going to be continued or how you look at it on a consecutive quarters?
- S. Sridhar:** As far as exports is concerned I think we are not doing well, last many things are only initiative levels are there and the realization levels are still very low. I think last year was very high, it is because we got some of the bulk institutional sales from African continent. Possibly this year also we have couple of things are in pipeline but the timing is not in our control, we really cannot predict on when exactly we will get those kind of a bulk deal. Certainly we expected this month itself but it has not happened. Today also our export sales is largely dependent on this kind of bulk sales, but many initiatives are on which are yet to give us the results. So there are small-small improvements, I think I will hold myself actually, there is a lot more work needs to be done on exports rather than making any good climb on what we have done so far actually.
- Ritin Shah:** Okay. And sir this is a 50 HP segment right now has grown by around 50%, right?
- S. Sridhar:** Yes.
- Ritin Shah:** Is this segment is going to be a major contributor going forward or how, because in India less than 20 HP is preferred majorly, and companies right now I think is doing a contract manufacturing for less than 20HP, so is there any plans to look at the 20HP segment or we will look at only 40HP or 50HP kind of segment going forward?



S. Sridhar:

Less than 20HP segment is very small, it is not that big, it is something like 2000 types per month, contributing to something like 8% to 10%, best time is 12%, beyond that there is nothing called 20HP. So neither there is a profit but it sometimes this gives an opportunity because these are all targeted towards small farmers, specialty farmers, also sometimes government ends up supporting. That is why no company wants to let go this kind of an opportunity, but if the cost structure does not support you we will never make money in those kind of product, that is why we took the route of outsourcing an activity and then collaborating with somebody else. Different organization who have a supporting structure to create those kind of products in a profitable manner. That is being prepared, anticipating certain eventuality of good quantity coming from various Governments, having said that today the quantities are still low. The 50HP segment possibly seven years back before the emission control reduction it used to contribute around 13% or 14%, it was also the highest growing segment because in the last seven years from 3% has grown up to 12% to 13%, fastest growth was happening there. Because of the emission rules many of the tractor got classified also has 49, 49.5 and those kind of area but the customers are there and then categories are expanding, it is very-very important that we are part of the category because at the similar classification of 10%, 11% possibly it will even land up to 18%. That is one of the reasons we don't want to participate, we wanted to take a leadership position eventually. These two category as I said bottom one is dependent on external factors where structure cost is very important criteria to make money on that where the top one is important not only from profitability point of view but it also gives you an image. So that is one of the reason we are participating at the top and there is a good success so far, this is our current status.

Ritin Shah:

Okay. And sir I just wanted to know about the railway segment, because company is doing a good margin so is this margin going to be continued going forward or how you look at it, what is your view on the margin front on the railway side?

Dipankar Ghosh:

We would be having a healthy margin in the railway business and we also see a good growth in the railway business because along with our present products what we have we are introducing two new products where we see a significant amount of traction. So we feel that we should be able to maintain a healthy margin, I would not comment on a particular number but yes we would be able to maintain a very healthy margin along with a good growth.

Moderator:

Due to time constraints our last question is from the line of Saket Kapoor from Kapoor and Co. Please go ahead.

Saket Kapoor:

Sir although if we compare the June FY14 with June FY15 the volume of tractor sold was down but still we have been able to maintain our margins, what would we attribute it to only due to the fall in raw material prices or is pricing formula also being changed?

S. Sridhar:

See this season one of the area is also the brand which are very popular, which is getting sold also adds to our advantage. For example, these are our Farmtrac time which is our premium end segment, so that is what has happened. But the long-term story we already have shared with you, the short-term story is little more different like quarter growth depends on the quantity what will happen, certain transition in terms of creating space in terms of existing products or the new



product. So there will be some short-term challenges but the long-term whatever we have shared with you that is the line what we are toeing and this brands also has peaked in various times at various geographies on various times scale. So it varies actually.

Saket Kapoor: No, but even though decline in volume is attributed to the raw material prices being down, going forward also will we get the benefit of the lower raw material prices?

Bharat Madan: No, so as was discussed in the beginning, somebody had asked that question, we said about 1% reduction has happened because of deflation in the commodity prices in this quarter, but the balance 1% if you compare sequentially against March quarter has come directly from the cost initiative that the company has been taking and that journey is on, like you said going forward in the next one year we expect further 2% to 3% improvement to happen because of this cost initiative. So irrespective of whether deflation continues or the inflation sets in on the cost initiative front the margin improvement will continue to happen.

Saket Kapoor: Sir my last question pertaining to the construction equipment part, is it only that the number of units being sold is below the breakeven part that we are making losses or something drastically has happened for which we have posted higher loss for the construction equipment for this quarter?

Sunil Saxena: As in the previous question somebody had mentioned, we have a breakeven at about 750 per quarter and we are operating below that number, that is only the primary reason.

Saket Kapoor: That is the overhead cost not being getting passed?

Sunil Saxena: It is not just the overhead cost, there are various elements that kick in because of that. So yes, it is largely a volume driven game at that point in time.

Saket Kapoor: And sir going forward also we are not seeing any revival in this segment?

Sunil Saxena: As I mentioned, normally the Q1 and Q2 are low quarters in any case particularly Q2, because of the rains that kick in. Add to that the economic activity which has not taken off despite of announcements. Added hurdle that we will have to cross as an industry is last year Q3 was largely euphoria of a new government coming in which really saw very good Q3 results, this year that euphoria is not there and there will be a lot of realism that will set in. However, Q3 will remain to be the largest quarter, our expectation which was for the industry at Q1 and Q2 is at least showing some 5% kind of growth has turned out exactly in the opposite manner in the sense we expect about 7% kind of decline in the quarter one and quarter two. So the industry per say is off by about 10% to 12%. We expect the climb up will begin sometime in Q3 and Q4 but what it will do is it will just cover up whatever was the decline in the first half. Overall we still see a flat or less than a flat year.

Saket Kapoor: Sir this pertaining to the construction part, how much is going to the mining sector because this is the only sector we can say that is getting lot of attention and activity going forward also as many mines in all minerals are getting being started up or are on the verge of being started. So



what role can we play sir, what percentage of our construction equipment will be deployed to the mineral segment?

Sunil Saksena: Yes, you are absolutely right, in fact if you really see the area where some amount of sectoral growth is taking place within the construction equipment industry is largely connected with large mines particularly coal. What really is happening is there the haulage is big therefore you see big dump trucks and the loaders where we are not present as a category and as a manufacturer. But those volumes are pretty low, there you have very high value and low volume. So even if there is a 30% what really happens is essentially 100 a month kind of dumpers go up to maybe 120. So it is that kind of a phenomena that takes place in mining sector also. And essentially the mining has been in doormat condition almost for 2.5 to 3 years and particularly it is something related to iron ore. So it is only going to be catch up even there.

Saket Kapoor: So sir our role in that part is pertaining to which segment then, we are not there in the coal part, neither in the iron ore so in case of mining our construction equipment part does not play a major role?

Sunil Saksena: Absolutely. We largely in the earth moving segment which is largely related again to some kind of secondary haulage which is related largely to road construction activities, constructions activities as such wherever there is a lot of earth moving that takes place. So let's say stone quarries where these kinds of materials get moved.

Saket Kapoor: Is it also pertaining to dredging also?

Sunil Saksena: Dredging, again secondary in the sense once the material is removed it needs to be carried from the banks to other places.

Moderator: Thank you Mr. Kapoor. Ladies and Gentlemen, due to time constraints that was the last question. I now hand the floor over to the management for closing comments.

Bharat Madan: Thank you Ladies and Gentlemen for being present on this call. For any feedback and query feel free to write into us at investorrelation@escorts.co.in. I would like to mention that we distribute our earnings release through our website www.escortsgroup.com, so do refer to our website for our earnings releases as well as other details and this transcript will be available on our website after some time. Also, you can visit our social media pages for the latest company news, development etc. We will meet again in next quarter. Thank you very much.