"Escorts Q1 FY 2018 Earnings Conference Call"

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MODERATOR: **MR. MAYUR MILAK -- INDIANIVESH SECURITIES LIMITED**

Moderator: Ladies and Gentlemen, Good Day, and Welcome to the Escorts Limited Q1 FY 2018 Earning Conference Call hosted by IndiaNivesh Securities Limited. 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 the operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Mayur Milak from IndiaNivesh Securities Limited. Thank you and over to you, sir!

Mayur Milak: Thank you. Good evening. On behalf of IndiaNivesh Securities Limited, I welcome you all for the Escorts Limited Q1 FY 2018 Result Conference Call. I also take this opportunity to welcome the management team from Escorts Limited.

Today we have with us, Mr. Shenu Agarwal -- Chief Sales and Marketing Officer, Escorts Agri Machinery; Mr. Ajay Mandahr -- CEO, Escorts Construction Equipment; Mr. Dipankar Ghosh -- CEO for Railway Equipment Division; Mr. Bharat Madan -- Chief Financial Officer; 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 Question-and-Answer session. Before we start, I would like to add that some of the statements that we make here, in today's discussion will be forward-looking in nature.

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

Bharat Madan: Thank you, Mayur. Ladies and Gentlemen a very good evening to you all. Thank you for joining us on the Earning Call for First Quarter ended 30th June 2017.

A snapshot of Company's quarter performance is as follows: Turnover at Rs. 1,163.2 crores against Rs. 1,048 crores last year, up by 11% led by volume growth in both tractor and construction equipment businesses.

Tractor volume is up by 7.3% to 17,561 on tractors as against 16,363 tractors in last year same quarter. Construction equipment volume is up by 20% to 886 machines against 739 machines last year same quarter.

EBITDA at Rs. 97.5 crores against Rs. 90 crores last year, up by 8.3%. EBITDA margin now stands at 8.4% at company level.

Finance cost went down by 28% quarter-on-quarter and 6% year-on-year to Rs. 8 crores. The total debt outstanding as of June 2017 is Rs. 179 crores comprising term debt of Rs. 95 crores and working capital of Rs. 84 crores, down from Rs. 263 crores in March 2017 because of reduced working capital during this season.

The PBT stands at Rs. 92.3 crores, up by 39.4% against Rs. 66.2 crores last year. The company reported a PAT of Rs. 62.6 crores versus Rs. 47 crores last year, up by 33.4%. PAT margin now stands at 5.4% versus 4.4% last year. EPS is reported at Rs. 5.24 against Rs. 3.94 last year same quarter.

Now, moving on to segmental business performance, starting with the Agri Machinery business, domestic tractor industry volumes went up 8.5% to 1.77 lakh tractors as compared to 1.63 lakhs tractors in last year same quarter.

Our domestic volume went up by 6.2% at 17,199 tractors as against 16,190 tractors in last year same quarter. While our retail sales grew by 9%, our wholesales were down due to destocking by the channel to minimize the transition impact of GST resulting in market share of 9.7% as against 9.9% last year same quarter.

Industry in our strong market in all its centers grew by 18% whereas industry went down 3% in our opportunity markets of South and West. EBIT margin in EM stands at 10.8% as against 11.3% down due to impact of rise in commodity prices, promotional expenses and some adverse product mix.

Our market share increase from 6.3% to 7.5% in more than 50 HP category during the quarter ended June 2017. In Q2 FY 2018, due to normal monsoon and early onset of festive season this time, domestic tractor industry is expected to grow by 18% to 20%.

Coming to the Construction Equipment Business, overall the industry grew by 15.6% in year-on-year. Our served industry comprising Backhoe Loaders, Pick-n-Carry Cranes, and Compactors is went up by 7% in the Q1 FY 2018. Pick-n-Carry Cranes grew by 64%; Compactors grew by 33%; and Backhoe loader had actually degew by 3% in the first quarter.

Our total volumes manufactured as well as traded products went up by 20% to 886 machines as against 739 machines in the previous fiscal. Revenue at Rs. 164.6 crores is up by 20% against Rs. 137.1 crores in last year same quarter.

Cost control measures in terms of fixed cost and material cost reduction have led to improvement of 368 bps at EBIT margin on Y-o-Y basis in Q1.

New products introduced by the company have been driving growth. **Jungli 5.54** Backhoe Loaders, Hydra 14 EX Plus Crane and other variance now contribute 15% of sale. We expect that our served Construction Equipment industry will continue to grow at 12% plus CAGR for next few years and we will be launching new innovative products/variance to cater to this growth.

Finally coming to the Railways division, the revenues are up by 12.8% at Rs. 65.2 crores in quarter ended June 2017 as against Rs. 57.9 crores in quarter ended June 2016. EBITDA margins at 9.9% against 16.3% last year are down due to adverse mix with high import content and lower exports volume. However, the same is likely to be made up in the coming quarters.

Order book for this division as of end of June 2017 stood at approximately Rs. 150 crores which will get executed in next six months to seven months.

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

Moderator: Thank you. Ladies and Gentlemen, we will now begin the Question-and-Answer Session. We take the first question from the line of Hitesh Goel from Kotak Securities. Please go ahead.

Hitesh Goel: Sir, can you just tell us about your outlook for the domestic tractor industry for this year and given that your presence in North and center list unit market is much higher and there the rainfall has been pretty good. Can you give us a sense on your market share movement for this year?

Shenu Agarwal: Okay, this is Shenu. I think the question was about outlook for the tractor industry this year, right?

Hitesh Goel: Yes. And your market share because you are stronger in the North and central and there your market share is higher, right?

Shenu Agarwal: Right. So, see, this year we are expecting the industry to be around 10% to 15% higher than that of last year that is the estimate so far and this in the backing of very good monsoon that we have experience so far and also the prices are holding up mostly. The sowing also has been very good and therefore, we see a momentum in the market right now. I think this will continue or this will slightly improve and the industry growth could be anywhere between 10% and 15% from last year. as far as market share is concerned, one good favorable thing which is happening is that this year the market is growing a bit faster in our strong markets that is North and center rather than in South and West. So, that is a bit favorable for us, so that should help us.

Hitesh Goel: Okay. And my second question is on the VRS. Any update that you can give us how much VRS you are provisioning for this year?

Bharat Madan: Well, as of now the scheme is still to be announced, i think slightly to be launched sometime in this quarter now in Q2 so possibly depending on the number of employees to accept the VRS it can range anywhere between 100 to 200 employees and on average it will be about 24 lakhs - 25 lakhs per employee, it can be anywhere 25 crores to 15 crores sort of outlay in this year.

Hitesh Goel: 24 to 25 lakhs and how many employees are we budgeting in that?

Bharat Madan: It is depending on range of 100 to 200 employees, so anywhere between that think it will fall.

Hitesh Goel: Okay. And my final question, if I may ask, on the construction equipment industry, can you share the segmental performance is that turned around now or what is outlook there?

Ajay Mandahr: The industry is doing well if you see in the first quarter, our segments were up by 7% in some market whereas overall market if you see as we have mentioned also that PNC are up 64% and compact is up 33% Backhoe was (-3%). But we think this market should grow at about 12% to 15% this year.

Hitesh Goel: Okay. No, I was asking more from Escorts perspective, has that construction equipment business turn profitable for Escorts?

Bharat Madan: So, we had mentioned in the last call also. So, first 6 months of the year normally are not good time for the construction business. So, normally the business picks up in the second-half which was also trend in last year. But on overall full year basis, we expect the business will be in black this year.

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

Raghu Nandan: My first question was on GST, sir. Do, we have any further updates on the tax rate for components or the time required for refunds and your general opinion on how you are seeing it and the positives and negatives? Thank you, sir.

Bharat Madan: Well, there is no indication as of now. Though the government did announce as of 30th June there will be reduction in rate from 28% to 18% on specific component which are meant for tractors but so far there is no notification. So, there has been representation given from the industry to the ministry as well as to the GST council. So, the council has meeting now on 5th of August so let us see we are not really sure whether this item is on the agenda or not, the industry is trying for it. So, I think and 5th of August, I think we will have more clarity on the fixed date

Raghu Nandan: And sir, on the time required for refunds and do you see this thing as negative or like how did change the working capital for us?

Bharat Madan: Well, it depends on the return mechanism which the government will propose for inverted duty structure cases. Industry has proposed simplified structure which is applicable in case of exports where the government is committed to give 90% of the money back within a week. So, this is the same structure we have proposed from industry also should apply in case of industries and in the inverted duty structure. So, if they agree to that request then the working capital will not be an issue. But if really the money gets struck which is a case probably we have seen in the past in case of like typically duty draw back refunds where the brand fixation happens so it clause anywhere between 9 months to 12 months. So, if that is the case there will be huge working capital issue for the industry anywhere between Rs. 1,600 to Rs. 2,000 crores money can get struck in the system if it does not get collected.

Raghu Nandan: Understood, sir. And sir, like on the GST itself would you be able to provide what was the GST related compensation which was given to dealers and when will it be accounted and our financials?

Bharat Madan: So, if you look at the government notification it says the opening stocks as of 1st of July need to be uploaded in the system within 90 days. So, by 30th September, the dealers are required to upload their opening stocks on the GST in portal. So, we will go with that number. So, whatever numbers are uploaded on the system so based on that we will have to pay the compensation to the dealers. In addition to the channel stock there is also going to be an impact on the stocks which are lying in our depos across India. So, I think it will be a combination of both, so depending on what numbers we get from the dealers on an average like it is at about 7% to 8% impact on per tractor which will be compensated. So, depending on the volume what we get really at the end of that period that compensation will happen in next quarter.

Raghu Nandan: Understood, sir. So, 7% if I take on a 5-lakh realization that is about Rs. 35,000 and even if I assume something like 5,000 kinds of inventory, so that could be the kind of impact which is a one-time exceptional item which would be occured in our financials, correct sir?

Bharat Madan: That is right.

Raghu Nandan: And sir, on the second question that I had was the HP wise mix for our first quarter FY 2018 volumes has slightly deteriorated with lower share of above 40 HP tractors. Is there any trend or anything like that or would it be mainly due to inventory correction?

Bharat Madan: If you look at our market share from the industry perspective if you look at first quarter the industry actually has improved in 41 to 50 HP quarter slightly by above 4%, the major growth has happened and more than 50 HP category and in 31 to 40 HP category. This is also the category where we have grown, actually we have outgrown the industry in 31 to 40 HP category and again, in more than 50 HP category. So, I do not think it is a trend, I think it s more better seasonality which typically happens in this quarter. So, I think on a overall full year basis we expect the same trend we will continue. But overall the swing if you look at in last few years 41 HP and above constitute almost now 50% to 53% of the industry that swing is happening to the HP as we go forward.

Raghu Nandan: And sir, like in that higher HP segment, we had launched a new product T-20 Classic, how is the response for the product sir, and do you see the volumes increasing there?

Shenu Agarwal: Yes. So, the T-20 Classic we had launched few months back that was only on one product and when we have introduced in one or two other products also which are flagship products. So, response has been good and that is why we have kind of introduced it in more products now. You can also see some effect of that in our market share growth in above 50 horse power in this quarter.

Raghu Nandan: And how much would be the volume sir for the product?

Shenu Agarwal: So, T-20 is pretty much standard in one of the brands which is Farmtrac. And Farmtrac constitutes almost all the volumes in above 50 horse power. Therefore, you can assume that T-20 is almost 100% in above 50 HP.

Raghu Nandan: Understood, sir. Last question I had was on the margin side, you mentioned that for the construction equipment division we would have a margin would be in the positive for this quarter. Can you give an outlook for the Agri and Railways division? Thank you.

Bharat Madan: So, Agri we had indicated we will be a double-digit this year and Railway again, I think this would be about 11% to 13% sort of EBITDA margin. I mean this is where we stand today.

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

Niket Shah: I had two major questions. One is on the export part of the business if you can share some of your thoughts I think we had some strategy to reach to 20% of our revenue is coming from exports or 20% of volume is coming from exports by 2020. Are we on track to kind of move towards the direction?

Shenu Agarwal: We are making some very strong from the exports but they are not reflecting the numbers are much. Because the numbers although have grown substantially in quarter one also I mean they are not at that benchmark level that we want to attain. So, exports are largely in last one year we have been working on a lot of new products. The good thing is that most of the product development is now though. We have started shipping the new products now in this last quarter to various new distributors and various markets that we have now entered. So, going forward you should see our sports growth building up to something like what we want to achieve in 2020.

But yes, some of the major milestones is achieved now in exports with all this product development that we have done in last one year.

Niket Shah: Got it. And if you can just share which are the major markets, would it be Africa and in case if that is a market what kind of differentiating stuff are we doing as compare to competition of out there whether it is more on pricing or it is anything specific that we are doing in terms of features where we will be outpacing that?

Shenu Agarwal: Yes, so basically, we play in the bottom of the pyramid in most of the exports markets. So, basically, we try to match the product, the features and the quality to players who are at the top of the ladder. But we can offer because of our cost competitiveness from India and otherwise, we can offer it at a much greater price points. So, we offer a great value for money as far as exports is concerned.

Niket Shah: Sure. And within the tractors for the business, this quarter has seen a 73-basis points margin uptick, which line item has actually help to get that 70 basis points?

Bharat Madan: On the tractor business?

Niket Shah: Yes.

Bharat Madan: Tractor business that has gone down in margin by about 0.5% this time because those some adverse product make some commodity price increases for the inflation but five in case would happen in this quarter.

Niket Shah: Right. No, I am saying on quarter-on-quarter basis actually which might not be…

Bharat Madan: Quarter-on-quarter was specially volume led, so last quarter obviously was lower volume quarter in the sense the more operating leverage have been getting benefited.

Niket Shah: And on the commodity price increase given the inflation that we have seen, any price increases likely to be taken in the near-term or have you already taken that?

Bharat Madan: So, there is one price increase which we have taken but obviously because the GST now there is some hick-up there so I think it will really get settle once the transition issue are resolved. So, that can probably in a position to take a call on that.

Niket Shah: Sure. And on the duty drawback for exports what would be the rates that we typically get for a duty drawback?

Bharat Madan: So, rates for all industry for tractor is 6%

Niket Shah: And that is so far the circular says that it is applicable to the quarter till the time there is no further clarity on it.

Bharat Madan: Yes, that was only applicable time till the time GST was not there. Otherwise, if we take the option of taking a set off on the duty paid by us on inputs then this rate was not applying, that will be only applicable for the import content which will be there in the imports which we use it will be very small because in tractor industry the import content less.

Moderator: Thank you. The next question is from the line of Dhaval Doshi from PhillipCapital. Please go ahead.

Dhaval Doshi: Sir, first on the overall wholesales for the month of July, so in June we saw a good amount of hit primarily because we were planning to destock at the dealer end. So, do we see that entire volume being shifted to July in addition to the normal volumes, or that is likely to phased out over the next couple of months?

Bharat Madan: we say it will get made up in Q2, obviously you will get slightly phase out between July and August. September is a big season, so I think the first two months will scattered and make it up.

Dhaval Doshi: Okay. So, roughly 4,000 - 4,500 units were the impact correct me if I am wrong. So, that is going to be scattered over the next two months, right?

Bharat Madan: No. So, it is the retail, in the first quarter was up by about 9%. So, the gap between retail and wholesale is not that high, it will be closer to roughly 2,000 odd tractors.

Dhaval Doshi: Okay. 2,000 odd tractors are what you are saying. Okay. Sir, also in Q1 we saw some impact in terms of the construction equipment volumes when the BS-III to BS-IV transition was happening. I hope that is behind us now and we not likely to see any such impact going ahead.

Bharat Madan: Well, it depends on the core tolling something which everybody is upset including tractors also got impacted because of that and construction also got impact where registration in various states were stop for various reason. But I think now it is behind us, so now that the clarification this has already come from the law ministry also and the court has also given the favorable ruling now. So, I do not think that will be an issue which will come up now.

Dhaval Doshi: So, what was the impact of that in Q1 both for tractors and construction equipment?

Bharat Madan: No major impact, it is only the retail registration was sought in the first month then April which was there on the construction equipment where the volumes also got impacted. But that got made up in the next two months. So, overall for the full quarter, I do not think there is any significant impact now because of that.

Dhaval Doshi: Sir, lastly on the gross margin, so if I were to look at the gross margin on a sequentially basis, we have seen a 40-bps improvement. This is despite of a weakening product mix, higher commodity cost, so what has really helped us improve our gross margin and what is the outlook on commodity cost going ahead?

Bharat Madan: No, like I said one is obviously the volumes, so if you look at tractor volume alone from the last quarter it was about 15,000 tractors and against that we have done 17,500 tractors. So, 2,500 tractors more in this period. So, that obviously is an operating leverage effect which is there, the contribution there was much higher compared to fixed cost. So, that benefit definitely comes along.

Dhaval Doshi: No, sir, I am talking of the gross margins, sorry not the operating margins.

Bharat Madan: Gross margin is very minor impact, I think it is 0.2 basis points because we took a price increase for the last quarter inflation in the end of March, so that impact has now come on a full quarter basis in this quarter. Though for this quarter inflation, the price impact really will happen in the next quarter which is the lag which we normally take these price increases. So, that has fairly helped the margin getting improved on the gross basis by about 20 basis points.

Moderator: Thank you so much. We will move on to the next participant that is from the line of Sameer Deshpande from Fairdeal Investments. Please go ahead.

Sameer Deshpande: Hopefully this GST implementation after this the demand which was postpone from June as you mentioned is likely to have a spillover effect in the Q2 which will be a better sales normally as against the weaker Q2, normally we have Q2 monsoon. I think with the Diwali propone in October this quarter is expected to be a substantially better one.

Bharat Madan: Yes. So that is what we said in Q2 because of these reasons we expect the industry should see a growth of 18% to 20%. They do 8% what we saw in Q1.

Sameer Deshpande: Okay. And this construction equipment, this GST the rates was increased from 28%.

Bharat Madan: On two categories on Compactors and Backhoe has been increased. On Cranes, it is 18%. So, overall there is not major impact on the construction business.

Sameer Deshpande: Okay. And now recently we hear a lot of problems of logistics that is the transportation is being aid so a lot of goods are not being transported here and there. So, does it affect our sales in any way for tractors and construction equipment?

Bharat Madan: So, as of now we have not really seen any significant problems coming in but there have been issues which the governments are still coming out with especially the provisions on the e-Way Bills which are the road permit issue which earlier was there. So, now some of the states have started coming out with their own announcements on this. So, obviously those legislation get intruded which government said will be done in another six months' time. Till that end the problem should not be there but again, the states have started acting on it again. So, that really comes back into the play then obviously there is will be some practical industry which the industry which have, so with logistics problems will have to resolve especially in terms of timelines which have been defined for delivering the goods I think is one of the key challenge I think from the industry.

Sameer Deshpande: So, currently we are not facing any problems as such.

Bharat Madan: As of now we are not facing any problem.

Sameer Deshpande: Last one the other income has doubled from Rs. 10 crores to Rs. 20 in this quarter, was there any one-off in this?

Bharat Madan: Yes, one of the item you can say one-off this is a sale of helicopter which the company has which took place in this quarter, so it is a gain of about Rs. 4 crores on account of that which is a non-recurring item. I think rest of the stuff is all official in nature including favorable exchange rates, so there is an income on account of that, there is some investment income which has flown in from mutual fund, so that is part of that, so there is no other non-recurring item other than this 4 crore item**.**

Sameer Deshpande: So, this Rs. 4 crores was only one-off the other things are which are normal.

Moderator: Thank you. We will take the next question from the line of Amit Goela from Rare Enterprise. Please go ahead.

Amit Goela: Mr. Madan, you had mentioned that in case about that working capital can go up for the industry by Rs. 1,800 crores something I just completely miss that, could you just explain that again?

Bharat Madan: So, I said extra refund because what is happening in our industry is if the rate of tax on input is 28% and on the output the rate is 12%. So, effectively 6% to 7% of the money which we pay on taxes will get stuck for which we will have to apply to for refund to the government. Typically, if you look at the historical data when we use to get apply for refund for the exports under drawback scheme, it used to take anywhere between 9 months to 12 months depending on case to case, you want to go for refund and verification use to happen from the tax and then only you will get the money. So, if that is a sort of timeframe which will get really put into place then for us to get a refund where there is inverted duty where the input taxes are higher than the output tax. So, this is sort the impact that the industry will face.

Moderator: Thank you. The next question is from the line of Yash Mata from Sushil Finance. Please go ahead.

Yash Mata: So, my question is regarding Construction Equipment industry, so you said the industry will grow around 15% to 18%, where do you expect the demand coming from? Like from which industry do you expect the demand coming from?

Ajay Mandahr: Okay, I will give you a response. Just correct your number, we talked about 12% kind of growth and this will be basically led by road construction, infrastructure per se and when you look at infrastructure that means all the serve markets that we are in would get impacted. So, we are talking about fully growing on all the segments in which we are.

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

Raghu Nandan: Sir, on the tractor side, we were working on certain initiatives to improve the financing part and we had done some tie-ups also there. So, how can we match up say the likes of Mahindra & Mahindra who have the captive finance with them? And what can be our future initiatives there over the medium-term? Thank you.

Shenu Agarwal: See, we have about a year or more ago, we had taken a very big step in this area by when we signed up a virtual JV with a very major bank of Europe for tractor financing. So after that virtual joint venture we are ramping up operations of that financing. In last one year I think we are ready have 80 clusters that we are into, each cluster typically has two or three dealerships and then there are plans to ramp up further to cover majority of our dealerships in next couple of years.

Raghu Nandan: Understood, sir. And sir, like can you also elaborate on what has been our strategies to improve our penetration in the opportunity markets?

Shenu Agarwals: Yes, as I have been saying in the past I mean we are sticking to our strategy there, so it is like majorly two-prong of course, there are other actions that we take on a practical basis. But first is like creating all the products that we have been traditionally weak for the opportunity markets. So, most of the products are now out and a few are in the pipeline that should be out in the next few months. The second part was developing channel, which can invest in our brand and give us that volume, right. So, in both the fronts we are moving ahead. But as I also said in opportunity markets also we are taking a very granular approach. So, we are looking at districts and areas where we have the right product, where we have an existing dealer which has the potential. And therefore, we are going district by district and getting our market share up, right? So, for example, I mean just to clarify for example, if we were to go in Maharashtra like we started a project in Maharashtra about a year and half ago so, we did not go to all 50-odd districts of Maharashtra. We have picked our 13 districts first and then we worked with those dealers and raise the market share to a double-digit level then we picked another about a dozen dealers and then did the same thing with them, right. So, that is our approach, so we pick our best bet and then phase by phase we increase market share in opportunity markets.

Raghu Nandan: And sir, like can you quantify what was the price hikes we took in the first quarter and because of GST I understand that players like Swaraj had taken a marginal cut, was there any cut at your end also on July? Thank you.

Bharat Madan: So, as of now coming to the price increase, we took the price increase in the Q4 last year, obviously the impact of that has come fully in this quarter which was about 1.2%. So, on the GST as of now there is no relation in the price which has been, like I said there is a lot of transitional stock impact there is no clarity as of now from the government's right, what will be the sort of compensation which will be required to be given by the industry. So, I think still we are watching the situation, so we will again take a call fairly in due course of time once we have more clarity on the subject.

Raghu Nandan: And like on our other expenses side that line item there has been an increase, generally it was at Rs. 135 crores odd, this time it has come in at Rs. 150 crores, this Rs. 15 crores increase any one-off is there in that?

Bharat Madan: So, there are two reasons, one is the spend on the R&D side which is almost double compared with the last year same quarter because like I said there is a portfolio for export market which is getting build-up. So, there will be very excessive spending which will happen on R&D this time to ready our portfolio, so that fairly will continue and also there is some tax advantage which we get because of that that will be one aspect**.** And second, there was some increase spend on the promotion cost which gain in this quarter, so that is another thing which has got cost in fact build into this quarter.

Raghu Nandan: So, if I understand correctly, the R&D would continue but the excessive promotion which happen per-GST that should normalize going ahead, correct sir?

Bharat Madan: So, that again comes along with the season. So, I think if the season starts the promotion activity picks-up. So, like we are starting this thing from September, so some spends which are happening from September onwards there will be season of two months September - October which is the key season, those two months we will see from higher promotional activities also.

Raghu Nandan: And sir, like what would be the full year effective tax rate?

Bharat Madan: Tax rate this because R&D weighted reduction this year has been reduced to 150% now compare to 200% last year. So, I think it will be anywhere between 30% to 31% about effective tax rate for us this time.

Moderator: Thank you. The next question is from the line of Sourabh Kumar from JPMorgan. Please go ahead.

Sourabh Kumar: Sir, what is your expected budget for the VRS for this fiscal and next fiscal if you can share?

Bharat Madan: So, as I had mentioned we are going to launch this scheme most likely in this quarter. So, as of now our expectation is number of employees will fairly go for the VRS will be anywhere 100 to 200 sort of ball park range and average cost will be anywhere 24 lakhs - 25 lakhs per person. So, it will be anywhere between 25 to 50 crores sort of outlay in this fiscal. And the next scheme will not be really in next fiscal, so I think it will fairly a year after. But I think as of now it is a difficult to put a number to that. But like I said, our overall target to do about 400 to 500 employees get through this scheme. So, it will cost somewhere around Rs. 130 odd crores - Rs. 140 odd crores in three years' time frame.

Sourabh Kumar: And sir, on your margin guidance you do some improvement which is also supposed to come from the raw material part as well. So, if you can give us as to how much you expect your raw material to actually improve this year?

Bharat Madan: So, raw material on account of cost initiative exercise which is obviously will flow in. But as of now like I said in this quarter there is an inflationary trend suddenly you see the price of rubber and steel both were going up through the roof so which is what actually has impacted the margin this time. But going forward we do not expect as of now indication for the next balance of the year is still not be major inflation now probably you will see some sort of deflation only happening on the commodity prices, so tire prices have already start coming down, so that could be something which will be favorable. No, in addition to that obviously the initiative from the company's side on reducing material cost is continuing so that will have some favorable impact, so that is why we are expecting the margin on tractor basis this time to be in the double-digit and slightly may be in the lower double-digit somewhere around 11.5% to 12%.

Sourabh Kumar: Okay, that is clear, sir. And sir, just one last question, on this market growth you have given us 10% to 15% for full year I mean can you just break it up your Northern markets, North and West and South?

Shenu Agarwal: See, in quarter one actually the opportunity markets have de-grown I think about 3% and the northern markets are our strong markets let us say have grown by 17%-odd with an average of about 8. So, I mean for this quarter we think the same kind of trend would continue. The gap may narrow down a little bit in the second-half of the year but the gap will remain, the North and Central will outperform South and West this year.

Sourabh Kumar: Okay. And just one last question, on your tie-up with Rabobank how much of your tractors are being financed now by Rabobank? What percentage of your tractor?

Shenu Agarwal: Yes, DLL actually is a subsidy of Rabobank so we have almost at the level of about 400 tractors to 500 tractors a month now. But that number is not very relevant because we are only at very few dealership, we are at only about 15% to 20% of our dealership right now. But the kind of penetration we are getting into a specific dealer is in the range of 30%-odd which we think is pretty healthy in such a short period of time.

Sourabh Kumar: So, in dealership where there is a DLL representative, 30% of the tractor are getting financed?

Shenu Agarwal: Right, that is an average.

Sourabh Kumar: Turnaround time will be similar as Mahindra Finance?

Shenu Agarwal: Turnaround time right now is similar as Mahindra Finance or any other player in the market but we are taking some actions which are very innovative for India to reduce that turnaround time.

Moderator: Thank you. The next question is from the line of Mayur Milak from IndiaNivesh Securities Limited. Please go ahead.

Mayur Milak: Just wanted to understand, we have seen Mahindra get into the Yuvraj which is less than 30 HP and we still see there is a lot of under-penetration into that particular segment of farmers, who typically own less than may be 5 acres. Do we as a strategy want to really target that kind of market?

Shenu Agarwal: You might be aware that we have created a joint venture with a company in Rajkot in Gujarat to manufacture less than 20 horse power tractors. Now, we are selling a small number right now because we are a new player in that market but we have already grown up to about 150 tractors a month with that kind of a product. Now, it is not a very strategic product for us because the margins are not very attractive. But this product from a portfolio completion perspective is important for us because in some markets this product commands about 40% to 50% of the share of the industry, right? So, to get the right distribution in those markets we need to have this product, right. So, we are going to continue to kind of drive volume growth there because the product is needed in the market but it is not going to do much of difference in profitability.

Mayur Milak: So, this will continue to be an outsourced product, you do not intent to really manufacture it or probably it does not make too much difference on profitability even if it is outsourced?

Bharat Madan: Yes, absolutely, we have a minority stake in this joint venture, so we will continue like this.

Mayur Milak: Okay. And my second question was, could you throw some light on the spare vertical that you are really looking to again look at in terms of growth prospects?

Shenu Agarwal: Spares I think has done a good job in terms of growth, I think they have registered a growth of about 19% if I am right in quarter one which is much beyond normal industry growth of 8% to 9%. So, I mean we are seeing some great good prospects of Spares in balance of the year also.

Mayur Milak: Yes. And if I understand well these spares will be common across other brands also, right? So, let us say if you are servicing may be any other brand would we be able to use our own spares into that brand or this is just for specific Escorts tractors?

Shenu Agarwal: These are largely for specific Escorts tractors because the designs are totally different.

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

Kaushik Dani: I wanted to know whether this delay compensation would be spread over all the balance quarters of the fiscal or the entire amount would come in Q2?

Bharat Madan: No, it will link to the opening stocks. So, whatever stocks are there and as and when they get liquated and there is a six months window which government has given to liquidate all the stocks to make them eligible to get any input credit. So, dealers will be under pressure to liquidate the entire stock. But if you look at the normal retail trend, stock levels are not very high with the dealers. So, hopefully within this quarter we will see most of the impact coming in Q2.

Kaushik Dani: Right. So, basically Q1 did not have any such number, right?

Bharat Madan: No, Q1 did not have. So, it is really from 1st of July.

Kaushik Dani: Right. So, basically Q2 we would be having two exceptionals – one is this dealer compensation and second would be VRS?

Bharat Madan: That is right.

Kaushik Dani: Okay.

Bharat Madan: VRS we are not sure whether it will fairly get concluded within this quarter, if it get spilled over to next quarter or there is some partial acceptance may happen in this quarter and partial in Q3 depending on the timing of the law of the scheme and its closure.

Moderator: Thank you. The next question is from the line of Deepak Jain from Subhkam Ventures. Please go ahead.

Deepak Jain: Just few clarifications. This dealer compensation quantum you indicated some 5,000 inventory is possible and around 35,000 so it should be around Rs. 17 crores - Rs. 18 crores, is it right way?

Bharat Madan: So, this compensation is payable on two items, one is the stock for the channel and second is stock lying in our own depos across India. So, there is no clarity as of now, so if you look at the legislation under the act they had said any stock lying with the manufacturer on that the trade will be allowed. But the rules which came out specifically excluded the exempted goods which were earlier not eligible for any duty. So, they had not been made eligible to take any credit. So, they still trade off uncertainly there in terms of law interpretation for which we have sought this clarification with government. So, I think let us see if the GST Council comes out with the clarification on 5th August in the meeting then we get that benefit on our stocks then the impact will be only about anywhere between 4,000 to 5,000 tractors. But if the impact is larger which includes our stock also on which it is not allowed then it can go to anywhere between 6,500 to 7,000-odd tractors.

Deepak Jain: Okay. So, the maximum we are looking at is 7,000 into 35,000-odd per unit?

Bharat Madan: That is right.

Deepak Jain: Okay. Sir, second thing is you said construction equipment is expected to become black in this year. so, are you talking about I mean single-digit EBIT margin is possible for construction?

Bharat Madan: Yes, so very low single-digit EBIT margin, it is anywhere between 1% or 2% sort of number. It will be just in black, so it will be EBITDA positive. But at EBIT level I think it will be very marginal positive.

Deepak Jain: Okay. And this double-digit margin which you are targeting is by when you said because of the easing commodity pressure just referring to that comment?

Bharat Madan: From which business you think?

Deepak Jain: See, overall I just want to get an understanding that what is the timeframe, we are targeting for double-digit EBITDA margins?

Bharat Madan: I think for the company as a whole this quarter we have still had about **8.4%.** So, I think it will still take some time may be FY 2019 I would say probably will be the likely year then probably you can see that number happening.

Moderator: Thank you. Ladies and Gentlemen, that was the last question. I now like to hand the conference over to Mr. Milak for his closing comments.

Mayur Milak: Thank you, all for participating in the conference. I would like to thank the management of Escorts also. And over to you Mr. Madan.

Bharat Madan: Thank you, ladies and gentlemen for being present on this call. For any feedback and queries, feel free to write into us at investorrelation@escorts.co.in. Do refer to our website and social media for our earnings releases as well as other detail. And the transcript will be available on our website after some time. We will meet again in the next quarter. Thank you very much and a good evening.

Moderator: Thank you. Ladies and gentlemen, on behalf of IndiaNivesh Securities Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines. Thank you.