



“Escorts Ltd Q1 FY20 Earnings Conference Call”

July 29, 2019



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MODERATOR: **MR. RAGHUNANDHAN N.L. – EMKAY GLOBAL FINANCIAL SERVICES LIMITED**



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Moderator: Ladies and gentlemen, good day, and welcome to the Escorts Limited Q1 FY '20 Earnings Conference Call hosted by Emkay Global Financial Services Limited. Before we start, I would like to add that some of the statements in today's discussion will be forward-looking in nature. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Raghunandhan NL from Emkay Global. Thank you, and over to you, sir.

Raghunandhan NL: Thank you, Neerav. Good evening and on behalf of Emkay Global Financial Services, I welcome you all for Escorts Limited Q1 FY '20 Earnings Conference Call. We thank the management for providing us this opportunity. I also take this opportunity to welcome the management team from Escorts Limited. Today, we have with us, Mr. Shailendra Agarwal -- Executive Director, Escorts Limited; Mr. Bharat Madan -- Group Chief Financial Officer and Corporate Head; Mr. Shenu Agarwal -- CEO, Escorts Agri Machinery; Mr. Ajay Mandahr -- CEO, Escorts Construction Equipment; Mr. Dipankar Ghosh, CEO, Railway Equipment Division and Investor Relations team at Escorts Limited. We would like to start the call with brief remarks from the management followed by an interactive Q&A session. At this point, I would request Mr. Madan to make his opening remarks. Over to you, sir.

Bharat Madan: Thank you, Raghu. Ladies and gentlemen, very good evening to you all. Thank you all for joining us on the earning call for first quarter ended 30th June 2019.

I will start with a snapshot of company's standalone quarterly performance, which is as follows: Turnover at Rs.1,423 crores against Rs.1,511.3 crores last year is down by 5.8%, which is primarily due to drop in Tractor and Construction Equipment volumes. Tractor volumes went down by 14.1% to 21,051 tractors as against 24,494 tractors last year. Construction Equipment volume went down by 20.7% to 1,067 Machines as against 1,345 Machines last year. EBITDA at Rs.142.4 crores against Rs.185.5 crores last year is down by 23.3%. EBITDA margin now stands at 10% against 12.2% last year. Finance cost went down by Rs.1.6 crores to Rs.5.9 crores as compared to quarter ended March '19. The total debt outstanding as of June 19 is Rs.124 crores down from Rs.277 crores in March '19. Net debt however continues to remain negative at Rs.409 crores. PBT stands at Rs.129.1 crore as against Rs.179.1 crore last year same quarter. The company reported a PAT of Rs.87.5 crores versus Rs.120.7 crores last year on standalone basis. PAT margin now stands at 6.2% versus 7.9% last year. EPS is reported at Rs.7.31 as against Rs.10.10 last year same quarter.

Now moving on to segmental business performance, starting with the Agri Machinery business, domestic Tractor industry volumes went down by 14.7% to 1.91 lakh Tractors as compared to 2.24 lakh tractors in previous fiscal same quarter. Our domestic volume went down by 15.9% at 20,122 Tractors as against 23,939 Tractors in previous fiscal same quarter due to channel inventory correction. The current channel inventory at the end of June '19 stands at about 3 to

3.5-weeks level which is a comfortable level. Industry in our strong markets degrew by 2% whereas industry degrew by 31% in the opportunity market of South and Western India. The sentiment of the farmers and industry have been dampened firstly due to delayed monsoon season and lower sowing, lower reservoir levels in western and southern regions, low subsidy sales in southern and western state and slowdown of commercial activity. Our domestic market share stands at 10.5% for the quarter ended June '19, against 10.7% last year. During the quarter ended June '19, besides industry degrowth, the company also carried out production cut to control own inventories and improve liquidity that adversely affected operating margins. The EBIT margin for the Agri Machinery segment stood at 10.9% for quarter ended June '19 compared to 14.2% last year and 13.1% in March '19 quarter. Even though monsoon was delayed and slow initially, but of late it has picked up momentum, and it is spreading across India. But overall, tractor industry sentiments continue to be negative as on date. Industry in Q2 FY '20 is likely to fare better than Q1 due to start of festival season from September 2019. The full year FY '20 domestic tractor industry growth though will depend upon how overall monsoon fares and the pickup in the festival demand and government trust and policies on agriculture sector. Escorts though stands on a better footing in view of its low channel inventory levels and its strong market performing better and in view of improved product offerings and sale processes.

Coming to the Construction Equipment business, our served industry which is backhoe loader, pick and carry cranes and compactors degrew by 27% in first quarter FY'20. Our total volume manufactured and traded products combined in the quarter ended June '19 correspondingly were down by 20.7% to 1,067 units as against 1,345 units in quarter ended June '19 leading to overall improvement in market share. EBIT margin in spite of volume drop have marginally improved to 2.5% for quarter ended June '19 as against 2.4% in previous fiscal same quarter. Construction Equipment industry has been seeing some slowdown on account of financing issues and delayed payments on ongoing infra projects; however, with continuous focus from current government on infra development, we expect the industry will see revival soon, and we continue to be optimistic on the outlook for this segment in medium to long-term.

Coming to the Railways division, revenues at Rs.118.1 crore went up by 34.1% as against Rs.88.1 crore in previous fiscal same quarter. This quarter we had better product mix compared to March '19 quarter that resulted in EBIT margin moving up to 20%. Order book for this division is around Rs.400 crores that will get executed in next 13 to 15-months. For FY '20, we expect Railway Equipment segment to grow at 15-20% level though margin for the segment may come down due to higher share of new products in overall revenue.

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

Moderator:

Thank you. We will now begin the question-and-answer session. The first question is from the line of Gunjan Prithyani from JP Morgan. Please go ahead.

Gunjan Prithyani:

Just on the industry, how are you looking at the remainder of the year, I do appreciate that this quarter was extremely bad, but is there any outlook that you can share for the year? And the other thing I am just trying to understand why there have been such a huge divergence in the growth trends in your strong markets vs. south and west, I mean, is there anything specific which is because I would have thought the monsoon is an issue across the board. Farm sentiment has been an issue across the board. So, why is there such a huge difference between the two regions? And how is the competitive intensity panning out given the demand is so slow? Just your thoughts on a few of these things?

Shenu Agarwal:

So, let me answer all the three questions that you have raised. So, first on the overall industry estimate. Right now, we are in a wait and watch situation because industry has dropped more than what anyone was expecting in the last few months. The primary reason is as we said is for this excess shortfall is the delayed monsoon or the overall monsoon behavior, not just delayed monsoon, but also the spread of monsoon that we have seen this time is a little bit weird or unusual than the previous year. So, I would say a lot of it will depend on how monsoon fairs in the remainder part of the monsoon season and we will have a better idea probably towards end of August how it will go. However, in Q2, we are a little bit fortunate that the festival season is preponed this time as against last year and there are some auspicious days occurring in September because of which we will see some positive industry movement in the next quarter as compared to Q1. As far as the spread of the industry is concerned or distribution of industry is concerned, one of the factors which is going against us right now or against the industry is that we are also sitting on a high base. So, in the last three years, the industry grew very, very rapidly. So, three years ago, we were at about 4.9 lakhs and last year we ended at about 7.9 roughly. And this was a kind of unprecedented growth in the industry. And the industry really grew quite a lot in South and West in this period of three years and prior to that, and therefore, other than other factors South and West is also sitting on a higher base of industry, and therefore the slowdown is more prominent there. But other big reason is the water reservoir levels which are really bad in parts of South and West, which has really brought down the sentiment and also the real sowing and other things on the ground. Of course, if the monsoon is better than expected then South and West could also see a better rebound in times to come.

Gunjan Prithyani:

How is the competition behaving right now, I mean, you guys have got your inventory fairly aggressively, is that where the market is or you are seeing discounting in the market and inventory corrections still being made?

Shenu Agarwal:

I do not think the competition intensity has changed dramatically. Of course, in pockets, people are playing kind of different strategies, but overall it is not and at least speaking for us we have not participated in any excessive discounting in Q1. So, as far as inventories are concerned, I think everybody is concerned about inventories, but as Bharat also said in his opening comments, we took a correction of inventory in Q1, we had built up some inventory in Q4 of last year because of the Navratras that was slated in early April. But those Navratras did not work well for the entire industry and therefore we took I think a wise decision to just cut back that inventory

and bring us to normal levels of 3, 3.5-weeks of dealer inventory. It is hard to say about competition what they are doing, but everybody in the industry is concerned about it. I think our stocking levels at dealership level are probably the best in the industry in terms of number of days right now.

Moderator: Thank you. The next question is from the line of Hitesh Goel from Kotak Securities. Please go ahead.

Hitesh Goel: Sir, there were some news flow in July there is some improvement in Tractor sales because of the pickup in monsoons. Can you just shed some light on it is there a YoY improvement that we are looking at it? And when you talk about dealer inventory coming down to 3, 3.5-weeks, was the retail decline significantly lower than wholesale volumes in this quarter?

Shenu Agarwal: In Q1, our retail was much better than the wholesale because of the correction in the inventory. So, on retail level, we did much- much better than the industry there. Of course, we do not share retail data among competitors but overall, we did much better on retail. Sorry, what was the other question?

Hitesh Goel: So, any trends on July because monsoons have been decent in July, there is some pick up. So, have you seen any positive traction?

Shenu Agarwal: Nothing major really, we have seen on the ground so far. Of course, July is yet to be over. But if there is an improvement, there is some marginal improvement in some pockets of the country, but nothing really major.

Hitesh Goel: In August even if the monsoons are normal, what kind of growth rate can we look at because we are not seeing any major improvement in prices and rural economy is really under big stress. So, that is what we want to understand. In a case where there is normal monsoon and August and September picks up significantly, what kind of growth can we look at or it could be declined?

Shenu Agarwal: As I said, it is hard to say, we'll have to wait and watch and see how the monsoon fairs really and more than the overall monsoon situation, what is more important is the spread of the monsoon especially in areas where water reservoir levels are very low. In August, we do not see much of a sign of improvement. As you know, although monsoon is very, very important, but tractor industry has a lag effect with the monsoon, and therefore if there is any positive sentiment build up happens that we will see only in the festive period which starts in the end of September because right now, there is no work that needs to be done in the farms, I mean, there is no tractor really required, and that is why like July and August are in any case lean periods. So, the best hope is end of September we may see a kind of what sought of trend

Hitesh Goel: A clarification; you said Tractor will grow in second quarter FY '20. You mean decline will be lower than the first quarter or do you expect to grow?

Shenu Agarwal: Most probably, yes, we do not see right now there is like a positive growth that we will see in Q2 as compared to last year same quarter, but the growth or the degrowth will be smaller in Q2 as compared to Q1.

Moderator: Thank you. The next question is from the line of Mihir Jhaveri from Avendus Capital. Please go ahead.

Mihir Jhaveri: Just wanted to ask you on the demand side. When you said that the festive season will be strong, we have very strong base anyways from October given that the last year second half was very good for us. So, how should we look at it in that sense just adding to what Hitesh was asking you in terms of demand? And secondly, a question to Madan, sir. He had spoken that there was a regulation change which had happened which the state government implemented in Bihar with regards to registration of tractors which was earlier not prevalent. So, can you just throw some light on that, what is the situation in other states and what is the inventory out there in that sense?

Shenu Agarwal: Let me respond to the first. The second half of demand last year was actually not that great. So, there is an opportunity that we see in terms of revival in the industry only because of that fact. Because last year until about October or November the industry was going very- very strong, I think, between 15-20% month-on-month basis growth, and then after November, the industry started kind of declining or the growth started slowing down, with I think February we actually started seeing a negative growth and January was pretty much flat and December also was very-very small. So, actually, second half of the year, the base was not as high as the first half. So, therefore if the sentiment improves and the festival season clicks, there is a chance that second half could be better.

Mihir Jhaveri: Sorry, I just missed it sir because if I see your numbers, you have grown 29%, 56%, 27%, 13%, 12% for the last year from October to February. So, am I missing something where is the base which is lower?

Shenu Agarwal: Of course, we increased our market share substantially in second half and therefore you will see our numbers better, but I was talking more from the industry point of view.

Mihir Jhaveri: Sir, my second question to Madan sir with regards to the registration effect which was there in Bihar. So, what is the situation?

Shenu Agarwal: Let me go ahead and answer that. So, see this new registration rules they are there, but the enforcement is very- very different in different states. So, Bihar we saw a kind of huge drive by the local government to enforce this law and therefore we saw some problems with the dealerships which reflected in industry as a whole. But the situation stays same as it was earlier. There is no like positive or negative movement in this regard. So, Bihar is still kind of better on enforcement than other states. Yes, since it has become a law now, so we expect that in times to come it will be enforced pretty much all over the country.

Mihir Jhaveri: Lastly, in terms of construction equipment, is it fair to say given that we had a weak quarter, for the full year we might be flat or negative in the Construction Equipment as well for this year or how do we look at it?

Ajay Mandahr If you see the industry, the industry is (-27%) and we are (-20%) roughly. So, we have gained market share there. Generally, if you look at the H2 side of the Construction Equipment, probably you get high demand on that side starting from October onwards and March is the strongest month. So, we expect the recovery to happen because now the demand side is strong if you look at. It is basically the financial crisis that has happened because of NBFC which is basically more money required in the market than what is available. So, we think there would be a positive turn that will happen from H2 onwards and we will keep growing our market share in those markets.

Moderator: Thank you. The next question is from the line of Pravin Yeolekar from CGS-CIMB. Please go ahead.

Pravin Yeolekar: My question was with respect to tractor ASP. We have seen a sharp spike in tractor ASP YoY and QoQ basis around 6%. So, could you just help us to understand what has led to this sharp spike in ASP?

Bharat Madan: Pravin, if we compare with last quarter, actually there are two reasons for this -- One is we are looking at the overall revenue for the segment. So, there is a two quotient to that revenue -- one is the tractor-linked revenue and second is the non-tractor business which we do in Agri. So, on non-tractor, we have seen 23% growth this time, non-tractor when we say it relates to spare parts, lubricants, engine and implement sale which we do. So, that has an impact of about 20,000 on realization this time if you are looking at the overall realization. And the tractor per se there is a recovery in realization of close to Rs.10,000 to Rs.11,000 per tractor which is partly on account of the price increase which we took in the beginning of April this time and also on account of the mix improvement compared to a sequential quarter in March, which has happened which is roughly Rs.5,000.

Pravin Yeolekar: A follow-up on this. What is the contribution of non-tractor revenue?

Bharat Madan: So, non-tractor this quarter is about 10% which normally used to be 7-8% level.

Pravin Yeolekar: How is the working capital situation for this quarter as compared to the 4Q?

Bharat Madan: I think as you have seen the impact on the margin this time, this is one of the reasons we said there is a drop in margin. So, it is not just the sales volume which got impacted by the industry going down by 15%. So, second impact which is a significant more, we also cut down production to control our inventories to reduce our working capital this quarter. So, as you can see the debt level has come down from Rs.277 crores in March to Rs.124 crores in June, so which means a lot of release of working capital has happened during this quarter which essentially has come

from the inventory side. Our production this quarter was 20% lower than the sales volume and sales itself was 15% down because the industry going down. So, that is why you see the negative impact on the margin is definitely steep this time though if it was the same sales and production number, the margin drop would not have been that significant.

Pravin Yeolekar: Lastly, on the tractor industry growth, could you quantify what was the total impact of this on the 1Q growth level because of tractor subsidy driven states because we have seen this year there is no continuation of this tractor subsidy?

Shenu Agarwal: Subsidy impact has largely come from Southern and Western states, largely Southern because last year there were some very aggressive subsidy schemes in the South of India. So, I do not have exact data right now, but let me say roughly speaking about 10,000 tractors would have been impacted in Q1 because of lack of subsidy or slowdown in subsidy scheme at the industry level.

Pravin Yeolekar: Could you see the similar impact in the next three quarters because of there is no continuation of tractor subsidy for many states or renewal of contracts?

Shenu Agarwal: Yes, speaking at the industry level some impact would be there because we do not see any major subsidy schemes coming in, in Q2 although there is one large subsidy program that is going to be unveiled in Assam. And that as quite a substantial one which may happen in Q2 or it may go to Q3 even but chances are it will start in Q2, and then major volumes you will see or major impact will come in Q3 and Q4.

Moderator: Thank you. The next question is from the line of Mr. Raghunandhan NL from Emkay Global Financial Services. Please go ahead.

Raghunandhan NL.: Sir, just wanted to understand how is the competition intensity in the domestic tractors?

Shenu Agarwal: So, competition intensity in our view is very similar to what we had in few recent quarters. Other than some pockets where few players are taking on different strategies, I mean, overall at the country level, we do not think it has been more intense than it was before. Yes, speaking for Escorts, we have not participated in any extra discounts, etc., in Q1 as compared to before. We are still focused on the retail sales through ground activations and through new products and other means.

Raghunandhan NL: This is to Bharat Madan sir. Is there any impact on IndAS 116 accounting changes? And also can you provide some color on the margin expectation for both the Tractors and Construction Equipment segment this year?

Bharat Madan: Adoption of 116 standard on leases there is minor impact of about 54 lakhs this quarter. So, about Rs.29 crores of additional liability will get deducted on the balance sheet because of this standard adoption but no significant impact

- Raghunandhan NL:** So, this 54 lakhs would be at the PBT level, right, sir?
- Bharat Madan:** Yes, essentially in the interest cost.
- Raghunandhan NL:** Sir, on the margin outlook broadly what range do you see for both the segments?
- Bharat Madan:** So, margin outlook I think if you look at the Tractor business though this quarter, obviously, there will be some effect on the operating leverage which will play out depending on how much we see the drop happening in the industry volumes. So, roughly we said for every 10,000 tractors we see 1% movement happening in the margin plus or minus. So, that will have an impact on the operating level. Obviously, the first quarter also had an impact because of the production cut we took. So, going forward, hopefully the production and sale number continue to be the same. So, we expect the margin recovery will happen from our first quarter margin. Overall, I think if you compare with the last year, yes, to some extent, whatever effect of volume will come on the margin front, that definitely will be there. The company is taking steps to also look at its cost structure and then cut down wherever possible and improve the efficiency. So, that should also play out towards the end of the year. But yes, so overall if you look at the margin wise, I think compared to last year definitely there is some pressure on the margin this year on the tractor numbers. On Construction Equipment segment, we expect margin overall profile should not change significantly even if we continue with the flat sort of volume on the number front, still adding margin, will be slightly better than last year.
- Raghunandhan NL:** On the Railways side, sir?
- Bharat Madan:** On Railways like we said, we are looking at good growth number, we already had a good opening order pad of Rs.490 crores plus and that will get executed during the next 12 to 15-months. But the mix of the Railways segment will be slightly negative. Like I said, there will be more orders which are from the new product category which may have some impact on the margins. So, we expect still the margin level will be in the range of 17%, 18%-odd on operating level on Railways business this year.
- Raghunandhan N. L.:** Can you share also the exports outlook for Tractors?
- Shenu Agarwal:** In Q1, we have done much better on exports, better than last year, of course but also better than the exports industry which is India exports out of India. I think like we have told you earlier that we have invested a huge amount of money and resources in new products for exports. That thing is now getting to show an impact. So, going forward also, we expect a decent growth in exports volume. Roughly the estimate is that we should do minimum 20% over last year.
- Moderator:** Thank you. The next question is from the line of Jinesh Gandhi from Motilal Oswal Securities Limited. Please go ahead.

Jinesh Gandhi: My question pertains to gross margins. So, in this quarter, we saw QoQ marginal decline in gross margins despite the commodity prices coming off. So, a) is it just the mix reflection or there is actually some bit of pressure on cost as well?

Bharat Madan: Hello, Jinesh. I think like you mentioned, there are two reasons for this -- The prime reason one obviously is operating leverage impact with the industry has gone down by 15%. So, that sales volume impact on the margin is roughly 160-170 basis points. The second impact is because of production cut which we took in this quarter, so, it led to the under absorption of manufacturing overhead which was another 160-170 basis points. So, this is one-off which has happened in this quarter, so that would not continue, but yes, operating leverage impact will continue depending on how the volume perform overall.

Jinesh Gandhi: But did we see any commodity related benefit in this quarter?

Bharat Madan: Very marginal, there is no significant benefit, there is very marginal impact of the commodity price, so, there is no inflation pressure as of now, so some prices have come down but that is less than I would say, 20, 30 basis points impact in this quarter.

Jinesh Gandhi: Do we expect any benefit in coming quarters particularly considering that commodity prices are materially down in the last six months?

Bharat Madan: Definitely, I think the pressure on commodity side has eased out. So, going forward, we expect benefit will continue and that again will depend how the same gets reflected in the margin, will depend on how the competition reacts to those changes in the commodity prices.

Jinesh Gandhi: Secondly, with respect to BS-VI norms for greater than 50 HP so, that is applicable from April 20, right?

Bharat Madan: October 2020.

Jinesh Gandhi: Any sense on what would be our contribution from greater than 50 HP?

Bharat Madan: 5% of sales really comes from more than 50 HP as of now.

Jinesh Gandhi: For industry, this would be what -- close to about 20%?

Shenu Agarwal: Industry is at about 7% and we are at about I think 4% or 5%.

Jinesh Gandhi: Lastly, for Construction Equipment business, while we expect second half to be better than first half overall would we be looking at decline in that business on YoY basis on volume terms or you expect some bit of recovery which will offset for first quarter decline?

Bharat Madan: I think as Ajay mentioned we expect normally H2 does better in Construction Equipment segment and we expect the recovery clearly will happen which can actually make up for the shortfall on the first half on any given side. So, overall fairly we can look at very marginal de-growth or maybe flat on volume for us on full year basis.

Jinesh Gandhi: For this year, what kind of CAPEX investment do we expect?

Bharat Madan: Like I said, we are planning for about 250-300 crores sort of CAPEX and major part of which is one-off CAPEX which is on the capacity expansion side and also in terms of setting up some capacity for the joint venture which we have formed with Kubota Corporation. So, that itself will be close to 140, 150 crores, and the balance 100-150 crores is on the normal CAPEX which we are doing for the businesses on the product side and the normal CAPEX.

Moderator: Thank you. The next question is from the line of Mitul Shah from Reliance Securities. Please go ahead.

Mitul Shah: I have two questions -- One is on the tractor side we are hearing discounts level in various schemes related to exchange offer has started increasing in last few days. So, due to slowdown, is it like kind of price or a type of situation are you facing by other players?

Shenu Agarwal: Yes, Mitul, this is Shenu. So, as I said, we have not seen like major discounting or increase in discounting at the industry level, of course, there are one or two players that do sporadically into some markets, they have come up with some offers in Q1. But as far as we are concerned, we are in the same ballpark as far as discount incentives are concerned as we were before. So, even with that situation, as we know, we have had a pretty good streak at the retail sale level, I mean, our number is not showing in wholesale as we reduced quite a bit of dealer stocks this time. So, we are going to continue with that philosophy because we have lot of fundamentals going in our favor, I mean, we have mentioned about those in the past like your distribution, some new products in orchards and rice, some other projects we are doing in our weakened opportunity markets where we have really grown market share even in Q1 substantially. So, those things are going in our favor. So, we do not need to resort to this. Of course, we have to wait and watch how competition reacts in the future.

Mitul Shah: So, even July is similar to Q1 or there is marginal increase towards the end of July?

Shenu Agarwal: I think overall at the industry level, July would be similar and the similar range as Q1 in terms of degrowth over last year.

Mitul Shah: Sir, my second question is on the new products if you can throw some light across the segments, Railways as well as Construction and Tractors also?

Shenu Agarwal: I will talk about the Tractors and then Ajay and Dipankar can talk about the rest. So, new products we launched in the recent past was one in the orchard category which is a smaller

compact tractor. Now that product is going fairly well. Of course, initially, we were going a little bit slow just to make sure that we receive the right customer feedback and establish the product in the right manner. But having done that now, and receiving very good customer response, we are now accelerating that to gain substantial market share in Maharashtra and other parts of the country where it is sold. On the rice special, we are still in a little bit of a cautious mode. We want to really get some deep-rooted feedback from the customers about the performance and reliability of the product. Before we accelerate, we want to make sure that we have the right product in the market. But that will continue maybe for another one season and after that we will accelerate that as well.

Mitul Shah: So, Euro series it is how much giving now?

Shenu Agarwal: Euro series is a rampant success, as you know, Euro 50 also received the Best Tractor of the Year Award for last year. I do not have the volumes, Mitul right now but I will give you those separately on Euro series, but Euro is like a craze almost because it has done really, really well in the last couple of years since we launched it.

Mitul Shah: Other segments?

Shenu Agarwal: So, these are the two or three products, the Euro series of course pans throughout the horsepower spectrum. Atom is on the lower side of the horsepower spectrum focused on some specialty applications of orchard and then the Euro 45 which is the rice special tractor is focused mainly in the rice markets. About construction, Ajay, would like to you say?

Ajay Mandahr: Yes, in construction, we are looking at portfolio expansion. I would not give you the specifics, but three new launches in H2 in crane and one in earthmoving. So, new products can come during the H2, they are under trials now, and the launch dates are in October.

Mitul Shah: On the Railways, sir?

Dipankar Ghosh: Mitul, this is Dipankar. For the Railways part, we have actually got approval for two major brake systems. So, they are going in for field validation trial. So, we expect that they should be commercialized within one year by next year. While few of the other new products, which we had already commercialized last year we have quite a significant order booking for those types of brake systems and couplers. But one of the brake systems has an input content where the margins are less but for the other brake systems and the couplers, we have a very healthy margin. So, we should be able to continue with our new product journey whatever we have started for the last three years.

Shenu Agarwal: Mitul, I just got one for the Euro series, so Euro series is now comprising of about 50% of the Powertrac brand volumes, that is Q1 data.

Moderator: Thank you. The next question is from the line of Riken Gopani from Infina Finance. Please go ahead.

Riken Gopani: Firstly, I would like to understand about the financing in the Tractor segment. So, could you throw some light about what percentage of our tractors are now financed by the captive? And also any specific trends that you are seeing in terms of the asset quality in that book if you could throw some light on that?

Shenu Agarwal: It is not really captive, it is like a virtual joint venture as you know with DLL Group. So, that part of the financing is penetrating well, I mean, it is increasing year-on-year and month-on-month and right now I think we are close to about 15-17% of overall penetration. You know that they are in all the states where we operate and therefore that expansion as goes along, then we will have better penetration. But other than that, we work with a lot of host of other finance companies like all the banks and major NBFCs. And the financing is not an issue as you would have heard that it is an issue especially with NBFCs and some other automotive segments for tractors being a priority segment we are not facing any difficulties at all right now. So, financing is not an issue, I mean, financing is available for tractors for every manufacturer, every brand, and I think we do not see any problems even in the future.

Riken Gopani: So, you are also confirming there are no specific asset quality trends in terms of the farmers are paying or anything on their particular book?

Shenu Agarwal: There are no major changes we have seen in the recent times.

Riken Gopani: The second question that I wanted to get an answer for is with regards to the fact that you have said that the inventory level is now comfortable for you. So, going ahead should we again start seeing Escorts growing ahead of the industry from Q2 onwards?

Shenu Agarwal: The answer is of course, yes. We have done that for the last several quarters. We have always been ahead of industry since last many quarters. And this quarter was a unique quarter because as I said we had to correct some stocks and it was a wise thing to do, because at this time, when industry is overall down 15% in some markets down like 30%, 40%, 50% also, right, dealer profitability becomes a challenge, and this is a time that we thought we need to support dealers and one way of supporting them among other things we are doing is to reduce their interest burden. Most of the working capital of the dealers is financed through banks or financial institutions, and therefore if they remain in high stock, the profitability is at stake especially with these lower volumes. So, we went ahead and took that call that we will reduce the dealer stock and bring them to some reasonably good levels. So, going forward, this issue is not going to be there because we are at 3, 3.5-weeks of inventory right now, I mean, we may increase a little bit in September because of the festive season demand because the demand would be significant at that time we will have to put something in dealer stock at that point in time, but that would be only temporary. But, yes, market share we hope you should see some improvements going forward.

- Moderator:** Thank you. The next question is from the line of Siddharth Bera from Nomura Securities. Please go ahead.
- Siddharth Bera:** Sir, my first question again is on the inventory side. Can you indicate how much will be the inventory at the company's end?
- Shenu Agarwal:** As Bharat has said that we have reduced significantly and that is reflected in our cash position and debt position. So, right now, we are at about two to three weeks of finished goods inventory inside the company.
- Siddharth Bera:** The inventory calculation is based on the retail data or the wholesale data?
- Bharat Madan:** Wholesale data.
- Siddharth Bera:** For the last month wholesale numbers, we calculate the inventory levels?
- Bharat Madan:** That is right. The reason is because we need to plan how much we need to bill to the dealers. So, we need to keep that sort of inventory level.
- Siddharth Bera:** Secondly sir, I missed the number of IndAS impact on the EBITDA. So, can you just indicate how much was that?
- Bharat Madan:** Overall on PBT level, cost has gone up by about Rs.54 lakhs in this quarter which essentially is reflected in the interest cost. So, EBITDA has improved by that much amount but the cost has shifted to depreciation and interest line.
- Siddharth Bera:** Yes, but would you have the number of how much the EBITDA was higher because of this change in this accounting?
- Bharat Madan:** Rs.1.3 crores higher.
- Moderator:** Thank you. The next question is from the line of Sabyasachi Mukherjee from Centrum broking. Please go ahead.
- Sabyasachi Mukherjee:** On the competition you are saying that you are facing similar level of competition for the last two, three quarters and there has not been any aggression from the competition, but when I see your market share on a sequential basis that has gone down from 15% to 10.5%. Is it something on some regions that you are facing the competition or it is a pan India level and your outlook on it?
- Shenu Agarwal:** I think in our industry it is better to compare market share on QoQ basis which means like same quarter previous year because there are significant shifts in the market share from QoQ on a sequential basis. So, normally Q4 is like very- very healthy for our company. Last year in Q4

we touched market share of about 15% and the year before that if you look at Q4 again you will see the market share in the range of 13%-plus while the average last year was close to 11.8%. So, you have to just look in the right context and sequentially may not give you a right picture.

Sabyasachi Mukherjee: On the pricing front that you mentioned in April you took a price hike. What was the amount of price hike if you can mention that?

Shenu Agarwal: The hike was roughly about 1%.

Sabyasachi Mukherjee: And do you intend to take any price hikes in near future?

Shenu Agarwal: Nothing right now.

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

Sameer Deshpande: Sir, regarding this working capital position you mentioned that the working capital is now fairly comfortable which we had stressed in the 31st March '19 it was I think due to two reasons was on the high inventory which you have corrected now, and also the amount had been blocked for GST which was around Rs.170, 180 crores. So, has this money got released now?

Bharat Madan: GST obviously continues to be a challenge. We have received some refund from GST which is about Rs.30-40 crores so far by end of June but the money which is still stuck continues to be in this range because there further recognition which has happened. So, it continues to be in the range of Rs.170, 180 crores which is still recoverable from the government. So, frankly, if the money had come back on time this entire debt position would have been likely negative, will be a zero debt free company if that was the case.

Sameer Deshpande: Now, I think you mentioned now our net debt is negative. So, some Rs.124 crores-odd is the working capital loan and we had some Rs.200-odd crores in the balances no?

Bharat Madan: So, we have Rs.409 crores of negative debt which means our cash position likely is Rs.409 crores plus Rs.124 crores, about Rs.533 crores cash on the balance sheet, net of debt is about Rs.409 crores.

Sameer Deshpande: So, it is quite comfortable now because that money can be used for the CAPEX without raising any loan as such, that will be available no. How is the position of the debtors now in terms of days?

Bharat Madan: Debtors, there are two issues -- one is institutional debtors which have also come down. So, good thing is we also recovered Rs.40, 50 crores from institutional outstanding which was there as of end of March. So, on the retail side, the liquidity pressures will continue to be with the channel which is the reason actually we took this correction in the channel inventory too to actually ease

out the pressure on this front. So, we expect I think by end of festive season we should be back to our normal levels with the retail too. So, as of now this continues to be some pressure on the liquidity side.

Sameer Deshpande: Some 50, 55, 60-days and odd is roughly...?

Bharat Madan: No, no, our debtors are not that high, on an average debtor have always been in the range of 20-30 days maximum. So, this time it will be close to 28, 29 days sort of level on tractor side.

Sameer Deshpande: The construction equipment after the March results, it was expected that we will report growth of around 15%, 20% and with the margins for the Construction Equipment to be (+5%) for EBIT level. So, now after this weak Q1, has this changed anything?

Bharat Madan: So, the margin (+5%) like Ajay mentioned in the beginning because normally you have very strong H2 in the Construction Equipment business where the volume growth is high. When you look at margin profile, in March quarter, our margin in Construction Business was close to (+7%). So, you will have high margin in the second half of the year, but in the first half of the year, the margins are typically low. But if you look at even compared to last year despite of the fact that the volume actually has gone down by 20% this time still the margins are marginally better than last year same quarter. So, overall, we expect the guidance which is there for about 5% margin will be maintained on a full year basis for Construction Equipment side.

Sameer Deshpande: Our realizations for the Tractor if I compare for the Q1 compared to the last year's Q1, realization has gone up by about 8%, so from 4,87,000 to 5,25,000 per tractor. So, there was effect of rise in prices or is there change of product mix which is affecting?

Bharat Madan: Like we mentioned in the beginning, obviously, one is the change of prices because there is inflation, which got passed on to the market, and that impact is close to 5-6% on account of prices. The balance is on account of the increases in non-tractor revenue, because you are looking at the overall segment revenue and dividing it by the overall volume for tractors. But actually this is also a component of 8-10% which actually is from the non-tractor revenue side which is essentially on account of spare parts, lubricants, engines and implement sale which happens. So, that has also gone up because the company has been focusing in terms of its Vision 2022 to also drive up its volume coming from these initiatives which are also good margin businesses, which is the result you are seeing actually on the top line, you should look at the average realization on a segment level basis.

Sameer Deshpande: And have you started this farm implements sales also, are we trading there or we are producing?

Shenu Agarwal: Implements we have started in a small way right now with only one product so far. So, there are a lot of products which are in the pipeline and it is a mix of some manufacturing but largely trading right now.

- Sameer Deshpande:** That segment can be a very large segment also along with the tractors?
- Shenu Agarwal:** We are working very seriously on it. We have a road map of like which products we want to get into which markets and what is going to be our strategy. Although it needs some time and patience to develop a good line of products, but we are very serious about it and we are working on that.
- Sameer Deshpande:** And I think at the AGM it was mentioned about these electric tractors, which we expect to launch by March, that is the end of this year. So, we will be the first in India as well as in the world for this?
- Bharat Madan:** Hopefully, it is so sir, I mean, there is still time left, so we do not know what will happen, but we are very seriously driving this technology and making it more affordable and making it more relevant to the Indian as well as global farmers, and hopefully by end of the year, we will launch it commercially though it will be at initial kind of level of commercial launch, and over the years, we will further improve this technology so it can go to masses.
- Sameer Deshpande:** Scrappage policy means which the government is likely to announce, it has been declaring a draft policy for some time, it includes commercial vehicles, so does tractor also come under commercial vehicles?
- Shenu Agarwal:** No, tractors do not come in commercial vehicles. They come under offload vehicles.
- Sameer Deshpande:** So, the scrappage policy will not benefit tractors?
- Shenu Agarwal:** No, no, it would not benefit tractors.
- Sameer Deshpande:** We are currently under BS-IV no?
- Shenu Agarwal:** We are under current under BS-III, and we are going to BS-IV from October 1, 2020, but that is limited to tractors above 50 horsepower. For tractors below 50 horsepower, there is no notification yet.
- Moderator:** Thank you. The next question is from the line of Abhinav Ganeshan from SBI Pension Fund. Please go ahead.
- Abhinav Ganeshan:** My question was that sequentially if I look at your market share in tractor, that has dropped a fair bit. So, can you give some ballpark number where it will rest if I look at an average or something with that?
- Shenu Agarwal:** So, as I just explained that it is not in tractor industry, particularly in our industry because of a lot of differences with respect to automotive industry. It is not kind of right to compare sequential market share, it is better to compare market share QoQ which means the quarter versus same

quarter in the last year, because lot of things that are different in our industry such as our industry is more festival-driven, our industry is kind of a lot of variety in terms of states, etc., So, I would suggest that you compare it with the same quarter previous year and that will give you a better picture.

Abhinav Ganeshan: And one more thing I just wanted to understand your outlook for the next say, 12 to 15-months on the tractor what are you seeing, your insights would be helpful?

Shenu Agarwal: As we said that right now, we are kind of waiting and watching, I mean, a lot depends on how this monsoon fairs in the next about 30 to 45-days because most of the current condition of the market is related to water, and therefore, we need to wait and watch. Having said that, July and August, we do not see any revival really, but there is a pretty good chance of a revival around the festival season which starts at the end of September. But I think we will be in a better position to give a estimate for going forward in about 45-days from now.

Moderator: Thank you. The next question is from the line of Lakshmi Narayanan from Katamaran. Please go ahead.

Lakshmi Narayanan: During the start of the call you mentioned that the stock of the vehicles have actually gone up because of last few years of increased sales in tractor from something like 4,90,000 to 7,90,000-odd. So, is there utilization issue in terms of tractors if you actually look at it whether as a utilization of the tractors that are there in the cost price is very high that incrementally tractor demand will be muted for a longer time irrespective of festival season or agriculture season...?

Shenu Agarwal: I do not think that is the case. When we said that the base is high, we just meant that tractor industry operates at a CAGR of 6-7% normally but in the last three years the CAGR has been upwards of 15%, and therefore the industry grew rapidly in the last three years as compared to historical averages. And we just clarified that this could be one of the reasons that industry has slowed down a little bit in the last few months. As far as like utilization or saturation levels are concerned, we think we are like really far away from that.

Lakshmi Narayanan: And how much of business is coming from non-agricultural, is there a broad number you track because in addition to agriculture, do you think some other activities that have actually kind of led to a slowdown?

Shenu Agarwal: If we talk about tractor industry, that is affected because of purely commercial activity that percentage might be really low, maybe 5-10% But a lot of decision-making about tractor sales or tractor purchase is now based on the fact that a lot of tractors' usage is now being done in commercial activities. So, if a farmer intends to buy a tractor at any given point in time he also looks at what are the additional opportunities for generating income out of the tractor other than the land he owns. And that percentage is very high, I think maybe on a national level it may be around 40% or so where the decision-making is affected by the commercial use of the tractor as well.

- Lakshmi Narayanan:** How much for our tractor volume is directly due to subsidies and how much is for the industries because some of the tractors that can be purchased even without subsidy. So, what is the mix for us and for the industry?
- Shenu Agarwal:** Q1, there have been no significant subsidies gained by and large, that is at pretty much zero industry as well as Escorts.
- Lakshmi Narayanan:** Annually how much it will be for on a regular basis?
- Shenu Agarwal:** Annually, it varies quite a lot. Last year was a good year for subsidy because of a large scheme in Assam as well as a large scheme in a couple of states in the south. So, last year the subsidy-led sales would be somewhere around like 70,000 to 90,000 tractors in that range and this includes some other states like Gujarat, Maharashtra. This year Q1 we have not seen any subsidy sales, but in Q2 we will see coming in as I explained earlier especially in Gujarat which has already started from 1st of July and Assam which is about to begin.
- Moderator:** Thank you. The next question is from the line of Vijay Sarathi from Anand Rathi Financial Services. Please go ahead.
- Vijay Sarathi:** Could you just help me understand what was the dealer inventory in tractors by November 2018 or rather the festive season that concluded last time, what could have been the dealer inventory if you can help me, it will be lower than the current average if you remember sir?
- Shenu Agarwal:** No, not lower, I think pretty much similar maybe.
- Bharat Madan:** End of October or beginning of November we were at roughly five weeks of inventory, which is now down to 3, 3.5 weeks.
- Vijay Sarathi:** So, as long as we are at five and below we should not have any problem both as company as well as industry level, am I right?
- Bharat Madan:** Like I think Shenu mentioned what we were trying to do was to look at in view of the liquidity issues or at least the channel also with the industry has already grown significantly higher in the last three years, so obviously the base has gone up significantly and the working capital requirement from dealers also has gone up. So, in order to ensure in these times we include the profitability for dealer also. We have taken a conscious call to cut down on the channel inventory which is I think we will try to maintain it at these levels.
- Vijay Sarathi:** Do you see any disproportionate figures at the industry levels between last time and this time in the festival season or do you think this is the same case for everybody?

Shenu Agarwal: It is hard to say, I mean, our competition, what we know or can guesstimate and then we could be wrong here also that industry would probably be about 4.5-5.5 weeks of dealer stocks right now.

Moderator: Thank you. The next question is from the line of Amar Singh from D&B. Please go ahead.

Amar Singh: When we talk about this quarter's performance, the revenue is not much of a worry because to an extent better than what was expected and went down by 5%, but on margin side, the decline is significant. So, if you could help me with some of it could be because of destocking that you did, some of it could be because of plant shutdowns, but any other region apart from this if you can breakdown this lower margin for me please sir?

Bharat Madan: I already explained at the beginning of the call. Probably you missed that portion. So, we said there are two reasons for the margin decline this time -- one obviously is the volume decline in the sales side which is exactly because of the industry going down, and second was the conscious call for the company to cut down on inventory because of which we took a production cut in this quarter, and the production this time is down by 20% compared to the sales number. So, one, the sales itself is down 15% because the industry going down; and second, the production is down further 20% over the sales number which leads to the unabsorbed overheads during this quarter which is the impact we are facing on the margin front. So, this is a one-off correction which has happened. Going forward, the production scale number will more or less be same. So, we do not expect the balance of year will see this sort of margin decline. So, if we have not done the production cut, this time the margin will be (+12%) on the Tractors business as well.

Amar Singh: So, we see course correction going forward in the remaining three quarters?

Bharat Madan: We think the margins will not be that low which we have seen in the first quarter which was a one-off thing which is done because of production cut.

Moderator: Thank you very much. As there are no further questions, I will now hand the conference over to the management for closing comments.

Bharat Madan: Thank you, ladies and gentlemen, for being present on this call. For any feedback and queries, feel free to write to us at investorrelations@escorts.co.in. We will meet again in next quarter. Thank you very much, and have a very good evening.

Moderator: Thank you very much. On behalf of Emkay Global Financial Services, that concludes this conference. Thank you for joining us. You may now disconnect your lines.