



“Escorts Kubota Limited
Q1 FY23 Earnings Conference Call”

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Moderator:

Ladies and gentlemen, good day, and welcome to the Escorts Kubota Limited Q1 FY'23 Earnings Conference Call hosted by DAM Capital Advisors 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 an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

Before we start, I would like to add that some of the statements that we make in today's call will be forward-looking in nature and are subject to risks as outlined in the Annual Reports and investor releases of the company. I now hand the conference over to Mr. Chirag Jain from DAM Capital Advisors Limited. Thank you, and over to you.

Chirag Jain:

Thank you, Mike. Good evening and on behalf of DAM Capital Advisors Limited, I welcome you all for Escorts Kubota Limited Q1 FY'23 results earning conference call. I also take this opportunity to welcome the management team from Escorts Kubota Limited. Today we have with us Mr. Bharat Madan, President Finance and Group Chief Financial Officer and Corporate Head; Mr. Shenu Agarwal, President Agri Machinery and Construction Equipment Business; and Investor Relations team at Escorts Kubota Limited.

We would start the call with a brief opening remarks from the management team, 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, Chirag. Good evening, everyone, and thank you all for joining us on this earning call for the first quarter ended 30th June 2022. I would like to present a few highlights of the company's standalone performance for first quarter ended June 2022 as follows.

Turnover up by 20.1% at INR 2,014.9 crore as against INR 1,677.00 crore in last year's corresponding quarter; tractor volumes up by 3.3% at 26,797 tractors as against 25,935 tractors in last year's corresponding quarter; construction equipment volume up by 59.4% at 966 machines as against 606 machines in last year's corresponding quarter; EBITDA at INR 201.6 crore as against INR 238.8 crore in last year's corresponding quarter, it's down by 15.6%; EBITDA margin now stands at 10% as against 14.2% in last year's corresponding quarter.

Steep inflation in commodity prices and unfavorable product mix has adversely impacted operating profit for this quarter. PBT at INR 198.1 crore as against INR 246.1 crore in last year's corresponding quarter. Profit before tax was further impacted on account of lower other income due to temporary mark-to-market losses on treasury investments. Profit after tax at INR 147.5 crore as against INR 185.2 crore in last year's corresponding quarter. Consolidated EPS stands INR 13.01 as against INR 18.13 in last year's corresponding quarter.

Now moving on to segmental business performance. Starting with the Agri Machinery business, the domestic tractor industry volume for the quarter ended June 2022, went up by 15.8% to 2.66 lakh tractors as compared to 2.29 lakh tractors in last year's corresponding quarter. This is on a low base of last year, especially of April-May when the rural part of the country was severely impacted due to COVID-19 second wave. This is highest ever industry volume for April to June quarter. We also recorded our highest ever Q1 volume at 24,608 tractors in quarter ended June 2022 as against 24,500 tractors in the last corresponding quarter.

Our growth in volume was lower than industry growth. The market share loss has mainly come from our strong markets and that too from a particular HP segment where industry shift has happened. We are putting in place corrective actions, and we hope to soon catch up with our market share growth trajectory. On export side, industry was up by 32% to 35,146 tractors as compared to 26,660 tractors in last year's corresponding quarter. Our export volumes were even highest - our ever highest quarterly volumes, and the same went up by 52.5% to 2,189 tractors in quarter ended June 22 as against 1,435 tractors in last year's corresponding quarter. This was driven by our continued focus on product development for export markets and expanding our channel footprint.

Sales through global Kubota network has also been increasing and now constitute more than 20% of our total export volume. We have taken price increases across our business segment to partially offset the impact of inflation on raw material and other costs. We are deeply focused on our cost reduction efforts, both in variable costs as well as in fixed costs. However, steep inflation in commodity prices, coupled with unfavorable product mix due to industry shift towards lower horsepower segment has adversely impacted operating profit for the quarter ended June 2022.

EBIT margin for Agri Machinery business stands at 10.6%, as against 14.9% in the same period last quarter. With the expectations of a good monsoon and likely record kharif crop production, we expect tractor industry to perform better in FY'23 as compared to last fiscal. The growth in our estimate should be low-to-mid-single-digit levels.

Now coming to the Construction Equipment business, in quarter ended June 2022, our served industry volumes of crane, backhoe loaders, and compactors went up by 47% as compared to last year's corresponding quarter. Backhoe loader industry grew by 55%, crane industry grew by 40%, while compactor industry was almost flat. Our total volumes of manufactured and traded products went up by 59.4% to 966 machines as against 606 machines in last year's corresponding quarter.

Our crane segment has outperformed the industry resulting in market share gain by almost 10% to 43% level in quarter ended June 2022 as compared to 33% in last year's corresponding quarter and 40% in sequential quarter. Segment revenue for the quarter ended June 2022 went up by 74% at INR 246.1 crore as against INR 141.1 crore in last year's corresponding quarter. EBIT margin for the quarter ended June

2022 was up by 332 basis points to 1% as against negative 2.3% in last year's corresponding quarter. The margins were adversely impacted due to steep inflation and commodity prices.

With government's thrust on infrastructure, we expect growth momentum to further accelerate in the current fiscal year 2022-23. We expect Construction Equipment segment to grow in high-teens and margins for this segment to improve gradually owing to our various cost reduction initiatives and improvements in other operating metrics.

So coming to the Railway division, revenue for the quarter ended June 2022 went up by 45.2% to INR 173.4 crore as against INR 119.4 crore in last year's corresponding quarter. Sales from new products now contribute 67% to total division sale as against 63% in last year's corresponding quarter. EBIT margin for the quarter ended June 2022 stood at 13.6% as against 14.6% in previous years. We are working towards indigenization of new products and we are happy to share that indigenously developed axle-mounted disc brake system are dispatched for field trials and expected to go under commercialization as per approval process. This quarter we witnessed very good traction in tendering process from wagon builders and order book for the division at the end of June 2022 stood at a healthy level of more than INR 850 crore. For FY'23, we expect Railway Equipment segment continue to grow in double digits.

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

Moderator:

We have the first question from the line of A. Pirani from J.P. Morgan. Please go ahead.

Amyr Pirani:

My question is actually on the market share performance that you mentioned. So in one of the slides you mentioned that north and central regions for the industry grew by around 22%. But you grew by around 4%. So given that these are our traditionally strong areas, what has driven the significant underperformance in growth?

Shenu Agarwal:

This is Shenu. Yes, so we know that we have lost in our strong markets, and we know that we have lost in some particular customer segments, especially the haulage segments or the low-end segments. As you know that we have been under unprecedented inflationary pressures since November 2020, and we were in a situation where we had to just balance out our profitability and our market share goals. So we took some very measured steps balancing the two and in the process it seems that we have lost some market share. The root cause of this loss is quite clear to us. We know exactly in which segments, in which horsepower, in which markets we have lost and to who. And now, since we are seeing some positives in terms of inflationary trends, also in terms of some of the cost savings that we were working on kicking in now, so we think this is the right time to go back to our market share goals. So, yes, we hope that in a few months from now, you will see that turnaround in market share.

- Amyn Pirani:** Okay. Sir, just as a follow-up. You have been, to some extent, prioritizing profitability over market share for the last few quarters as well, but in this quarter the profitability has also been impacted. So would it be right to say that if you went for market share, then the financial performance could have been even weaker? Is that what we should understand from this?
- Shenu Agarwal:** Yes, for that if you compare our results with the other companies in our space for which data is publicly available, I think you would get that sense. Yes, it will be very hypothetical to say that if we would have done better on market share, would we have lost more profit. I wouldn't like to comment on that. But yes, directionally we were trying to balance the two, the market share and the profit.
- Amyn Pirani:** Okay. And sir, just lastly, would you give any update on the expectation for tractor industry growth for the year? I think the last time when we spoke, you were expecting a mid-to-high single-digit kind of growth on a full-year basis, if there is any update on that. That will be my last question.
- Shenu Agarwal:** Yes, as Bharat had said in his opening comments, right now our expectation is that the tractor industry for FY'23 should be in low-to-mid single-digit level growth from last year. So a lot depends how things fare up in the rest of the months, but this is what we think right now.
- Moderator:** We have the next question from the line of Gunjan from Bank of America. Please go ahead.
- Gunjan:** Just taking on the point from the earlier question, I'm still very perplexed to see this margin performance. It's almost a 5-percentage point decline. Now when I look at there was no loss of operating leverage as such from a quarter to quarter, we did try to take some price increases or work on balancing the profitability. My sense is you guys wouldn't have gone too aggressive on discounting given, from a market share perspective, we haven't seen that reflect. So if you can help us map this, how much was the cost increase, did we take any price increases? Because 5% just seems a pretty steep decline Q-on-Q. And also on the ASP if you can give some color because that's also come off sequentially. So what's happening on the product mix side?
- Shenu Agarwal:** Yes, Gunjan, if you look at our profit sequentially, you will see that most of the loss has come from inflation itself, even comparing quarter 1 of last year to quarter 1 of this year, that is the key reason. We are not really expecting that inflation would be so high in this last quarter, but really, the commodity prices went up in March and April beyond our expectations.
- Gunjan:** Were there any price increases?
- Shenu Agarwal:** Yes, yes. So coming to price increases, so we took one price increase in quarter 1, I think to the extent of roughly 2%. So that we took, but the inflation was much more than that.

Gunjan: And mix side? Because still 2% price increase, so I'm guessing that there should be some mix deterioration also here.

Shenu Agarwal: Yes. So industry has shifted. Industry has shifted to lower, lesser profitable segments. You know that FY'21 the rural economy was going very well, and we saw a very significant shift to more expensive tractors or higher horsepower tractors. So that correction is also now taking place. It took place last year, and it's taking place now.

Gunjan: Okay, got it. The second question is maybe related questions. Market share, Aryn did ask about it, but can you give us more sense on who's in your strong markets? Is it the price discount which is enabling the share gain for the competitors or it is sheer weaker positioning in certain product segments like you yourself called out haulage? So is that something we should keep in mind when we're thinking about market share? And secondly, I think this was also a first quarter after the open offer got concluded. So maybe if you can share your thoughts as to how are the initial conversations in terms of integrating the 2 brands going on.

Shenu Agarwal: Yes, so firstly, Gunjan, on the market share side, yes, we have done our analysis. In fact, we have been continuously looking at it every month since we have been losing market share. And the root cause is quite clear to us. We know what needs to be done, and we know in which segments we have to do better. Now just in terms of timing, as I explained, we think that this is the time to go back to our market share goals because of the factors I described. Inflation pressure is going down. Not that we have no unabsorbed inflation right now. But still there is some softness in the commodity prices, so we hope that will help us in the ensuing quarters.

And also, some of the cost reduction initiatives we took in the previous quarters are now kicking in into good savings. So this is a time to focus back now on market share. It was just a call. Different companies take different call, and we just wanted to make sure that we balance our market share and profit aspirations. There is nothing fundamentally wrong with our market positioning; that I can say very confidently. So give us a few months and you will see some turnaround in market share.

Now coming to integration part. Yes, we are. In the last few months we have been deliberating over a midterm business plan for FY'28 and FY'30 as to how we will use the strengths of Escorts and Kubota, both the partners, to strengthen our market share presence in the country and also overseas. So we are hoping that we will complete this by September sometime and immediately after that we would like to share this with you.

Moderator: We have the next question from the line of Chirag. Please go ahead.

Chirag Jain: Sir, just a follow up on the market share thing. You mentioned that you lost market share to some competitors. But would that be more of a local

or regional brands or national brands that you would have lost your market share to? Because even national brands would have faced similar headwinds with respect to, let's say, profitability versus market share, let's say, whatever dynamics. So maybe some color around that.

Shenu Agarwal:

Yes. There are hardly any regional brands really. You know all the players are active nationally. Of course, they have different strengths in different markets. In our case, whoever we lost to, is not like a single player. It depends on the market, the segment, et cetera. But generally speaking, we lost in more price-sensitive markets, more price-sensitive customer segments. And the answer or the response to this when we run our market share revival story now would not be discounting, and it would be a mix of several things, including positioning the right product or come up with some different variants to appeal to those particular segments, et cetera.

Chirag Jain:

Okay. And second, also, in terms of, let's say, the way monsoon has been progressing, what we understand is that UP and Bihar they are lagging in terms of the rainfall so far. So any specific comments on those regions' markets and what could be the implication for the tractor industry, or let's say the broader rural segment in those regions?

Shenu Agarwal:

Yes, that is right. Monsoon has been a little bit uneven. UP, Bihar, and some parts of MP have not received as much rainfall. But I think looking at the forecast from the weather agencies, it seems that it will get covered up. If it does not, then, of course, it has tendency to impact the market. Now you also know that more than the monsoon, it is actually the availability of water in various reservoirs that affects the tractor industry in immediate sense. But that situation is quite positive throughout the country actually. We have plenty of water in the reservoirs. And therefore, even if a few areas get a little bit less rainfall, I think it should not affect the industry this year. It may affect it next year, but it may not affect this year.

Chirag Jain:

Okay. And just last thing, maybe if you can share the channel inventory both for us and for the industry.

Shenu Agarwal:

Yes. We are still within the range of roughly a month of channel inventory let us say between 27, 28 to about 35 days. That is where we maintain our channel inventory and have been maintaining at those levels. I think the competition is slightly more than that, maybe a couple of weeks more than that.

Moderator:

We have the next question from the line on Mitul Shah from Reliance Securities. Please go ahead.

Mitul Shah:

Sir, again question on margin side. So in terms of product mix HP wise, there seems to be hardly difference of around 100, 200 basis. Earlier we used to have 91% contribution coming from 30 HP onwards. This quarter it is around 89%. So just 200 basis is not explaining pure pressure on the margin because of the product mix. So is there anything

to do with the intensified competition earlier, our leader has given discounts in previous quarters to gain market share, so that is creating any pressure? Do you feel that for this quarter? And we also following the similar strategy of slightly higher discount?

Shenu Agarwal:

Yes, Mitul, this is Shenu. I can't answer that specifically. But yes, we do feel that there is some disparity that has happened in the customer and prices or the transaction prices with the customer, in spite of the fact that most of the industry players have increased their prices in the similar ballpark. So I don't know how to read that. But when we compare transaction prices, it seems there is some distortion between our prices and competition prices.

Mitul Shah:

And sir, second question is on, as you indicated, mid-single digit growth for the full year, but can you give more visibility at least for next quarter, that is Q2, given this July number declining by 15%, 20%, and August probably would also decline, but September because of the festival coming early, what could be the expected number for industry for Q2 given the inventory level is still much higher industry wide?

Shenu Agarwal:

Yes, for Q2, we are expecting a small growth, maybe in the mid-single digit kind of a growth. And you are right, Mitul, July and August would be drop. July we have already seen is a drop. August would also be a drop it seems. But September, because of the early onset of the festival period, there would be momentum both on the retail side, at least in the last few days of September, and, of course, on the wholesale side to build up stocks for the Dhanteras and Diwali and so on. Yes, there would be some pressure on some of the brands who are sitting on slightly higher channel stocks. So we will see how that pans out during September and October.

Mitul Shah:

Last question on Construction Equipment side, what could be stable margin expectation and what are the levers for that going forward considering commodity softening or pricing power or competitive situation there?

Shenu Agarwal:

Yes, Mitul, in the Construction segment, we participate in 3 broad segments: one is cranes, the other is compactors, and the third is backhoe loaders. So in the cranes, it's a duopoly kind of a situation where there are only 2 big players, and therefore, the pressure on inflation or because of inflation is normally not that high. The compactors is an altogether different story where there are many, many players in the segment. And, of course, there are intense pressures because of this inflation scenario, because of both the extent of the price increase and the timing of the price increase. Also, compactor is the one segment where individual deals are made with the customers, sometimes directly also, and therefore, the tendency to offer a certain price to capture the deal is actually even more. Backhoe loader, we are a very, very small player. We operate in a niche. So, therefore, we don't really worry about competition that much because we just operate in a niche within a few customer segments. So overall, I'd say, yes, all the businesses have been affected by inflation, but the impact in Construction business is not as

much as in Tractor business because there is a play that is available to us, especially in the cranes segment.

Moderator: We have the next question from the line of Sonal Gupta from L&T Mutual Fund. Please go ahead.

Sonal Gupta: Sir, just sorry to belabor on the market share point, and one thing was that you had anyway lost market share because of the component shortages in FY'21 and then '22 also we've not been able to recover that, in fact, in the second half and in the first quarter we've again underperformed. And this is very surprising because you have probably the strongest balance sheet, probably even better than the leader. So I'm just curious, I understand, historically, the industry has operated balancing profitability, but I just don't understand if the others are being more aggressive, why have you not chosen to defend your market share.

Shenu Agarwal: Yes, so don't feel sorry about asking this question. In fact, we are equally worried about the market share story, and we were just waiting for the right time to go back at it. I don't know how to explain this, but different companies take different calls, especially in tough times like we are going through in the last 1.5 years, mainly because of the inflationary pressures. And right or wrong, hard to say, but we had taken the call that we will balance it maybe a little bit more than what competition has tried to do. You will know that the pressure on profit is a little bit more on Escorts for the reason that our profitability is not at par with many of our peers in the industry. Although we have bridged the gap quite a lot in last 7 or 8 years, but we are still like 4% to 5% behind some of our peers. So it's just a judgment call that we had to take from time to time. I would request you to wait for a few months and see how the market share story pans out now.

Sonal Gupta: No. Sir, why am I asking this question is because what historically we've seen is that the market shares tend to be quite sticky, and it's difficult to recover market share once you lose ground there. Because now that you're saying that, okay, commodity prices are coming off, there's room for potentially being more aggressive, but that's true for the industry as a whole. That's not specific to you. So essentially, what gives you the confidence that you will be able to gain back that market share?

Shenu Agarwal: Yes, as I explained, we have analyzed this in quite a bit of detail. You are right, I won't disagree with you that the market shares in our industry are sticky. But we haven't found any fundamental problem within the loss of this market share. The best thing is that we have lost in our strong markets and not in our weaker or opportunity markets that much, which actually gives us that confidence that we can take it back on the strength of our products, on the strength of our brands, and the strength of our channel. If it would have been the other story where we would have gained in strong or lost more in weaker and opportunity markets, then we would have really worry. But I think we know the reason, and we know that we have very strong footing in these markets, and we should be able to take it back.

- Sonal Gupta:** Got it. Just a related question. Would financing have a role to play in this? Because clearly what you're talking about, haulage, et cetera, and the lower-end segments, which are more price sensitive, some people do have closer relationships with financing companies, so would that have impacted you?
- Shenu Agarwal:** Yes. So we know that we do not have a captive finance company. And the brands that have a captive finance arrangement do tend to benefit in such tougher times, because when you have to increase prices every quarter, then a finance partner can really step up and help you with better LTVs, et cetera. We do have that fundamental weakness in our whole story, and we would be working on that maybe in future sometime. But yes, you are right, it's not so much about the financing relationships, but having a captive finance always helps in tougher times.
- Sonal Gupta:** Got it. And just lastly, could you talk about the corrective actions that you've talked about? Have you launched some newer products which you were looking at?
- Shenu Agarwal:** It would be a 360-degree kind of approach. We would be looking at several things, and it would include repositioning some of the products in terms of variants, features, in terms of price positioning against specific competition or specific customer segments. It would also have some channel actions. It is also very important for us to bring that morale of the channel back up again. So it would be a 360-degree story. It would be lot of market communication that we'll have to do around some of our new products that we had launched within last two years, and we haven't been able to make enough noise around them. So, yes, it would be a mix of all those actions.
- Moderator:** We have the next question from the line of Mihir Jhaveri from Avendus Capital. Please go ahead.
- Mihir Jhaveri:** Sir, earlier what Sonal asked actually in terms of Escorts gaining market share going forward and you're saying that it is low-to-mid single-digit growth for the full year. That means that we'll have very negligible growth or probably a decline for the rest of the year. On a sequential basis, sir, how we should look at it that, while we will have some commodity easing but the operating leverage will not be coming to us. Secondly, we'll have this market share gain strategy where, as Sonal mentioned that everybody will have that advantage and everybody else will also try to be aggressive. So is it fair to assume that the margins would remain in this range for some time before we can gain anything material in the coming quarters? That's my question, sir.
- Bharat Madan:** So, Mihir, margin, obviously, will depend on how the commodities market play now going forward. So there are two actions which were taken in the past: so one is how much the deflation happens now on the commodity side and how much impact you get. So as you know, the last quarter, we have actually passed on, this was the peak of the inflation. March and April month actually were the peak. So the price increases which have been given to suppliers are based on those peak levels now.

So we're not seeing those peaks now likely to come back. So only seeing the deflation happening now in the month of May, June, July also we saw there was some softness has happened.

And second is the pricing action which Shenu talked about. So we already took one price increase in this quarter also. But I know if you look at the last call also which we had, we had mentioned there will be 4% to 5% unabsorbed inflation, which will have an effect on the margin, and this was discussed I think quite a bit in the last Concall and the last quarter results. So in spite of that, there's about 2% of price increase which has been taken. So we still have 3%, 3.5% lag on the inflation side, which we're carrying. Now either you get a deflation on the commodity side to that extent to offset it or you get some further price increase movement happening maybe going forward, which looks difficult looking at the way the last 6 price increases have been taken by the industry. So the absorption capacity of the customer looks very, very limited. So that may also be one of the reasons why you're seeing the market shifting towards the lower HP segment because of the price increases.

So I think it will be a balance of the two. So depends on if the commodities prices soften quite a bit and you get that advantage, maybe the margins can come back. But definitely next 2 quarters look quite challenging I think by the time you get to the stable margins. So Q4 I think will be the period where you can look at some normalcy coming back to the margin side.

Moderator:

We have the next question from the line of Hitesh Goel from CLSA. Please go ahead.

Hitesh Goel:

Sir, my first question is on if I look at the Vahan registration data, and I think better way to look at the industry will be April to July rather than looking at July month per se. So there has been a growth in UP. Actually, the state which has declined is mostly Gujarat. So UP is doing fairly well, and correct me if I'm wrong, it depends a lot on water table there because irrigation densities from the ground level is quite high. So that is my first question if you can talk about that.

Second is on what Bharat said right now. There's still 3%, 3.5% cost inflation left. Are we talking from this quarter or are we talking from the peak margins? Because commodity prices have declined significantly from the fourth quarter levels, especially steel, so not able to reconcile this. If you can talk about it.

Shenu Agarwal:

Yes, Hitesh, I'll talk about the market first. So, yes, UP you know has been sitting on a low base because UP hasn't grown as much as some of the other markets have grown in the last few years. So I think it is time for UP to probably come back, and we should see good momentum in UP in this year and next year probably as well, which should help us because we are quite strong in UP. And you are right, it mostly depends on the water table, and the water table situation is quite good right now even in North India. So even if UP has certain deficiency in rainfall, we

are not too much worried. The momentum on the ground is good in UP. Bihar also should catch up it seems maybe after the Vishwakarma Day because the on-ground momentum is quite good even in Bihar now. I'll pass on to Bharat for the other question.

Bharat Madan: Yes, Hitesh, so I think as we mentioned in the last con call, so that time we said there's a 4% to 5% of unabsorbed inflation which will remain by end of Q1, we were comparing it against the level of margin, which was there in Q4, which was roughly 16%. So even the 3%, 3.5% is against that level only, not against this quarter.

Hitesh Goel: And sorry, just to clarify on that. So basically, when does the steel price contract come for renegotiation, because spot is down like 15% from the fourth quarter levels. So that would be a big jump on margins if the pricing remains stable.

Bharat Madan: So I think in tractors it's not just steel. So it's a combination of castings, forging, steel, and then on the proprietary parts, so all these 4 play an important part and there are different benchmark used in the industry to get the price changes done in the purchase order. So normally, in the past, we had actually been doing these changes on a quarterly basis, but because this peak happened in March and April due to war situation, so suppliers were under a lot of pressure, and we actually ended up giving them the inflation based on the month average for the March and April. So that's why when we look at the data now for the margin, last quarter we've given the inflation at a peak level now.

So we don't see any more downsides should happen, even though we are hearing that there's another price movement happened upward, but we expect that should get offset with the decline which we're looking at in the steel prices now going forward. But still in spite of the pricing action taken in Q2, still there'll be some unabsorbed inflation which will still be there, unless we see major drastic reduction happening on the prices on the steel side in the next 2 months.

Shenu Agarwal: And Hitesh, just be a little careful about your inference on Gujarat because, as you might be aware that, sometimes Gujarat customers have a tendency to delay their registrations just because of some subsidy issues.

Hitesh Goel: Yes, yes, so July-August was very high months and then it normalized. Maybe there's some registration issues.

Moderator: We have the next question from the line of Jinesh Gandhi from Motilal Oswal. Please go ahead.

Jinesh Gandhi: Sir, my question is continuing on the steel price discussion. So based on the current steel prices, should we see a good reversal in the RM cost in 2Q and beyond, that prices remain where they are?

Bharat Madan: Yes, Jinesh, so normally, we follow the benchmarks on the commodity prices. So the leader is who do the settlement with the steel suppliers. So

the large players or there's a large association who do this closure. So we normally follow them. So yes, if they get the benefit, the industry will get the benefit, then we also follow them. So if they give a deflation benefit, then we'll also get that benefit.

- Jinesh Gandhi:** Okay. And what are the cost increase on account of commodity in 1Q?
- Bharat Madan:** See, in the last quarter, we had almost 5% to 6% increase in the commodity side, and this was again, like you said, based on the peak levels of March and April commodity prices.
- Jinesh Gandhi:** Okay. 5% to 6% increase in the RM basket in 1Q. Is that what you're indicating? Hello? You said 5% to 6% increase in RM basket over fourth quarter. Is that the right understanding?
- Bharat Madan:** Yes. So that is the case in Q1, which is what I think is getting factored in the financials, too. And if you look at the commodity cost, material cost side, even on the overall company level looks like only 2% increase has happened. But effectively because of the higher production volume in this quarter compared to Q4 and also because of some impact on the price increases, so the impact normally would have been about 4%. So that's something I think, which will clearly get reflected going forward on an exact basis in Q2, which is why I mentioned I think Q2, Q3 is going to be a tough quarter. So depending on how much benefit we get from deflation and there's no further pressure on the commodity side, like, we are again hearing on the steel prices side government is going to relax export duty, which can again maybe put some pressure on the price which were earlier coming down, may get again stabilized and they may start moving up slightly from the current level. So it's very difficult to predict. But whatever happens to those prices, these are something which the industry will follow and we'll also get the benefit or the disadvantage either way.
- Jinesh Gandhi:** Sure. And the price hike taken in second quarter is what, again, 2% or higher than that?
- Bharat Madan:** Yes, it's roughly 2%.
- Jinesh Gandhi:** Okay. And lastly, a clarification, when we are saying there is a shift towards lower HP segment, generally, are we indicating there is a recovery in the commercial segment which is now visible in a material way?
- Shenu Agarwal:** Jinesh, like I said, it's actually kind of a correction. In FY'21 we had a huge jump in 40 and above HP segment sales at the industry level. And there is some correction happening since FY'22 itself. Commercial segment is coming up but not very, very strongly so far. But we are expecting that from September or October onwards commercial segment should also play well.
- Jinesh Gandhi:** Okay, got it. And Bharat, can you talk about the CapEx for FY'23 what we are looking to invest?

- Bharat Madan:** So CapEx for this year, our plan was to do about INR 300 crore to INR350 crore of CapEx. So right now in the first quarter, the cash flow has not been much. So I think it's only about INR 40 crore to INR 50 crore which has happened. But going forward, we expect that pace will get picked up. So we're still maintaining the same guidance practice for this year.
- Moderator:** We have the next question from the line of Chirag Shah from Edelweiss. Please go ahead.
- Chirag Shah:** Yes. Sir, my first question is again on the commodities, and apologies for harping on it. So if I understood correct that in Q1 your indexation was based on for the highest price because you followed a monthly average basis, right? So when the commodity price started falling, the impact should also be in similar fashion for us in Q2. Is it right understanding, first point?
- Bharat Madan:** So earlier we used to give it on the quarterly average basis, and this time because of the spike which happened in the month of March and April, we had to convert to the monthly one to continue our supplies on the production side. So going forward, the correction which is set to happen obviously this was a one-off thing which happened. So it doesn't mean that we're shifting to monthly now. We will continue to follow the quarterly cycle only, so that benefit will come on a quarterly basis. But obviously, that will factor in whatever the reduction has happened in the month of May and June also.
- Chirag Shah:** And, sir, secondly, on castings and forgings and other aggregates, what is the impact of the conversion cost inflation? Is it already there or there is some lag effect pending?
- Bharat Madan:** So that is another issue which suppliers are raising, which is why we are finding it difficult for the industry to really take back the deflation because the process cost was not factored in when the inflation was given. So this is a, I think, struggle that most of the industry players are today dealing with. So it depends on how much process cost gets settled and whether we need to adjust that in the deflation or not. That will define how much benefit we get because of commodity price movement. So that is why we said it is very uncertain as of now because the industry hasn't settled those prices and suppliers are demanding process costs, too, but there again the inflation has happened. So that may actually maybe lead to some lower benefit come in because of deflation on the commodity side. But, again, that will be something which the industry will decide, and we'll also follow the same benchmark what industry does.
- Chirag Shah:** Okay. So some lag effect of that could come in Q2. That is the right way of looking at it. And probably Q3 onwards it would be cleaner quarter on the commodity side, including the aggregates?
- Bharat Madan:** Yes, that's right.

- Chirag Shah:** Okay. Sir, secondly, just a follow-up question again. Is the underlying demand turning slightly weak because April-May was suddenly very strong months, then June was reasonably okay, not that strong, then suddenly we are seeing this. Is the demand currently relatively weak and hence inventories are slightly higher and OEMs would look at clearing the inventory and bringing it to normalized level? Or this is more of a blip last one month or 45 days?
- Shenu Agarwal:** No, no, we don't see any letup in the demand actually on the ground. All the factors are in favor of the tractor industry right now. When we compare month on month or a monthly positives and negatives in the industry, we have to just look at the base effects also. Last 2-3 years were very, very inconsistent that way. So, yes, if July and August are down, then we are really expecting a very good September, October and November. Also, we must remember that FY'21 was an unusual year where the industry reached its ever highest and that was also abnormal for the industry to grow to that extent just in a single year. Therefore, some correction, of course, is bound to happen. So if we look at like FY'19, FY'20 base, then we would get a better sense of how industry is moving.
- Moderator:** We have the next question from the line of Abhinav Chandak from Ratnabali Investments. Please go ahead.
- Abhinav Chandak:** I just wanted to understand the entire merger process. Where is it right now?
- Bharat Madan:** The merger, still, I think the advisors are working on the valuation side. So, obviously, we intend to have this meeting soon. So, I think once the agreements are finalized and the valuation is done, we'll really get it done. So I'll say maybe a month or so.
- Abhinav Chandak:** Okay. So the valuation part is being worked out by advisors, but then the management has already indicated 1% to 2% is the maximum valuation which will happen. Even in the last call I had asked the same question. And so how long would be the timeline for you to draw the final parlance for the merger?
- Bharat Madan:** So the court process, obviously, may take 9 months to 12 months because this will have to go through the stock exchange permissions, SEBI approval.
- Abhinav Chandak:** No, I mean finalizing the terms of the merger. The entire regulatory process will take 12 months. That's okay.
- Bharat Madan:** That what I said within a month. So we're indicating about a month's time so we should be able to close that.
- Abhinav Chandak:** And on the cancellation of shares held by the trust, so we have received approval sometime in June, it was mentioned in your press release. So

by when do we see the actual cancellation getting reflected in the shareholding pattern?

Bharat Madan: So, again, this will be a court process. So the shareholders' postal ballot is on right now. So once the results get over, then we will file the scheme with NCLT for reduction. And then again that's a court process. It may take, again, 6 months' time by the time it becomes effective.

Abhinav Chandak: Okay. And on your business plan, by September, do we expect the business plan to be out? Because earlier we were indicated Q1, then it shifted to July, and right now on this call you have indicated September. So by September do we expect.

Bharat Madan: It's an internal approval process which we'll follow, and then, obviously, we will make it public to the investors in the third quarter.

Moderator: We have the next question from the line of Sameer Deshpande from Fair Deal Investments. Please go ahead.

Sameer Deshpande: I would like to know after the cancellation of equity, the equity capital will be around INR 110 crore to INR 111 crore, and the stake of Kubota would be around 53.5%. And Nanda's will be continuing to hold 14%. So is it correct?

Bharat Madan: Yes, post-reduction, that will be the percentage around that, yes.

Sameer Deshpande: Okay. What is the cash and bank balances position now?

Bharat Madan: So liquidity will be close to INR 5,000 crore investment which we have on the balance sheet as of end of June.

Moderator: We have the next question from the line of Mitul Shah from Reliance Securities. Please go ahead.

Mitul Shah: Sir, one clarification on Q2 tractor industry number again. We expect decline roughly around 15%, 20%, possibly in August, similar decline in July. So even if we assume record high number for September base, it has come to roughly more or less flat volume. So growth seems to be very difficult. So do you expect inventory levels to remain high or do you expect inventory would correct, but retail sales would be like 130, 140 in the month of September? Assuming current inventory level close to 140,000 now.

Shenu Agarwal: So, Mitul, July-August would be low. We are still looking at roughly like 215,000 for Q2. That is what is our ballpark estimate. So that is why I said it could grow into like low or mid-single digit.

Mitul Shah: And, sir, secondly, on your strategy in north we are losing market share, and again these northern states, particularly UP, Bihar facing problem in last month of July and probably because of the uneven monsoon. So

what could be the strategy here? Because our stronger markets are also declining, and we are losing market share there.

Shenu Agarwal:

Yes, Mitul, so as I said, we have a completely analyzed it state by state, cluster by cluster, even at the dealership level, and we know in which areas or which tehsils we have lost against which competition and which customer segment. So as I said, we have very, very strong brand perception, with at least one of our brands in these markets. We have a very, very strong channel. In many areas, we have been either number 1 or number 2. So using that strength and taking some corrective actions wherever required, especially in the identified segments, we should be able to come back, Mitul.

Mitul Shah:

Sir, my question is in terms of whether it would be product strategy, pricing, strategy, or are we expecting network expansion in those territories? Anything if you can throw some more light?

Shenu Agarwal:

No, no, network expansion, Mitul, we don't need. We are quite saturated with our network in our stronger markets. There are only like a handful of whitespaces only. That is because of some churning that we see sometimes, but otherwise, there is no need for any network correction. Yes, we are going to work on the product. We are going to work on the right optimal price. We are going to work on introducing some variants that we need to respond to competition with. And we are also going to work on the dealer profitability side a little bit. Because of the frequent changes in prices, you know there is always a lag effect between our raising the price and the customer giving that increased price. So dealer profitability, et cetera, has also a little bit weakened. So it is going to be a 360-degree approach. We are also going to make a lot of noise about some of the new products that we have launched in 1.5, 2 years, such as the Powerhouse Series, the NEXT series, in Powertrac, and similarly some new series in Farmtrac. So it's going to be an all-round approach. We don't think a single lever will work. We'll have to accelerate on many levers.

Mitul Shah:

Thank you for detailed explanation, sir. Sir, lastly, if you can give some details on the EV tractor side. I think we are selling 50, 60 units monthly to USA. Right, sir?

Shenu Agarwal:

Yes, yes, that is right. We are selling to U.S., and we are selling in Europe also a few units. As you are aware, we have not commercially launched it in India yet, although we are making just a handful of supplies to few government agencies in India. Yes, so EV as I have been saying, we are very cautious to ramp it up because we want it to go through a complete cycle of customer validation or market validation. So, yes, there is lot of potential. We have lot of orders that we want to serve, but cautiously we are moving on this front.

Moderator:

We have the next question from the line of Shridhar Kallani from Axis Securities. Please go ahead.

- Shridhar Kallani:** Sir, I have a question regarding exports as to how will currency depreciation will it be playing to our advantage and how is the export segment wise, which countries are we exporting mainly to, shed some light on that.
- Shenu Agarwal:** Yes, of course, the forex or the exchange rate will have its own bearing. But also remember that some of it gets negated with the inflation, which is also happening on the export products. As far as the markets are concerned, we will tell you a little bit more about which markets we will focus, et cetera, where we will go direct and where we will use Kubota's channel strength, so that we will explain to you in the MTBP discussion we will have with you. But largely speaking, you know that we have a subsidy in Poland, so some of the tractors are exported through Poland. Europe is very, very strong for us. We are also supplying to Kubota in Europe through their channel. But we have a lot of other markets where we are regularly supplying, such as Mexico, Sudan, U.K., Chile, ASEAN countries, et cetera. So let us come back to you. We have huge aspirations on exports. We know there is a huge potential there. So we'll come back to you during the time of our MTBP discussion.
- Bharat Madan:** But just on the exchange side, just to further update what Shenu mentioned, this is Bharat Madan. So, as you mentioned, so most of the exports right now is happening in the euro denominations. Almost 66%, 70% exports are in euro. So there the exchange benefit is not really there. So if you look at dollar-euro are more or less now coming at par. So if it was a dollar invoicing or billing, then obviously you would have got that advantage. So that is happening only on certain volume, 30% of the volume in what we're exporting today. So on the euro side, we are not going to see any major benefit coming on the exchange front.
- Moderator:** We have the last question from the line of Chirag Shah from Edelweiss. Please go ahead.
- Chirag Shah:** Just a clarification and you've partly answered that. You had indicated that there is a reasonable stickiness of brand in the region where you perform, generally for the industry as a whole. So the loss of market share cannot be attributed to the pricing actions adopted by peers. That cannot be the single biggest driver, because the pricing action can never be so distorted that it could change the mathematics by 10%, 15% in one month. So I presume it is more to do with your dealer the way you are trying to restructure the dealer towards the Kubota integration process, is that the driver of some of the market share losses?
- Shenu Agarwal:** No, no, not at all. We haven't started even a bit around any kind of channel integrations with Kubota and neither do we want to in the short term or even in the midterm. We are very, very clear that all the 3 brands have unique strengths, and they cater to different kinds of customers in different segments. And therefore, we would like to maintain a unique channel. Of course, there would be some synergies in channel that we would explore, like if we have a strong dealer and they want to have another dealership of a different brand within EKL, then, of course, we'd be more than happy to explore those kinds of synergies.

So it has got nothing to do with the integration process. I do understand that what you are saying may generally be true. But see, like I specifically said that these are markets where price sensitivity is very, very high. For example, the haulage market, et cetera. Generally, you are right the price should not affect so much if the brand is very, very strong. But it depends on the quantum also, which I haven't described yet. But yes, these are price-sensitive segments.

Moderator: That was the last question. I now hand it over to the management for closing comments.

Bharat Madan: Thank you, ladies and gentlemen, for being present on this call. For any feedback and/or queries, please feel free to write into us at investorrelation@escorts.co.in. Thank you very much and have a good evening. Stay healthy and stay safe.

Moderator: Thank you. On behalf of DAM Capital Advisors, that concludes the conference. Thank you for joining us and you may now disconnect your lines.