"Escorts Limited Q2 FY20 Earnings Conference Call"

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MANAGEMENT:	**MR. SHAILENDRA AGRAWAL – EXECUTIVE DIRECTOR** **MR. BHARAT MADAN - CHIEF FINANCIAL OFFICER & CORPORATE HEAD** **MR. SHENU AGARWAL – CEO, ESCORTS AGRI MACHINERY** **MR. AJAY MANDAHR – CEO, ESCORTS CONSTRUCTION EQUIPMENT** **MR. DIPANKAR GHOSH – CEO, RAILWAY PRODUCT DIVISION.** **INVESTOR RELATIONS TEAM**
MODERATOR:	**MR. SAKSHAM KAUSHAL – PHILLIPCAPITAL (INDIA) PRIVATE LIMITED**

Moderator: Ladies and gentlemen, good day and welcome to the Escorts Limited Q2 FY20 Earnings Conference Call hosted by PhillipCapital (India) Private 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 '*' and then '0' on your touchtone phone. I now hand the conference over to Mr. Saksham Kaushal from PhillipCapital (India) Private Limited. Thank you and over to you, sir.

Saksham Kaushal: Thanks, Neerav. Good evening all. And on behalf of PhillipCapital, I welcome you all for Escorts Limited Q2 FY20 Earnings Conference Call. I also take this opportunity to welcome the management team from Escorts. Today, we have with us Mr. Shailendra Agarwal – Executive Director; 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 start the call with a brief opening remarks from the management followed by Q&A. Before we start, I would like to add that some of the statements in today's discussion will be forward-looking in nature. At this point, I would request Mr. Madan to make his opening remarks. Over to you, sir.

Bharat Madan: Thank you all for joining us on the earning call for second quarter ended 30th September 2019. A snapshot of company's standalone quarterly performance is as follows:

Turnover at Rs. 1,323.9 crores against Rs. 1,398.4 crores last year. It's down by 5.3%. This is primarily due to drop in tractor and construction equipment volumes. Tractor volumes went down by 6.1% to 19,750 tractors as against 21,039 tractors last year. Construction volume went down by 29% to 945 machines as against 1,331 machines last year.

EBITDA at Rs. 126.7 crores against Rs. 157.5 crores last year, is down by 19.5%. EBITDA margin now stands at 9.6% against 11.3% last year, impacted by product mix, lower operating leverage and higher manpower costs. Finance cost is down by Rs. 2 crores to Rs. 3.9 crores as compared to quarter ended June '19. The total debt outstanding as of September '19 is Rs. 79 crores, down from Rs. 277 crores in March '19. Net debt however continues to remain negative at Rs. 391 crores. There is an exceptional item of approximately Rs. 9.2 crores on account of an old product liability claim in U.S.A. market that we settled during the quarter.

PBT stands at Rs. 108.7 crores as against Rs. 154.4 crores last year same quarter. The company's standalone PAT now stands at Rs. 104.6 crores versus Rs. 102.7 crores last year due to company opting for lower tax rates from this financial year, that resulted in tax rate gain of the first quarter and restatement of deferred tax liabilities at revised rate amounting to Rs. 23 crores approximately incurring in this quarter. As a result, PAT margin now stands at 7.9% versus 7.3% last year. EPS stands at Rs. 8.75 as against Rs. 8.6 last year same quarter.

Now moving onto segmental business performance:

On Agri machine business, domestic tractor industry volumes went down by 10% to 1.68 lakhs tractors as compared to 1.85 lakhs tractors in previous fiscal same quarter. Our domestic volume went down by 8.6% at 18,789 tractors as against 20,553 tractors in previous fiscal same quarter.

Industry in our strong markets in North and Central India de-grew by 1.8%, whereas industry de-grew by 18.2% in the opportunity markets of Southern and Western India. Our domestic market share stands at 11.2% for the quarter ended September 2019, marginally up over previous fiscal same quarter. Our exports have done well, which grew by 97.7% from 486 to 961 tractors, basically on account of very strong response to ATOM series around the world.

On channel front: We have added net 45 new dealers in India during the quarter, taking total number of dealers to 950 plus. Going forward, we'll continue to expand our dealer network in both strong and opportunity markets. The current channel inventory at the end of October 2019 stands at comfortable level of less than 4 weeks.

This quarter, on account of lower sales and production volume and unfavorable product mix, EBIT margin now stands at 10.3%. Industry in the second half is likely to fare better than first half due to festival season and plentiful rains in most parts of the country, leading to improved farm sentiments on the ground, but lower quantum of construction activity and low subsidy allocation by Central and State Governments continue to affect the industry.

Coming to the Construction Equipment business:

Our served industry, backhoe loaders, pick and carry cranes and compactors de-grew by 30.1% in Q2 FY20. Our total volume including manufactured and traded products in the quarter ended September 2019 correspondingly was down by 29% to 945 units as against 1,331 units in previous fiscal same quarter, leading to marginal improvement in market share. Despite volume drop, EBIT margin improved due to reduced commodity prices, better product mix and price increases to 2.7% for the quarter ended September 2019 as against 0.7% in previous fiscal same quarter. Construction Equipment industry continues to see some slowdown on account of financing issues and delayed payment for ongoing infra projects. However, in the mid- to long-term, we expect that our served construction equipment industry will grow in high single digit.

Coming to the Railway Division:

Revenues at Rs. 126.7 crores, went up by 19.6% as against Rs. 105.9 crores in previous fiscal same quarter. During the quarter, we have executed 42% of the total orders coming from new product category, which are more import content and lower margin as compared to the previous fiscal, when it was only 30%. EBIT margin for the segment now stands at 19.1%. Order book for this division as of September '19 stood at around 500 crores, that will get executed in the next 12 to 15 months. For FY20, we expect the Railway Equipment segment to grow by 15% to 20%, and margins for the segment are likely to be maintained.

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

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Raghu Nandan from Emkay Global. Please go ahead.

Raghu Nandan: Sir, my first question was, how was the performance for tractor industry in the festive season? Which regions, states have supported performance? Do you see the recovery sustainable? And what is your outlook for FY '20, '21?

Bharat Madan: So there's a question from Raghu from Emkay Global, on the festive session, how it has gone and which regions have done well, and what is the market outlook for next year, '20, '21?

Shenu Agarwal: In festive season, we saw some good signs of recovery in the last months, starting with Navratra in September. And April-August industry, as you know, was moving at about 15% down. And September-October industry has still de-grown, but has de-grown only to the extent of minus 5%, right? So there is a significant recovery from minus 15 to minus 5 compared April-August to last 2 months, September-October. And as we continued in the season, actually things got better. So we had some good signs in Navratras and then as we approached Dhanteras and Diwali, I think the momentum was a bit better. Now this momentum we think is going to continue because you know we had a delayed sowing this year, which resulted in delayed harvest, so the natural cycle is also delayed all over India. And therefore, the number at least until the next 2 to 3 weeks should see a good momentum on the region side. In terms of regions, North India, I mean, there were some specific regions which did better than others. But I think except 1 or 2 states in the country, every part of the country saw good cycle. So I think it is slightly inclined more towards North and Central and Maharashtra. I am talking about the recovery, but I think in future, South should also see some good recovery because of the kind of rainfall we have received.

Raghu Nandan: Yes, just 1 clarification. For the festive season, festive this year versus festive last year, was it a positive growth or a marginal decline?

Shenu Agarwal: Yes. So that is remain to be seen because the September, October, November, because Dhanteras and Diwali was in November last year, and therefore we have to complete this November to see how did the overall season fare. But my expectation is that we will still see a strong recovery, although the overall numbers would be smaller than last year season, which I mean by September, October, November combined.

Raghu Nandan: And the outlook sir, what you would see for FY '20, '21?

Shenu Agarwal: It's a little bit too early to comment on it. But I think, let us go through November. But I'm definitely sure that what we have seen in April-August, this was minus 15% down. I think the entire year would be much better than that, maybe negative single digit.

Moderator: Thank you very much. Next question is from the line of Hitesh Goel from Kotak Securities. Please go ahead.

Hitesh Goel: Sir, basically, I just wanted to get a sense on the outlook for third quarter and fourth quarter, specifically. You are saying that it will be still a decline on second half because if I see the base is quite low. So can you just attribute the reasons why there should be a decline because Rabi crop should be very good, right? I mean just wanted to get a sense on just November to March kind of outlook?

Bharat Madan: Hitesh, I think, the response what Shenu gave was not that the H2 is going to be low. He said the overall for the full year, the de-growth is likely to be down to single digit, which is about 5% level compared to the first half, where the de-growth is 10% plus. So actually H2 will be better than H1. But it will probably still be even if it's at a stretch flat, still it will lead to 5% de-growth on a full year basis.

Hitesh Goel: Okay. And sir, last year, you had said that subsidiary sales were only in single digits as per industry per se. So why has that been an important factor this year for tractor demand to come down? I can understand the first half was weak because of delayed monsoon. But in second half, is NBFC is also a big factor that NBFCs are not aggressively taking calls on the tractor side, and maybe a few customers at the margin are getting rejected, which is also a factor? If NBFC situation improves, you could see much better growth. Can you just tell us something about that? On NBFC funding side, what is happening?

Shenu Agarwal: Yes, on the funding side, we had a little bit of a situation with NBFC. I don't think it is going to directly related to tractor industry performance as far as their portfolios are concerned. But I think it was more of an overall scale that the NBFC is going. But thankfully starting this season, there was a real recovery from the NBFC side also, so they went very aggressively to push the market. So at least in the season, we did not see any problems as far as our financing was concerned.

Hitesh Goel: Okay. And just my last question. If you see a strong Rabi crop basically, which is likely, and government has increased MSP also, then what would be your outlook for FY '21? At least first half should be a decent growth because you've seen a very bad base in the first half, would that be a fair assumption to make for FY '21?

Shenu Agarwal: Yes, see right now we are considering 2 scenarios. In both the scenarios, we are saying that the things are going to be far, far better than what we have seen in the last 8-9 months. Now the point we are considering is whether the momentum has really increased from March or whether it will take up to May or June, right? So that is still a kind of question that remains unanswered. But definitely, next year would be far better than what we have seen in last few months.

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

Riken Gopani: Sir, I first wanted to just understand that in your market share performance, I particularly noticed that in markets like UP, there has been some market share corrections that have happened. If you could elaborate any specific trends there? And anything that you would like to attribute that to?

Shenu Agarwal: Yes, see, as we have been talking about our focus, our focus has largely been in our opportunity markets for last 1 year or so. And in the last 2 or 3 years, we have put in significant initiatives in these markets. So if you look at our market share, we have clearly grown an opportunity in these weak markets which is the eastern block and western block and also in some states of the southern block. So that is the focus area. In the strong market, right now, we are trying to maintain our market share, which is already at about 14% to 15% range. And in the opportunity markets, where we are between, say, 3% to 8% range, that is where we are hoping for most of the growth.

Riken Gopani: Also, if you could highlight what is the sort of growth that you're looking at in the exports volume for next year? With the Kubota relationship now entering second year, how do you think things should pan out?

Shenu Agarwal: For next year?

Riken Gopani: And a related thing, if you could update on how the JV with Kubota is panning out? Or if you can share any update on that effect?

Shenu Agarwal: Yes. So on the exports front, I think this year will be a tremendous year for us in exports in terms of growth from the previous year level. So I think the growth should be in the range of 35% to 40%, something like that. And even so far in H1, we had that kind of growth already experienced. So this year would be a good year for exports, and of course, we want to build on that going into future. Because you know that by means of ranking, we are still one of the bottom players as far as exports out of India is concerned, right? But we have been talking about a lot of investments we have made in on products for exports for Europe and other markets, and therefore, those investments, I think will bring some results next year also. Now we have not completed our budgeting process, but please do consider significant growth next year also in exports volume. As far as Kubota JV is concerned, the status is very much same as last year because it has the kind of a gestation period. So we are in the process of building a factory right now. And I think things are going more or less on schedule. The target was to start production around mid of next calendar year. So that should happen on schedule.

Riken Gopani: Understood. And lastly, in terms of the pricing environment if you could highlight, would you characterize that being steady in the tractor market or any specific discounting trends that are existent?

Shenu Agarwal: No, there were some players who indulged in some on and off discounting in quarter 1. But after that, we are back to kind of a steady state, right? So right now, I don't think there is any extra push on pricing that is being made by any one of the players. We are going towards like kind of deflationary environment, but the prices are quite stable.

Moderator: Thank you very much. The next question is from the line of Jinesh Gandhi from Motilal Oswal. Please go ahead.

Jinesh Gandhi: My question pertains first on tractors. In this quarter, we have seen almost 3% Q-o-Q drop in tractor realization. So is that just a reflection of mix or there is anything more to that?

Bharat Madan: You are saying quarter-on-quarter?

Jinesh Gandhi: Quarter-on-quarter, yes, vis-à-vis first quarter.

Bharat Madan: Yes, so essentially, basically, it's on account of mix, so there's no major change. And another reason is obviously this time there's a slight drop in the non-tractor sale actually, so I think which was 10% to 11% range in the last quarter has come down to about 9% in this quarter. So that also has a play because you are looking at a consolidated picture of both tractor and non-tractor revenue in that number. So otherwise, on per realization basis on tractor per se, there's no major change. But on non-tractor sale, definitely, there is some decline, which is reflected here in the realization.

Jinesh Gandhi: Secondly, the rail PBIT decline is again reflection of this higher import content in the new orders or again, anything beyond that?

Bharat Madan: In Railway?

Jinesh Gandhi: Right.

Bharat Madan: Yes, in Railway, it's essentially like you said, Jinesh, this time the mix of new product is almost 42% in the overall orders, which have been executed compared to 30%, which was last year. So that new order book is growing, though in terms of absolute number, obviously we are doing much higher revenue now. But yes, in terms of margin, it's slightly low compared to the normal conventional product which we had. So that, again, is a temporary impact, I think, which will be there for about a year or so. But after that, we expect we should be able to improve on the margin. But even on a full year basis, we are likely to sustain the margin at the last year level.

Jinesh Gandhi: Okay. And what would be the contribution of this new products in 1Q FY '20?

Barat Madan: In FY '20?

Jinesh Gandhi: Right.

Bharat Madan: Yes, in overall, in terms of revenue contribution, there will be almost 40% to 45% range.

Jinesh Gandhi: Sorry, my question was for 1Q FY '20, what was contribution, first quarter?

Bharat Madan: First quarter was 34%.

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

Mitul Shah: Sir, my first question is on the product mix in the tractor segment, which impacted our ASP as well as the profitability to some extent. So can you give exact detail in terms of Powertrac versus Farmtrac ratio? And whether this similar product mix continued in the month of October, and what would be the situation going forward?

Bharat Madan: See, between Powertrac and Farmtrac, if you look at this quarter, it's almost 41% sales coming from Farmtrac and 59% coming from Powertrac. And really, if you compare it with the last year same quarter, it's about 38% for Farmtrac and 63% for Powertrac. Though in October, the share of Farmtrac has slightly moved up, so the mix is slightly better in October compared to what we have seen in the last 6 months.

Mitul Shah: On full year basis, FY '19, if you can give a similar number for Powertrac, Farmtrac?

Bharat Madan: Roughly 40-60 ratio on a full year basis.

Mitul Shah: So going forward, this would not change much?

Bharat Madan: Not much change.

Mitul Shah: So second question, sir, you highlighted that whether recovery would happen from March or it maybe from the June, July. So in both the cases, there is then possibility that next year number would grow from the FY '20 level. So in this situation, in past, we have observed that cyclical downturn last for 2 years at least, just a decline for 2 years, then it starts growing. But in this situation, then it will remain negative only for 1 year during down cycle. So do you expect recovery much ahead of the normal cyclical downturn this time because of various economic factors or including monsoon you highlighted?

Shenu Agarwal: Yes, Mitul. See, actually, the slowdown started from last year only, like November, maybe October, November onwards. And then some of the competitors also reported that last year Dhanteras, Diwali was not as per the expectation, right? So actually, on ground, the slowdown was there since October onwards last year. So if the recovery or the growth starts happening from let us say June, then firstly, it will be about 18 months of slowdown. The second thing is like you said, right, that the monsoons have really helped this quick turnaround because right now the water reservoir levels has raised, most of the parts of the country has received excess rainfall. And I have been personally, like, traveling just a lot because of the season. And I have personally talked to customers and the sentiment is really good. And they are really expecting bumper crop and they are very positive about the future, at least next 2 years or so.

Mitul Shah: So positive monsoon of this year would have a positive impact for next 1, 1.5 year kind of situation, right?

Shenu Agarwal: I think at least 3 crop cycle.

Mitul Shah: Last question on the Construction Equipment side. Our breakeven point is down significantly and right now it has reported positive EBIT. So what would be the new breakeven according to this new structure of the cost as well as ASP and product mix?

Bharat Madan: So this year, we expected to be somewhere around 280 to 300 machines a month, average.

Mitul Shah: Sir, what is your view on this in terms of next 2, 3 years point of view on the volume as well as on the margin side? Once the industry, right now it is declining, once it starts recovering, what would be your margin target for that?

Bharat Madan: So like we've said, our long-term margin target on this has been high single digits. So we've been targeting to reach a level of 8% to 9% margin on this. So this year, right now, we are at less than 3%. And we expect probably on a full year basis will be somewhere around 4% sort of margin. But yes, the idea is to target 8% to 9% sort of margin in the next 2 to 3 years' timeframe.

Mitul Shah: So you see Q3, Q4 margins much better?

Bharat Madan: That's the normal trend. I think if you look at the last 2 years also, normally second half is better for the Construction Equipment industry. But obviously this time it lot depends on how the financing issue really pans out and how the NBFC respond to the situation. That's been one of the bit of a challenge right now for the Construction Equipment industry. And second also in terms of the funds which are stuck with the government for various infra projects. If the money gets released, then we will see probably good revival. So demand is there in the market, but the issue is the liquidity is released.

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

Ravi Yeolekar: Sir, my question was on Construction Equipment segment. We have seen significant improvement in realization sequentially in the Construction Equipment for the last 2 to 3 quarters. So I just want to understand what's the current product mix? And is it sustainable, this realization?

Ajay Mandahr: It is a combination of the realization, which is coming out of the product mix, the cost initiatives that we have taken inhouse. And we feel that going forward, probably the product mix will become even better in terms of realization per product. So as Bharat has said, even this coming 2 quarters, it should be improvement definitely and we are all working towards bringing down our cost breakeven point to come down, and that will be the trend that will follow for some of that.

Ravi Yeolekar: Sir, what's the current product mix in terms of cranes, backhoe loaders and compactors?

Ajay Mandahr: 70% is cranes more or less, and then you have the backhoes and compactors going in tandem. So 74% to be precise on the crane side. And out of that, 50%-51% is of high-value products, high-end cranes.

Ravi Yeolekar: Right. And sir, on this Doosan Infracore partnership, so how is it going and what's the current contribution in terms of volume mix on the Doosan?

Ajay Mandahr: So it's basically a niche product for us. It's a high-value product, which we are competing on the top of the market in terms of price. And there is element of foreign exchange as well that plays a role in the game that we play, because most of the manufacturing has been always globalized by the competition in India. So we have our niche play and that too in the mining sector. So because of the monsoons that we had, heavy on Rajasthan side, these numbers were less, but now we are seeing that uptrend coming in, so we should be able to sell a good value there.

Ravi Yeolekar: Could you just indicate this volume mix in percentage?

Ajay Mandahr: In the excavator?

Ravi Yeolekar: Yes.

Ajay Mandahr: In terms of Doosan, as a percentage of revenue you are talking about?

Ravi Yeolekar: In terms of volume or revenue?

Ajay Mandahr: 5 to 6% in revenue.

Moderator: Thank you very much. The next question is from the line of Amit Goela from Rare Enterprises. Please go ahead.

Amit Goela: I have just one question, could you throw some light on the inventory situation now, like we have always been hearing that the inventory situation is quite difficult, so could you throw some light on that and we saw that you generated a fair amount of cash? Could you throw some colour on that also?

Shenu Agarwal: Amitji, I will respond on the inventory and may be Bharat respond on cash. The October or us especially was really a very good month because we had all-time high monthly record on both our deliveries and releases and with that momentum that we could generate, our inventory is actually at a very optimum level right now, both the company inventory of finished goods and also the dealer stocks. Actually, I think in terms of dealer stocks, Escorts is placed best in the industry right now in terms of number of days of sales, which means that we did the vehicle stocks a little bit in September because of the festive season that we have to only correct it now in October. So on the inventory, we are fine and October definitely was a record month for us in the entire industry of the country.

Amit Goela: That is very encouraging Shenu and what about the cash situation now? That must be reasonably liquid now, no?

Bharat Madan: Yes, so I think if you look at the cash flow also, I think, this time, the cash from operation has been almost 300 crores positive this time compared to the negative situation last year. So last year, we were building up inventory, expecting a very good season going forward too. So this time, obviously, a lot of collection has happened. So even in the first 6 months, the production compared to last year is down by almost 24%, even though the sale has been down only about 10%, but there is a sharp cut which has been taken in the production side to be cut down on the inventory levels. So that is what reflected in the margin too, which has actually got impacted in the first 6 months but in terms of cash flow, I think situation is pretty good as of now.

Amit Goela: So, Bharat you are expecting some recovery in the margins in the second half?

Bharat Madan: Yes, so we expect some margin recovery to happen now because going forward on the inventory units like you said at the end of October, we are sitting at only less than 2 weeks of inventory within the company and less than 4 weeks of inventory within the channel. So overall, institutional inventory is pretty good, so going forward, if the market really recovers or even if it is a flat market, we expect, I think, the overall margin improvement will happen in the next 6 months in this second half basically.

Moderator: Thank you very much. Next question is from the line of Mayur Malik from India Nivesh. Please go ahead.

Mayur Malik: Just trying to understand the operating efficiencies, so we have seen Y-o-Y volumes were down 6% but we have seen the operational efficiency get hit by more than 200 bps, so despite your gross margins improving significantly, we could not really see that benefit coming into the EBITDA margins, some light on that?

Bharat Madan: Yes. So like I said, when the sale is rebel, has a decline, which is only 6%, the production decline has a steep, which is 19% in this quarter. So that obviously led to the inventory correction, which is I think reflected in the cash position also because overall operating cash has actually improved significantly. So we did correct inventory in this particular quarter also. It is a 19% reduction, so over and above the 6-month sale decline which happened, so effectively, we did 13% more production decline to really maintain our inventory levels at a reasonable position. So which is what has impacted roughly 2% margin on account of production cut, which got undertaken in this quarter. So which is why we are saying going forward, we expect the recovery margin to happen in second half.

Mayur Malik: So this should ideally mean that the benefit of lower raw material will continue along with operating efficiencies coming back?

Bharat Madan: That is right.

Mayur Malik: And secondly, just wanted to know how is the trend in the horsepower, so are we selling more of the 40 plus as the trend was in the past or you have gone back to doing the 30, 40 HP more because of focus more on the agri side?

Bharat Madan: So I think like we mentioned, I think the big sales are slightly negative if you compare really with last year. So last year, our less than 40 HP sales was roughly 51% and more than 40 was 49%. So the trend got slightly adverse this year, with less than 40 HP has gone up to 55% and more than 40 HP has gone down to 45%. The 4% adverse change has happened in the mixed store front. And obviously, the major change has happened in the less than 30 HP segment, where the margins are low. So that is another factor which impacted the margin, even though we did a lot of cost initiatives to make up that shortfall in the mix but still that is one factor which has been impacted compared to last year.

Mayur Malik: So would this also be because construction activity has been low, so ideally just want to believe that assuming that people would pick up higher HP for multipurpose use including construction, so could that also be a reason why we have seen sales of the 50 plus not really picking up in the recent past?

Shenu Agarwal: No, I think the fact that construction activity was very slow in the first half, but they did not really impact the way the HP segments move because 31 to 40 was same in terms of industry weightage and also 41 to 50 was same, right. So although that is a fair assumption to make that construction would have impacted this, but it hasn't. I think in our case, lower than 40 HP sale is kind of by design because we did launch some new models in this category, especially the Compact Series, which is actually doing quite well and our market share in 21 to 30 has more than doubled in H1 compared to previous year H1. So we were absent in that market and we were leading a large chunk of the market and handle the competition and that is why we designed the tractor which has been received very well. Now of course, margins are lower in this new range, but we are working towards it to raise the margins as we go along.

Moderator: Thank you very much. Next question is from the line of Dhaval Shah from Girik Capital. Please go ahead.

Dhaval Shah: Just one question from my side, sir what were the subsidiary driven sales at the industry level for the first half? Last year there were some 70 to 90,000 tractors were sold on the subsidiary?

Shenu Agarwal: Yes, the first half was a little subdued. I don't have the exact numbers first half versus previous year's first half right now but right now, it has been quite subdued so far and the main reason was mainly, like, elections because of which a lot of funds got sweat out for some time separately but in the second half, we are seeing some momentum or expecting some momentum from markets like Assam, Telangana and a couple of other markets like even Maharashtra and Gujarat, so I think probably we will be maybe 5 to 10% overall in subsidiary sales at an industry level. That it should catch up in H2.

Dhaval Shah: In Gujarat, the subsidiary was supposed to start from July onwards, I think that is what we discussed in one of the two previous calls, so has the subsidiary started? You are seeing any volume impact?

Shenu Agarwal: Yes, subsidiary has now started in Gujarat on the scheduled date of July 1. So Gujarat will see some buoyancy because of that but as I said, Gujarat is very steady on subsidiary and every year, pretty much it starts around June or July.

Moderator: Thank you very much. Next question is from the line of Shrinivas Seshadri from MiRabilis Investment. Please go ahead.

Shrinivas Seshadri: Sir, I have one question regarding this emission norms change from the next year, I think about a year away from now, so broadly, if you can help me understand, basically what will change in terms of the Indian part? And secondly, your own preparedness in terms of the coming out with the product well in time and also, what kind of economics it would mean for the buyer? And whether it can result in a meaningful pre-buy for the tractor industry per se?

Shenu Agarwal: Yes, first of all, let me clarify that the new emission norms which are going to be applicable from 1st of October next year, this is the current schedule date. This affects only the tractors above 50 horsepower, which is right now only about 7% of the total market. It may not have a hugely significant impact on the overall industry because the volumes affected will be only 7% to 8%. Secondly, of course, there will be some change in the bandwidth as the cost of the tractor or the price will increase in the range of let us say 1 lakh or upwards on the current base price of 6.5 lakhs to 7 lakhs. So there would be about, let us say, 15% kind of impact on the price of the tractor. So there will be some change of bandwidth about 50 horsepower, so some customers may then prefer to buy lower than 50 horsepower tractor. On this, there will be no addition new emission norms or they may even go up and buy 60-65 horsepower tractors to justify that additional cost with some extra power they have received. So in terms of our readiness, I think we are completely ready, although the market will take time to adopt this new technology. The automotive industry is getting familiar with it, as they are already through this kind of norms and this kind of new engines, which we call CRDi engines. So generally, customers at least through all automobiles, they are familiar with it, right? So it won't be, I think, much of a challenge but definitely, there would be some change in the market dynamics in the higher HP.

Shrinivas Seshadri: And sir, for the below 50 HP, is there any timeline around this change in the emission norm sir?

Shenu Agarwal: There is no scheduled date yet, it is still under discussion with the government.

Shrinivas Seshadri: Sir, just one question on the railway segment, you mentioned that you have a higher share of credit because of the dip in demand to the new tech products, so is there any plan to localize that and what kind of timeframe are you looking at to again bring it down for that?

Dipankar Ghosh: Yes, we have a very targeted localization plan for all the import content what we have but as you would appreciate in this government safety business, where you have a lot of field validation trials and all the stuff before you can actually do a localization, so we have already localized some of the products. They are, as we speak, are going out for the field validation trials, so that is why we are saying it will take a year or so to do the localization because in railways, there are 2 parts of the localization. One is the physical localization of the product and the second part is the trials and testing in the field. So that helps us to be competent. That is why we are talking about a year's timeframe from now.

Moderator: Thank you very much. Next question is from the line of Naveen Kumar from Bandi Investments. Please go ahead.

Naveen Kumar: Sir, we are holding Coffee Day, what about Coffee Day, we exit or hold it?

Bharat Madan: I think this is wrong question raised to us, so maybe you need to, I believe you are on the wrong call.

Moderator: We move on to the next participant. The next question is from the line of Hitesh Goel from Kotak Securities Limited. Please go ahead.

Hitesh Goel: Sorry sir, I just missed that point of one gross margin expansion on Q-on-Q basis, so how much of the commodity cost benefit has come through on a Q-on-Q basis and how much is more likely to come through because steel prices have come off quite a bit?

Bharat Madan: Hitesh, I think the major benefit for the steel prices actually is on the Construction Equipment segment. We were seeing some positive movements, so almost 1% improvement has actually happened because of the commodity prices over last year. Though on the tractor side per se, the benefit has not been much because we don't really buy much of steel there. So it is more like costings and forgings which we really have bought, where the impact has not been much and also the rubber side, we are seeing some price escalation happening. So while some impact has been there favourable in the last 2 quarters on the material cost side, so where we are seeing about 0.3%-0.4% sort of benefit coming in on the commodity prices side and going forward, we expect the same will get sustained, so we don't expect anything significant to change really in the third quarter on the commodity front.

Moderator: Thank you very much. The next question is from the line of Bharat Gianani from Sharekhan. Please go ahead.

Bharat Gianani: Sir, I heard your comment on the previous question that for FY21, you are expecting tractor industry to grow, so have I heard it correctly and what could be the reasons for the same if you can highlight?

Shenu Agarwal: Yes, so you heard it correctly, that is what we are actually mentioned right now. As I said, the customer sentiment has been very positive right now. The monsoons have been much better than expectations and quite even the spread also throughout the country and based on what we are seeing at the ground, we think that this momentum will continue to increase. I think on the financing side also, there are no major threats right now and we have actually seen some improvements in the last 2-3 months. If you look at the industry scenario also, April-August minus 15 to September to minus 5 is a very positive sign. So we do think because of these reasons and some others, we will see some growth in tractor industry next year. We have to quantify right now. I think we should wait another 60 or 90 days to put a number on it.

Bharat Gianani: So it is fair to assume that it will be single to mid-single digit kind of growth if the November sort of that sentiments continue to sustain?

Shenu Agarwal: May be on the next call, I can confirm that.

Moderator: Thank you very much. Next question is from the line of Raghu Nandan from Emkay Global. Please go ahead.

Raghu Nandan: What would be the breakup of CAPEX across segments, in terms of the segmental effect changes, railways capital employed seem to have grown faster than other segments?

Bharat Madan: For railway, there are 2 unique reasons. I think other than CAPEX has not been much really on railway side. I think one of the issues in railway is because from this year, all the tendering process, the government has shifted from, earlier they used to accept the bank guarantees as earnest money and now they have shifted it to cash basis. So that has led to some accumulation on the tender money really with the railway, so which clearly will take some time to before it really comes into the cycle. So we have about 25 crores to 30 crores, which is now stuck in the earnest money deposits if you see in the first 6 months. The second issue which railway had was on the GST accumulation. If you remember, in the railway parts, the output is taxed at 5%, it used to be taxed at 5% and your input costs were much higher and there was no provision of any refund against those input taxes but recently, the government has shifted the tax rate from the railway products also from 5% to 12% based on the representing from the industry lobby and now going forward, we expect that the accumulation will not be there but whatever has happened in the last 2, 2.5 years, which is roughly 25 odd crores, so that will be get utilized over next 12 to 18 months. So hopefully going forward, we will have a better capital employed in the railway business coming down compared to what we have seen in the last maybe 6 to 9 months.

Raghu Nandan: Sir, another question on the debtor days that is roughly about 50 days, how do you target reduction ahead?

Bharat Madan: So obviously, like you said, September, since we are looking at the big retail season, which happened in October, so there was a buildup of inventory, which happened, which led to some increase in the receivables, so October situation has been pretty good actually, so we had a record cash inflows in October month. So this is one of the highest retails which happened really on the tractor side too. So obviously, the debtor days as we move to third to the end of December period, we will have a much better visibility and the days would have actually coming down to a normal level, which used to be about 35 to 40 days range.

Raghu Nandan: And for the tax rate, given the deferred tax benefit, full year tax rate should be around 23 to 24%, would that be a fair assumption or much lower?

Bharat Madan: Effective tax now because earlier, our ETR was about 32% plus, which will be now down to 25% plus, which is there and obviously, there is a onetime benefit from the deferred tax liabilities, which is about 14 crores which you have already taken in this quarter. So yes, on a full year basis, I think it will be somewhere close to 23%-24% this year but going forward, it will get stabilized at 25% plus.

Moderator: Thank you very much. Next question is from the line of Sabyasachi Mukherjee from Centrum Portfolio Managers. Please go ahead.

Sabyasachi Mukherjee: Couple of questions, first of all, can you help me understand the retail sales during quarter 2 and as well as the festive season during October?

Shenu Agarwal: Yes. So, festive season retail sales, we have a record in October and even September-October combined, it was much better and yes, I mean, retail scenario is actually better than the current scenario. I think we don't share retail numbers; therefore, I will restrict the comment to this right now, but if you may want to…

Sabyasachi Mukherjee: If you can specify the quantum of Y-o-Y growth probably festive to festive?

Bharat Madan: Yes, I think the festive season last year extended till November, so it will be long to compare, really we are still in the middle of the season. So we can't really give the number when the November is still running. So for the first 2 months, definitely, we have seen growth in the retail but obviously, since the November this time is not a festive month, so it will be wrong to give comparison based on just 2 months performance. So we will rather wait for November to be over and then look at the entire festive season of September to November, which will be a real indicator. So as of now, I think it will be more misleading if people tell you about a growth pattern, but they are in growth across the industry, but that is because of preponement of the festive season to October. So let us wait for another month, and then for the combined 3 months, we can definitely share the number, how the retail is looking like.

Sabyasachi Mukherjee: And secondly on the subsidy status, last time when we spoke at the Q1 call, you said there are large subsidies awaiting in Assam and probably something is expected in Telangana as well, how has that come up or should we expect something in Q3?

Shenu Agarwal: Yes. So both Assam and Telangana are expected to start in Q3. Telangana, in fact, has already started moving a little bit in the last couple of weeks and Assam also, we should have a final decision around end of this month, so I hope surprise starts from December or January onwards.

Sabyasachi Mukherjee: And anything on Maharashtra?

Shenu Agarwal: Maharashtra, the subsidy is ongoing. There is no date or new scheme yet. There are some discussions underway within the government, but nothing specific yet.

Moderator: Thank you very much. The next question is from the line of Priya Ranjan from Antique Stock Broking. Please go ahead.

Priya Ranjan: One is on the, what will be the share of non-tractor revenue in the overall tractor segment? And how it has been moving because for last 2 to 3 years or the last 2 to 3 quarters when the entire downturn has happened?

Bharat Madan: In this quarter, the non-tractor revenue is about 9% and it was about 10.7%-10.9% in the last year and in the previous quarter, so historically it has been in the range of 8 to 9% but we have been trying to focus on this particular segment to improve going forward, so but this quarter obviously there has been some impact on the demand side, but we think in the full year basis, it will get made up but we will be back to 10 to 11% sort of revenue on this full year.

Priya Ranjan: So entire farm distress or whatever you want to call it or entire tractor industry declined for last one year, how do you see, I mean this revenue was also or this equipment business has also suffered significantly in terms of downturn?

Bharat Madan: Yes, if the agricultural activity gets impacted, then definitely your other revenues and the spare part implement also gets impacted, so that is obviously the direct correlation over there.

Priya Ranjan: But I mean the tractor is still significantly penetrated compared to the other farm equipment implement etc., so there you have more of a penetration gain as well, so ideally this would not have too much of impact because you might be getting some sale as well?

Bharat Madan: Yes, that is the thing. In the long term definitely, we expect this segment will continue to grow which is also our aspiration if you look at even vision 2022 document, so it talks about the growth coming in from the non-tractor segment which includes your engines, implements and spare parts, so that will be long-term trend but in the short term on quarter to quarter basis, if we really try to compare on 1 to 2% movement here and there can happen.

Priya Ranjan: And in terms of the construction equipment business, if I look at this year, this quarter of first half, the crane business has been significantly, so if the backhoe loader which is more of a road construction and other parts, so that business starts picking up, then how do you see the margin panning out because that is one segment where the problem is in terms of profitability?

Ajay Mandahr: Our focus for this year is to have, we are focusing on EBITDA margins that is very important for us and we are not chasing the market share per se if you ask me, so that will be the objective as we go along this year and the next year.

Priya Ranjan: So we are kind of avoiding market share in the backhoe loader or we want to just keep some contract where we can't make money, is it what we want to go?

Ajay Mandahr: On the niche market side where you have the aggregate handling or money applications, so that segment is the segment which gives us the right kind of remuneration, so that segment will focus and the retail segment, the competition is very stiff and discounting happens, there we would tend to pick and choose.

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

Sameer Deshpande: It is nice to see recovery in the volumes in the last two months and despite the very high base which we had, we have been growing by at least 2 to 3% over that and now after hearing this festive season sales etc., do we expect to have some modest growth in the second half in the tractor volumes over the last year?

Shenu Agarwal: Yes sir, we have yet to see but definitely, we are sure about one thing that September-March industry will perform much better than April-August.

Sameer Deshpande: Because I think you mentioned that at the end of the year, it is likely that the volumes can drop by about 4 to 5% compared to the last year, so if you derive the figure?

Shenu Agarwal: The estimate will be available on combined basis, but on full year basis, we are expecting a single digit negative growth.

Sameer Deshpande: Single digit?

Shenu Agarwal: Negative growth for the full year because April-August was already minus 15, so even things have improved September last year. I would still think there would be some negative growth for the entire year.

Sameer Deshpande: So from that if you derive the half 2 volumes the last year volumes were 51,000 odd so it seems that you will be in a position to hold on to those levels?

Shenu Agarwal: Let us see, we also hope to do our best and definitely better than the industry.

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

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

Moderator: Thank you very much. On behalf of PhillipCapital (India) Private Limited that concludes this conference. Thank you for joining us. You may now disconnect your lines. Thank you.