"VST Tillers Tractors Limited Q2 FY-19 Post Results Conference Call"

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MODERATOR: **MR. ANNAMALAI JAYARAJ – BATLIVALA & KARANI SECURITIES INDIA PRIVATE LIMITED**

Moderator: Ladies and gentlemen good day and welcome to VST Tillers Tractors Limited Q2 FY19 Post-result Conference Call hosted by Batlivala & Karani Securities 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 '*' then '0' on your touchtone phone. Please note this conference is being recorded. I now hand the conference over to Mr. Annamalai Jayaraj of Batlivala & Karani Securities India Private Limited. Thank you and over to you sir.

Annalamalai Jayaraj: Thank you. Good afternoon everyone. On behalf of B&K Securities welcome to 2Q FY19 Post Post-Results Conference Call of VST Tillers Tractors Limited. We have with us today Mr. K. U. Subbaiah – Chief Executive Officer, Mr. P.M. Keshava – Chief Financial Officer and Mr. Chinmaya – Company Secretary. I would now handover the call to Mr. Subbaiah for his opening remarks and to be followed by the question and answer session. Over to you Sir!

K.U. Subbaiah: Good morning everybody and thank you all for participating in this investor call. I will give a brief summary of Quarter 2 performance as well as the first six month's performance.

Power tiller sales is down by 8.4% in Quarter 2 compared to the same period of last year and 17% lower in H1 compared to the same period last year. The lower sales numbers are mainly due to the delay release of subsidies allottments in states like Karnataka, Andhra Pradesh, Maharashtra and Gujarat. Tractor sales are down by 33% in Quarter 2 over last year same period and 29% lower in H1 of 2018-19 compared to the same period last year. Once again the major reason is the delay in subsidy allocations in Karnataka and Andhra Pradesh. However the other important factor is a nonstarter of subsidy allocations for 10,000 tractors announced by Maharashtra government at the beginning of the financial year. In addition the declaration of drought in major regions of Maharashtra and Gujarat has impacted the sales in Quarter 2.

The operating profit in H1 declined to 8.15% from 11.82% in H1 of 2017-18. The drop in operating profit is due to lower sales volume reducing the contribution margins by 17 crores. The manpower cost went up by 3 crores for the Company in H1 on account of the annual salary revisions. In addition, there has been one-time expenses towards Golden Jubilee function of the Company, inauguration of the new tiller plant at Malur and expense towards channel partners conference at Macau. The power generation cost has increased due to increase in fuel price and the electricity board tariff as well. The warranty cost in tractor increased due to product related issues in new launches, additional amount was spent towards repair and maintenance of critical machines at our component plant in Mysore. The operating profit in Quarter 2 is lower than Quarter 1 due to the reasons mentioned above other than the Golden Jubilee function, plant inauguration and channel meet which happened during Quarter 1. Provision of 3 crores due to non-moving spare parts impacted the material cost in Quarter 2 in addition to regularization of the commodity price increases passed on to the suppliers. In Quarter 2 the provision towards CSR expenses. Distribution and freight costs were much higher in Quarter 2 compared to Quarter

1 due to the region of freight rates and additional premium freight to accommodate sales requirements of new models varies. The overall tractor industry in Maharashtra declined by 10.5% in first half of the year while the 0 to 20 HP segment declined by 39% and 21 to 30 HP declined by 6.2%. VST market share in 0 to 20 HP segment is 50% which has had a dent on the sales numbers in Maharashtra.

I'm very happy to inform that we have launched the higher Horse Power tractors into the market in Quarter 2 the VST Shakti Branson 47 HP, Viraj series 39 HP, 45 HP and 49 HP V.

Thank you all

Moderator: Thank you very much Sir. Ladies and gentlemen we will now begin the question and answer session. We have our first question from the line of Ramkrishnan Seshan from Spark Capital.

Ramkrishnan Seshan: Could you help us with the revenue breakdown between power tillers, tractors spares and for the quarter?

P.M. Keshava: Power Tiller value is Rs.70 crores and Tractor Rs. 53 crores.

Ramkrishnan Seshan: This is for the first quarter you said?

P.M. Keshava: Yes.

Ramkrishna Seshan: Quarter two as well please.

P.M. Keshava: Tillers Rs.72 crores and Tractor Rs.58 crores.

Ramkrishnan Seshan: These figures of power tillers and tractors would also include the ancillary spares for tractors and power tillers?

P.M. Keshava: No, it only includes the products.

Ramkrishnan Seshan: So the balancing figures both then these spares because….

P.M. Keshava: In tractors it will be spares, in power tillers segment it will be other trading goods like RTP, Reapers and power tiller spares and other items.

Ramkrishnan Seshan: Could you also give us the granular breakdown of the subsidy situation in three power tiller states and thereby your prognosis for power Tiller volumes for FY19?

K.U. Subbaiah: No, I mentioned in my summary earlier that the subsidy allocations in Karnataka, Andhra Pradesh, Maharashtra and Gujarat delayed which impacted the tiller sales. In Karnataka it was

delayed because of the new government order for the mode of payment of subsidy which was announced in September. This process has started and we expect that it will get streamlined in a few weeks where in the second half of the year we expect that whatever volume's we lost in the first half of the year will be made up in Karnataka. In Andhra Pradesh they have gone in for online DBT wherein the subsidy gets paid to the dealer. While the government promised that the subsidy payments will get paid in less than 15 days, the reality is that whatever we supplied since July the payments are yet to come from the government to the dealer. In Maharashtra the subsidy has been announced in few key districts so the tillers sales have started happening now from the month of October. And in Gujarat the subsidies came for the second half of the year, will start from November. With all this thing we believe that we will be able to significantly cover up our lost sales of tillers in the first half of the year during the second half of the year. While in case of tractors once again the same situation in Karnataka where the government order was released in September so we just started regularizing the deliveries in Karnataka. Andhra Pradesh the movement is good so we expect numbers to catch up in Andhra Pradesh and second half of the year. While in Maharashtra is the biggest hit for VST and as I mentioned in my call that the compact segment 0 to 20 HP segment which is the main breadwinner for VST, the industry dropped by 43%. Added to that the government announced subsidies scheme at the beginning of the year for 10,000 tractors which was not there in Maharashtra earlier. However till date they have not released any allocations for these tractors. So with that we believe that in tractors is difficult for us to catch up entire lost numbers but definitely second half we would see better numbers which will make up for the whole year.

Ramkrishnan Seshan: So keeping all these in mind would like to give some guidance of the kind of volume that you expect for FY19 is a whole, power tillers and tractors?

K.U. Subbaiah: Power tillers I would say that we will be reasonably closer to the last year number. While in tractors I would say that we may be about 10% to 15% lower than the last year numbers.

Moderator: We have a next question from the line of Arjun Khanna from Kotak Mahindra AMC. Please go ahead.

Arjun Khanna: My first question is in terms of FY19 why you have spelt it out how is FY 20 looking up given that we are looking at launching a slew of new tractors also and how is the product pipeline looking?

K.U. Subbaiah: Even this year we expected good sales except for the fact that we got badly hit by the nonstarter of subsidy allocations. Hoping that next year the rainfall will not play a spoilsport and the government allocations also will come on time. I expect that next year we should see reasonable growth. I don't see issue because we have enough products in the pipeline. We launched the higher horsepower tractors; the Branson 47 HP followed by the 39, 45 and 49 HP, the Viraj series. These tractors we should be able to sell in good numbers. And the 27 HP product issues

has all been resolved so we expect good sales happening in 27 HP as well. So with all these positive things happening we believe that FY20 should be a good year to us.

Arjun Khanna: In terms of our new product launches, so for the previous quarter Quarter 2 what would be the number of tractors sold in the non-compact segment?

K.U. Subbaiah: We sold totally 25 tractors till date and about 6 tractors of Branson.

Arjun Khanna: And what would our plan be for the remaining of second-half FY19?

K.U. Subbaiah: Actually the market demand is good. We plan was to sell at least more than 700 tractors.

Arjun Khanna: You had mentioned that Maharashtra had announced a 10,000 tractors subsidy scheme. Has it not been rolled out at all till date?

K.U. Subbaiah: No, it has not been rolled out at all till date. They announced by end of March and even till date they have not ruled out a single tractor. But the farmers are still waiting hoping that the government will release the subsidy allocations.

Arjun Khanna: Could you just help us with the inventory situation currently in tillers in tractors?

P.M. Keshava: We have 3047 nos. of tillers and 1503 nos. of tractors as stocks.

Arjun Khanna: The total value?

P.M. Keshava: The total value of the inventory is around 180 crores as on date.

Arjun Khanna: FG?

P.M. Keshava: FG stock value is Rs.80 crores.

Pankaj Tibrewal: This is Pankaj Tibrewal. Just one more additional question I would like to chip in. If you look at your longer term trend since FY15-16 you used to operate at 17%-18% margins and that has gradually been coming down as in every year you have been talking about margins coming back to that 15%-16% and higher. But something or the other is always hitting you, either it be supply-chain or the demand or the raw material. One thing that we have noticed is your staff cost has gone up again in the first two quarters and it's in double-digit now which used to be 7%-7.5%. Can you help us understand what are the controls you are taking on your cost management side and when do we see margins, what will be the margins on a more sustainable basis?

K.U. Subbaiah: First of all you have to realize that commodity prices have severely impacted not only VST but all the manufacturers. The commodity prices have gone up by almost 2.5%. That has made a

major impact on our margins which we had not envisaged during last year when we said that we are going to spring back in our margins. Secondly, the contribution margin has come down because of the volume reduction if you look year-on-year itself ours sales top-line has come down by almost 70 crores that is because of the tiller and tractor sales both been lower on account of the subsidy related issues. Three, the manpower cost is planned manpower and it is not like it has gone out of control. You are aware that we have been investing more than 250 crores towards infrastructure and new product launches. Unfortunately the market did not support us on account of drought in Maharashtra, in Gujarat and non-starter of subsidies schemes in various states. The headcount additions have happened only in critical functional areas like product engineering and sales and marketing. There have been some extraordinary costs in Quarter 2 as I mentioned some repair cost and spare parts cost for our critical machines in Mysore which is one time which will not recur. And the freight cost has been abnormally high in Quarter 2. Lot of expenses which you have seen in Quarter 2 which are one time which will not recur in second-half of the year and with that we believe that our margins will definitely shape up to be better in second-half of the year.

Pankaj Tibrewal: But that we're assuming commodity prices remain where it is and currency doesn't depreciate too much, do you think for the whole year you would be near about last year's margin or is it something which is very difficult?

K.U. Subbaiah: Given that the commodity prices have gone up much beyond what we expected because even as on date the commodities are increasing. I suspect very much if we will be able to meet come close to last year's margin. But we are on the job to see that the margins are not eroded provided we are able to catch up with the volumes in second-half. I think that is the key. If we are able to get the volumes what I spoke off in earlier than I do not see that there would be any disappointment on the margin front.

Moderator: We have a next question from the line of Viraj Kacharia from Securities Investment Management. Please go ahead.

Viraj Kacharia: And in terms of us incrementally going more into the above 30 HP space in terms of launches since bulk of the launches are focused on those HP areas then how are we looking when we are saying we are looking to scale those products, how are we thinking going about with the scale up?

K.U. Subbaiah: The next launch is the 30 HP product. The field trials are already in progress. We have made couple of prototype tractors which are being validated. Our 39, 45 and 49 HP we delivered 25 tractors which have been well accepted in the market and we believe that is an area where we can see very good growth rate once we ramp up our production volumes. So we believe that the greater than 30 HP segment will be another major revenue boost up for VST in the coming years.

Viraj Kacharia: In above 30 HP is price the strategy to gain volumes or what is the overall value proposition when we go to farmers in terms of selling the product?

K.U. Subbaiah: It's the brand image what we have. Most of the farmers who buy our big tractors are also our customers in the small tractors and the compact tractors so they have seen value in VST tractors in terms of maintenance, in terms of the service support what they get from our team and they are eager to have another bigger tractor in the same brand rather than going for a different brand. So these are one type of customers who will buy our brands and there are other types of customers who are willing to challenge and buy VST products because they have heard of VST brand, price competitiveness and service support. So the value proposition is there for them in terms of price, in terms of the quality of the product, in terms of the ruggedness to the product and in terms of the performance of the product.

Viraj Kacharia: If we look at the quarterly results, in the notes we have highlighted there is certain amount of around 3 crores which is pertaining to certain fraud which is committed by certain employees. So if you can elaborate that what exactly happened and what kind of controls we have now in place so….?

K.U. Subbaiah: Yes, during April of this year our CFO during one of the approvals for payment into the bank, he noticed that the certain payments going in the name of a particular employee and quite significant sum. Upon scrutiny we have found that this particular employee was working in the finance department and he used to create fictitious bills and transfer the money to his own account or to his relatives account. So in the initial finding it was observed that this employee had manipulated almost about 37 lakhs of rupees. Subsequently we informed the board of and the audit committee and they recommended that we get a forensic audit done. Upon detailed forensic audit we found that the financial embezzlement was almost to the extent of 3.54 crores including this 37 lakhs. This has been provided during this quarter. Internal processes have been strengthened to ensure that such incidents to do not re-occur. Moreover by April or May of next year the new ERP system SAP S/4 HANA will get implemented and with that we believe that the controls will be 100% foolproof.

Viraj Kacharia: If we look adjust the other expenses in this quarter even for those one offs and the provision we made we still have seen a growth in other expenses. Now typically in the past we have been making higher investments either in branding, marketing or providing additional incentives to dealers to move to a tighter credit cycle. But considering the market environment and other things we've still not seen a moderation in those expenses. So how should one look at those expenses going forward?

K.U. Subbaiah: So at the beginning of the call I did mention I gave the breakup of other expenses and I told that these are all one-time expenses which will not happen in second half of the year. For example I told you about repairs and the spare parts for critical machines at Mysore. I spoke about the CSR

expenses which was provided which was not there during last year. I spoke about the distribution and freight cost which was much higher in Quarter 2 because of the freight cost increase and then some of the new products which had to be shipped through premium price. I also talked about power and fuel cost increase because of the increase in diesel costs and an electricity board tariff increases. So I had given and the warranty cost in tractors increase because of the issues which we had in Virat Plus. So almost all the breakup I had given up front.

Moderator: We have a next question from the line of Ayush Bhutada from Aequitas Investment Consultancy Private Limited. Please go ahead.

Ayush Bhutada: I wanted to know what this other income of 13 crores exactly includes during the quarter excluding the 3 crores of fraud amount.

P.M. Keshava: Other income for the quarter ended 30th September it was 16 crores. 16 crores comprises of 3 crores towards that fraud amount which has been reversed as prior period income and we have provided also and included under expenses. Then we wrote back 4 crores marketing expenses which are no longer payable and there was a reversal of provision towards annual incentive payments to employees amounting to 2.75 crores. That was the 2 + 4= 6+ 3= 9.

Ayush Bhutada: And total is 13 right?

P.M. Keshava: Other one was normal dividend income and all those things.

Ayush Bhutada: You said the commodity prices have increased 2.5% during the quarter, right?

P.M. Keshava: Quarter 2 there is a provision of 3 crores towards nonmoving spare parts so that has also impacted the metal consumption.

Ayush Bhutada: Coming back to the last participant's question regarding the other expenses, so do we expect excluding the one-time 20 crores normalized figure of other expenses to continue every quarter?

P.M. Keshava: No, there are some expenses which are not repetitive as CEO has already told like expenses which are provided as bad advances. Since we are into Ind-AS there will be ups and downs in the equity related investments which we have to factor at the current market value.

Ayush Bhutada: In this quarter the total one-time expense would be approximately 6 to 8 crores?

P.M. Keshava: Rs.1.65 crores was provide towards CSR expenses. That won't repeat in the second-half of the year. Another Rs.3.16 crores is the provision towards doubtful advances that too won't be repeating in the second half. There on Rs.5-6 crores like this which are one-time expenditures which will not be there in the remaining part of the year.

Moderator: We have a next question is from the line of Mayur Milak from IndiaNivesh Securities. Please go ahead.

Mayur Milak: You have said that the fraud amount was actually taken off as raw material expenses initially and now we have also provided for that in other expenses and you made a counter entry in other income also am I getting it right?

P.M. Keshava: No, it cannot be combined under other material. It is under other income and other expenses.

Mayur Milak: So when it was embezzled he was taking it off as against bills raised.

P.M. Keshava: Against traveling expenses.

Mayur Milak: So it was always part of other expenses basically you are saying?

P.M. Keshava: Yes.

Moderator: We have a next question from the line of Viraj Kacharia from Securities Investment Management. Please go ahead.

Viraj Kacharia: Just had one query on other income, in the past we had a significant investment in equity investment in certain company like Rane Holding and others and we have seen a good amount of fair value adjustments from that. So does that investment still holds or we have exited from those investments?

P.M. Keshava: No, we had 1,25,000 worth Rane Holdings. The part of it and that is around 30,000 numbers have been sold, balance still we are holding.

Viraj Kacharia: What is the product thought process on these investments going forward?

P.M. Keshava: Right now we do not have any plan to de-invest. It will continue.

Moderator: Thank you Sir. As there are no further questions I now hand the conference over to Mr. Annamalai Jayaraj from Batlivala & Karani Securities India Private Limited for closing comments. Sir over to you.

Annamalai Jayaraj: On behalf of B&K Securities I would like to thank Mr. Subbaiah, Mr. Keshava and Mr. Chinmaya for sparing the time for the call. We thank management for offering us the opportunity to host the call. Have a good day.

K.U. Subbaiah: Thank you.

Moderator: Thank you very much Sir. Ladies and gentleman, on behalf of Batlivala & Karani Securities that concludes this conference call. Thank you for joining with us, you may now disconnect your lines.

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