



“Escorts Limited Q4FY13 Earnings Conference Call”

October 24, 2013



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MR. GVR MURTHY – CEO, ESCORTS CONSTRUCTION EQUIPMENT
MR. LALIT PAHWA – CEO, ESCORTS AUTO PRODUCTS
MR. DIPANKAR GHOSH – CEO, ESCORTS RAILWAY PRODUCTS
MR. BHARAT MADAN – GROUP FINANCIAL CONTROLLER
MRS. JYOTI KHATUKA – HEAD OF TREASURY FUNCTIONS OF ESCORTS GROUP
MR. SAIKAT MUKHOPADHYAY – CFO, ESCORTS CONSTRUCTION EQUIPMENT
MR. RAJEEV DASS – VP, CORPORATE AFFAIRS AND COMMUNICATIONS
- MODERATOR:** **MR. RAGHAVENDRA JAIPURIA** – ANALYST, PERFECT RELATIONS.

Moderator: Ladies and gentlemen good day and welcome to the Q4FY13 Earnings Conference Call of Escorts Limited. As a reminder for the duration of this conference, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need any assistance during this conference call, please signal an operator by pressing '*' followed by '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Raghavendra Jaipuria of Perfect Relations. Thank you and over to you, sir.

Raghavendra Jaipuria: Thank you Shyama. Good afternoon and thank you for joining us on Escorts Q4FY13 results conference call. Today we have with us Escorts Limited senior management represented by Mr. S Sridhar – CEO, Escorts Agri Machinery; Mr. Murthy – CEO, Escorts Construction Equipments; Mr. Dipankar Ghosh – Business Head-Escorts Railway Products; Mr. Lalit Pahwa – CEO Escorts Auto Products; Ms. Jyoti Khatuka – Head Treasury; Mr. Bharat Madan – Group Financial Controller; Mr. Saikat Mukhopadhyay – CFO, Escorts Construction Equipment and Mr. Rajeev Dass, VP, Corporate Affairs and Communication. We will start the call with a brief opening remark from the management followed by an interactive Q&A session. Before we start I would like to add that some of the statements that we make today will be forward looking in nature. At this moment I would now request Mr. Rajeev Dass to make his opening remarks. Thank you and over to you.

Rajeev Dass: Ladies and gentlemen thank you once again for joining us on Escorts Limited Fourth Quarter Earnings Con-call. We welcome you all. Before we start, I would like to mention that the board of Directors of Escorts Limited in its meeting on October 2nd has decided to extend the financial year by 6 months up to March 31st 2014, consequently pushing the AGM Meet by 6 months too. In the same meeting, the board declared an interim dividend of Rs. 1.20 per equity share.

Our continued focus on profitability and operational discipline has led to a strong 12 months closing. Tractor volumes have increased by 9.2% to 66,230. Construction equipment volumes stand at 3,375. Our operating income increased to 4,149 crores whereas our EBITDA percentage increased 170 basis points to 6.4%. Company's standalone PBT more than doubled to 183 crores and PAT increased by around 1.5 times to 167.6 crores. Our standalone EPS stands at 14.05 as against 5.84 for the same period last year.

Our performance quarter-on-quarter basis has also been morale boosting and consistent. Tractor volumes increased by 14.6% to 14,842. Construction equipment volumes stood at 661 numbers. Our operating income rose 14% whereas our EBITDA increased 38% and now stands at 6.8% as we exit the quarter. Company's standalone PBT more than doubled to 48 crores and PAT increased by a similar multiple as that for the 12 months period ended at 43.6 crores.

Ladies and gentlemen I now start with our agri machinery division. Agriculture has been the only green offshoot in otherwise faltering economy in the country and the clear shift is seen towards farm mechanization which means that we are looking at exciting times and consistent

times ahead. In the past 12 months, clear signs of revival have been visible and we did well to capture not only a higher share of the customer mind space, but also higher volume growth as compared to industry without comprising on margins. We ended our Q4 with 14,842 tractors which is 15% growth as compared to corresponding quarter. With improved product mix and volume increase, the EBIT for the quarter increased to 82.4 crores and margins expanded by 180 basis points. This quarter, the agri machinery division made inroads in the Cambodian market with the launch of its premium tractor range, Farmtrac, the distribution for which will be done by Tata International. Tractors are ranged from 25 HP to 110 HP and will also offer four wheel drive. These models are best suited for the paddy, sugarcane, palm and rubber plantations in that country. In yet another development, we are delighted to share that we are launching our Farmtrac Europe series and Farmtrac Heritage series at Hannover Agritechnica fair on the 11th November 2013. These are two models, the Farmtrac Europe series and the Farmtrac Heritage series which are directed at the European market primarily and will also follow through to the other world markets in the months ahead. Despite focus being on improving profitability and having a strong hold in the premium segment, it is heartening to see that our market share on a 12-month basis is pretty much unchanged at 10.2%.

Coming to the construction equipment division, the headwinds remain strong. Delays in clearance and uncertainty in implementation only means that will take some more time before the industry start showing signs of revival. The revenues during the quarter saw a growth of 6.3% versus last quarter and the losses at the EBIT level were contained to Rs. 4.8 crores. We sold 661 units in this quarter versus 718 units in the third quarter. We will continue to shift towards the better product mix and leaner manufacturing and sales setup to overcome these tough times.

Moving onto our railway division, the order inflow from railway continues to remain subdued. Finalization in terms of new orders or tenders has been slow and inconclusive. The order book of Rs. 51 crores at the end of June was successfully executed this quarter. Income for the quarter increased to 50.5 crores, an increase of 30.2% on a year-on-year basis. EBIT for the same period was Rs. 4.3 crores and margins at 8.6%. Order book for this division as of 30th September stood at 34 crores which will get executed in the next 2-3 months.

Coming to the auto products division, the automobile sector continues to be under pressure and the slowdown in the economy has severely impacted sales to OEMs. This along with higher interest rates and lower discretionary spending are not helping the cause either. Escorts Limited continues to face challenges in the current environment. The fourth quarter saw an income from this division increased by 3.3% to 31.4 crores versus same period last year and a loss of 5.2 crores at the EBIT level. The 12 month period saw revenues increased to 150.6 crores, an increase of 5.2% and at the EBIT level, division incurred a loss of Rs. 13.1 crores. Ladies and gentlemen now I would like to open the floor for Q&A session.

Moderator:

Thank you very much sir. Participants we will now begin with the question and answer session. We have the first question from IDFC Securities. Please go ahead.

Pramod Kumar: Sir this is Pramod Kumar from IDFC. Sir I think good set of numbers considering what you say the volume slippage on a sequential basis. Just wanted to understand any particular reason why our capital employed on the agri side has gone up, is it got to do with the inventory of finished tractors which has got build up at the plant level or is it something more to that sir?

Bharat Madan: Pramod this was essentially an inventory buildup because the season starts from October, all the Navratras and other festivals are in this month. So lot of deliveries in retail has to happen in this month and since we cannot do that much production in October, so we had to maintain that inventory by September end which is what you are seeing, but this inventory depletion will happen in this month.

Pramod Kumar: So ideally it should normalize right?

Bharat Madan: It will get normalized in this month.

Pramod Kumar: I believe we are shifting to the normal fiscal right which will be ending with March, am I right?

Bharat Madan: This was in line with the new company's act because there is a requirement for a company to shift from April to March financial year. So we thought this is a good opportunity for us to do that now.

Pramod Kumar: Excellent sir. In that case, so I can just wanted because there has been a historical mismatch between how the other companies are being talking about the market and the market share and us. So now that we are going to shift to March, what is your reading sir as to how do you see the growth for the industry for FY14 ending March and similarly for the year next as in generally what is your growth outlook for the industry going forward?

S Sridhar: Very quickly in the last 2 years, I think the industry growth was almost a flat. I think the last big quarter was the June, September 11 that is when we have say something like 25% kind of a growth rate and recent ones are revival. So that is almost markets are reviving and given that monsoon and the outlook what we see, the revival should happen. The quantity of revival is not very sure because I think the monsoon god was much more graceful than what we expected. So there may be some seasonal delay. Having said that, something like 14% kind of a growth rate in this quarter and going down to something like 8-10% growth rate for the second half is a realistic expectation we would like to build on.

Pramod Kumar: And for next year sir given the base buildup which will happen in FY14 and the earlier election in the first quarter, how do you see FY16 as for the industry generally?

S Sridhar: The long-term outlook what we take is something like 8% is the CAGR growth rate we look forward to. All other planning is based on that. The way things are happening if government policies do not go against this, it should be upward of 8%, will not be below 8%.

Pramod Kumar: And this is you are talking about the entire cycle, including the downturn years?

- S Sridhar:** Yes.
- Pramod Kumar:** And sir this on market share for this quarter if you can throw some light and how it has moved on sequential at YoY basis?
- S Sridhar:** I think the last 6 months as the market share was something like 10.8% and the overall year is something like 11.1 which is almost like 0.4-0.5% below last year whereas in the last 6 months, it was something like 10.8. The major reasons are the growing markets; phenomenal growth what is happening now is happening in South and West something like Maharashtra, Gujarat, Andhra, and Karnataka. These are all the markets which are growing of the order of 40-50%. So there, our market share is generally less. We are at the order of 4-4.5%.
- Pramod Kumar:** And in a way is the strategy of not chasing market share, the expenses of brand and profits is still on because you talked about it in the last call as we have a pretty good long-term strategy for you guys. Will that be partly the reason for the loss of market share especially in the September quarter I would say?
- S Sridhar:** You are correct. We have the priorities are clear. First is profit, but nobody is preventing us from growth. So not compromising the profit targets. The way we have spoken 15% end of 3 years, I think we are into the second year. That goal is very much there. So we will achieve that kind of a target, but we have to also look beyond that. So I do not want to disclose much more, but the way you said is without compromising the profitability target, we will also get prepared for a growth plan.
- Pramod Kumar:** And sir export what is the current share and what is the outlook going forward because that is one where I think the pricing competition may not be that significant and you can really differentiate with your performance and the power range what you have?
- S Sridhar:** Yes. I think you are right, but unfortunately in the exports, see in exports the way we see it is two different hubs; Europe centric exports because that is where we have our Poland operations, another is India centric exports. India centric exports, so far we have not done a good job. The numbers are very less; it is like 50, 60, and 70 per month of the order. , But having said that we are only strategizing now, identifying market, priorities, products, and studies is going on. Possibly it will take one more year to come with a substantial number for an India centric market, but where we are ready is the Europe centric strategy, Poland centric strategy where we will be unveiling our product positioning under global strategy in Germany on 11th of November. So may be post that unveiling, we will be in a position to share with you much greater detail of how is our outlook of the world seeing through European eyes.
- Pramod Kumar:** But what is the current export as a percentage of your volume sir?
- Rajeev Dass:** Very insignificant if you are talking of....
- S Sridhar:** Take for example 600-700 numbers out of 65,000 numbers.

- Pramod Kumar:** That is very low because and that compares even poorly with the peers in the industry because quite a lot of these companies, smaller companies are actually thriving on the export model in a big way.
- S Sridhar:** Of course we, we are late starter, we will work on that.
- Pramod Kumar:** Good to know that and sir lastly on auto ancillary. I do not know who will take that question, but is there a thought of actually divesting that business because it has been consistently have been making losses and in the current environment, it is not a great space to be in as in without much specialization or a scale advantage. So is there a thought process that you could eventually somewhere down the line divest this business altogether?
- Lalit Pahwa:** There are plans that we are working on and we are also looking for partners. So we will take a call when an appropriate partner shows up or we have a good opportunity because the macro situation of the automotive market is quite positive and we are looking at possibilities of strategic partners to help us to get there.
- Rajeev Dass:** On the auto products, the 12-month performance was severely affected by the last 2 quarters where the downturn in the domestic demand from the OEM affected us quite badly. So whereas we were earlier talking about containing the entire red ink to bare minimum level that has got little inflated by the last 2 quarters which actually impacted us. The management is completely seized of this situation. We are actively looking for strategic partnerships in taking on a go-forward basis. As we speak, the mandate is out and we are actively in the decision in finding our strategic route on this matter as we speak and I think we will have something to share with you by the time we have the next con-call.
- Pramod Kumar:** And sir finally on your debt position. What is your current gross debt position and the cash position sir?
- Jyoti Khatuka:** The gross debt is 248 crores of term debt and working capital outstanding are 170 odd crores and cash and bank balance excluding escrow is 180 crores.
- Moderator:** Thank you. We will take the next question from the line of Mahantesh Sabarad from Fortune Equities. Please go ahead.
- Mahantesh Sabarad:** Actually I wanted to understand; 1) your tax rate for the quarter has sharply fallen down to 9.7%. What are the reasons for that and that is number one and when I look at the other expenses and employee cost on a sequential basis, there is a small fall as well. What are the reasons for that?
- Bharat Madan:** For one on the tax part, I will just address that. See when the March results were declared, the return for tax was not filed and it generally gets filed by this time by September-October, so there is lot of actualization that happens on the expenses for which we get deduction including Section 43-B deduction which is allowed on payment basis. The statutory dues payments up to

date of filing of tax return are taken into account for getting the tax rebate. So this time we got about 6.5 crores additional rebate on account of 43B deduction .

Mahantesh Sabarad: What is that, can you just clarify?

Bharat Madan: Under Section 43-B, the statutory dues payment is allowed as tax deduction on payment basis. So by the time you file your returns, if any payment is made for those statutory due which were outstanding as of end March before the time of filing of return is allowable as tax deduction. So this time post the last quarter results where we estimated that the tax rate will be about 20%, now this time we got the rebate of about 6.5 Cr in respect of the payment towards statutory dues made subsequent to June quarter. So it is this benefit that we are seeing in this quarter, but going forward the rates will remain in the range of 15-20% for us in the next 2 quarters at least.

Mahantesh Sabarad: Any accumulated losses that you have been able to get because your tax rate is obviously far below the marginal tax rate, so?

Bharat Madan: There are two reasons. One, the R&D expenses where we get a weighted deduction of 200%.

Mahantesh Sabarad: But that could be very small for you?

Bharat Madan: It is about 45 odd crores every year.

Mahantesh Sabarad: I mean in terms of saving potential on the tax front?

Bharat Madan: So there are no accumulated losses and obviously on that front we don't have much potential. So expenses on R&D side and whatever accumulated statutory liabilities which we had on the Balance Sheet that we are paying and cleaning up now, on that we are getting this tax deduction on payment basis. So these two are the main available options right now.

Mahantesh Sabarad: But your guidance is virtually half of the marginal tax rate, so just wondering is there a substantial difference between income tax profits and book profits that you are reporting?

Bharat Madan: The third reason is the CAPEX which was happened in the last 2 years on which accelerated depreciation is available under income tax and that is also helping us now.

Mahantesh Sabarad: And when will that unwind?

Bharat Madan: It will unwind may be after 2-3 years , so then the position will reverse.

Mahantesh Sabarad: Fine. That is what I understand and other question I had was related to the construction equipment division. I noted that you sold about 661 numbers of construction equipment machines this quarter, this is lower than the preceding quarter of 718 if I am right and much lower than last year's 888 number. Yet when I look at your turnover, there seems to be the

turnover is higher compared to the lower numbers. Can you explain is there a substantial mix change here?

GVR Murthy: Yes. There is a substantial product mix change which has brought in this benefit towards in terms of the topline. Though the equipment numbers have come down.

Mahantesh Sabarad: And what set of equipment or machines are selling more and what set?

GVR Murthy: Most of the contribution has come from slew crane sales. We introduced a new slew cranes from 20 tonnes to 40 tonnes and we have been successful in promoting this product. That product mix has got in some advantages and in addition to that, it has a substantial impact of our price increase position which we have taken and that is adding up to that. We are getting that advantage of it now. Price increase has been also a portion of this increase in the revenues.

Mahantesh Sabarad: What is the roadmap to make it EBIT positive?

GVR Murthy: The EBIT positive, we expect from this quarter onwards, we are very confident that we will make the EBIT positive.

Mahantesh Sabarad: What kind of volumes are you likely to do in the year ahead, you sold about 3300 machines.

GVR Murthy: We have not lost any market share in any of the products what we sell. In fact in some places, we have increased our market share substantially and at the same time, the market is driven by the political situation outside and I expect the next 2 quarters to be not worse than this, it will be in the same phase and then we are keenly watching as to what is going to unfold by March. So if you want to make a comment on next 2 quarters, I would say we are expecting the market to be same situation and the volumes of our business will be in the same level.

Mahantesh Sabarad: But then profitability you are suggesting it will be far better because of price increase?

GVR Murthy: It is not price increase, product mix and of course we have taken substantial actions from optimizing the cost which is going to take an impact in this quarter.

Mahantesh Sabarad: I had another question on the new tractors that you are launching in the European market, any volume guidance you would like to offer on the exports front and hence any margin guidance here because generally it is assumed that your export margins to Europe should be better than what they are in India. Correct me if I am wrong?

S Sridhar: See as far as the exports are concerned, we have already expect the Europe centric, our Poland centric operations already account for something like 650-700 machines. They are all basically higher horse power tractors. The product what we are launching is targeted towards creation of a new category. If I have to give you a good idea, the approach what we are taking is an approach what Japanese have taken for an American market 30 years back. When everybody was selling huge fuel guzzlers, they brought in a very nimble fuel efficient, cute, compact

machine. We almost approach the same subject of our Europe. Obviously this will be a money spinner. The quantity estimates, now those kinds of things are too early. This is where I said exports were little early, but what we are unveiling is product strategies, shortlisting partners, distribution partners of our Europe. This is why we are trying to organize for the next one year. The result to come is clearly one year away and if that succeeds, this will be a repetition for many markets including USA and other major tractor markets. So we are very hopeful. On the long-term, it should be high positive the way we are talking about Indian story from something like 4.5-5% EBIT into a 15% story. The similar one you will hear about the export strategy as well, but for the current year volume guidance, I think we are too early to give any guidance on volume.

Mahantesh Sabarad: So one should assume that for virtually one year, there would not be any products to be launched from this new platform in the European market or commercially sold I should say from this new product.

S Sridhar: Sales will happen in almost like in two quarters, but the volume to quote in terms of impact for topline and bottom-line is still one year away.

Mahantesh Sabarad: Sir I just wanted to understand what are the addressable markets in Europe?

S Sridhar: Generally European markets are I think it is little too early, still I will give you some clues on what kind of an idea we are bringing in. The average Horse Power in Germany what are talking about is something like 125 Horse Power, 150 and 200, this is the range. The series what we have been talking about is 50-75, this is what we talked about the top end of Indian market what we are developing, this will become the bottom of the pyramid up Europe. So this is the kind of a new category creation as an auxiliary tractor to otherwise 150 Horse Power tractor buyers. This is the kind of a segment targeted and the rest of the details are possibly we will unveil through a press, the Indian Press Conference something like two months, may be in December we will do that.

Moderator: Thank you. We will take the next question from the line of Arjun Khanna from Principal Mutual Fund. Please go ahead.

Arjun Khanna: My first question is in terms of the geographical coverage of India, you did mention that there are some parts of India where market share is lower. What are we doing to address this and do we really intend to go for those parts or we are happy in the regions that we currently are?

S Sridhar: The point is there are couples of things. First we said our guidance whatever is accrued by our own committee is profit first and the profit growth is already sharing it is in public domain. We said our goal is to reach up to 15% EBIT margins for the division. We are on that path. We already reached the very decent level. Whatever the target levels we have set for ourselves year ending September, we have surpassed almost by 0.2%. We are on this path. Having said that, without compromising that, it is a time for us to address all those issues. The most important markets where we are missing are south and West. South and west when we are saying, it is

like Tamil Nadu, Andhra, Karnataka, Maharashtra, and Gujarat. This contributes almost 30% of the overall industry and our market share is something like 4-4.5% and this market also given interesting opportunity of higher Horse Power tractor category, but generally MNCs do very well. The entire product planning what we are trying to do is to concentrate on that kind of a market, what we call E+ kind of a market. The products are ready, getting rolled out. This revival has come as a surprise rather 6 months earlier than our expectation. That is where if I am to say we are just bus by almost 6 months. So these products will get rolled up. We will do some actions in those kind of an area, but generally having said that, it may take at least two years for us to come to a pretty decent level, so that is our internal plan.

Arjun Khanna: Just to take it forward, you did mention new launches which are heartening to hear. In terms of market share, do we have a kind of target to where we would like to be sir at the south and west region?

S Sridhar: It is very difficult to say, but all that what I can tell you is we are almost 4-4.5% today. Nationally, we are at 11.5%-12%. So our goal is to reach the national level, but having said that, actions are in place, thinking is in place rather actions will happen over a period of 1.5-2 years. Difficult to get on what will happen in terms of market challenge, but we are getting ready.

Arjun Khanna: So my second question is just to understand the industry, are the retail volumes largely tracking the wholesale volumes for the industry?

S Sridhar: No, but almost we should guess it so because quarter-after-quarter people cannot wait and there also we are just out of a recession and so people would have almost retailed it. Having said that, in September everybody would have been pumping lot of quantity depend upon their ability to hold stocks. People would have produced more in the month of August and September hoping for a very big season on this thing. So these adjustments may happen between the quarter and on annualized basis, I think industry should be on a natural level. It should not be any artificially high level.

Arjun Khanna: Sir finally in terms of our CAPEX, could you give us a guidance how we see that going forward?

S Sridhar: The CAPEX indications are more on new products, less on capacity expansion.

Jyoti Khatuka: The total CAPEX that we have done in last 12 months is approximately 80 crores and we have further 50 crores planned in next 6 months.

Arjun Khanna: So we should largely be decreasing the amount of debt we hold?

Jyoti Khatuka: Debt yes but if further CAPEX is there, some of the CAPEX would be met by further debt. So on an average; you can assume debt would be probably 15-20 crores lower.

- Moderator:** Thank you. We will take the next question from the line of Raghunandan from Asian Market Securities. Please go ahead.
- Raghunandan:** Sir just wanted to understand how is the utilization level across segments?
- Bharat Madan:** On the capacity?
- Raghunandan:** Yes sir.
- Rajeev Dass:** Capacity utilization across all segments?
- Raghunandan:** Yes sir.
- Bharat Madan:** They remain in the range of 60-70% which is what I think we mentioned last time also in the concall. There is no major change in the volumes if you look at the trend. So it ranges in that range only, about 65-70%.
- Raghunandan:** Can you broadly indicate how it is segment wise if possible?
- Bharat Madan:** Segment wise, 77 for railways and auto products, 50% for construction, and 66% for agri for tractor.
- Raghunandan:** Agri is 77 I thought.
- Bharat Madan:** 66%.
- Raghunandan:** Sir with reference to tractors if I just look at last 4-5 general elections, usually the year coming to the general elections sees an increase in the agri spending and then the next year with the lag, there is an improvement in the growth for tractors. So do you foresee like similar growth scenario for FY15 because of this upcoming election and increase in agri spending. I think this budget provides for like 18% increase in the agri spending for FY14, so do you expect any trickle down effects next year?
- S Sridhar:** I think in our own estimate, it is less to do with elections and more to do with monsoon. So I think this is how the fast trend. If you do a cycle study, whatever the trade cycle studies whatever we have done, the dominant factors are that way, but it can have a general push, but I do not think that is something substantial. Elections have got nothing to do with it. All these happened I think two-three elections back where people used to wave up lot of money. They are putting lot of money. Those kinds of things used to be very different, but today I do not think we will count on that. We are counting on more on in terms of groundwater, water levels have moved up. Things look much better not only for this second half, it will be much better even for the whole of the year. So rather we would like to bet on those kinds of parameters.

Raghunandan: And sir like with reference to the farm mechanization, so how is that area spanning out sir, if you can throw some color as to what are the trends you are seeing there and how much government subsidy or push is helping out overall industry?

S Sridhar: Farm mechanizations are there. Tractors, subsidy is not major, it is just not there, we can just say that, pretty minimal. Here and there it is there, but it is not making any impact. As far as tractors are concerned, our understanding is concerned tractors are becoming bigger and bigger, but only thing what we will see is some data you will see a blip because of the emission norms for 50 got introduced, those things get reclassified as 49.5 Horse Power and 49 Horse Power and all these. The trends what we see is the bigger tractors, the demand will go up. With this kind of a recording happening, things become little more prosperous. Those kinds of things will go up and other tractors which will emerge this are specialty tractors, special purpose tractors. These are all the areas which are under very preloaded stage in India, but we expect substantial growth over a period of 10 years. This is why there are actions around this. Ferrari tractors and those kinds of actions are taken. So these are all major patterns, but other than tractors, it is predictable actually. The next is farm equipment space.

Moderator: Thank you. We will take the next question from the line of Nishant Vyas from ICICI Securities. Please go ahead.

Nishant: Sir first question on the market share and the volumes per se. If I am doing an analysis on the segmental market share, we have lost close to 500 basis points in the fastest growing segment that is 41-50 Horse Power segment, we were at around 16.5%, now we are around 11% and this is April to August that I am quoting and also we have gained in the slower segment which actually degrew that is 31-40 Horse Power segment. I wanted to understand that the industry is now at nearly 6 lakh, just want to clock 6 lakhs for the financial year and what would be the number that we are quoting for when we move to March, what is it, is 10% market share that we are going to go or we are going to go slower than industry because we are losing market share in the fastest growing segment.

S Sridhar: Where we should see the data is this is 40-50 Horse Power tractor is the general classification. If you do one more classification as 45-50 Horse Power, this is little higher. I think our market shares are something like 23% I think year before; we are almost at 20% today. So there is a 2-3% drop in that kind of a market share because that is where we concentrate. That is where what we call it as an E category and E+ category. Here the delay is one is from our side. This is predominantly it is about the Farmtrac face lift whatever we have planned to launch got delayed by almost 2-3 months and largely we should attribute product delay from our side in terms of delay, that kind of a loss in market share, but going forward all our actions are around this kind of a category only. Many products face lifts are all around this kind of a category right this month, it is happening. It is going to happen in future quarters. So that is not a matter of anxiety because that is where we wanted to grow and that market and E+ category together is what we are targeting something like a 30-33% over a period of another 3-4 years. This is the kind of what you call segmental focus what we are talking about. This is about we said premium category making more money means this kind of an action. Now the second category

what you are talking about, the C category are 35-40 Horse Power. What you will not see through the data is for example in the 35-40 category, half of our volume what we call 439 comes under high end of the category. We charge a premium price almost like a Rs. 20,000 over the standard products of that kind of a product, 50% of our volume comes through the high end of that category. Not only in the category of 35-40, also this is true for 30-35 that means even on the lower segment, the products what we sell are the most expensive products. This is the way things are. This is to tell you a positioning strategy and also to tell you the focus continued to be the profitability. So this we do through not only pricing, but supporting through a right products and then pricing it right. Now another major reason as I said is what we are losing in the last 6 months if I have to say so, it is a major revival of Maharashtra, Andhra and off late Gujarat and Karnataka in the last 2-3 months. These markets as I said contribute close to 30% where our market shares are lower. So this combination of this kind of some of our segments as well as the markets are the reason, but having said that our focus will remain on our own profitability, but we do get prefer for actions for this kind of market, but it is a 2-year story, it may not happen immediately.

Nishant: Thank you sir. Sir coming on to profitability actually by I have a second question on this and it is directed to Mr. Madan. Sir I was doing an analysis for last 6 years, it is kind of bit odd to see that the average interest cost that we have in the company is since last 6 years averaged around 19%. Even this year, we have entered at, what I am dividing is interest cost divided by the debt at the end of the year or the average debt, the average debt is around 19%. When I look at the annual report around 30-35% of that finance cost is coming from banks finance charges and line item called others. So I just wanted clear overview as to why are we paying so much, our average cost is so high while the market even if you are opening a working capital financing could be not more than 15%.

Bharat Madan: Nishant, there are two-three reasons. One when you look at the finance cost in the balance sheet, it is not only in the interest which is there, there are bank charges also which we classify as finance cost. So if you exclude bank charges which are more related to the operations side, on cash management side or the payment side, that itself is about Rs. 14-15 crores. Now besides that, there are other cases like we got security deposits from the dealers on which we pay interests. There are other cases where we pay interests to the vendors in some cases. So, it is not only pure borrowing which you should look at, but you should look at the total interest-bearing liability on the balance sheet. They remain between 500-600 crores.

Nishant: So that is what I am asking. At the end of the day, it is affecting the profitability. When I look at the last year's annual report...

Bharat Madan: This is operational. We will take deposits from the dealers; it is in the normal course and they are interest bearing deposits, though we pay lesser rate of interest on that. But if you look at the other side of this, there is Other Income which is basically the interest arbitrage which we make. So inspite of paying higher interest cost, we are making more money on the arbitrage there, whether it is towards dealer funding/ channel finance or other routes. So there is

significant increase in the other income also if you look at this quarter as well as for the year figures.

Nishant: So basically would you be saying this high level of working capital, whatever this might be a working capital thing, is it across the industry phenomena or may be other competitors would also be doing the same thing?

Bharat Madan: Other competitors I cannot say because they have huge cash on their balance sheet which we do not have unfortunately. So as of now, our average cost of borrowing remains at 12-13%. What we see on the balance sheet at 16-19% like you said is including all those banks charges and other factors. So if we exclude that, net-to-net borrowing cost on the debt will be about 12-13%.

Nishant: So sir if I can take a small last question. Sir in terms of your ESOPs on the balance sheet, sir how much is the actual ESOPs in that portion; it shows 3.1 crores shares as the end of FY12.

Bharat Madan: About 33 lakhs shares are there under ESOPs.

Nishant: When are they systematically going out, what is the timeframe?

Bharat Madan: There are schemes which are floated from time to time. So based on these schemes, the Options are given, or forfeited, so it is an ongoing process. So total numbers of shares actually remain about same in the Trust.

Moderator: Thank you. We will have the next question from the line of Riken Gopani from Infina Finance. Please go ahead.

Riken Gopani: Sir I just wanted to understand one thing is on the pricing side, what kind of price hikes have we taken on the tractor side over the last 6 months and any plans of any price hikes going forward?

Bharat Madan: In the last one year, we had taken about 3% price increase. In the last quarter, we had not done any price increase now. On the full year, we have taken about 3%.

Riken Gopani: Sir this 3% would include the hike you taken in September, is it?

Bharat Madan: Yes, the one in last September.

Riken Gopani: September last year?

Bharat Madan: That is right, that was about 1.5%.

Riken Gopani: And given the increase in cost, may be because of currency, is there a need for you to take any further price hikes right now, just highlight on that?

- Bharat Madan:** It depends on the product portfolio. Now where we are selling our imported products, there we are taking the calls on price increases depending on currency fluctuations, but normally at a company level, if you look at our total imports then it is very, very low. I think it is about 1% only on the total material consumption. So really on inflation side because of the exchange, any significant price increases would not be there. So it is not really affecting the material cost to a great extent, but where we are dealing in the traded products like Ferrari in Tractors or in construction equipment side, there we will also be making the price adjustments as and when the exchange situation goes up or goes down.
- Riken Gopani:** Because even the landed cost of various raw materials that we might be consuming in may be INR, they might have got increased because they might be linked to global prices and the rupee. Say for example steel cost, all those costs have not increased for you because of the currency?
- Bharat Madan:** In the last one year, we are not seeing the pressure really on the inflation side, but yes, going forward, we are getting some indications from the industry suppliers to that affect. So we will assess the impact when it happens but at least in the next six months we do not see any significant increases, but yes to some extent some inflation will happen.
- Riken Gopani:** And to that extent, would that be correct that you would then pass it on to the customer because the market is tight?
- Bharat Madan:** That is right. We will go with the industry on that, definitely.
- Riken Gopani:** You will go with industry on that okay. The other question that I had is just in terms of clarification. Since I am not aware about this on the balance sheet side, there is an investment which is lying I think that is the shares of Escorts itself. Just wanted to understand the strategic reason of the same and what is the plan for that?
- Bharat Madan:** These are the treasury stocks which we discussed in the last con-call also, which company is holding, as a beneficiary. Escorts is the sole beneficiary for that trust in which treasury shares are held. So we will take a call on those shares as and when we feel there is a need of selling them off depending upon whether money requirement is there on the company side, but as of now we do not see that happening at least in the immediate future.
- Riken Gopani:** No plans on that side.
- Bharat Madan:** No plans as of now.
- Riken Gopani:** And the infra size on the volume outlook, Mr. Sridhar mentioned that the overall volume growth for FY14 should be in the range of 8-10%, is that correct?
- S Sridhar:** No, the first half and this quarter and next quarter, we should look forward to something like 13-14% growth and the second half should be around 8%-9% type.

- Riken Gopani:** Which means the March and June quarter of this year extended year should be more than 7-8% whereas the Diwali quarter could be around 14% kind of growth for you?
- S Sridhar:** Correct.
- Moderator:** Thank you. We will take the next question from the line of Ashish Agarwal from Almondz Global. Please go ahead.
- Subramaniam Iyer:** This is Subramaniam Iyer. Two questions from my side. One is that on a sequential basis, the EBIT margins of the agri machinery division are slightly under pressure, what is the key reason?
- Bharat Madan:** Essentially volumes, since Q3 was a peak volume period. If you look at the industry trend also, the industry gets almost 30-32% of the volume in that quarter and obviously if the volumes are high, then the margins improve and we did about 19,000-20,000 Tractors volumes in that quarter. Against that we have done only about 14,500 Tractors in this quarter. So obviously the margins have come down because of that.
- Subramaniam Iyer:** We are planning new product launches. How will that impact the overall margins?
- Bharat Madan:** We will be able to maintain the margins.
- Subramaniam Iyer:** My second question is on the capital employed. The segment capital employed, others unallocated capital employed is close to 800 crores, can I have a breakup of that?
- Rajeev Dass:** We need to come back to you on that question. We will send you the breakup. You can give your email id; we will send it to you.
- Moderator:** Thank you. We will take the next question from the line of Ameen Pirani from Deutsche Bank. Please go ahead.
- Ameen Pirani:** May be you have answered this before, but I just wanted to get a sense of we have been obviously hearing the rural cash flows are quite strong this year because of the good monsoons and the MSP increases. Are you seeing that in your own experience that actually happening? Is there a significant improvement in the cash flows in rural India and hence there could be a sustained demand for tractors and other agricultural implements?
- S Sridhar:** Answer is yes, that is why we are talking about industry growth rate of 13-14% for 5-6 months and subsequently 8%-9% types.
- Ameen Pirani:** You are already seeing that or are that expected to happen in the next 2 weeks in terms of the rural cash flows becoming stronger?
- S Sridhar:** This we are speaking based on the quarter 3 last year what you call April to June experience and July, August, September monsoons which together give us the feeling that this is what

should happen. Currently the going is good in the whole of India excepting few belts where there is excess rain, this is delaying the crop and those areas also when we join, I think overall condition it should be on the expected line that it should not be a surprise.

Ameen Pirani: And just one house-keeping question. This quarter your other expenses were significantly higher than the trend and in terms of growth as well as percentage to say, any particular reason why that would have happened?

Bharat Madan: There are some higher expenses on the repair and maintenance side. There is some increase in the fuel cost and also the power rates have increased. So the manufacturing costs on that account have gone up and third on account of promotion spends done in this quarter which are higher than what we did in the last quarter and year before and fourth is obviously the volume impact if you compare with the last quarter corresponding numbers., Because of the volume increase, whatever variable costs are linked to that have also gone up. In terms of percentage increase, it is more on account of the extra spending we did on repairs & maintenance, power & fuel costs and advertisement.

Ameen Pirani: So this would sustain at these levels or you can expect some improvement?

Bharat Madan: So they will get rationalized. So they will get aligned to average of the last quarter and this quarter at say 11-11.5% levels.

Moderator: Thank you. We will take the next question from the line of Nishit Jalan from Nomura. Please go ahead.

Nishit Jalan: Just one thing, when you mentioned 13-14% growth, which period exactly do you mean? Do you mean next calendar year or what?

S Sridhar: October to March.

Nishit Jalan: October to March period and what is the kind of inventory levels which you had by the end of September quarter?

Bharat Madan: Our own inventory levels were to the tune of about 3 weeks and dealers' inventory would be about 45 days.

Nishit Jalan: That is the normal level for inventory.

Bharat Madan: That is the normal level, but this time inventory level, like someone said earlier in our case, it has slightly gone up because of the season which is there in October-November. So we had to build up inventory, but that will get rationalized. So we are normally working on 2 weeks inventory.

Moderator: Thank you. We will take the next question from Dron Capital. Please go ahead.

- Pathik Gandotra:** This is Pathik Gandotra from Dron Capital. Part of my question had been answered, but I just wanted to ask it slightly differently. Is it around the treasury stock? Does the new company's act which prohibits any more treasury stock in companies so will that affect your existing treasury stock and so while you said that you will sell it to raise capital whenever you need, but will you be forced into selling your treasury stock by the new company's act?
- Bharat Madan:** The new company's act is silent on this aspect and it does not talk about the old existing treasury stocks. The Act states that the new treasury stock will not be allowed to be created. So as of now, there is no provision in the act which says you have to sell it off.
- Pathik Gandotra:** I am sure you would have had conversations with lawyers, etc.
- Bharat Madan:** Yes, we have discussed that.
- Pathik Gandotra:** So there is no kind of first kind of requirement here, right?
- Bharat Madan:** As of now, there is nothing. Unless something new comes up in the rules in future, we do not know.
- Moderator:** Thank you. We will take the next question from the line of Mukesh Saraf from Spark Capital. Please go ahead.
- Mukesh Saraf:** I just had one question primarily relating to the lower HP tractors. You have recently launched the Steeltrack I think which is the sub 20 HP tractors and wanted to get your view on the overall industry for this lower HP tractors because you have been mentioning that the industry will move more towards higher HP tractors, but since you have also launched the product. Could you give us some sense on this less than 20 HP or around the 20 HP tractors and the demand drivers for this segment?
- S Sridhar:** I think the size of this kind of industry is close to something like 1500 per month and this is what happens actually. The dominant player in this category is Mahindra and they have Yuvraj brand which will be selling around 1200 number times and the rest is from various players. There are selected packets there is a demand for a raw crop area and those kinds of customers need this kind of tractor, this is also a part of a specialty tractor. So this is a completely an outsourced activity. We only help that dealer channel and assistants in terms of doing that, their specifications and we help them in identifying customer segments, specifications and then giving the backup service. Financially it does not make great sense for our company, but we wanted to have that kind of a complete solution to the customer that is why we organized this. Having said that, whatever we launch in last month, customer reception is very good. So to that extent, I think customers and dealers will be very happy, do not make much sense for Escorts.
- Mukesh Saraf:** But in general do you see demand more in the South or in the North or where do you see demand for these types of tractors?

- S Sridhar:** Predominantly West, Maharashtra and Gujarat.
- Mukesh Saraf:** Any sense on what could be the growth rate sir in this segment, could it be significantly high because the base is really small and the penetration now would increase because I think a lot of other players also have entered this segment in the recent past.
- S Sridhar:** This is like another reputation of a Nano. A lot of expectation, actually the deliveries was very limited. I think three year back, the first tractor got launched. Now also the overall size is less than 10,000-12,000 type. So far there is not much significant activity here. Having said that, the challenge in this kind of segments is it is not a profitable segment. So with that in mind, even if it grows at 20-25%, it may not make much sense for a company like Escorts where our clear strategy is to move on a very profitable segment in a very different manner. So this is an approach. So even if it grows, we will only watch, but what will emerge, the specialty as tractors will emerge. For example the Ferrari what we are talking about, it is something like 8 lakh tractors, where is 2.5 lakhs, 2.25 lakhs and where is 8 lakhs. That is also a horse power. So Escorts will put the entire mind behind creation of category around those kinds of tractors not into small tractor.
- Moderator:** Thank you. We will take the next question from the line of Kaushik Poddar from KB Capital Markets. Please go ahead.
- Kaushik Poddar:** I think in the last con call, you had talked about rationalizing your factory instead of 3 places, 2 places or something. So can you give us an update on that?
- S Sridhar:** I think action plan is on. It is a 3-year goal. I think we are on the way. I think significant actions will start happening may be by March next year. In 6 months, first significant milestone we will achieve, but having said that it is a 3-year action.
- Kaushik Poddar:** And will that result in their overheads coming down and you can sell up some land or something out that is sort, what is the engine for that, for this rationalization?
- S Sridhar:** We should see it in two ways. It is not about integrating the plants alone, it is also about outsourcing. Otherwise we have been a capital intensive company. We have been investing lot of money in expanding the production capacity which we have totally stopped. The money what we spent may be 1 or 2 crores types, not 50 or 100 crores what would have done it in the past. So outsourcing is the obsession. So initially the integration is also being put in and what our little money relieved out of the system is also what is used for outsourcing those kinds of activities. So when we move into 1 lakh, 1.2 lakhs capacity without major investments, this is the basis. So it should be seen as a lean manufacturing objective, not only seen as integration of three plants. So lot of things is hidden on this. What is the second question?
- Kaushik Poddar:** About the use of the surplus plant.

- S Sridhar:** Use of the plant that will come back. There are lots of businesses ideas are emerging. So as and when we free up our space and the business ideas are also there and at that point of time we will take an appropriate call. May be it is little too early to discuss in public.
- Kaushik Poddar:** But this rationalization is part of that your gain plan for getting their OPM to 15%, is it part of that or that 15% OPM happens without this rationalization?
- S Sridhar:** Some marginal effect, I will not count on it. I think I will count more on branch strategy and your power of pricing is much more than you're cleaning up act. At best, we can save as 1% or 2%, but where we will be betting significantly is our ability to charge more from the customer.
- Kaushik Poddar:** And my last question on this 15%, your end point of 15% in volume terms, it will be how much, some 18-19,000 tractors annually or?
- S Sridhar:** The point is very difficult; I cannot put all those numbers and then give. All that what I am telling you is the financial goal set, I think we are already into that firm path. We are almost at 11% type, around 10.2 or 11. After two quarters, we are there. So we are on that path, may be this year and one more financial year, we are almost reached there, but having said that, the secondary objective of dominating the profitable segments will become an objective. So what becomes the secondary objective over a period of time will also become a primary objective, but this I am just sharing with you the principal, difficult to put a number on it, but the way industry will grow, this 80-90,000, it is a matter of happening. It should happen far quicker than our expectation, but I do not want to put a number after it.
- Moderator:** Thank you. Participants due to time constraints, we will take the last question from the line of Basudeb Banerjee from Quant capital. Please go ahead.
- Basudeb Banerjee:** Carrying forward the aspect which you were just now discussing, if you see volume in FY11 was around 65,000 and volume in yearend September this year is around 66,000. So in last 2 years, volume has gone nowhere, but if you see the EBIT per unit has moved up from somewhere around 28,000 to present levels of 55,000 that has almost doubled. So what has been the reason you will assign primarily behind this improvement in margin with volume remaining the same and what are the drivers you see going ahead from these levels?
- S Sridhar:** I just repeat it because we have been sharing this and then we are consistently doing it. Whichever is a non-profitable segment under products like A category, some model like Escorts with 335, all those model which were contributing close to 2000-2500 kind of model, first we stopped it, we cleaned up from the system and the cost of volume in market share first we said we are shedding those sort of model number one. Second one is we have chosen the segments where we will participate and then we will start leading it. That is where we said E and E-Plus category. That is 45 Horse Power, 50 Horse Power and above. These are all the segments which give you good profit margin. When we say it is good, it is between the lower category B category and this category, the margin difference could be as high as it is double. If I have to tell you like industry parameter, it can even be doubled. So that kind of category is

what we have targeted. The third action is even in B and C category, the way I was explaining; it is not 30-40. If you look at it, 35-40 Horse Power whatever we are doing, 50% of our volume comes at the highest slab of pricing what we call DS Plus or the model whatever we have launched. Our products are priced very high. So 50% of the volume does not come under mean level or at the lower level. It has come at the highest pricing level. So these are all the actions what we have done predominantly besides there are a lot of cost cutting measures, reduce incentives, elimination of many area officers, 250 positions of officers we have shed. There are lot of things have happened. So something to do with cost control and also the increase of pricing power, chosen segment domination, stopping those kinds of products which do not add value to the system. Broadly these are all the actions we have taken which has moved us this far.

Basudeb Banerjee: And sir what kind of similar actions are you planning to take in the construction equipment division, any quantification of any breakeven revenue per quarter because despite decent set of revenues 120 crores kind of continuously we are seeing negative EBIT for past several quarters.

GVR Murthy: You would see from the last quarter, every quarter you are seeing a reduced cost and we were also seeing an improved EBITDA, though they are still in the negative situation, you will see a significant thing. We expect the volumes to be whatever it is. We have brought in a breakeven volume levels to significantly down and the EBITDA level earlier someone is talking about 330-340 units, we are now talking about 250-240 units and in addition to that, couple of things what we have executed is increasing the price impact in addition to the cost optimization internally. These two added to EBITDA levels to this level and we expect EBITDAs to be positive as we move forward in this quarter.

Basudeb Banerjee: Last question sir. In the balance sheet, there is a line item called long-term provision which has come down by somewhere around 60 crores on a year-on-year basis. So can you describe that?

Jyoti Khatuka: Escrow, we had a provision for escrow FD of 55 crores which we have netted off from the escrow amount. So that is why other provisions are decreasing, but you would say investments, if you refer to investments also, that is also decreasing, other current asset.

Moderator: Thank you. I now hand over the conference to Mr. Rajeev Dass for closing comments. Thank you and over to you sir.

Rajeev Dass: Thank you ladies and gentlemen. Once again thank you for sparing your time and being present at this conference call today. Diwali season and greetings from everybody from Escorts and will catch you later in our quarter 5 when we hold the call in January. Once again thank you very much and we look forward to connect you again in 2014.

Moderator: Thank you sir. Ladies and gentlemen on behalf of Escorts Limited that concludes this conference call. Thank you for joining us. You may now disconnect your lines.