Q5FY13 Earnings Conference Call

January 28th, 2014

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MR. LALIT PAHWA – CEO, ESCORTS AUTO COMPONENTS
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MR. BHARAT MADAN – GROUP FINANCIAL CONTROLLER
MRS. JYOTI KHATUKA – HEAD OF TREASURY FUNCTIONS OF GROUP
MR. SAIKAT MUKHOPADHYAY – CFO, ESCORTS CONSTRUCTION EQUIPMENT, ESCORTS
MR. RAJEEV DASS, VP, CORPORATE AFFAIRS AND COMMUNICATION

Moderator: Ladies and gentlemen good day and welcome to the Q5FY13 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 Good afternoon. Thank you for joining us on Escorts Limited Q5 and 15 months FY 13 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; Mr. Rajeev Dass – VP, Corporate Affairs and Communication; Mr. Bharat Madan – group financial controller; Ms. Jyoti Khatuka – Head Treasury; and Mr. Saikat Mukhopadhyay – CFO, Escorts Construction Equipment.

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 made in today's call will be forward looking in nature. At this moment I would request Mr. Rajeev Dass to make his opening remarks. Thank you and over to you.

Rajeev Dass Ladies and gentlemen a very good morning to everyone and greetings from Escorts on the New Year. As you are aware Escorts Ltd has extended its financial year by six months that is up to 31st March 2014 as approved by the Board of Directors in their meeting held on 2nd of October 2013. The results reported yesterday are for Q5 and 15 months ended 31st December 2013. This quarter Escorts has delivered significant results on the back of strong customer focused product strategy, operational efficiency, cost rationalization and sales growth.

Let me give you a small snapshot of the quarter ended December 2013:

Tractor volumes for the quarter were reported at 19,047 up by 28.3% sequentially and 11.4% correspondingly. Construction equipment sold 737 units up by 11.5% on a sequential basis. Our operating income increased to Rs.1159.6 crores whereas our EBITDA up by 34% to Rs. 71 crores as compared to Rs.53 crores last year. Finance cost down by Rs.5.9 crores to Rs.15.5 crores. Profit before tax, PBT up by 82% to Rs.56.8 crores as that of Rs.31.2 crores last year same quarter.

Let me turn my attention to our performance on 15 months basis ended 31st December, 2013 – Tractor volume increased by 9.6% to 85,277. Construction equipments volume stood at 4112, our operating income rose by 7.9% to Rs.5308.6 crores whereas our EBITDA increased 42.6% to Rs.335.5 crores and now stands at 6.3%. Finance cost down by Rs. 21 crores to Rs. 97 crores. PBT more than doubled to Rs.239.8 crores and PAT increased by a similar multiple in 15 months ended to Rs.213.1 crores.

I will now turn our attention to division performance, starting with Agri-Machinery Division. Last 15 months, the tractor industry has grown by about 14% with strong growth coming from South and West markets. We see the trend to continue and in the 18 month cycle which we will complete by March 2014, the industry should show a similar cumulative growth in the range of 14% to 15%. We did well to capture volumes growth in line to industry without compromising on margins. Tractor volumes went sequentially up by 28.3% to 19,047 tractors in Q5 as compared to 14,842 tractors in last quarter. During same period domestic industry grew by 25% and we grew by 28.3%. With customer focus, improved product mix and volume increase the EBIT for the quarter increased to Rs. 92 crores and margins at 9.4%. In order to expand our reach to customers Escorts has continued to expand its dealer footprint across the country focusing on the profitable strategy and keeping our focus on growth through profits, company took price hike in November last quarter. This quarter agri-machinery division made inroads in the European market with the launch of its Europe line and Heritage series tractors in Hannover in November, with its global brand Farmtrac and with it brings a stunning mix of Indian engineering excellence and world class engines and designs. These products are aimed at the revolution in the under sub small HP farm market to its world-class competitively priced products. This range of products will be accompanied by further strengthening of its higher HP range of European Farmtrac tractors. In yet another development the company recently launched its new Powertrac Euro series offering European comfort and stylish features for the new age Indian farmers. The new Powertrac, Diesel Saver, DS plus Euro series offers increased comfort and pleasant environment for more work and more earning opportunity for the Indian farmers. The Indian farmer today wants to work for long hours and therefore requires a driver oriented tractors with comfort seating and features which the Powertrac DS plus Euro series meets the requirement.

Turning to the Construction Equipment Division – the industry is facing challenges from various issues of the Indian economy including lower GDP growth, delays in clearances of projects and long-term finance related issues. Infrastructure projects and expansion plans are stalled for reasons from the problems of land acquisition, to tardy clearances of projects, to non-availability of finance. Delays in clearance and uncertainty in implementation only means that it will take some more time before the industry shows signs of revival. At Escorts Construction Equipment business we are working at product enrichment and lean manufacturing and with this approach in mind we had reduced our breakeven point by a fair margin mainly through fixed cost rationalization. The revenue during the quarter saw a growth of 12.6% versus last quarter and there was a positive swing of 212 basis points at EBIT levels from the last quarter. We sold 737 units this quarter versus 661 units in the last quarter. On a corresponding basis even though we sold approximately 150 machines less but turnover is being flat but a positive string of 310 bps at EBIT level. We will continue to shift and move and take initiatives towards a better product mix, leaner manufacturing, improve our sales reach and better management of fixed cost to overcome the tough times ahead.

Moving to the Auto Product Division – The Indian automobile industry is witnessing continued pressure owing to sustain deceleration in economic activity and consequent weakness in consumer and business sentiment. High inflation, fuel price and interest rates have resulted in a declining in annual car sales for the first time after 2002. Car sales in India have witnessed muted growth for only three of the past 17 months and de-growth for the remaining part. Commercial vehicles are badly hurt due to lack of mining activities and stalled infrastructure projects. In the last five years the Indian auto, component industry witnessed the slowest revenue growth in 2012-2013 as suppliers face weak demand from domestic auto mobile companies, sluggish exports and tepid replacement market sales. The sector is expected to witness improvement from the second half of 2014 with a likely fall in interest rates and deferred purchases materializing into better sales. Also industrial activity and infrastructure spending are expected to pick up. However, increasing competition is likely to keep margins under pressure in the auto and auto, component industry. Escorts Auto Products continues to face challenges in the current environment and we are disappointed by the performance. Fifth quarter saw income from this division decreased by 21.5% to Rs.29.4 crores versus the same period last year. As we speak the mandate is out and we are actively looking for strategic partners to take this business to the next level.

Finally coming to our Railway Products Division – The order inflow from Railways continues to remain subdued. Finalization in terms of new orders or tenders has been slow and inconclusive. The order book of Rs.34 crores at the end of September was successfully executed this quarter, at Escorts we are developing products for new generation rolling stock as we are seeing a decline for the old generation rolling stocks. The Escorts Air brake system for the Bogie Mounted Breaks system have been performing well in the field and the commercial benefits for which will start to appear post approval in mid-2014. Income for the quarter increased to Rs. 33.23 crores an increase of 20.2% on a year-on-year basis and a positive swing of 1986 bps at EBIT level at 4%. Order book for this division as of 1st January stood at Rs.38 crores which will get an executed in the next two or three months. You can also visit our social media pages for the latest company news and updates.

I will now request the moderator to open the floor for the question and answer session with our management team. Thank you ladies and gentlemen.

Moderator Ladies and gentlemen we will now begin with the question and answer session. First question is from the line of Basudeb Banerjee from Quant Capital. Please go ahead.

Basudeb Banerjee After three consecutive quarters of improving RM-to-sales, this quarter it was up by 330 basis points and almost back to the previous levels of 72.5% from which it started falling, what are the reasons for the reversal?

Bharat Madan If you look sequentially, last quarter the material cost showed a dip because we were building inventory for the season months, but this month we have done correction of inventory. So as a result the absorption of over heads in the last quarter was pretty good, we build almost 3500 tractors in stock and this quarter we reduced it by about 1200 tractors, so overall the impact on the bottom-line is almost for 4500+ tractors absorption of over heads. As a result material cost saw an increase but this is the current run rate and it is likely to remain at the 72+ range going forward as well.

Basudeb Banerjee If I see your capital employed in ECE that has also jumped quite a lot on QoQ whereas volume traction is more or less in sync with demand of industry. So is there any working capital issue in ECE or something else?

Bharat Madan Actually we were reducing our short-term borrowings, so this time we have paid off the borrowings because of which capital employed has increased, borrowings has gone down by almost Rs. 60 odd crores in this quarter.

Basudeb Banerjee The tax rate is quite volatile, what kind of level should one take going ahead?

Bharat Madan We had given guidance last time also because in last quarter we did a correction because of which we got a one-time deduction. Our guidance last time was that the rate will remain in the 15% to 20% range and this time tax rate was reported at ~19%. Similar rates are expected to continue in the next quarter as well.

Basudeb Banerjee We are entering the new calendar year and with the harvest season again building up in the next three months, how do you see region wise demand panning out?

S Sridhar I think right now the South and West are growing much faster than all India. UP, MP**,** Punjab, Rajasthan and Haryana are the traditional Hindi belt which we call as the stronger market so those market represents 60% the rest represents almost 40%. Of that 40% of the market South and West are growing at 35% and the northern markets are growing at half this rate. We expect that to continue by one more year.

Basudeb Banerjee Any positive or negative impact because of this election, any comments on that?

S Sridhar Elections, historically when you look at the data perhaps it's disrupts almost 20 to 30 days kind of timeframe but over a period of three months or six months there is no actual impact on the industry. Temporarily it may disturb from 15th April to 15th May. The disturbance will happen because of the documents customers seek from village officers become inaccessible as they are busy with the election work, so the tractor hire purchasing in these period briefly suffer but the customers also adjust themselves, either they buy a little early or little later so overall effect is nil actually.

Basudeb Banerjee Have your Farmtrac & Ferrari series exports started full-fledged?

S Sridhar No not yet, we continue to sell whatever we have been doing from India, and Europe was already there. But now we have unveiled our global strategy for exports in Germany through the new series of tractors called Farmtrac Heritage series, these tractors were unveiled in November are getting homologated in Europe and expected to be available for sale May onwards.

Moderator Next question is from the line of Mr. Arjun Khanna from Principal Mutual Fund. Please go ahead.

Arjun Khanna My first question is in terms of the agribusiness, we have been launching a number of tractors abroad and in India. How do you we see our sales growth for the year ahead and especially if you could talk about the south?

S Sridhar Though this strategy is already in public domain it is still beneficial to restate it again so that everyone can comprehend it in full. I'm giving you the way Tractor Manufacture Association (TMA) classifies the industry. Tractors up to 30 HP contributes the 10% of the market, 30-40 HP something like 35% of the market, 41-50 HP is 50% of the market and 50 HP+ is 5%. Within this market we have already stated that in the bottom 10% of the market we do not participate. From around 3.5- 4% market share which we use to have 2 to 3 years back, now that percentage is almost nil to 0.5%. In other words we are not participating in the bottom 10% to 11% and the reason is simple, there is no profit. The next significant segment is the 31-40 HP which contribute close to 35% of the industry. Currently we enjoy a market share of around 14.2% in this segment which historically was close to 20%. This 20% share kept coming down over the past 4-5 years and this is the first quarter where we have seen a stagnation phase at around 14.2% market share. The Powertrac DS plus series and Euro series is part of this segment. The Euro series which we are launching now got delayed by 75 days because of some technical glitches which now has been fixed and is getting launched countrywide. The good news is that even before the launch we are marginally positive and are hopeful that from this quarter onwards we should look at a market share growth in this segment. What percentage of market share will we be able to achieve there only time can say. Our own expectation is for example from 500 numbers of Euro plus last quarter we should be able to sell 2500 units in this quarter which will be a significant number for the brand. Going forward it has the potential to go up to 4000 kind of a number. This is just to give you an idea of what we should except from Euro series in the 31-40 HP.

Next important category is the 41-50 HP category which represents 50% of the business. This category is predominant in South and West. These markets do very well in this kind of a category where we lost market share of almost 1.5%. For this category we have scheduled four products launches in this month within the Euro series something called 445, 4455 and we also have Farmtrac series for this segment. Our idea is that from 10.4% maybe in two to three quarters we should go back to 12% and then back to the original market share of around 14% in the next financial year.

The last segment is the 50+ HP; this is an image segment which as per TMA represents 5% of the market. In this segment till three years back we use to have 1.5% market share, which increased to 3% the year before, last year that moved to 4% and currently it stands at 6%. Going forward in the next two quarter one can expect to reach a market share of 8-10% and by Q4 of 2015-16 possibly we will be close to 20%. We are targeting a leadership position in this segment.

To summarize, the bottom segment of 10-11% we have vacated, we lost volume there as it is meaningless for us to have products without good contribution. In the top end image segment we target a leadership position with a 20% market share for which we are on path from the last three years. Two large segments for us are one, Euro series launch is under implementation and second, is the launch which happening this quarter, results of which you will see two quarters later. This is a brief summary on how we are approaching the subject and South and West market should greatly benefit out of this 41 HP to 50 HP series action plan what we have schedule.

Arjun Khanna How long before you would actually see traction in the South and West segment?

S Sridhar South and West are market share is almost negligible with 3%, from this level our plan is to move the market share to 6% in the next two more quarters. When we say 3%-6%, that is more through a segment of our choice and in our view in a three-year program we can possibly hit a market share of 10-12% in those regions. Market share should come from a better segment where realization will also be better. Having said that right now we need to invest more on sale promotion expenditure and apportion more for South and West for at least four more quarters.

Arjun Khanna Just this quarter since we did so much of this would we have seen that in this quarter numbers where we would have had additional marketing expense? If there is some one-time element?

S Sridhar No, it won't be one-time; it will be for a minimum period of four quarters. And possibly we are also getting prepared for three year action plan to bring that market share upto 12%. What we can always share is that from the level of around 80 to 100 tractors in Andhra Pradesh, the first quarter of action has resulted in double this volume. Having double the volume also does not mean much in an industry of 3500 or 4000 tractor, so we have a long way to go.

Arjun Khanna My second question was on the auto ancillary business. You mentioned that you have given a mandate for strategic partner, are we looking at exiting this business or are we looking at further investment in this business?

Lalit Pahwa No, we're not exiting this business but certainly looking at strategic partnerships to consolidate and grow.

Moderator Next question from the line of Mr. Riken Gopani from Infina Finance. Please go ahead.

Riken Gopani EBIT for the agri-segment on YoY basis is more or less flat now, so since the volume has seen such a strong traction and we have also taken corrective price hikes wherever necessary, so what would be the factor why the gross margins remain more or less stable on YoY basis?

S Sridhar We can attribute this to a couple of reasons, firstly, the benefit of Euro series launch which we were expecting could not be materialized fully this quarter due to the delay. We sold 500 tractors last quarter as against a plan of 2500 for the first full quarter, so I would say for close to 1000 tractors we could not benefit due to delay. The second one is even though we have increased price the same is not true for the entire industry and the way the South and West is growing, the overall industry is registering a growth of around 20%. I would like to estimate in the next 2 to 3 quarter the competitive pressure will start coming down and we will have a far better flexibility in terms of pricing. So as of now we have cleaned up a little more, there are pricing possibilities which we can explore and there are choices for certain segments. These pointers should help us improve margins. We are also getting ourselves prepared for certain action plan in South and West so that we can de-risk over selves and in cash opportunities emerging from these markings.

Bharat Madan Just to add to that, like I explained earlier there, was as stock correction, so it would not be right to read-only quarter margins on a stand-alone basis. So if you look at the cumulative YTD margins they still stand at 10%, so there you have seen an improvement from 8% to 10% level and that is the rate we are continuing today.

Riken Gopani Just to get more clarity on this, this quarter there has been a reduction in the inventory that has caused this margin?

Bharat Madan If you look at published result where approx. Rs. 153 crore stock correction has happened from last quarter to this quarter, the variance which you are seeing. This is essentially because of absorption of overhead the benefit of which went to last quarter due to loading on inventory but sale happened in this quarter, so it is essentially the gap between production and sales number. Going forward our production & sale numbers are more or less likely to be same so that variance will not be visible, and run rate will remain same at about 10%.

Riken Gopani And the second question is more in terms of the growth outlook. You have said last quarter that there were some signs of slowdown post Q5 numbers in terms of growth rate. What is your outlook as of now, anything that you would like to highlight? What should be the trend for next 2-3 quarters in terms of growth?

S Sridhar We do not read it that way; and have no reasons to expect a deceleration. The growth sales started happening from the April-June quarter last year that means we have seen three quarters of good growth rate. I think we should expect growth close to 18% this quarter also, or at least 14%. This kind of growth of 14% is definitely expected for financial year ending March, 2014 unless something grossly goes wrong which is beyond our comprehension.

Moderator Next question is from the line of Mr. Vinay Nair from Rare Enterprises. Please go ahead.

Vinay Nair Just wanted to classification this 18% is for the current quarter, the 6th quarter?

S Sridhar Yes.

Vinay Nair Secondly in one of the previous questions to Mr. Madan on the capital employed he had given an answer I'm not very clear on what exactly are the reasons for the increase in the capital employed. Can you please explain it again?

Bharat Madan For capital employed calculations, the current liabilities including short-term borrowing are netted-off. If you look at our balance sheet which we publish every six months, we also include the short-term borrowings in Current Liabilities. So this time the short term borrowings have been paid off because of which the current liabilities have gone down as a result of which the capital employed has gone up.

Moderator Next question is from the line of Mr. Sachin Kasera from Lucky Investments. Please go ahead.

Sachin Kasera My question is to Mr. Madan, you did explain that we are about 300-400 basis points higher than the competition in terms of raw material to sales and about 300 to 400 basis points higher in terms of employee cost where we seem to be doing well but our raw material to sales yet not reflects that kind of confidence, so can you throw some light on that front? My second question is for Mr. Sridhar, what gives you confidence that you will be able to gain market share when you are fighting against M&M and rest of the other players, so just wanted to get your understanding on this particular point?

S Sridhar I will just tell you overall philosophy here. Overall market share does not mean anything for us, possibly the similar thing you would hear from a Honda CEO, in one of his interviews which I read recently. What is most important is the segment of our choice where we want to participate, where we put in our action plan is very important, this is what I have tried to explain earlier. For example upto 20 HP category is growing but we have not showed much interest there, we do have an outsource program but are not participating because there is no money. Even in 20-30 HP which contributes about 8% of the industry and where we had 3.5-4% market share has now become zero market share, as we are vacating it. The reason for my quoting this is as to how it will have an impact on the overall market share because it is very important for us to clean up ourselves so we sharply focus on the brand the way we want to. Now having said that there are only three categories we're talking about, the first category, the image category, if you look at it in the last three years our market share has moved up continuously from 1.5% in 2010-11 to 3% in 2011-12, to 4% in 2012-13 and in this quarter we are at 6%. In couple of quarters from now we can be around 8-10% level. This in itself is a very steep journey from 1.5% market share to 10% market share in three years and this 10% can reach to 20% in one and half year or so. This is where our collaboration with companies like Porsche Design and other many alliances for which we have tied up projects are halfway through and as per target. This market share which we are talking about is even before we launch world-class products through our collaboration, this is to tell you that we are on our way to become an image leader; for which programs are firmly in place. The second category is the 45-50 HP category, even though TMA reports only for 41-50 HP category. In the 45-50 HP category, which we call it as E-category, we used to have a market share of 18-20% couple of years back which came down to 16%, this fall is mainly because of the South and West phenomena. We are not present in markets for example Maharashtra which has over 60% of the market in this kind of segment. I spoke about three different products launches in the category of 45-50 HP, these products together in our hope should move the market share from 16% to 20% over a period of two years. Definitely 2% odd on an all India basis but the South and West should increase its market share from something like 3% to 6-7% type, this is what our plan is as long as we are focused on the kind of products and our pricing is on the top one-third percentiles. If I have to give you an example; products like Swaraj and Eicher fall under bottom one-third of the percentile, Mahindra may be in the middle and we are on the top one-third percentile in terms of pricing. Even with that pricing we are moving our market share. What may be perplexing is when you look at the overall market share which has declined but we will be consolidating in the segment and market of our choice. Market of our choice should happen but if it doesn't it really doesn't matter as we will be governed by the bottom-line rather than top-line.

Bharat Madan And just to address the questions on the financials, the manpower cost we have been able to put on hold as of now. If you look at the numbers for this quarter versus last year we are actually at the same cost in spite of the settlement with union and increments being given. On the material cost there are two things which we need to look at, one of the top-line like Mr. Sridhar talked about, we are moving towards the product mix which will be towards higher end products/ premium products, so the revenue will go up. Second on the material cost we have taken action but such actions generally take longer time to get implemented and bring the benefits on the books, So the efforts are on, and the reduction is as per plan and you will see gradual reduction happening on material cost front going forward. As of now we continue to be at around 72% on tractors business.

Sachin Kasera Can you give a road map in terms of the material cost, as to where you would like to be over two years from now?

Bharat Madan We are benchmarking against the best in the industry where the gap is of about 4% today and we aim to capture at least 50% of that in next two year's time.

Sachin Kasera What is the total debt?

Bharat Madan We are at approx. Rs. 411-413 crores by end of December.

Sachin Kasera This number is kind of likely to plateau?

Bharat Madan It will continue to be in this range, As, we said say for long term debt, we are raising debt for the CAPEX program and we are also repaying which will be more or less neutralizing each other. Now working capital loans keep fluctuating and in a season when cash flow is good, it will go down...like June quarter... but again, during September- December quarter in off-season months it goes up again…so average basis overall debt will continue to be in the same range.

Sachin Kasera Where will you use your cash flow?

Bharat Madan As of now, it is being used to repay the short term loans. We have reduced our working capital loans in this quarter, If you compare versus last year we have reduced our borrowings by almost Rs.100 crores. , You can see that in reduction in interest cost which has gone down by almost Rs. 6 crores. So there is opportunity in working capital borrowings and as and when we have surplus cash, we will obviously park it in short term loans and reduce the debt.

Sachin Kasera In terms of CAPEX you said you're going to use the money for CAPEX, so this is what CAPEX?

Bharat Madan This is the product related CAPEX which we are doing.

Sachin Kasera CAPEX will typically go in the balance sheet or in the P&L?

Bharat Madan In the balance sheet.

Sachin Kasera How much every year?

Bharat Madan Roughly Rs.80-90 crores a year.

Moderator Next question from the line of Mr. Aksh Vohra from Praj Investments. Please go ahead.

Aksh Vohra I just wanted a clarification, you mentioned that from 41-50 HP contributes 50% that is for Escorts or overall industry?

S Sridhar This is for industry.

Aksh Vohra And one more thing you mentioned in 50+ HP and we were aiming to have market share around 20%, so where will be the demand coming from mainly from South region or in India or from export?

S Sridhar Exports is separate, this what we're talking about this category of products also goes to exports, the entire European series what we have launched is in this kind of a category, this kind of a category emerges in South, West, evolved markets like Punjab, Haryana, which are predominant in this, over 50 HP.

Aksh Vohra So mainly what we are aiming market share expanding in South around 12% next two years would be mainly coming from 50 and above HP?

S Sridhar It will come from 45 -50 HP and 50+ HP

Aksh Vohra You said that for FY14, we will be able to grow around 10-15% for full 18 months, so that would be for tractor division or for the company as a whole?

S Sridhar This is I have not spoken about the Escorts, this I spoke about tractor industry.

Aksh Vohra Tractor industry is will be growing at 10-15%?

S Sridhar Yes.

Aksh Vohra Lastly our margins in tractor division came slightly below the expectation, so would it be able to sustain or will it be about 10% level?

S Sridhar We talked about a targeted EBITDA of something like 15% as a part of a three-year program and also like Mr. Madan has already explained that we are almost at 10% level, so we are very much on our path.

Aksh Vohra I just wanted to know that will it be maintained for the next 2-3 quarters about 10% or it will be below 10%, just wanted to know?

Bharat Madan It is likely to be maintained.

Moderator The next question is from the line of Mr. Hardik Doshi from First Voyager. Please go ahead.

Hardik Doshi Just wanted to follow up a bit on your commentary on the overall demand on tractor to grow by about 14% next year, I just wanted to tally that, Mahindra Finance in the recent conference call was saying that in the West at least in MP and Maharashtra they were seeing a little bit of weakness in the near term because of the delay in Paddy price and Soya bean prices being firmed up and also in the South they were seeing delinquencies, I know your market share out here is small but can you just give any sense of are you seeing any kind of stress levels at all in your markets out there?

S Sridhar In fact we do not share their view that prices for example what they are talking about the crop for prices whatever they're talking about the delay, see the growth and what exactly what has been happening we do not have a direct correlation at all, it has been already growing, if you look at the last few quarters the growth rates are very high, it is in the range of 22-25% so the next time what'll happen is that the growth rate will get moderated, it will be moderated in our estimate to 12-16% that is why we are taking the average rate what of 14%. We do not see anything abnormal for example overall conditions were much better, quality of monsoons was much better, crop quality is much better, output should happen. The second better season over the first season generally keeps that momentum going. Already people are in a good sentiment as far as the rural folks are concerned, fundamentally there is nothing wrong with monsoon or crop prices nothing is deteriorating and we do not see any negative things to dampen those kind of stuff, so invariably around 12% to 16% is the kind of band we would like to take.

Hardik Doshi Anything in Andhra related to the weather disturbance in the third quarter. Any impact that had on the agri-output and demand environment there?

S Sridhar As I said we are too small in Andhra but overall in the industry we do not see any impact.

Moderator The next question is from the line of Mr. Ajay Shethiya from Centrum Broking. Please go ahead.

Ajay Shethiya Just wanted to understand on the industry side, how is the demand - supply scenario and secondly what would be the utilization rates for the industry?

S Sridhar I think as of now there is no short supply, I think there is enough capacity.

Ajay Shethiya I was referring to was the oversupply which is likely to come, with player's sort of adding capacities?

S Sridhar No, I think nobody has added capacities in the last 1 to 2 years, the industry was flat with almost 0% growth for two full years. There is enough capacity so far, so there is neither short supply, and the kind of demand what is going to happen will ease out that is why I said competitive pressure is expected to come down in the next three or four quarters actually.

Ajay Shethiya Second thing within the South market Tamil Nadu as a pocket has seen a de-growth of almost 45% to 50% and there was an expectation that from January onwards TN would pick up, any signs which are looking or gathering from the marketing guys over there?

S Sridhar No, because Tamil Nadu again we are non-existent. Tamil Nadu and Kerala together have suffered of a very bad North East Monsoon, so a monsoon failure resulted in certain problems and Tamil Nadu is slowly becoming a non-agrarian state, so the industry size is also becoming marginal. For us it barely matters we are out of Tamil Nadu, we are very small.

Ajay Shethiya How is the trend sort of moving on non-Agri usage of tractors, maybe if you can just take us through the last 2 to 3 years what sought of trend you are looking at?

S Sridhar Non-Agri usage of tractors happens more with the resale tractors, it is a trade-in tractors, and 50% of the purchase gives the old tractors and buys the new tractors. Old tractor are sold for haulage purposes which have considerably come down in the last two years because of that the resale value has also come down, so this is one of the sufferings. For that area we do not see any recovery yet so while agricultural activities are positive those areas are not much but I would assume that in another one or two quarters even those areas will start seeing a recovery, when that recovery happens the resale value becomes better and that really helps the industry to further grow. These are all the areas which would differentiate what would happen between 12% industry growths to 16% industry growth.

Ajay Shethiya This last question what would be the inventory levels for the industry, would be in the comfortable zone given the fact that the demand is quite strong?

S Sridhar Yeah of course this is reasonable, we do not have any reasons to believe that anybody has lesser stocks.

Moderator The next question is from the line of Mr. Viraj Kacharia from Security Investment Management. Please go ahead.

Viraj Kacharia I have two questions, first one is on the Ferrari Tractors in the sub 20 segments, so how has been the response so far and what are the thoughts on that particular product?

S Sridhar Ferrari is a niche product, we have already have said that 100 tractors in a year will be considered a very big number. I think we have sold 48-50 so far. The current pricing of that product when compared to a similar product from Kubota may be at around Rs. 4.5 Lakhs and this is at around Rs. 8 Lakhs, so it is pretty expensive. The idea behind these products is to enhance the imagery and also we are exploring possibilities of selective localization to bring down the cost, so there is a discussion going on between our R&D team and Ferrari Europe, so as and when there are developments I think we will share it with you.

Viraj Kacharia But you did have some plans to launch something in the 20 or 22 HP segment more Ferrari tractor?

S Sridhar Ferrari tractor is 24 HP but it is a pretty expensive tractor and not like a Rs. 2 Lakh tractor for example like Mahindra Yuvraj. This is 4x expensive than the other tractors but we are doing something, some localization. These things are too early to discuss but these things are required to be seen more in terms of a long-term outlook. Say around three years from now these kind of segments will become very significant, so actions are put in place more keeping in view of future.

Viraj Kacharia As you rightly pointed out that the fact that the price differential is pretty big say Rs. 2 Lakh versus Rs. 8 Lakh, even if you invest, the difference is still be a big factor for any farmer to go for Mahindra Yuvraj vis-à-vis Ferrari, so what is the thought process?

S Sridhar The idea is not about money, it is not about Rs. 2 Lakhs versus Rs. 8 Lakhs for example Rs. 2 Lakhs tractor is bought by the guy with one or two acres, the Rs. 8 Lakh tractor is brought by the exporter of grapes. So the profile of the customer is very different but this kind of a segment is impacted because the compact tractor as segment in India is yet to emerge, it will emerge. Currently we have a utility range, the entire industry operates on a utility range, so this kind of an area we needed to make a beginning and I would like to leave it that way, this has a lot of strategic implication on what we call internally 2020 plan. For those kind of plans Ferrari will have an very important play but not on the immediate quarter and immediate year.

Viraj Kacharia Just wanted to get your views on how you look at the other agri-machinery like you have tillers; rice transplanters, what is the medium-to long-term view on the how you view those segments and weather Escorts is looking to venture into those fields as well?

S Sridhar There is a huge opportunity and I need not even mention that everybody understands this and the world has moved on to an advanced stage, we are just scratching the surface. Having said that there are a couple of decisions we have taken, we are short listing equipment, trial operations are on, it is almost one and a half years we are into those kinds of studies. We will not be manufacturing those kinds of equipments which do not give us a very good margin and very good scale, so we will be outsourcing those kind of implements and I think possibly we will be in the position to share in one quarter down the line, so serious evaluation is going-on on those kinds of areas.

Viraj Kacharia Any particular product segment you are looking to target for vis-à-vis others?

S Sridhar No, that I think I should not disclose right now, let me do this and maybe the next conference call we will be in a position to share something on this.

Moderator The next question is from the line of Mr. Kaushik Poddar from KP Capital Market. Please go ahead.

Kaushik Poddar Can you speak something about the railway products?

Dipankar Ghosh Railway products actually if you see in this quarter which ended in December, the top-line was little bit down because we were expecting a few big tenders which are still to be concluded particularly wagon tenders which we are a big supplier of, the whole of the wagon industry for almost one-to-one and a half years did not have any orders coming out from the Railway Board. We expect that now with the joining of the Member Mechanical and the Chairman, Railway Board we should be having some new tenders coming out which should also give us a significant amount of business. We have recently launched a few products which are in consolidation mode which should be there available for us to commercialize by July-August timeframe of 2014, so that would be a big impetus for us.

Kaushik Poddar What is the kind of growth that you are looking say next year?

Dipankar Ghosh Next year we are looking at 15 to 20 % growth.

Kaushik Poddar And your overheads and all these things will remain same?

Dipankar Ghosh We are also working on a fixed cost and we hope to reduce our fixed cost quite a bit.

Moderator The next question is from the line of Mr. Sunil Jain from Nirmal Bang Securities. Please go ahead.

Sunil Jain This is more related to auto ancillary products, no doubt the revenue came down along with the industry but the losses seems to be mounting on a revenue of Rs. 29 crores we are incurring a loss of Rs. 9 crores, so what is the reason behind that and how we are taking up this. No doubt you are trying for some tie up but till that happens what measures we are looking in it?

Lalit Pahwa Actions are already on to reduce the fixed cost and convert some of them into variable costs so that we are better prepared to take the industry downturns or volume downturns which happened in the auto industry so that actions are on and in the coming quarters I think the results of that would be visible.

Sunil Jain But was there any extraordinary in this Rs. 9 crores EBIT loss?

Lalit Pahwa No, our fixed costs on an absolute basis did go up because of manpower costs going up and that is something that is being worked up on and brought down.

Sunil Jain So the key reason for the continuous loss in this particular division is manpower only or it is something else?

Bharat Madan No, it is both volume drop which is significant, plus the manpower cost increase which is there and then there is another reason which is the product mix which was not favorable compared to what we had last year because of which bottom-line has been affected adversely.

Sunil Jain Apart from this in Construction Equipment, we are seeing uptick in volume also and plus revenue also, so can you throw some light how this is likely to move in the coming period?

GVR Murthy The construction industry continues to be policy driven and we have seen a significant drop in the industry as the quarters are moving ahead. You see the number of equipment being sold on a unit terms is probably we are growing better than the industry fall that means that we are keeping our market share intact and in some of our prime products like Backhoe loaders our DigMax II market shares have gone up in spite of the downturn. That means it has given us better product mix and focusing on the core product has given us the volume growth. The profitability portion of it came probably from cost optimization from our end and on also price increases and netter price realization.

Sunil Jain But any outlook on the coming period since you are growing better than the industry, so any steps you might have taken to sell a product more in the market which may be driving all these things, so any outlook on that?

GVR Murthy When you look at our product range almost all our products have seen a downturn but one product that continues to be very stable is the Backhoe Loader business So we're focusing very seriously on retaining the Backhoe Loader market share with us. We are very many small player there but we are increasing our market share significantly today, we can say that we reached a market share of something like 5% and we are focusing on that and we look forward to drive that business. Coming to the forecast I would be very reserved and we are looking at that this current situation we will continue for the next at least two quarters.

Moderator Ladies and gentlemen due to time constraints that was the last question from the participants. I would not hand over the conference back to the management for their closing remarks. Thank you sir.

Rajeev Dass Ladies and gentlemen as usual once again it has been a pleasure talking to you and we do thank you for sparing your time and being with us on this conference call. We at Escorts very strongly believe in our core values, not only respect for our own individual internal team members but respect for our investors, our stakeholders, empowerment, transparency, and collaboration come up in the next areas of our core values. We do our business on the basis of these beliefs and we look forward to once again having and sharing your thoughts with you at our next quarterly investor call. Ladies and gentlemen thank you so very much.

Moderator Thank you. On behalf of Escorts Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.