



“Escorts Limited Q1FY15 Earnings Conference  
Call”

**July 30, 2014**



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**MR. DIPANKAR GHOSH – CEO, ESCORTS AUTO &**  
**RAILWAY PRODUCTS**  
**MR. BHARAT MADAN – GROUP FINANCIAL CONTROLLER**  
**MS. JYOTI KHATUKA – HEAD, TREASURY**  
**MR. SAIKAT MUKHOPADHYAY – CFO, ESCORTS**  
**CONSTRUCTION EQUIPMENT**  
**MR. RAJEEV DASS – VICE PRESIDENT, CORPORATE**  
**AFFAIRS & COMMUNICATION**

**MODERATOR:** **MR. RAGHAVENDRA JAIPURIA - PERFECT RELATIONS**



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**Moderator:** Ladies and gentlemen, good day and welcome to the Escorts Limited Q1FY15 earnings conference call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference, please signal an operator by pressing "\*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Raghvendra Jaipuria of Perfect Relations. Thank you and over to you sir.

**Raghvendra Jaipuria:** Good afternoon. Thank you for joining us on Escorts Limited Q1FY15 results conference call. Today we have with us Mr. Sridhar – CEO, Escorts Agri Machinery; Mr. Ajay Sambrani – CEO, Escorts Construction Equipment; Mr. Dipankar Ghosh – CEO, Escorts Auto & Railway Products; Mr. Bharat Madan – Group Financial Controller; Ms. Jyoti Khatuka – Head, Treasury; Mr. Saikat Mukhopadhyay – CFO, Escorts Construction Equipment and Mr. Rajeev Dass – Vice President, Corporate Affairs & Communication.

We will start the call with brief opening remarks 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 in today's discussion will be forward-looking in nature. At this moment, I would request Mr. Dass to make his opening remarks.

**Rajeev Dass:** Thank you Raghvendra. Ladies and gentlemen, very good afternoon to you all. Thank you for joining us on the first quarter conference call for financial year 2015. Just one minor change before I go into the details. Mr. Ajay Sambrani is not with us today, but is represented by Mr. Saikat Mukhopadhyay who is the Chief Financial Officer of our Escorts Construction Equipment business.

Unlike the earlier times, I would like to dive in straight with our operating businesses and comments and presentation on that and then round it up with a group perspective during the course of this call.

Starting with the Agri-Machinery business, our tractor volumes were up sequentially close to 15% for the quarter, although lower by 8% correspondingly. The industry also has degrown by 2% in this quarter compared to last year. Industry degrowth is attributable to the subnormal rainfall in the Northern and Central region and the unusual weather witnessed at the start of the quarter. To give you some perspective, our strong markets with mix are close to two-third of the industry volume degrew by 7% and the weak markets which contribute the remaining one-third of the industry volume grew by 11%. As mentioned in previous calls, we have almost vacated the sub 30 horsepower segment and aim for a market leadership position in the higher HP segments. In this regard, industry in the 50 plus HP segment grew by 5.7% and now contributes 11% to the overall industry tractor volume. In this growing segment, Escorts registered a robust growth of 66%. The FT 6055 model in this segment alone sold 787 tractors against the zero base volume. This model along with value addition in the existing models underlines our endeavor to

command a leadership position in the higher HP segments. It is also encouraging to see an uptake in our export market share which has increased to 3.1% from 1.7% last year.

Tractor inventory, our dealerships have been brought down by 983 tractors. This was done keeping in mind the anticipation of a weaker monsoon. As mentioned in our earlier calls, our focus on material cost reduction is being monitored very closely along with the external consultants and we are confident that this fiscal year itself will see a significant addition to our bottom-line on the cost reduction that will be managed on our material front. Credit finance facility to tractor customers will see a significant enhancement with the tie-up in Larsen & Toubro finance and will be a key step for adding to our customer reach.

The recently concluded budget was positive for the agriculture sector with government announcing an outlay of Rs. 8 lakh crores for agri credit for improving farm productivity through farm mechanization. Such initiatives will help shape sector for a more sustainable growth in the future and also provide the much needed impetus for industry participants and farm mechanizations.

I now switch to the construction equipment business. The volume remained flat versus last year, but the revenue increased by 11% and stood at Rs. 121 crores. This increase is a reflection of our focus on better product mix and realization per unit. Also when compared to the last quarter, our volumes increased by 42 units and the income was up almost 10%. Focus on premium and differentiated products along with prudent cost structure and rationalization has helped improve our margins both at the corresponding and on a sequential basis. As discussed in the last quarter, we have engaged with consultants to bring down raw material cost. In the current quarter, our losses came down by 30 basis points versus last year and by 150 basis points when compared to the last quarter. We will continue to develop offer innovative products and move up the value chain in this area. This along with the ongoing cost rationalization activity, gives us the confidence to perform better than the industry in the fiscal ahead. Lastly, new government's focus on building the country's infrastructure will further boost the prospects for the construction equipment sector and aid Escorts Limited in consolidating its position in the infrastructure machinery space.

Coming to the Railway division, Railway division stands to gain from the renewed focus of the government on reviving the rail infrastructure in India. Railway Board's finalization of the wagon tenders has given impetus to airbrake requirements. Also the potential introduction of high speed and long haul trains and the dedicated freight and passenger corridors augurs well for our three main new products.

Looking at the quarter performance, the revenue of Rs.43 crores was down by 5% as compared to sequentially and 20% correspondingly. EBIT at Rs.1.63 crores as that of Rs. 4.84 crores sequentially and Rs.5.42 crores correspondingly. The order book of approximately Rs.33 crores stands to be executed in the next coming quarter.

The Auto division reported a revenue of Rs.23 crores, down 25% sequentially and 38.6% correspondingly. The loss during the quarter at Rs.9.2 crores as that of Rs.7.1 crores sequentially and Rs.3.4 crores in corresponding quarters. We continue to evaluate partners for this business. However, to reduce losses, we have introduced the VRS scheme to rationalize the blue color manpower cost and will further bring it down to industry standards within the next quarter.

I now turn to a brief look in our group financial numbers before we turn it over for a question-answer session. The turnover for the quarter increased by 15% to Rs.1,129 crores sequentially and down 4% on a corresponding basis. The material cost as a percentage of sales was maintained around 72%. Employee cost of Rs. 116 crores decreased as a percentage to sales by 100 basis points compared to last quarter. Other expenses, however, were up by 48 basis points sequentially and by 173 basis points correspondingly. EBITDA up by 24% sequentially to Rs.57 crores and down by 38.7% correspondingly. We continue to bring down our debt resulting in finance cost down by 34% compared to last year to Rs.13 crores. Our total debt outstanding as of June 2014 is Rs.376 crores. The PAT was reported at Rs.34 crores for the quarter ended June. Ladies and gentlemen, now I request the moderator to open the floor for question-answers which the team will ready to comment on. Thank you.

**Moderator:** Thank you. Participants, we will now begin with the question-and-answer session. We have the first question from the line of Mitul Shah from Karvy Stock Broking. Please go ahead.

**Mitul Shah:** My question is on the tractor industry volume growth. In the CNBC interview, Mr. Madan said that they expect 3%-4% growth for the second half. For the first quarter industry already reported 2% decline and for the second quarter it is expected to be declined in the range of 5%-6%. So that means for full year industry will decline in the range of 2%-3%?

**S Sridhar:** Mr. Mitul Shah, see the way we should see the first quarter itself is explicitly 2% down. The segment which is growing is the micro tractor that means the Yuvraj types, that is something like less than 20 horsepower tractor. If you provide for that, then the industry growth will be further coming down to something like -5%. To that extent, it was on expected lines, the 5% down expectation is what we have discussed on the last con-call. So this was on the expected lines, but what we did expect was something like marginally positive, around 3% we expected in the second quarter too. Now the way it is happening with the 51% sowing, whatever we have seen looks like it may not be even 3% or 4%. The best estimate can remain as around 0 to 1%. So to that extent, industry will go through their moderation period. You can also see CRISIL and all other reports, they are also validating the same thing whatever we expected. So the second half, the growth rate can still be around 4%, because there again the quarter 4 was very low. So with that, it can be something like 1% or 2% kind of a registration is what we should expect for the entire year.

**Mitul Shah:** Because sir again first half base is very high. So if we decline on that base, anyone if we grew by 3%-4% on the second half, so overall industry's growth comes down to minus 2%-3% kind of thing.

**S Sridhar:** Still we really do not know. The quarter 3 and quarter 4 growth can still be very high. The quarter 3 growth can still be like as I said is 2%-3%, we really do not know. Still we do not know the impact of monsoon. So the base rate what you are saying is correct. The quarter one base rate was something like 26% which was very high. Even if it is -5%, it is not all that a bad show. If you look at it, that is not really bad from a 26% growth rate of last year. So if you look at it that way, it is going to be moderate. It is going to come down. It can happen that way, I cannot say. It will be something like a 2% type is the best you can expect for the whole of this year actually.

**Mitul Shah:** And for sir higher HP segment, what is your view in the second half, the growth will come from the higher HP side will it be across the segments?

**S Sridhar:** See if you look at the higher horsepower segment, on a long-term point of view, it is here to stay. This is what we have shared 2 years back and the same thing we are sharing now also. What started small it started growing. I think other than the micro tractor, the biggest growth is happening only on the 50 horsepower and above. We had also made a commitment that that is the segment where we want to be the leader possibly in the year 2015 and 2016 was our explicit commitment. In that way, I think 3-year back from a market share of 1%-1.5%, we become 3%, 5%, 7% and then this year the plan was to do something like 11%, we have already achieved that in the quarter one. So to that extent, we are on our way to the higher horsepower segment. There are no surprises there. But what is most important is the segment one thing below which is something like 45-50 horsepower where we did had some huge market share, something like 21%-22% types some 5-7 years back and that has come down to 16%-16.5% today. So that is an area where we do have lot of action plan. We are hopeful of reversal trends there.

**Mitul Shah:** Thanks sir. Second question is on the regional mix. In the first quarter, we have seen south growing by around 10% in all other segments. Other regions North, Central declined or remained almost flat. So for the second half if you are expecting industry growth of around 3%-4%, so which regions you do expect to grow?

**S Sridhar:** I think in a way it is very difficult to guess still let me try to give you some assessment. First thing is in terms of share data, the last year last quarter the area where we operate what we call our strong market, something like 60% of India was growing at the rate of 35%. Whereas the weaker market, the 40% of rest of India which is something like Gujarat to South of India including Bengal, this we call it as weak market. And that was last year same quarter was growing at 11%, continue to grow at the same rate of 11%. There is no change in that market whereas our strong market from 35% has come down to -7%. In a way it is a shock to our own segment, but having said that there is one advantage where we operate, the half of this area is an irrigated area to that extent, I think it has a better ability to absorb shock. See this reason for my

quoting this is if you look at the States like Tamil Nadu and the States like even half of Maharashtra, they were dropping at around 30%-35% year-on-year for 2-3 years. Those things we should not expect in our market because of better irrigation facility. I would expect a much more moderate stand from -7 it should almost become marginally positive if not very high.

**Mitul Shah:** Because sir South and Western despite reporting higher growth last year, still base is much lower as compared to last 6-7 years levels. So there is high probability this region would outperform or the industry growth would come from these regions. So what we are doing anything in terms of improving market share or strengthening the position in this regions?

**S Sridhar:** I think exactly three quarters back, we have talked about an initiative to derisk the company because that is the zone where we are operating. If it becomes vulnerable what happens is just as what you call business derisking activity. We wanted to take couple of major states in South and West and we wanted to crack. I think to tell you explicitly, we targeted Andhra and Maharashtra for example. Three quarters back, we started an initiative in Andhra, we canceled something like 15 dealerships in 10 districts and those areas after three quarters against the industry growth of something like 8%, and our growth is around 30%. The reason for quoting this is, that means whatever formula we have tried out and those kind of markets seem to be working. Now we have to scale it up. Scaling costs is first thing is money and as far as the time, we do not want to upset the overall apple cart. So over a period of 2 years' time, we will take it to the two States which is Andhra and Maharashtra, eventually spread it to Karnataka and other major States. So we are into an action plan. The way we have already discussed is for us to see an end benefit, it is a 2-year activity. It cannot be anything less than that. But I think initially it is showing some success in the three quarters that 10 districts of 15 dealerships are showing a huge success if have to say so.

**Mitul Shah:** Sir my last question is on the Construction Equipment business. Revenues are up by around 10%-11% on YoY as well as sequentially and your average price per vehicle is also up by 6% on a QoQ basis. Still losses are almost in the same region and when last conference call you highlighted that losses because of some annual adjustment and which will not continue going forward. Still the loss remains close to Rs.9 crores as compared to almost Rs.10 crores last quarter and around Rs. 8.7 previous corresponding.

**Saikat:** Mr. Shah, while the realizations have gone up, the number that you see as far as EBITDA losses are more or less on the same front because of certain exceptional expenditure that we are incurring to improve our bottom-line while the variable and average costs, we are on top of it. But over the next 3 months or so, the exceptional item of cost that we are incurring at this point of time will go over. So while the realizations are up, within this quarter we will be over this expenditure.

**Mitul Shah:** Sir out of this 9 crores, what would be the quantum of that exceptional part?

- Saikat:** It is about Rs. 2 crores.
- Mitul Shah:** Sir what will be the breakeven revenues? Of course the losses combined the ancillary and construction equipment are close to 23%, is taking roughly 23%-25% of the profitability of the tractor segment, Agri-Machinery. So what would be breakeven point or when do you expect it to be turnaround?
- Saikat:** The green shoots are starting, we are seeing that and this quarter, the initial part of it is getting crystallized, but the main crux's of it will come in the October and January quarter where the things will come under the implementation phase. So that is the quarter to watch out as far as Construction Equipment business is concerned.
- Rajeev Dass:** In our last conversation Mitul, we had mentioned that January 2015 is our deadline for very healthy breakeven at the EBITDA level. We are internally targeting to try to achieve that in the month of October-November itself as Saikat has confirmed to you today. The industry volumes still need to grow a lot more than they have grown till today. We are seeing visibility in the material handling space where we are seeing visibility of growth, but correspondingly we have seen some degrowth in the backhoe loader segment. But having said that, we are geared in our backend operations for new dealers and new coverage geographies with the new product DigMax II which has been very successfully received. I do feel that the target of getting to breakeven by October-November would definitely be met earlier than the earlier commitment which we had given of January 2015.
- Mitul Shah:** Sir what would be the breakeven volume roughly, Construction Equipment side?
- Saikat:** At about 300 volumes which is about Rs. 50 crores of turnover.
- Moderator:** Thank you. We have the next question from the line of Arvind Sharma from Citigroup. Please go ahead.
- Arvind Sharma:** My first question would be what the pricing scenario, like in an industry is. Do you see discounts rising or incentive rising given the tractor demand has been weak as you said.
- Sridhar:** I think of course this is the characteristic of this industry. Whenever the industry goes through this kind of a negative growth, there is lot of pricing pressure do happen. So that is prevalent for the quarter one. It really happened that way. But having said that, certainly we are moving our prices up from first of August. We are moving the customer prices up on an average by Rs.5,000 which may be varying from something like Rs.2,000 to Rs.8,000 kind of a thing depending on the model. We are moving the prices up. This is here to stay. I think we are more interested in keeping ourselves stirring clear up this kind of activities.
- Arvind Sharma:** But sir, have you seen increasing incentives from the competitors?

- Sridhar:** I think here the level of activity has gone beyond the incentives. They are all advertising in the press. They are all putting at a newspaper crossing the prices actually. So it is all explicitly offered to the customers. If you look at the scenery of today except couple of brands, one is Swaraj as well as Sonalika, I think the whole industry seems to be under severe pressure where people dropping market share heavily. So these things are bound to happen. These two brands are generally an entry level brands which are attractive pricing and things like that possibly. So this is here to stay for at least three more months.
- Arvind Sharma:** Thanks. Sir my second question would be that do you see any increase in demand from the non-agri usage of tractors? Has it happened over Q1 or do you see it happening over next 6-12 months?
- Sridhar:** The first thing is infrastructure. The moment the non-agri activities goes up, first I think my own sister division will be the beneficiary. As and when the demand picks up, this kind of a tractor is a spinoff. This will happen with the lag effect of minimum 6 months. So I don't think I should count on infrastructure activity as a basis of tractor increase for the next 2-3 quarters.
- Moderator:** Thank you. We will take the next question from the line of Aditya Makharia from JP Morgan. Please go ahead.
- Aditya Makharia:** You did mention that you all are focusing more on the 50 horsepower plus segment and also this segment I believe has grown while the rest of the 30 and 40 sub segments have declined. So what could you attribute this increase to?
- Sridhar:** No, see the point is, one is the size itself is a small, that direction itself is continuous. This is not a new phenomenon. This is a phenomenon which is witnessed for last 8 or 10 years now, so this in any case it is there. I cannot attribute as one packet on one immediate reason, this is a general trend actually. And from our side, I think we have got a lot of product initiatives. Whatever we have put it across, this is yielding results and that segment it started yielding results and what we are keen is now is under 45-50 category. That is where we are working now.
- Moderator:** We will proceed with the next question that is from the line of Bharat Gyanani from Reliance Securities. Please go ahead.
- Bharat Gyanani:** I just wanted to really understand your strategy on the auto ancillary side because the losses have sort of widened dramatically. If you see it last 3 quarters it seems that our efforts towards increasing the revenues or bringing down the costs have not really worked out like if you see the losses have really widened from Rs.3-4 crores to a level of about Rs.10 crores now roughly. So what is really the strategy of the management on that side, if you can throw some light on please and what breakeven time do we expect from that segment? Thanks.



- Bharat Madan:** No, Bharat I think one of the reasons for EAP not giving the desired number is obviously the top line which you see the decline happening. From the last year or so, the number it was about 31 crores. We are down in turnover to about 22 crores this time. So one of the key reasons and that reason was the manpower cost which we are not taking measures to address it now. We have recently launched VRS scheme. We had announced in the last quarter concall also they will be coming out with their VRS scheme to take care of this manpower issue. The manpower in this division is almost 20%-22% of the total sales value which eats away most of the margins in this division makes. So one obviously is the driving of the topline which will be one of the key priorities for the company and second is in terms of bringing down this cost structure. VRS is already on. We are hoping by end of this quarter, we will be able to address that issue. I think on an annualized level, Rs.10-12 crores of the manpower saving should happen from that effort alone. So from H2, you will probably see the numbers becoming better both in terms of topline improving as well as in terms of the cost control which will come into play by that time.
- Bharat Gyanani:** And sir like that is good to hear from on the employee side, but the strategy which is highlighted in the last quarter that you would be focusing more on the exports side and the aftermarket side of the business, but then it really seems not to be worked out. So like when we expect the management strategy of turnover improvement to really play out in this segment particularly?
- Dipankar:** Primarily as Bharat said that we are going into a turnaround of that particular division. The major fixed cost portion we are taking care of through the VRS of the old legacy staff and as per whatever we had talked about in the previous quarters, about introducing new products and entering into new markets like the aftermarket of the export aftermarkets. We are going into that and this has usually a lag time of around 3-4 months. We expect to see all those improvements and the new products and the new market entry contributions coming in the H2 of this year.
- Moderator:** Thank you. We have the next question from the line of Mukesh Saraf from Spark Capital. Please go ahead.
- Mukesh Saraf:** My question is primarily on your margins. So obviously on the farm equipment side, EBIT margins of 8.3% is low YoY, but if I look at your standalone numbers, if I look at your gross margins and if I assume that as an indicator of your gross margins at your tractor business as well, I am not seeing an improvement there despite a product mix improvement. Because if I look at your volumes, I see that greater than 50 HP is more than 7% of your volumes now and this was just 2% last year same quarter. So product mix is probably improving in the higher HP, but I am not seeing gross margin improvement and obviously the EBIT margins also falling. So could you just help us understand this?
- Bharat Madan:** One of the reasons for EBIT margin falling is obviously there is some half percent increase which was happened on the material cost front and like Sridhar mentioned just as now we are increasing the prices from 1<sup>st</sup> of August to pass on that inflation. So it will get neutralized in this quarter. Secondly, in terms of overall cost if you look at is generally inflationary trend in the

other cost. So the selling and admin costs both have gone up. SGA have really gone up in this quarter. So that is one area I think which we are controlling right now. So I think from next quarter, you will see an improvement happening on that front as well. But again depends if the industry continues to be in this same manner, we will be looking at a flat industry or a degrowth, then obviously there will be some pressures on the selling side which will continue.

**Mukesh Saraf:** So the gross margin reduction, I would say is only on the back of material cost and that should go back to may be 70%-71% of sales from next quarter is what you are saying?

**Bharat Madan:** Yes. Plus in addition, we said we are also taking the help of external consultant. We have already undertaken a project. The mandate has been given to reduce the material cost further in the next 2 years' time, which we had discussed last quarter as well and that project is already on. The benefit of that project will start coming from Q4 of this year and it will be more reflected in next year going forward. So I think that will be major game changer for the company and you will see the margin coming back to the double digit numbers.

**Mukesh Saraf:** But isn't there a positive impact of the product mix? Despite the fact that may be our material costs have gone up slightly and again next quarter you will again hike prices and get it back in control, but your product mix should also reflect in some improvement. Should not that happen sir?

**Bharat Madan:** There is an improvement, but like Sridhar has been mentioning in the past also, now in this market which is not growing, the ability to pass on the material cost increases and about new products which have been introduced in this segment is very difficult. So once you see the recovery happening in the market, our ability to pass on those cost increases to the market will be very high. So as of now, that restriction is there which is why we are actually doing some under recovery in those models in the higher HP category which probably will be taken care of in the second half when we see some improvement happening in the market sentiment side.

**Moderator:** Thank you. Our next question is from the line of Riken Gopani from Infina Finance. Please go ahead.

**Riken Gopani:** Sir wanted to understand that this quarter, your automotive division has seen a very sharp decline in revenues on a Y-on-Y basis given that whatever various automotive companies have reported on volumes, this has been a pretty good quarter for all automotive companies. So any reason why our ancillary business has declined so sharply this quarter?

**Dipankar:** The primary reason is that we are going for a massive restructuring through a VRS of the old legacy blue-collar worker and as you would appreciate once you go for this sort of a restructuring in the shop floor with the old legacy labor there, the overall operational efficiency and the productivity drops. And also accordingly what has happened is because of the fact that you have to create at times the conducive atmosphere for the people to take VRS, we had to let

go off lot of our top lines along with seek lot of disciplinary measures what we were taking in the shop floor. So that was the primary reason. We hope to recover in the coming quarter and as I said in the previous response that in H2, we would be going back to black that is the plan what we turnaround for this division.

**Riken Gopani:** So absolute number of people, how many are being given VRS in the automotive division and what is the total number of people today?

**Dipankar:** Total number of people would be in the range of 550 plus. We are targeting around 250-300 people VRS that we are targeting.

**Riken Gopani:** And just to understand this better, this VRS plan is in order to curtail this business overall. What is the plan here? Is it that we were overstaffed or just wanted to understand why such a massive exercise being undertaken here?

**Dipankar:** Primarily, we were overstaffed. There is a huge fat out there. So we are cutting down the flab. We are becoming lean. We are trying to improve our operational efficiencies. That is one of the major portions as in the previous response, Bharat also said that we have almost 23% of this fixed cost as the overall manpower cost, so that we are trying to tackle down through this massive VRS scheme and if we are able to tackle which we are confident that this quarter we should be able to close it, then we would see a subsequent reduction of almost Rs.12 crores in the fixed cost and that itself would be a huge turnaround story for us going forward. Parallel as we do this, we are also getting into new markets and new products. We are introducing new shock absorbers and TFFs and all other new products. So we feel that the next H2 would be the actual turnaround of this division. And parallelly, we are also working with a new European technology partner with whom we are trying to not only enter into their home markets of contract manufacturing, but also getting technology for active damping which would be a new one once we introduce it to the Indian markets.

**Riken Gopani:** And one question on the construction equipment side, again is there a similar point that we are doing that we are cutting employee expenditure there or what are the various areas where we are basically focusing on for improvement there?

**Saikat:** Looking at cost is a continuous approach whether it is the raw material, the other cost or manpower for that matter. So the process is continuous. Yes, we are looking at all fronts as far as reduction is concerned including manpower. And just to add on to that, we have employed a very good consultant as far as looking at each and every process of our cost is concerned. So whether it is manufacturing cost, whether it is the raw material procurement cost or the right staffing at the various places that we have. All those things are getting revisit and in a period of say quarter or two, we should be able to optimize all the areas of costs that we are looking at.

- Riken Gopani:** Sir overall for the group in terms of whatever staff cutting that we are planning to do, what kind of VRS expenditure would that entail in terms of one-time expenditure that you might have to do?
- Bharat Madan:** It may range from Rs.25-35 crores depending on the number of people will take up.
- Moderator:** Thank you. Our next question is from the line of Nikhil Deshpande from Sharekhan Limited. Please go ahead.
- Nikhil Deshpande:** As per news reports that you are looking at a strategic partner for your ancillary division, what kind of partnership are you looking at and could you update on that?
- Dipankar:** Primarily, we are looking for someone who can bring in new technology and also we are looking for partners where we can get into new components for these big auto ancillary markets. So the two things what we are looking for is one high technology and second is new products.
- Nikhil Deshpande:** So you could be looking at some JVs or something like that going forward or how is it?
- Dipankar:** Yes, we are open for JVs. We are talking to some of our European partners. So once things crystallize, we may also go in for a joint venture.
- Nikhil Deshpande:** Sir could you update on what is the CAPEX you are looking at for FY15-FY16?
- Bharat Madan:** This year is about Rs.100- Rs.110 crores total.
- Moderator:** Thank you. We will take the next question from the line of Aksh Vora from Praj Financials. Please go ahead.
- Aksh Vora:** In January quarter, I think so we said that we are aiming to double the market share in South and West from 3% market share to 6% and total into 11%-12% in 2 years' time. So where do we stand right now sir?
- Sridhar:** The actual situation today is except in Andhra Pradesh where we are still at 3.5%, all other places we are actually losing market share. In other words whatever from 4-4.5%, this is something like 2.5-3%, this is what is the current situation. But having said that, the way to reverse is not working everywhere. For example, this area was also an area of vulnerability for our company. We have been operating without any good products, good structure, good strategy and net result was we were also losing money. The credits people not paying and all that. Today, I think fundamental cleaning in terms of removal of inoperative dealers are done and the company credits to those kind of dealers were almost close to nil now, very negligible. People are operating with their own money. So the hygiene kind of an activity is already done definitely in Andhra, large extent in Maharashtra, some other area also it is going through. So those portions are already done. So the next what we are trying to do is an appeal. The new product whatever we are talking about, new solutions what we are trying to talk about is what is being

done. This is what I have said is even within the state, first we have started off only with the 10 districts are 15 dealerships types and those areas are showing a very good result. Slowly we will spread that it to Andhra. So this is the way we want to take it to a national level market share which is something like a ~10.5% for rate cuts, that should happen may be over a period of another 3-4 quarters and we will spread it out to other places over a period of time.

**Aksh Vora:** But sir what kind of products are we dealing into South and West means are we going into higher HP tractors or what is the demand kind of over there?

**Sridhar:** The South and West is generally a higher horsepower category as well because these markets are also belongs to higher horsepower. To that extent, we are not creating a product which is very different for South, it is not that. Whenever we develop a product on 45 to 50 and 50 horsepower and above, this naturally suits this market and it is designed that way. Mostly important is if I have to give you some perspective from instead of a general market, we are all creating specialized products. Just to give you one example, like tractor on top harvester which is very popular in South. Now this is a near monopoly of John Deere for those kind of products. This is what is happening today. Now we are launching a series which is called foreign crop specialists. This is a very different product proposition which only our product can do. Those kind of activities are application based, district based and market based we are applying. This is I have just given you one example and there are many such activities in that way. So eventually you will see a result.

**Aksh Vora:** So can you just give the breakup from 30-40 horsepower, 40-50 and 50 above horsepower, growth kind of breakup.

**Sridhar:** See, all this 30-40, 40-50, all the growth of this industry is almost like zero/-1. It is all neither stagnant or fall. There is not a great story whereas we said if it is 50% and above, there is a growth story. Less than 20 horsepower, something like 40%-50% is the growth rate. Very high growth is happening at that level more through government support. So this is what the current scenario is.

**Aksh Vora:** Sir on the margin front, we have seen a significant reduction in the margin front. So what would be the sustainable margin going ahead in next couple of quarters. I understand there is a degrowth in tractor industry as a whole, but what would be the sustainable margin as far as we going for cost reduction and all sort of things. So according to you, what would be the margins we are going ahead in the FY15?

**Sridhar:** Very difficult to put a number on what will happen to quarter 3, quarter 4, what EBITDA, prediction is very difficult. But what we can always indicate is the projects whatever we have, for example like we have supply chain project was flagged-off like the way construction equipment and in then the tractor division. It has a 2-year tenure, it has an explicit agenda of making it something like 72.5% material cost bring it down to somewhere around 68%. These

benefits are expected, but it is expected definitely not in this quarter, very small on next quarter and then onwards the substantial benefits are expected. This is one way. Another area where we are trying to do is a huge staff reduction program which is already we have done it. Now it is on white collar, blue collar, everywhere we are somewhere around 8%-8.5% what we have. Certainly there is a scope of bringing it down by another 0.5%-1%. Actions are on, but the results again will take a couple of quarters. These two are just to give an idea of what all are the possibilities, what all are initiatives are already underway. Now we also talked about, today 25% of our business is by the new products. Last time also, we have spoken about it that 25% is by new product and then we are not in a position to recover the whole money. This is where we said when we launched this program by November and December, the growth rates were very different. The whole thing has changed in February and March. So we have to go slow. We said that still over a period of 4 quarters, we said we will recover that money. So we are into it. End of the third quarter and fourth quarter, hopefully we should also be in a position to recover that kind of an additional money and also achieve certain cost reduction initiatives either it is a manpower or material cost initiatives which should start showing results. So in terms of percentages, we have been hovering something like 9.5%-10% comfortably. Certainly we should exceed those kind of marks quickly and then the eventual goal is to further climb 12%, 12.5%, 13%. But precisely when it will happen, it also depends on how the industry is going to behave. So this quarter is a quarter to watch. So may be by quarter three and quarter four, we will be in a position to give much more realistic estimate.

**Aksh Vora:** Sir just to have a proper view, how is the July month panning out as far as in all the regions?

**Sridhar:** I do not know about industry. Whatever we hear is the best estimate could be a flat estimate.

**Aksh Vora:** And lastly sir are we sticking to our goal estimate of margin to 15% on 3 years' time period?

**Sridhar:** Of course that is why we are in a hurry. What we are going to do it a little more leisurely in terms of cost compression working more on the pricing pump alone. Now we are rushing through all those initiatives trying to target in the next 2 years. So end of 2 years what we are talking about we are gearing up and going very close to that. But all this initiative starts very slow and then grows very exponentially. So in 2 years from now, we are still targeting those kind of margins.

**Moderator:** Thank you. We have the next question from the line of Amit Goela from Rare Enterprises. Please go ahead.

**Amit Goela:** Could you just explain your auto strategy once more because I see like Rs.23 crores of topline and Rs.9 crores of losses, could you just explain your auto strategy again please.

**Dipankar:** See, auto strategy primarily is that we are initially taking care of all the fixed cost. The huge additional fixed cost what we have, we are cutting down the fixed cost primarily by giving a

VRS to the old legacy labor of what we have and parallel we are also introducing some new products like new shock absorbers and new TFFs and we are entering few of the new export aftermarkets in Europe and also in the Middle East and the third part is that we are bringing in two technology partners one from Europe and one from Australia who has technology for high-end active damping shockers which we do not have and with both of them, the arrangement is that we are talking about contract manufacturing for their home markets also. But all this contract manufacturing and these new markets will primarily crystallize in the H2 of this year. This half, the previous quarter which has gone and this quarter what we are in, we are actually focusing on cutting down the labor cost and also the operational improvements to bring about contribution changes.

**Amit Goela:**

So you are looking at similar losses in the current quarter also?

**Dipankar:**

It would be similar because as we go through the VRS, it is a process which takes almost 1.5-2 months. So in these 2 months, we will not be able to bring in any major change from the previous quarter.

**Amit Goela:**

And in H2, your technology, everything will be in place and you think the picture will change dramatically.

**Dipankar:**

That's what we were intent to do.

**Moderator:**

Thank you. We have the next question from the line of Anil Shah from ICICI Securities. Please go ahead.

**Venil Shah:**

Sir firstly, can you give me the number of construction equipment units sold for the quarter and also for the corresponding quarter last year?

**Saikat:**

It was same Venil, 719 and 718. So from the volume perspective, there was not much of a change in the correspondingly two quarters of last year and this year.

**Venil Shah:**

But on terms of ASP, we are seeing a significant jump. Is that a measure of the cost improvement or we take any price hikes in the same?

**Saikat:**

See one, definitely there was a price correction which we had implemented in the last quarter of the financial year of the previous year and there has been some improvement which has been accruing on part of the cost initiatives that we have taken. So combined both of them, we are getting a positive result on that account.

**Venil Shah:**

Sir my second question is if we look at our major states like Bihar, MP, UP and Haryana for tractor segment, we seem to be losing market share vis-à-vis other players. So are we seeing some structural change in terms of competition or pricing pressure on those states?

- Sridhar:** No, I think Bihar we are not losing. Madhya Pradesh, I think we have Chhattisgarh and area continue to be our weakness. It continued to be a very low market share area, same time it is a growing area. Chhattisgarh behavior is more like an Andhra behavior. Some of our activities whatever we are planning also will get replicated in Chhattisgarh. So some actions are on the cards but more importantly Madhya Pradesh also except in the area, things are not really good. The market which is growing even on Madhya Pradesh is that micro tractors. That is what is showing like a growth. Otherwise conditions are bad only.
- Venil Shah:** So we are not seeing any structural change in terms of competition and pricing over there?
- Sridhar:** No.
- Moderator:** Thank you. We have the next question from the line of Kaushik Poddar from KB Capital Markets. Please go ahead.
- Kaushik Poddar:** You just said that you will be giving a lot of emphasis on this or coming out with new products for this 45-50 horsepower in the tractor segment. What is the percentage share in the whole tractor mix portfolio? This segment constitutes what kind of percent in the total tractor market?
- Sridhar:** See, this is I think little over 25% of the industry lies there. See we talked about the top end is 5%-7%.
- Kaushik Poddar:** Which is (+50), is it?
- Sridhar:** Yes, this is over 50. This 45-50 horsepower is a significant category. This is something like precisely 28% may be in the industry. But this is important for two reasons because this is the segment which Escorts historically used to do very well. We used to have something like 21-22% types industry 7 years back and then we lost it and then there was lot of competition here and currently we are at 16-17% of a market share is what we have. The entire initiative whatever we are putting it to, in addition to the over 50 horsepower is this category. Lot of actions are already on. We are not planning. Lot of things are already on, but we need to consolidate and reverse. This market also is significantly South and West market. So lot of challenges we need to come out, but all that what I can tell you is this is also another important focus segment for us.
- Moderator:** We will take the next question that is from the line of Saket Kapoor from Suyash Finance. Please go ahead.
- Saket Kapoor:** Sir looking at especially the thrust the new government has put on the railway part, how well positioned is our company to get itself in that ecosystem, if we take the railway equipment as a segment in which we operate. How well are we positioned and what kind of feelers are we getting from the railway board or any other authorities related to this which are concerned with our company because railway is a big gamut altogether?



- Dipankar:** We do see a very positive outlook for the railway market per se. We have two very important products like the bogie-mounted brake system and the axle-mounted disc brakes which we have introduced the bogie-mounted brake system is also on the anvil of crossing the field validation trials. So there we see a huge market potential because the previous government was actually for almost 1-1.5 years there were no wagon tenders. That is one of the primary reasons that Q1 we did not have much to bill because one of our major customers at the wagon builders and in the last 6 months of the Q1 we did not have much tenders coming out, but as we speak we have quite a significant number of wagon builder tenders coming out. We see a very positive outlook and with the products which we have now recently introduced and also are going to the validation trial, we feel that the Q3 and Q4 would be pretty positive for us.
- Saket Kapoor:** If you quantify it on the turnover front, what ballpark figure should be looked at sir? What kind of revenue we can book if those orders do?
- Bharat Madan:** Sure. Railway, we do quarterly about Rs.40-60 crores is the range which we do every quarter. So I think that is the number which will be there in Q3 and Q4 as well.
- Saket Kapoor:** That will be the ballpark you are telling.
- Bharat Madan:** Yes.
- Saket Kapoor:** Sir then why the EBITDA level was down in the railway equipment part. It was around Rs.4.48 crores for the March quarter, preceding quarter and it was Rs.1.62 crores for this quarter although that turnover remains flat sequentially.
- Bharat Madan:** The one obviously the turnover was one of the reasons because it went out from Rs.45 to Rs.42 crores and second was the product mix because we supplied some couplers which is a major order for this quarter which we supplied with the margins were less. So that is one of the reason which has impacted the EBIT margin for railway business this time. But going forward that will get corrected. So I think we will see it going back to the normal margin levels.
- Saket Kapoor:** Sir what is the update on the auto ancillary new partner or JV being signed where previously we are getting some feelers from the management that we are looking for somebody joining the company or it is getting hived off altogether. At what stage are we sir in that implementation? Although I have joined late in the conference, so I did not get the earlier part correct. So just wanted to get myself corrected.
- Dipankar:** Primarily, as we look for partners what we thought is that we should cut down the fat which we already have. So we are internally becoming very lean by going in for a massive VRS restructuring scheme. We will almost be targeting around 300 people of the old blue-collar legacy worker what we have and we are putting in lot of operational improvements where we can do a turnaround story. As we speak about the turnaround story, we are open for all other different

technology partners coming in and forming a joint venture. As of now, we have just kept the hiving off portion little bit distant. Primarily, we are looking out for a turnaround by one cutting down the fixed cost, bringing in new technology and third, we are expecting a European technology partner joining us in the coming quarters where we can not only share technology for the Indian market, but also do a contract manufacturing for their home markets.

**Saket Kapoor:** On the interest front sir, are we looking at this run rate only or are we doing something more for the working capital management or the interest cost is remained in this ballpark figure of 13-14 crores for the quarter?

**Bharat Madan:** It will be in this ballpark at least for this year and then depending on how the cash flow is and how the profitability improves, so obviously that will look at the debt again. Some repayment would happen there.

**Saket Kapoor:** One comment on that dividend policy of the company, we see that in many corporates. Even if we take a PSU example, we have 25% of the profit being distributed as dividend in many of its PSUs. Do the management holds some view about giving guidance for what would be the dividend payout ratio as per the numbers declared or it will be as per the board decisions only and we will get to know only when the board decides. One can get a ballpark percentage at this that will be the payout ratio.

**Bharat Madan:** See, at this point in time, the company remains in the growth phase. If you look at the kind of CAPEX which we have spent in the last 3-3.5 years, we spent almost Rs.400 crores plus of money on the CAPEX side. Now we are also to working on the turning around and cutting down on the flab and cutting down on blue collar manpower which again will involve lot of investment. So as of now, the board has taken conscious decision not to put a formal policy into place, but they will take a call based on year-to-year at least for another year or two.

**Moderator:** Thank you. We will take the last question from the line of Viraj Kataria from Securities Investment Management. Please go ahead.

**Viraj Kataria:** Sir I have two questions. One is if you can just provide some update on new agri allied businesses which we are planning to venture into apart from tractors.

**Sridhar:** See, I think a crop solution is still too early. As I said is lot of experiments and lot of application studies are there, lots of discussions are happening. Still I think it is too early. Let it become a powerful business case, then we will start unveiling it.

**Viraj Kataria:** Sir any particular products or farm mechanization space or anything particular we looking at within the farm mechanization space. So any indication broadly on what segments we are looking at?

**Sridhar:** No, we said paddy as a crop is where we said we are working. So this is a very crop centric approach is what we are working on.

**Viraj Kataria:** So be it in the likes of the similar products.

**Sridhar:** So once we firm up, we will just check.

**Viraj Kataria:** And second is, you did mention answering to one of the previous participants' question was the micro tractor which is sub-20 has been turning and growing in double digits for trade. So what is the yield underlying demand driver because these are the kind of segments who are impacted more in the downturn? So if you can just throw some insight on what has really been driving?

**Sridhar:** No, I think this is just a tractor which is priced to something like Rs.2 lakhs- Rs.2.25 lakhs and these are all something like micro tractors. This is certainly growing. What was started as like what you called a Gujarat centric or Maharashtra centric markets slowly is to spreading to other areas as well? So having said that, these products have least profits because this is not a very profitable segment at all. This is why what we have done is we have outsourced the entire activity with different partners. Products are developed. We did sell some very small number, something like 100-150 types. This is not very significant. So many governments are giving subsidies and support to help these small farmers. All these things are there. So it's also being used some light haulage purposes in the city. These are all the reasons what is moving, but having said that financially still does not make a very big business case at least for Escorts to get into directly. So we have an outsourced model. We will continue with that way. Our preoccupations, I have again been maintaining. This is about 50 plus and 45-50. These are all the categories which has got a big money and big potential and we are chasing it and this is where we are.

**Viraj Kataria:** When you say 150 tractors on an outsourced model, is it primary the Ferrari tractors you are talking about or it is actually the sub-20 tractors you are talking about?

**Sridhar:** No, I am not calling Ferrari into this kind of, I think. This I am talking of the way typically Rs.2 lakhs types- Rs.2.5 lakhs. Ferrari is something like Rs.8 lakhs. There is a huge difference between Ferrari and this kind of a tractor. I am talking about typical micro cheaper tractors. I do not want to call it as a cheap tractor, but if that clarifies much is the cheap tractor.

**Viraj Kataria:** But as a strategy, are we still focusing even through the outsourced model, are we still focusing on that segment or we gradually looking to vacate and focus on the high HP segment?

**Sridhar:** Escorts will only focus, focus means design, develop, manufacture, and everything we will do only for a profitable image segment which has a global opportunity as well, we will work on this. Whereas this kind of area, sometime it helps the dealer in terms of filling the portfolio. So those kind of activities, we have identified a very good partner who makes very good quality products.

Those kind of things are there, but small numbers this is not a focus number. So we do have something which is slowly for example on an average now 30-35 tractors are being produced and sold every month. This is as against competition will be doing thousands of tractors. There is a huge difference, but for customer yes. For Escorts, still does not make great sense.

**Viraj Kataria:**

What will be the volume of this tractor for FY14?

**Sridhar:**

I really do not remember. This is something like 1,500 tractors you can say actually per annum. Per month, this is the kind of numbers we should look at it.

**Bharat Madan:**

Last quarter, the industry was about 7,800 tractors in sub-20 HP segment which has gone by almost 41% in this quarter versus last year.

**Viraj Kataria:**

So in Q1, it was around 7,800.

**Bharat Madan:**

That is right.

**Viraj Kataria:**

And which has gone by 41% and we target to have a volume of around 1,000 tractors per month.

**Sridhar:**

No, we have no target. This is not a strategic segment. As far as we are concerned, we found a solution. We have an outsourced partner. We will give it to dealer. But we refrain from spending our time discussing on those kind of segments because financially does not make a great sense. So we just staring. It is a help to the dealer. We keep it that way.

**Viraj Kataria:**

And you did mention that government support is driving this particular demand. So given Q1 was primary impacted by the whole election period. You still have seen a 45% growth in the segment. So any other particular reason driving this particular growth?

**Sidhar:**

The government support is nothing to do with election. Generally what kind of subsidy they give it to a very small farmer. The assumption is very small farmers buy those kind of products is the way they have given. Predominant states like Gujarat and partially in Maharashtra and now even places like Tamil Nadu and other states and Northern states are also picking up. The biggest constraints on these kind of tractors are its pricing has to be razor sharp. Otherwise people have no reasons to buy those kind of a tractor. So this will always be under pricing pressure. Though only when you have a marginally higher capacity, those kind of things we can do. As far as we are concerned, we do not want to block our capacities. So this whole thing is really outsourced. So it is done by somebody else and Rajkot for us.

**Moderator:**

Thank you. I now hand the floor back to the management for closing comments. Thank you and over to you.

**Rajeev Dass:**

Thank you ladies and gentlemen. Before I finally close the meeting today, the discussion today, I just want to emphasize that the bleed on the construction equipment and the auto products



*Escorts Limited*  
*July 30, 2014*

business forms the top focus of the management for the next 9 months. There is no question about it that by the conclusion of either the third quarter in the case of ECE, the construction business and certainly by the close of the fourth quarter of the auto products business, the endeavor of the management here would be to see that both these businesses stop being a bleed on the overall pressure on the margins which has been seen in this particular quarter. And across the spectrum of whether it is material management, whether it is addressing the blue collar reduction through our VRS schemes which are being very aggressively pursued and whether it is building the business model, whether it is contract manufacture alliances which the auto products people are looking at very seriously. The attempt and the management focus for the next 9 months would be to make sure that this bleed is eliminated and it adds to the overall margins and profitability that we were looking for; however, as our internal target for the year. I would also just like to mention that we distribute our earnings release through our website which is [www.escortsgroup.com](http://www.escortsgroup.com). So do refer to our website for our earnings releases and other details that will accompany this call. Also you can visit our social media pages for the latest company news, developments, innovations etc. Ladies and gentlemen once again thank you for your time and being present at this Conference Call today and we will meet again at the end of our quarter two results. Thank you very much.

**Moderator:**

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