



**“Escorts Limited Q2FY15 Earnings Conference
Call”**

November 7, 2014

**MANAGEMENT: MR. S. SRIDHAR – CEO, ESCORTS AGRI-MACHINERY
MR. SUNIL SAKSENA – CEO, ESCORTS CONSTRUCTION
EQUIPMENT
MR. DIPANKAR GHOSH – CEO, ESCORTS AUTO &
RAILWAY PRODUCTS
MR. BHARAT MADAN – GROUP FINANCIAL CONTROLLER
MR. SAIKAT MUKHOPADHYAY – CFO, ESCORTS
CONSTRUCTION EQUIPMENT
MS. JYOTI KHATUKA – HEAD, TREASURY
INVESTOR RELATIONS TEAM**



Escorts Limited
November 7, 2014

Raghvendra Jaipuria: Thank you. Good morning everyone and thank you for joining us on Escorts Limited Q2FY15 results conference call. Today we have with us Mr. Sridhar – CEO, Escorts Agri Machinery; Mr. Sunil Saxena – 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 the Investor Relations team at Escorts Limited.

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. Madan to make his opening remarks.

Bharat Madan: Thank you Raghvendra. Ladies and gentlemen, very good morning to you all. Thank you for joining us on the Second Quarter Earning Call for financial year 2015. A snapshot of company's quarterly performance is as follows:

Turnover for the quarter increased by 5.1% on YoY basis to Rs.992.6 crores, this is primarily due to increase in volumes both tractor and Construction Equipment as compared to last year. Tractor volumes at 15,013 correspondingly up by 1.2% as against 14,842 last year. Construction volume at 747 numbers, correspondingly up by 13% as against 661 last year.

The EBITDA has dropped to Rs.33.5 crores as against Rs.64.5 crores last year. The major reasons for the fall at profitability are: lower production volume leading to under absorption of production overheads as compared to last year in agri machinery and poor product mix in Construction Equipment resulting in increase in material cost by 205 basis points; however, sequentially it has improved by about 113 basis points.

Increase in other expenses was on account of increased promotional spends, consulting charges and expenses pertaining to export orders for tractors. There was a marginal increase in employee cost as a result of long-term settlement with trade unions, however the cost is down sequentially compared to Q1 2015. Exceptional expenses of Rs.31 crores for VRS. We continued to bring down our finance cost which is lower by 23% compared to last year at Rs.14 crores. Our total debt outstanding as of September 2014 is 505 crores.

Now moving on to segmental business performance:

Starting with the agri machinery business – domestic tractor industry is flat at 141,483 tractors as compared to 141,241 tractors last year. This is due to the sub-normal rainfall in the northern and central region, our domestic tractor volumes were down by 3.3% as compared to last year and export volumes were up by 270%.

In line with our strategy to become market leader in higher HP segments, our tractor volumes in 50+ HP grew by 218% as compared to last year. Our market segment in this segment also grew from 3.46% to 8.64% in Q2. This segment also grew by 27.6% and therefore its share in the total industry has increased to 5.1% against 4% last year. EBIT margins EAM has gone down from 10.9% to 7.1%, we expect the margins to improve in the second half with the help of new product launches and reduced material through our initiatives. In the next three to six months we shall also be recovering full price for our new products which are established well in the market.

Coming to the Construction Equipment business:

The served industry volume is down by 9.5% whereas our volumes are up by 13% to 747 numbers against 661. Our revenue increased by 4.6% to Rs.121.5 crores, the increase in our market share is a result of growing product acceptability in the market. We will continue to develop and offer innovative products and move up the value chain. Our EBIT losses however went up to Rs. 10.8 crores from Rs. 4.8 crores as compared to last year, we are now focusing on improving sales mix, improve spares sales and increase our realizations to move to profitability in this business. As mentioned earlier, we have taken a number of initiatives in the area of material cost reduction and production standardization. We are making a good progress in these areas, with the result of these projects coupled with better sales mix and realizations we are confident of achieving positive EBITDA by Q4 FY15.

Coming to the railway division:

The order flow from railway continues to remain subdued. At Escorts we are developing product for new generation rolling stocks as we are seeing a decline for the old generation rolling stocks. We are also evaluating new technological tie-ups to widen our product portfolio. Sales up by 10.8% sequentially and down corresponding by 6.29% to Rs. 47.35 crores, the margins are up by 580 basis points sequentially and 105 basis points correspondingly to the 9.6%. Our order book for this division stood at Rs.34 crores which will get executed in the next three to four months. The railway division stands to gain from the renewed focus of the government on reviving the rail infrastructure in India. We expect to complete testing and win new orders for our new product bogie-mounted braking systems in the coming quarter.

Lastly on the auto division:

It reported a revenue of Rs. 26.8 crores, up by 17% sequentially. The EBIT loss for the quarter reduced to Rs.6.99 crores from Rs.9.21 crores in Q1 2015. This is due to the increased sales and reduced manpower cost. The full effect of reduced cost shall be visible in the next quarter and losses are further expected to go down in the next quarter.

As disclosed earlier, with a focus to increase profitability and productivity we have successfully implemented companywide VRS and particularly at restructuring Escorts Auto Product Division, it's largest ever VRS at Escorts was availed by around 350 employees, we incurred a one-time expenses of approximately Rs.31 crores, the pay back for this will be less than two years. With all these initiatives the management expects improvement in margins in H2 of this financial year 2015.

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

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Sameer Deshpande from Fairdeal Investments. Please go ahead.

Sameer Deshpande: The tractor industry is not doing well that everyone knows but still the segment margins have come down substantially to almost 7%. The volumes we just maintained this time because the rains were bit erratic. But in the construction equipment segment, our growth in volumes is about 13% and the outlook is likely to be better, but we are still losing almost Rs. 11 crores. If the turnover is growing and our loss is increasing how can we say that there is an improvement in the Construction Equipment business?

Sunil Saksena: Your question is absolutely apt, in fact Bharat did mention about some of the areas where we are now concentrating which is related largely to the sales mix where we need to sell more of value-added products which is what we have started with our renewed Digmax-II which is now very well accepted by the customers. It is one of the best backhoes, which we have. It is coming around, and that really adds value both in terms of top line and a better bottom line. So as a Construction Equipment Division, our topmost priority is to ensure that the sales mix is in that direction. That obviously took some time as the industry itself in quarter two was not coming off well. Now that the industry is improving our sales mix is really going to yield results. Spares was also one of the areas where we had to really connect with the customers. This is one area where we have strongly come back and you will see things really resulting into better top line and bottom line as we go into Q3 and more importantly in Q4 actually.

Sameer Deshpande: But when are we expected to operationally breakeven in that EBITDA level, in the construction division?

Sunil Saksena: In terms of the EBITDA we will certainly see a positive level by the end of Q3, in fact we have started realizing better margins for our product and you will see that happening around Q3 in terms of realization but EBITDA positive will certainly start off as we start of the Q4.

Sameer Deshpande: So Q3 you expect to breakeven and you maybe positive in Q4?

Sunil Saksena: Yes, Q4 is what we expect to be.

Sameer Deshpande: Our pick and carry crane business, which was the main bread and butter business, is it continuously losing money?

Sunil Saxena: See, as I said we have to shift gears in terms of value added product and also the mix. We have to really have a high ticket item in terms of the product range and that comes from the backhoe industry which is also the major industry in Construction Equipment industry. Not that the pick and carry crane is something which is not giving us margins. We need to sustain that but more importantly increase the proportion of backhoe sales which has got a better realization and also a larger volume in the industry. And since we are relatively new in the industry out of the 10 players and to establish ourselves to a leadership position will really take some time. In fact the good part is that in Q2 we were the only player out of the 10 players who were improving in the backhoe industry compared to the other players. So you will see that results spinning off in Q3 and Q4.

Sameer Deshpande: Okay. And you are experiencing some positive trends in Construction Equipment?

Sunil Saxena: There is lot of talk but if I want to say has it happened on the ground completely, not so because the industry still is not in a growth mode, it is still showing decline. Thankfully we have got good customer base right now and we are showing better than the industry in terms of the growth results.

Sameer Deshpande: Okay, all the best to you. And now my earlier question on agriculture related.

Bharat Madan: Sameer you would recall I just answered this in the opening remarks, the three reasons essentially for the agri business EBIT going down. If you look at the sequential quarter in June, we were at about 8.1% EBITDA margin and in this quarter we are 7.1%. One of the prime reason for this is the increase in other expenses, now we had executed a large export order in this quarter, there is an order for Nigeria which we executed so there is a onetime expense which has happened this quarter. So the other cost has gone up significantly in this quarter by about 14%. That's one of the reason why the EBIT margin for agri has come down, otherwise on all cost initiatives whether manpower cost or on the material cost front you see an improvement from the sequential quarter. So in terms of margin expansion for agri business we are confident going forward in Q3 and Q4 that the margins will come back to the normal level. Also this normally is the leanest quarter in the entire year, therefore because of lower volumes this quarter you see an impact on the EBIT margin.

Sameer Deshpande: But this one time expenditure relating to Nigeria which you mentioned, can you quantify that?

Bharat Madan: This will be to the tune of Rs. 11 to 12 crores in this quarter.

Sameer Deshpande: Relating to Nigerian export solely?

- Bharat Madan:** That is right.
- Sameer Deshpande:** So you expect the segment margins to be 8% plus next time?
- Bharat Madan:** Yes, it will be.
- Sameer Deshpande:** And we have not increased the prices last time?
- Bharat Madan:** We have taken the price increase from 1st August, so it was about 1% price increase on the tractor
- Sameer Deshpande:** Despite that we had this set back, so now are we planning to increase it?
- Bharat Madan:** That depends on the markets, so clearly we will take a call in Q4 but not in Q3 definitely.
- Moderator:** Thank you. The next question is from the line of Yashesh Mukhi from Morgan Stanley. Please go ahead.
- Yashesh Mukhi:** My question is pertained to the agri business, just wanted to get a sense of how demand is at the retail level and what do you expect going forward for the rest of the year?
- S. Sridhar:** It is about industry so first let me answer about the industry itself. So far in the last two quarter the industry has reported flat volumes, actually this is not the case. If you recall our before interactions in Q1 and Q2 itself we talked about a negative 5% in 1st quarter, a negative 2 to 3% in the second quarter, expected to be little positive in third quarter and substantially better in the fourth quarter, this is the way we had anticipated. At secondary level it has almost happened that way but the wholesales were not supporting what was happening in the market. The net result is that it has become flat even though it was negative so far. On the contrary, whatever you are seeing now on the releases the wholesales billing side of it will see a huge negative, almost like a 12% drop in October. Going forward in this quarter it may report something like 8% to 10% of negative growth. But the truth this is not as severe as it will get reported now, maybe the stocks are getting adjusted. So if you look at it, overall picture is not really bad. It happened the way we actually expected. But end of the year we did expect a positive 2 to 3%, but it may remain a negative 2-3%. Therefore a swing of positive to negative 2-3% is what would emerge over a period of six months.
- Yashesh Mukhi:** Right. So for the full year you will see about negative 2% to 3% year-on-year growth?
- S. Sridhar:** That's right.
- Yashesh Mukhi:** What will drive the sharp growth in the second half?

S. Sridhar: It will not grow, what happened was that there was a low base effect. If you look at the data a little more closely, the quarter one of last year grew somewhere around 26% to 30%. With that kind of a growth rate I personally was looking for a negative 5%, but it came at a zero growth. So it is not surprise and same is the reason of almost a year before last year something like 20% growth and now onwards it will get moderating at 15% and something like 6-8%. So the base effect is getting moderated. Secondly, we expected quarter four to be very positive but which I think now needs a little moderation because the sheer quantity of rainfall was not adequate. So the ground water availability and the other parameters are also not that positive. So the net effect will be that quarter three and quarter four is not going to be that bullish but it will also not be that negative, the outlook we had developed based on the wholesale billing.

Yashesh Mukhi: What proportion of tractors currently sold would be for non-agri use, can you give us a sense of that?

S. Sridhar: See every tractor is being used for both the purpose. It is only the extent that really matters. There are some products that are dominant in that kind of a sector, some products are not so dominant in that kind of a sector. If I have to give you an insight both the Powertrac and Farmtrac brands are not very effective in that kind of a sector. So you will see us launching one of the new products what Bharat has spoken about and will be launched in couple of months specifically targeting that sector.

Yashesh Mukhi: I mean what proportion you would say the non-agri proportion be. Is 30-40% a fair comment?

S. Sridhar: See what happens is for some of the brand this is really predominant and for some it is not. But you can estimate around the 50% to 55% on what you call the haulage market. But where haulage happens it happens intensely but otherwise it varies from place to place.

Moderator: Thank you. The next question is from the line of Murugesha S from Cholamandalam Securities.

Murugesha s: I just joined the call a little late so if you can give me the tractor volumes and Construction Equipment volumes that will be great?

Bharat Madan: On the tractor we did 15,013 numbers total out of which 896 were exports and on Construction Equipment we did 747 numbers.

Murugesha s: Okay, my next question is, on the previous con-calls we had mentioned that the 45-50 HP tractors which was a pressure point for Escorts in particular because of the lack of presence in markets like Andhra where it was growing continuously. Could you throw some light on where the industry is now, how the industry has been in the last two quarters and how has it been for us in the last two quarters. Have we added more dealers trying to extend our presence and how successful our endeavor has been?

S. Sridhar:

See I think what you are asking is more to do with our own strategy direction which does not change over a period of time. So when it comes to segment growth we already have said almost 12% of the segment which represents the bottom of the tractor industry we do not participate, so that is why we do not go at overall market share calculations as some of this segments we stay away where we do not see a profit potential. What is growing is the bottom most segment and the top most segment. Below 20 HP and 50 HP plus are the two segments which are growing the fastest. In the bottom most segment we do not participate, so we stay away from that. Whereas the higher most segment is where we are betting on, and aiming for a leadership position eventually, targeting something like 18% to 20% market share in a three year timeframe, this is what we disclosed one year back. So in that segment from almost 0% to 1% share we are almost 8.5% share in the last quarter and ours is the fastest growing brand in that segment with a growth rate of around 218%, so we are very clear on our path. Another important segment where lot of profits are there are the 45-50 HP segment. This is where lot of launches are scheduled, things are happening, our executive products are doing very well, even though the quantities are small. These are few brands which went out of stock if I have to tell you the least, so these things are received very well in the market. But if I am to give you another side of the picture, like Hero is another series is what we launched, around November last year. So from almost 0% to now almost 40% of our Powertrac sale is through Hero brand which is little more expensive. It has got a lot of new generation features and this is also the reason we quoted that we have difficulty in absorbing the entire material cost, and said four quarter timeframe will be required to absorb that kind of a money. Now let me tell you that we are almost there, with August price increasing we have almost recovered 80% to 90%. So some more things are left but otherwise we are there. So if I have to summarize what I said with reference to our strategic intent we are already there, we are progressing on our choice of segment. So maybe in two more quarters we have to wait and see a substantial progress in those kind of market share of the chosen segment.

Murugesha s:

Would it be possible for you to give me a target, I understand that 50HP plus is our main focus and we have vacated the 20HP segment. But in the case of 45-50 HP segment do you have a target as far as the market share is concerned or the number of tractors you would want to sell within next few quarters?

S. Sridhar:

See, this kind of a segment is not tracked by any external body including TMA so it is very highly internalized so you will not even get to know. But even to give you an idea, from 16% to 17% we would like to eventually take it to 22% to 23% in another 2 to 3 year timeframe. So the most important segment for us is in addition to the above 50 horsepower segment is the 45 to 50 horsepower segment. Today we are hovering around 16% to 17% market share in those kind of segments.

Murugesha s:

Going back to my original question, would it be possible for you to give sense as to I mean have we added more dealers in Andhra regions or Karnataka regions which is the pressure point for us?

- S. Sridhar:** See, we have already mentioned we do not look at channel as a basis of differentiation, we look at our own brands and products as a basis of differentiation and then we support through a dealer network. For example we have some 12 dealers in Andhra who already are reporting anywhere around 15% to 20% market share as against overall market share of 4%. So as and when our product strategies are working in the chosen market the proportionate number of dealers will get increased. So there is a wave of action put in place but this will take almost three years, almost one year has passed, two more years have to go.
- Murugesha s:** And can I squeeze in one more question regarding VRS. I understand that we have been giving VRS segments specially for the Auto Segment to bring down the legacy employee cost that we have, I just wanted to understand where do we stand right now and when do you expect to finish this?
- Bharat Madan:** We have already implemented the VRS so this quarter and have already seen the exceptional item of Rs. 31 crores coming on out of that, so about 350 employee workers have taken the VRS since the last quarter. So you will see the benefit coming in from Q3 onwards.
- Murugesha s:** Would it possible to quantify how much benefit it would be in terms of the margin?
- Bharat Madan:** Yes, payback spend was close to 1.5 to 2 years so I think most of it will get recovered in next two years timeframe.
- Moderator:** Thank you. The next question is from the line of Viraj Kacharia from Securities Investment Management. Please go ahead.
- Viraj Kacharia:** Most of my questions have been answered just two more. We launched the Steeltrac which is sub-20 tractor in October 2013. Can you just give some color on how is the response been so far and what states we launched the model in.
- S. Sridhar:** Steeltrac, is a sub 20 HP tractor and we call this kind of segment a non-strategic one. This segment neither enhances our top line nor the bottom line, therefore we take the route of outsourcing. So these products are completely outsourced to one of our own major supplier who are very competent and have a cost structure to support those kind of product which are potentially a low margin and eventually can be a high volume kind of a product. I think we started selling in small quantities so it is being done. Further volumes will gear up. Generally we do not count on for those kind of financial discussions actually so it is on.
- Viraj Kacharia:** As we continue to focus on the above 45 HP segment, are we looking at any product expansion in the sub-20-25 HP segment. So as a strategic focus are we looking at expanding the products range in that segment through outsourcing?

S. Sridhar: When we said the sub 20 HP segment is not strategic, we mean Escorts will not spend its own time, money, resource into those kind of activities. But having said that there is a demand for those kind of a products, there are channel partners who want their portfolio to be complete and there are customers who are wanting to buy, so how do they answer this. The route what we took is outsourcing, in other words even though it is not a matter of our interest directly, eventually those kind of demand will be met through an outsourcing partner. So in less than 20 HP we already have one product line. There are other programs which are going on, and is profitable for that firm and may not be for companies like Escorts. So those kind of things will get address at the first stage, eventually we will address the 20 to 30 HP as well. But having said that, that is not our focus neither we want to discuss on those kind of areas today. So may be two years from now you will understand some of our product plans which will also make those category very attractive, but as of now we are not concentrating on those segments.

Viraj Kacharia: So are these also sold through Escorts current dealer network?

S. Sridhar: These things will be sold only through existing network because creating network also cost money. Every channel increase is an obligation so it involves money. So this kind of a product, which lives on a very-very marginal costing has to live on the existing kind of a network. So it will be sold through our own network.

Viraj Kacharia: Any update on the other small agri farm machinery segment which we are looking to venture into.

S. Sridhar: See the business models are being developed, as we said that as and when we become thorough we will start sharing it with you. I think now also I feel we are not yet comfortable in terms of public disclosure so kindly give us two more quarters then we will share it in full.

Moderator: Thank you. The next question is from the line of Kamlesh Kotak from AMSEC. Please go ahead.

Kamlesh Kotak: My question is pertaining to the construction machinery business. You said units for this quarter is 747 right?

Sunil Saxena: Yes 747.

Kamlesh Kotak: How much for the half year and year on year numbers.

Sunil Saxena: Half year was 1,466 and last year half year was 1,379 and quarter last year was 661.

Kamlesh Kotak: Can you further break it up into the backhoe and the pick and carry cranes, other the major segments of that?

Sunil Saksena: Largely on the backhoes we have now been getting to a volume of about 75 a month. We have to further increase our volumes there in terms of better sales mix. In fact we are really happy to state that we are the only one in the first half of this year where we were showing growth vis-à-vis the previous year same time out of the 10 players.

Kamlesh Kotak: And what is about the pick and carry crane volumes? How that has panned out?

Sunil Saksena: Pick and carry cranes for the first quarter we had a volume of 478 and the second quarter was 488.

Kamlesh Kotak: And how much was that last year?

Sunil Saksena: Vis-à-vis last year on the cranes we have been growing at about 10%.

Kamlesh Kotak: How is the competitive intensity in terms of the pricing and overall industry is panning out.

Sunil Saksena: The industry is really going through a very torrid time for last almost 30 months. There has been a consistent decline if you were to look at month-on-month or you were to look at the same period last year. Albeit in the last about three or four months the extent of decline has coming down steadily. What we expect is the industry will cross the horizon that is zero sometime around end of Q3. In fact the industry was still down by about 15% at the end of September. What we expect is with all the announcements particularly in the mining, coal sectors and other material handling equipment areas the industry will start showing a positive result by the end of Q3. That is where we really will see benefits of whatever we have done in the past let say about six months in the division.

Kamlesh Kotak: And so going forward sir how you see the growth across this two main verticals the backhoe and this crane. How you see the volume or the value growth panning out the next year may be?

Sunil Saksena: In terms of the industry as such we anticipate a CAGR of around 10% to 12% over next two years on the backhoe industry. We have been relatively new players in the industry having launched our first backhoe in 2010 and have launched the version which the customers wanted with lot of USPs and have received a positive feedback, which was about just less than a year back. With that our product is finding a favor and we expect to beat the growth rates of the industry. Backhoe is one area where the ticket size and the value would be larger, therefore we have been continuously saying that our sales mix and profitability should improve once we show good growth on backhoe. Having said that, in the first six month itself vis-à-vis industry we have been growing on backhoe so the acceptability of our product in the market which has almost 10 players and some of them entrenched for over last 15, 20 and even 30 years has been extremely good and very encouraging from the customer perspective.

Kamlesh Kotak: So should we assume 12%-15% kind of growth vis-à-vis 10% growth for the industry?

Sunil Saxena: In fact if you see the current performance itself on the backhoes we have been growing at that rate and we will continue to put pressure on our entire channel partners as well as own team to ensure that we really come out with flying colors particularly in the backhoe area.

Kamlesh Kotak: And on the crane side what could be our growth trajectory vis-à-vis the industry for the next year?

Sunil Saxena: The industry itself is marginally growing, it is just about 3 odd percent kind of growth that has happened. We have been again growing better than the industry there. Now it is an industry where the value addition is low and the ticket size is also very small so large growths in cranes aren't going to change too much for us except for the fact that the capacity utilization would be there. So we will be sustaining our game plans on material handling but more importantly within that, like we do on tractors, we will be concentrating on higher value add products on the cranes and improve on the value chain. Which means the Hydra would be something which will be sustaining the volumes but will be moving up in terms of the carrying capacities like power booms, TRSs which has more value addition and therefore they augur well for the industry standards and the growth also.

Kamlesh Kotak: So may be next year we can expect double digit growth in that segment as well?

Sunil Saxena: I think double digit growth will still take some time because what will happen is the larger volume is in the 12 ton which is the Hydra equivalent volumes. The volume above that is pretty small and exactly like tractors where the value add or the high tonnage products formulate a lesser volume out of the total. So unless you see an overall growth in the industry itself of about 15% you will not see a significant play in the higher tonnage. What it will do is, if we concentrate on the mix it will give us a better profit.

Kamlesh Kotak: Can you help us understand the debt profile, is there any debt reduction plan because this quarter I think the debt has gone up compared to the March amount. So how you see that panning out for the year?

Bharat Madan: This time the quarter was slow so the cash flow was slightly negative on the operation side as this quarter is typically a lean quarter but the next quarter will again get made up. So if you look at overall debt profile September end we were at Rs. 505 crores, of which term debt was about Rs. 235 crores and balance was working capital. So working capital collection would happen in the months going forward like October was a good month for cash flow. But overall the average debt will continue to be in Rs. 400-450 crores range, though the term debt repayment is happening every year for about Rs. 80 crore, so in another 3-3.5 years if there is no major borrowing further it will get liquidated in three years' time.

Kamlesh Kotak: Sure. And any idea on the CAPEX side for this year and the next year?

- Bharat Madan:** CAPEX this year we are looking at a CAPEX of Rs. 80 to 90 crores and I think the similar number will continue going forward also at least in the next two years.
- Kamlesh Kotak:** For farm equipment's or for which segments?
- Bharat Madan:** This is for the overall Escorts group.
- Moderator:** Thank you. The next question is from the line of Saket Kapoor from S Financial. Please go ahead.
- Saket Kapoor:** My query is regarding the railway product segment. The EBIT margin was up 580 basis point sequentially, was there any particular product mix that created this increase in margin and is it sustainable over the next two quarters and what should be expected on an annualized basis on the railway equipment.
- Dipankar Ghosh:** The EBIT margin is sustainable. Though there has been a little bit of subdued outlook from the market because some major order though supposed to be released and have LOIs for is still not released and expect those things to be released by Q3. So we will be able to sustain the EBIT margin in the Q3 & Q4 going forward. And some of the new products what we talk about like a bogie-mounted brake system should be taking us to a better EBIT margin may be in Q4 and the next year.
- Saket Kapoor:** So that means it will be a double digit, right now we have clocked a margin of 9.6% so are we heading towards 10 + margins going forward?
- Bharat Madan:** Well this year I think it will remain in this range only, it will be somewhere 9 to 10% range. But probably going forward as the order book expands and we started getting the order released from the government then we can see a margin improvement happening there.
- Saket Kapoor:** There is order in the pipeline so what should be the ballpark, just now the order book is around only Rs. 34 crores as on 1st October as stated earlier.
- Dipankar Ghosh:** Actually the order book is more but the problem is that there is a huge paralysis in the government. Though the order book shows Rs. 34 we have lot of LOIs which have to be finally converted to orders that we are expecting in Q3 and Q4. I do not want to give a forward-looking number but it will be in the range of almost Rs. 60 to 70 crores.
- Saket Kapoor:** Additional Rs. 60 to 70 crores in addition to this Rs. 34 crores.
- Dipankar Ghosh:** But again until and unless they are converted nothing much can be said as railway is still going through a huge fund crises and obviously decisions are not been taken. Also there is a big new in the market of a railway board restructuring. So until and unless these things fall in place we will not be able to really have major change in the top line and also the EBIT levels.

- Saket Kapoor:** This Rs. 34 crores order book is executable over what period?
- Dipankar Ghosh:** This is executable in Q3.
- Saket Kapoor:** So the Q3 will be a huge bump up because generally we are clocking a turnover around Rs. 45 to 50 crores so it should be up exponentially in the region of Rs. 80 crores.
- Dipankar Ghosh:** No. You got it wrong, it will remain in this range only.
- Saket Kapoor:** In the construction equipment part although the turnover has improved but we are missing the product mix therefore losses are being posted on higher turnover. So how soon will this position be corrected and what should we be expecting it on an annualized basis going forward in the two quarters.
- Sunil Saxena:** In the two quarters our attempt is to first ensure that on the EBIT end we turn positive by the end of Q3 which means coming to Q4 we should certainly be positive and that will be by virtue of a better product mix as well as the demand which is now expected to shed negative trends.
- Moderator:** Thank you. The next question is from the line of Karthik Subramanian from HSBC. Please go ahead.
- Karthik Subramanian:** On the Agri machinery business I think I just missed the number so could you just repeat the industry growth you foresee for FY15, is it 2-3% growth?
- S. Sridhar:** This is what we were originally looking for. It can come down to negative 2--3% as well.
- Karthik Subramanian:** Could you just throw some light on the current trends in discounting in the tractor business you are seeing in the industry in general?
- S. Sridhar:** Discounting is high, you would have heard the same from other manufacturers in their own investor calls. So when the industry is going for a negative growth you will see discounting, incentives and all other things moving up. Currently it is very high.
- Moderator:** Thank you. The next question is from the line of Indranil Das from Eight Capital. Please go ahead.
- Indranil Das:** If you can share your current capacity utilization number for the agri-machinery products and auto ancillary products?
- Bharat Madan:** For construction it is at about 41% last quarter, auto product it is at 44%, tractor is close to 70% and railway is 93%.

Moderator: Thank you. The next question is from the line of Yashesh Mukhi from Morgan Stanley. Please go ahead.

Yashesh Mukhi: You mentioned that discounting levels are quite high across the industry, could you give us a sense of what those numbers could be in terms of percentage of selling price?

S. Sridhar: Something like Rs. 15,000 on a product of Rs. 5 lakh on average. This is advertised, whatever I am talking about is there in public domain. What goes below in the form of dealer incentives we have no formal access. So 15,000 is the kind of price drop seen through paper advertisements.

Yashesh Mukhi: What are the other main drivers of tractor industry growth apart from monsoons? Is it highly linked to that or there are other factors that could influence demand?

S. Sridhar: Two things are important in agri field the crop output and the price. So if inflation is depressed, which may be good for the common man, but generally not a good idea for tractor industry. So the farmers really do not make money unless there is some food inflation. And this year what happened, thanks to the erratic monsoon the kind of crop the farmers have opted for are less remunerative and drought resistant kind of varieties which does not get them a good price. So if they do not get a good price it is a problem. So the prevailing price is a very important indicator. That is why sentiment is down overall. Some parts if you go, places like Maharashtra where I have personally visited I think farmers sentiments were really negative, not very happy.

Yashesh Mukhi: The non-agri front you mentioned almost half of the tractor demand which I believe is growing, what are the key drivers there?

S. Sridhar: It was not growing. What you see on the surface it is a flat demand but what was happening was a negative growth. It was almost down 5% in the first quarter and 2-3% in the second quarter. This was not noticed because billing was happening on a particular rate and those things are getting corrected now. What I said was suddenly from a 12% drop in the month of October which will mean something like 8-10% negative growth in quarter three will look depressing but the real situation is not that way. Still it can be negative 3-4% and not be 8% to 10% the way it will get reported subsequently.

Yashesh Mukhi: Sir my question was pertaining to the non-agri part of the demand. So what drives that primarily?

S. Sridhar: The haulage market is not about agriculture. It is about overall construction, road making, and every activity what is there in the rural-urban area. So it is more to do with the economic wellbeing actually. And evidences there are also not very good and that we have already said. But they have an indirect effect on tractors because of buying back, the secondhand tractors what the dealer buy back, which is over 50% of the tractors. The pull for those kind of product

category gets established making it easier for dealers to sell new products. Even that is choking, that means that part of the economy is also not doing well.

- Moderator:** Thank you. The next question is from the line of Kishan Gupta from CD Equisearch Pvt. Ltd. Please go ahead.
- Kishan Gupta:** How much would you think the restructuring of auto products business will help in curtailing losses?
- Dipankar Ghosh:** 350 people have moved out from Escort group as a whole of which almost 200 people would be moving out from auto business itself. On a month on month basis more than a crore sort of a thing and entirely there are few other cost initiatives which we have undertaken within the division. So that itself we are confident that by March 2015 we should be back in black.
- Kishan Gupta:** But as you said that the quarterly saving will be somewhere in the range of Rs. 1 crores and if we see the EBIT loss was around Rs. 7 crores last quarter. So how will it work out?
- Bharat Madan:** The quarter saving on account of VRS will be close to Rs. 3.5 crores in a quarter, so it is Rs. 1 crore plus in a month. Over and above the VRS which is already been introduced and implemented any volume growth which happened under product expansion, improvement in product mix will primarily lead to the breakeven levels in Q4.
- Kishan Gupta:** Any other VRS expense expected in coming quarters?
- Bharat Madan:** Not in this year. We will review the situation next year depending on how the cash flows are at that time.
- Kishan Gupta:** And how would we explain almost Rs. 100 crores dip in non-current assets in the first half.
- Bharat Madan:** There is a reclassification of an item in the bank balance, lying in an escrow account and it has been reclassified from non-current to current. So we will see an increasing happening on the current asset side and decrease happening on the non-current side so overall the balance sheet size is same.
- Kishan Gupta:** Why hasn't the Construction Equipment business shown traction despite double digit growth in volumes?
- Sunil Saxena:** The construction industry is continuously on a decline mode. And what really is happening is the low value-add on the material handling is where numbers are sustaining but the high ticket items where earth moving takes place which is largely related to work for sand, coal, mining and real construction sites where roads were built, all those activities have really not taken off. So in terms of the volume growth unless the market for backhoe and compactors both show

increase only the material handling equipment increase would not bring in the kind of both top line and bottom line that we expect.

Kishan Gupta:

So it is only on revival of overall economy which will turn the business?

Sunil Saxena:

There are two things, within our mix we need to look at the value added products. Within the material handling itself the higher tonnage cranes, cranes which have power booms and cranes like Frana where we are market leaders. So essentially concentrate more on the value added and high tonnage products. At the same time ensure that in the backhoe market despite of a decline our volumes increase and our product finds acceptability which is what is happening currently. The constraints with which we are working in the backhoe area is we are the latest entrant out of the 10 players and our product is just about getting established after the Digmax-II was launched about a year back. So we had very positive reviews despite of the decline in the market of backhoes. The volumes of backhoes even at a small base for Escorts has been increasing. So once we reach a threshold minimum of about 150 that is the time you will really see things happening for the Construction Equipment group. We expect as I have been saying after we will exit possibly the Q3 to start off EBITDA positive and we should see by that time things getting better for the industry as such.

Moderator:

Thank you. We will take our last question which is a follow up from the line of Sameer Deshpande from Fairdeal Investments. Please go ahead.

Sameer Deshpande:

I wanted to know our policy of export credit because earlier I remember few years back we had problems with respect to recoverable which were very high and we had to write them off as bad debts. We had bad experience in US and Africa also. Secondly are we making better margins in export and what is the credit period and what are the precautions we are taking to prevent bad debts?

Bharat Madan:

Exports to countries and companies which are other than our own subsidiary are all based on LCs and typical credit period ranges from at sight to 90 days and they are all LC backed so they are really secured and we are taking extra precaution wherever it is unsecured we go for an ECGC cover, insurance cover which is also there.

Sameer Deshpande:

So there is no risk of bad debts as such?

Bharat Madan:

No risk.

Sameer Deshpande:

Europe is again facing a slowdown. So, I am asking this question because we are targeting Europe only.

Bharat Madan:

In Europe we have one subsidiary and our export is very low as of now. And earlier it used to be big number because we are supplying fully built tractors from India. But now we only cater



Escorts Limited
November 7, 2014

to SKDs which is about 20-25% of the component which they assemble and balance is procured locally from there. So in terms of our exposures they are low compared to the total outstanding in export so it is not very high. And that assets you cannot cover through ECGC because the beneficiary and insurer are the same.

Sameer Deshpande: And the trend in export continues to be good?

Bharat Madan: Yes, it continues to be good. We will see good numbers coming in and going forward from the export front from our side. And the margins from the export which is another question you asked is comparable to the domestic margins. As long as rupee does not appreciate to an alarming level.

Sameer Deshpande: And about this VRS it was mentioned that payback period is two years. So do we expect to see around Rs. 4 crores on our employee cost every quarter if I go by that way eight quarters?

Bharat Madan: Yes it will be around that, it will be more than that slightly.

Sameer Deshpande: Okay, Rs. 4 to 5 crores on that front.

Moderator: Thank you. As there are no further questions. I would now like to hand the floor over to the management for closing comments.

Bharat Madan: Okay. Thank you gentlemen for being present on this call. Also I would like to mention that we distribute our earning release through our website www.escortsgroup.com. So do refer to our website for our earnings releases as well as other details. And this transcript will be available on our website after sometime. Also you can visit our social media pages for the latest company news, developments, etc. We will meet again at the end of our quarter three results. Thank you very much and have a good day.