



“Escorts Kubota Limited
Q2 FY 23 Earnings Conference Call”

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MANAGEMENT:

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MODERATOR:

MR. RAGHUNANDHAN - EMKAY GLOBAL FINANCIAL SERVICES LIMITED

Moderator: Ladies and gentlemen, good day, and welcome to the Escorts Kubota Limited Q2 FY'23 Earnings Conference Call hosted by Emkay Global Financial Services Limited. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

Before we start, I would like to add that some of the statements that are made in today's call will be forward-looking in nature and are subject to risks as outlined in the annual reports and investor releases of the company.

I now hand the conference over to Mr. Raghunandhan from Emkay Global Financial Services Limited. Thank you, and over to you, sir.

Raghunandhan NL: Thank you, Vivian. Good evening, ladies and gentlemen. And on behalf of Emkay Global Financial Services, I welcome you all for Escorts Kubota Limited Q2 FY'23 Results Earnings Conference Call. I also take this opportunity to thank the management for giving us this opportunity.

We welcome the management team from Escorts Kubota Limited. Today, we have with us Mr. Bharat Madan, President Finance, Group Chief Financial Officer and Corporate Head; Mr. Shenu Agarwal, President, Agri & Construction Business; Mr. Sanjeev Bajaj, Chief Executive, Construction Equipment; Mr. Ankur Dev, Chief Executive, Railway Product Division; Mr. Neeraj Mehra, Business Head, Agri Machinery and Mr. Prateek Singhal, Investor Relations at Escorts Kubota Limited.

We would start the call with brief opening remarks from the management team followed by an interactive Q&A session. At this point, I would request Mr. Madan to make his opening remarks. Over to you, sir.

Bharat Madan: Thank you, Raghu. Good evening, ladies and gentlemen. And thank you all for joining us on the earnings call for the second quarter and half year ended September 30, 2022. Few highlights of company's standalone performance for second quarter ended September 2022 are as follows; revenue from operations during the quarter was up by 12.2% at INR 1,883.5 crore as against INR 1,678.8 crore since previous fiscal. Agri business and railway products segment continued to outperform. Their segment revenue grew by 15.7% and 7%, respectively, while Construction Equipment segment revenue came down by 3.1% on Y-o-Y basis.

On sales volume front, tractor sales volume was up by 12.5% to 23,703 tractors as against 21,073 tractors last year same quarter. Whereas Construction Equipment volumes was down by 14.6% to 917 machines as against 1,074 machines in last year same quarter.

EBITDA for the quarter ended September 2022 came at INR 152.7 crore, down by 32.6% as against INR 226.7 crore last year same quarter. EBITDA margin for Q2 stood at 8.1%, as against 13.5% last year same quarter. Margin was adversely impacted mainly due to unabsorbed inflation, both in commodity and other costs. Company continues to be debt free with sufficient available liquidity for growth. PBT before exceptional items at INR 191.5 crore as against INR 237.4 crore last year same quarter.

Net profit at INR 87.6 crore as against INR 176.7 crore last year, impacted due to exceptional cost provision of INR 72.8 crore on account of impairment of investment in the joint venture Tadano Escorts India Private Limited.

On a consolidated basis company financial performance for 6 months ended September 2022 is as follows; turnover at INR 3,922.9 crore is up by 15.5% Y-o-Y. EBITDA margin at 9%, down by 480 basis points as against 13.8% in last year same

quarter, adversely affected by inflation in commodity and other costs. Net profit at INR 239.4 crore as against INR 351.9 crore last year. EPS stands at INR 22.14 as against INR 35.75 last year same period.

Now, moving onto segment wise business performance, starting with the Agri Machinery business. The domestic tractor industry, during the quarter ended September 2022, was up by 4.8% year-on-year to 2.22 lakh tractors. This is primarily attributed to positive farmer sentiments led by above normal monsoon and onset of an early festive season leading to channel stocking. Our domestic sales volume came at 21,396 tractors as against 18,950 tractors in last year same quarter, registering growth of 12.9% on the year-on-year basis, higher than the industry growth.

During the quarter, industry, in our strong regions of North and Central India, grew by 12%, whereas industry in our opportunity regions of Southern and Western India was down by 2%, resulting in overall domestic market share gain of 69 basis point to 9.7% in quarter 2 as compared to that of 9% last year same period. Our total dealer count in India now stands at 1,170 plus with most of our new dealers coming up in the Southern and Western regions. Our market share in our opportunity markets continues to be on the rise.

Tractor export industry volumes were down by 1% to 35,300 tractors as compared to 35,600 tractors last year. We continued our growth momentum in exports and have achieved our highest ever quarterly export volume at 2,307 tractors, up by 8.7% year-on-year, way higher than the industry growth, resulting in increased export market share to 6.5% against 6% in same quarter last year. This is driven by our continued focus on new product development and on expanding our distribution network through new channel partners. Sales through Kubota's global network is also gradually increasing and during second quarter contributed more than 20% of our total export volume.

Segment revenue was up by 15.7% at INR1,454.9 crore as against INR1,257 crore in corresponding quarter previous fiscal. EBIT margin for Agri Machinery business stood at 8.4% as against 14.9% last year corresponding quarter, mainly affected by inflation in commodity prices and other costs. For FY'23, we expect domestic tractor industry to grow in single-digit and may touch new peak in current fiscal. The last peak observed was in FY'21 when the industry was about 900,000 tractors.

So this will be mainly led by overall positive rural sentiments on account of good rainfall and better water reservoir levels. Good and timely sowing of rabi crop, higher crop MSPs, better retail finance availability and early festive season in March 2023 this time.

Now coming to the Construction Equipment business. Our served industry backhoe loaders, pick and carry cranes and compactors was up by 2% in Q2 led by growth in backhoe loader industry by 7%. Crane industry marginally was up by 1.54%, but compactors industry was down by 37.3%. Our total volumes manufactured and traded products combined went down by 14.6% to 917 machines as against 1,074 machines in last year's same quarter.

Segment revenue went down by 3.1% at INR241.9 crore as against INR249.2 crore in corresponding quarter previous fiscal. EBIT margin stood at negative 2.6% as against 3.6% in corresponding quarter previous year. The margins were adversely impacted by lower volume and steep inflation in commodity prices and other costs. In the long run, we expect growing infrastructure spends and growing economy will lead to overall surge in the demand for Construction Equipment in India. For full year FY'23, however, we expect Construction Equipment segment to grow in single-digit and margins for the segment to improve in second half, led by higher volume and stabilization of inflation and product prices.

Coming to the Railway Equipment Division, revenue for the second quarter went up by 7% toward ever highest quarterly revenue of INR182 crore as against INR170.2 crore in the corresponding quarter. EBIT margin for quarter ended September 2022 stood at 14.6% as against 17.3% in corresponding period last year and 13.6% in Q1. Continuing our focus on expansion and diversification of railway product lineup, we successfully completed field trials for indigenously develop brake pads for Indian Railways and Dampers for Chennai Metro. Additionally, we are in the process of developing brake systems and couplers for train 18. Order book for the division at the end of September 2022 stood at healthy and ever highest level of more than INR900 crore. For FY' 2023, we expect Railway Equipment segment will grow in double-digit.

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

Moderator: The first question is from the line of Tanpreet Kaur from CapGrow Capital Advisors. Kindly proceed.

Tanpreet Kaur: My question is operationally, what changes have happened after Kubota has come in, in terms of overseas business opportunities and how is the company leveraging on Kubota's expertise?

Bharat Madan: So see the changes are still happening, so as you know the teams are now getting into place. Exports, we already seen the numbers have started moving up. So these are the low hanging fruits, which was there, especially in the existing product category, which you can export to the network. So you already opened certain markets, so like in Europe we have been exporting now, we opened the markets of South Africa and we also started export to Sri Lanka.

So already the contribution in the export, if you look at this quarter or the first 6 months has increased to almost 20% for the tractor which are getting sold with Kubota network and this will continue to go up as we penetrate more markets and Kubota opens a network for other markets too. So this is one of the lower hanging fruit. Obviously, there are many other initiatives which are undertaking within the company, both on the operations side, R&D side, product development area as well as on the front-end side. So I think as the time passes we will definitely see many more such initiatives, which will start bearing fruit and we'll also start making those initiative public. So we will have better knowledge maybe in the coming quarters

Moderator: The next question is from the line of Mr. Raghunandhan from Emkay Global. Kindly proceed.

Raghunandhan N. L.: Congratulations on the strong market share performance coming back towards 10% mark in Q2. Sir, I had 4, 5 questions. Firstly, starting on the cost pressure side, so can you give some more color, what happened in Q2 because the impact of higher cost seems to be visible in various line items. If you can elaborate and explain in more detail, what are the items which led to cost increase and by when do you see the normalization of margins?

Bharat Madan: Sure, Raghu. So, this is Bharat Madan. So on the cost front, as we had mentioned in the first quarter call also, so there have been obviously pressure from the inflation on the commodity prices side. And if you see in the last 5, 6 quarters, the cost has actually gone up by almost 30%, 35% on the material front, while the price increases in the market have not been to that extent. So in the end of Q1, we had an unabsorbed material costs to the tune of almost 4% to 5%, which we had indicated, we are still going to carry and we'll see going forward, how the commodity prices play out.

And there's one price increase, which has taken in the last quarter in Q2, or in the middle of July, which was roughly 2%. But still as we end this quarter in September end, we used to have very minor inflation, so inflation has actually come down. So

we had some commodity, we actually got the deflation benefit, but there are certain commodity, like tire, et cetera where the price actually went up in this quarter, but net-net the impact was much lesser than what we're seeing in the earlier quarters.

So as a result, we are still carrying the similar impact of unabsorbed inflation, which is close to 4.5%, which has not get passed into the market. We are keeping a close watch on the industry performance and the market leaders, how they react to this and we expect some price increase will happen going forward from the market, but we can't say, what would be the magnitude of those price increases. But at the same time, some deflation benefits should start coming in from Q3 onwards.

But coming back to the margin structure, I think we have seen the way margins were earlier from the peak level of about 16% margin which the company had achieved in FY'21, which is a COVID year and exceptional year. The margin trajectory going up has been spread over 6 to 8 quarters. So again, when you looked at this margin going back to normalcy, we think maybe the similar period will happen, so it will not happen overnight. The trajectory will be slow and gradual, but we expect the improvement should be visible now in the coming quarters. So we don't see a major downside now from the level, which we already reached now. So we already see the positive side going forward and the margin should only improve from here onwards.

Raghunandhan N. L.:

Got it, sir. And in terms of commodity deflation benefits from Q3 onwards, any quantification, sir, how much benefit you can get there?

Bharat Madan:

So that is very difficult to quantify it now, because normally these prices are set by the industry leaders and we normally follow the industry norms. So the major item there is a casting, where the price reduction hasn't happened, and there is a material impact, which will happen. We were expecting this to come in, in the second quarter, but some of the vendors were not really willing and the settlement did not happen in the industry. So now we expect hopefully the settlement will happen in third quarter and that would be a good benefit which will accrue.

But we don't see the further inflation pressure now, so it's only a question of how much deflation really can come in. And even the price increase in the market will be a derivative of how much deflation can you offset against the unabsorbed inflation. And only the differential probably will get passed on. So let's see, so like you said, the downside is not visible from the current level, so we only see the positive margin trajectory, which will come from third quarter onwards. How much will it be? It's very difficult to quantify at this point in time.

Raghunandhan N. L.:

And on the cost saving efforts, sir, there would be various areas which company is continuously working on. Any potential on the cost reduction efforts? And can they add anything over the next few quarters?

Bharat Madan:

Yes, Raghu. So like I said material cost improvement is a continuous exercise. So we had taken internal targets within this year, looking at the high inflation and the projects are still on. And we expect they will start yielding results and will get definitely some improvement in the margin from those projects. But on the other cost structure as you see, the inflation is not hitting just the commodity, even the other costs whether it's travel cost or the other cost, so manpower cost, the inflation is hitting everywhere. So given the effort which had been done by the management to cut down on cost, they get negated by this inflation, which sets in on the other cost structure too. So I'm sure as the deflation starts coming in, so gradually these costs will also go under line. And you are probably we will see a better numbers coming in, in the coming fiscal.

Raghunandhan N. L.:

And sir, in terms of company has been able to increase its market share, but the competition intensity level in the industry seems to be on the higher side. So if you can talk a bit about the tractor industry competition intensity whether there has been

increase in discounting during the festive season and whether there is an expectation that these discounts can reduce in the coming quarters?

Shenu Agarwal:

Raghu, this is Shenu. So Raghu, as you know, this is a common phenomenon in tractor industry. The discounts slightly go up during the peak season. But over a quarter or so, they do normalize to a normal levels. And that is the same scenario, that we are witnessing this time. Competition intensity is of course high, but there has been high for few years now, so we don't think there is a significant change there.

Raghunandhan N. L.:

And sir, if you can also talk about how the festive season performance was there for the industry and for the company?

Shenu Agarwal:

Yes. So as you can see, as we told you in the last call, after end of Q1, that we will make some correction in our market strategies and positioning, product positioning, et cetera, which we did in the middle of August. And after that, we have seen some very encouraging response from the market for both our brands. So for Q2, as you know the industry was up by 5% and our volumes were roughly up by 13%, leading to a market share gain of about 0.7%. We hope that we will continue this phenomena going forward. October also has been very good.

As far as the industry is concerned, the industry is moving pretty much at the same pace, since the beginning of the year. If you look at April, July, where the industry growth was roughly 9%. And then from August onwards, for example, like August, September or August, September, October, since October numbers are also out for the industry, the industry growth is 11%. So it has moved from 9% April, July to 11% August, October.

So it is pretty much moving at the same pace. The good thing is that last year was a kind of a little bit of a high base, during this time, especially the festive time. And despite that, the industry has shown good results in September and October. So we hope this positive momentum will continue, although there are some problems in some geographies because of some macro factors. But we are really hoping that those market should also show some positive trends going forward.

Raghunandhan N. L.:

Got it sir. Just a clarification before I get back into the queue. Based on your understanding, how would be that retail growth for the industry and Escorts in that 30-day festive period?

Shenu Agarwal:

Yes. Very similar, Raghu, because see even last year, every year there is this phenomenon. The only thing is that the festive season following the Hindu calendar, it moves little bit, so we know that this year it was a little bit early. So there was some impact in Q2 retail because of that, although there were only 4 or 5 days of Navratra in September this time. So not the full impact, but slight impact of that, right? So this will get corrected in October and November. So when you see the results of October and November, again this will get normalized.

But otherwise, I think generally speaking, the retail momentum and wholesale momentum are quite matching. There was, of course, an increase in stocks level prior to the festive season, and slightly in August and more in September. But in October, the stocks also have come down to a reasonable level, although some more stock reduction is expected at the industry level in November and December. But, yes, I mean, to just answer your question straight, I mean, the momentum is good on both retail and wholesale.

Moderator:

The next question is from the line of Mitul Shah from Reliance Securities. Kindly proceed.

Mitul Shah: Yes. And first of all, I would like to thank to Shenu ji for insightful knowledge shared over so many years, while it is his last call on Escorts Kubota. So, sir, thank you very much for whatever knowledge you especially give on the tractor side and industry side.

Sir, my question is on the tractor industry inventory post festival, which used to come down at least by 40,000, 50,000 after Diwali season over last so many years and probably should stabilize around 90,000 to 1 lakh units. This time it doesn't seem to be happening, because most probably October retail would be somewhere around 145, 150, wholesale number coming roughly 123,700. So the decline in inventory is just around 20,000 to 25,000 compared it should be 40,000, 50,000. So what is happening here or is it the industry trend now that in the inventory level would remain above 120, 130 post-festival. So that's first question.

Shenu Agarwal: Okay, Mitul, firstly thank you for your kind comments. And then, as far as the industry is concerned or the stocks are concerned, I mean, we don't think that the industry is going to operate at the stock level of 90,000. I think it would be higher than that. This year, as you know that we are the industry is going to hit a new peak most probably, right. So the industry would be about 900,000. So, in any case, I mean, even if you take one month of stock, that comes to roughly 80,000 and the industry normally operates at the stock more than that, roughly about 45 days or so, right, So I think the normal stock levels could be around like 110 or so, in my view, right.

And you are right that we are not at that level as far as the industry is concerned. So there might be some reduction in stock, in November and December as well. But my view is that 90,000 is too lower stock where industry would operate even in the future. As far as our stocks are concerned, we are pretty comfortable. We are roughly between 30 and 35 days of stock. So the stock increase, which we had done earlier before the festive season, we have corrected quite a bit. So there is not a huge correction that we expect going forward.

Mitul Shah: Sir, second question on region-wise, if you can give some detail on the region-wise during the festival? And particularly in October, we have observed that UP was under huge pressure because of erratic monsoon of water spillover from the Nepal side in few territories. So industry people are indicating growth in UP in November compared to other regions. So probably, how you look at November on a retail term and some details on the geography wise or zone wise?

Shenu Agarwal: Yes, Mitul, thank you for that. So as you also know that a few markets did extremely, extremely well, actually beyond our expectations during the festive period. So MP and Maharashtra really stood out in that sense. And you're also right, that some of the markets, especially the paddy growing areas where we had a very late rainfall, and also some other water issues, because of the border countries. So the industry did not move as expected, especially UP and to some extent, in some areas of Bihar and West Bengal. So yes, we are expecting that, because this led to a delay in the harvest and delay in sowing, et cetera. So UP, especially the Central and Eastern parts, should show some retail momentum in November also, going up to maybe November 20 or 25th of November.

Also like the Eastern part of Madhya Pradesh also, although Madhya Pradesh overall did very well. But Eastern part of Madhya Pradesh also, we expect that the industry momentum would really continue into November, up to even third or fourth week of November. So these are the areas where we think that this will surprise us in November probably. And therefore, they will help pulling up the overall industry in November also.

Moderator: The next question is from the line of Eshit Sheth from Anvil Wealth. Please proceed.

Eshit Sheth: Sir, one question was on the market share, I think even in the previous call, we had alluded to certain strategies to improve this market share substantially. Now if you look at, there has been some improvement, especially for the quarter. But again, when I look at the October numbers for us versus competition, again which seems like we've dropped some market share. So how do you see and you had spoken about certain targeted actions that we would take to retain the market share. Can you just throw some light on how the market share would play out?

Shenu Agarwal: Eshit, thank you for your question. Just a couple of correction in what you said. So we did not drop market share in October, although the gain was little bit lesser than what we had experienced in August and September. And the other thing is, especially during the festive season, it would be better to kind of look at the market share over a period of 2 to 3 months, not in a single month, because as you are aware, there are heavy stock fluctuations from different manufacturers, different brands in different markets. So one month market share actually doesn't give you a good idea.

So when October market share is out, then you would see, August, September, October would be the best way to compare relative market shares of different brands. And I assure you, that you will see a good positive market share increase in our case. That is one.

The other is that a Q2 market share has increased from 9.0% last year to roughly 9.7% this year. Again, like I said, whatever the strategies we deployed in the market, they took effect from kind of late August, beginning like mid-August until late August, depending on the market. And therefore, the Q2 results don't show you the full impact of those actions that we took. But if you look at like September market share or when you look at the future market share, now August onwards up to let us say December or quarter 4, then you will see the real impact of this. So we are very hopeful, very confident that this market share gains, which we have witnessed in last few months would continue.

Eshit Sheth: Sir and in terms of realization, we generally see some kind of a sequential bump up from Q1 to Q2, plus we had a 2% price hike that Mr. Madan spoke about. So generally, I mean, where do you see the realization stabilizing, because as we spoke we might go for a small price hike if industry also does it. So can you just talk a little bit on the realization?

Shenu Agarwal: Yes. So realization basically is coming from 2 factors. Firstly, it is coming from the price hike. And secondly it is also coming from the fact that the industry is moving towards higher horsepower, therefore enhancing realizations for every brand in the market. So as far as price hikes are concerned, Bharat has already said, that our policy is to follow the market leaders, and we are waiting and watching different brands, how they react to further price hikes. One thing we must keep in mind that, industry has already taken 6 or 7 price increases in almost that many quarters. And therefore, the ability to take further price increases would be now kind of limited. But we do still expect that some price increase at the industry level might happen. So I was saying that you can expect some price increase to happen between now and March. And then maybe again in the first quarter of the next year, right. By extent of the hike, it's not possible to advice right now, yes, but we expect something to happen this quarter and something to happen then in quarter 1 of the next fiscal.

Moderator: The next question is from the line of Amber Shukla from Motilal Oswal. Kindly proceed.

Amber Shukla: So, sir, you have already elaborated on the current demand scenario, but just wanted to get some sense on what would be the annual guidance for FY'23. So is there any change versus our earlier guidance?

- Shenu Agarwal:** Yes. So as Bharat has already said, we are expecting that this could be a record year for the tractor industry and last record was traded in FY'21, when the industry touched up the 900,000 units. So we do think that there is a high probability that we'll cross that numbers this year. I think the overall growth for the full fiscal would be roughly in the mid to high single-digits.
- Amber Shukla:** Okay. And there are 2 questions, first of all, Construction Equipment. So while there was a single-digit growth at industry level. And we have seen a double-digit de-growth in volumes for us. So why there was such an underperformance versus the underlying industry?
- Sanjeev Bajaj:** Yes. So this is Sanjeev Bajaj. Thank you for your question. Actually, we have witnessed one of the toughest inflation in the second half of the first quarter and then this impacted our industry dramatically. And the strategy which we had taken as an organization was to try to pass on the inflation to the market. And although the industry has not grown to the expected level, it has been shown some improvement. But in quarter 2, it was everybody trying to pass on their costs over to the customer. But if you look at the industry from construction perspective, quarter 2 generally goes into rainy period and then therefore the construction activity that is low. So therefore, it was very difficult because the demand itself was low, so it would be very difficult for all manufacturers to be able to pass on that costs.
- Having said that, as we have moved past to the monsoon, we see that the demand is again picking up. And therefore, we are able to pass on almost 80%, 85% of the inflation, which we have been witnessed. So I would say that quarter 2 was everybody trying to manage inflation. And making sure that the products are not a higher cost, viable for the customer. And this has also given opportunities to manufacturers like us who have been able to introduce products at a reasonable price for the customer or the variants, which are in low premium variants and which are helping both the customer as well manufacturers to be able to go back to the market. Now as the construction activities are going up, I think the new product ranges which we have that is helping us and the inflation also going down, I think it is like dividing the whole business scenario.
- Amber Shukla:** And just one last question, if I can squeeze in. So on railways, so there was a healthy growth during the quarter, so how should we see revenue shaping up for next year and half so? And then subsequently the margins as well considering the strong order intake and the kind of order book we have right now?
- Ankur Dev:** So good evening, Amber. This side Ankur Dev. Thank you for your question. So I think we will be able to maintain the same momentum in this fiscal year. So we are expecting a double-digit growth. And in terms of margin, we expect that margin will slightly improve from this as we will have some benefit from the deflation side. So our margins should be slightly better than the last financial year. And for the next financial year, I think we will target to have a similar kind of double-digit growth in the next financial year also. So which is the order book we have in hand.
- Moderator:** The next question is from the line of Gunjan P. from Bank of America. Kindly proceed.
- Gunjan Prithyani:** I had 2 questions. Firstly, on the regulation, so the trend for regulation was my sense is the cut-off was October, right? So I just wanted to understand what has been the implication of that on the industry, has there been sort of some advancing of demand on 50 HP side and what sort of cost or price increases happened for 50 HP portfolio?
- Shenu Agarwal:** Okay. Gunjan, this is Shenu. So first let me give you an update on this trem 4 deadline for about 50 horsepower tractors. So the cut-off was supposed to be end of September and on the last day of September we received the draft gazette notification from government, that they would probably like to extend it by 3 months, right. So we haven't received the final confirmation from the government on

this. But most likely since that draft has already come, most likely it would be extended to December 31, now. So that is one part. The other part is that, yes, there was work some kind of demand that was pulled back into September and August because of the earlier notification. And of course, now everybody has stock and now all the manufactures are free to manufacture more tractors until end of December, which everybody I think is doing. So the real impact is now we've seen in quarter 4, because we are back to kind of square one right now.

Gunjan Prithyani: Shenu sir, we need to dispatch by December, but the retail can continue to sell for some time, is that how it flows or cut-off date for retail and dispatches both the same?

Shenu Agarwal: So the cut-off date is for production, not dispatch or retail or billing. It is for production, right? So we should have produced the tractor by the cut-off date. And then they allow 6 more months for the tractor to get registered. So after 6 months, the RTO officers will not register those tractors anymore. But cut-off it moves to end of December then the registration cut-off move to end of June.

Gunjan Prithyani: Okay. So the dispatches can still continue, but production cut-off is there. In any case, we saw some positive mix impact of 50 HP in July and August. Of course, now the regulation has been deferred out a bit.

Shenu Agarwal: Yes. That is right. So we might see another small impact in December now if the regulation is extended.

Gunjan Prithyani: And the cost increase ballpark remains similar, I think if I'm not mistaken, 100,000-odd or if you can share little bit more on, how the cost increase will happen?

Shenu Agarwal: Yes. That is right. So it is in the ballpark range of roughly 60,000 to 100,000 depending on the size of the tractor and everybody has launched these tractors already because nobody wanted to wait until the deadline, right, because the customers and dealers also need to get acclimatized with this new technology. So all the tractors are in the market. So it is like not that something really will change after December. Customers are already buying these tractors, right now.

Gunjan Prithyani: Okay. Got it. And now, going back to the margin performance and sorry, I may get a little repetitive because I missed the initial part. But I understand the unabsorbed commodity bit, but I thought that unabsorbed 400 basis points, 450 basis point was at the end of June quarter. Incrementally, if I look at few actions that you all have taken is, you took a price increase, it may have partly flowed through. There was a better mix of 50 HP coming through. Despite that Q-on-Q margin has gone down. So I mean, I'm just trying to understand why should there be a Q-on-Q decline, when you had a better mix and some flow-through of the price hikes. And this is for the farm segment.

Bharat Madan: So Gunjan, one impact obviously is because of volume, so Q1 volumes were higher than the Q2 volumes, so that itself is a significant impact. And second on the material cost front, we were actually expecting the deflation to set in from Q2. But unfortunately, we again saw the increase happening on the tire prices, which actually neutralize some of the deflation which did come in Q2. So going forward, we expect, I think the Q3 onwards we should start getting that benefit now. The only thing is we don't know how much quantum it can happen, but we have to keep our fingers crossed. But yes, the prices have started softening down now, across all commodities, be it castings, forging, sheet metal, et cetera.

Gunjan Prithyani: Okay. And the commentary that you made that back to normalization will be gradual. When I look at the normal EBIT margin, we also touched the high of 20%. So is that something when we're looking at back to normalization, is that where the target is or how should we think about the medium-term target for the farm segment now?

- Bharat Madan:** No, 20% was exceptional, and that's one another exceptional year which is COVID year, which we had unprecedented demand. But I think in the Agri side, 15% to 16% sort of margin, I'm saying this is EBITDA number, maybe EBIT number would be 14% to 15% number, which we should look at in the long-term, it should be there.
- Gunjan Prithyani:** Okay, just last question on the industry outlook, if I recall the comments last time, there is sort of modest commentary that we're seeing patchy monsoon, some markets are not doing that great. But when I hear you this time, it just seems that you all have far more optimistic and positive on tractor demand. What is fundamentally changed in last 2, 3 months and do we see that, this is more of sentiment in rural improving? Some color on what's happening on the ground.
- Shenu Agarwal:** Yes. Gunjan, this is Shenu. So a couple of things, right, which has changed from last time to this time. Firstly, the monsoon has been better than everyone was expecting at that point in time, right? So it was like about normal. And as you can see, the reservoir levels are very, very high, the moisture content is very, very high, right? And therefore that added to a positive sentiment, not just for this festive season but also for the upcoming rabi crop. So that is one.
- The other thing, which played a little bit of spoilsport was that the monsoon was little bit erratic or unseasonal, as to sales. So few of the markets like I was explaining to Mitul, had problems with this, especially the Eastern part of India like UP, Central East, Bihar, et cetera, West Bengal and so on. But even there we are hoping that although the harvest has been delayed, but we think that the markets would come back in November, because the overall underlying economy is quite okay. So, yes, I mean, right now, we are also surprised by the way the market has reacted in the festive season. And we think the industry will create a new record this year.
- Moderator:** The next question is from the line of Shridhar Kallani from Axis Securities. Kindly proceed.
- Shridhar Kallani:** Almost all my queries have been resolved. Just one bookkeeping accounting question that I have with regards to the amalgamation that will be happening of Escorts Kubota India Private Limited and Escorts Agricultural Machinery, since both of these are JVs for the company and now they will be amalgamated with Escorts Kubota Limited. So earlier they were under Ind AS31, I believe, and recognized as in the balance sheet item. But in the future, I believe they will be reflecting in the income statement. So if a little bit guidance could be given as to the top line and bottom line and the effect on EPS that these might have on the company?
- Bharat Madan:** Yes. So, if you recall, when we had actually the Board had approved this merger, so we had to give on investor guidance note, where we had indicated the top line and bottom line of both the companies, about the JVs. So roughly, you can assume the top line will be in the range of INR2,000 crore plus. The bottom line for the manufacturing JV was negative and the sales it was positive. But now since the merger will take into account from 1st of April next year, so really we expect maybe next year should be more like a breakeven year for those JVs, as in the capacity utilization in the manufacturing side was still low.
- So when those both JVs get merged into this company, we expect initially there'll be a dilution of roughly 2% in margin, so the top line will get added and they are as of now more like a breakeven sort of operation. But the synergies for the integration will start flowing in over next 2, 3 years. Then the ultimate target has truly taken them back to the same level of margin, what the cost enjoys in the Agri business segment. Though that will be a 5 to 6 years sort of journey, but that will be the end objective. And this may gradual improvement, which we will see happening every year.

- Moderator:** The next question is from the line of Sonal Gupta from L&T Mutual Fund. Kindly proceed.
- Sonal Gupta:** Just trying to understand further from Gunjan's question. I mean, on the RM cost side, I mean, do you expect a meaningful reduction in like steel and like you mentioned castings, forgings coming through in Q3?
- Bharat Madan:** So it may not be that significant, but like I said, this very difficult to say now, because they were supposed to come into play from middle of April. It was supposed to be effective from mid of April when the price actually started coming down and after peaking in the month of March and April post war scenario. But somehow the vendors cannot really agree to pass on those benefits yet to the OEMs, because of cost increases in the other process cost too, which they have now been started claiming. So the settlement on that account and the industry is still to happen. And casting is a major component in the tractor industry kind of which you won't probably see in the other automobile players. You've already seen the benefit coming in for the sheet metal and the forging side in Q2. But going forward, once the castings also gets settled, so we think that could be significant.
- Now, how much will be the quantum is very difficult to say, because the rates have been moving now in October, again in the beginning we saw the hardening of the prices started happening, so the vendors also held back and giving back the benefit. So we're keeping our fingers crossed, so and keeping a close watch on the commodity movements. But general expectation is the way industry is, the global recessionary condition, which are likely to prevail in the next year, things will likely become closer to the normalcy, it used to be there may not be pre-COVID period I would say, but still nothing much better than probably what we've seen in the last 6, 7 months.
- Sonal Gupta:** Just to understand this a bit better, so what is the typical lag and is this index to some prices or this is more a negotiation driven thing?
- Bharat Madan:** So it's a mix, most of the commodity like sheet metal is all indexed to the commodity benchmarks and the benchmarks available from CRISIL, from SIAM data that always gets published. On the other commodity there are some leaders who take the call, especially on the forging side. So the industry leader in auto industry would normally take a call. It can be Tata Motors or it can be Maruti Suzuki. And then in castings, typically it's the Mahindra which takes the call. So as they set the ball rolling, then the industry follows.
- On proprietary, it's simply a negotiation, but you can't benchmark those particular parts. So it's just typically a mix of negotiation and maybe some sanity, which we've tried to do. So it's a mix and combination of all these factors, so thing is very difficult to pinpoint and really track how the movements were happening and how much benefit we'll be able to get. And normally we get it with a lag of a quarter, we'll also pass it on with a lag of the quarter. So what we'll get is also with a lag. So that will be something, which will happen maybe in the coming quarters.
- Sonal Gupta:** So you think, I mean, just to clarify, this is going to come over Q3 and Q4 or you think that you will get all the benefits by Q3?
- Bharat Madan:** No, no. So like you said, it will have to be gradual. The way the margins reduction has happened is last 6 quarters have taken really to inflation to come up to this level and we expect when the downside happens it will be in the same manner. So maybe you've to see it really spread over next 4 to 5 quarters when the gradual impact will start coming in. So every quarter we see some better improvement over the previous quarter.
- Sonal Gupta:** Got it. And just on the price increase, is the full impact reflected in this quarter or would that come also again in Q3?

- Bharat Madan:** So we've taken the price increase from 10th of July, so that's why the very marginal impact probably would not have been there, but generally it's the full impact which is factored in. So the first 10 days not much sale was there in July. So really you can resume the more or less the objectives are already factored in the Q2 numbers.
- Sonal Gupta:** Got it. And just on CapEx, I don't know if you've given guidance for this year or next?
- Bharat Madan:** So on CapEx, we had earlier given the guidance of roughly INR300 crore to INR350 crore of CapEx to happen. But I think things have slightly slowed down there. So I think some project, we look is happening now. So we expect this year, looking at the spend, which we had done till the first six months, we don't expect it should cross INR250 crore in this fiscal. But that doesn't mean the plates are getting scrapped. Some of the plates are getting relooked at and carried over to next year. So next year, we are still in the process of making plans and believe we'll come back to you, but we expect that number will likely increase in the coming year. So when we come back to the investors with the mid-term business plan, I think we'll give you better guidance over next 4 to 5 years, what sort of CapEx plan we have at a company level.
- Sonal Gupta:** And when do you expect the MTBP and then your related permission to be release?
- Bharat Madan:** Let's say, we are trying to finalize that within this month. So I think some dates if which we have chosen from the directors and senior management team, so we'll come back and obviously all of you will be there. And all of you will be invited when we do this unveiling.
- Moderator:** The next question is from the line of Amber Shukla from Motilal Oswal. Kindly proceed.
- Amber Shukla:** I just have a follow-up question on other income, so which has gone up substantially, compared to the last quarter. So is there something or just a one-off?
- Bharat Madan:** See in the first quarter, you know when the interest rates have started rising, so there is a mark-to-market impact on the investment, which we have on the mutual fund sides. So that's been picked obviously, yes, that too nullified now in this quarter. But in the first 2 months, we got the benefit back. But going forward, if the RBI again takes further hikes and depending on how much quantum they take and whether that is already factored in the market or not. So some impact may happen temporarily, but since most of these investments will be held till maturity, so we don't see this will be only timing issue. I think quarter-to-quarter, they may see a variation, but overall, we expect this will be the kind of return, which we'll get, full return will come if this really continue till maturity. So we don't see a downside. So our thing is, I think roughly, INR60 crore every quarter is roughly the broad average, which we expect should happen on the other income side.
- Moderator:** The next question is from the line of Raghunandhan from Emkay Global. Kindly proceed.
- Raghunandhan N. L.:** Sir, with merger of Kubota Agri Machinery and Escorts Kubota India Private Limited, the focus is on localization. Can you provide some update on the localization efforts and is that also providing an opportunity to start exporting components to meet global Kubota requirements?
- Bharat Madan:** So localization plan is definitely there, Raghu, although it's not yet started, but it will happen over a period of time. That definitely will lead to the opportunities for the export of component, but this is one of the objective for this partnership. So it's not just the tractor or the finished products which will get exported, but component exports will also be a big number going forward. So yes, we also looking forward to

that, maybe even we share our mid-term business plan, we will give you some idea, what the journey on this part too.

Raghunandhan N. L.: Sure, sir. And on the export side, 20% of exports is through the Kubota channel. So can you indicate how many markets are we supplying to and how is the ramp-up expected ahead?

Bharat Madan: So I don't have the ready data. But yes in terms of the demand from Kubota is definitely there. So as I mentioned as we open more markets with them, and obviously we need some product changes to happen. So it are not the same product which will go as it is. It will be co-branded product and depending on the market requirements some changes will need to be done, which take some time. But this will be gradual. But yes, the share of Kubota will definitely continue to go up, going forward in this overall export numbers.

Moderator: The next question is from the line of Mitul Shah from Reliance Securities.

Mitul Shah: Sir, I have question on cash and cash equivalent and working capital. So overall working capital has increased roughly around INR500 crore between March and September. So certainly it's because of the pre-festival inventory related. So post this, how much do you expect cash release from working capital side? And as of September end, how much is cash and cash equivalent on those balance sheet?

Bharat Madan: So, Mitul, as you rightly said, so definitely in the first quarter in Q1, it was a cash positive quarter for us. But in second quarter because of the buildup for the festive season, the inventory levels did go up, so that did suck-up lot of cash from the system. So which are roughly about INR500 crore to INR600 crore. So net-net in first half, we are actually use some of the cash, but this has started coming back, so the October was a very good month in collections. So I think overall, we got I think about INR150 crore of free cash, cash surplus. And we expect the similar trend will continue in the balance funds too. So the cash will get released. So we had 4,200 crore to 4,300 crore sort of liquidity on the balance sheet as of end of September. And we expect by the time we end this fiscal; we should be somewhere close to 4,800 crore to 5,000 crore range.

Mitul Shah: Second, just reconfirming you stated that CapEx would be somewhere around INR250 crore only, right?

Bharat Madan: Yes. This year, that's the outlook now.

Mitul Shah: This all the 3 verticals put together, Railway, Construction as well as tractor?

Bharat Madan: Yes. That's correct.

Mitul Shah: So next year would be at least probably about 350, some spillover of this fiscal end.

Bharat Madan: So next year we're still finalizing, Mitul, and the budgets are being made. So we are still discussing the CapEx plan for next year, it is not yet final. But I think it'll be way higher because first the merger will also happen in the middle of the year. And there is some CapEx plan for the JV also, which will come into play. And for EKL standalone also I think the numbers, whatever projects we had for this year, some of them have been carried forward to next year because of the margin stabilization which was happening now. So I think post-integration, we'll see the impact will be start coming in. And we expect maybe a little bit higher. But maybe when we meet maybe in the next call, we'll have a better flavor of the exact number, what sort of CapEx we expect to happen in the next fiscal. But definitely will be higher than INR300 crore, INR350 crore, what we indicated initially.

Mitul Shah: Sir, lastly, again on this competitive pressure, you already replied to some extent. But sir in past also when commodity inflation was even sharper than what we have

seen in Q2. But we maintain margins not only we but overall industry-wide, all the players particularly in the tractor segment where we have seen pricing discipline over so many years, so there was a pricing discipline. This time it doesn't seem to be. So it is probably rather than commodity inflation seems to be a competitive pricing pressure this time, even leader has taken a sizable discount during last 2, 3 months. So what is your sense on this?

Shenu Agarwal:

Yes. Mitul, so as I explained, Mitul, I mean this is our normal phenomenon in the tractor industry. So in season times, the discounts are slightly higher because everybody is planning for volumes with the high base for the industry. And then these discounts normalize during the off-season. So we don't think like there is a significant departure from the normal. If it is there at all, I mean, it would be very, very small. I think we would see discounts now coming down as we approach November and December and January. So this will get normalized. Every year I think this kind of stuff happens. So this is a normal phenomenon.

I think everybody is reeling under the pressure of reduced margin side now, because of inflationary impact. So I think the industry's focus would be going forward to come back to normal margin levels. However, like Bharat explained, it may be gradual and it may take a few quarters.

Moderator:

Ladies and gentlemen, that was the last question. I now hand the conference over to Mr. Bharat Madan for closing comments.

Bharat Madan:

Thank you, ladies and gentlemen, for being present on this call. For any feedback and/or queries, please feel free to write into us at investorrelation@escorts.co.in. Thank you very much and have a good day and stay safe and healthy. Thank you.

Moderator:

Thank you. On behalf of Emkay Global Financial Services Limited, that concludes this conference. Thank you for joining us. You may now disconnect your lines.