“Escorts Limited Q3 FY20 Earnings Conference Call”

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Moderator: Ladies and gentlemen, good day and welcome to the Escorts Limited Q3 FY2020 post result conference call hosted by IndiaNivesh Shares and Securities Private 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 this conference call please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Mayur Milak from IndiaNivesh Shares and Securities Private Limited. Thank you, and over to you, Sir.

Mayur Milak: Thank you. Good evening and on behalf of IndiaNivesh Shares and Securities Private Limited, I welcome you all for Escorts Limited Q3 FY2020 Results Earning Call. I also take this opportunity to welcome the management team from Escorts Limited. Today, we have with us, Mr. Shailendra Agarwal, Executive Director, Escorts; Mr. Bharat Madan, Group CFO and Corporate Head; Mr. Shenu Agarwal, CEO, Escorts Agri Machinery; Mr. Ajay Mandahr, CEO, Escorts Construction Equipment; Mr. Dipankar Ghosh, CEO, Railway Equipment Division and the Investor Relations Team at Escorts Limited.

We will start the call with a brief opening remark from the management followed by an interactive Q&A session. Before we start, I would like to add that some of the statements that we make in today's discussion will be forward-looking in nature. At this point, I would request Mr. Madan to make his opening remarks. Thank you.

Bharat Madan: Thank you, Mayur. Good evening, everyone, and thank you for joining us for our Q3 results earnings conference call. Moving on to the quarterly standalone financial performance for the period ended December 2019, turnover at Rs.1,633.4 Crores against Rs.1,655.1 Crores last year is down by 1.3%. This is primarily due to drop in tractor and construction equipment volumes. Tractor volumes went down by 2.5% to 25,109 tractors as against 25,743 tractors last year. Construction equipment volume went down by 26.1% to 1,044 machines as against 1,413 machines last year. EBITDA at Rs.212.3 Crores against Rs.200.5 Crores last year is up by 5.9%. EBITDA margin now stands at 13% versus 12.1% last year same quarter. This is the highest-ever quarterly margin earned by the company in at least last 15 years.

Finance costs went down by Rs.1.4 Crores to Rs.2.9 Crores as compared to quarter ended December 2018. The total debt outstanding as on December 2019 is Rs.9 Crores down from Rs.277 Crores in March 2019. Net debt continues to remain negative at Rs.718 Crores. PBT stands more or less at same level at Rs.209.4 Crores against Rs.210 Crores last year same quarter. The company's standalone PAT improved to Rs.153.1 Crores versus Rs.140.1 Crores last year, up by 9.2% due to company opting for lower corporate tax rate from this year. PAT margin now stands at 9.5% versus 8.5% last year corresponding quarter. EPS stands at Rs.12.81 as against Rs.11.72 last year same quarter.

Now moving on to quarterly segmental business performance starting with the Agri Machinery business. Industry momentum has improved on a quarter-on-quarter basis. In Q1, industry de-growth was 15%. In Q2, industry de-grown by only 10%, better than Q1 and in Q3, the domestic tractor industry volumes are down by 6% to 2.04 lakh tractors as compared to 2.17 lakh tractors in previous fiscal same quarter. Against 6% industry de-growth, our domestic volume went down only by 2% at 24,219 tractors as against 24,720 tractors in previous fiscal same quarter. Industry in our strong markets in North and Central India de-grew by 4.2%, whereas industry de-grew by 8.1% in the bustling markets of South and Western India. In line with our guidance, we have gained market share across all major states. Our domestic market share stands at 11.9% for the quarter ended December 2019, up by 47 basis points as compared to previous fiscal same quarter. Our exports, however, during the quarter went down by 13% to 890 tractors as against 1,023 tractors in previous fiscal same quarter, mainly due to lower sales in neighboring countries like Nepal. At industry level, tractors export out of India fell by 3% in Q3.

During the quarter, Farmtrac to Powertrac brand ratio improved to 39:61 as compared to 36:64 last year same quarter also our product mix has improved towards higher HP tractors with more than 40 HP proportion improved in this quarter to 54% against 47% in corresponding quarter last year. EBIT margin are up by 22 basis points, now stands at 14.5% against 14.3% last year supported with softening of commodity prices.

On channel front, we added 20 new dealers in India during the quarter, total dealer count now stands at 970 plus. Going forward, we will continue to expand our dealer network in both strong and opportunity markets. The current channel inventory at the end of December 2019 stands at comfortable level of around 3 to 4 weeks, which we believe is probably the best in the industry. As guided during the last earnings con-call, we expect H2 domestic tractor industry to fare much better than H1. In Q4, we expect industry to grow by low single digits.

Coming to the Construction Equipment business. In our served industry, backhoe loaders volume went down by 5.1%. Pick-n-carry cranes went down by 29.7%, and Compactors went down by 20.8% in third quarter FY2020. Our total volume, including manufactured and traded products in the quarter ended December 2019 correspondingly was down by 26.1% to 1,044 units as against 1,413 units in previous fiscal same quarter. Despite volume drop, EBIT margin improved by 133 basis points to 4.8% as against 3.5% in the previous fiscal same quarter, led by cost optimization measures, reduced commodity prices, improved product mix and price increase carried out by us.

Construction equipment industry continues to see some slowdown on account of financing issues and delayed payment for ongoing infra projects. The new emission norms coming into effect on October 1, 2020, may also, in the short term affect the demand scenario in the industry. However, in the mid to long term, we expect that our served construction equipment industry will grow in high single digits.

Coming to the Railway division. Revenues at Rs.124.4 Crores went up by 28.8% as against Rs.96.6 Crores in previous fiscal same quarter. During the quarter, we have executed 44% of total orders from new product categories with more import content at low margin as compared to the previous fiscal when it was only 24%. EBIT margin for the segment now stands at 18.4%. Order book for the division is more than Rs.450 Crores that will get executed in the next 12 to 15 months. For FY2020, we expect Railway Equipment segment to grow by 25% plus and margins for the segment are likely to be maintained around these levels. Now I request the moderator to open the floor for Q&A.

Moderator: Thank you. We will now begin the question and answer session. The first question is from the line of Jinesh Gandhi from Motilal Oswal. Please go ahead.

Jinesh Gandhi: Sir, my question pertains to tractor realization so if we see, there is a Q-o-Q improvement in realization in this quarter as well so is there any price increase which we have taken or it is due to mix as well as share of nontractor further going up?

Bharat Madan: This is certainly due to mix so nontractor proportion compared to last year remains same at about 10%, 10.2% though compared to the last quarter there is some improvement in the nontractor sales by almost 1%.

Jinesh Gandhi: Okay so it is largely mix. We have not taken any price increase?

Bharat Madan: No price increase in this quarter.

Jinesh Gandhi: And in January, have you taken any price increase?

Bharat Madan: No, not yet.

Jinesh Gandhi: Okay. Secondly, with respect to Kubota JV, so we have indicated that exports have started under E Kubota brand from Q3 so can you give some flavor on what products are we exporting, which markets are we targeting under that?

Shenu Agarwal: Yes so we have started sending some shipments on E Kubota brand so these tractors are basically Escorts tractors, but painted in orange color under E Kubota brand with slight changes in specs and also in sidings and going into Kubota channels, global Kubota channel outside India so it is just a start. Of course, this relationship is a long-term relationship, and we are expecting some significant growth in our export volume through Kubota channel worldwide.

Jinesh Gandhi: Okay. But this would be what 30 to 40 HP tractors or...

Shenu Agarwal: No. This is the entire range so like we start with compact tractors. The compact tractors are about 25, 26 horsepower, and we go up to high HP also, which will be up to 90 HP.

Jinesh Gandhi: Okay and this will happen over the next six to nine months in terms of entire range being prepared?

Shenu Agarwal: Yes so we have started with a couple of models right now with 1 or 2 countries, but every quarter we will add up countries and add new models to this channel and you know that Kubota is very, very strong outside India in many countries and therefore, this is definitely going to help.

Jinesh Gandhi: Okay and if I may ask, particularly for 50 HP and above, how would our product portfolio compare with Kubota in those markets. I am presuming they will also be selling similar spec tractors, though it might be premium than what we might be offering so how do we position E Kubota versus Kubota brand in local markets?

Shenu Agarwal: Yes so see, Kubota is a very different kind of as far as the product is concerned, very different than what we do in India. Our tractors are mostly very fuel efficient and very rugged, so they last for long. Kubota tractors are very different, like other MNC tractors outside India they have built so these tractors are like more performance and feature-oriented, better on aesthetics, ergonomics, driving comfort, etc., so they are very, very based for very different customers so we do not have a major overlap or any conflict in the positioning of the two products, yes but we will, of course, make sure we go to the right market and address the right customer base.

Jinesh Gandhi: Understood and in terms of domestic market, you indicated fourth quarter to be low single-digit growth, any sense on FY2021 could it see a good recovery with high single-digit or double-digit growth?

Shenu Agarwal: It is a little bit early for us to comment on that. But we think it is going to be a positive year for tractor industry. It is not going to be negative. Now to what extent the recovery will happen, because this year, of course, we will end up in a negative whole fiscal year basis, we will end up at a negative growth in tractor industry. But next year, it should be positive and the year after that, we are thinking that the full recovery should happen. Next year, how much it will happen, it is a little bit early to say. But we know that not full recovery will happen next year so the full recovery will take one more year.

Jinesh Gandhi: Understood and lastly, a question to Mr. Madan. What would be your capex for this year and any indication for next year?

Bharat Madan: So, this year, we expect to do about Rs.250 odd Crores capex and as of now, we are looking at probably something similar number for next year too.

Jinesh Gandhi: Understood. Thanks Sir and I will come back in the queue.

Moderator: Thank you. The next question is from the line of Raghu Nandan from Emkay Global Financial Services. Please go ahead.

Raghu Nandan: Congratulations for a good set of margins. Sir, firstly, on the margin front, can you give some more details, like the margin expansion has been strong on a Y-o-Y basis and like how would you attribute it to the commodity benefit and other factors?

Bharat Madan: So, if we compare Y-o-Y, it is not really very strong. If you look at the tractor business margin, it is only up from 14.3% to 14.5% so I think marginal improvement and essentially led by the commodity prices softening in this quarter compared to the last year and railway, obviously, some base bottom construction. There are 3, 4 factors like we mentioned so there is obviously the cost measures that the company is taking there and also the deflation on the commodity side and some price increase and, obviously, some better product mix so I think all 3, 4 factors have led to improvement in the margin over there.

Raghu Nandan: And how are you seeing the commodity benefit coming in the coming months, I mean steel prices have been recently going up so how do you see Q4 margins to pan out I just wanted to understand how sustainable do you see the gross margins going ahead?

Bharat Madan: Yes, so I think we are also getting those feelers from the market, the price of steel has been going up so it will have definitely some impact on the construction equipment margin. On the tractors side, normally we have in contract with a lag of a quarter so in Q4, for tractor, we do not see major impact on the deflation side. The inflation will start hitting only from Q1 of next year over there so Q4, we still expect that we will be able to hold on.

Raghu Nandan: Understood and Sir, to Shenu, Sir. How are you seeing the performance in agri and nonagri segments in tractors and generally, what is directionally, how do you see both these segments going forward?

Shenu Agarwal: See, for the year, for the whole fiscal year ending March 31, 2020, I think the industry will be like maybe probably 7% down for the whole year and I attribute most of this decline actually more to infra rather than to agri because a lot of projects got held up because of several reasons that we know, elections and other things and even today, not all infra projects are up and running at full steam. Of course, there is a positive momentum we have seen in the last few weeks and maybe a couple of months, but nothing in the order of what we have seen in the past. Right now, that situation is going to improve as we go along so that is why we will see some positive movement in Q4 and then maybe a little bit more positive going forward.

Raghu Nandan: So I mean, on the agri side, you have support of the rabi and farm crop output prices. But on the infra side, are you seeing any improvement, or would you say that recovery would still take time?

Shenu Agarwal: So, we are seeing improvement. The situation is not as bad as it was in the first half of the year. But nothing like what we have seen in the past, so it is recovering, but recovering very, very slowly. Of course, agri will remain positive. Agri has been positive for the last 2, 3 months now after the positive sentiment built up after the rainfall, after the monsoon and that will continue to improve because we have a fabulous crop in the field right now and very good prices.

Raghu Nandan: And can you roughly indicate that 7% fall, how would you break up between agri and infra?

Shenu Agarwal: I am saying this roughly right now, maybe I can give you more exact figures later on. But I would say about 70% because of infra and 30% because of agri.

Raghu Nandan: Understood and recently, there seems to be an improvement in the South region performance. December volumes were positive for Karnataka, Andhra, Tamil Nadu tractor volumes. Would you say that South is seeing a recovery, and would that mean that, that would lead to market share risk for Escorts? What I was trying to drive at was, going forward, what would be the focus areas for further market share gains for the company?

Shenu Agarwal: Yes, so I mean, if you look at South, we are doing extremely well in South for the last 18 to 20 months. Every quarter, we are increasing our market share. Our market share in all the four states is on the rise of the South, AP, Telangana, Karnataka, Tamil Nadu. Kerala is not much of a tractor market, so we are not as concerned about South now since we are growing faster than the market there. We are not as concerned about South as we used to be. The same goes for Maharashtra and Gujarat. I mean, in some of these markets, our market share is inching up to like close to 10% now, so yes, so first of all, it does not worry us that much as it used to. Secondly, South, of course, the recovery happens first when it comes to water so if the downfall is because of water, and the water is sufficient, then South recovers very fast because South is totally rainfall dependent or mostly rainfall dependent, I mean, in relation to North and East and other parts, but the good thing is since rainfall is pretty widespread and adequate, although late, but still adequate and widespread, so recovery should happen in rest of the country also.

Raghu Nandan: And the market share gain strategies, which you will be focusing going forward?

Shenu Agarwal: Yes. That is clear. I mean this is not a quarterly strategy. I mean we have put in place a strategy that will work for next 3 to 5 years and we are very, very focused on that strategy and just to recall just a couple of broad points is that on the channel side or the brand side, we are going to invest in both our brands and we are going to create separate distribution channel for both the brands. Then in the South and other, some big markets, we are running some very, very unique, special projects, which are very unique to the industry actually and creating a buzz around our brands and the third is that on the product side, step by step, we are covering all the wide spaces that we used to have. In our product penetration, our product coverage as a portfolio was only about 60% about 3 years ago and now I think we are like more than 90% so all 3 fronts, we are very, very focused and of course, some other enablers like finance and stuff like that, that also we are working so we have a good mix going on right now.

Raghu Nandan: Thank you so much Sir. I will come back in the queue with more queries.

Moderator: Thank you. The next question is from the line of Gunjan V from JP Morgan. Please go ahead.

Gunjan V: I had two questions. Firstly, on the inventory levels, if you can talk where we are right now and how does it stand for the industry as well?

Shenu Agarwal: Yes, as I said, the dealer inventory is pretty much in control. I think although a firm data is not available, but just knowing from the market, our stock levels are probably the best in the industry so we are at about 3 to 4 weeks of dealer stock right now and if I am not wrong, the industry could see kind of upwards of 5 weeks, so we are very comfortable on this. Our deliveries or retails have been higher than what number we report in billing despite that, we are getting right market share quarter-on-quarter so that is very comforting for us.

Gunjan P: And on the financing side, how have things shaped up in the last couple of months are you seeing that there is more willingness in terms of rates, has there been any benefit?

Shenu Agarwal: Yes, so see, financing was not a major issue for tractors. I mean of course, in our construction equipment business, it had a huge impact. But tractors being priority sector lending, we did not have much of a problem. Of course, there was some problem. But starting the Diwali season, I think all the banks and NBFCs came back, and they were actually pretty aggressive so we had some very, very good tie-ups for the season with most of the big banks and NBFCs and the situation right now is pretty much in control so like all the banks are willing to lend.

Gunjan P: Has there been any change on the LTVs that you have seen because I think that is where some bit of pain point was that, given the cash flows last year was bad, it was difficult for farmers to bring in the upfront money, has there been any change on the LTV norms that you have seen in the industry or anything that you are working with the dealers to make buying more easier, so that when crop comes in the rabi season, it becomes easier for them to pay down, any kind of changes in the schemes that you have seen?

Shenu Agarwal: So actually, in our case, in tractor industry, the LTV has never dipped so what happened actually was the customers had no margin money so we had to work with banks to actually enhance the LTVs for the season period, which is like September, October, November, right, which they did so actually, we passed that phase very well with the support of banks. Now LTVs have come back to normal, right so we never had kind of an LTV issue really. We had a margin money issue because of which we had to work with the banks to enhance the LTVs temporarily.

Gunjan P: Okay and one more question on the industry growth, which you pointed 4% for Q4 and positive for FY2021. In terms of regional, can you give some sense do you think that South and West can see sharper or good bounce back given the water table issues are lesser of a concern now and these have been the markets which have not been doing well also for last 2, 3 years?

Shenu Agarwal: Yes, so recovery, as I said, will happen first in South and West, but I think North and East and Center would catch up very, very soon. Because, as I said, the monsoon has been very, very widespread. I mean, other than a few pockets, there are hardly any areas where we do not have good water level right now, so it is just a timing issue, but I do not think North, East and Center are too far off.

Gunjan P: Okay and lastly, any guidance on export volumes that you can give?

Shenu Agarwal: Guidance, I mean, this year, we will probably grow our export volumes by about, let us say, 20% to 25% as compared to last year. Now this, you must keep in mind that, particularly this year, the overall exports out of India as an industry is way down. I do not have the number right now, but I think it is like minus 15% or so in the first 9 months, so as against that minus 15% at the industry level, we will be up by about 20%. Of course, we have a small base also, so percentages do not matter so much. But we are...

Gunjan P: And similar scale up next year as well or...

Shenu Agarwal: Yes, similar or better.

Gunjan P: Okay. Thank you so much.

Moderator: Thank you. The next question is from the line of Riken Gopani from Infina Finance Private Limited. Please go ahead.

Riken Gopani: Sir, first, just a small clarification so the growth that you have mentioned for the last quarter is a low single-digit growth for the industry?

Shenu Agarwal: No growth in Q3 was minus 6% at the industry level. I think what Bharat was saying in his opening address was that Q1, the industry de-grew by 15%, de-grew. Q2 was minus 10%, and I think Q3 was minus 6% so he was saying that the momentum is improving. The industry momentum, which was like at minus 15% or so has now come down to minus 6%. And now Q4 may be a low single-digit growth, actually.

Riken Gopani: Okay and you expect Escorts to continue to outgrow the industry or you expect it will...

Shenu Agarwal: Yes, with your blessings and good wishes, yes.

Riken Gopani: All right. Sir, the first question that I had was with regards to the point that Mr. Madan alluded in the opening remarks regarding the mix of volumes being higher in the higher HP segment. If you can call out any particular reasons for the higher growth, there and any specific trends that you can highlight for the period going forward?

Shenu Agarwal: You were talking about the segment-level market shares, etc?

Riken Gopani: More so regarding the growth call out that the growth in the higher HP segment was higher, which has supported realizations as well. I am trying to understand was there some...

Shenu Agarwal: Yes, so there are two things happening. One is that the industry itself is shifting to higher HP, which is helping actually all the players in the industry for better realizations, so that is one. The second thing is that we are actually improving in higher HP more than the others, right so for example, for 9 months of this year, 41 to 50 HP industry was last year 47% or 47.5% and this year, it is touching about 48.5% so this is like the contribution of 41 to 50 actually in the total industry, so this itself is improving that is one and then our market share is improving further in 41 to 50 so we are doing much better than we were doing in the past so first 9 months, our market share in 41 to 50 is now 10.5%, which was 10.2% last year in the 9 months and before that, in 9 months it was 9.8%,so we are continuously kind of growing in higher HP now.

Riken Gopani: Okay and you expect this trend to continue?

Shenu Agarwal: Yes, because this is based on some structural changes we have made, both in terms of the channel and also in terms of products.

Riken Gopani: Sir, one question related to the growth outlook. The industry also must have faced significant de-growth on the subsidy-based tractor sales this year, correct me if I am wrong and do you see any trends of that reversing and any outlook on that for the next year?

Shenu Agarwal: Yes, so you are right I mean, subsidy sales were at an industry level was much lower as compared to 2018-2019. Now there is some positive movement that we can see there so there are a couple of states where some new subsidy schemes have either been recently announced or will be announced soon, so we are also expecting a little bit of addition to our normal volumes in Q4 because of subsidy sales.

Riken Gopani: Understood. That is very helpful and just one last thing. I noticed that compared to Q2, the order book on the Railways division was relatively lower. Is this specific to some, say, patterns of ordering or anything you want to call out regarding growth in Railways for the next year based on the order book accretion?

Dipankar Ghosh: I think it is more of a sporadic event, there were some issues. The railway was going into a huge restructuring exercise, as you may have read in the news so the tenders and everything were not being decided. Things have now started improving, and we hope to see a much more better order book in the coming quarters.

Riken Gopani: Understood so the growth momentum for next year, should continue for Escorts in the Railway Division?

Dipankar Ghosh: Yes, growth momentum continues in the next year also and next to next year's also.

Riken Gopani: Great Sir. That is very helpful. Thank you so much.

Moderator: Thank you. The next question is from the line of Mitul Shah from Reliance Securities. Please go ahead.

Mitul Shah: Congratulations for very strong performance across segments. Sir, I have a question on construction equipment. We reported close to 5% EBIT margin despite volume decline so this is due to some product mix change also, as you highlighted in past quarters so what would be our new breakeven point in terms of volume?

Ajay Mandahr: Breakeven points are much lesser. If you see, we are 30%, 31% lower than last year on the breakeven point and all 300 machines for breakeven point. Earlier, it used to be much higher.

Mitul Shah: Because in last con-call, you highlighted roughly 750 to 800 would be quarterly volume required for breakeven point. Now still we are saying 900 units per quarter.

Bharat Madan: That was the target what we are looking at so 250 to 275 number is what we are looking at. I think with all the initiatives, which really will come in, maybe next year we will see that number. Certainly, we will be able to achieve if the trend continues like this.

Mitul Shah: And any further details in terms of new products and how the margin would pan out with the product changes in this segment?

Ajay Mandahr: Yes, next quarter plus the first of next fiscal year, we are going to launch some new products. We will not give you details at this point in time because of competitive information. And I think with the kind of products that we are talking about, we are only trying to play in the high-value segment, where we have better contributions. The volumes will be lower, but the contribution levels would be much better, so it plays exactly the same that we are going to work on the profitable growth irrespective of not getting into too much of market share kind of business.

Mitul Shah: My second question is on the tractor side, Sir. We are highlighting that infra was a main issue this year and again, if you look at the crop pattern as well as last year monsoon deficit was close to 10%, previous year I am talking about and subsidies were also very low in this year so if all these three things pan out well, as we noticed that monsoon is already surplus, subsidies should increase at least from this level and infra projects are also improving so next year would be very strong and even FY2022 recovery would come in FY2021 itself?

Shenu Agarwal: Yes. Mitul, it is quite possible. As I said, it is like too early to predict exactly what will happen. But we are thinking internally that probably it will take more than a year for a full recovery so next year would definitely be positive, but maybe not to the extent that we can call it full recovery.

Mitul Shah: Sir central has already reported very strong growth in 9 months, it is close to 9.5%, so that is already growing and South and West started recovering.

Shenu Agarwal: I hope you are right, Mitul. We are all set. We will be all prepared for a great recovery, if it happens. Because you know, we have been growing market share for many quarters now and if we continue to achieve better market share with a better recovery, then we will have a home run.

Mitul Shah: Sir, last question on this Q4, you highlighted low single-digit growth. Whether that factors in the possible announcement of the government subsidies or excluding that, we are saying that growth and if those will come, growth would be much higher?

Shenu Agarwal: Yes so we are not yet kind of predicting what government will say for next year in the sense of the subsidy, but we definitely have some idea of like normal subsidy schemes that are direct on equipment so those we have already factored in our current estimates. But maybe when we speak after the budget or maybe March, then we will give you a better estimate for next year.

Mitul Shah: Thank you Sir.

Moderator: Thank you. The next question is from the line of Mayur Milak. Please go ahead.

Mayur Milak: So just wanted to have the update on our investments so we were trying to set up a 50,000-tractor capacity in the plant, so what is the status there?

Bharat Madan: So, the plant is obviously under construction right now so the scheduled run for commercial production is somewhere in Q2 of next fiscal, so we think we are on track, so things are happening. Some installation has already happened so the plant will go live for commercial production in Q2 next year.

Mayur Milak: All right. And this is under the JV, right, if I understand this right?

Bharat Madan: Yes, this is under the JV.

Mayur Milak: So, when this is under JV, all the expenses that are specifically included for this setup will be a separate JV and then you will add your share of expenses into the main company or how is it going to be?

Bharat Madan: You are saying for the sourcing arrangement?

Mayur Milak: Yes, for the sourcing arrangement.

Bharat Madan: So sourcing arrangement will be obviously on a cost per basis on the JV for initial years.

Mayur Milak: All right so the JV will have its own set of profit and loss. And then, of course, we pick up, in the end, whatever our share of profit is from the JV.

Bharat Madan: Yes, it will be loaded on the product, which is sourced from that.

Mayur Milak: All right secondly, on the RMC Sir so basically, we all know now that the anticipation for rising steel price is pretty much there. We made the strong gross margins during this quarter and even if we presume that it comes with a one quarter lag effect, is the industry and Escorts both in a position to really pass on even if, let us say, we have a 4% or 5% or 10% kind of steep hike, we will be in a position to really pass on this and still maintain our gross margins or there could be some pressure in the near term?

Shenu Agarwal: See, I can speak of tractors. See tractor industry normally has not had any difficulty in passing it on, right, any kind of inflation. Now as far as emission norms are concerned, I mean, tractor industry is only affected above 50 horsepower because that is quite a bit of cost increase that we will have to pass on to the market. Now but the thing is that the problem is very limited because in our case, tractor industry, it is only 7% of the industry which is greater than 50 HP so only 7% of the industry will be affected and these are also buyers or farmers who are like more progressive and more wealthier and that have larger pieces of land so affordability is not like huge concern with them so I do not think it will have a major impact. If there is some regular inflation, we should be able to pass it on.

Mayur Milak: All right and do we have a real estimate or a tentative estimate as to how much would be the hike for this upgrade into norms?

Shenu Agarwal: Yes. This will be somewhere between Rs.1 lakh to Rs.1.5 lakhs, depending on the size of the tractor.

Mayur Milak: Thanks.

Moderator: Thank you. The next question is from the line of Bharat Gianani from Sharekhan. Please go ahead.

Bharat Gianani: Congratulations for a great set of numbers. I had two questions. One is, in your earlier remarks, you pointed out that FY2021, you expect the tractor industry to recover, but not fully, and you expect a full recovery in FY2022 so is my reading correct that FY2021 may see a positive, probably a low single-digit or a mid-single-digit growth and then in FY2022, the growth will accelerate to 8% to 10%. Is that the right way of understanding or am I missing something in that?

Shenu Agarwal: I would say, directionally, it sounds okay. But as I said, we will be able to give a better estimate in towards March, especially after the budget is there. But yes, definitely, FY2021, as you said, it will be positive and FY2022, should be better than FY2021, so I think it will take some time. I think next Diwali season should be actually quite good, so if we see some major momentum developing from, let us say, October or November, then you will see a full recovery happening in FY2022, so that is why I am just saying because maybe I mean, maybe it takes a little bit of a time for things to improve, and probably FY2021 is therefore going to be a kind of a turning point and the FY2022 should be quite good.

Bharat Gianani: Okay, fair enough, Sir, next question is on the construction equipment side. Because in the earlier remarks, you pointed out that the financing issue and a lot of infrastructure projects are stuck up so the construction equipment, obviously that is visible in the numbers. But then any outlook for FY2021 you would like to share, like depending on how the financing situation is panning out currently, it is obviously improving and based on government's initiatives on infra, what is your outlook for FY2021 for the construction equipment sector?

Ajay Mandahr: We expect recovery is going to happen because the kind of projects that have been given or billed out are much higher than the previous years, we are going to look at, so I think the government is working on it. They are working on various schemes for infrastructure projects. We are trying to get into this project so I think there will be some growth that we will see next year. Now what has happened in the recent past, and I would say, 2 months, last 2, 3 months, banks have started participating well in equipment finance. That is good for us because earlier NBFCs were more active. If you see the ratio, 60:40, 60 NBFC and 40 for the bank. Now it has switched to 65 from the bank and 35 from the NBFC so bank is taking active role now in financing. And I think with some structural correction and some things coming out of the budget, probably things will improve.

Bharat Gianani: Okay. So basically, we are like expecting some growth in the construction equipment segment in FY2021?

Ajay Mandahr: Yes, next year for sure.

Bharat Gianani: Okay and Sir, my last question would be, can you highlight the products that you are going to launch in both the construction and railway equipment because we had plans of introducing new products progressively because of modernization of railways and obviously to increase our portfolio in the construction equipment so anything you can highlight?

Ajay Mandahr: Yes. But I cannot tell you right now. We have 3 portfolios, existing portfolios. In each of the portfolios, something is going to come. Thus, we are working on the expansion of the business also. The work is in progress so it is not the right time to announce or to say anything about it so we will come back to you later as and when we finalize.

Bharat Gianani: Sir anything on the railways that you can highlight?

Dipankar Ghosh: New products, there are a lot I mean in this year itself; we have got approval for 3 new products. And we have few more in the pipeline for FY2021 and our primary growth in the coming years will be to the new product because as you would have seen in the media, railway is going in for new type of coaches and new type of locomotives so that way our primary growth will be through new products.

Bharat Gianani: So basically, this will be the existing range of products in the modern coaches and locomotives. Is that right way of understanding or...

Dipankar Ghosh: Not really. The existing range of products in existing families will be there, like brake systems will be brake systems. But it will be much more different brake system from a simple air brake system to a much more complex axle-mounted brake or a locomotive brake electronic, something of that sort same for the couplers and the dampers and all the stuff.

Bharat Gianani: Thank you Sir and all the best.

Moderator: Thank you. The next question is from the line of Pravin Yeolekar from CGS-CIMB Securities. Please go ahead.

Pravin Yeolekar: Sir, my question was basically on the wage negotiation. Actually, if I am correct, we are due for the wage negotiation for this year so can you just highlight what kind of impact will be on cost increase in employee cost, what are the progress on?

Bharat Madan: See right now, the negotiation on the financial front has not really started so I think there is some legal issue, which has come up with the union. As a result, the body is not really in a position to negotiate with us for the time being. I think as and when it happens, maybe when the talks start again, that does leave us in a better position to indicate. But looking at the historical change, I think normally they have been in constant rates of about 6% to 8% on an annualized basis on the previous 3 years setting when this happens and we expect, I think it will be somewhere around that only at this time.

Pravin Yeolekar: But on top of that, the majority of the impact will be in the FY2021. Is that understanding correct?

Bharat Madan: So the negotiation due date for that was of November 1st of this year so normally, when union comes for a discussion, they also expect something to happen from the due date so there will be some lump sum payment value, which will come in whenever this amount gets finalized so that at this point, we do not know so obviously, for that impact, all will really flow in, in maybe FY2020, if the discussion would not happen till March.

Pravin Yeolekar: Okay and Sir, the second question was on the Escorts, DLL partnership so how is that ramp up going on and what is the current penetration?

Shenu Agarwal: Yes, so the ramp-up is going on as per plan, more or less so 2 years ago, we ended around 4,500 to 5,000 tractors. Then last year, we did about 11,000 and this year, and I am going back, so this year meaning 2019, we did about 14,000 to 14,500, so in 2 years, we have kind tripled the volume. The penetration is at all India level roughly, it is around 16% to 18%. But if we exclude areas where Escorts Credit or DLL is not present, then that penetration is close to 27%, 28%.

Pravin Yeolekar: Thank you.

Moderator: Thank you. The next question is from the line of Shashank Kanodia from ICICI Securities. Please go ahead.

Shashank Kanodia: Congratulations on good set of numbers. Sir, just wanted to check what is the working capital position as of date because the last time we checked the year gone, could not get inventory as well as the dealer network right?

Bharat Madan: So the working capital, right now, I think very decent to look at the cash position also of the company in the first nine months of this year so we believe there was Rs.300 Crores plus of working capital from what the level was, I think, in the beginning of this year so overall, at this point in time, I think the cash flow is pretty decent and we do not see any concern on the working capital side. The way we had seen this actually in the last few years so basically there are 2 reasons for that. One was from government-based programs in which we participated and some money got stuck and the GST refund which was one of the key issue so this year, we got some good amount from the GST refund also from the government, both for export as well as for the inverted duty system for tractors. And also the money which was stuck with the government earlier now has got released quite a bit so there is very small amount which is pending so those concerns have been addressed and inventory was corrected in the first 6 months, you have seen the results in the first 6 months so we had cut down on the production drastically over and above the sales volume which happened with the industry degrowing, all those questions have already been addressed and taken care of now so going forward, we do not expect degradations will be there.

Shashank Kanodia: As per the prudent that you have mentioned, the points, you guys generate in excess of Rs.500 Crores of free cash flow this year, right?

Bharat Madan: Yes, that is right.

Shashank Kanodia: So, what is the plan of distributing, can we see good amount of dividend payout, any special dividends for the shareholders?

Bharat Madan: If you look at, I mean, the cash flow also, I think in the first nine months so like we started the year with a huge debt position of almost Rs.277 Crores, which was the first priority, which the company has now repaid so as of December end, we are only standing with a debt of about Rs.9 Crores now so I think going forward, depending on how the quarter ends really, typically in this particular quarter, in March, there will be some requirements for working capital as the volume is expected to be good and only margin is not from a season perspective so it probably will take some working capital. Broadly, as the things improve, we will look at the next year's cash flow and then really the Board will take decision on the distribution strategy also.

Shashank Kanodia: And Sir, lastly, we have good amount of treasury shares in the company's books so any plans to monetize them in the near future or any transfer being done back to the promoters or anything else?

Bharat Madan: Well, I think, as of now, there is nothing, I think, in the pipeline. But if some development happens, definitely we will come back to the shareholders and investors and keep you in the loop.

Shashank Kanodia: Sure Sir. Thank you so much and I wish you all the best.

Moderator: Thank you. The next question is from the line of Ankit Suchanti from Axis Securities. Please go ahead.

Ankit Suchanti: Congratulations on a good set of numbers. Most of my questions have been answered. The one question that I had was on the Railway Division, where you have been mentioning that new product market share of breakup in the new product is increasing and that has a lot of import content, which is affecting margins so I want to understand what is the import content right now in terms of percentage and what are the plans of localizing that going forward and what will be the stable margin that can be assumed for the Railway segment?

Bharat Madan: In the new product for railway segment, the import content is as high as 40% and it is not really the content, this is the pricing for those imports is not really in our control so which is why I think is in the government side, basically tender is raised through government, but these actually are borne by the external price, but the input costs are not within your control so that typically will be certain bit of challenge so I think there, we are finding it slightly difficult in valuing it for the short term so I think once the entire thing gets indigenized or localized, then the margin improvement will be much better there.

Dipankar Ghosh: Yes, and the localization is already set in. But as you would appreciate, this being a brake system, a safety item, railway has their own time frame of 1 year to 18 months for the testing and validation so we are in that particular testing phase, which will take some more time to complete and we have our own local systems for that, where the margins will again be back again to what we have seen.

Ankit Suchanti: Okay so FY2021 will grow?

Dipankar Ghosh: FY2021 we will have to because the trial, as I said, takes 1 year to 18 months, so FY2021, we may not be seeing the benefits of localization. But obviously, FY2022 we will see them.

Ankit Suchanti: Okay and growth will be in that of around 25% to 30%.

Dipankar Ghosh: It will be more than 25%.

Ankit Suchanti: Okay. Thank you.

Moderator: Thank you. The next question is from the line of Amin Virani from Yes Securities. Please go ahead.

Amin Virani: Actually, my question was on the infra side of tractors. Now first of all, I want to understand, are tractors bought exclusively for infra or is it mostly that they are bought for agri purposes, but in the off season, they are used for infra? What has been your experience in that?

Shenu Agarwal: The latter is more common. Exclusively, we think there are like very, very few people who buy exclusively for infra projects. But normally, tractors are mix use so in the agri time, they are used in the fields and then rest of the time, they are taken to infra side and used for income generation.

Amin Virani: Yes so in that case, so say, even if you have a pickup, say, in infra projects and the usage of tractors next year, I mean, how should we look at the capacity on the ground as of now because can it happen that initially the tractors which are not being used right now, they may be picked up earlier and hence, the growth in the volumes may not follow the infra pickup next year I am just trying to understand what is the already idle capacity on the ground. I do not know if you have a sense of that?

Shenu Agarwal: Yes, it is difficult to say. But normally, from our experience, we can tell you that there is a lag between the start of the project and the start of a new tractor sale, there is a small lag. Now it just depends how much that lag is based on like what kind of projects we are talking about, right now most of the problems related to infra, we are feeling like most of the regions like Bihar, Eastern, Central UP, also in Eastern MP, so that belt we are getting most of these. In other areas, there is some small movement, so your assessment is right. I mean there would be a lag, but not a huge lag because these infra projects drive a lot of purchase decision making so it is like a guy who is actually he wants to buy a tractor for mix use and he does not see any infra-led income, then he may even postpone his purchase. He would not buy it so as soon as those projects are announced, he would rush to the dealership and start making the purchase, even if he knows that the infra income will appear later.

Amin Virani: Understood but in any case, you are also guiding for a very moderate recovery next year and a bigger recovery in FY2022. So, I think that also is in line with...

Shenu Agarwal: That is right.

Amin Virani: Fair enough. Thanks for the opportunity.

Moderator: Thank you. The next question is from the line of Sameer Deshpande from Fair Deal Investments. Please go ahead.

Sameer Deshpande: Congratulations for the very good results, regarding this budget, which is around the corner so what are the expectations of experts from the budget relating to tractor and construction equipment industry?

Shenu Agarwal: Yes. I mean no real specific expectations. I mean we just want this sector, this whole agri rural sector to be given more attention because it needs attention and it is a large part of the country's economy and country's population, but no real expectation. I think we are good. I think the direction is already set by the government. We are not expecting any positive or negative big surprises also so yes, as long as the direction is maintained, we are all set.

Sameer Deshpande: And the GST, I think, for construction equipment continues to be at 18% only, no?

Shenu Agarwal: Yes.

Sameer Deshpande: And for tractors, it is at what rate?

Shenu Agarwal: 12%.

Sameer Deshpande: 12% but some of our input components used to have higher duty of some 28%, GST?

Bharat Madan: Yes, that is right so there are certain components, which are common with the auto industry, so the rate is 28%.

Sameer Deshpande: So, is there any possibility that any recommendations have been done?

Bharat Madan: So unless they are able to identify those spots specifically for tractors, only then the government really will be in a position to reduce the rate so from the Tractors Manufacture Association side, there is a representation, which has been given to the government, and we have given some options for them, including the option like reducing the input taxes on the tractor components, specifically marked for tractors to a figure less than 18% to 12%, so that no accumulation happens so that is one of the scenario which was represented to them and second option is to maybe expedite the entire refund process where in a lot of cases, where the accumulation has been happening so we are still sitting on I mean even today, at end of December, we have accumulation of Rs.200 Crores, and we have got application of the file, and we started getting money, but still the process is very slow in terms of government perspective so we have been lobbying with the government, but since the government collection itself is not really up to the mark, so we do not expect any significant relief will come in, in terms of from those.

Sameer Deshpande: So, if that is, then that will be a positive?

Bharat Madan: Yes.

Sameer Deshpande: And what are the cash equivalents as on December 31, 2019?

Bharat Madan: Cash?

Sameer Deshpande: Net cash equivalents.

Bharat Madan: The net cash equivalent is Rs.718 Crores, excluding the escrow account.

Sameer Deshpande: Rs.718 Crores, excluding?

Bharat Madan: Escrow account so there is another Rs.140 Crores in escrow, which we cannot access since this whole is matter in litigation.

Sameer Deshpande: Rs.850 Crores is the cash available equivalent. In the next year, our tractor industry, you mentioned that it will be lower single-digit growth for the next year?

Shenu Agarwal: Now that we mentioned for Q4. For next year, we said there will be a growth, but the extent is, it is too soon to say how much it will be?

Sameer Deshpande: That will be post March, that is...

Shenu Agarwal: Post March, we will be able to give you a good estimate.

Sameer Deshpande: Thank you and all the best.

Moderator: Thank you. The next question is from the line of Mitul Shah from Reliance Securities. Please go ahead.

Mitul Shah: One clarification. As we shared that single-digit growth for Q4 and, probably, we would grow our market share, that last year base for Escorts was very high. In fact, market share in the month of March was close to 18% so do you think you would be able to outperform the industry in Q4 as well?

Shenu Agarwal: Yes, Mitul, it is kind of a phenomena or a trend for us. Because in Q4, of course, last year, Q4 market share, I think, was close to 15%. March was higher because of certain reasons, but Q4 was 15% and if you look at previous years, our market share in Q4 has always been about 2% to 2.5% better than the rest of the quarters in the year. Now you know why this is. I mean, because some of the players they pump stocks in the beginning and then in the last quarter to address the balance sheet concerns, they take the stocks down, right, in March, so it is always that phenomenon. Like, we do not normally do this unless there are some seasonal requirements, so our market share appears higher in Q3 and appears lower in Q1 and Q3 so yes, so it is not like something we are doing great on the ground in Q4 as compared to Q3. But it is just like that the industry moves, yes so, I think if you understand that, like that phenomenon, and it continues, then it should not be a problem beating last year's market share.

Mitul Shah: Even if the South and West recovers, we are not worried, or we do not find any threat of losing market share?

Shenu Agarwal: Well, like as I said, South and West actually, most of our growth right now is coming from South and West so since we are growing, I mean, really fast as compared to industry, so that concern is a little bit less as we go forward.

Mitul Shah: Okay Sir, thank you.

Moderator: Thank you. The last question is from the line of Raghu Nandan from Emkay Global Financial Services Limited. Please go ahead.

Raghu Nandan: Sir, Raghu here from Emkay. Sir, just wanted to understand the progress on the rice specialist tractor how has the pilot run been, how is the acceptance? What is the plans there to launch more products and what kind of volumes are we currently seeing?

Shenu Agarwal: Very happy with both the rice tractor and also the compact tractor series. These are like 2 our landmark product launches that we have done in the recent past now as far as compact is concerned, that is focused mainly on Maharashtra and then some parts in Gujarat and Karnataka. I have been telling you in the various conference calls that we wanted to go slow with these products because we wanted to ensure that we have the right mix available in the market and the right support system and the right level of product performance so on the Atom, we are now through that stage, and we are ramping it quickly. We have started ramping it quickly now so I think this year we will sell about, maybe 1,500 to 1,800 of those. As far as C45 or the rice special is concerned, that tractor, we are still keeping under observation, although it has produced fantastic results for us in markets like Orissa, Chhattisgarh and some pockets of South, but we will keep it under watch for another maybe 3 to 4 months before we start scaling it up. But no problem so far, product is performing well, customers are happy.

Raghu Nandan: One last query to Bharat Sir. Last few years, Escorts has been quite successful on the cost reduction initiatives. Just wanted to understand that incrementally what are like, triggers or catalysts available on the cost reduction side and what could be the quantum?

Bharat Madan: This year also, as I did mention, I think there is a lot of cost optimization measures which are going on, I think, including on the raw material cost side so if you really compare, like we said, with the best benchmark in the industry, we still see there is a scope of maybe 300 to 400 basis point gap from where we are versus what is the best benchmark level today in the industry so obviously, those are the targets for us so this is a continuous exercise, which will continue in future too so we are working, as of now, very strongly across all divisions at least now with cost initiatives. This year also we have taken good improvement, and we are taking a very good target for next year too for the long tail side. And as those efforts continue, I think as long as we do not see any obstructing trend in the industry, we think the profitability should continue to do better.

Raghu Nandan: Any targets would you like to share for FY2021?

Bharat Madan: No target as of now. I mean, we do not share those numbers. But yes, I think, let us say, in terms of overall margins, what we are looking at from next year, it will definitely be better than this year.

Raghu Nandan: Thank you so much and all the best.

Moderator: Thank you. As there are no further questions, I would now like to 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 in to us at investorrelation@escorts.co.in. Thank you very much and have a good evening.

Moderator: Thank you. Ladies and gentlemen, on behalf of IndiaNivesh Shares and Securities Private Limited, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.