“Escort Limited
Q2 FY2021 Result Call Conference Call”

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MODERATOR: MR. RAGHUNANDAN N.L - EMKAY GLOBAL

Moderator: Ladies and gentlemen, welcome to the Q2FY21 Results Call of Escorts Limited hosted by Emkay Global Financial Services. As a reminder, all participant lines will be in the listen only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need 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. I would now like to hand the conference over to Mr. Raghunandan N.L of Emkay Global. Thank you, and over to you Sir!

Raghunandan N.L: Good evening everyone. On behalf of Emkay Global Financial Services, I welcome you all for Escorts Limited Q2FY21 Results Earnings Call. I also take this opportunity to welcome the management team from Escorts and thank them for giving us this opportunity. Today we have with us, Mr. Bharat Madan, Group Chief Financial Officer and Corporate Head, Mr. Shenu Agarwal, CEO, Escorts Agri Machinery, Mr. Ajay Mandahr, CEO, Escorts Construction Equipment and Mr. Dipankar Ghosh, CEO, Rail Equipment Division along with the Investor Relations team at Escorts Limited. We would start the call with brief opening remarks from management followed by 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 earning call for Q2 ended September 30, 2020. With trust each of you are safe and healthy. We are pleased to take you to standalone financial performance that also happens to be our best ever quarterly performance so far.

The turnover during the quarter was up by 23.9% at Rs. 1.639.7 Crores as against Rs. 1,323.9 Crores in previous fiscal. Agri Machinery and Railway segment continued to odd perform, segmental revenues going by 32.8% and 26.4% respectively while construction equipment segment revenue came down by 21.9% on Y-o-Y basis.

Tractor sales volume went up by 23.8% to 24,441 tractors as against 19,750 tractors last year same quarter. Construction equipment sales volume went down by 13.1% to 821 machines as against 945 machines last year same quarter.

Highest ever quarterly EBITDA at Rs. 300.9 Crores up by 137.4% as against Rs. 126.7 Crores last year. EBITDA margin now stands at 18.4% as against 9.6% last year same quarter. Company is debt free as of September 2020 with strong liquidity positions ported with very strong cash flows and significantly improved working capital.

PBT at Rs. 307.8 Crores as against Rs. 108.7 Crores last year same quarter is nearly up by three times. Net profit more than doubled at Rs. 229.9 Crores as against Rs. 104.6 Crores last year same quarter, our quarterly ever higher. EPS stands at Rs. 17.72 as against Rs. 8.75 last year same quarter.

Now moving onto segmental business performance starting with the Agri Machinery business; Domestic Tractor Industry volumes went up by 41.4% to 2.36 lakh tractors as compared to 1.67 lakh tractors in last year same quarter. The rural demand remained positive led by low base of last year, pent up demand from COVID-19 aided lockdowns and fundamentally positive macroeconomic factors.

Timely and widespread monsoon, record Rabi crop production in this minimum spot price of all key crops along with faster procurement by the government and good availability of retail finance helped drive positive famer sentiment.

Our domestic volumes went up in Q2 by 23.2% at 23,156 tractors as against 18,789 tractors in last year same quarter. The production remained constant especially in the first half of the quarter because of severe supply chain issues while inventories continue to remain lower than the normal, we are now producing close to a peak capacity. About two-third of domestic sales came from above 40 HP tractors resulting in significant model mix gains.

Our export volumes were up by 33.7% to 1,285 tractors as against 961 tractors in last year same quarter. EBIT margins for Agri Machinery business went up by 973 basis points to 20% against 10.3% last year same quarter, our highest ever while favourable model mix and operating leverage helped, we continued to maintain our focus on cost efficiencies.

Sequentially, EBIT margins were up by 557 basis points as compared to 14.5% in Q1 FY21. However, increasing inflationary pressure on the commodity prices, product mix changes and increasing SGA costs as situation normalises may put some pressure on the margins in balance of the year from the current levels. With continued efforts and on channel expansion, the total Dealer count I now close to 1050. Overall tractor industry sentiments are positive. We now expect FY2021 domestic tractor industry to grow at low double-digit levels.

Coming to the construction equipment business, our served industry Backhoe Loaders, pick n Carry and Compactors grew by 31% in Q2. Compactors have been the biggest gainer in Q2 with growth of 47% followed by Backhoe Loaders that grew by 43.6% in Q2. However, due to COVID-19 and cash flow issues in market, pick n Carry Crane industry has shifted to price sensitive hydra segment and still industry is down by 20%.

Our total volumes traded products combined went down by 13.1% to 821 machines as against 945 machines in last year same quarter. EBIT margins stand at +1.7% as against negative margin of 32% in sequential quarter. We have seen good traction coming back from September onwards and same momentum is expected in H2 of this fiscal two and fully margins are also likely to be maintained at last year's level.

Coming to the Railway Equipment division; revenue for the quarter ended September 2020 went up by 26.4% at Rs. 160.2 Crores which also happens to be the highest ever quarterly revenue for this business segment. EBIT margins up by 119 basis points stands at 20.3% in quarter ended September 2020 as against 19.1% in last year same quarter.

During the quarter, we have executed 58.4% of total orders from new project category as compared to previous fiscal when it was 42.3%. Due to unprecedent COVID-19 pandemic situation during first half of fiscal 2021 and the total stoppage of all train operation except for few Shramik special trains, all the course locomotive production units and wagon manufacturers have cut down the annual production for FY21 drastically. Hence fresh orders, tendering and order inflow have been affected.

Our order book for the division at end of September 2020 is more than 350 Crores that will get executed in the next 6 months to 8 months. Going forward, we expect tendering process to get back to pre-COVID level by Q4 of current fiscal. For FY2021, we now expect railway equipment segment to smartly grow in revenue year-on-year and margin for the segment are also likely to be maintained at last year's level.

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

Raghunandan N.L: Thank you Sir. Congratulations on wonderful set of results. Just two questions from my side**.** Firstly, the tractor market share has come off partly due to production constraints as you highlighted, how do you see the reversal going forward, would you be able to broadly sustain market share on a full year basis. Secondly, on realization and gross margin, there is a sharp improvement, how much of the improvement is sustainable going forward? Thank you so much Sir and congratulations again.

Shenu Agarwal: I will answer the question on market share, Of course, we have lost market share because of some production constraints, you know we normally keep very, very lean inventory and therefore at this time when the demand was very, very skewed in the last quarter, we faced this issue of bidding, so our stocks are very, very low, they have been low throughout the quarter and even now they continue to be low. Now as per as full year, it is going to be a challenge of course to sustain last year's market share because the situation on supply side would probably continue to affect us if not as much as it did in the past but there would be some issues and even at industry level, the stocks are very, very low at this time but we will see, we will give out of it sharp but it will be difficult to sustain last full year market share this time.

Raghunandan N.L: Thank you Sir. Mr. Madan, on the realization and gross margin, the improvement, how do you see it sustainability of these high level of margins?

Bharat Madan: Obviously, margins have been held three to four factors, I will just try to explain that. One obviously is the operating leverage which is at place which we are doing pretty well, production is also running at peak capacities now and we have seen the growth momentum which has been in this quarter and second advantage we got was also from the very favorable product mix, so as I mentioned it was like two-third of the sale actually in the tractor segment has been happening which is more than 40 HP which happened in this quarter which happens to be actually the highest margin segment, in the profitability wise, so that is something which definitely helped, so model mix has been quite good in this quarter. Third aspect is from the cost front because the COVID situation, so the selling and general admin costs were still low, so your costs like travel, promotions that people are not bringing to the extent it used to be in a pre-COVID level, so that is another factor which that play and the fourth very important factor was also the commodity prices which continue to remain soft through the quarters, so it is only from September, we saw some pressures started building up on the inflation side , otherwise for the full quarter, the impact of inflation was not really seen, so it may actually happen more going forward, so all these three-four factors may actually undergo some change as and when situations normalizes, so there may be some impact which can happen on the margin from here, I think what we have seen 20% sort of margin. So, obviously it will really have some going to effect in the next two quarters, so maybe few basis point, 100 to 200 basis points impact may happen from these levels, otherwise we expect the kind of momentum which is there, we should be able to hold on to 70%- 80% margin in future.

Raghunandan N.L: Thank you Sir and all the best. Ayesha I will request you to open the floor for Q&A.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Mike Sell from Alquity. Please go ahead.

Mike Sell: Thank you, I have two questions. Firstly, if you give us some more thoughts about the volumes you are as both you achieve over for rest of the year, obviously this is the perfect situation for the tractor business as you said and it would be very disappointing if we are not able to make through you saw it given the production constraints and secondly, on the construction equipment's, could you talk about when you expect this significant improvements there where government spending infrastructure etc. Thank you.

Shenu Agarwal: Yes, on the first part as we have already said that we expect the whole year or the full year industry to be growing on a full year basis in lower double digits, so although it is true that in Q1 we could sustain our market share and Q2 we lost because of our inability to produce sufficient quantities but going forward as I said I think the supply chain issues will smoothen out within the next month or so and going forward I think we should be able to at least retain our market share. So, that is currently the broad outlook for us to be.

Ajay Mandahr: Mike, what I am saying is that I think the government is doing a fantastic job by putting in the outlays that has been budgeted for, it was about 100 billion and 40% of that has already been voted and is under construction and balance is getting is that various stages of project awarding and the reaction to start. I think the work is over or construction equipment and we have some traction coming in September, October even better and bring forward I think it should be a good day ahead for us in construction equipment.

Mike Sell: Thank you gentlemen.

Moderator: Thank you. The next question is from the line of Viraj Kacharia from Securities Investment Manager. Please go ahead.

Viraj Kacharia: Thanks for the opportunity and congratulations for geed set of numbers. I just want to get some outlook on the tractor business, so is it that the industry saw a lot of advancement in terms of sales in Q2, is that the way right one should look at it and growth and second half may be low single digit, at max five single digit kind of a run rate because it is not just low base, we have just seen a flattish kind of volumes for players in the industry, so just trying to understand and how the retails happen?

Shenu Agarwal: This is Shenu Agarwal. I am sorry there was a little bit of noise, so I am not sure if I could gather your question well but specifically on tractor business there has been very, very fundamental positivity in the market and it is because of the reasons known to us I mean Rabi crop has been a record crop, the crop prices have been happening, Kharif crop sowing has been going on at a very, very good pace, there is no dearth of financing available for farmers right now and the monsoon has been very, very widespread and more than expected. I think all those factors have a really made a positivity, the cash flows are good and therefore there is a fundamental shift in the industry to the positive side, although it is a fact that there has been a pent up demand from the lockdown period and that pent up demand is probably going to be you know slowing down or dying over the next few weeks but there has been fundamental positivity also because of the macroeconomic factors also you may like to note that the retail industry have been hired because more or less all players are to some extent had supply issues, I think overall it is very, very positive.

Viraj Kacharia: What is the retail trend we are seeing say September or October and you said the retail inventory is higher for everyone in the industry, is that right?

Shenu Agarwal: No, I said the retails were higher as pretty much everyone in the industry because everyone has had some kind of supply constraints of course to different extent depending on the inventory they were carrying. Overall at industry level, retail was higher, so I mean the numbers that you are seeing is actually the numbers would have been greater if you know all the players would have supplied more products and off side now both the dealers and at depots are at the lowest ever, I mean for us it is very, very low and I think for the industry also it is not as much as the normal level.

Viraj Kacharia: Okay and the supply issues or by and large gone now?

Shenu Agarwal: Yes, it seems more or less I think it is smoothening up, it may take a few more weeks before it completely comes to normal but as you know there would be some volatility in the supply, so something can happen unexpectedly which has been the case in last few months, so to that extent nobody can say how it will pan out but most of the fundamental issues have been resolved.

Moderator: Thank you. The next question is from the line of Ashwini Agarwal from Baroda Mutual Fund. Please go ahead.

Ashwini Agarwal: Good evening Sir. Congratulations for a good result. The first question is I had asked about the EBITDA margins the sustainability of this 18% EBITDA margins, so can you just throw some light that how is it 18% margin would pan out in the next three years?

Bharat Madan: I mentioned there are three-four factors which we must look at while looking at these margins, one is the operating leverage this is at place in this quarter, so we have been running mostly other peak capacity and second is the soft commodity prices which continued throughout the quarter, so it is only towards the end of September we saw it seems some inflation building up but otherwise on net basis on a full quarter basis, we still had no inflation pressures so that definitely help material cost which actually came down. The third was we mentioned in the opening remarks, so the model mix has been quite healthy this time, so if you look at two-third of the sale of tractors this time has happened in the above 40 HP category which happens to be a good margins segment actually the best margins segment which happens is about 40 HP, so the higher the volume there definitely a model mix advantages will need to come and play which also helps in improving the margin and the fourth factor is on the other selling and general admin costs which as in the current situation COVID-19 so lot of cost like travels, promotions etc., have been kept under check as and when the situation normalizes and the demand probably starts seeing some impact may be these costs will also get build up in future, so as of now we think this obviously this is something which is very good number and would like this to be sustained but given the reality of these costs we can move up in the coming months, so there can be definitely some impact on the margin as we go along but on the Agri business side which delivered 20% EBIT margin this quarter I think maintaining level of 17%-18% looks like visible in next few quarters too.

Ashwini Agarwal: What about construction equipment and railways?

Bharat Madan: Construction railways as we guided we should be able to hold on to the last year's level of margin in this year in spite of dip happening in the construction equipment volumes and the railway business still lagging, we should be able to mildly grow last year and in spite of the new product shall moving up there, we still be able to hold.

Ashwini Agarwal: What is the reason we lost market share in the domestic tractor?

Shenu Agarwal: Basically the market share was driven by supply this time in this quarter, so whoever could produce or ship more I mean that is how the market share responded, so as I said there was a shortage for everyone but there were more shortages for some players than others and it depended on the inventories that different players carried at the pre-lockdown level and also it depended on the ability to fetch supplies, so every player has kind of a different format of suppliers and every player has different levels of inventory to begin with and those two factors determine basically how each player could shift to the market, so it is not a fundamental kind of reflection of strength of each of the brands in the market, it is basically determined by some very temporary supply chain factors, so that is the thing, in our case we had a very, very low inventory relatively speaking at the pre-lockdown levels and of course there were some supply challenges as well.

Ashwini Agarwal: My last question for the next three years or five years what is the strategy to increase the market share because we are just 10% or 11% of the entire market and typically this type of product sales as we see more offer products, as you said you tend to buy more of these brands, which works so how do you plan to increase market share and what is your target for next three years or five years?

Shenu Agarwal: Yes, when we released our vision 2022 document about four years ago, we had said that we will try to reach about 15% market share by 2022, now because of the disruption in this year, this year is kind of a bad year for market share for us because we have lost some after having gained market share for about three or four years now, so we have gained about 1.5% to 1.7 % in the last four years and we have been the second fastest growing tractor company in the country. The market share, fundamentally our strategies have not changed, so this year is probably not a reflection on what we are going to do in future because our strategy remains the same, so we are investing in the right products, we are fulfilling our white spaces both in the product lineup and also in the geographical channel coverage. We are going with a dual distribution strategy which means that we are trying to make both our brands independent and stand on their own feet in terms of gaining market share, we are doing some very, very special projects in our weaker and opportunity market, so all those things are continuing, so this year probably is an aberration in our journey, I think we should be back to giving ways very, very soon as the market as supply side situation normalizes but our strategy is impact.

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

Gunjan Prithyani: Thanks for taking my question. I had two follow ups on the tractor segment, firstly you mentioned this favorable product mix couple of times on this above 40 HP, now is this something which is specific to Escorts or is it in industry wide phenomenon and what is really driving this mix shift. Do you think that this is the significant could share more insights on this?

Shenu Agarwal: It is true that it is also an industry wide phenomenon and it is also true that Escorts has gained market share in the bigger horsepower category. So, we have taken more advantage then the industry has but it is kind of industry phenomena as well. So, major reason that I can feel why that sudden shift has happened and the shift has been quite drastic in a short period of time is basically because of the fact that tractors are used primarily for two purposes, one is pure agriculture purpose and the other is kind of a commercial purpose or mix of agri and commercial. In the last four month or five months the commercial side of the tractor usage dropped because of lot of infrastructure projects got delayed or got stopped and therefore the demand from that side of the market was actually much lower. Normally the commercial segment of the tractors they use lower HPs specially for haulage and some other purposes and the agri uses the higher HP tractor and therefore we have seen a drastic shift because the demand on commercials low and agriculture was really booming and therefore we saw this sudden shift. Now, this is not going to sustain because the haulage side the demand is also coming back now and therefore it will get to normal levels, but it will still be higher than normal times the higher HPs. So, that is the reason that Escorts had advantage over the industry in high HP because of our new products that we have launched last year before the lock down and we are seeing some gains from this.

Gunjan Prithyani: Okay, just before I move to my next question on tractor Bharat Sir, it will be possible if you have share what is the impact of the favorable mix on the margin any ballpark number?

Bharat Madan: Yes, you can say roughly 18-20 Crores impact has come because of favorable mix in this quarter in absolute terms.

Gunjan Prithyani: The second question on the tractor business is you do point out that there is a production constant which seems more an issue in the month of October and prior to that we did face some issues on the supply chain side also. Now, when I look at the industry growth clearly in new industry until September-October it is up somewhere around 10% and some of the other unlisted players have gained share let say TAFE. Now, what is it that they are able to manage better is because from my understanding the component suppliers would be broadly similar for everyone. So, what is it that they are able to mange from the supply chain better and secondly, are we able to use the Kubota JV capacity to fill in some of these shortages that we seeing in the business?

Shenu Agarwal: Let me respond to that. So, the ability to sell at this point in time specifically Q2 was not just from the level of production but also was a factor of the stocks that different brands were carrying before the lockdown started. So, when you analyze the production data versus the sales data you will see that difference coming in, in terms of how much stock each brand had carried before the lock down. But it is although you are right that the type of suppliers are very same but still there is a lot of difference in the location of the suppliers, in the capacity of the suppliers etc., and therefore in such times which were very volatile times it just depended of ended where the supplier was and in what circumstances the supplier was what was the location of the supplier and how much it got effected with COVID and other things but it is very difficult to say but I just want to point out that it is not just the ability of production or getting the goods but also it was a factor of how much stock each brand carried pre-lock down period.

Gunjan Prithyani: Last question if I can just ask on the Railway business the order book has some off and you pointed out that the new ordering has been slower but does this in any way hamper the revenue visibility going into next year if you can just share thoughts on that?

Dipankar Ghosh: As of now since the tendering and everything was postponed and lot of orders have been postponed to FY2022 business so, there may be little bit of our issue about the order book being build up because it usually takes around five month to six months to build that order book but what we see is that lot of activity has already started in the Railway Board and the different zones. So, we are very hopeful by December or January it should be becoming normal again and we should be having the similar or may be better order book going forward.

Gunjan Prithyani: Thank you so much.

Moderator: Thank you. The next question is from the line of Hitesh Goel from Kotak Securities. Please go ahead.

Hitesh Goel: Thank you Sir. I would like to congratulate the management for a very good of set of results. So, I just wanted some more on the tractor margin. So, when I see say for example that I am comparing the topline of 3Q FY2020 versus this quarter it is almost similar. You have reported a margin of 14.5% EBITDA margin in that time so, new normal you have been consistently improving margins in all new normal was 14%-15% of tractor margin which is now you are saying 17%-18% is you margin which can happen on the tractor business. I can understand the mix had an impact of 1.5% in this margin. But what explains this 1.5% -2% additional margins which you are talking about and if the topline remains similar do we expect this is the new normal for the company assuming commodity costs are also flattish, so assuming everything being normal. So, just wanted to understand the structural cost advantage is that you have done in this business?

Bharat Madan: Hitesh if you require we have been guiding mostly for the tractor business margin to improve by 150 basis points to 200 basis point this year which was in the normal case which will be any case factoring in but that is the cost initiative what company took last year for which the annualized impact will likely to come in this year. So, especially on the material cost front whatever initiative we have taken where we have got the result only towards the end of last year so that full year impact will be coming now in this year which is another 2% gain which has actually happening on the material cost front. So, that is one factor which definitely will sustain so which is why we are saying 17%-18% now looks feasible given the other situation what we are looking at both on the other cost front and the front of model mix game which has actually come up now and assuming some of you will definitely sustain even if not fully but still some gains will definitely sustain looking at the kind of product launches what company has done. So, that gives us more confidence may be sending at the level of 17-18% looks like feasible now for tractor business given these volumes if it continues if you continue to be in this stage where 24,000 plus volume is almost annualized 100,000 tractors volume so at that volume definitely these sort of margin can happen.

Hitesh Goel: Just follow up there basically the construction equipment is coming back very sharply government spending is also going to revive basically now. So, tractor on the infrastructure side also pick up so, mix unlikely to deteriorate in second half in my view because you do not have capacity plus is it fair to say that 50 hp plus with huge knowledge your margin will be much higher as well. So, mix also should not get you a risk is that fair to assume?

Shenu Agarwal: Yes, mix will deteriorate from the Q2 levels what we have registered. As I explained the lower HP segment was not performing as much as higher HP segment on the industry side itself. But I also explained that we gained market share of about 40 HP tractors. So, mix would be much better than normal level, but I think it will not be as good as Q2.

Hitesh Goel: What is the capacity stretch capacity with the company gain though now on a monthly basis or annual basis?

Shenu Agarwal: Right now, we have been able to stretch ourselves beyond our capacity because our constraint in capacity were not really from the assembly point of view, they were more towards like the machining capacity and also the supplier capacity. So, in such times we have really slogged very hard to go even beyond the capacity right now, so we have produced more than 11,000 tractors in September and October each.

Moderator: Thank you. The next question is from the line of Shyam Sundar Sriram from Sundaram Mutual fund. Please go ahead.

Shyam Sundar Sriram: Sir, good evening. My question is on the pent-up demand that we spoke about in tractors specially, you did mention that the pent-up demand in tractors is now almost coming to an end and hereon we should see slightly lower level of demand per se. Now, if you can try to explain this point in detail why do you take this is pent demand because industry is already grown well above last year levels. So, why do you think this demand is more of the pent-up demand per se and secondly from a geography wise perspective which are the regions where in the pent-up demand has been mostly satisfied and which region still has more underlying demand coming through? Thank you.

Shenu Agarwal: Thank you for the question. As you know we had lockdown since last week of March and then the retail started happening only like towards middle of June and therefore there were lot of customers who could not buy tractors at that time and those customers came back and bought tractors between June and October period. So, if you look at H1 level like first six months despite very low demand in April and May still like we are 12% higher this year as compared to H1 last year. So, there had been definitely pent up demand and you saw like July, August, September the industry went up by 41% which has of course not like a fundamental thing to grow by such a huge amount. But that demand I think it is just our opinion that pent up demand is dying down or dying away and therefore now the real fundamental demand we will see so, which of course is very positive. Now as far as the geographical spread the industry of course has been growing much more in South and in some other markets. But as far as the pent-up demand is concerned of course the pent-up demand came in every market because every market was locked out.

Shyam Sundar Sriram: Thanks for that perspective. The other question is to Bharat Sir, from balance sheet perspective the receivables has come down compared to March levels there around Rs.200 Crores odd whereas the payables are at similar levels are there any change in terms of trade or any sales in the policies with the dealers especially if you can highlight any that sense? Thank you.

Bharat Madan: This time since the cash flows of the rural side are pretty good so company is also trying to shift now as it is since we have seen there is a supply constraint so it is really a seller side of the market the company has been pushing to convert most of the dealers to cash and carry situation which is why you looked at the debtors which has come down by almost 58 days level which was there last year to about 30 days now at a level. So, which is quite a significant change while on the credit payable continues to high because you are running at the peak capacities now so as Shenu mentioned in the last two months going beyond our capacity of around 10,000 tractors trying to do maximum production. So, obviously the payables continue to be high which are still in not due category that is why you are seeing a very good working capital and liquidity is what happening now in this particular quarter.

Shyam Sundar Sriram: Understood. Thank you very much. I will fall back in the queue.

Moderator: Thank you. The next question is from the line of Jinesh Gandhi from Motilal Oswal Financial Services. Please go ahead.

Jinesh Gandhi: Sir, my question pertains to the EBITDA margin the PBIT margins for tractors you indicated there were some benefit of lower SG&A cost and do you expect that to normalize and secondly on the commodity side what kind of pressures are you seeing and thirdly with respect to 40 HP and above you indicated preferred in this quarter. How it was same quarter last year and in first quarter? Thanks.

Bharat Madan: Sorry Jinesh can you just repeat the question?

Jinesh Gandhi: Yes, from the margin front three clarification, one is you said SG&A costs were lower due to COVID do you expect that to normalize in coming quarters, secondly on commodity side what kind of cost inflation are you seeing and thirdly share of over 40 HP tractors in same quarter last year and then Q1?

Bharat Madan: Okay, so on SG&A costs as per things slowly start becoming normal we will see the cost pressure will start building up, so as of now still lot of places are still under lockdown, travel is restricted, the promotion costs are not getting incurred to the extent it would be in the normal course because you are also looking at a supply constant right now so demand is not an issue. As you cross festive season and things really start becoming normal so these costs will likely start building up. When it will happen, it is very difficult to predict because we do not know what the situation will be like after two months- three months and how the second wave will even play out in India. So, that is something which we are all keeping our fingers crossed but yes in the normal course the SG&A levels will likely start moving up that much I can confirm. Coming to your second on the commodity prices, yes and we are expecting the inflation is starting now on seeing some increase happening may be another three months to four months time we expect the cost movement will happen which can be somewhere around 1.5 % sort of level going to up to 2% level movement can happen on the inflation on especially on the steel prices etc., so that is something which we are closely watching and see how the competition reacts to those cost changes and how the demand really pans out which will actually decide the ability to pass on those cost increases to the market. On the 40 HP front, 40 HP and above last year end quarter we did 45% and first quarter was 62%.

Jinesh Gandhi: Sir just one clarification this 11000 production of tractors is just at our plants and now we have Kubota's capacity also available, is that correct?

Bharat Madan: Kubota production right now is started only for their products for our products it will start somewhere in next fiscal that is why the capacity right now is not available but given even if the capacity is available the costing of the supply side would still happen there if you are issues from the supplier itself this is more assembly so that will slip really would have been a challenge so, first preference is to really ramp up the capacity at the supplier level and also smoothen the supply chain and then also increase capacity as seen mentioned on the machining shop side. Last year when the demand side coming down, we actually held back that capex but now looking at the current demand we again releasing that money hopefully by next six months to nine months we will have those capacities ramp up also happening.

Jinesh Gandhi: Okay, are we increasing our capex guidance for FY2021 and FY2022?

Bharat Madan: We have earmarked about Rs.90 Crores to Rs. 100 Crores for the additional capacity both at the supplier end as well at our end. Right now like said our stated capacity was about

10,000 tractors per month against which we are running at a stretch with this additional capex we expect we should be somewhere around 12500 odd tractors per month which is about 150,000 capacity which will be with Escorts and then will be another 30,000 which will be available with the JV, with Kubota, so about 180, 000 capacity can happen by next fiscal.

Jinesh Gandhi: What would be our capex for FY2021?

Bharat Madan: FY2021 we have said about Rs.200 Crores to Rs.250 Crores but now looking at the current situation the additional capex being earmarked so cash flow wise we may still be in the range of same Rs.250 Crores-Rs.260 Crores but commitment wise it will be much higher Rs.300 Crores to Rs.350 Crores capex may happen. That is the cash next year.

Jinesh Gandhi: Got it. Thanks, 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: Sir, thank you for taking my question and congratulations on the very strong performance. Sir, my question is on clarification on a market share you stated that it would remain under pressure but that is because of the first half result compared to second half this year versus last year and again your monthly volume last year was roughly 6000 for balance of the period between November to March. So, capacity should not be an issue despite this you expect market to remain under pressure?

Shenu Agarwal: Yes, Mitul there are a couple of factors that we cannot predict right now so first of all we know that the inventory levels are very low, so lot of supply chain side pressure might still continue because those inventories will get filled up and therefore it is hard to say exactly what would happen but more or less I would say that we will try maintain our market share going forward at least if not gain. But there are some of the things that are hard to predict right now in terms of relative advantages or disadvantages.

Mitul Shah: Sir, on the margin side if I look at your monthly number, November being more than 13,000 even this October 13,000 plus we produce and November-December even if I assume low single digit growth still sequentially your quarterly volume Q3 tractor volume would be higher than Q2 and despite that you think that product mix and all those things will have a negative impact on the other hand construction equipment will also improve sequentially, Railway also we are expecting higher orders now onwards. so, putting all these things still Bharat Sir do you expect margin will come down?

Bharat Madan: Already in October month we have seen the product mix has actually started going against us so it is not same as it was in the period till September and second like you mentioned the inflation there is an another factor which is already started catching up now we have already given some cost increases to the suppliers even in September and again in October. The price increase obviously is still on hold we are still waiting for festive season to be over and we will also wait and watch how the competition react to these inflation pressure. So, these will obviously impact the margin in the coming quarter even though the volume may look slightly better than Q2 and Q3 but the margin worries we will have to keep a wait and watch which is why I indicated 17% to 18% is more looks like achievable numbers then fairly what we did in the Q2. Even that the volume may look slightly better than Q3, Q2 and Q3 but I think margin wise I think we still have to keep wait and watch which is why I indicated 17% to 18% is especially more like achievable numbers than fully what we did in the Q2.

Mitul Shah: Sir, I am asking about the construction will improve, railway improves still blended margins will come down?

Bharat Madan: Yes, with section margins are not very high so when you look at we are able to hold down for the margin for railway and construction segment going forward to in fact railway did better this quarter so the margins in railways are also good for 20% so there we do not see the impact will really be there. On the construction equipment side the margin are going to be in 3% to 5% out of reach which is their level which we achieved last year. So, that is not going to be a major game changer so essentially the margin risk will be impacting the overall status will be the tractor business only.

Mitul Shah: Thank you Sir.

Moderator: Thank you. The next question is from the line of Vivek Gedda from HSBC Securities. Please go ahead.

Vivek Gedda: Very good set of numbers. Congratulations on that. I just had one question for Shenu, it is just an observation am I correct in saying that probably our market share region wise has not been significantly different from last year at least in north, central and east and the only market share loss on the blended basis is mainly because of south and west doing much better or have we actually seen some bit of market share erosion in our regional basis as well?

Shenu Agarwal: So, both factors one is that the industry has really boomed relatively speaking and like more in south and west but even like otherwise we have some market shares for example even in our strong markets we have lost some and opportunity markets again we have lost some. So, actually in our weak markets like south, the whole states of south we have actually gained market share because of some of the fundamental things that we are doing there but the market share loss is everywhere except in south and that is only because of our inability to produce as much as the demand was there.

Vivek Gedda: Got it. So, it is just related to that so going forward over the next two quarters based on your demand checks on the ground, you still expect the south and west continue its outperformance and if so what are the key reasons that are leading to that kind of outperformance, as I understand I think even the sales because of subsidies are lower right now this year because of strong demand, so just wanted to get a sense on that?

Shenu Agarwal: Yes, so largely the growth that we are seeing in south and west is because of the base effect right, so I mean this time south and west had like plenty of rainfall and the water reservoirs are really up like and it is at record levels so that is just showing up in the demand and I mean if you look at last three years to four years or five years going back you will see that south got really subdued because of the lack of water but now since water is coming back therefore you are seeing this extraordinary growth in some of these markets which are very rain dependent. So, at this point in time because of the good monsoon all the rain dependent markets or largely rain dependent markets will show better growth because of the base effect.

Vivek Gedda: Got it. Sir, second question for Bharath Sir, I just wanted to get a sense on the paid-up capital which has gone up so after the stakes into Kubota, have we actually already extinguished our treasury sales or is that yet to come?

Bharat Madan: So, that is the process which will run through the NCLT, Vivek so it will take some time I think it takes few nine months to year to really cut that through so we made application to the stock exchanges, we have got some queries from them on the process so we are just sorting that out, so after stock exchanges approval is there then we will file the scheme with NCLT for capital reduction and that will take I think about six months more time and looking at the current situation with the COVID-19 the bench is not really working to full efficiencies so that will take may be another six months to nine months for this to happen.

Vivek Gedda: Sir, if I may squeeze just one more question, from a long-term perspective, we have seen pretty strong pickup in margins and ROCEs have picked up as well but now that we have such a huge cash that has come and sitting on our book, how do we look at ROE trends probably two years or three years from now. Probably what I would also look to hear probably is on the capital allocation part, how do we actually look at, are we on capital allocation together?

Bharat Madan: Yes, as we were mentioning earlier so definitely we also recognise this fact that more cash on the balance sheet will only dilute your return ratios so we also need to see the right opportunities for the business where we can put in money, this can deliver much better returns than whatever we are getting now on this liquidity, so we are working like we are working with Kubota to develop this joint business plan which is under discussion with them which includes sure investment which will happen over the next few years in terms of where we want to go put this cash in terms of developing the implements for the further capacity ramp up, or for building up volumes for exports, so the new model development which will happen so I think all these factors which definitely will be requiring cash from the perspective of overall business growth which will be the first priority and secondly also I mentioned about the opportunity which are exploring in the railway segment with the another segment which we think will actually show very good growth potentials and already we are seeing some visibility there so that is the another sector which will really need some bit of cash from us. So, those will be mostly the priorities; so the first priority will be to redeploy the money in the business which can be deliver much returns in the capital allocations and obviously another option which obviously we are exploring is in the in terms of the distribution which will also be really one thing which we had not been doing in the past, we will be looking at the cash flows and the requirement on the capex side but now given the good free cash may be that is the another possibility which the board will look at.

Vivek Gedda: Got it. Thanks so much and all the best.

Moderator: Thank you. The next question is from the line of Sonal Gupta from UBS. Please go ahead.

Sonal Gupta: Thanks for taking my question. I just wanted to ask on the retail side in the month of October how things been because what I can see from the Vahan data it seems to suggest that the retail is down for the industry by 20% month-on-month, so if you could just shed some lights on that I mean like how do you think underlying retail has been actually for the industry?

Shenu Agarwal: Yes, two factors we have to consider when we look at Vahan data. One thing is that it comes with the lag of a month almost, the other thing is that there has been a kind of festive shift this year so last year Diwali and Dhanteras which are like very big days for tractor industry, they were in October and this time Diwali and Dhanteras both are in November, so there has been kind of some shift as well as some lag so I mean for a particular month Vahan data is not a real reflection of the things going on the ground.

Sonaal Gupta: Okay and you said that the delay is like almost a month, so the lag is almost like a month not a week or two weeks.

Ajay Mandahr: No, in case of tractors because we have a slightly longish kind of retail, financing cycle so the delay is roughly about a month, in some states it is probably like two weeks to three weeks but some other states is like three weeks to four weeks.

Moderator: Thank you. The next question is from the line Prateek Poddar from the line of Nippon India Mutual Fund. Please go ahead.

Prateek Poddar: Just wanted to check, is it fair to say that now your breakeven points are structurally down when we these kind of margins, I was just trying to think about your breakeven points though they are quite lower but just trying to think that how much of these cost savings would be structural at this end even if there is a down cycle you would be able to report better the EBITDA margins then what you would have in the comparable down cycle?

Bharat Madan: That is right, Prateek. So, given the contribution improvement which we are seeing on the grounds when the gross contribution are going up so some of it is structural and some of it is may be temporary in nature like you said the model mix changes may not be the permanent feature but may be a temporary phenomenon or it may not sustain to the same level as we have seen in the past but definitely the changes in the material cost of the initiative that would come into that is something which is really more permanent in nature and when you say permanent means it all depends on how the product mix undergoes changes so that is going to be cost and exercise the company has to continue doing so that will continue but yes that will definitely have a much longer impact and those savings do continue for the longer period so to your question yes the breakeven levels have been going down and that is to across the businesses including on construction equipment side also we are now aiming to totally hit our level of 200 to 210 machines a month as a breakeven level by end of this year even though right now there was slightly higher.

Prateek Poddar: Sir, you said that Rs. 20 Crores is the model mix impact, right, which is very small on the EBITDA of Rs. 300 Crores, is that a fair understanding?

Bharat Madan: In the quarter it was 1.25% in this quarter itself and the tractor mix will be even higher.

Moderator: Thank you. The next question is from the line of Ritesh Badjatya from Asian Markets Securities. Please go ahead.

Ritesh Badjatya: Thank you management, my all questions are been answered.

Moderator: Thank you. The next question is from the line of Chirag Shah from Edelweiss Securities Limited. Please go ahead.

Chirag Shah: Sir, just one question. See, on this favourable tractor mix that you indicated more on 40 HP, is there a regional mix also driver, are different in different regions and that could also be a reason where north is slightly 100% and hence demand for our HP tractors, will that also be a driver for a higher HP contribution?

Shenu Agarwal: Theoretically, yes but it is hard to say I mean exactly because I am in terms of like at the industry level you are short on supplies, most of the manufactures who would tend to reduce the tractor margins so I mean the data will not reveal everything that is actually going in the ground but yes generally I would say the impact was also because the commercial side of the market demand was slightly slower but it is also because of the supply chain shortages so if you can produce only at some part of tractors then you would produce more of them high margin levels.

Chirag Shah: Sir, when you say commercial you are excluding construction equipment set of demand right?

Shenu Agarwal: I am basically saying haulage type of demand, so haulage type of demand largely comes from lot of infrastructure kind of projects.

Chirag Shah: Yes, but the tractors which are used for sand mining or basic expecting that would be the higher HP factor and the demand has to come back?

Shenu Agarwal: Yes, I mean in commercial usages tractors are used like across from low to high HP but if you just average them out the concentration is more towards the lower HP.

Moderator: Thank you. The next question is from the line of Viraj Kacharia from Securities Investment Managers. Please go ahead.

Viraj Kacharia: Thanks for the opportunity again. I just had the follow up, you mentioned that you had some issues in supply chain and supply and components which led to the market share loss, vis-à-vis the competition so what are the components that we are talking about if you can just provide some colour?

Shenu Agarwal: Mostly, it has been a problem like with some proprietary components like fuel injection pumps and tyres etc. On the other side there was also some issues with some castings, so it is not so much about the component itself that created a problem or a type of component, it was more or less related to the location of the supplier and the impact of COVID in that location in terms of lockdowns etc.

Viraj Kacharia: Thank you.

Moderator: Thank you. The next question is from the line of Shanti Patel from Shanti Patel Investment Advisors. Please go ahead.

Shanti Patel: Good evening Sir. My question is, can you give the breakup of our revenue in terms of various segments in terms of percentage and secondly about the government there will be more emphasize on the rural side and want to double the income of farmers, what is that profit does impact on the tractor demand and supply side, then who are our main competitors?

Bharat Madan: Revenue split you want for the quarter?

Shanti Patel: I mean normally, I do not want to say specifically for this quarter, it can vary little bit here and there?

Bharat Madan: On an average we used to be about 70% to 80% used to come from the tractor business and 12% to 13% was from the construction equipment and 6% to 7% from the railways, so in this particular quarter railway construction are more at similar level and tractor business continues to be at about 80%.

Shanti Patel: **G**overnment emphasis in doubling the income of farmers, will it at all affect the demand for tractors in future and then what will be scenario of demand and supply in the industry?

Shenu Agarwal: Yes, there are like two types of interventions that government does, one is like very short-term intervention like announcing some subsidies or some direct cash benefit or direct cash benefit to the farmers so those of course have an immediate impact on the rural cash flows and therefore on the tractor market and there are some other things that the government does which are more longish term in nature and therefore those impact will come in the future and yes you are right government is very focused on rural side, COVID essentially has put the tension on the rural and the farming for even the general public so it has some into a lot of attention in the last six months to eight months, to simply answer your question yes it will have a positive impact on the rural demand and therefore on the tractor industry.

Shanti Patel: Who are our competitors if you can give the two names?

Shenu Agarwal: I need lot of time to answer that but because the competition changes from geography to geography depending on the market dynamics yes but of course its cost is in the fight to regain our market leadership and therefore we look at everybody who is challenging us but it is hard to generalize I mean it is like brand centric and geographic centric.

Moderator: Thank you. The next question is from the line of Soniya Vernekar from Equentis Wealth Advisory. Please go ahead.

Soniya Vernekar: Thank you for the opportunity. I have only one question, is from the vision 2022 plan which you had shard so if take the base of FY2017 and we calculate the numbers which we have shared in the outlook so the growth rate which we have achieved till FY 2020 and growth rate which we need to achieve for reaching that level by 2022 there is a big gap, so what do you think, do you think this is doable the numbers which we have shared in for 2022, are they achievable or do you think that because of FY 2021 and all this pandemic things, do you think that can go one year or two year ahead, what is your view on that?

Shenu Agarwal: Yes, generally speaking right for tractors I can say I mean especially the volumes and the market share so this year has been a setback on our journey so we were building it up quite nicely in the last three years but this has been a setback, so therefore it will be with the delay only that they will probably reach our FY2022 aspiration so probably I would say a year to two year and half delay.

Soniya Vernekar: Thank you.

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

Sameer B Deshpande: Congratulations for the excellent numbers and I wanted to know whether our main markets in north and central are currently growing at I think lower rate than the south and west but with the good crop and good Rabi season also expected with the good monsoon, will that change going forward in half two?

Shenu Agarwal: As I said overall at the yearly level FY2021 we are looking at a low double digit load at the tractor industry, there has been a skew in the first six months between north, west, south and centre and to some extent I would say that skew will continue for the rest of the year. So, south and west are going to outperform and north, centre and east at least until March and April this year.

Sameer Deshpande: But we will continue to grow ahead of the industry?

Shenu Agarwal: As I have explained it before for the next few months it is going to be a challenging thing, it is very hard to predict because of this skewness in the market which COVID has created, in terms of stocks, in terms of supply chains situation so it is very hard to say but that is what we are hoping for that going forward at least from December-January onwards when the supply situation should smoothen out I think then we should back in our winning ways in terms of going beyond industry.

Sameer Deshpande: Regarding the construction equipment and railway, half two will be better than the last year half two because now the COVID things are behind so do we hope to maintain revenues and profits which were higher in half two compared to the last year?

Ajay Mandahr: Hi Sameer, this is Ajay. Sameer, generally what happens is second half is 50% to 55% of the total volume of the year and with the positivity that we are looking from September onwards I think the number should be similar to last year numbers with the industry I am talking about and we would be in a position in that again as Shenu said they are straightened issues on our side as well so trying to mitigate that but the industry is moving in the right direction and continue this positive movement going forward this year.

Sameer Deshpande: For railways also?

Dipankar Gosh: For railways we had a very good quarter, Q2 was one of the very best we had for all the last few years so Q3 and Q4 may not be that strong as I was saying before lot of tenders have not happened, lot of tenders have been postponed so we are assuming the tenders will be again starting from the December-January timeframe but as you would appreciate that the government tender by that time you get the physical order in hand, for execution it takes almost two and half month to three months. So, that way we may not be able to mix the Q2 sort of growth, but we will at least maintain whatever we have been doing till the last year.

Sameer Deshpande: I was asking about last year half two only because we have the order back log of Rs. 350 Crores which we have to complete within the next six months to seven months?

Dipankar Gosh: But what happens is I mean railway is also postponing many of the orders, the order book is intact but many of the order railways says I do not need now because almost 50% to 60% of the coach production, locomotive production, wagon production has come down because of the COVID and the trains are not running for the last seven months to eight months so that way I mean not sure whether we will be able to fully execute, order will be there but whether you will be able to execute within this H2 so that we will be knowing may be another one month or so, so that way we will be able to get a more clarity about that.

Sameer Deshpande: Let us hope for the best and all the best to you all.

Moderator: Thank you. The last question is from the line of Sanjay Satpathy from Ampersand Capital. Please go ahead.

Sanjay Satpathy: Can I just understand from you that when you say that you will start your winning ways from January, so are we talking about it in terms of wholesale or retail levels in terms of market share gain because I believe that retail is what will matter as such?

Shenu Agarwal: Yes, Sanjay I mean fundamentally both, market shares numbers are projected only at the wholesale level but I mean both retail and wholesale they have to in a long-term they have to go together so I think once the supply side situation smoothes out then you should see that fundamental growth coming back to Escorts.

Sanjay Satpathy: Sir, as such November-December pace are pretty low compared to the number that you did in September and October, despite that why are we saying that we will still face supply challenge in November as well as December, I am not confined to that?

Shenu Agarwal: For example like November I would say that most of the players have stocked out so basically the sales in November for example or the ability to sell would be limited to the ability to produce so from that point of time even November would be kind of a constraint so it seems like demand will still outplays supply because probably nobody has stocks left so that is one and then going forward although the market will not be as high in December as it was in October and November but then everybody would like to fill their inventories back both at the dealerships and the depots and also the raw material and therefore still December would be tight in terms of supply chain I would say.

Sanjay Satpathy: It is only from January that will be normal, that is what you are saying?

Shenu Agarwal: That is what we are hoping for, it all depends on how the market behaves and how the inventory levels pan out but yes, we expect that from January sometime or early February the supply chain situation should be back to the normal. There is some volatility at this time, so it is hard to predict with accuracy but yes that is what we are hoping for.

Sanjay Satpathy: Understood Sir and if you can just touch upon with more granularity about this Kubota which is delayed, right?

Shenu Agarwal: Kubota, JV plant has already started running, they have already started shipping tractors and the plan itself was they would produce Kubota branded tractors first and Escorts branded tractors would come later, there was a delay of a few months in starting the plant, from our original plant there was a delay and some of the delay got because of COVID also but at this point in time the plant has started running now.

Sanjay Satpathy: At what capacity and how much is Kubota is likely to sell in Q4?

Shenu Agarwal: Yes, it is hard to say about the capacity because right now the plant is in stabilisation mode so the plant has just started operating from the last less than two months I would say, so I think we can give you more clarity after about two months to three months on that once the plant stabilises its production so when you start a new plant it always takes a few months to stabilise it. So, I think if you put wait for another few months then we can give you a better picture on that.

Sanjay Satpathy: Thanks a lot, and all the very best.

Moderator: Thank you. As that was the last question, I would now like to hand the conference over to the management for closing comments. Bharat Sir, would you like to add any closing remarks.

Bharat Madan: Thank you ladies and gentlemen for being present on this call. For any feedback and 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, that concludes this conference. Thank you for joining us and you may now disconnect your lines.