

Escorts Group Conference Call January 07, 2008

Moderator: Good afternoon ladies and gentlemen. I am Sandhya, the moderator, for this conference. Welcome to the Escorts Conference Call hosted by Centrum Broking Private Limited. For the duration of the presentation, all participants' lines will be in the listen-only mode. I will be standing by for the question and answer session. I would like to hand over to Mr. Nikhil Nanda. Thank you and over to you sir.

Nikhil Nanda: Good afternoon gentlemen. My name is Nikhil Nanda. I would like to introduce my team. I have Mr. Rohtash Mal, the Executive Director and CEO of AMG Business. He has been with Escorts for less than 5 weeks. He comes in from a very rich experience from Ballarpur for 17 years, and he has also then worked in Maruti for about 3 years as the head of marketing and sales and then with Bharti Airtel for about 6 years. He is a graduate from IIM, Calcutta, graduate engineer from IIT, Delhi. I have also Mr. Rakesh Budhiraja who is the CFO of Escorts Group, an LLB and MBA in finance and company secretary, has 27 years of rich experience in finance, accounts, worked in JK Tyres for 4 years and Kajaria for over 8 years. I am also joined with Mr. G.B. Mathur, company secretariat of Escorts Group and Mr. Kamal Bali who is the Managing Director of Escorts Construction Equipment Ltd. During the course of this call, we would be answering and briefing you on numerous matters. Our answers and briefing may be forward looking, and you know that we do not guarantee any outcome of this call. Our briefing is based on information that is already public, and we are required to bring and briefing into the public domain after this conference call under the relevant SEBI regulations. I would ask Mr. Rohtash Mal to give you a brief synopsis after Mr. Rakesh Budhiraja gives you a snapshot of Escorts results of the last 12 months for 2006-2007, and give you an indication of our 2007-2008, and then we will take specific business matters of AMG, which Mr. Rotash Mal will take forward and Mr. Kamal Bali on Escorts Construction, so over to Mr. Rakesh Budhiraja.

Rakesh Budhiraja: Good afternoon and belated happy new year to all of the people who are on the conference call. The annual results are already with you gentlemen. The gross sales have been higher by 18%, and we have attained a turnover of 2102 crores vis-a-vis 1,781 crores in the previous year. Twelve percent growth has come by the way of volumes. Another 6% has come by way of price

increase. The domestic industry has seen a degrowth of 0.2% in the second half of September 2007, but as per the ICCRA estimates for the current year, it is expected that the industry will grow between 7% to 9%. Escorts has increased its market share from 8.7% in 2004-05 to 15% in the current year. The profits in the current year have been impacted mainly because of the increase in the input cost which could not be fully passed on. The government is seized of the situation and increased the minimum support price of the wheat from 750 to 1000 per quintal for the ensuing rabi season, and we expect the tractor industry to do well in the coming season. As a further extension of the promoters' confidence, they have exercised their warrants which were issued in March 06 and put in 27.33 crores during the current year in addition to the money brought in by way of QIP placement during the last year. The cash profit for the current year is 40.54 crores vis-à-vis 22.36 crores in the previous year. The profit would have been higher by 14 crores except for the exchange loss. The PBT-PAT margins after if we exclude the exchange locks works to 5.88%, vis-à-vis 6.02% in the last year. On an consolidated basis, we have done an EBITDA of 161.22 crores vis-à-vis last year of 59.25 crores, and on the net profit before tax, it is 3.44 crore negative vis-à-vis 18.67 crores last year. I will pass on this mike to Mr. Rohtash Mal, who will give you the business perspective for the current year as well as for the future year.

Rohtash Mal:

Good afternoon, Rohtash Mal here, and thanks for coming on to the call. Belated Happy New Year and I think the New Year is a leap year, so we at Escorts are also looking at some leaps in performance. As Nikhil mentioned, I have been on board for all of 5 weeks. It has been a great immersion experience, so I will share with you some initial impression, some diagnosis if you like, and path going forward, and round that off with a couple of initiatives that are already in the pipeline, and some thoughts on few initiatives coming up. Over these few weeks and in the few weeks that we were contemplating my coming on board, one thing I recognized that Escorts is and was an institution, but what I recognized after coming on board was the fact that it has great technological depth, in fact significantly greater than competition. If I map it on technology and other such vectors, it has got a great environmental respect, lot of committed people, although one would admit that the population is ageing in comparison. What does strike one right upfront is that it is a huge opportunity for enhancement of performance. Going forward and recognizing a lot of challenges that one has in the next few years, I think one of the main vision elements, (definitely vision for the time being or what I am stating is with a limited purpose), the fact is that nothing would please me more than to be in the running for a business excellency CII award or a Deming award 2 to 3 years down the

road, and that would get Escorts back to stature that it has and is rightfully is as an institution, and the respect of the stake holders that it has as an institution. There are some, as is usual for any company at any point of its history, more so perhaps for Escorts, there are few gaps that need to be fixed, but the identification of the gaps needs to be done, is already done, and I would put together for you a couple of thoughts as we go ahead in this conversation.

We do need to put in a major strategy component on the platform of if you like for want of a better world on a business excellence model. There are a couple of challenges up ahead for my team and me.

I see the first as customer orientation, in fact market orientation, and I think the marketing and sales system requires (to use automotive language) significant engine overhaul I, and one has already begun that. This will lead to an enhanced level of liquidity and profitability as we align the marketing and sales system towards the customer. As an example, I would say that we have thousands of salesmen out there. We have got 33 area officers in 9 regions, but it does require alignment, so that the dealer level productivity is enhanced. Another area which is before me for significant exploitation is the quality system of the organization both in terms of product as indeed in terms of processes. The point that I am making is the fact that at existing levels of product quality and processes, Escorts already stands its own in the market. It has very strongly come back to a market share position which it had lost over a period of time, and the rightful share if you look at it from that point of view of almost a quarter of the market, it is on its way there. We are already at 15.5% to 16% up from 8%. Hesitate I do in measuring performance only in market share terms. I think as an orientation we would like to drive the organization towards on an EBITDA orientation rather than measuring market share in terms of tractor numbers.

The next area that stands before me is the containment of costs, and I will speak briefly of that as well as the management of the performance of the organization as a whole. In this line, we have in the course of the last few weeks already announced 3 initiatives, one in terms of overhauling the market system, the marketing system if you like, the quality system, and as we go ahead, we are looking at partnering with very respective names on the consulting business on the containment of costs. I would just take a couple of minutes to sort of give you a flavor of what I think needs to be done in order to enhance performance at the market systems over and above what I have spoken so far. The first would be to drive volumes in the hierarchy of profitability and clearly some work needs to be done there. As indeed the work that needs to be done in the rationalization of models, my belief is

(if I take a leaf out of my Maruti Suzuki book) that there are perhaps more models than are required with attendant consequences on working capital and indeed market stocks. The second area of endeavor would be to make sure that our dealer development strategy and our dealer productivity strategy is put in positions which will include consolidating dealerships and definitely increasing points of presence in the market, but definitely consolidating dealerships and keeping a focus on the revenues that we drive into the dealerships which effectively has a good bearing on dealer profitability. We recognize that on this side our performance is equal to the sum total of performances of all our dealers, so it will be in our interest as indeed in our direction to ensure that dealer performances are driven. I will seek to do that through a vehicle we already have at Escorts called the Escorts Dealer Development Association Limited, and I am in a sense of speaking dusting out that organization and making it very contemporary. There is some work to be done on the availability of flow finance and indeed retail finance. My colleague, Rakesh Budhiraja, just mentioned to the effect that there has been a degrowth in the industry in the last little while. Now, it really depends how one measures it. My sense of degrowth is that these are numbers that are defined by volumes that tractor manufacturers bill into the dealer network. It is more than likely that if one were to look at retail sales which are the true index of health of any sector, I dare say the market will look significantly different, but nevertheless, whatever those numbers are, fact of the matter is that this business is going to be very strongly driven by a push factor which requires an engine overhaul of the sales and marketing system, but with very strong requirement of retail finance which is what really sells this product. On the quality side, I have taken charge of this function myself. It was embedded in the manufacturing system, and a recent organization change announced on January 1st, 2008, I have taken this under my direct control, and I will seek to drive quality, product quality and process quality, through a business excellence model which we are architecting. Hopefully, we will look at senior professionals for industry to drive a business excellence model of which quality will be a part in due course, leading on to embedding TQM, work on which has begun about a year ago, and then leading this on to Six Sigma approach to the business.

We recognize that opportunity for price movements in the market may not be as easily easy to come by, and therefore in that sense, we need to drive cost sensitivity and cost targets into the system. We are in discussions with 2 very senior industry consultants to bring in 2 missions, one on raw material costs and one on non-raw material costs. On the people side, while we do have a significantly strong managerial force, I am going to be looking at strong reduction in these numbers with attendant decreases in

cost to ensure that the right age profiles and the right skill profiles are put in, and I will seek to make sure that these savings thus obtained would be driven back into management of performance. Going forward, there is a piece, I think what I have just laid out so far seems to be the early things to do in the next 3 to 6 months, but in that period, we are not going to lose sight of the fact that we need to put together a planning and a strategy structure to make sure that the next few years of AMG are healthy. We would like to stop looking at tractors and start looking at farm machinery space, in fact our real customer benefit is the driving of productivity at the farm level, and there would be more opportunities so to speak or to make sure that more revenue lines are made available. As an example of co-products, I believe there is an opportunity which we are seeking to monetize of ensuring that our engine production capacity is used to make engines for the generator business at one end of the market. From a factory end, we are going to embark on an exercise to see what is possible in terms of other co-products.

I mentioned a little while ago that I am going to be driving at through a business excellence model. I think most people understand and appreciate that try and bring focus on stake holder and customer and processes, and we are looking at reorienting the organization. In that sense, look at benchmarks, internal, external, improvement of processes for effective management and indeed through that use the drive on innovation into the organization. Lastly, on the 1st of January, we have as an approach stated that our retail focus will start measuring what margins are available at the retail end, and sensing some opportunity, we have increased prices of our products by 7000 rupees roughly on the average against an anticipated cost increase of 5000. The intent will be that we increase our contributions over a period of time by the containment of cost certainly, but looking for opportunities to increase prices to some extent even if marginal beyond cost increases.

In due course, ladies and gentlemen, I look forward to interacting with you individually and collectively all through the medium of this conference, look forward to questions and advice indeed in the reverse direction which will be gratefully accepted and acknowledged. I would like to turn this over to my colleague, Kamal Bali who heads the Escorts Construction business for his stake on ECEL, thank you.

Kamal Bali:

Thank you, Rohtash. Good afternoon ladies and gentlemen, and once again, a belated happy 2008 to you all. I will sensitize you on Escorts Construction Equipment Limited (ECEL) in terms of what our activities are and, going forward, what we are seeking to achieve in this outfit. As some of you might remember, Escorts Construction Equipment has pioneered the evolution of India's

Construction & Earth Moving Equipment (ECE) industry over the last 36 years. We started the concept of Hydraulic Mobile Pick – n-Carry Cranes way back in 1971, and since then, we have maintained a position of leadership in the industry. In fact, today, we are the largest manufacturers of Hydraulic Mobile Pick-n-Carry Cranes in the world. Besides the Pick-n-Carry cranes, ECEL also manufactures Hydraulic Mobile Slew Cranes for yard as well as rough terrain applications, upto 40 tonne lifting capacity. In addition, we have the exclusive distribution rights for India for Doosan Fork Lifts. Last year, in 2007, we added two very significant products for distribution, namely Crawler Cranes upto 280 tons, with IHI of Japan, and Tower Cranes. While we have recorded a huge growth in the material handling equipment segment, we have also done exceedingly well in the vibratory compaction segment, manufacturing Vibratory Compactors for both soil as well as asphalt applications. All in all, the company has maintained leadership positions in most of the product lines that it currently handles. Coming to the current fiscal year, we are continuing our growth story, and as a precursor to the mega transformation journey that we have embarked upon, we have achieved a growth of over 50% in the top line in the first 8 months (Y-o-Y). Remember our financial year is from April – March. The growth that we have recorded in the current year is about ten percentage points over the Budget and is better than the industry growth rate of around 35%. Our new, upcoming mega facility at Ballabgarh, near Faridabad, is expected to go on stream by April this year, and this promises to be one of the finest manufacturing facilities in the construction equipment industry at least in India. We are also putting up an assembly facility in the tax haven of Rudrapur to assemble about 1500 Pick-n-Carry Cranes going forward from April in the next financial year. Our new product introduction plans are in place, and the market will see a slew of new products from our stables in the various verticals of the ECE industry. Broadly, in this very diverse ECE industry, there are typically three major verticals, namely the Material Handling Equipment, the Construction Equipment vertical and the Earth Moving Equipment vertical. Overall, the total industry across all the three verticals, in India, is currently estimated to be around 2.25 billion US dollars, which is expected to grow to about 10 billion US dollars by the year 2015. This is corroborated by McKinsey report released November last year. So, while we are present very aggressively in the Material Handling and the Construction Equipment segments, we intend to make forays into the remaining verticals of the ECE industry, going forward, thanks to the non-complete clause which gets over by the end of January this year. For the present, I will not talk about the other verticals right now because we will showcase our plans during our next briefing, maybe some time in April, when we

are ready to make some very definitive announcements on this front. So, we are talking of growing in the next year at over 40% . This year, we expect to close the year at around 55% y-o-y growth. Also, to prepare ourselves to face the challenges associated with this kind of exponential growth driven by new products' introduction and increasing our market share in the existing products, at ECEL, we have embarked upon a number of transformation initiatives including the Lean Sigma journey, paradigm changes in the manufacturing technology which comes alongwith our new facility in Ballabgarh, value stream mapping for all our product lines, skills enhancement, and supply chain transformation. We are also looking at a couple of products for exports and markets we have already identified. We are already doing about 100 units annually on exports, but we are going to step up the accelerator on exports starting from April once we are able to meet some of the requirements for equipment for exports. In summary, the outlook for Escorts Construction Equipment Limited appears very very buoyant. We are very confident to maintain our position of leadership in the existing products, make forays into new product verticals, which shall make a an organization to really reckon with. I shall be pleased to take questions that anybody may have but, before that, let me turn this on to Mr. Nikhil Nanda. Thank you very much.

Nikhil Nanda: Ok gentlemen. We would like to open the floor for Q&A, and if the facilitator can please open the channels on the other side, so we can receive the questions and will be more than happy to answer them.

Moderator: Thank you very much sir.

Nikhil Nanda: Yes.

Moderator: We will now begin the Q&A interactive sessions. Participants who wish to ask questions please press *1 on your telephone key pad. On pressing *1, participants will get a chance to present their questions on a first-in-line basis. Participants are requested to use only handsets while asking a question. To ask a question, please press *1 now. I repeat, participants who wish to ask questions may kindly press *1. First question comes from Ms. Supriya from ICICI Direct. Over to you ma'am.

Ms. Supriya: Yes. Good afternoon everybody. Sir, you said there is a 12% growth in terms of volume for the year. Could I kindly have this number, exact number, the number of tractors sold and in which category that has been sold, the major contribution on which category.

- Rohtash Mal: Yes, the primary increase in the sales came from the domestic category where sales grew from 42,000 units to 47,700 units at about 13.4%. The exports were flat at around 5500 units. So, that gave a weighted increase of 12%.
- Ms. Supriya: Thanks a lot sir. What is your outlook going forward? What are the numbers you expect going forward for the year?
- Rohtash Mal: I will not be in a position to provide numbers going forward, but given the fact that the Government of India is placing huge emphasis on the agriculture sector, the banks which are getting quite aggressive in retail finance in the agriculture sector, I anticipate this sector to have strong growth in the coming few months.
- Ms. Supriya: Okay sir, and couple of months back, there was news that we are trying to enter into the real estate development also, by considering our operations at one place and selling the excess land, so any.....
- Nikhil Nanda: Well, the news on the real estate from the company stand point of view is completely speculative in nature. At this moment in time, the company refrains from making any comments, and as and when, the company does any kind of restructuring, we will appraise you after having taken to the board of directors.
- Ms. Supriya: Okay.....
- Nikhil Nanda : So, there are no movements as of now. Thank you.
- Ms. Supriya: Yes, thanks.
- Moderator: Thank you very much ma'am.
- Rohtash Mal: Yes, any other questions.
- Moderator: Participants who wish to ask questions may kindly press *1. Next question comes from Mr. Ricken Gopani of Radha Madhav Advisory. Over to you sir.
- Ricken Gopani: Hello.

- Nikhil Nanda: Yes, hi.
- Ricken Gopani: Hi. Actually, I would like to understand more on your Escorts Construction Equipment business. What is the turnover that we have achieved in the current year, and what is our outlook in terms of what market share are we at right now, and how much can we achieve in this segment.
- Kamal Bali: Well, the year ending March 07, we recorded a turnover of around Rs 415 crores and, in the first eight months of the current year, we have registered an over 50% growth over the same period last year. That is the trend currently in terms of the turnover. In terms of our market shares, as I mentioned in my brief a few moments ago, we are operating at about 60% share of market in the Pick-n-Carry Cranes, about 30% in Slew Cranes. In the different product categories, there are a different set of players. So, while we have the clear leadership position in the Pick-n-Carry cranes, we are the number 2 position in Vibratory Compactors as well as the Slew Cranes. This is the current position with respect to our existing products.
- Ricken Gopani: And if I were to understand, as you said, that the total market size right now is at 2.5 billion dollars.
- Kamal Bali: Yes.
- Ricken Gopani: What is it that we can be able to address out of this overall expansion plans that we have?
- Kamal Bali: Yes. That is a very good question. For that purpose, we intend to be present in all the three verticals of the Earth Moving & Construction Equipment (ECE) industry which, as I explained earlier consists of Material Handling, Construction equipment, and the Earth Moving Equipment. Currently, we are present quite aggressively in the Material Handling Equipment vertical. We are partially present in the Construction Equipment, and we are yet not present in the Earth Moving Equipment vertical. However, going forward, we expect to be present in all three verticals quite aggressively. Therefore, once that happens, I would reckon that we would be potentially be present in at least 50% of the total ECE industry, over the next couple of years. We would be dealing with a much larger segment of potential customers.
- Ricken Gopani: Okay, and for this addressability, what kind of gross block that you have currently and how much are you adding.

- Kamal Bali: Well, those numbers I may not have right now.....Yes, by the end of this year (March 2008), I think, we would have a gross block of over Rs 90 crores.
- Ricken Gopani: Okay, and how much would you need beyond that. Is there any expansion plan going.....
- Kamal Bali: Yes, yes, we have expansion plans, and we have already committed certain investments, but we cannot share at this point in time. In fact, we have very aggressive expansion plans.
- Ricken Gopani: Okay, so for those expansion plans, do you see any IPO raising in the next one and one and a half years?
- Kamal Bali: Well, yes. There are plans on the anvil, and let me pass this on to Mr. Nikhil Nanda to answer that question.
- Nikhil Nanda: Well, all I would say at this moment in time is that as in any other company, we are exploring all aspects of fund raising. All I can say is that we are very very focused in gearing our market share presence and the management and the promoters are recognizing the growth potential, the construction industry has to offer, and in the next 3 to 4 years, I personally believe a lot of value would be coming in Escorts Group through our investments in this vertical. To give you an exactitude and so on which instrument and way we are going to go about in raising the funds, I would like to refrain myself in giving you that aspect or inflow, but in the next 2 to 3 months, as and when we take any decision, we will come back to you.
- Ricken Gopani: Okay. Lastly, I would like to understand since you are now also getting into the earth moving segment.....
- Nikhil Nanda: That is correct.
- Ricken Gopani: What would be the tie-ups of technological requirements which we are having with international players?
- Nikhil Nanda: At this moment in time, all we can say is that we will make an entry into the earth moving post our noncompete which ends on the January 15, 2008. To give any exactitude of tie-ups, it is a sensitive information, and I would like to refrain from giving you any answering on that.
- Ricken Gopani: Okay. And coming back to the tractor business, would just like to get some sense as to do whatever initiatives on the cost front we are doing, what do we expect the EBITDA margin to be going forward in the next 2 years?

- Rohtash Mal: Rohtash here again. I think again while keeping away from projecting numbers, I feel particularly a very strong impact in terms of EBITDA. Our last years' results were about 115 crores. I, without giving numbers, would expect a very significant improvement return on these initiatives alone.
- Ricken Gopani: Okay. That's all from my end. Thank you.
- Moderator: Thank you very much sir. Participants who wish to ask questions may kindly press *1 on the telephone key pad. I repeat, participants who wish to ask questions may kindly press *1. At this moment, there are no further questions from the participants. I would like to hand over the floor back to Mr. Nikhil Nanda for final remarks.
- Nikhil Nanda: Thank you gentlemen for your interest, and all I would like to say as a company we would like to be transparent and from corporate governance perspective, we are going to be having fresh calls at least once a quarter, and we are delighted for your time and attention for this call, and we would be back again next quarter. In the meanwhile, if you have any interest or any specific questions, please feel free to contact the company secretariat or our investor community desk, or Centrum for that matter. I do thank you for your patience and thank you very much.
- Moderator: Ladies and gentlemen, thank you for choosing WebEx Conferencing Service. That concludes this conference call. Thank you for your participation. You may now disconnect your lines. Thank you.