Q1FY13 Earning
"Escorts Limited Conference Call"

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MANAGEMENT:	**MR. SRIDHAR – CEO, AGRI MACHINERY BUSINESS** **MR. GVR MURTHY – CEO, CONSTRUCTION EQUIPMENT BUSINESS** **MR. LALIT PAHWA – CEO, AUTO COMPONENTS BUSINESS** **MR. DIPANKAR GHOSH – CEO, RAILWAY BUSINESS** **MR. BHARAT MADAN – CFO, AGRI MACHINERY BUSINESS** **MRS. JYOTI KHATUKA – HEAD OF TREASURY FUNCTIONS OF GROUP** **MR. RAJEEV DASS – VP CORPORATE AFFAIRS & COMMUNICATION**

Moderator Ladies and gentlemen good day and welcome to the Escorts Limited Q1 FY13 earnings conference call. Please note that this conference is being recorded. At this time I would like to hand over the conference to Mr. Raghavendra Jaipuria from Perfect Relations, thank you and over to you sir.

Raghavendra Jaipuria Thank you good afternoon and thank you for joining us on Escorts Q1 FY13 results conference call. Today we will start the call with brief opening remarks from the management followed by an interactive Q&A session. Before we start I would like to add that some of the statements that be made in today's discussion may be forward-looking in nature. At the moment I would request Mr. Rajeev Dass to make his opening remarks and introduce the new management. Thank you, over to you Rajeev.

Rajeev Dass Ladies and gentlemen a warm welcome to you all from Escorts Limited. Joining me today on this call, is our senior management represented by Mr. Sridhar – The CEO of the Agri Machinery Business, Mr. GVR Murthy –CEO Construction Equipment Business, Mr. Lalit Pahwa –CEO Auto Components Business and Mr. Dipankar Ghosh – CEO Railway Business. Also joining us is the Mr. Bharat Madan CFO Agri Machinery Business and Ms. Jyoti Khatuka Head of our Treasury Functions at the group level. With your permission ladies and gentlemen I would like to take you first through brief a synopsis for the quarter which happens to be the first quarter of the financial year for us.

The quarter's improved performance is actually attributable to discipline on the cost front, new launches and better product mix offering to our customers. On the cost front raw material cost has strategically being reduced by the way of maintaining the right balance between our design requirements and raw material costs. Apart from raw material our focus has also been on improving manpower cost keeping in mind an optimized balance between the needs of today and tomorrow. In the coming years you will see the company derive significant return from synergies. For this in the next 36 months, through the optimization of our manufacturing layout and plant utilization, the tractor business will reduce its plant from three to two which will increase the capacity to 120,000 from the current capacity today of 95,000. Along with focusing on improving cost efficiency the management has also increased the sales volume on the back of better product mix and new launches. Recently, we have launched several new tractors at both the premium and the economy segments and going forward we will continue to do so. With the new strategy in place we target to reach an EBITDA level which is double of what we are trying to do today in the coming 36 to 48 months.

As you all know the Escorts construction equipments focuses on Earth Moving Machinery, high end slew cranes and other machines with technically superior features. In order to enhance overall contribution contract manufacturing option is being evaluated for some equipment on a go-forward basis. Post the merger of Escort's construction equipment with the parent, we are in progress to realize not only the commercial but also the technological benefits to both the construction equipment and the tractor business. It's imperative to mention here that very soon the pick and carry cranes and DIG MAX backhoe loaders will utilize the common technology platform between ECE, our Escorts Construction business, and tractor business and feature the exclusive fuel efficient escorts engines which will be fitted into the machines of ECE. This is one of the many initiatives the company will take in the coming years to generate value for his customers as well as other stakeholders. We are well aware of the subdued operational margins of the construction business and thus are actively working on its improvement. In the quarters to come we will see a significant operational and financial efficiencies by the way of centralization of materials, manufacturing excellence, finance and HR departments. For the engineering company like ours logistics and outsourcing are critical areas which will yield better results on a consolidated basis in the quarters ahead.

For the construction equipment segment the extensive pan India network of the tractor business will be helpful and will result in optimum coverage and utilization and will eliminate overlaps between the two companies and common utilization of facilities will lead to enhanced margins.

Auto components division is poised to see a turnaround and we are in the process to place an active program of product upgradation and technology induction. On the similar line railway component business is gearing up to meet modernization needs of Indian Railways. Brakes, couplers and high-end pads will see a significant technological change in the months ahead as we all know the Indian Railway is embarking on the path on the dedicated freight corridor and then speeding up the trains in the years ahead.

Coming to the brief summary of the numbers which probably you have all seen but just to highlight them once again on a quarter-to-quarter basis the consolidated sales posted a significant increase of 25% and stood at Rs. 1028 crores. Robust growth was reported on corresponding basis for EBITDA which grew by 74% and the margins of EBIT expanded by over 200 basis points. Tractor volumes increased by 32% sequentially and stood at 17,106. Total sales for the agri machinery rose to Rs. 845 crores an increase of 9.5% and the EBIT margin for the quarter expanded by 336 basis points to 9.4 on year-on-year basis. For auto products the sales stood at Rs. 37.5 crore posting a growth of 20% on year-on-year. We saw a strong improvement in margins over 1,100 basis points. The segment is still reeling under high input cost though. Railway products segment sales had decreased by close to 9% with an order book of Rs. 60 crores we are eying a turnaround in the quarter ahead, which is a very healthy order pad right now. You are all aware of the slowdown in the capital goods sector, we too have been impacted by the macro environment of slow growth and high interest rates, and this has led to a decline in volumes to the tune of 41.5% on the construction side. However the quarter two on a go forward basis we are seeing signs of revival and I think the year will close on a much healthier note than we are seeing today, as far as the construction equipment business is concerned. Escorts is not only committed to the operational and financial performance but also on the transparency and best practices front, in this regard we are working to further improve our internal controls and compliance processes. Chairman and JMD offices are keeping a close watch on these procedures directly. With this I would like to ask Mr. Bharat Madan to take over the financial review of our results on Q1 basis. Thank you.

Bharat Madan Thank you Rajeev. I am sure you people would have gone through the numbers. I will try to take you through the numbers which have been published. On the top-line the volume for the Agri business has grown to 17,106 tractors against 12,950 tractors sequentially and as compared to last year when it stood at 16,606. So, the volume growth of 3% over year-on-year and about 32% over the sequential quarter has been reported this period. On an overall sales value front this quarter has remained flat compared to the last year but sequentially the growth has been there to the extent of almost 25%. Significant improvement can be seen on the material cost front, on a year-on-year basis material cost has down from 74.7% to 72.5%, this improvement is a result of cost reduction initiative the company has taken in the past and which was reflected in the current quarter also. On a quarter-to-quarter basis there was a slight increase in the material cost because of some inflationary pressure and partly also due to the product mix changes which took place.

Coming next to personnel cost head, which has been an area of concern for the company, and will be keenly watched by the management going forward also. In terms of overall percentage it remains at the same level of 11% compared to the last quarter but in terms of absolute number, since we follow the cycle October to September, so this quarter reflects the increments affects which has come in this quarter. Besides generally in the last quarter lot of actualization happens on the provision front, so comparison of numbers on a year-on-year basis will provide a better picture. In terms of other expenses the level has been more or less stable, at 11.4% against 11.6% last quarter and about 12% same period last year. This is more reflective on the volume changes which will happen in this quarter and there is nothing to worry about on this front. Overall on the EBITDA front the expansion in margins has happened as it is clearly visible from the last year from 2.97% we are up to 5.15%. Both compared to the last quarter there is slight dip of about 0.5% in the EBITDA margins which is essentially driven by the product mix changes and the material cost impact which we just talked about.

On the other income front which increased by about Rs. 5 crores against last quarter on account of exchange fluctuations and some income coming from the channel finance side. For Finance cost we are more or less at par so the debt is gradually coming down leading to saving which is reflected in the financial cost. At a PBT level, we are at 3% which is about 0.5% improvement over the last quarter saw a significant improvement on corresponding basis which was at 0.84% almost a 218 basis points improvement coming on the PBT line. On the PAT front we are again at 2.74% at Rs. 28 crores versus Rs. 9 crores last year. Last year's numbers also include the numbers for construction business which has merged subsequently but the last year published numbers do not reflect the construction equipment division numbers, but for the ease of comparison we have included construction equipment numbers in this time numbers, so there is no disparity in comparison.

Now on to the segmental performance, if you look at the agri business our sales have grown by about 34% sequentially and the EBIT improvement has been about 38% with EBIT margin expanding to the extent of 0.3% from 9.1% up to 9.4% The year-on-year performance has been driven by Agri, the sales is more or less 9% up in terms of value, which is more inflationary trend, and on volume side we are more or less at 3%. But on the EBIT margins front there is an improvement of more than 3% on the agri margins.

EAP, the auto parts division has also shown improvement, the sales has grown by about 23% quarter-on-quarter to about Rs. 37.5 crores and I guess last year it has gone up by about 20%. The EBIT margins are still negative but they have shown an improvement so the losses are declining which is a positive and healthy trend for us. The total EBIT to sales ratio for the auto parts business has improved by almost 1100 basis points over last year and by about 500 basis points over the last quarter.

Coming to the railway products business, the numbers were slightly negative and the volume has gone down over here, by about 29% versus last quarter and about 9% versus year-on-year. The EBIT margins also have been impacted and registered a negative number. This is because of the product mix, low volumes along with the fixed cost of sale that has contributed to the negative margins, which is at minus 16% compared to minus 6.6% the year before. The construction equipment business has also shown marginal decline in sales because of the slowdown in the industry and we are hoping for a recovery going forward. The sales is now down to Rs. 129 crores, it is about 4% down quarter-on-quarter and about 38% down when compared to last year. EBIT margin showed marginal improvement compared to the last quarter from negative 5.8% to negative 4.5% this quarter, a slight improvement of more than a percent in terms of EBIT margins and but compared to the last corresponding quarter there is a decline by about 6%.

This brings me to the end of the financial highlights. May I now request the moderator to open the floor for a Q&A session. Thank you.

Moderator We have the first question from the line of Kaushik Poddar from KB Capital. Please go ahead.

Kaushik Poddar Firstly, what is the steady margin rate you are looking at for your agri equipment division and secondly, when you reduce the number of plants from three to two what do you with the third one, will you dispose it?

Sridhar as we all know we are going through a recession and market is actually stagnant for almost one-and-a-half years now. The priority itself is to conserve, whether it is man, material or other things. Meaning consolidation and cutting down cost but it does not mean that we do not explore any future opportunity. The third plant will become handy as and when we start seeing revival and then look at the future opportunities for doing whatever is relevant to our business, but beyond this I think we will not be in a position to elaborate.

Kaushik Poddar The 9% EBITDA margin which was seen for the last quarter for Agri equipment division, where do you see it three years down the line post rationalizing your number of plants and increasing your capacity to say 120,000?

Sridhar See there cannot be a direct answer for it but still indicatively I will try and answer this. When things were very good, means not in the last one – one-and-a-half year, the average margin for this industry was something like 14% to 15% EBITDA margin, I am talking about tractor industry of top players. Currently I think it may be hovering around 12.5% - 13%, whereas you would have seen we were at the bottom, at around 6%. So many of these consolidated initiative has helped in terms of saving those kind of money so may be around 6% to 9% is a possibility through those synergy related measures. Beyond this what we will be initiating is a lot of a brand related activities which normally automobile companies concentrate on and tractor people don't concentrate on. These kind of initiatives will be put in place, the talks are already over, actions are underway, possibly the research should start making the difference from may be a couple of quarters down the line. Where we will end, we really don't know but the goal is to be at par with the best in the industry, hopefully it should happen in another two to three years actually.

Kaushik Poddar Do you think you will be in a position to ramp up your exports in a big way or will it be mostly domestic center for whatever you are producing on the agri equipment side?

Sridhar Exports is a huge opportunity and we are fully aware of it. But first thing first, if our domestic continues to be a weak area with us lagging behind in terms of EBITDA margin compared to others then our top most priority will be the domestic market. Once this is set right the top-line and bottom-line objectives will be met but having said that the kind of a brand and the products what we are putting in, the same product is what will help us win in India like markets, meaning not only Africa, even Southeast Asian countries. Right now the exports activities are only seeding activities. For example for a typical market like Malaysia, though the numbers are few, we are just generating footprints at the moment. But going forward these penetrations will come handy, may be in the next two to three years. But currently I think numbers are additional actually.

Moderator Thank you. We have the next question from the line of Mahantesh Sabarad from Fortune Financial.

Mahantesh Sabarad This is Mahantesh here from Fortune. I had two questions, one a little more elaboration on the brand building initiatives that you are taking because on the tractor front currently there is a brand royalty that is being expensed out to the promoters. So are we changing the brand altogether and will save on the brand royalty expenses? My second question is on the balance sheet front, in terms of what is the current size is, key heads and the cash on the books?

Bharat Madan The royalty for the company will continue but that is for the use of Escorts brand and we are not giving away the Escort brand at it will continue going forward also. On the balance sheet side I think if you look at the numbers in the segment report it shows a balance sheet of close to Rs. 2000 crores, essentially coming from the Agri business, which is the major one, along with investment in the corporate and the other companies. The cash on the balance sheet if you look is close to Rs. 250 crores which is a mix of bank balances, freight fees, etc.

Mahantesh Sabarad The loans on the books are?

Jyoti Khatuka Debt is Rs. 240 crores and we have working capital outstanding of Rs. 211 crores. The total debt is close to Rs. 450 – 460 odd crores at the end of December, 2012.

Mahantesh Sabarad Is the entire cash deployable and usable right now?

Jyoti Khatuka Out of the total cash balance, Rs. 80 crore is Escrow and balance all is all usable

Mahantesh Sabarad Can you elaborate on that Escrow what is that, I didn't understand?

Jyoti Khatuka When we sold Escorts Heart Centre there was an income tax demand and in that term we had deposited Rs. 80 crores in an Escrow Account. This is still under dispute and we are contesting against it therefore the money lies in a fixed deposit in an Escrow account.

Mahantesh Sabarad Does the company get interest on that?

Jyoti Khatuka Yes, we get interest on that.

Mahantesh Sabarad What is the brand royalty expenditure in the quarter and the year gone by?

Bharat Madan The year gone by it will be close to Rs. 18 crores and for the quarter it's about Rs. 5 crores.

Mahantesh Sabarad Right so you are suggesting that once you take this brand building initiatives there won't be any enhancement to this amount of Rs. 18 crores per annum, it will remain there about the same, right?

Bharat Madan The royalty will continue on the brand.

Mahantesh Sabarad On the business side, because you did mention about recession for about 1.5 years on the tractor side in the market yet your volumes for the quarters at 17,000 have not only grown quarter-on-quarter substantially but have registered a growth over the previous year's numbers unlike most of your competitors. So just wanted to understand how you were able to manage that and is this some move towards additional market share that you are gunning for?

Sridhar Mahantesh, I think our priority is clearly not the market share, not the volume growth. Fundamentals we want to move up on the EBITDA margin front, there is a lot of scope, we can select a segment of our choice where we want to be associated and build our future and the brands. This is heavily reflected in the brand building, technology selection and the products what we choose and which segment we want to serve and we are getting into a lot of activities for this. The contrast of this activity is that Escort is not willing to discount even by a rupee. The discounts going out in the markets are something between Rs. 15,000 to Rs. 25,000 by competition. So this is the kind of initiative we are taking. Incidentally, we are holding on to our market share, we have not lost anything last financial year, last quarter was 0.1% or 0.2%.

More importantly the way we looking to build our future is to be most profitable tractor company within three years time span, so that's our objective number one. Now when your fundamentally strong, you will also see markets share going up, volumes going up but the volume definition is more of a market revival, so I don't think we should worry more about it, it should happen. One-and-a-half years was really a flat year, it's a question of may be six months to one year, that also depends largely on the government initiative, but we are very clear on what we should do and that is exactly what we are doing Mahantesh.

Mahantesh Sabarad So, you are suggesting that there won't be any discounting in the markets that will be practiced by you to enhance the brand image or the brand quality behind your tractor?

Sridhar Discounting and brand image doesn't go together, these things are opposite of each other and that is exactly what we refuse to do in the last one year. Going forward also we will refrain from doing so.

Mahantesh lastly, I have not been receiving the monthly volumes from your side?

Rajeev Dass Mahantesh I am surprised, actually it's my responsibility here. But I put out the monthly and quarterly volumes on a very regular basis and Im surprised on you not receiving it. Though will make sure going forward you receive the same.

Mahantesh Sabarad Even if the equipment volumes can be disclosed on a monthly basis?

Rajeev Dass The practices in the tractor businesses are little more evolved and the information is a fair play between all the players in the tractor business, unfortunately on the construction business I find the competitor's data sharing not so evolved and transparent. So the disclosure of my volumes & details and brand breakups etc is actually being used to twist other stakeholders which is detrimental to our interest, however having said that I can still share with you on a confidential basis I would imagine or I can share some broad numbers.

Mahantesh Sabarad Broad numbers, how many cranes and how many backhoe loaders, I think that should suffice?

Rajeev Dass I think those numbers we will put out to you.

Moderator Thank you. We have the next question from the line of Sagar Tanna from Kotak. Please go ahead.

Sagar Tanna What is the kind of volume growth that we are looking in 2013?

Sridhar As I said there are something's we can control, something's we are working on, something is in the consequence of something else. The industry is stagnant, it's very difficult to predict on how it will move, for example the last two to three months saw negative growth, moreover the industry growth we expect for this financial year is something like 3% to 4% at best, and it can easily be zero as well. Under these circumstance volumes growth is difficult to predict because this not only depends on our action but also on the competitors action. So what we are very clear on is which segment to choose, what is that we should sell, certain practice what we will not do and how do we see our future those actions is where we are very fussy about and that is giving us good results. So that is why despite heavy discounting from competition you will not see any larger impact on Escort. So, since you were asking about volume the industry revival should happen anywhere between six months to one year and hopefully if the government policy also supports things should happen much faster.

Sagar Tanna Yes sir where do you see volumes being impacted most, in which region.

Sridhar Overall for the industry if you look south zone is doing very badly, luckily if I am may say so Escort is not greatly affected because of the south but having said that even for north some of the crop prices and season do play a havoc. So on overall basis I think the revival should happen it’s almost one-and-a-half year now, two years is a good enough time in the normal circumstances for market to revise. So, we do hope that government also will do their bit so the revival is faster.

Sagar Tanna So, on a worst case basis do you think volumes will be flattish for this year.

Sridhar See for the industry definitely, for Escorts as I said is not our priority because it largely depends on how the industry behaves. But the segment what we choose is what you call higher premium segment or higher horsepower tractor segment. These are all the areas where we wanted to specialize in. So, our obsession is more to do with the profitability and volumes will follow, if not now six months later.

Moderator Thank you. We have the next question from the line of Aniket Mahtre from Standard Chartered. Please go ahead.

Aniket Mahtre The railway equipment business over the last few quarters has witnessed a sharp deterioration in margins, and earlier it was one of the biggest margins drivers for us. I would like to understand when can we see a revival in this business?

Dipankar Ghosh What has happened is that in the last quarter the government unfortunately had gone only for L1 base tender we have not really gone in for a feature base tender where even if you have features the prices go up but there is still struck some of the divisions of the railways staff who had L1 base tender so we had some major losses in that particular contract so that way our margin went down, but we are very confident in the coming quarters to really come back with better margins.

Aniket Mahtre The new contracts that you have announced about Rs. 60 crores odd worth of contracts to be executed in the next three to four months would that are on better margins?

Dipankar Ghosh We hope that they would be on better margins.

Aniket Mahtre But will we be able to breakeven with those contracts?

Dipankar Ghosh Yes, all the losses we see in Q1would are taken care of in the Q2, once we execute that. Actually in reality we have much more than Rs. 60 crore but it will be recovered in this particular Q2.

Aniket Mahtre Also want to understand the basis of our merger that we did last year. Could you help us understand how the merger ratio was arrived at and the financials of your group companies that is Escorts Construction and the Escorts Finance that was merged into the parent?

Bharat Madan You are talking about the financial ratios in terms of the merger valuations?

Aniket Mahtre Yes or at least if you could share the financials of these companies when the merger took place then we could understand how the ratio was worked out.

Bharat Madan Now again, what if you can give your email ID we can revert it to you but this is part of the scheme which was filed with the Court, the financials are part of that and this valuation was done by independent value based on which we have derived this ratio and this merger has happened.

Moderator Thank you. We have the next question from the line of Srinivas Rao from Deutsche Bank. Please go ahead.

Srinivas Rao My first question is on your tractors business, the target of improving margins as you have mentioned. Obviously, you can see your numbers and Mahindra's numbers are quasi in terms of estimating the tractor business profitability. Where do you think is a big gap between your numbers and Mahindra's, I am talking in terms of percentages and hence you see the maximum room for improvement.

Sridhar In terms of hygiene issues, I think fundamental differences you will see more in the manpower cost itself, there is clearly 4% to 5% difference between us and Mahindra. The moment that is resolved our EBITDA margins will be much better than Mahindra this is to start with but not necessarily it has to end with this. The strategy what we are trying to put it place is to far exceed this. For that we need to clean up that manpower related problem that we will try to do, other are strategies which are brand related and can take us beyond this. For example Mahindra has dominated mid segments and small tractors whereas we would like to concentrate on something on bigger tractors by choice it's not that they don't serve the market, but we would like to place our major emphasis on big tractors and then premium end of the tractor which should give us the better margin, so by chance when you sell it to some segment and then promote it, it should result in higher returns.

Srinivas Rao On a related note how much of a difference in profitability would you assign to the relative differences in the scale of operations and I am not talking just in volume numbers because of your choice for premium tractor segment. I am talking in terms of revenue base so do you think the gap between the revenue base is the key source of lower profitability for you and hence if you bridge that it should improve your margins also.

Bharat Madan Obviously that would be one of the key reasons because once you cross your fixed cost beyond a point then obviously everything has to be bottom-line. So that's one of the key reasons. But the gap between the margins, EBIT margins between us and Mahindra is almost double today largely driven by volume, also the cost structure they are pretty old , 50 – 60 years old company so the cost structures are not very different, so in our case because of the fixed cost being high like Mr. Sridhar mentioned about the manpower cost which is one of the reason, but you really compare the companies which are in the similar volume buckets, so like the company like Escorts is about Rs. 4,000 to 5,000 crores bucket so the cost structure is comparable to other companies in the industry but when look at the larger companies like we have Mahindra and Maruti of the world which is about Rs. 30,000 – 40,000 crores bracket, so obviously they have the margins improvement happen because it is shared driven by volume under the revenue on the top-line.

Srinivas Rao Another question is that since you are going to be present as slightly in a more premium segments, I am assuming that the southern markets particularly AP and Karnataka would be the markets the right sources of demand is that a right reading of the tractor market.

Sridhar In a way it's right but at the same time it's completely, the markets like Maharashtra are leading in terms of higher horsepower tractors but having said that this trend you can see in the whole of India with no status and exception. It is like a country going through into a bigger cost on bigger bikes same is the phenomena in tractors as well. What was supposed to be 6%, share seven – eight years back today has already become 12%. We would expect that segment share of the higher horsepower tractors to become something like 20% to 22% in another six to seven years. This is the kind of a trend seen everywhere including UP, Bihar and not necessarily Maharashtra where the market has already reached the level of 40% - 45% of the entire industry is on a higher horsepower side. The trend direction is the same but the percentage or the intensity varies between states to state.

Srinivas Rao Okay fair enough sir and in terms of serving these kind of markets do you see a higher sort of challenges in servicing the tractor or higher expectations or customers in terms of quality and service levels and is that something which you have thought about in terms of dealer network.

Sridhar These things will follow. Service, dealer and all other things will follow, but the first thing is we have to set the expectation for the customer, so the customers are prepared for the change. This still can be further accelerated provided somebody champions cost. So we will be championing the cost, you will be seeing us in terms of actions may be within two months followed by every third and fifth month the kind of tractors we will be putting out will be reflecting those kind of aspirations.

Srinivas Rao	I mean from your commentary and even from other sort of industry parts it seems that the tractor industry does not want to revert back to their older ways of discounting is that something which you believe is the case, I mean I know discounts are prevalent now but is it too high relative to historical trends given that we are in the mid of recession so discounts are expected but are they at unnatural levels.
Sridhar	See I don't know about the history because I am watching them only for the last one year but whosoever is sharing the pain perhaps almost everybody is discounting, it's very unfortunate portion of it. But see what we can control is we can choose a segment, we can participate, we can correct our behavior, we are very clear on the way we want to create our future. The rest is up to the industry how they wanted to behave, so currently discounting is prevalent.
Srinivas Rao	**W**ould you like to throw some outlook around the relative differences between the regions as you made some comment that south given a combination of factor is probably going to have a second year of weak numbers any comment on the north or the central part which are also big regions.
Sridhar	See if we have to say Central is doing much better, North is normal, average I will say, South is weaker this is exactly what is happening now.
Srinivas Rao	And sir we also had commentary during the last two three years where tractors were being put to non-farm usage has that trend moderated or reduced given the lack of activity from the government side.
Sridhar	Exactly that is certainly moderated with overall economic activities coming down that portion of tractor usage has significantly come down.
Srinivas Rao	And any number you would like to put in the share of that I mean we keep hearing a lot of anecdotal numbers on that, starting from almost 40% to 60% so.
Sridhar	That's true actually 40% of the tractor usages are meant for non-farm usages but the non-farm usages have considerably come down.
Moderator	Thank you. We will take the next question from the line of Nishant Vass from ICICI Securities. Please go ahead.
Nishant Vass	Sir, you have been putting a lot of emphasis on EBITDA margins but since SY09 we haven't seen the face of double-digit margins, even with volumes being headed up and down. So, there is a structural problem with margins going down. I don't share the same kind of exuberance and I really want the management to give a clearer picture as to how you would and what would be the roadmap to the double-digit margins?
Sridhar	See what you are saying is actually right if you look at last seven – eight years except '08 – '09 when the material prices had crashed worldwide because of the Lehman Brothers. The

EBITDA was stuck on a particular level of 4% - 4.5%. The challenge for the current management firstly is to shake that up, move it forward. So lot of initiatives what you are hearing can be fundamentally challenged. The 4% EBITDA is not very unique I can quote you many, many companies who are stuck at between 4% and 6% this is to give you a perspective on what exactly is happening in automobile sector. Other challenge here itself is to break out of it, come to a different orbit altogether. The first evidence of this itself is what you saw sequentially but that doesn't guarantee that we are out of woods but what is most important is the kind of actions we are trying. For instance, instead of having three plants almost one-third of the area we have been able to vacate, all machineries which are very old are being revived through TPM initiatives. Outsourcing is becoming very heavy, consolidations are happening, synergy between the groups which were never thought off is happening simultaneously. There are many group management committees being formed just to squeeze the cost out of the entire system. Many things are improving but some of these fundamental problems still continue to exist, I am talking precisely about tractor division not about construction division, it's a manpower cost. The day that manpower cost is crashed that means we are 3% to 4% of the EBITDA margins straightaway saved, having said that these are all challenges on an ongoing basis we will continue to do. More importantly what we are trying to improve in the last one and one-and-a-half year is the pricing power of the company. This is where we choose a segment of size and put the money on brand where we want to stand and today when we don't discount, this will reflect the character of Escort, Escort is the only company which does not participate in discounting today. In the one-and-a-half year this forms the character of the company, this is the way you move yourself into inelastic segment or in the premium end of the tractor segment. The collective activities are going which includes squeezing cost, sweating assets, outsourcing along with working on fundamental problems and debating on them. So there is a lot of internal challenges which we are working on like on manpower cost and how we structure and crack it. All these actions are parallely on. My estimate is a two to three year journey and when all things will fall in place is the time the margin of this company will be the finest in the tractor industry and I don't think this is such an impossible task that we cannot structure and clearly this should happen in this kind of time.

Nishant Vass So, is there a big threat of we not following any discounts and volume. We are not changing so is there a threat of volumes not growing on a year-on-year basis for SY13.

Sridhar It's possible but see if you look at the last two one year itself, our market, I am talking about last financial year ending September, our market share was the same 11.7% - 11.7% it has not moved even by 0.1% up or down, but this really doesn't matter with the kind of incentives we were giving to the dealer, the kind of a discounts and all other things were all stopped. The kind of a price increase we have done to the customer is much more when the industry was going down when the overall industry EBITDA margins were coming down by 2% to 3% on year-on-year basis. Whereas our margins were on the increase so when we want everything together then the sequence is more important, sequence for us is the EBITDA percentage and then kind of a brand imagery and selections what we are trying to do is more important. If these fundamentals are followed as and when the market revives and the competition intensity also slackens, you will see a huge jump in terms of not only top-line but also bottom line.

Nishant Vass Continuing with from the shareholder's perspective we are extremely bullish and confident on the growth and you might come out with excellent set of numbers and you are also cutting down on your plants, then why doesn't the company try and do a buyback at this time you have more than around Rs 400 crores – 500 crores of cash and cash equivalents for investments also and the market cap of the company has come down to something like Rs. 700 crores – 800 crores only plus you have a land bank on your balance sheet also which is significantly undervalued, this is a very attractive price for the company to come and give shareholders some confidence.

Bharat Madan See today just now mentioned we still got Rs. 460 cores of debt on the balance sheet, so even though we are looking at a growth going forward, so I don't think we will be able to take the step at this point of time, I think we will wait and watch, let the cash kitty grow and then we will take a call at that appropriate point of time, if you look at most of the industry in tractor industry we hardly see any company who has got debt on their balance sheet, we are the only exception here so I think having said that that is one of the reason why we are not being bullish on buyback at this point of time. The promoter stake going up and they have been showing the confidence in the company which has gone up to 42% in this quarter so that shows a sign of and the confidence level which is there in the company from the shareholder perspective and we will take those steps as and when the time comes and when we have sufficient cash.

Nishant Vass So, sir how much is the land bank that we have which is unused right now?

Bharat Madan So, as of now the entire plants are being used but like I said the strategies will be integrating the plants so it depends now whether how we address that thing whether we go for growth or whether we go for some other expansion we enter into some other categories so I think we will take that view may be two years, three years down the line when that has really happened so there is no point speculating at this point of time.

Moderator Thank you. We have the next question from the line of Sameer Deshpandey from Fairdeal Investments. Please go ahead.

Sameer Deshpandey First I would like to congratulate for the good results and a lot of effort, I think which you have put in seems to be yielding the results. But as the talk on the margins which is the most important problem with Escorts as someone rightly put it double-digit margins were there three years back and after that we are still not seeing that levels. We are around still 5% in spite the management concentrating so much. Then there are two areas which need to be concentrated on is this manpower cost is around 11% of our turnover which should come down to at least 6% to 7% as there are with other auto majors by the way of outsourcing and will help improve margins. Secondly, the company needs to bite the bullet on the auto ancillary segment which has been raising false hopes for the last five years. The company is draining money about Rs. 12 crores – 15 crores every year on auto-ancillary segment. The potential is the sector is huge but the size of our business is just Rs. 130 crores – 140 crores and if you see the auto component segment of other competitors in that segment and the size of their operations we are nowhere. But if we sell this business we will save Rs. 12 crores – 15 crores annually thus improving our margins straightaway.

Now, another thing is the interest costs which were about Rs. 100 crores last year and in this quarter also there are about Rs. 22 crores, now we have a total debt of about Rs. 500 crores on the books, I think when the average cost is so high at around 14% why are we not in a position to lower the interest cost given we are an old company and we have been paying our debts on time, so why is the interest rate so high and why can't we procure loans at 11% to 12%. The management should look at other sources of finance that is if the company raises fixed deposits, I think it should be in a position to get it at 10% - 10.5% so company can save about 3% to 4% on the interest cost and around about Rs. 200 – 300 crores if the company replace these bank debts and will be in a position to save about Rs. 15 crores – 20 crores so that can add to the margins. So I think you have to look at these two – three points on margins and closure of the loss making businesses which will help improve Escort's image in the market. Currently the stock is being punished and I think because of two reasons the capital is not being respected, the shareholders have their capital in the company for so many years and I see that it is not being respected because company is draining money in the other three segments except tractors which is the milking cow which also needs to be improved. I would also like to welcome Mr. Murthy on Escort's Construction Equipment. I would like to know how Escort's Construction Equipment can position itself against the international companies like Caterpillar and Volvo, Ingersoll Rand and how will the company be in a position to plug that place and make profits and when are we expected to come in profits on that front.

GVR Murthy

May I start with the last question from construction industry gentleman thank you very much for receiving me well. One thing I must say is that our product mix is one of the best things we have today and if you look at it traditionally our strongest point is pick and carry, where we have been doing very well and we continue to have over 50% market shares. Even here we have brought in equipment and products that we call safe cranes, which is giving us additional advantage and being is a leader there also. The safe cranes which are the voice of the customer today and the customer wants these cranes to be safer and safer because of the conditions at which we work in the industry and this product mix, initially it was touching around 10% and slowly we see a change in the customer requirements and demands and this product mix is gradually changing towards 30 and we would like to focus on this product mix especially the pick and carry cranes and grow the business to make it a positive impact on the bottom-line and the profitability of the company and I may be too open in making this comment that at least we are two years or three years ahead of our competition when it comes to introducing this new technology cranes in the market.

Moving ahead from the backhoe loaders you said that you would like to compare us with the competition. The mission that we have today is to definitely be technically more advanced than our competition and I would like to emphasize that when we start getting our market shares up and running with this product we will be able to cash in on this and getting the better product mix as well as the revenues into the company and profitability of the company. We cannot with certainty predict the revival of the sector but in our opinion we feel with the products what we have and the diversity of product range will definitely take us back and probably we will be better than the market in our growth. I must say that we are there and it is matter of time that we have to make it profitable and as my other colleagues are talking about one of the things we have fixed cost is one of the issues and this fixed cost has to be looked in a positive way of that we have invested to be ready for the market, we have invested in the talent and our R&D and these products which are coming out now even during this difficult last six – eight months they will take us in a long way in the future to come.

Lalit Pahwa Sameer this is Lalit answering your question on auto products. You are absolutely right the auto business of Escorts has been bleeding but we have again even at the risk of sounding cliché we have taken a fresh look at the business and are making structural changes both at the product technology level and at cost and that will resulted in the bottom-line improvement that you will see. In percentage terms last quarter to this quarter, last year same quarter to this quarter there is an 11% positive swing at the EBITDA level and even on a sequential quarter-on-quarter basis there is a significant improvement as you can see from the numbers and we are solidly on that path and hope to make this business profitable turnaround this year and build from there make new investments and access new markets.

Sameer Deshpandey But our size doesn't allow us to do that we are a very small company, Rs. 140 crores - 130 crores and we are incurring Rs. 12 crores – 15 crores operational losses. This story has been continuing despite the automobile industry boom over last five years, we had a boom except for the last two years, in automobile industry and how are we expecting when the automobile industry is at a stagnancy to make any profits. These points have been reiterated many times but there have been no signs of improvement and have not seen a quarterly profit also over last five years.

Lalit Pahwa Sameer you have answered your own question. In the boom years we may not have done well but the last two years though there have been soft for the auto component industry our performance has shown significant improvements we are still in the ditches, we are still in the red but there is a significant and visible improvement and we did report a profit in one quarter last year.

Sameer Deshpandey But that again is aberration it has been continuing, you have again been bleeding this time also.

Lalit Pahwa Yes, because we are still operating at the edges in terms of profitability there are quarters where we go down but the direction is clear and our bottom-line numbers, top-line numbers reflect that.

Sameer Deshpandey We hope to make a profit in this year at least and the end of the year for the full year?

Lalit Pahwa Yes, again we don't want to be speculative or commit forward-looking numbers, but yeah that's the path.

Sameer Deshpandey So, at the end of the year you may be at least at the breakeven level.

Lalit Pahwa You should hope so.

Sameer Deshpandey Now, actually another thing was is there any substantial growth potential for agriculturally implement sector because the tractors, I have seen that 60,000 is a figure where we have stagnated for last three years there is a lot of intensity of increasing competition, there are many new players like Sonalika, etc., who have been eating into our market shares also in the north they have been strong. Now, so to beat the competition innovation in tractors I think it has its own limitations so what is the new area we are looking at like farm mechanization and other segment, are we looking at these segments actively?

Sridhar See the farm mechanization itself it's a huge potential and there is a huge opportunity but unfortunately these things take 10 to 15 years so the initial set of activity is mastering a particular area, seeding it, lot of experimentation that is the kind of level which is going on, it is too early for me to disclose but possibly in six months time we will start putting out our strategies on those kind of area. But in terms of bottom-lines and the top-line impact what we are asking for these things will take at least three to five years from now. I don't have anything to promise for the span in between but it's a very, very interesting story being developed on a long-term format anywhere between three to five years period, you will start seeing a huge one.

Sameer Deshpandey Currently, are we getting any turnover from that type of, at least trading in those, are we importing anything and selling here or anything?

Sridhar We are doing but I don't want to quote anything. It is so minuscule that it's not worth discussing, so small.

Sameer Deshpandey So, it will take few years for that segment to grow.

Sridhar Yes.

Sameer Deshpandey So, why I was asking that is because we have the third plant which is vacant so we will be in a position to go for the futuristic products in that.

Sridhar We will do, opportunities are plenty, and India is an emerging opportunity country but first thing first, consolidation cutting down cost and how does we save ourselves? These are the things of top most priority today. Two years from now lot many opportunities will come our way, we will decide, we will discuss lot of things are there being discussed.

Moderator Thank you. We will take the next question from the line of Sonal Gupta from UBS. Please go ahead.

Sonal Gupta One was what's the sort of export volumes we had in this quarter?

Bharat Madan We had about 145 tractors in this quarter.

Sonal Gupta So primarily domestic. And secondly, I just want to understand that given you have traditionally been a strong player in the higher horsepower segment and given the industry shift is moving towards that, why are you not looking at gaining or improving your market share, ideally that should result in improvement in market share and could you also just I share a defined concrete plan in terms of the manpower reduction, etc., and moving from these three plants to two plants and by when do we see this happening, I mean in terms of the manpower side of it so any plans in terms of the next year or year and a half.

Sridhar See for both the question the answer is yes. The manpower reduction will happen thanks to the consequence of some other action. This plant integration and activities like this will result in lot of manpower reduction. But for that to realize it's a matter of two to three years. See, many things are being worked concurrently, this is one of the concurrent actions which are already debated, discussed, and shortly it will get approved, but the results as I said is two to three years from now. The first question what you have talked about higher horsepower yes historically we were doing well, it was our category in between the last 8 or 10 years we have lost it that is the category we are targeting, entire effort is on and the markets are also first it will improve in only those kind of category. Our internal goal is in three years to become number one in that category only, the way precisely you said is the way we are aligning ourselves.

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

Bharat Gyani I just wanted to get a sense of what would be the CAPEX plan for this year and in which segments, if you could elaborate.

Jyoti Khatuka CAPEX this year we planned about Rs. 100 crores in our tractor units and in construction equipment also we are planning of about Rs. 10 crores to 15 crores total is around Rs. 30 crores over next two years. And in our auto division also we are planning some CAPEX in terms of capacity improvement and balancing equipment so the total CAPEX would be something around Rs. 130 crores across all the three divisions.

Bharat Gyani Okay and out of this, what would be the maintenance CAPEX?

Jyoti Khatuka Maintenance CAPEX would be around Rs. 25 crores to 30 crores for all four divisions.

Bharat Gyani **Rs.** 25 to 30 crores for four divisions?

Jyoti Khatuka Yes.

Bharat Gyani And Rs. 100 crores capex would be basically to increase the capacity as you said earlier from 95,000 to 120,000 units?

Bharat Madan No it's more product led CAPEX which we are doing.

Bharat Gyani Basically for the premium range?

Bharat Madan Yes, for the launching of the new products, the premium range and the new variants, we have done some launches in the last two quarters and we are continuing with that.

Bharat Gyani Okay, but then the increase in the capacity would not require significant CAPEX.

Bharat Madan No, it would be a mix of outsourcing and bit of integration and balancing.

Moderator Thank you. We have the next question again from the line Pramod Kumar from IDFC Securities. Please go ahead.

Pramod Kumar This is Pramod Kumar from IDFC Securities. Sir, I just wanted to understand what is the current industry capacity in tractors which we have as of FY13?

Sridhar I think current production is around two-third of the capacity actually.

Pramod Kumar Two third so the industry is still at 60% - 67% utilization in the next six months to one year looks a bit of a challenge in terms of when the growth or the recovery would happen and sir within that I think the further capacity coming in from Mahindra's new plant in South and given that I think our market share position if you can just share us to where do we stand exactly as of end of third quarter in terms of market share sir.

Sridhar See today capacities really doesn't matter, everybody has got adequate capacity and if anybody wants to create a capacity also the lead time is only two to three quarter, I don't think capacity will ever become deterrent okay.

Pramod Kumar No I am hinting at other way around sir that when capacity is not getting fully utilized and hiring capacity is very easy and the market is getting fairly crowded as in there are at least seven or eight relevant players in the market right now. So, all I am trying to get is that given that it's the crowded market place and our market share position if I am not wrong we should be the third largest right now and with around 10% to 12% market share?

Sridhar That's right and almost 11.5%.

Pramod Kumar 11.5% and the second largest player is TAFE with around 20% to 23% market share and Sonalika is again at around 10% market share very closed to us. So, all I am trying to get at it whether how relevant would be the margin of strategy vis-à-vis the volume strategy, so I just want to understand your thoughts as to whether, of course having higher margin is a great thing but as you would appreciate I think given your business size volumes will play a critical role in your margin expansion, especially in terms of employee expenditure to sales and everything because there is only so much you can do on the innovation side as one of the earlier participant pointed out and we are not talking about John Deere or New Holland which are again very close or not that far from our position and who have a fair bit of technology on their side, so all I am trying to understand is how relevant is the margin strategy in the tractor market, vis-à-vis say two wheeler for example so I just wanted to understand your thoughts on this sir.

Sridhar See since you talked about a two-wheeler and cars for example 15 years back or 20 years back the entire car market was crowded with 800 cc and 1000 cc, 1000 cc was considered as a high-end it was Maruti 1000 was to be the premium car precisely 20 years back at that point of time if people have not spotted how the direction of car is going to move, they would have missed that opportunity. The whole of the country is moving in terms of whether it is car or bike or a tractor, it is all becoming bigger ones are growing faster, the smaller ones are crashing. Now, I will give you some statistics with reference to the tractor. Six or seven years back the higher horsepower tractor percentage, 50 horsepower and above we call it as a higher horsepower tractor those kind of areas are used to be only 6% and within seven years it has become 12% to 13% currently and that is expected to be around 20% to 22% in another six to seven years.

Pramod Kumar What's the market share in the 50 bhp and above segment sir?

Sridhar We are almost at 7% and at 20% there is a leadership opportunities will start, so this is a kind of growth rate. Simultaneously the smaller tractor which used to be something like 26% six years back has come down to 13%. It is not the question of aspiring for margin, first thing is we have to latch on to the segment which is going to create the future, so first the identification is that we have to be part of the new growth story what is emerging. Lucky for Escorts because of the kind of a segment we have had in the history, 15 year back when Ford tractors were there those kind of history was to Escorts' advantage so this is what we are rebuilding it so when the segment is growing and if you are a market leader already the biggest growth story comes to your advantage. This is the story of Pulsar in Bajaj and this will be the story of Escorts within the tractor industry, this is to simplify straightaway. It does not mean that other segment we will not work, for example, the mid segment is highly dominated by companies like Mahindras and TAFE we cannot straightaway compete with them, neither we have the financial muscle nor the echo system which is to their advantage, is not there with us,. So what is the way to compete, better route is go through the top, which are the brands and the technology story, once you go to the top the image is set, we are being looked at as innovators then the rest can be followed as a drop down, many of the features technologies will be a drop down from the top guy into the middle one that is how the next brand what we call power track which is a mass brand that story will follow from three year from now, almost by 2020 from seven or eight year from now, our goal, internal goal is to become a distinct number two, that is both in terms of volume of course the profitability wise we have already have told you by that time we will be the largest profit making company hopefully in the Indian tractor space, this is the kind of what you call the internal ballparks and benchmarks we are working, how soon it will happen what will be the competitive industry, what will happen in the next quarter we have to face it, what we are in control of things are the control of actions what we are taking. Results will depend on how well the competition responds or how well the industry response, this is to give you some broad idea actually.

Pramod Kumar Sir and as we talked about brand just want to understand what is the kind of price premium does a John Deere or the New Holland enjoy over a competing product of Escorts?

Sridhar See for example, see one is the price premium its consequence, John Deere is a company which is very apparitional, today in the Indian market, Indian customer see it is a high end tractor I think John Deere comes to their mind first. In terms of price premium I think currently it may be 10% to 15% is the price gap, we do expect over a period of one year this will become zero, we will be on par, see the idea is one is reducing the price premium, number two is creating the tractors which expands the segment as well, some of the tractor what we are creating will be appealing to the Indian census and the applications. So, it's a two pronged strategy, expands the segment and also narrows the price premium with the leaders, which is John Deere in this case.

Pramod Kumar Excellent sir and can I have the email ID of the finance guy whom we need to send a mail for the monthly and quarterly volumes sir.

Rajeev Dass You can take down my email ID rajeev.dass@escorts.co.in

Pramod Kumar And can I suggest that why don't you send the disclosure to the stock exchange on a particular date of the month so it becomes fair and transparent to everyone.

Rajeev Dass Good idea we will do that.

Moderator Thank you. Participants that was the last question. I would now like to hand the floor back to the members of the management for closing comments, over to you sir.

Rajeev Dass Gentlemen this has been hopefully a very engaging session for all of us and this is from the management here and all my colleagues here this is the first of the many that we will hold on a regular basis so that we maintain the culture of being fully transparent and understanding of where we are headed with our financials, where we are headed with our strategies and I thank you for taking your time out, I know it's trading hours for coming and participating at this little engagement with us and we hope to meet you again in the next quarter or even earlier. If you have any queries any additional informal my email ID is out there, please reach us and we will get back to you. Thank you very much.

Moderator Thank you sir. Ladies and gentlemen on behalf of Escorts Limited that concludes this conference call. Thank you for joining us, you may now disconnect your lines. Thank you.