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Re-engineering Escorts

Faint stirrings of an unlikely turnaround are being felt in Escorts. Demonstrating a willingness to change, Nikhil Nanda has drafted in professionals to head each of its four businesses and is taking hard calls, report **Chanchal Pal Chauhan & Satish John**

THIS February, when Nikhil Nanda, joint managing director of Escorts and the third-generation scion from the HP Nanda/Raj Kapoor family, set out to woo investors in a rare conference call, he faced their concerns instead. Not even the monthly despatch numbers of tractors and construction equipment are made public, investors rued of a company they perceived as not being transparent.

Investors have been pretty vocal in their displeasure over the way the Nandas have run Escorts, the ₹4,000 crore tractor maker, with additional interests in construction, railway equipment and automobile parts. Since 2003, its market capitalisation has grown from ₹266 crore to ₹771 crore. In the same 10 years, the market cap of Eicher — a rival that sold its tractors business to TAFE in February 2005 — grew from ₹155 crore to ₹8,810 crore. And market leader M&M saw its valuation increase almost five-fold to about ₹58,000 crore.

It's been a forgettable 10 years for Escorts, with failures in many unrelated diversifications eroding value. Nikhil Nanda, 39, who was appointed as JMD in September 2007, has been in charge of Escorts for the better part of this utterly forgettable decade. But now, the first faint stirrings of an unlikely turnaround are being felt within the group. Three things are causing this.

THREE NEW MOVES

First, its net profit over the last four quarters has doubled to ₹103 crore, when compared with the corresponding four quarters of the previous year.

Second, Nanda has personally wooed some top-class talent to helm several strategic leadership roles in the group, raising expectations that the new band of empowered professionals may help stem the rot. "The first thing I did right was to get the right people," says Nanda.

In the last two years, Nanda has appointed a professional to lead each of its four businesses. Leading this wave is former Bajaj Auto executive S Sridhar, who joined Escorts in October 2011 to head its farm-equipment business, which currently brings in 80% of the company's revenues. Sridhar was part of the core team that worked with Rajiv Bajaj to help Bajaj Auto get its mojo back. GVR Murthy, former joint MD of Tractors India, was hired in November 2012 to lead construction equipment, which contributes about 15% to the company's overall revenues.

Two relatively smaller businesses too have new CEOs. Dipankar Ghosh, an ex-Railways officer, with experience in John Deere and Bombardier, joined in October 2012 as CEO of the railway products; and Lalit Kumar Pahwa, an ex-Tata hand who now heads the auto products business came in May 2011.

Third, Escorts is taking tentative steps to re-engage with the analyst/investor community, and hopefully win them back. Sample this, responding to investor criticism at a conference call, Nanda has since made sure despatch numbers are made public monthly. "I look at myself more as a custodian," says Nanda, and quotes the two treatises of Jim Collins — 'Good to Great' and 'Built to Last' — as his gospel to re-build Escorts.

There seems to be a "turnaround", acknowledges Arun Kejriwal, director of KRIS, an investment advisory firm, who has tracked Escorts for a decade. "They have done quite a bit of downsizing and are trying to concentrate on a core portfolio."

OLD PROBLEMS

Nanda may have been at the helm for almost six years now, but the roots of some of Escorts' biggest problems go back before his time. An unrelated diversification into telecom via Escotel, which owned licences to operate in Punjab, UP (East), Rajasthan and Himachal Pradesh, singed the group, which lacked the alacrity and deep pockets to match other telecom entrepreneurs.

Telecom was divested later. So was its crown jewel — Escorts Heart Institute and Research Centre, with four specialty hospitals — in order to pay off creditors.

As recently as last year, a merger of three group outfits earned the ire of proxy-advisory firms, who argued the move hurt minority investors. Even as the group was coping with these challenges, rivals in the tractors business made significant moves. TAFE gobbled up Eicher's tractor business in 2005 and M&M acquired Punjab Tractors in March 2007, leaving Escorts as the weaker third player. Nanda realises that. "Our plate is full," he says, adding the group has since eschewed the aggressive diversification of the nineties.

Its shaky financial position also limits possibilities. "They (Escorts) are tight on cash," says a senior executive of a leading tractor maker, not wanting to be identified. In the last five financial years (October to September), Escorts net cash generation has ranged between ₹111 crore and minus ₹100 crore. "They have to deal with the short term even as they have to find the cash for the long term and free cash flow. That begs the question how are they going to fund their expansion," adds this executive.

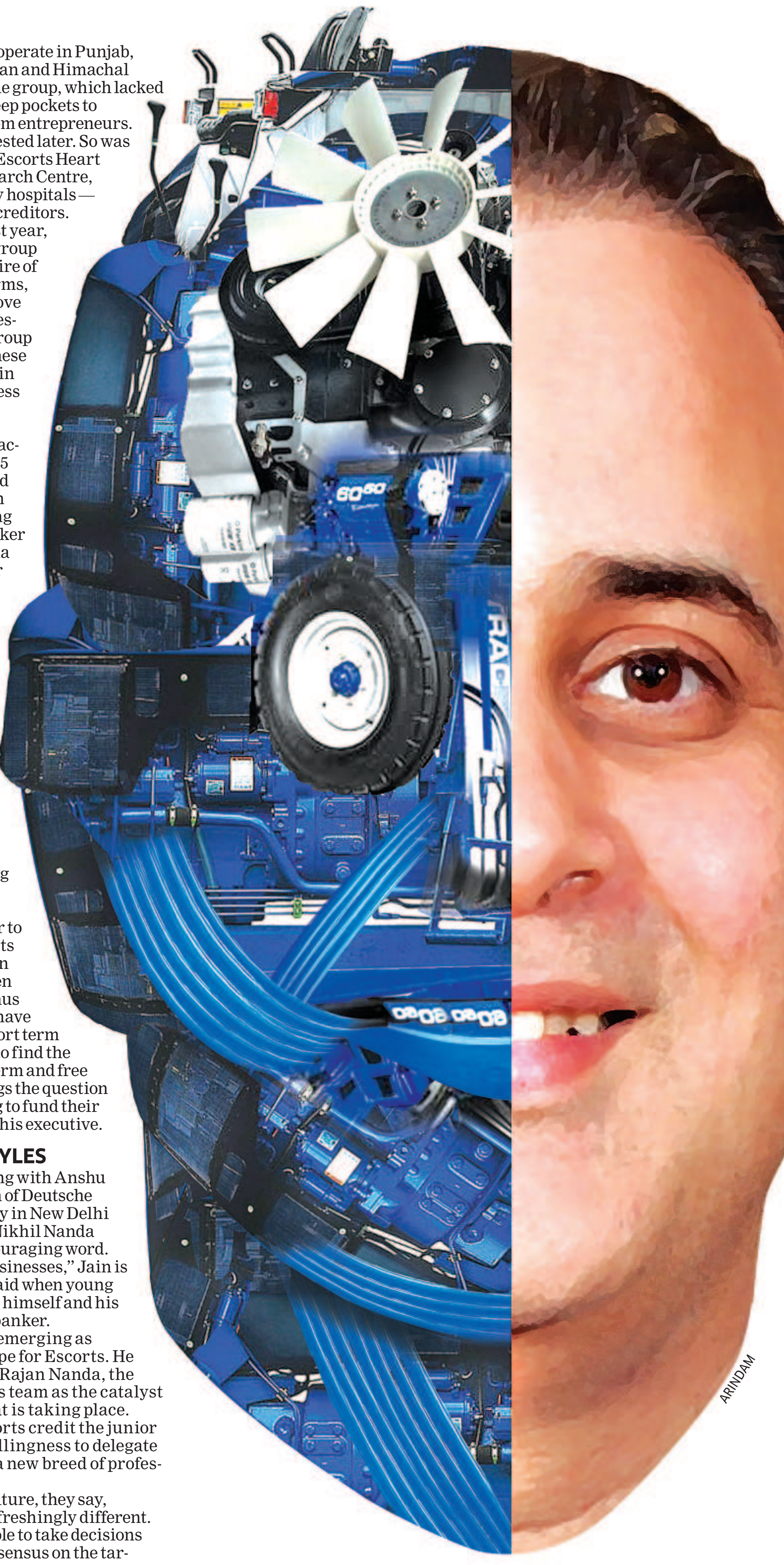
DIFFERENT STYLES

At a chance meeting with Anshu Jain, co-chairman of Deutsche Bank AG, at a party in New Delhi earlier this year, Nikhil Nanda earned a rare encouraging word. "You're in good businesses," Jain is reported to have said when young Nanda introduced himself and his businesses to the banker.

Nanda is slowly emerging as the new face of hope for Escorts. He credits his father Rajan Nanda, the chairman, and his team as the catalyst for the change that is taking place. But people at Escorts credit the junior Nanda and his willingness to delegate responsibility to a new breed of professional managers.

In the Escorts culture, they say, Nanda's style is refreshingly different. He empowers people to take decisions after building consensus on the targets. Nanda's style of managing, Sridhar says, is different from that of Rajiv Bajaj, his former boss. "He (Rajiv) plays hard. He is competition- and brand-centric and will precisely differentiate and then attack competition," says Sridhar, who cherishes his decade-long association with Bajaj Auto and Rajiv Bajaj.

By comparison, says Sridhar, Nanda is a "values-driven" guy. "As a boss, he is only an enabler." In his first meeting, Sridhar walked in expecting to be grilled on industry issues, but was instead surprised by a barrage of questions that Nanda used to understand him as a person. "He even recorded the interview, wanting to reflect on it later," Sridhar recalls. Nanda, who is married to Amitabh Bachchan's daughter, Shweta, is patient to a fault and is willing to learn from past mistakes, adds Sridhar.



NOW, AN OFFENSIVE

Under Nanda, Escorts has been cutting flab: its white-collar head count is down to 1,250, from 1,577 in 2010-11. This will be pared further to 900 by 2014-15, says a senior company official, not wanting to be named. Interest costs have been pared by 15% to ₹43 crore, from ₹51 crore. Receivables are down to 30 days, from 40 days; their value is down by ₹80 crore from the last half. "The focus is on cash, cash and cash," Nanda says. He explains how Escorts freed up space in its Faridabad headquarters by one-third, and cut flab even while increasing capacity.

While these incremental gains are welcome, Escorts needs to regain some of its lost tractor market share before analysts take the company seriously again. In the last five years, it has seen its share drop to 11.5%, from about 14.2%. "It is not an industry where it is easy to gain market share," says the executive from the rival tractor maker quoted earlier.

Sridhar, the new head of the farm equipment business, is going back to the lessons he learnt from the Bajaj Auto revival and reapplying them at Escorts. Bajaj introduced Pulsar, a premium motorcycle, to fight established leaders in the bike commuter segment and followed it up with the Discover at the lower end to engage competition with a pincer attack strategy.

At Escorts, Sridhar is implementing a similar two-pronged strategy. In the higher horsepower (premium) segment, the Farmtrac tractors will open up a new market of 50-60 horsepower tractors. In the lower, Powertrac segment, the focus will be on fuel economy.

With this, Escorts claims it has retained pricing and on odd occasions increased prices in a slowing market. "For us, M&M and TAFE are not the competition," says Sridhar. "It is John Deere, an American maker of high-powered tractors. We will be focussing on premium tractors." Counters the executive from the rival tractor maker: "Higher horsepower tractors have not evolved a lot in India and that's something they've to keep in mind. It is not going to be easy in this country."

Escorts won't have it easy since M&M and TAFE dominate the market, analysts say. "Where will growth come from," asks KR Choksey, a veteran stockbroker cum investor. "The market is not growing and so how will Escorts grow?" Choksey, an Escorts shareholder, says talk of rapid expansion when the industry is slowing down is a difficult proposition.

One answer, Sridhar counters, could be to venture out to East European countries, Southeast Asia and Africa. But he is confident that a premium play in the domestic market will also click. "Hopefully, we won't take 10 years (as Bajaj did), but fewer, as we'll avoid mistakes from experience," he says. "Three years from now, we'll be playing only in the premium segment and there is space for every player to grow."

Nanda, his boss, is game for the race. "We are already on the treadmill," he says, adding in jest that he lives in Escorts Faridabad HQ, returning to Delhi only to sleep.

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Under Nanda, Escorts has been cutting flab. His big challenge will be to revive the tractors business, which brings in 80% of revenues, but has lost market share from 14.2% to 11.5% in the past five years

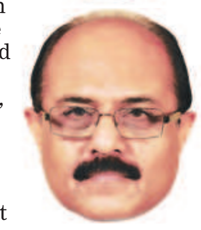
Placing Professionals at the Helm

In the last two years, Nanda has inducted experienced professionals to head each of the four businesses of Escorts:

S Sridhar
Head, Farm equipment business
JOINED: October 2011
PAST: President (Motorcycle business), Bajaj Auto

GVR Murthy
Head, construction equipment business
JOINED: November 2012
PAST: Former joint MD, Tractors India

Dipankar Ghosh
Head, railway products business
JOINED: October 2012
PAST: An ex-Railways officer, with work experience in John Deere and Bombardier



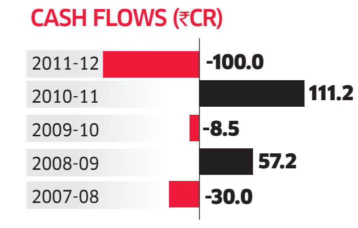
Lalit Kumar Pahwa
Head, auto products business
JOINED: May 2011
PAST: Former MD of TAL Manufacturing Solutions Limited, a Tata group company

Challenges for Escorts

TRACTOR MARKET SHARE
Slipped from 14.2% to 11.5% in the last five years. And unlike motorcycles, brand loyalty is tough to dislodge in tractors

NEW BUSINESSES
No deep pockets and tepid cash flows means growing other businesses will be a challenge

CASH FLOWS (₹CR)



Net change in cash and cash equivalents

Why PEs Follow Shriram

Even in most difficult year, PE funds booked ₹520 crore in profits from exits in Shriram Group, reports **Baiju Kalesh**

R Thyagarajan, Chairman, Shriram Group

ON May 10, when American private equity fund TPG Capital scored a seven-fold return in as many years by exiting its investment in Shriram Transport Finance, it joined a growing line of PEs to travel down this road. It worked like a mathematical formula. Invest in a Shriram Group company, stay invested for five to seven years, and make a bumper exit.

Even in the past nine months, when PEs faced some of the toughest conditions they have ever faced in India, funds have made four exits from Shriram companies, characterised by TPG's 9.9% stake sale in India's largest truck financier to Ajay Piramal for $304 million (₹1,652 crore). In the past 8 years, 16 PE funds invested $675 million in the Shriram group companies, run by the affable, 76-year-old R Thyagarajan. The group is valued at about $1.07 billion (around ₹6,000 crore) at present.

So far, 12 funds have booked profits of $403 million, via 12 deals. Reason? "A huge market opportunity, hunger to grow and the wherewithal to manage risk attracted PEs to the group," says PR Srinivasan, managing director at Exponentia Capital, a PE fund. "Credit to PE investors who had the foresight."

Credit also goes to the man who has delivered such stellar growth: the loan book (loans disbursed to customers) of Shriram Transport Finance has grown 50 times since 2002, from ₹778 crore to ₹32,000 crore. "We were only half-convinced when we looked at the company. Then, we realised it was built on strong fundamentals," says Ashish Dhawan, former chief executive of ChrysCapital, a PE fund. "Thyagarajan's unique leadership style of empowering his employees and common-sense approach, rather than academic management style, accelerated the company's growth." ChrysCapital earned a 10-fold return in four years when it exited from Shriram City Union Finance, a non-banking finance firm, in 2009.

POWER OF PARTNERSHIPS

For Thyagarajan, partnerships have always been a vehicle for growth, be it with companies, PE funds, partners or employees. His entrepreneurial journey started with his chit fund business in 1973.

Yet, even after five years and deposits of ₹500 crore, the business did not do well. "The regulatory environment was strangulating us and we realised it after getting into it," says Thyagarajan. But the goodwill and customer friendships helped him when he entered the second-hand truck financing business, in 1979.

This time, he turned to four friends for ₹5 lakh capital and partnered with Ashok Leyland and Tata Motors. "I think Thyagarajan invented the concept of bottom of the pyramid before academicians," says R Seshasayee, vice-chairman of Ashok Leyland, India's second largest truck maker. "We invested in the company in the early stage fascinated by his focus on the second-hand vehicle market and finding opportunities at the bottom of the pyramid."

MANTRA FOR SUCCESS

Thyagarajan's recipe for success is a mix of employee motivation, amicable relationship with partners and insulating the management from his family. "The uniqueness of Thyagarajan is his courage to blaze a new trail," says Seshasayee, who was on the board of Shriram Transport Finance in its early stages. "He believed in internal entrepreneurship than internal controls."

"RT (as Thyagarajan is affectionately called by his employees) always advised us to work with an entrepreneurial spirit. This gives me a feeling that I am the owner of the company," says Umesh Revankar, who joined Shriram Transport Finance as an executive trainee way back in 1987 and rose up to become its managing director. "I work more like a businessman," says Revankar, adding that he declined job offers paying two to three times his present salary.

The spike for the group coincided with PE entering its picture in the early part of the century. "Shriram Transport was a unique and differentiated model," Puneet Bhatia, managing director, TPG, told ET in an earlier interaction. "But it was not open to external constituents, had zero research coverage and a board filled with insiders. It could build a loan book of ₹5,000 crore, 25 years since its inception."

In May 1998, the Reserve Bank of India even warned customers against investing in the Shriram Group. "We opened all our offices for any customer to withdraw their deposits," says Thyagarajan. "Everything settled in few days. However, the RBI is yet to give reasons for the warning."

According to Thyagarajan, the group was unable to source cheap funding because of its average credit rating. "We were not following a lot of parameters rating agencies required," he says. Bhatia brought in Ranveer Dhawan, a former Citibank hand. "Finally, after much improvement, we received a better rating, which we could use to negotiate with lenders and save interest costs."

Breaking away from the tradition of Indian business families passing wealth to the next generation, Thyagarajan has transferred all his ownership in its financial services business to the Shriram Ownership Trust.

Neither Thyagarajan nor his two sons own a single share in the group, and are eligible for a share of the trust only if the trustees agree. The trust owns 24% of Shriram Capital, the group's holding company for financial services. As reward for their role in growing the company, senior employees — 37 at last count — have been given 1.5-2.5% each of the trust's ownership, which they can sell back when they leave or retire.

"Capital is not important…people who worked and built the organisation are important," says Thyagarajan who lives in a 1,300 sq ft house in Chennai and drives a Maruti Swift owned by his wife or travels in a Santro for official purposes. He depended on talent from smaller cities and towns to build his business. Thyagarajan wants to leave his legacy to the next generation of his employees. "They may run the way we managed it," he says. "Some will be desirable and some undesirable."

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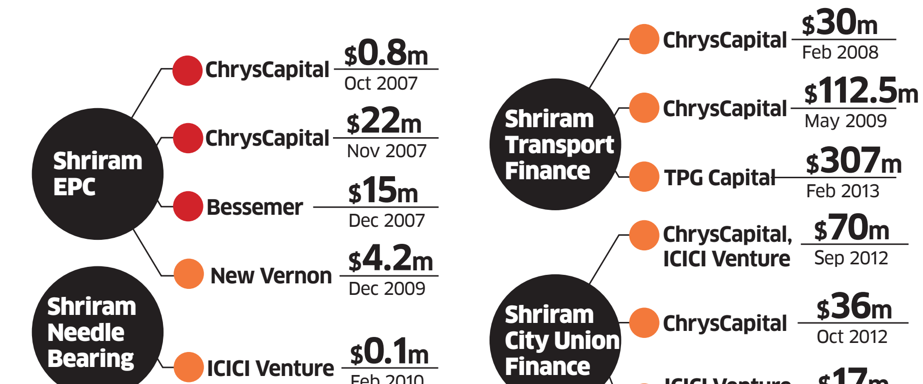
PE Exits in Shriram Group since 2004



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