

Escorts Ltd

Sector: Commercial Vehicles /Mid-Cap | Event Update

BUY

12 December 2018

Background: Escorts Ltd (ESC) is one of India's prominent players in the Automotive / Tractor industry, with an overall market share of 11.1% in the domestic tractor industry. ESC is also present in construction and material handling equipment, such as cranes, compactors and forklifts with 55% market share in material handling segment. Revenues share by segment in: Agri machinery (80.0 %), Constriction equipment (14.5%), and Railway equipment (5.5%). In construction equipments, the company has 53 dealers and 120 touch points.

Escorts join hands with Kubota for global leadership

- ESC and Kubota Corporation, Japan's biggest tractor manufacturer have announced their global joint venture to manufacture high end technology tractors for domestic and export geographies. ESC will hold 40% stake in this JV, which will enable it in leveraging Kubota's technology and overseas distribution network, spread across 100 countries.
- As part of collaboration, Kubota will export ESC tractors through Kubota global distribution network in specific markets as mutually agreed. The management stated that South Africa, Turkey and ASEAN markets have been identified for exports in Phase I. Turkey is the 4th largest tractor market globally with a market size of USD3.5bn(2017).
- Currently, ESC is the smallest player in the export segment. In FY18, company exported ~2,000 Units compared to India's export of 87,000 units. We believe that the JV would help plug this gap. Management has guided exports to grow at a CAGR of 40-50% over FY18-22 to export ~8,000 – 10,000 units.
- In addition to this, ESC will invest INR 1.2bn as an initial investment toward the joint manufacturing facility with a capacity of 50,000 units and it is expected to become operational by June 2020. Management has highlighted that the investments would be financed through internal accruals. The products jointly developed with Kubota would be rolled over the next 2 years and the ticket size of these tractors would be in the range of INR 0.4-0.5mn.
- The tractors of ESC and Kubota manufactured in the joint facility on a contract basis would be sold separately by the companies through their respective distribution channels and would compete in the domestic market. Kubota currently only assembles tractors in India by importing from Thailand and Japan. The contract manufacturing facility would help the company optimize on costs. It would also provide ESC some relief on capacity front as their current utilization is over 80%.
- We believe that the manufacturing joint venture between Kubota and ESC respectively will enable both partners to optimize their current and future capabilities in the segment globally.
- Sale of RT crane business: ESC transferred the RT crane business to its JV Partner Tadano on a slump sale for a consideration of INR 350mn. The revenue from this segment was INR 170mn in FY18 with an EBIT margin of 5%. The company had a market share of 9% in the RT crane segment. The value of assets being transferred as part of the sale would be ~ INR 150-180mn.

Valuation: The management expects a 12%-15% growth in the domestic tractor industry for FY19. The domestic and export penetration which would be achieved through this partnership would further aid growth. At CMP, the stock is trading at P/E of 12.7X/10.6x on FY19E/FY20E EPS, respectively. We arrive at a price target of INR 1,057 based on P/E of 17x FY20EPS and maintain a **BUY** rating on the stock. **Risks:** Slow pace in infrastructure spending, further increase in commodity prices.

Sensex	35,779
Nifty	10,737
Price	INR 659
Target Price	INR 1,057
Recommendation	BUY

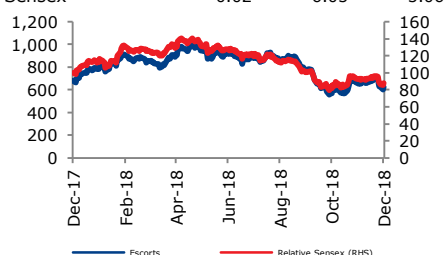
52 Week High/Low	INR 1,018/543
Bloomberg / Reuters	ESC IN/ESCO.BO
Equity (shares in mn)	122.6
Mkt. Cap in bn	INR 80.8 /\$1.1
Avg. Daily Vol. ('000)	1,536
Avg. Daily Vol. (mn)	INR 1012/\$ 14.1

Shareholding	Sep-17	Jun-18	Sep-18
Promoters (%)	42.98	40.07	40.07
FII (%)	15.3	24.14	22.42
DII (%)	5.79	5.66	6.09
Others (%)	35.93	30.13	31.42
Pledge (% of promoter holding)	0	0	0

Valuation Summary (INR bn)

Y/E March	2018	2019E	2020E
Revenue	50.2	61.6	70.1
EBITDA	5.8	7.1	8.5
Adj PAT	3.8	5.1	6.1
Adj EPS	39.0	51.7	62.2
% growth	77.0	33.0	20.0
P/E	16.9	12.7	10.6
P/ BV	4.3	3.4	2.8
EV/EBITDA	14.2	11.1	9.3
EV/Sales	1.6	1.3	1.1
Div Yield (%)	0.3	0.7	0.9
ROE (%)	18.0	20.8	21.0

Performance %	1M	3M	12M
ESC	-6.03	-18.64	-7.84
Sensex	-0.02	-6.05	5.06



DISCLOSURES/ APPENDIX

I. ANALYST CERTIFICATION

I, **Sai Lavanya K** hereby certify (1) that the views expressed in this research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this research report, (2) No part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this research report by Chola Mandalam Securities Limited or its Group/associates companies. (3) has taken reasonable care to achieve and maintain independence and objectivity in making any recommendations.

Disclosure of Interest Statement	Update
Analyst holding in the stock	No
Served as an officer, director or employee	No

II. ISSUER SPECIFIC REGULATORY DISCLOSURES, Unless specifically mentioned in Point No. 9 below:

1. The Research Analyst(s), Chola Mandalam Securities Limited (CSL), Associate of Analyst or his relative does not have any financial interest in the company(ies) covered in this report.
2. The Research Analyst, CSL or its associates or relatives of the Research Analyst associates collectively do not hold more than 1% of the securities of the company (ies) covered in this report as of the end of the month immediately preceding the distribution of the research report.
3. The Research Analyst, his associate, his relative and CSL do not have any other material conflict of interest at the time of publication of this research report.
4. The Research Analyst, CSL and its associates have not received compensation for investment banking or merchant banking or brokerage services or for any other products or services from the company(ies) covered in this report, in the past twelve months.
5. The Research Analyst, CSL or its associates have not managed or co-managed in the previous twelve months, a private or public offering of securities for the company (ies) covered in this report. \
6. CSL or its associates have not received compensation or other benefits from the company(ies) covered in this report or from any third party, in connection with the research report.
7. The Research Analyst has not served as an Officer, Director or employee of the company (ies) covered in the Research report.
8. The Research Analyst and CSL has not been engaged in market making activity for the company(ies) covered in the Research report.
9. Details CSL, Research Analyst and its associates pertaining to the companies covered in the Research report:

Sr.No.	Particulars	Yes/No
1	Whether compensation has been received from the company(ies) covered in the Research report in the past 12 months for investment banking transaction by CSL	No
2	Whether Research Analyst, CSL or its associates or relatives of the Research Analyst associates collectively hold more than 1% of the company(ies) covered in the Research report	No
3	Whether compensation has been received by CSL or its associates from the company(ies) covered in the Research report	No
4	CSL or its associates have managed or co-managed in the previous twelve months a private or public offering of securities for the company(ies) covered in the Research report	No
5	Research Analyst, his associate, CSL or its associates have received compensation for investment banking or merchant banking or brokerage services or for any other products or services from the company(ies) covered in the Research report, in the last twelve month	No

10. There are no material disciplinary action that been taken by any regulatory authority impacting equity research analysis activities.

STOCK RATINGS

BUY : The stock's total return is expected to exceed 15 % over the next 12 months.

OUT PERFORMER: The stock's total return is expected to be within 5-15% over the next 12 months.

MARKET PERFORMER : The stock's total return is expected to be between -5% to +5% over the next 12 months.

UNDER PERFORMER: The stock's total return is expected to be between -15% to -5% over the next 12 months.

SELL: The stock's total return is expected to more than -15% over the next 12 months.

III. DISCLAIMER

The information and opinions contained herein have been compiled or arrived at, based upon information obtained in good faith from sources believed to be reliable. Such information has not been independently verified and no guaranty, representation of warranty, express or implied, is made as to its accuracy, completeness or correctness.

This document is for information purposes only. This report is based on information that we consider reliable, but we do not represent that it is accurate or complete, and one should exercise due caution while acting on it. Descriptions of any company or companies or their securities mentioned herein are not complete and this document is not, and should not be construed as an offer or solicitation of an offer to buy or sell any securities or other financial instruments.

Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. All opinions, projections and estimates constitute the judgment of the author as on the date of the report and these, plus any other information contained in the report, are subject to change without notice. Prices and availability of financial instruments also are subject to change without notice. This report is intended for distribution to institutional investors.

This report is not directed to or intended for display, downloading, printing, reproducing or for distribution to or use by, any person or entity that is a citizen or resident or located in any locality, state, country or other jurisdiction where such distribution, publication, reproduction, availability or use would be contrary to law or regulation or what would subject to CSL or its associates to any registration or licensing requirement within such jurisdiction. If this report is inadvertently sent or has reached any individual in such country, especially, USA, the same may be ignored and brought to the attention of the sender. Neither this document nor any copy of it may be taken or transmitted into the United State (to U.S. Persons), Canada, or Japan or distributed, directly or indirectly, in the United States or Canada or distributed or redistributed in Japan or to any resident thereof.

Any unauthorized use, duplication, redistribution or disclosure of this report including, but not limited to, redistribution by electronic mail, posting of the report on a website or page, and/or providing to a third party a link, is prohibited by law and will result in prosecution. The information contained in the Report is intended solely for the recipient and may not be further distributed by the recipient to any third party.

CSL generally prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, CSL generally prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover. Our salespeople, traders, and other professionals or associates may provide oral or written market commentary or trading strategies to our clients that reflect opinions that are contrary to the opinions expressed herein. Our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein.

The views expressed in this research report reflect the personal views of the analyst(s) about the subject securities or issues, and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations and views expressed by research analyst(s) in this report. The compensation of the analyst who prepared this document is determined exclusively by CSL however, compensation may relate to the revenue of CSL, of which sales and trading are a part. Research analysts and sales persons of CSL may provide important inputs to its affiliated company(ies).

Foreign currencies denominated securities, wherever mentioned, are subject to exchange rate fluctuations, which could have an adverse effect on their value or price, or the income derived from them. In addition, investors in securities such as ADRs, the values of which are influenced by foreign currencies effectively assume currency risk. CSL, its directors, analysts or employees do not take any responsibility, financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report including but not restricted to fluctuation in the prices of shares and bonds, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, etc

CSL and its associates, officers, directors, and employees subject to the information given in the disclosures may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation (financial interest) or act as a market maker in the financial instruments of the company (ies) discussed herein or act as advisor or lender / borrower to such company (ies) or have other potential material conflict of interest with respect to any recommendation and related information and opinions. The views expressed are those of the analyst and the Company may or may not subscribe to the views expressed therein.

CSL, its associates and any third party involved in, or related to, computing or compiling the information hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any of this information. Without limiting any of the foregoing, in no event shall CSL, any of its associates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind. The Company accepts no liability whatsoever for the actions of third parties.

The Report may provide the addresses of, or contain hyperlinks to, websites. Except to the extent to which the Report refers to website material of the Company, the Company has not reviewed the linked site. Accessing such website or following such link through the report or the website of the Company shall be at your own risk and the Company shall have no liability arising out of, or in connection with, any such referenced website

CSL shall not be liable for any delay or any other interruption which may occur in presenting the data due to any technical glitch to present the data. In no event shall the CSL be liable for any damages, including without limitation, direct or indirect, special, incidental, or consequential damages, losses or expenses arising in connection with the data presented by CSL through this presentation.

Neither CSL, nor any of its other group companies or associates, shall be responsible for any decisions taken on the basis of this report. Investors are advised to consult their Investment and Tax consultants before taking any investment decisions based on this report.

RESEARCH			
Sathyanarayanan M	Consumption	+91-44 - 3000 7361	sathyanarayananm@chola.murugappa.com
Mugilan K	Technicals	+91-44 - 3000 7353	mugilank@chola.murugappa.com
Keerthi S	Banking & Financial Services	+91-44 - 3000 7363	keerthi@chola.murugappa.com
Sai Lavanya K	IT, Auto & Auto Ancillary	+91-44 - 3000 7266	sailk@chola.murugappa.com
Muthu Kumar J	Associate- Research	+91-44 - 3000 7360	muthukumarj@chola.murugappa.com
Sahil Jain	Associate - Cement	+91-44 - 3000 7360	sahilj@chola.murugappa.com
INSTITUTIONAL SALES			
Venkat Chidambaram	Head of FII Business & Corporate Finance*	+91-44 - 24473310	venkatc@chola.murugappa.com
Kishore K Ganti	Mumbai	+91-22-26597239	kishorekg@chola.murugappa.com
Bhavesk Katariya	Mumbai	+91-9860297739	bhaveskgk@chola.murugappa.com
Sudhanshu Kumar	Institutional Equities*	+91 - 9953175955	sudhanshuk@chola1.murugappa.com
Balaji H	Compliance Officer	044 - 30007226	balajih@chola.murugappa.com

*Employees of Business Partner - RCCR