

Tractor business, Kubota partnership merit BUY...

Escorts is a prominent tractor player domestically with market share in excess of 11%. The company's brand of tractors is particularly strong in the northern as well as the eastern belt of India. With rural India relatively less impacted due to Covid-19, record food-grain procurement by government agencies as well as expectation of normal monsoon 2020, we expect the tractor industry to outperform the larger automobile space in FY21E with Escorts a key beneficiary. Escorts in the recent past has also entered into a strategic partnership with Kubota Corporation of Japan (one of the global leaders in farm machinery and implements), which provides further visibility of growth for the company, going forward. On the b/s front, Escorts is a net cash company thereby holding surplus cash on books (~₹ 1,000 crore as of FY20) and also realises healthy return ratios matrix (RoCE at ~20% in FY20), thereby making a compelling case for an upgrade to **BUY**.

Kubota equity infusion, partnership a strategic play!

Kubota would be acquiring 10% stake in Escorts for a sum of ₹ 1,042 crore (1.23 crore shares @ ₹ 850/share). In addition to the investment, Kubota would get two board seats in Escorts. Along with the existing JV for manufacture & export of tractors (initial combined investment of ₹ 300 crore for total capacity 50,000 units p.a.), as part of the recent announcements, Escorts would replicate 40% stake in Kubota's India sales and marketing arm. The deals signal a deepening of ties between the two players into a symbiotic relationship, with Escorts gaining from Kubota's R&D and technology expertise, access to production knowledge & opportunity to serve sourcing needs of Kubota's global operations. On the other hand, Kubota would gain presence in one of the faster-growing Indian players & obtain access to lower-cost but quality manufacturing & sourcing.

Tractor industry in good stead, rural slate to limit decline

The domestic tractor industry has been at the forefront of farm mechanisation and clocked sales volume of 7.09 lakh units in FY20, down 9.9% YoY. Despite the dip, however, the industry outperformed the wider automotive space as it remained unburdened by regulatory disruption in the form of new safety features & emission norms. Going forward, also, the tractor space is expected to outperform the automobile sector courtesy good Rabi harvest, healthy crop procurement and expectations of a normal monsoon 2020. Once supply side issues due to Covid-19 abate, we anticipate a faster recovery in this space vs. the wider automotive industry.

Valuation & Outlook

We derive comfort over long term growth prospects amid its healthy B/S and capital efficiency. Therefore, we upgrade the stock to **BUY**. We value Escorts at ₹ 1,020, on SOTP basis, assigning 18x P/E to its core FY22E EPS and ascribing 25% holdco discount to its treasury shares in books.

Key Financial Summary

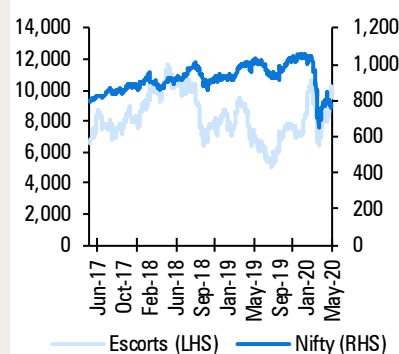
Key Financials	FY18	FY19	FY20P	FY21E	FY22E	CAGR (FY19-22E)
Net Sales	4,995.1	6,196.4	5,761.0	5,556.7	6,333.8	0.7%
EBITDA	557.2	733.3	675.8	637.3	791.4	2.6%
EBITDA Margins (%)	11.2	11.8	11.7	11.5	12.5	
Net Profit	344.8	484.9	485.6	500.1	616.3	8.3%
EPS (₹)	28.1	39.6	39.6	40.8	50.3	
P/E	31.3	22.2	22.2	21.6	17.5	
RoNW (%)	13.8	15.6	14.2	10.1	11.1	
RoCE (%)	21.0	21.7	18.9	13.3	14.2	



Particulars

Particular	Amount
Market Capitalization (₹ Crore)	10,780.0
Total Debt (FY20P) (₹ Crore)	6.6
Cash & Investments (FY20P) (₹ Crore)	956.6
EV (₹ Crore)	9,830.0
52 week H/L (₹)	914 / 423
Equity capital (₹crore)	122.6
Face value	₹ 10

Price Chart



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Kubota – Escorts Association Summary

1) Direct equity Infusion

Kubota plans to buy 10% stake in Escorts @ ₹ 850 with the right to appoint two non-executive directors. Promoter & promoter group (including trust) holding in Escorts is expected to reduce from 40.25% to 30.25%. Core promoter holding remains unchanged at ~13% while trust (ownership with company) stake reduces from 27.5% to 17.5%

2) JV for manufacturing tractors: Escorts-Kubota India Pvt. L ("EKI")

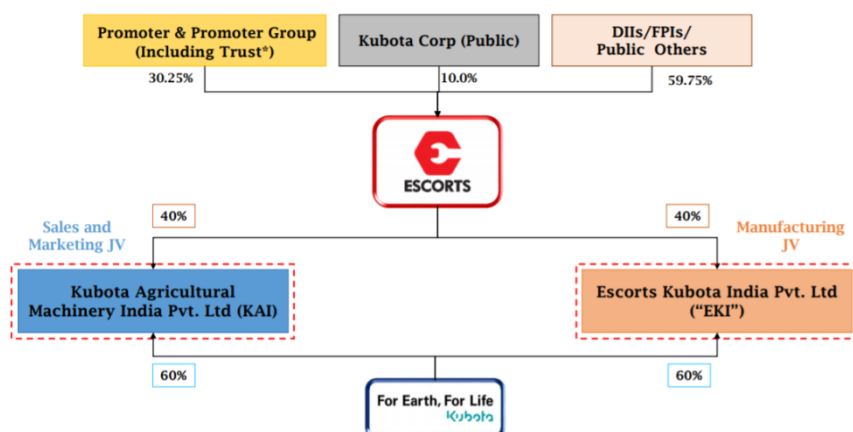
Escorts (40%) and Kubota (60%) are developing a manufacturing set-up (brownfield at Faridabad, Haryana) to manufacture 50,000 tractors annually with a Capex of ₹ 300 crore, with likely commissioning in Q3FY21.

3) Escorts to buy 40% stake in Kubota sales & marketing arm @ ₹ 90 crore: Kubota Agricultural Machinery India Pvt Ltd

This entity will appoint chairman by rotation between Escorts & Kubota. Its board will include three directors from Kubota and two from Escorts.

Exhibit 1: Kubota- Escorts Partnership Summary

Resulting Relevant Structure



Source: Company, ICICI Direct Research

Exhibit 2: SOTP table (Target price calculation)

Particulars	Amount (₹)
FY22E EPS (₹/share, A)	50.3
P/E Multiple (x, B)	18.0
Value of Base Business (C =A*B)	905
No of Treasury Shares (crore)	2.1
Current Market Price (₹/share)	880
Value of Investments (₹ crore)	1,888
Holding company discount (%)	25
Revised value of Investments (₹ crore)	1,416
Contribution per share (₹/share, D)	115
Target Price (C +D)	1020
Potential Upside (%)	16

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 3: Profit and loss statement		₹ crore			
(Year-end March)	FY19	FY20P	FY21E	FY22E	
Total operating Income	6,196.4	5,761.0	5,556.7	6,333.8	
Growth (%)	24.0	-7.0	-3.5	14.0	
Raw Material Expenses	4,040.3	3,449.3	3,334.0	3,800.3	
Employee Expenses	471.7	510.3	501.9	532.6	
Other expenses	750.7	755.2	722.3	797.9	
Total Operating Expenditure	5,463.1	5,085.1	4,919.5	5,542.4	
EBITDA	733.3	675.8	637.3	791.4	
Growth (%)	44.1	-7.8	-5.7	24.2	
Depreciation	85.4	104.6	118.8	140.1	
Interest	18.5	15.5	1.0	1.0	
Other Income	80.8	92.3	146.1	140.0	
PBT	722.4	638.9	663.6	790.3	
Total Tax	237.5	153.3	167.2	199.2	
PAT	484.9	485.6	500.1	616.3	
Growth (%)	40.6	0.1	3.0	23.2	
EPS (₹)	39.6	39.6	40.8	50.3	

Source: Company, ICICI Direct Research

Exhibit 4: Cash flow statement		₹ crore			
(Year-end March)	FY19	FY20P	FY21E	FY22E	
Profit after Tax	484.9	485.6	500.1	616.3	
Add: Depreciation	85.4	104.6	118.8	140.1	
(Inc)/dec in Current Assets	-769.0	190.7	101.8	-525.5	
Inc/(dec) in CL and Provisions	-49.9	112.4	-306.6	266.8	
CF from operating activities	-248.7	893.1	414.1	497.7	
(Inc)/dec in Investments	93.8	-247.2	-1,000.0	0.0	
(Inc)/dec in Fixed Assets	-147.3	-210.4	-297.0	-300.0	
Others	0.0	0.0	0.0	0.0	
(Inc)/dec in Deferred Tax Asset	0.0	0.0	0.0	0.0	
CF from investing activities	-80.9	-497.5	-1409.0	-396.8	
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0	
Inc/(dec) in loan funds	258.9	-280.1	0.0	0.0	
Dividend paid & dividend tax	-36.8	-36.8	-42.9	-49.0	
Inc/(dec) in Sec. premium	0.0	0.0	1,029.8	0.0	
Others	26.7	8.4	0.0	0.0	
CF from financing activities	248.9	-308.5	986.9	-49.0	
Net Cash flow	-80.7	87.1	-8.0	51.9	
Opening Cash	311.9	231.1	318.3	310.3	
Closing Cash	231.1	318.3	310.3	362.2	

Source: Company, ICICI Direct Research

Exhibit 5: Balance Sheet		₹ crore			
(Year-end March)	FY19	FY20P	FY21E	FY22E	
Liabilities					
Equity Capital	122.6	122.6	122.6	122.6	
Reserve and Surplus	2,900.3	3,357.5	4,844.6	5,411.8	
ESOP	0.0	0.0	0.0	0.0	
Total Shareholders funds	3022.9	3480.1	4967.1	5534.4	
Total Debt	286.7	6.6	6.6	6.6	
Other non-current Liabilities	63.7	83.7	83.7	83.7	
Long-term Provisions	24.5	30.1	30.1	30.1	
Total Liabilities	3397.7	3600.5	5087.5	5654.8	
Assets					
Gross Block	2,501.6	2,645.8	2,995.8	3,315.8	
Less: Acc Depreciation	924.7	1,012.7	1,115.7	1,238.7	
Net Block	1,577.0	1,633.0	1,880.1	2,077.1	
Capital WIP	53.1	104.4	54.4	29.4	
Total Fixed Assets	1630.1	1737.4	1934.5	2106.5	
Net Intangible Asset	53.8	52.3	33.4	21.3	
Investments	862.0	1,172.8	2,300.5	2,350.5	
Inventory	821.9	822.2	700.2	1,035.1	
Debtors	932.0	756.5	761.2	867.6	
Loans and Advances	20.0	37.7	29.1	59.7	
Other Current Assets	298.9	265.8	289.9	343.5	
Cash	231.1	318.3	310.3	362.2	
Total Current Assets	2,303.9	2,200.4	2,090.6	2,668.1	
Creditors	1,212.5	1,264.0	1,065.7	1,214.7	
Provisions & Other Curr.Liab	386.8	447.7	339.4	457.2	
Total Current Liabilities	1,599.3	1,711.7	1,405.1	1,671.9	
Net Current Assets	704.6	488.7	685.5	996.2	
Deferred Tax Asset	-52.9	-30.3	-30.3	-30.3	
Other non-current assets	117.7	119.0	103.3	150.1	
Application of Funds	3397.7	3600.5	5087.5	5654.8	

Source: Company, ICICI Direct Research

Exhibit 6: Key ratios					
(Year-end March)	FY19	FY20P	FY21E	FY22E	
Per share data (₹)					
EPS	39.6	39.6	40.8	50.3	
Cash EPS	46.5	48.1	50.5	61.7	
BV	246.6	283.9	405.2	451.5	
DPS	2.5	2.5	3.5	4.0	
Cash Per Share	75.4	82.6	91.0	101.0	
Operating Ratios					
EBITDA Margin (%)	11.8	11.7	11.5	12.5	
PAT Margin (%)	7.8	8.4	9.0	9.7	
Inventory days	48.4	52.1	46.0	59.6	
Debtor days	54.9	47.9	50.0	50.0	
Creditor days	71.4	80.1	70.0	70.0	
Return Ratios (%)					
RoE	15.6	14.2	10.1	11.1	
RoCE	21.7	18.9	13.3	14.2	
RoIC	23.2	21.5	16.5	17.3	
Valuation Ratios (x)					
P/E	22.2	22.2	21.6	17.5	
EV / EBITDA	14.3	14.6	13.9	11.1	
EV / Net Sales	1.7	1.7	1.6	1.4	
Market Cap / Sales	1.7	1.9	1.9	1.7	
Price to Book Value	3.6	3.1	2.2	1.9	
Solvency Ratios					
Debt/ EBITDA	0.4	0.0	0.0	0.0	
Debt/ Equity	0.1	0.0	0.0	0.0	
Current Ratio	1.6	1.4	1.5	1.7	
Quick Ratio	0.9	0.8	0.9	1.0	

Source: Company, ICICI Direct Research

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