

Standing tall in tough times

- Escorts (ESC) delivered a decent operating performance in Q1FY21 amid a tough environment. EBITDA de-grew 16% YoY to Rs 1.19bn (vs est Rs 1.13bn). EBITDA margin improved 125bps YoY to 11.3% led by better product mix (higher HP tractor) and cost control initiatives
- Revenue declined 25.4% to Rs 10.61bn led by 12.7% decline in Agri-machinery products, 75% in construction equipment and 53% in railway equipment.
- Management stated that the overall rural sentiment is positive because of the record output of Rabi crop and a good early monsoon. Tractor sales grew 22% YoY in June, led by a sharp 60% growth in the southern region. Despite weak Q1, the management expects lower single digit growth for the tractor industry for FY21.
- The company is operating at 50-60% utilization and is expected to scale up to full capacity by mid-August with smoothening of supply chain and labor issues.
- As rural demand and the agricultural sector are likely to be the least impacted by COVID-led disruptions with a quicker bounce back compared to the urban counterpart, we believe the tractor segment will outperform other automobile segments. In addition, re-stocking will also aid volume growth in the forthcoming months (overall system inventory stands at ~3.5 weeks which is 50% lower than normal level).
- Construction equipment and Railway division demand will also improve with revival in the macroeconomic scenario once the COVID-19 pandemic ebbs.
- We estimate EPS CAGR of 24% over FY21-23E led by 11% growth in Agri-machinery business and 24% growth in other two segments. We roll forward valuation from FY22E to FY23E and value the stock Rs 1,279 (16x for FY23E EPS) and recommend Accumulate rating.

Rural recovery and cash balance are key tailwinds

A strong Rabi output and good monsoon are key positives for rural sentiment and continue to support the demand for tractors. In addition, expanding market presence across domestic and international markets, combined with enhancing product offerings in its three (contd.)

Q1FY21 Result (Rs Mn)

Particulars	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Revenue	10,616	14,230	(25.4)	13,807	(23.1)
Total Expense	9,420	12,805	(26.4)	11,862	(20.6)
EBITDA	1,196	1,424	(16.0)	1,944	(38.5)
Depreciation	264	241	9.6	278	(4.8)
EBIT	932	1,183	(21.3)	1,667	(44.1)
Other Income	298	167	78.7	278	7.5
Interest	19	59	(67.1)	28	(32.0)
EBT	1,211	1,292	(6.3)	1,916	(36.8)
Tax	289	417	(30.5)	512	(43.5)
RPAT	922	875	5.3	1,404	(34.4)
APAT	922	875	5.3	1,404	(34.4)
			(bps)		(bps)
Gross Margin (%)	32.9	31.0	185	37.8	(490)
EBITDA Margin (%)	11.3	10.0	126	14.1	(282)
NPM (%)	8.7	6.2	253	10.2	(149)
Tax Rate (%)	23.9	32.2	(835)	26.7	(283)
EBIT Margin (%)	8.8	8.3	46	12.1	(329)

CMP	Rs 1,106
Target / Upside	Rs 1,279 / 16%
BSE Sensex	37,920
NSE Nifty	11,132

Scrip Details

Equity / FV	Rs 1,226mn / Rs 10
Market Cap	Rs 134bn
	USD 2bn
52-week High/Low	Rs 1,210/Rs 736
Avg. Volume (no)	29,91,670
NSE Symbol	ESCORTS
Bloomberg Code	ESC IN

Shareholding Pattern Jun'20(%)

Promoters	40.3
MF/Banks/FIs	6.5
FIIs	20.4
Public / Others	32.8

Valuation (x)

	FY21E	FY22E	FY23E
P/E	21.3	17.5	13.8
EV/EBITDA	16.4	13.0	9.9
ROE (%)	12.3	11.8	13.0
RoACE (%)	12.2	11.7	12.9

Estimates (Rs mn)

	FY21E	FY22E	FY23E
Revenue	58,455	67,866	75,413
EBITDA	6,904	8,179	10,197
PAT	5,246	6,392	8,081
EPS (Rs.)	51.9	63.2	79.9

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core businesses would be the key driver for medium to long term growth. Although outlook is expected to be muted for the CE business in FY21, it is expected to improve from FY22 once investments in infrastructure projects return in full swing with an improvement in government finances. Improving cost structure in the construction equipment business, better traction in the high-margin railway business, with its strong order book (about Rs 5bn to be executed in the coming 12-15 months) are likely to support margin. No major near-term capex and purchase of stake by Kubota will improve cash flows and strengthen its Balance Sheet.

Exhibit 1: Actual vs DART Estimates

Particulars (Rs mn)	Actual	Dart Estimates	Variance	Comments
Revenue	10,616	10,751	(1)	
EBIDTA	1,196	1,129	6	Cost control measures
EBIDTA Margin (%)	11.3	10.5	77bps	
PAT	922	865	6	Higher other income

Source: Company, DART

Exhibit 2: Change in estimates

Rs Mn	FY21E			FY22E		
	New	Previous	% Change	New	Previous	% Change
Volumes (units)	90,016	87,317	3.1	98,646	98,063	0.6
Net sales	58,455	58,901	(0.8)	67,866	67,864	0.0
EBITDA	6,904	6,950	(0.7)	8,179	7,954	2.8
<i>EBITDA margin(%)</i>	11.8	11.8	-	12.1	11.7	33bps
APAT	5,246	5,192	1.0	6,392	6,060	5.5

Source: Company, DART

Exhibit 3: Key Assumption Sheet

(Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Tractor Volume (units)	96,412	86,018	90,016	98,646	1,06,364
% YoY	19.9	(10.8)	4.6	9.6	7.8
Revenue (Rs mn)					
Agri Machinery Products	47,440	44,376	48,200	54,218	59,633
% YoY	19.9	(6.5)	8.6	12.5	10.0
Railway Equipment	3,941	4,772	4,558	5,532	6,547
% YoY	37.5	21.1	(4.5)	21.4	18.3
Construction Equipment	10,541	8,398	5,682	8,116	9,233
% YoY	35.1	(20.3)	(32.3)	42.8	13.8
Total Sales	61,964	57,610	58,448	67,866	75,413
% YoY	23.3	(7.0)	1.5	16.1	11.1

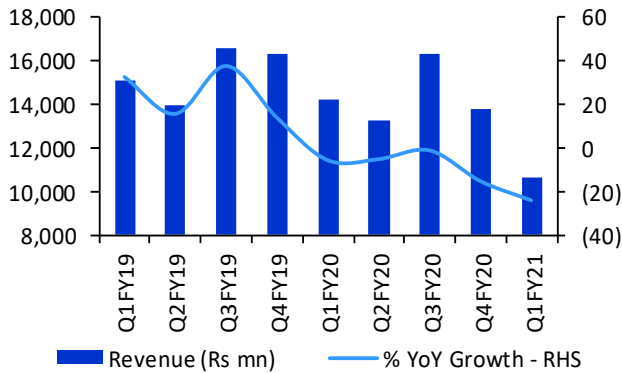
Source: DART, Company

Key Concall Takeaways

- The management is hopeful for strong growth in 2HFY21 and guided a low single digit growth for the domestic tractor industry in FY21.
- The company restarted its operations from the second week of May in a single shift. Rural agriculture demand has been encouraging and government focus on rural areas, will aid farming to continue the momentum. Good monsoons, bumper Rabi harvest and promising Kharif season has boosted rural confidence.
- June was a promising month witnessing growth across regions, except West Bengal and Chhattisgarh. Southern region has reported a growth of 60% vs overall growth of 22%.
- Company is currently operating at 50-60% capacity utilization and is expected to scale up with resumption of supply chain, which remains challenging due to frequent lockdowns. However, issues with suppliers are resolving and company expects to operate at full capacity by mid-August.
- EBITDA margin improved to 11.3% on account of better product mix (higher HP tractors), cost optimization initiatives and inventory pile up. Company is working towards reducing fixed costs by 10-15% in FY21 which will start reflecting from Q2FY21.
- Current system inventory (channel and company level) is 3.5 weeks (50% lower than normal). Average inventory holding period is 2-3 weeks for the company and 3 weeks for the channels.
- Escorts continues to expand its dealership network in East and South regions, amid challenging conditions. Company currently has 1,070 dealerships Pan-India and is working towards adding 150 dealers in Q2 and Q3FY21. Dealerships churn is 7-8% and it expects to reach ideal dealership strength of 1,200 dealerships in 18 months.
- Company has initiated 'Project Bahubali' to establish smaller dealerships in Telangana with the only target of boosting sales in small regions to achieve market penetration. This dealership model will be applied to other South Indian states gradually.
- In order to mitigate the issue of lower production due to supply chain disruption, Escorts is adding warehouse and storage capacity and purchasing key raw materials in advance to ensure adequate supply for the key demand months of October and November.
- Financiers have no problem funding agricultural equipment buyers.
- The construction equipment division is operating at 30% of last year and is expected to improve from H2FY21 onwards. Breakeven sales units are 230-250 units per month.
- The railway segment has a healthy order book. Covid related lockdowns led to decline in business, and company is expected to recover from Q2FY21.
- Contract manufacturing for Escorts and Kubota product is likely to start from Q3FY21. E-Kubota tractors will be reported in the JV segment.
- Escorts has a planned capex of Rs 2.25-2.50bn in FY21 towards new product development, capacity addition in the machining division to be used for both, Escorts standalone and Kubota JV. Major capex directed towards the agriculture equipment segment with Rs 300-400mn for construction equipment.
- Gross debt as of Q1FY21 end is Rs 600mn.
- Subsidiary business is expected to recover in FY21 and contribute towards industry with 7-8% of sales.

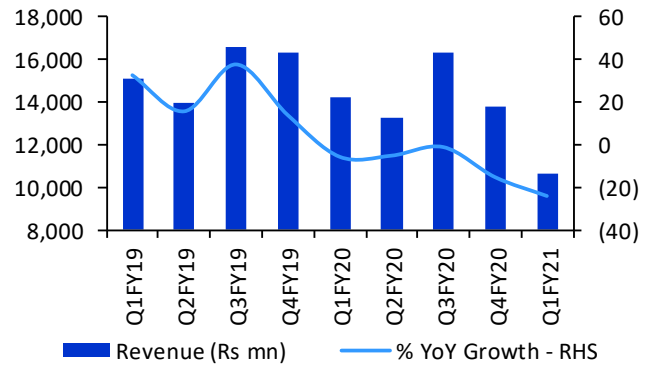
- Escorts is targeting exports of 8,000-10,000 units in 3 years.
- Average replacement demand is 45-55%, with mature markets like Punjab at 80-85% and immature markets being 20-25%. Average replacement cycle for tractors is 8 years.

Exhibit 4: Revenue decline due to lockdown



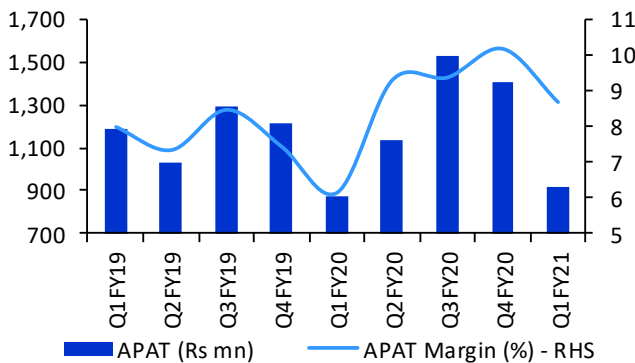
Source: DART, Company

Exhibit 5: EBITDA margin expanded YoY



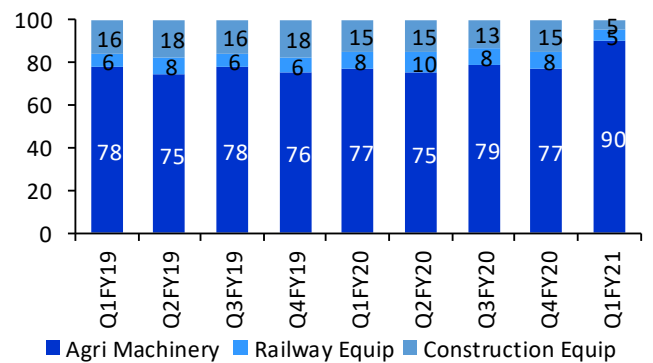
Source: DART, Company

Exhibit 6: PAT (Rs mn) vs PAT Margin (%)



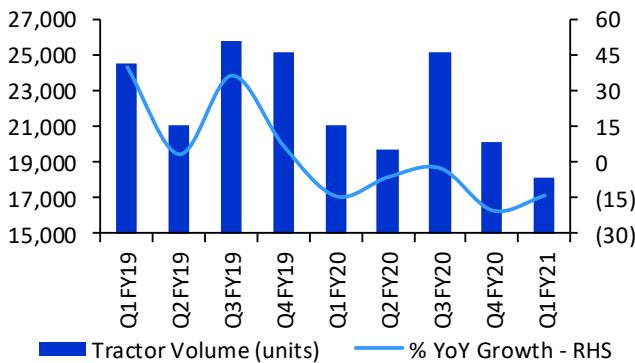
Source: DART, Company

Exhibit 7: Segmental Mix (%)



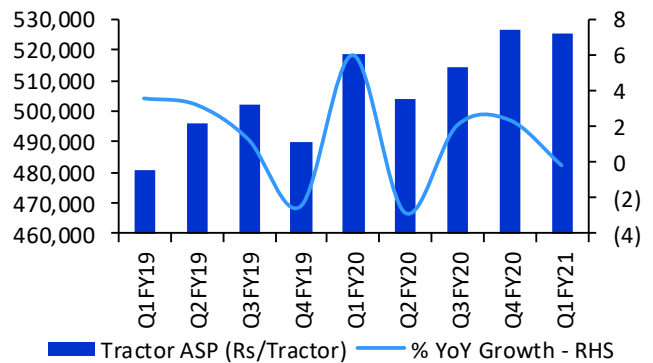
Source: DART, Company

Exhibit 8: Tractor volume (units) de-grew 13% YoY



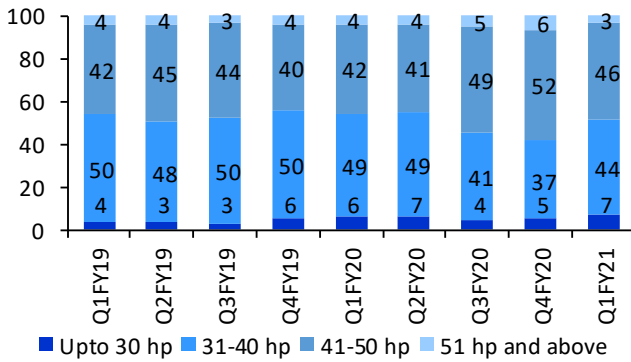
Source: DART, Company

Exhibit 9: Tractor ASP remained firm



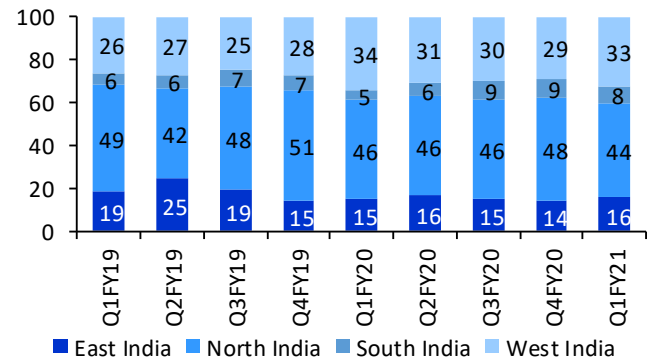
Source: DART, Company

Exhibit 10: Escorts Domestic HP segment share (%)



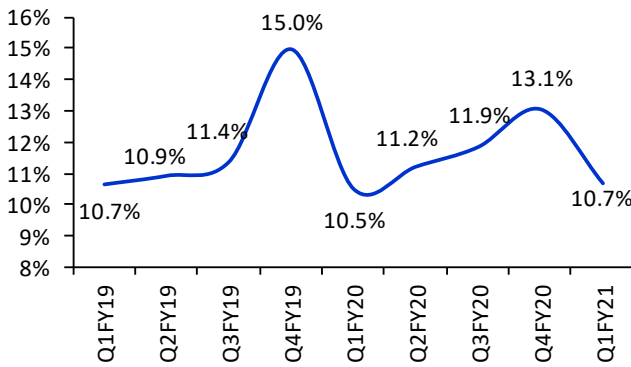
Source: DART, Company

Exhibit 11: Escorts Domestic region wise share (%)



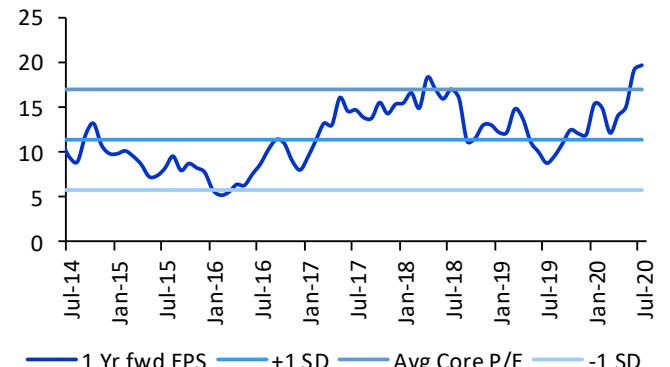
Source: DART, Company

Exhibit 12: Escorts Market share in Tractor segment



Source: DART, Company

Exhibit 13: PE Band chart



Source: DART, Company

Profit and Loss Account

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
Revenue	57,610	58,455	67,866	75,413
Total Expense	50,851	51,551	59,687	65,216
COGS	38,196	39,081	45,647	50,372
Employees Cost	5,103	5,301	5,629	6,085
Other expenses	7,552	7,169	8,412	8,759
EBIDTA	6,758	6,904	8,179	10,197
Depreciation	1,046	1,108	1,175	1,253
EBIT	5,713	5,796	7,004	8,944
Interest	155	48	39	34
Other Income	923	1,292	1,614	1,937
Exc. / E.O. items	92	0	0	0
EBT	6,573	7,039	8,579	10,847
Tax	1,533	1,793	2,188	2,766
RPAT	5,040	5,246	6,392	8,081
Minority Interest	0	0	0	0
Profit/Loss share of associates	0	0	0	0
APAT	4,948	5,246	6,392	8,081

Balance Sheet

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
Sources of Funds				
Equity Capital	1,226	1,226	1,226	1,226
Minority Interest	0	0	0	0
Reserves & Surplus	33,575	49,587	56,592	65,213
Net Worth	34,801	50,813	57,818	66,439
Total Debt	483	383	333	283
Net Deferred Tax Liability	303	303	303	303
Total Capital Employed	35,587	51,499	58,454	67,025

Applications of Funds

Net Block	17,081	18,467	19,888	20,230
CWIP	1,044	1,044	1,019	994
Investments	6,468	7,059	7,845	8,361
Current Assets, Loans & Advances	28,528	41,818	49,169	57,961
Inventories	8,222	8,267	8,652	9,814
Receivables	7,565	7,686	8,367	9,297
Cash and Bank Balances	3,185	13,664	18,993	23,792
Loans and Advances	168	366	254	435
Other Current Assets	3,005	3,951	4,021	4,740
Less: Current Liabilities & Provisions	17,534	16,891	19,467	20,522
Payables	12,639	12,810	13,945	15,496
Other Current Liabilities	4,895	4,080	5,522	5,026
sub total				
Net Current Assets	10,994	24,928	29,702	37,439
Total Assets	35,587	51,498	58,453	67,025

E – Estimates

Important Ratios

Particulars	FY20A	FY21E	FY22E	FY23E
(A) Margins (%)				
Gross Profit Margin	33.7	33.1	32.7	33.2
EBIDTA Margin	11.7	11.8	12.1	13.5
EBIT Margin	9.9	9.9	10.3	11.9
Tax rate	23.3	25.5	25.5	25.5
Net Profit Margin	8.7	9.0	9.4	10.7
(B) As Percentage of Net Sales (%)				
COGS	66.3	66.9	67.3	66.8
Employee	8.9	9.1	8.3	8.1
Other	13.1	12.3	12.4	11.6
(C) Measure of Financial Status				
Gross Debt / Equity	0.0	0.0	0.0	0.0
Interest Coverage	37.0	121.7	177.9	264.1
Inventory days	52	52	47	47
Debtors days	48	48	45	45
Average Cost of Debt	9.2	11.0	11.0	11.0
Payable days	80	80	75	75
Working Capital days	70	156	160	181
FA T/O	3.4	3.2	3.4	3.7
(D) Measures of Investment				
AEPS (Rs)	48.9	51.9	63.2	79.9
CEPS (Rs)	59.3	62.9	74.8	92.3
DPS (Rs)	3.6	5.1	5.1	5.8
Dividend Payout (%)	7.4	9.8	8.1	7.3
BVPS (Rs)	344.2	502.6	571.9	657.2
RoANW (%)	15.5	12.3	11.8	13.0
RoACE (%)	14.7	12.2	11.7	12.9
RoAIC (%)	17.9	16.5	18.1	21.6
(E) Valuation Ratios				
CMP (Rs)	1106	1106	1106	1106
P/E	22.6	21.3	17.5	13.8
Mcap (Rs Mn)	1,34,237	1,34,237	1,34,237	1,34,237
MCap/ Sales	2.3	2.3	2.0	1.8
EV	1,25,152	1,13,073	1,06,694	1,00,845
EV/Sales	2.2	1.9	1.6	1.3
EV/EBITDA	18.5	16.4	13.0	9.9
P/BV	3.2	2.2	1.9	1.7
Dividend Yield (%)	0.3	0.5	0.5	0.5
(F) Growth Rate (%)				
Revenue	(7.0)	1.5	16.1	11.1
EBITDA	(7.8)	2.2	18.5	24.7
EBIT	(11.8)	1.4	20.9	27.7
PBT	(6.0)	7.1	21.9	26.4
APAT	4.6	6.0	21.8	26.4
EPS	4.6	6.0	21.8	26.4
Cash Flow				
(Rs Mn)	FY20A	FY21E	FY22E	FY23E
CFO	8,860	4,391	9,102	7,371
CFI	(5,173)	(4,529)	(4,297)	(3,028)
CFF	(2,814)	10,618	524	456
FCFF	6,528	1,896	6,532	5,801
Opening Cash	2,312	3,185	13,664	18,993
Closing Cash	3,185	13,664	18,993	23,792

E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	> 20%
Accumulate	10 to 20%
Reduce	0 to 10%
Sell	< 0%

Rating and Target Price History



Month	Rating	TP (Rs.)	Price (Rs.)
May-20	Reduce	798	824

*Price as on recommendation date

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