

Healthy growth, stellar margin performance

- Escorts (ESC) reported strong all-round performance in Q2FY21. EBITDA jumped 137% YoY to Rs 3bn with significant margin expansion at 18.3% (+878bps YoY; +708bps QoQ) on account of better mix (2/3rd sales for 40HP and above tractor), softening of commodity prices and cost control measures.
- The net revenue grew 24% YoY to Rs 16.4bn led by 32.8% growth in Agri machinery products and 26.4% growth in railway equipment, partially offset by 22% de-growth in the Construction equipment segment.
- Management stated that the overall rural sentiment is positive because of the record output of Rabi crop along with better realization, strong Kharif sowing season and easy availability of retail finance.
- Management expects demand momentum to continue with supply chain issues smoothing out. Moreover, the current inventory at channel level is very low and re-stocking will also aid in volume growth in the coming quarters.
- Construction equipment demand is also picking up with revival in the macro-economic activities. The railway segment order book has been slower due to postponement of orders to FY22. However, management expects the situation to improve by January'21 with resumption of normalcy.
- We sense margin to taper off in coming quarter due to 1) sharp up move in commodity prices and normalization of product mix. We increase EPS estimates by 14/4% for FY22/23E factoring in expansion in margin led by better mix and cost control measures. We forecast 16% EPS CAGR over FY20-23E and value the stock Rs 1,334 (16x for FY23E EPS) and retain Accumulate rating.

Tractors sales continue to be on strong footing

Rural agriculture demand has been encouraging due to favorable macro-economic factors with good monsoons, bumper Rabi harvest and Kharif sowing season and ample availability of retail finance with good cash flows for the farmers. (contd.)

Q2FY21 Result (Rs Mn)

Particulars	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)
Revenue	16,397	13,239	23.9	10,616	54.5
Total Expense	13,389	11,972	11.8	9,420	42.1
EBITDA	3,009	1,267	137.4	1,196	151.5
Depreciation	274	260	5.2	264	3.5
EBIT	2,735	1,007	171.6	932	193.5
Other Income	376	211	78.4	298	25.9
Interest	32	39	(16.6)	19	66.3
EBT	3,078	1,271	142.1	1,211	154.2
Tax	779	41	1805.4	289	169.4
RPAT	2,299	1,230	86.9	922	149.5
APAT	2,299	1,138	102.0	922	149.5
			(bps)		(bps)
Gross Margin (%)	36.4	33.0	345	32.9	358
EBITDA Margin (%)	18.3	9.6	878	11.3	708
NPM (%)	14.0	9.3	473	8.7	534
Tax Rate (%)	25.3	3.2	2210	23.9	142
EBIT Margin (%)	16.7	7.6	907	8.8	790

CMP	Rs 1,218
Target / Upside	Rs 1,334 / 10%
NIFTY	11,669

Scrip Details

Equity / FV	Rs 1,226mn / Rs 10
Market Cap	Rs 148bn
	USD 2bn
52-week High/Low	Rs 1,343/ 736
Avg. Volume (no)	23,88,430
Bloom Code	ESC IN

Price Performance	1M	3M	12M
Absolute (%)	(4)	11	87
Rel to NIFTY (%)	(4)	8	92

Shareholding Pattern

	Mar'20	Jun'20	Sep'20
Promoters	40.3	40.3	36.6
MF/Banks/FIs	10.0	10.0	8.5
FIs	19.3	20.4	30.7
Public / Others	30.5	29.4	24.2

Valuation (x)

	FY21E	FY22E	FY23E
P/E	17.8	16.9	14.6
EV/EBITDA	13.7	12.6	10.5
ROE (%)	15.8	12.9	13.0
RoACE (%)	15.7	12.8	12.9

Estimates (Rs mn)

	FY21E	FY22E	FY23E
Revenue	61,500	69,701	76,861
EBITDA	9,136	9,368	10,664
PAT	6,908	7,278	8,430
EPS (Rs.)	68.3	72.0	83.4

Analyst: Abhishek Jain

Tel: +9122 40969739

E-mail: abhishekj@dolatcapital.com

Associate: Ketul Dalal

Tel: +91 22 4096 9770

E-mail: ketuld@dolatcapital.com

In addition, expanding market presence across domestic and international markets, combined with enhanced product offerings in its three core businesses would be the key driver for medium to long term growth. Outlook for the CE business is also improving with ramp up in infra activities. Improving cost structure in the construction equipment business, better traction in the high-margin railway business, are likely to help to protect margins. No major capex in the near-term 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 Est	Var (%)	Comments
Revenue	16,397	15,293	7	
EBIDTA	3,009	1,820	65	Better mix, higher contribution from tractor and railway division and cost control measures
EBIDTA Margin (%)	18.3	11.9	645bps	
PAT	2,299	1,427	61	Higher other income

Source: Company, DART

Exhibit 2: Change in estimates

(Rs mn)	FY22E			FY23E		
	New	Previous	% Change	New	Previous	% Change
Volumes (units)	1,01,323	98,646	2.7	1,08,942	1,06,364	2.4
Net sales	69,701	67,866	2.7	76,861	75,413	1.9
EBITDA	9,368	8,179	14.5	10,664	10,197	4.6
EBITDA margin(%)	13.44	12.05	139bps	13.87	13.52	35bps
APAT	7,278	6,392	13.9	8,430	8,081	4.3
EPS (Rs)	72.0	63.2	13.9	83.4	79.9	4.3

Source: Company, DART

Exhibit 3: Key Assumption Sheet

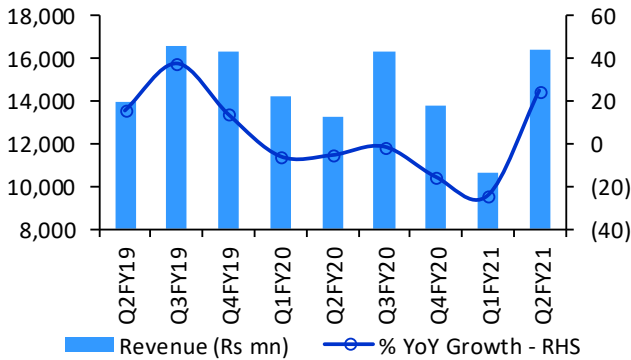
(Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Tractor Volume (units)	96,412	86,018	94,341	1,01,323	1,08,942
% YoY	19.9	(10.8)	9.7	7.4	7.5
Revenue (Rs mn)					
Agri Machinery Products	47,440	44,376	50,193	54,546	59,824
% YoY	19.9	(6.5)	13.1	8.7	9.7
Railway Equipment	3,941	4,772	5,056	6,231	6,915
% YoY	37.5	21.1	5.9	23.2	11.0
Construction Equipment	10,541	8,398	6,240	8,924	10,122
% YoY	35.1	(20.3)	(25.7)	43.0	13.4
Total Sales	61,964	57,610	61,500	69,701	76,861
% YoY	23.3	(7.0)	6.8	13.3	10.3

Source: DART, Company

Key Concall Takeaways

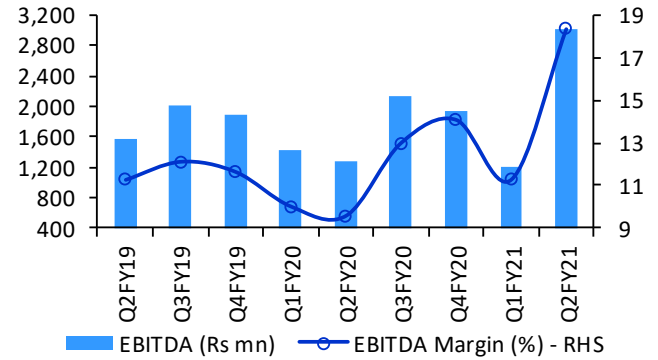
- EBITDA margin improved to 18.3% on account of better product mix (2/3rd sales for 40HP and above), cost optimization initiatives, operating leverage and low commodity costs. Expect margins to be in the range of 16-17% in the coming quarters with resumption of normalcy in operating costs and commodity cost inflation.
- Shift in demand towards higher HP tractors was on account of lower demand of haulage in commercial vehicles (lower HP tractors) which led to benefit of Rs 180-200mn at EBITDA level for Escorts.
- In Q2FY21, Tractor industry grew 30% YoY in North and central region and 56% YoY in South and west region. The management is hopeful for strong growth in 2HFY21 and now expects FY21 domestic tractor industry to grow at low double digit levels.
- Escorts tractor market share declined due to supply chain constraints as company maintains lean inventory. Challenging to maintain market share similar to FY20 levels.
- Management hopes to resolve supply chain challenges within a month or so and is witnessing some positive developments in the construction and railway equipment space as well and is hopeful of full recovery soon.
- Rural agriculture demand has been encouraging due to favorable macro-economic factors with good monsoons, bumper Rabi harvest and Kharif sowing season and ample availability of retail finance with good cash flows for the farmers.
- Capacity utilization was at 85% for tractor segment for Q2FY21. The company is currently operating at peak capacity utilization and produced 11,000 tractors in the months of September and October each.
- The railway segment order book has been slower due to postponement of orders to FY22. However, expects situation to improve by January'21.
- The construction equipment EBIT margin is expected to be in the range of 3-4%, similar to last year.
- Current inventory level is very low at channel and depot level industry wide due to supply chain constraints.
- Debtor days are lower as the company is pushing dealers to adapt the cash and carry method due to good financial condition of buyers.
- Company is debt free as of Q2FY21 end vs (Rs 600mn debt at Q1FY21 end).
- Company currently has 1,050 dealerships.
- Contract manufacturing for Escorts and Kubota products started from Q2FY21. Both teams are currently discussing the joint development of new products.
- Escorts has a planned capex of Rs 2.50bn in FY21 towards new product development, capacity addition in the machining division to be used for both, Escorts standalone and Kubota JV. With increase in capacity, Escorts to have production capacity 1,50,000 tractors (from 1,20,000 currently) in addition to 50,000 tractors from the Kubota JV.

Exhibit 4: Revenue grew 24% YoY



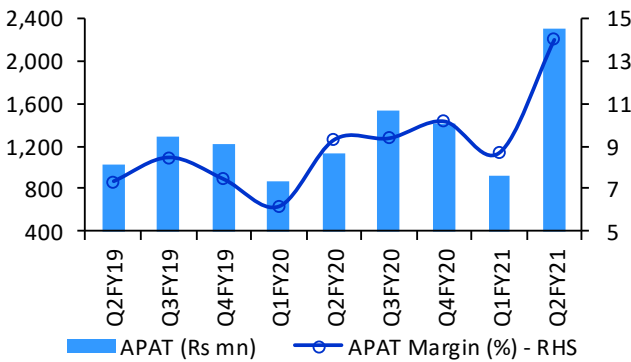
Source: DART, Company

Exhibit 5: EBITDA margin expanded YoY/QoQ



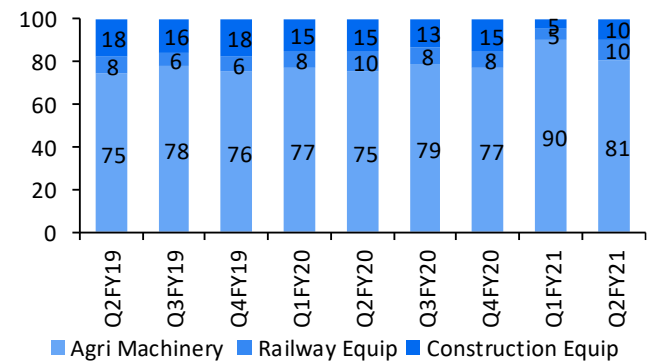
Source: DART, Company

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



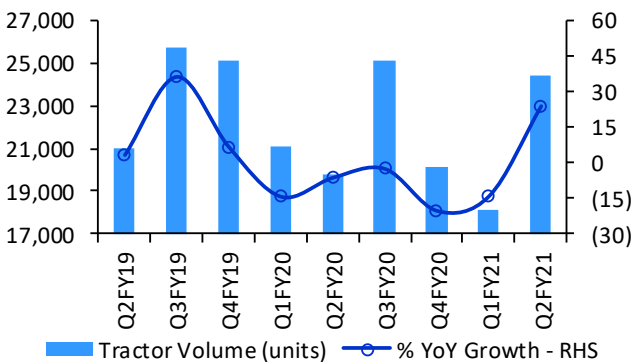
Source: DART, Company

Exhibit 7: Segmental Mix (%)



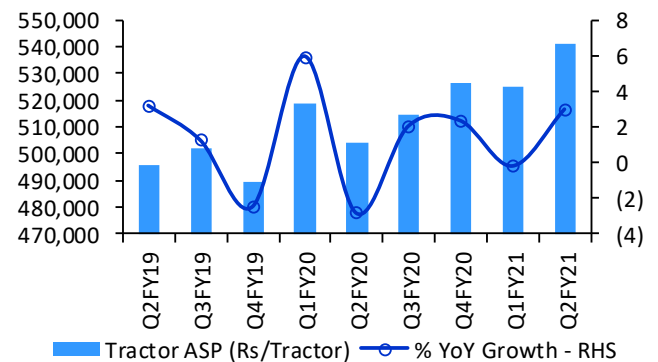
Source: DART, Company

Exhibit 8: Tractor volume (units) grew 24% YoY



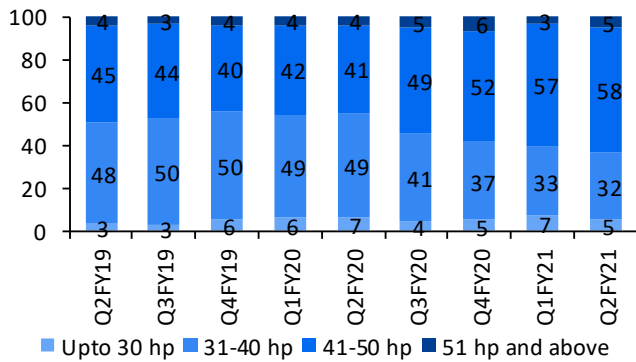
Source: DART, Company

Exhibit 9: Tractor ASP remained firm



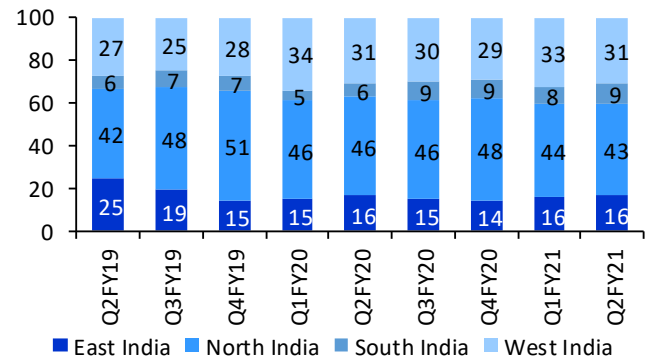
Source: DART, Company

Exhibit 10: Escorts Domestic HP segment share (%)



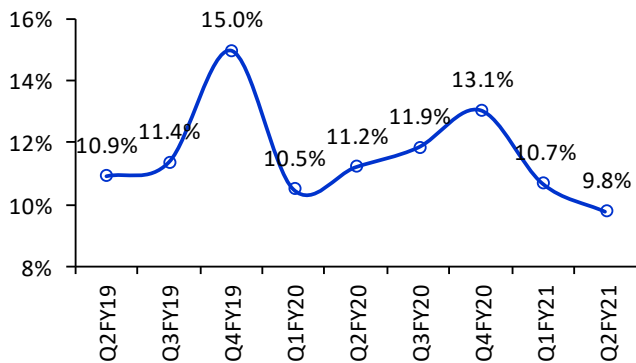
Source: DART, Company

Exhibit 11: Escorts Domestic region wise share (%)



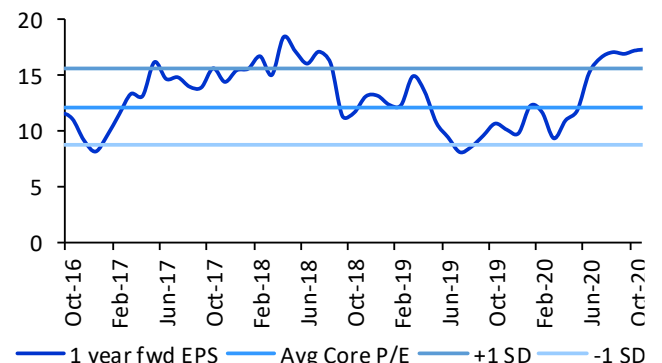
Source: DART, Company

Exhibit 12: Escorts Market share Domestic 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	61,500	69,701	76,861
Total Expense	50,851	52,364	60,333	66,197
COGS	38,196	40,138	46,003	50,933
Employees Cost	5,103	5,345	5,781	6,202
Other expenses	7,552	6,880	8,549	9,062
EBIDTA	6,758	9,136	9,368	10,664
Depreciation	1,046	1,108	1,175	1,253
EBIT	5,713	8,028	8,194	9,412
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	9,272	9,769	11,315
Tax	1,533	2,364	2,491	2,885
RPAT	5,040	6,908	7,278	8,430
Minority Interest	0	0	0	0
Profit/Loss share of associates	0	0	0	0
APAT	4,948	6,908	7,278	8,430

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	51,248	59,140	68,109
Net Worth	34,801	52,474	60,365	69,335
Total Debt	483	383	333	283
Net Deferred Tax Liability	303	303	303	303
Total Capital Employed	35,587	53,160	61,001	69,921

Applications of Funds

Net Block	17,081	18,467	19,888	20,230
CWIP	1,044	1,044	1,019	994
Investments	6,468	7,181	7,796	8,468
Current Assets, Loans & Advances	28,528	44,386	52,052	61,336
Inventories	8,222	8,485	8,986	10,038
Receivables	7,565	8,088	8,593	9,476
Cash and Bank Balances	3,185	15,219	21,472	26,419
Loans and Advances	168	394	243	460
Other Current Assets	3,005	4,318	3,874	5,060
Less: Current Liabilities & Provisions	17,534	17,919	19,753	21,107
Payables	12,639	13,479	14,322	15,793
Other Current Liabilities	4,895	4,440	5,431	5,314
<i>sub total</i>				
Net Current Assets	10,994	26,467	32,298	40,229
Total Assets	35,587	53,160	61,001	69,921

E – Estimates

Important Ratios

Particulars	FY20A	FY21E	FY22E	FY23E
(A) Margins (%)				
Gross Profit Margin	33.7	34.7	34.0	33.7
EBIDTA Margin	11.7	14.9	13.4	13.9
EBIT Margin	9.9	13.1	11.8	12.2
Tax rate	23.3	25.5	25.5	25.5
Net Profit Margin	8.7	11.2	10.4	11.0
(B) As Percentage of Net Sales (%)				
COGS	66.3	65.3	66.0	66.3
Employee	8.9	8.7	8.3	8.1
Other	13.1	11.2	12.3	11.8
(C) Measure of Financial Status				
Gross Debt / Equity	0.0	0.0	0.0	0.0
Interest Coverage	37.0	168.6	208.1	277.9
Inventory days	52	50	47	48
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	157	169	191
FA T/O	3.4	3.3	3.5	3.8
(D) Measures of Investment				
AEPS (Rs)	48.9	68.3	72.0	83.4
CEPS (Rs)	59.3	79.3	83.6	95.8
DPS (Rs)	2.5	3.5	3.5	4.0
Dividend Payout (%)	5.1	5.1	4.9	4.8
BVPS (Rs)	344.2	519.0	597.1	685.8
RoANW (%)	15.5	15.8	12.9	13.0
RoACE (%)	14.7	15.7	12.8	12.9
RoAIC (%)	17.9	22.8	21.2	22.7
(E) Valuation Ratios				
CMP (Rs)	1218	1218	1218	1218
P/E	24.9	17.8	16.9	14.6
Mcap (Rs Mn)	1,47,837	1,47,837	1,47,837	1,47,837
MCap/ Sales	2.6	2.4	2.1	1.9
EV	1,38,752	1,25,118	1,17,815	1,11,818
EV/Sales	2.4	2.0	1.7	1.5
EV/EBITDA	20.5	13.7	12.6	10.5
P/BV	3.5	2.3	2.0	1.8
Dividend Yield (%)	0.2	0.3	0.3	0.3
(F) Growth Rate (%)				
Revenue	(7.0)	6.8	13.3	10.3
EBITDA	(7.8)	35.2	2.5	13.8
EBIT	(11.8)	40.5	2.1	14.9
PBT	(6.0)	41.1	5.4	15.8
APAT	4.6	39.6	5.4	15.8
EPS	4.6	39.6	5.4	15.8
Cash Flow				
(Rs Mn)	FY20A	FY21E	FY22E	FY23E
CFO	8,860	6,068	9,855	7,674
CFI	(5,173)	(4,651)	(4,126)	(3,183)
CFF	(2,814)	10,618	524	456
FCFF	6,528	3,573	7,285	6,104
Opening Cash	2,312	3,185	15,219	21,472
Closing Cash	3,185	15,219	21,472	26,419

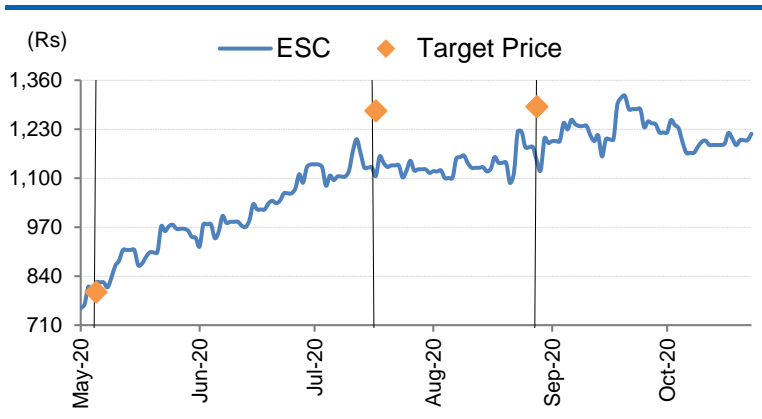
E – Estimates

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
Jul-20	Accumulate	1,279	1,106
Sep-20	Accumulate	1,290	1,146

*Price as on recommendation date

DART Team

Purvag Shah	Managing Director	purvag@dolatcapital.com	+9122 4096 9747
Amit Khurana, CFA	Head of Equities	amit@dolatcapital.com	+9122 4096 9745

CONTACT DETAILS

Equity Sales	Designation	E-mail	Direct Lines
Dinesh Bajaj	VP - Equity Sales	dineshb@dolatcapital.com	+9122 4096 9709
Kapil Yadav	VP - Equity Sales	kapil@dolatcapital.com	+9122 4096 9735
Yomika Agarwal	VP - Equity Sales	yomika@dolatcapital.com	+9122 4096 9772
Jubbin Shah	VP - Derivatives Sales	jubbins@dolatcapital.com	+9122 4096 9779
Ashwani Kandoi	AVP - Equity Sales	ashwanik@dolatcapital.com	+9122 4096 9725
Lekha Nahar	AVP - Equity Sales	lekhan@dolatcapital.com	+9122 4096 9740
Equity Trading	Designation	E-mail	
P. Sridhar	SVP and Head of Sales Trading	sridhar@dolatcapital.com	+9122 4096 9728
Chandrakant Ware	VP - Sales Trading	chandrakant@dolatcapital.com	+9122 4096 9707
Shirish Thakkar	VP - Head Domestic Derivatives Sales Trading	shirisht@dolatcapital.com	+9122 4096 9702
Kartik Mehta	Asia Head Derivatives	kartikm@dolatcapital.com	+9122 4096 9715
Dinesh Mehta	Co- Head Asia Derivatives	dinesh.mehta@dolatcapital.com	+9122 4096 9765
Bhavin Mehta	VP - Derivatives Strategist	bhavinm@dolatcapital.com	+9122 4096 9705

Dolat Capital Market Private Limited.

Sunshine Tower, 28th Floor, Senapati Bapat Marg, Dadar (West), Mumbai 400013

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SEBI Registration No: BSE - INB010710052 & INF010710052, NSE - INB230710031& INF230710031, Research: INH000000685

Registered office: Office No. 141, Centre Point, Somnath, Daman – 396 210, Daman & Diu

Board: +9122 40969700 | Fax: +9122 22651278 | Email: research@dolatcapital.com | www.dolatresearch.com
