

All-round optimism bolsters constructive view...

Escorts reported stellar Q2FY21 results. Total operating income for Q2FY21 came in at ₹ 1,640 crore, up 24% YoY. Within its segments, gross revenue from agri equipment machinery (EAM), tractors were at ₹ 1,322 crore (volumes up 23.8% to 24,441 units, ASPs up 7.7% YoY to ₹ 5.4 lakh/unit). Gross revenue from construction equipment (CE) de-grew 22% YoY to ₹ 157 crore (volumes down 13% YoY to 821 units) while railway equipment division (RED) revenues grew 26.4% YoY to ₹ 160 crore. EBITDA margins came in at multi-year high of 18.3% (up 878 bps YoY). The improvement in margins was attributable to tractor division recording 20% EBIT margins for the quarter (up 973 bps YoY) on the back of improved product mix, operating leverage benefits and cost control initiatives. Consequent standalone PAT in Q2FY21 came in at ₹ 229 crore, up 119% YoY.

Strong tractor demand, bottoming out CE cycle bodes well

The substantial divergence in domestic tractor industry performance vis-à-vis other pockets of the auto industry in post Covid months continues unabated. Retail tractor volumes (using Vahan data as proxy) have grown ~40% YoY in June-October 2020 vs. double-digit decline in other segments. Farm sentiment and cash flows have been positive, fuelled by remunerative crop prices, normal monsoons, sustained government support and lower pandemic incidence. Escorts expects the industry to post low double-digit YoY growth for FY21E. We build 9% tractor volume CAGR over FY20-23E. Pick-up in infrastructure and construction activity along with revival of government spends also boost the outlook for Escorts CE division (~36% market share in cranes, also serves backhoe loaders and compactors), which formed ~15% of FY20 revenues. RED (~8% of FY20 revenues) has an orderbook of >₹ 350 crore (to be executed in six to eight months), with railway tendering activity expected to normalise from Q4FY21E.

Margins set to move to higher plane

Blended margin trajectory at Escorts has undergone a drastic improvement (~6% in FY14 to ~11.7% as of FY20), backed by volume growth and product mix improvement. The company posted highest ever quarterly EBIT margin of 20% in tractors during Q2FY21, riding on sharp product mix improvement (>40 hp segment forming about two-third of sales vs. 45% last year, cost initiatives, operating leverage). Commodity cost pressures and normalisation of some stated benefits is seen shaving ~100-200 bps off the record print. However, the management expects ~17-18% EBIT margin levels to be sustainable in coming quarters. This is expected to lead to further steep jump in blended EBITDA margins to ~15%, going forward.

Valuation & Outlook

Sales, PAT FY20-23E CAGR is seen at ~11%, 27%, respectively. Continued strength in tractors and positive margin guidance help us retain **BUY** rating on Escorts. We value it at ₹ 1,460 (SOTP, 17x P/E on average core FY22E & 23E EPS, 20% holding company discount to its treasury shares).

Key Financial Summary

Key Financials	FY19	FY20	FY21E	FY22E	FY23E	CAGR (FY20-23E)
Net Sales	6,196.4	5,761.0	6,126.0	7,022.4	7,833.8	10.8%
EBITDA	733.3	675.8	919.4	1,061.4	1,198.8	21.1%
EBITDA Margins (%)	11.8	11.7	15.0	15.1	15.3	
Net Profit	484.9	485.6	729.1	870.2	991.4	26.9%
EPS (₹)	39.6	39.6	59.5	71.0	80.9	
P/E	30.8	30.8	20.5	17.2	15.1	
RoNW (%)	15.6	14.2	14.0	14.5	14.3	
RoCE (%)	19.3	16.2	15.3	15.3	14.9	

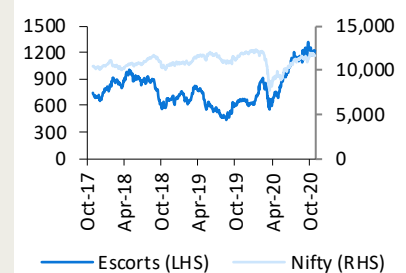
Source: ICICI Direct Research, Company



Particulars

Particular	₹ crore
Market Capitalization	14,945.0
Total Debt (FY 20)	6.6
Cash & Investments (FY 20)	956.6
EV	13,995.0
52 week H/L (₹)	1343 / 527
Equity capital (₹crore)	122.6
Face value	₹ 10

Price chart



Key Highlights

- Revenues rose 24% YoY in Q2FY21 tracking ~24% YoY tractor volume growth
- Margins jump sharply to 18.3% amid best ever tractor EBIT margins of 20% courtesy operating leverage and better mix
- Post Covid tractor recovery going strong, tailwinds set to continue. Sustainable tractor EBIT margin guidance of 17-18% to take blended margins to a higher plane
- Maintain BUY with revised target price of ₹ 1,460/share, valuing core business at 17x average of FY22E & FY23E EPS

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Exhibit 1: Variance Analysis

₹ crore	Q2FY21	Q1FY21E	Q2FY20	YoY (Chg %)	Q1FY21	QoQ (Chg %)	Comments
Total Operating Income	1,639.7	1,514.2	1,323.9	23.9	1,061.6	54.5	Topline came in ahead of estimates tracking beat on ASPs in tractor division and better than anticipated revenues in railway division
Raw Material Expenses	914.6	893.4	782.9	16.8	641.1	42.7	RM to sales came in substantially lower at 63.6% of sales vs. its usual trend of 65%+
Purchase of Traded Goods	127.7	98.4	104.2	22.5	71.7	77.9	
Employee Expenses	125.6	128.7	125.3	0.2	126.2	-0.5	Other expenses were controlled due to cost saving initiatives at company
Other Expenditure	171.1	196.8	184.7	-7.4	103.1	66.0	
EBITDA	300.9	196.8	126.7	137.5	119.6	151.6	EBITDA & EBITDA margin for the company came in substantially higher tracking savings in all overheads (RM, employee costs, other exp)
EBITDA Margin (%)	18.3	13.0	9.6	878 bps	11.3	709 bps	
Interest	3.2	1.7	3.9	-16.6	1.9	68.9	
Depreciation	27.4	29.3	26.0	5.2	26.4	3.6	Depreciation came in largely on expected lines
Total Tax	77.9	53.5	4.1	1,805.4	28.9	169.4	
PAT	228.9	160.3	104.6	118.9	90.7	152.3	PAT for quarter more than doubled to ₹ 229 crore tracking substantially high EBITDA margins
Key Metrics (₹ crore)							
Tractor Segment revenue	1,322	1,290	996	32.8	954	38.7	Tractor segment revenues came in higher due to better product mix and consequent rise in ASPs. Tractor realisation for quarter at ₹ 5.4 lakh/unit, up 3% QoQ
Construction Equipment revenue	157	135	201	-21.9	53	198.9	
Railway Equipment revenue	160	89	127	26.4	55	191.8	Railway segment revenues came in better than our estimates at ₹ 160 crore for Q2FY21

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

₹ Crore)	FY21E			FY22E			FY23E	Comments
	Old	New	% Change	Old	New	% Change	Introduced	
Revenue	5,899.2	6,126.0	3.8	6,649.2	7,022.4	5.6	7,833.8	Upgrade our tractor segment revenue estimates tracking robust tractor demand domestically, improving product mix. Introduce FY23E estimates. We expect revenues to grow at 10.8% CAGR over FY20-23E
EBITDA	728.6	919.4	26.2	847.8	1,061.4	25.2	1,198.8	
EBITDA Margin (%)	12.4	15.0	260 bps	12.8	15.1	230 bps	15.3	Upgrade our margin estimates for FY21E-22E post sharp improvement in EBITDA margin seen in Q2FY21 with management guidance of sustaining large part of efficiencies. Introduce FY23E estimates
PAT	565.3	729.1	29.0	668.6	870.2	30.2	991.4	
EPS (₹)	46.1	59.5	29.0	54.5	71.0	30.2	80.9	Upgrade in revenue & margin estimates leads to sharp upgrade in earnings estimates for FY21-22E. We expect earnings to grow at 27% CAGR over FY20-23E

Source: ICICI Direct Research

Exhibit 3: Assumptions

	Current			Earlier			Comments		
	FY18	FY19	FY20	FY21E	FY22E	FY23E		FY21E	FY22E
Tractor volumes (no's)	80,417	96,412	86,018	94,591	104,047	111,330	88,182	94,787	Upgrade volume estimates tracking upbeat tractor demand domestically. We expect tractor sales volume to grow at 9% CAGR over FY20-23E
Average ASP (₹)	492,166	492,053	515,890	532,032	546,329	557,310	529,533	538,512	Better product mix leads to marginal upgrade in ASPs

Source: ICICI Direct Research

Q2FY21 earnings conference call highlights

Tractors division

- At the industry level, tractor demand, so far, has included an element of pent up demand. However, a confluence of supportive factors for rural cash flows and sentiment, such as remunerative Rabi harvest, higher Kharif production, normal monsoons, continued government focus on farm incomes and rural infrastructure and easing financing availability are expected to continue to act as tailwinds in coming months. **Escorts expects the industry to clock low double-digit YoY growth in FY21E**
- The company is operating at peak capacity (~10,000 units per month). Supply constraints have continued to impact output. However, these are seen easing over the next few weeks. Demand continues to outstrip production, with inventory levels low. **The company would be expanding capacities by ~2,500 per month, taking total capacities to 1.5 lakh units per annum at a cost of ~₹ 90-100 crore, with total capex spends for FY21E seen at ~₹ 250-260 crore**
- Stellar margin improvement during Q2FY21 was attributable to improved product mix (~65% from > 40 hp segment vs. 45% in Q2FY20 and 62% in Q1FY21; impact of ~₹ 20 crore), operating leverage benefits, soft commodity prices and lower selling and distribution expenses. Product mix improved for the better courtesy lower demand from lower hp haulage segment (due to reduced infrastructure activity during the quarter). The same is expected to move towards more normal levels in coming months. Similarly, rise in commodity costs (3-4%) and incrementally higher selling costs would lead to ~100-200 bps reduction from Q2FY21 margins. **The management believes ~17-18% EBIT margins in tractor business is sustainable over the next few quarters**
- The tractor industry grew ~30% YoY in the north and central markets in Q2FY21 vs. 56% growth in south and west markets. Low base of last year aided in higher growth in those geographies. South and west markets are seen outperforming in H2FY21E also
- Tractor market share as of Q2FY21 was at 9.8%, down 144 bps YoY. Supply constraints led to market share loss. The company said it would be difficult to come back to previous ~11% range by the end of the year

Construction Equipment division (CE)

- In construction equipment industry, total volumes rose ~31% YoY comprising 44% growth in backhoe loaders, 47% growth in compactors and 20% decline in cranes. Escorts volumes fell 13% (derives ~60% from cranes), with capacity utilisation at ~30%
- Escorts expects to witness greater momentum in H2FY21E amid a pick-up in government infrastructure spending. **Margins are seen being maintained at last year's levels. The company said the worst looks over for the CE industry**
- Escorts is targeting reduced breakeven of ~200-210 units per month by the end of the year

Railway Equipment division (RED)

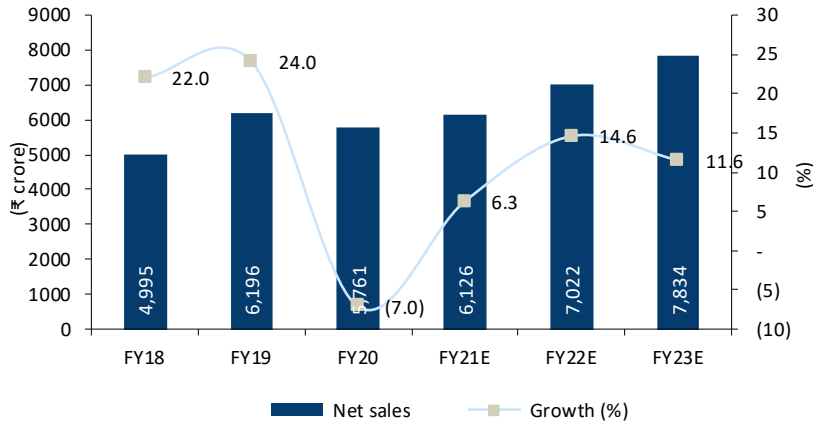
- Covid disruption and suspension of most rail services in the country affected order inflow in RED. Escorts expects ordering to go back to pre Covid levels by Q4FY21E. **It expects the division to post YoY growth in FY21E with margins maintained at last year's levels.** Present orderbook of >₹ 350 crore is to be executed over the next six to eight months

Others

- In respect of the strong cash generation, the company said that probable uses for the same would be deployment for business purposes and also possibly for distribution to shareholders

Financial story in charts

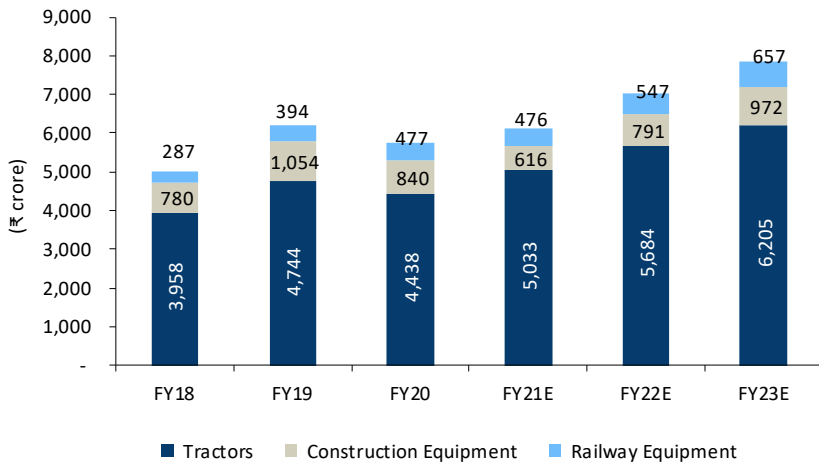
Exhibit 4: Total operating income trend



We expect total operating income to grow at ~11% CAGR over FY20-23E on the back of 9% growth in tractor volumes

Source: Company, ICICI Direct Research

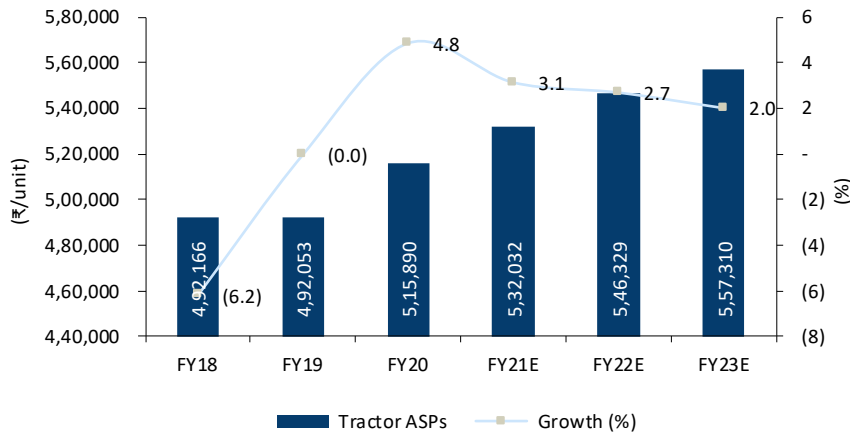
Exhibit 5: Segmental revenue mix



Tractors continue to dominate total sales with their share in total sales pie at ~77% as of FY20. Construction equipment constitute ~15% of sales while railways segment constitutes the rest at ~8%

Source: Company, ICICI Direct Research

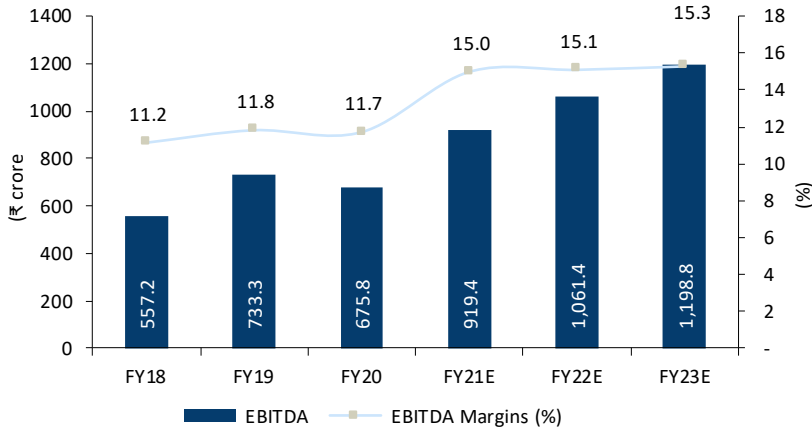
Exhibit 6: Trend in tractor ASPs



Tractor ASPs are expected to grow at 2.6% CAGR over FY20-23E on improvement in product mix

Source: Company, ICICI Direct Research

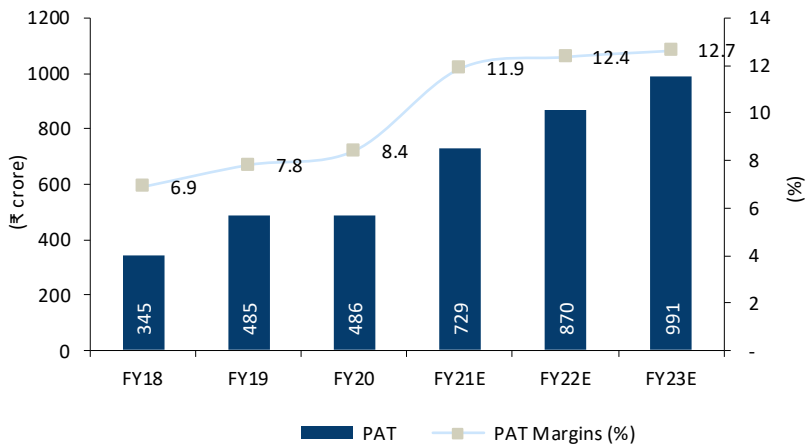
Exhibit 7: EBITDA trend and margin profile



EBITDA margins are seen moving to ~15% levels, going forward, amid rise in core tractor business EBIT margins

Source: Company, ICICI Direct Research

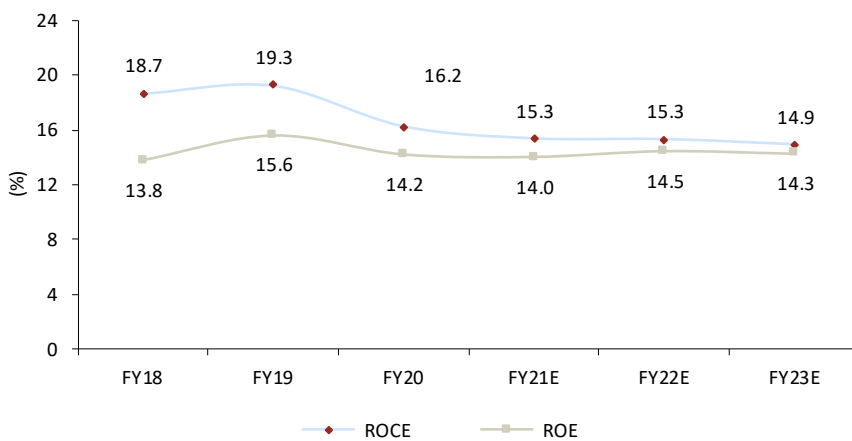
Exhibit 8: Profitability trend



PAT is seen growing at ~27% CAGR over FY20-23E to ₹ 991 crore

Source: Company, ICICI Direct Research

Exhibit 9: Trend in return ratios



We expect the company to clock ~15% RoCE levels in coming years. Return ratios look optically suppressed due to substantial cash on company's books

Source: Company, ICICI Direct Research

Exhibit 10: Valuation Summary

	Sales	Growth	EPS	Growth	PE	EV/EBITDA	RoNW	RoCE
	(₹ cr)	(%)	(₹)	(%)	(x)	(x)	(%)	(%)
FY 18	4995	22.0	28.1	114.9	43.4	25.5	13.8	18.7
FY 19	6196	24.0	39.6	40.6	30.8	19.9	15.6	19.3
FY 20	5761	-7.0	39.6	0.1	30.8	20.7	14.2	16.2
FY 21E	6126	6.3	59.5	50.2	20.5	13.4	14.0	15.3
FY 22E	7022	14.6	71.0	19.4	17.2	11.2	14.5	15.3
FY 23E	7834	11.6	80.9	13.9	15.1	9.4	14.3	14.9

Source: Bloomberg, ICICI Direct Research

Exhibit 11: SOTP valuation matrix

Particulars	Amount (₹)
FY22E & FY23E Average EPS (₹/share, A)	75.9
P/E Multiple (x, B)	17.0
Value of Base Business (C = A*B)	1290
No of Treasury Shares (crore)	2.1
Current Market Price (₹/share)	1,220
Value of Investments (₹ crore)	2,617
Holding company discount (%)	20
Revised value of Investments (₹ crore)	2,094
Contribution per share (₹/share, D)	170
Target Price (C+D)	1460
Potential Upside (%)	20

Source: Bloomberg, ICICI Direct Research

Exhibit 12: Shareholding pattern

(in %)	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20
Promoter	40.3	40.3	40.3	36.6	36.6
FII	21.8	20.4	19.3	18.6	21.6
DII	4.8	6.5	10.0	9.1	8.5
Others	33.1	32.8	30.4	35.7	33.3

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 13: Profit and loss statement					₹ crore
(Year-end March)	FY20	FY21E	FY22E	FY23E	
Total operating Income	5,761.0	6,126.0	7,022.4	7,833.8	
Growth (%)	-7.0	6.3	14.6	11.6	
Raw Material Expenses	3,449.3	3,541.9	4,073.0	4,543.6	
Employee Expenses	510.3	519.5	553.7	603.0	
Other expenses	755.2	706.1	842.7	940.1	
Total Operating Expenditure	5,085.1	5,206.7	5,960.9	6,635.0	
EBITDA	675.8	919.4	1061.4	1198.8	
Growth (%)	-7.8	36.0	15.5	12.9	
Depreciation	104.6	117.3	136.5	158.5	
Interest	15.5	5.1	3.6	2.5	
Other Income	92.3	174.2	199.4	220.0	
PBT	638.9	971.2	1,120.7	1,257.8	
Total Tax	153.3	243.5	282.4	317.0	
Tax rate	24.0	25.1	25.2	25.2	
PAT	485.6	729.1	870.2	991.4	
Growth (%)	0.1	50.2	19.4	13.9	
EPS (₹)	39.6	59.5	71.0	80.9	

Source: Company, ICICI Direct Research

Exhibit 14: Cash flow statement					₹ crore
(Year-end March)	FY20	FY21E	FY22E	FY23E	
Profit after Tax	485.6	729.1	870.2	991.4	
Add: Depreciation	104.6	117.3	136.5	158.5	
(Inc)/dec in Current Assets	190.7	303.6	-465.1	-333.6	
(Inc)/dec in CL and Provisions	112.4	-23.7	241.9	218.7	
CF from operating activities	893.1	1126.3	783.5	1035.0	
(Inc)/dec in Investments	-247.2	-1,500.0	-250.0	-500.0	
(Inc)/dec in Fixed Assets	-210.4	-247.0	-280.0	-319.9	
CF from investing activities	-497.5	-1882.7	-597.3	-874.4	
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0	
(Inc)/dec in loan funds	-280.1	-6.6	0.0	0.0	
Dividend paid & dividend tax	-36.8	-42.9	-49.0	-61.3	
(Inc)/dec in Sec. premium	0.0	1,029.8	0.0	0.0	
Others	8.4	0.0	0.0	0.0	
CF from financing activities	-308.5	980.3	-49.0	-61.3	
Net Cash flow	87.1	223.9	137.2	99.3	
Opening Cash	231.1	318.3	542.2	679.4	
Closing Cash	318.3	542.2	679.4	778.7	

Source: Company, ICICI Direct Research

Exhibit 15: Balance Sheet					₹ crore
(Year-end March)	FY20	FY21E	FY22E	FY23E	
Liabilities					
Equity Capital	122.6	122.6	122.6	122.6	
Reserve and Surplus	3,357.5	5,073.5	5,894.7	6,824.8	
Total Shareholders funds	3480.1	5196.1	6017.3	6947.4	
Total Debt	6.6	0.0	0.0	0.0	
Other non-current Liabilities	83.7	84.5	85.4	86.2	
Long-term Provisions	30.1	35.8	41.4	47.1	
Total Liabilities	3600.5	5316.4	6144.1	7080.7	
Assets					
Gross Block	2,645.8	2,945.8	3,245.8	3,545.8	
Less: Acc Depreciation	1,012.7	1,114.2	1,233.6	1,371.0	
Net Block	1,633.0	1,831.6	2,012.2	2,174.8	
Capital WIP	104.4	54.4	29.4	29.4	
Total Fixed Assets	1737.4	1886.0	2041.6	2204.2	
Net Intangible Asset	52.3	33.4	21.3	20.1	
Investments	1,172.8	2,800.5	3,100.5	3,650.5	
Inventory	822.2	755.3	962.0	1,073.1	
Debtors	756.5	587.4	769.6	965.8	
Loans and Advances	37.7	23.6	46.6	31.8	
Other Current Assets	265.8	212.2	265.5	306.5	
Cash	318.3	542.2	679.4	778.7	
Total Current Assets	2,200.4	2,120.7	2,723.1	3,156.0	
Creditors	1,264.0	1,258.8	1,443.0	1,609.7	
Provisions & Other Curr.Liab	447.7	429.2	486.9	538.9	
Total Current Liabilities	1,711.7	1,688.0	1,929.9	2,148.6	
Net Current Assets	488.7	432.7	793.2	1007.4	
Net Deferred Tax Asset	-30.3	-30.3	-30.3	-30.3	
Other non-current assets	119.0	132.7	155.8	166.1	
Application of Funds	3600.5	5316.4	6144.1	7080.7	

Source: Company, ICICI Direct Research

Exhibit 16: Key ratios				
(Year-end March)	FY20	FY21E	FY22E	FY23E
Per share data (₹)				
EPS	39.6	59.5	71.0	80.9
Cash EPS	48.1	69.0	82.1	93.8
BV	283.9	423.9	490.9	566.8
DPS	2.5	3.5	4.0	5.0
Cash Per Share	78.0	218.7	250.3	299.2
Operating Ratios				
EBITDA Margin (%)	11.7	15.0	15.1	15.3
PAT Margin (%)	8.4	11.9	12.4	12.7
Inventory days	52.1	45.0	50.0	50.0
Debtor days	47.9	35.0	40.0	45.0
Creditor days	80.1	75.0	75.0	75.0
Return Ratios (%)				
RoE	14.2	14.0	14.5	14.3
RoCE	16.2	15.3	15.3	14.9
RoIC	23.3	32.2	31.3	31.7
Valuation Ratios (x)				
P/E	30.8	20.5	17.2	15.1
EV / EBITDA	20.7	13.4	11.2	9.4
EV / Net Sales	2.4	2.0	1.7	1.4
Market Cap / Sales	2.6	2.4	2.1	1.9
Price to Book Value	4.3	2.9	2.5	2.2
Solvency Ratios				
Debt/ EBITDA	0.0	0.0	0.0	0.0
Debt / E equity	0.0	0.0	0.0	0.0
Current Ratio	1.4	1.1	1.3	1.3
Quick Ratio	0.8	0.6	0.7	0.7

Source: Company, ICICI Direct Research

Exhibit 17: ICICI Direct coverage universe (Auto & Auto Ancillary)

Sector / Company	CMP	TP	Rating	M Cap	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	(₹)		(₹ Cr)	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Apollo Tyre (APOTYR)	143	120	Hold	8,180	8.3	4.9	8.9	17.2	29.1	16.1	7.4	6.4	5.5	4.7	4.7	6.6	4.8	2.5	4.9
Ashok Leyland (ASHLEY)	84	90	Buy	24,588	0.8	0.3	2.5	103.0	316.3	33.9	22.6	28.1	14.5	4.5	2.3	9.2	4.7	1.1	9.4
Bajaj Auto (BAAUTO)	2,930	3,570	Buy	84,785	176.2	142.5	180.2	16.6	20.6	16.3	13.2	14.7	10.6	23.9	24.1	27.3	25.6	18.5	20.7
Bharat Forge (BHAFOR)	453	415	Hold	21,090	7.5	3.5	13.7	60.4	130.0	33.1	21.2	28.8	15.9	5.8	2.2	7.9	7.8	3.0	11.1
Eicher Motors (EICMOT)	2,100	2,470	Buy	57,246	67.0	46.6	71.3	31.3	45.1	29.5	23.2	29.1	19.9	17.3	11.5	15.4	18.3	11.6	15.4
Escorts (ESCORT)	1,220	1,460	Buy	14,955	39.6	59.5	71.0	30.8	20.5	17.2	20.7	13.4	11.2	16.2	15.3	15.3	14.2	14.0	14.5
Exide Industries (EXIIND)	157	180	Buy	13,345	9.7	6.3	8.9	11.8	18.0	12.9	9.6	11.9	9.2	15.7	10.3	13.5	13.4	8.2	10.7
Hero Moto (HERHON)	2,900	3,450	Buy	57,913	181.9	123.6	161.8	15.9	23.5	17.9	13.0	14.9	11.2	21.3	16.6	20.6	22.7	16.0	19.0
M&M (MAHMAH)	600	760	Buy	74,592	11.2	29.1	40.0	53.8	20.6	15.0	12.3	12.6	9.5	12.9	10.8	13.8	6.4	9.2	11.6
Maruti Suzuki (MARUTI)	6,950	6,335	Reduce	2,09,946	187.1	132.1	191.8	37.2	52.6	36.2	23.9	34.1	22.1	7.4	3.6	7.6	11.7	7.8	10.6
Minda Industries (MININD)	325	370	Hold	8,364	5.9	2.8	10.0	55.0	115.5	32.4	15.1	17.5	11.3	10.2	6.3	12.7	10.3	4.0	13.0
Tata Motors (TATMOT)	135	165	Buy	48,569	-33.3	-16.6	6.1	NM	NM	22.1	5.1	4.8	3.5	1.3	2.8	6.4	-18.7	-10.6	3.7

Source: Bloomberg, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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