

BSE SENSEX
 59,636

S&P CNX
 17,765

CMP: INR1,803 TP: INR1,700 (-6%)
Neutral

Stock Info

	ESC IN
Bloomberg	ESC IN
Equity Shares (m)	135
M.Cap.(INRb)/(USD\$b)	243.1 / 3.3
52-Week Range (INR)	1825 / 1098
1, 6, 12 Rel. Per (%)	20/34/-8
12M Avg Val (INR M)	2099
Free float (%)	63.4

Financials Snapshot (INR b)

INR million	2021	2022E	2023E
Sales	70.1	77.4	78.7
EBITDA	11.3	11.5	11.8
EBITDA Margin (%)	14.4	13.1	13.1
Adj. PAT	8.7	9.1	9.8
EPS (INR)	76.9	90.4	88.8
EPS Gr. (%)	42.5	17.4	-1.7
BV/Sh. (INR)	443.3	580.1	781.1

Ratios

RoE (%)	21.4	16.8	13.5
RoCE (%)	28.6	22.6	18.0
Payout (%)	9.7	6.6	7.9

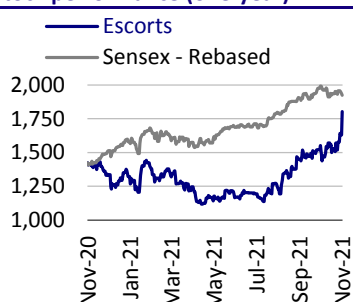
Valuations

P/E (x)	23.4	20.0	20.3
P/BV (x)	4.1	3.1	2.3
EV/EBITDA (x)	17.0	16.4	17.1
Div. Yield (%)	0.4	0.3	0.4
FCF yield (%)	4.2	1.9	3.9

Shareholding pattern (%)

As On	Sep-21	Jun-21	Sep-20
Promoter	36.6	36.6	36.6
DII	7.6	5.6	8.5
FII	23.6	23.4	23.8
Others	32.2	34.4	31.1

FII Includes depository receipts

Stock performance (one-year)

Kubota to hike stake via preferential allotment, open offer
Stake to rise to 53.5% | FY23E cash to increase to INR58.7b

ESC's board on 18th Nov'21 approved sale of ~6.4% stake in the company to Japan's Kubota Corp. for ~INR18.7b (at INR2,000/share), taking Kubota's stake to ~16.4% (after the extinguishment of the first round of treasury shares). This will trigger an open offer by Kubota for a 26% stake in ESC. Assuming the successful open offer and cancellation of all treasury shares, Kubota's stake in ESC will rise to 53.5%. Its stake will rise further as it is consolidating its Indian operations under ESC by merging two JVs in India with ESC. These transactions further strengthen its relationships, which was initiated in Dec'18 through a JV and transited to ~10% stake purchase in Mar'20. With ESC being the only vehicle for Kubota in India, we expect faster leveraging of synergies from the India operations, with easier access to: a) global product knowhow (in Tractors and implements), b) global distribution network, and c) global supply chain (by leveraging India's cost base). Factoring in share capital, excluding treasury, would result in ~9% dilution and ~4% cut in its FY23E EPS. We are also not factoring in mergers of the two JVs with ESC. After the first acquisition of stake in ESC by Kubota, the stock got substantially re-rated (from pre-Kubota LPA P/E of ~11.5x to ~20x currently). With this anticipated event behind us, we expect the focus to shift back to fundamentals. We remain cautious on the Tractor cycle. We now value ESC at 18x (v/s 15x earlier; in line with our target PE multiple for MM's Tractor business) and maintain our Neutral rating with a TP of INR1,700.

- **Transaction details:** ESC will issue ~9.36m shares (or ~6.4% stake) at ~INR2,000/share to Kubota for ~INR18.7b. Subsequently, Kubota will make an open offer to the public shareholders for 26% of ESC's capital (after the proposed extinguishment of the first tranche of treasury shares).
- **Other proposals:** The board has proposed: a) extinguishment of the remaining treasury shares (21.4m shares, or 16.3% stake), b) merger of the two JVs between ESC and Kubota (ESC's stake at 40%) and Escort Finance, c) increase in the number of directors on ESC's board as it plans to have four directors nominated by Kubota (from two currently), four nominated by the promoters, and eight independent directors, and d) change in the name of the company to 'Escorts Kubota Ltd'.
- **Kubota's stake to increase to 53.5%:** After the proposed allotment of shares, Kubota's total stake in ESC would increase to ~16.39% (adjusted for extinguishment of the first phase of treasury shares). Its stake will increase to ~44.8% after the open offer. Post cancellation of the remaining treasury stake, it will increase to ~53.5%.
- **No change in the executive management:** Except for an additional two board seats for Kubota, there wouldn't be any change in the executive positions of the company. Mr. Nikhil Nanda (promoter) will continue to remain the Chairman and MD.
- **Five-year shareholding lock-in for both partners:** As per the shareholders' agreement between Kubota and the promoters, there would be a five-year lock-in equity holding. Mr. Nanda reiterated that they are fully committed to ESC and have no intention of selling any shares.

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- The eventual holding of Kubota and other shareholders will depend on the share swap ratio for the merger of the two JVs and Escort Finance. The two JVs had a combined FY21 revenue/EBITDA/PAT of INR18.b/INR1.2b/INR0.6b.
- The management expects to complete the preferential allotment and open offer by Mar'22.
- **Business level benefits:** This transaction further fortifies its earlier announced synergies and consolidates the entire operations of Kubota in India into ESC (adding ~2.5% market share in India). With ESC being the only vehicle for Kubota in India, we expect faster leveraging of synergies from the India operations as well as much easier access to: a) global product knowhow (in Tractors and implements), b) global distribution network, and c) global supply chain (by leveraging India's cost base). In the domestic market, ESC now would have an additional Tractor brand of Kubota, which will complement its two brands of Farmtrac and Powertrac. Kubota's Tractors are more suited for the wetland/paddy crop.
- The mid-term plan (6-7 years) is being worked upon and will be ready by Jul'22. It would focus on: a) strengthening its Tractor portfolio for India and global markets, b) Agri-implements for India, c) Earthmoving Equipment (Kubota is a global leader in mini Excavators) for India, and d) component sourcing from India. It would also evaluate manufacturing engines in India to meet its global requirement.
- **Cash increase and plans for deployment:** Post this transaction, ESC's cash balance on its books will rise to ~INR59b as of Mar'23 (~25% of its current m-cap). The management said it would finalize its cash deployment plans on completion of its mid-term plan, which may require investments in newer opportunities.

Valuation and view

- For this transaction, we are factoring in an equity stake sale in ESC and cancellation of treasury shares only. Due to limited clarity on various aspects of the partnership, we are not yet factoring in any contribution from this partnership. We are also not factoring in mergers of the two JVs with ESC. Factoring in share capital, excluding treasury, would result in ~9% dilution and ~4% cut in its FY23E EPS.
- Kubota plans to acquire majority stake in ESC lends credence to its commitment to this partnership. It has scope to cover additional areas like implements, Construction Equipment, and component sourcing from India. It has the potential to structurally improve ESC's growth trajectory in the medium to long term.
- After the first acquisition of stake in ESC by Kubota, the stock got substantially re-rated (from pre-Kubota LPA P/E of ~11.5x to ~20x currently). With this anticipated event behind us, we expect the focus to shift back to fundamentals. We remain cautious on the Tractor cycle. We now value ESC at 18x (v/s 15x earlier; in line with our target PE multiple for MM's Tractor business) and maintain our Neutral rating with a TP of INR1,700.

Exhibit 1: ESC's shareholding pattern (%)

% of total	Post pref. allot				
	Current	Post 1st	Post 2nd	Post 1st	Post 2nd
Promoters (Ex Treasury)	11.6	10.8	11.9	14.2	14.2
Treasury	25.0	23.4	16.3	0.0	0.0
Kubota	9.1	15.0	16.4	19.6	53.5
Others	54.3	50.8	55.5	66.3	32.4
Total Shares	100.0	100.0	100.0	100.0	100.0

* Assuming 100% success of open offer (for 26% of capital post 1st phase of extinguishment of shares)

Source: Company, MOFSL

Exhibit 2: Two JVs between ESC and Kubota, to be merged with ESC

INR m	Escorts Kubota India		Kubota Agricultural Machinery India	
	FY20	FY21	FY20	FY21
Revenue	103	3,215	10,865	15,133
EBITDA	51	-299	498	1,476
EBITDA Margin (%)	49.1	-9.3	4.6	9.8
PAT	6	-339	111	892
Remarks	➤ Manufacturing entity with an annual capacity of 50k Tractors		➤ Sells imported Tractors and Agri-machinery in India, sources components for global markets	

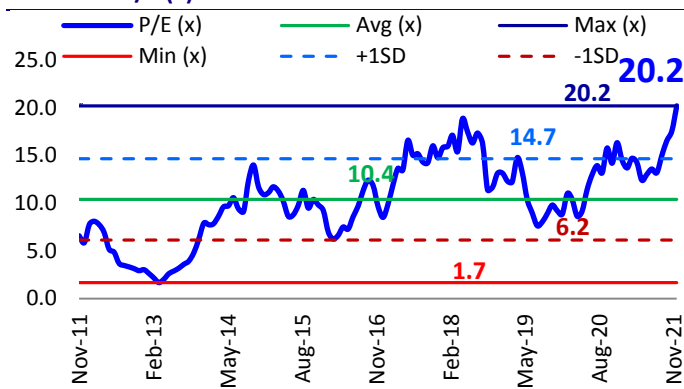
Source:

Exhibit 3: Revised forecast (consolidated)

(INR m)	FY22E			FY23E		
	Revised	Old	Change (%)	Revised	Old	Change (%)
Net Sales	77,355	77,355	0.0	78,743	78,743	0.0
EBITDA	11,487	11,487	0.0	11,772	11,772	0.0
EBITDA (%)	14.9	14.9	0bp	15.0	15.0	0bp
Adj. PAT	9,138	9,138	0.0	9,813	9,335	5.1
EPS (INR)	90.4	90.4	0.0	88.8	92.3	-3.8

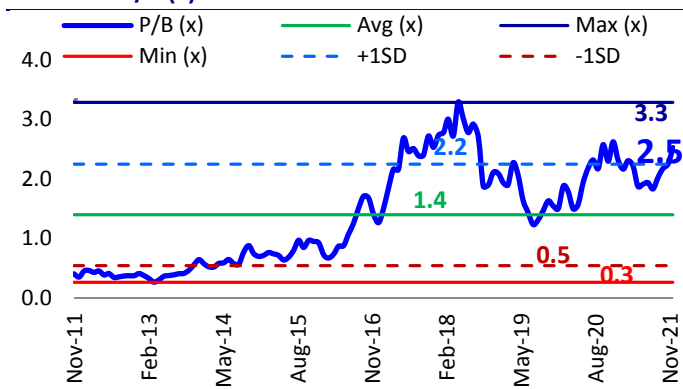
Source: Company, MOFSL

Exhibit 4: P/E (x) trend



Source: MOSL

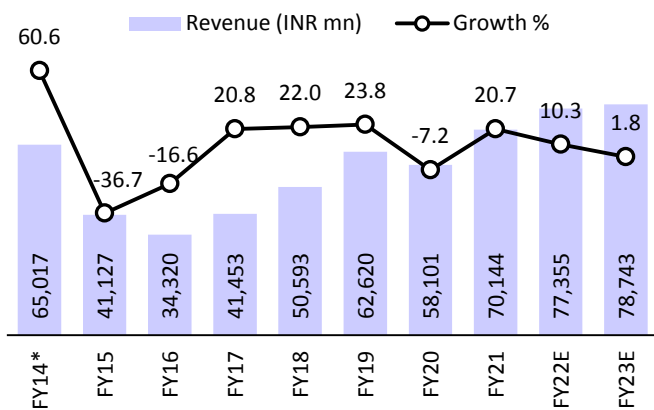
Exhibit 5: P/B (x) trend



Source: MOSL

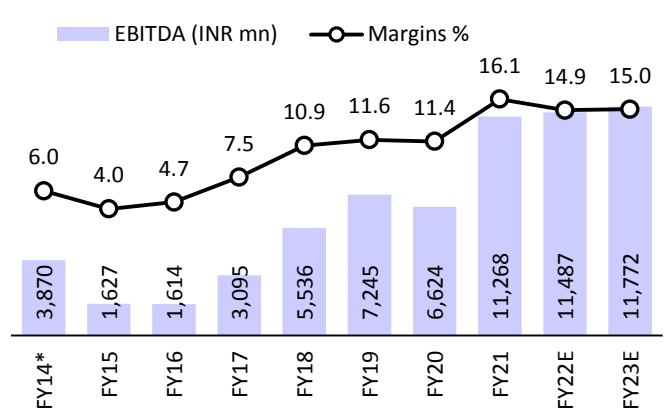
Story in charts

Exhibit 6: Revenue and revenue growth trend



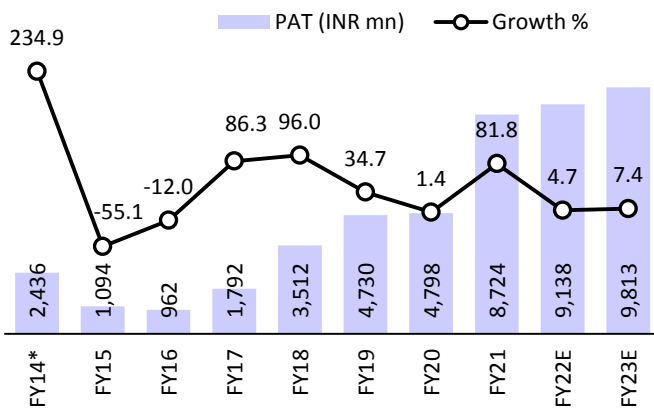
Source: MOFSL, Company

Exhibit 7: EBITDA and EBITDA margin trajectory



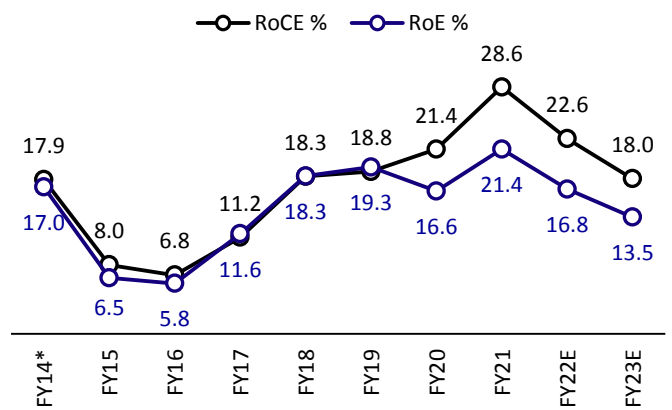
Source: MOFSL, Company

Exhibit 8: PAT and PAT growth trend



Source: MOFSL, Company

Exhibit 9: RoE and RoCE trend



Source: MOFSL, Company

Financials and valuations

Consolidated Income Statement								(INR m)
Y/E March	FY16	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E
Total Income from Operations	34,320	41,453	50,593	62,620	58,101	70,144	77,355	78,743
Change (%)	-16.6	20.8	22.0	23.8	-7.2	20.7	10.3	1.8
EBITDA	1,614	3,095	5,536	7,245	6,624	11,268	11,487	11,772
Margin (%)	4.7	7.5	10.9	11.6	11.4	16.1	14.9	15.0
Depreciation	581	634	732	872	1,072	1,183	1,332	1,453
EBIT	1,033	2,461	4,804	6,373	5,552	10,085	10,156	10,319
Int. and Finance Charges	511	322	295	195	172	133	120	120
Other Income	608	471	653	924	976	1,604	2,175	2,730
PBT bef. EO Exp.	1,130	2,610	5,162	7,102	6,356	11,555	12,211	12,929
EO Items	-306	-112	-68	56	-92	0	0	0
PBT after EO Exp.	824	2,498	5,094	7,157	6,263	11,555	12,211	12,929
Current Tax	123	773	1,625	2,371	1,535	2,832	3,073	3,116
Deferred Tax	0	0	0	0	0	0	0	0
Tax Rate (%)	14.9	30.9	31.9	33.1	24.5	24.5	25.2	24.1
Less: Minority Interest	0	11	4	20	0	0	0	0
Reported PAT	702	1,715	3,466	4,767	4,728	8,724	9,138	9,813
Adjusted PAT	962	1,792	3,512	4,730	4,798	8,724	9,138	9,813
Change (%)	-12.0	86.3	96.0	34.7	1.4	81.8	4.7	7.4
Margin (%)	2.8	4.3	6.9	7.6	8.3	12.4	11.8	12.5

Consolidated Balance Sheet								(INR m)
Y/E March	FY16	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E
Equity Share Capital	1,226	1,226	1,226	1,226	1,226	1,348	1,226	1,105
Total Reserves	13,439	14,984	20,926	25,509	29,948	48,913	57,444	85,204
Net Worth	14,665	16,209	22,151	26,735	31,174	50,261	58,670	86,309
Minority Interest	19	17	-4	56	51	-9	-9	-9
Deferred Liabilities	0	0	197	529	307	233	233	233
Total Loans	3,153	2,179	147	2,810	192	17	17	17
Capital Employed	17,836	18,406	22,492	30,130	31,724	50,502	58,911	86,550
Gross Block	25,050	24,600	24,960	26,213	28,040	30,193	33,218	35,961
Less: Accum. Deprn.	9,051	8,707	9,082	9,741	10,813	11,996	13,328	14,780
Net Fixed Assets	15,999	15,893	15,878	16,472	17,227	18,197	19,891	21,181
Capital WIP	216	266	657	800	1,044	412	387	394
Total Investments	398	2,123	5,490	4,908	7,974	19,380	19,380	19,380
Curr. Assets, Loans, and Adv.	12,184	13,187	17,700	24,890	23,895	30,792	38,930	65,625
Inventory	4,326	4,503	5,657	8,574	8,834	7,182	9,264	9,395
Account Receivables	3,750	4,565	5,920	9,311	7,319	6,576	8,477	8,629
Cash and Bank Balance	2,530	2,441	3,173	2,433	3,249	13,218	16,608	42,103
Loans and Advances	1,578	1,679	2,949	4,572	4,494	3,817	4,581	5,497
Curr. Liability and Prov.	11,604	13,587	17,242	16,952	18,430	18,279	19,677	20,030
Account Payables	9,997	12,064	15,746	15,495	16,867	16,771	18,014	18,338
Provisions	1,606	1,522	1,495	1,458	1,563	1,508	1,663	1,693
Net Current Assets	580	-399	458	7,938	5,465	12,513	19,253	45,595
Deferred Tax assets	643	523	8	12	14	0	0	0
Misc. Expenditure	0	0	0	0	0	0	0	0
Appl. of Funds	17,836	18,406	22,493	30,130	31,724	50,502	58,911	86,550

Financials and valuations

Ratios

Y/E March	FY16	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E
Basic (INR)								
EPS (excluding treasury)	11.3	21.0	39.5	53.2	54.0	76.9	90.4	88.8
BV/Share	172.0	190.1	249.2	300.8	350.7	443.3	580.1	781.1
DPS	1.7	1.5	2.0	2.5	2.5	7.5	6.0	7.0
Payout (%)	25.2	9.2	6.2	5.6	5.7	9.7	6.6	7.9
Valuation (x)								
P/E	159.8	85.8	45.6	33.9	33.4	23.4	20.0	20.3
P/BV	10.5	9.5	7.2	6.0	5.1	4.1	3.1	2.3
EV/Sales	5.1	4.2	3.5	2.9	3.1	3.3	2.9	2.6
EV/EBITDA	109.3	56.7	32.4	25.2	27.1	17.0	16.4	17.1
Dividend Yield (%)	0.1	0.1	0.1	0.1	0.1	0.4	0.3	0.4
FCF per share	13.0	19.5	28.9	-31.6	50.2	75.3	34.6	70.5
Return Ratios (%)								
RoE	5.8	11.6	18.3	19.3	16.6	21.4	16.8	13.5
RoCE	6.8	11.2	18.3	18.8	21.4	28.6	22.6	18.0
RoIC	5.6	12.0	24.5	24.2	20.2	41.2	38.0	33.2
Working Capital Ratios								
Asset Turnover (x)	1.9	2.3	2.2	2.1	1.8	1.4	1.3	0.9
Inventory (Days)	66	58	61	73	84	56	65	65
Debtor (Days)	39	39	43	54	46	34	40	40
Creditor (Days)	106	106	114	90	106	87	85	85
Leverage Ratio (x)								
Net Debt/Equity	0.0	-0.1	-0.4	-0.1	-0.3	-0.6	-0.6	-0.7

Consolidated Cash Flow Statement

(INR m)

Y/E March	FY16	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E
OP/(Loss) before Tax	734	1,903	5,091	7,157	6,253	11,548	12,211	12,929
Depreciation	607	649	732	872	1,072	1,183	1,332	1,453
Interest and Finance Charges	145	11	-26	-301	0	0	120	120
Direct Taxes Paid	11	-437	-1,021	-2,166	-1,748	-2,527	-3,073	-3,116
(Inc.)/Dec. in WC	494	548	-181	-7,449	3,272	2,748	-3,350	-846
Others	132	365	5	-456	-877	-1,639	0	0
CF from Operations incl. EO	2,122	3,038	4,601	-2,343	7,972	11,313	7,240	10,540
(inc.)/dec. in FA	-532	-654	-1,059	-1,529	-1,822	-1,157	-3,000	-2,750
Free Cash Flow	1,590	2,384	3,541	-3,873	6,150	10,155	4,240	7,790
(Pur.)/Sale of Investments	-294	-1,196	-2,934	994	-2,390	-20,778	0	0
Others	376	304	252	362	0	0	0	0
CF from Investments	-450	-1,546	-3,742	-174	-4,212	-21,936	-3,000	-2,750
Issue of Shares	0	0	2,501	28	0	10,576	-123	18,599
Inc./(Dec.) in Debt	-1,212	-1,031	-2,134	2,309	-2,644	-221	0	0
Interest Paid	-463	-287	-216	-138	-100	-76	-120	-120
Dividend Paid	-132	-128	-161	-289	-260	-245	-607	-773
CF from Fin. Activity	-1,900	-1,131	-10	1,906	-3,001	9,991	-849	17,706
Inc./Dec. in Cash	-227	361	849	-611	758	-632	3,391	25,495
Opening Balance	559	331	693	1,542	931	1,689	1,057	4,448
Closing Balance	331	693	1,542	931	1,689	1,057	4,448	29,943

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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