Escorts (ESCORT)

ICICI direct Research

CMP: ₹ 1,550 | Target: ₹ 1,900 (23%) | Target Period: 12 months | BUY

November 1, 2021

Robust capital efficiency, healthy b/s merit upgrade

About the stock: Escorts is India's fourth largest tractor maker (11.3% FY21 market share) and also serves the domestic construction equipment, railways space.

- FY21 sales mix – tractors 82%, construction equipment 11%, railways 7%
- Past five year's CAGR: 44.9%, 59.8% in EBITDA, PAT; cash positive b/s

Q2FY22 Results: The company posted a decent Q2FY22 performance.

- Total operating income at ₹ 1,622 crore was up 1.4% YoY
- EBITDA margins declined lower than expected, by 131 bps QoQ to 12.6%
- PAT declined 24.5% YoY to ₹ 173 crore

What should investors do? The share price of Escorts has grown ~4x over last five years from ~₹ 380 levels in October 2016, vastly outperforming Nifty Auto Index.

- We upgrade Escorts to **BUY** amid robust capital efficiency, net cash b/s

Target Price and Valuation: We value Escorts at revised SOTP-based TP of ₹ 1,900 (20x P/E on core FY23E EPS, 20% discount on treasury shares; previous TP ₹ 1,325)

Key triggers for future price performance:

- Expect ~13% tractor revenue CAGR over FY21-23E (5.5% volume CAGR), constrained by high installed base despite favourable macro tailwinds
- Construction equipment (CE), railways (RED) growth to be faster amid expected pickup in economic activity and positive outlook for mining, construction, road building and general infra push by government
- Operating leverage gains to expand EBITDA margins to ~14% by FY23E
- Optimum utilisation of surplus cash on b/s, possible stake increase by Kubota Corporation (currently 10%) could be a large value driver

Alternate Stock Idea: Apart from Escorts, in our auto OEM coverage we like M&M.

- Focused on prudent capital allocation, UV differentiation & EV proactiveness
- BUY with target price of ₹ 1,000

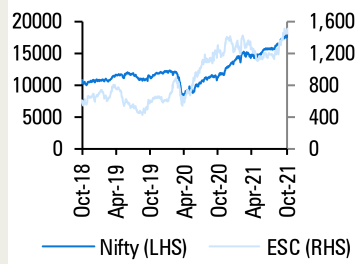
Particulars

Particular	₹ crore
Market Capitalization	19,000
Total Debt (FY21)	0
Cash & Investments (FY21)	2,968
EV	16,032
52 week H/L (₹)	1587 / 1100
Equity capital (₹crore)	122.6
Face value	₹ 10

Shareholding pattern

	Dec-20	Mar-21	Jun-21	Sep-21
Promoter	36.6	36.6	36.6	36.6
FII	23.8	26.0	21.3	21.5
DII	7.1	5.6	5.6	7.6
Other	32.5	31.9	36.5	34.2

Price Chart



Recent event & key risks

- Reported decent Q2FY22 results
- **Key Risk:** (i) Slower than expected pick-up in sales volume in tractor & construction equipment space, (ii) Inability to pass on commodity cost increase

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Result Update

ICICI Securities – Retail Equity Research

Key Financial Summary

Key Financials	FY19	FY20	FY21	5 year CAGR (FY16-21)	FY22E	FY23E	2 year CAGR (FY21-23E)
Net Sales	6,196.4	5,761.0	6,929.3	15.6%	8,069.2	9,149.8	14.9%
EBITDA	733.3	675.8	1,129.2	44.9%	1,100.8	1,282.2	6.6%
EBITDA Margins (%)	11.8	11.7	16.3		13.6	14.0	
Net Profit	484.9	485.6	873.3	59.8%	870.0	1,029.9	8.6%
EPS (₹)	39.6	39.6	71.2		71.0	84.0	
P/E	39.2	39.1	21.8		21.8	18.4	
RoNW (%)	15.6	14.2	16.2		14.1	14.6	
RoCE (%)	19.3	16.2	18.7		15.7	16.0	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

Q2FY22 Results: Better than expected numbers

- Among segments, EAM (i.e. tractor) revenues declined 6.1% YoY to ₹ 1,241 crore amid 13.8% volume decline to 21,073 crore. However, tractor ASPs surprised positively, growing by 8.2% QoQ to ₹ 5.89 lakh/unit
- CE revenue rose 77.2% QoQ to ₹ 249 crore while RED posted revenue growth of 42.5% QoQ to ₹ 170 crore. CE volumes jumped by 77.2% QoQ to 1,074 units. Present Railway order book is at >₹ 310 crore
- Margin performance was better than expected. Gross margins expanded 180 bps (we had expected 170 bps contraction) but 280 bps QoQ increase in other expenses on percentage of sales basis mitigated some of the gains. EAM EBIT margins dipped 50 bps sequentially to 15.1%
- Escorts posted negative CFO of ₹ 516 crore for H1FY22 vs. ₹ 778 crore in H1FY21 amid working capital position deterioration (higher inventories and debtors)

Q2FY22 Earnings Conference Call highlights

- Escorts guided for +- 2-3% YoY tractor industry volume growth in FY22E amid high installed base & slightly uneven rainfall distribution. Structurally, however, industry macros related to rural sentiment and farm incomes remain positive. Non-farm tractor sales are seen picking up in H2FY22E
- In Q2FY22, industry volumes declined ~19% YoY in the company's strongholds i.e. North and Central India while decline in South and West India was limited to ~3% on YoY basis. Accordingly, Escorts' market share declined to 9.0% in Q2FY22 vs. 10.7% as of Q1FY22 & 9.8% in Q2FY21
- Escorts expects strong CE demand revival in H2FY22E, led by project execution and new project awarding. CE division is seen posting double digit growth for the year. RED is also seen posting mid-teen digit growth with 16-18% margins
- There was under-recovery of raw material cost increase to the tune of ~2.5-3%. Escorts has undertaken price hikes of ~7-8% since last year, with another hike of ~3-4% planned post festive conclusion
- Escorts' aims to be return to normal 25-30 day inventory levels (tractor) post festive conclusion. Total dealer count is at >1,100, with most new additions taking place in South and West India.
- Share of >40 hp segment is at ~ 61% in H1FY22
- CE breakeven volumes are ~250 units per month, with full year margins seen at ~4-5%
- FY22E capex guidance - ₹ 250 crore
- The company will start utilising joint production capacity (with Kubota) from Q4FY22E onwards

Peer comparison

Exhibit 1: ICICI Direct coverage universe (tractors)

Company	CMP	TP	Rating	Mcap	Total lakh volumes			EBITDA margin (%)			RoCE (%)			P/E		
	₹	₹		₹ crore	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Escorts (ESCORT)	**1,550**	**1,900**	**Buy**	**19,000**	**1.1**	**1.1**	**1.2**	**16.3**	**13.6**	**14.0**	**18.7**	**15.7**	**16.0**	**21.8**	**21.8**	**18.4**
M&M (MAHMAH)	884	1,000	Buy	1,09,899	3.5	3.8	4.0	14.4	13.4	13.5	9.5	9.8	10.9	NM	26.3	22.6

Source: Company, ICICI Direct Research

Note – Volume data above is specific to tractor divisions for both companies

Exhibit 2: Variance Analysis

Particulars	Q2FY22	Q2FY22E	Q2FY21	YoY (Chg %)	Q1FY22	QoQ (Chg %)	Comments
Total Operating Income	1,662.3	1,552.1	1,639.7	1.4	1,671.5	-0.5	Revenues were higher than expected tracking beat on tractor ASPs which grew by 8.2% QoQ as well as higher than expected revenue from Railways
Raw Material Expenses	965.4	985.6	914.6	5.6	1,027.7	-6.1	Gross margin performance was strong, with raw material cost declining by 180 bps QoQ vs. our expectation of ~170 bps increase
Purchase of Traded Goods	140.8	100.9	127.7	10.3	113.4	24.2	
Employee Expenses	139.6	135.8	125.6	11.2	137.1	1.8	
Other Expenditure	206.4	147.5	171.1	20.6	160.1	28.9	Other expenses rose sharply by ~280 bps sequentially on percentage of sales basis
EBITDA	210.1	182.4	300.9	-30.2	233.2	-9.9	
EBITDA Margin (%)	12.6	11.8	18.3	-571 bps	14.0	-131 bps	Margins came in higher than expected at 12.6% tracking beat on gross margins
Interest	3.6	1.9	3.2	12.5	3.0	22.4	
Depreciation	32.9	33.1	27.4	20.3	31.4	4.9	
Total Tax	60.7	46.6	77.9	-22.1	60.9	-0.4	
PAT	172.9	147.3	228.9	-24.5	174.8	-1.1	PAT beat was on account of higher than expected revenues and margins
Key Metrics (₹ crore)							
Tractor Segment revenue	1,241	1,170	1,322	-6.1	1,411	-12.1	Tractor ASPs rose by 8.2% QoQ to ₹5.89 lakh/unit vs. our expectation of ₹5.55 lakh/unit.
CE revenue	249	254	157	58.8	141	77.2	
RED revenue	170	128	160	6.2	119	42.5	Railway revenues were higher than expected

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

	FY22E			FY23E			
(₹ Crore)	Old	New	% Change	Old	New	% Change	Comments
Revenue	7,949.9	8,069.2	1.5	8,926.3	9,149.8	2.5	We marginally raise our revenue estimates by building in higher ASPs in the tractor division
EBITDA	1,035.7	1,100.8	6.3	1,205.1	1,282.2	6.4	
EBITDA Margin (%)	13.0	13.6	60 bps	13.5	14.0	50 bps	Margin estimates are revised upwards tracking improvement in gross margins
PAT	829.5	870.0	4.9	958.3	1,029.9	7.5	Upward revision in revenue and margin numbers lead to upgraded PAT numbers
EPS (₹)	67.7	71.0	4.9	78.2	84.0	7.5	

Source: ICICI Direct Research

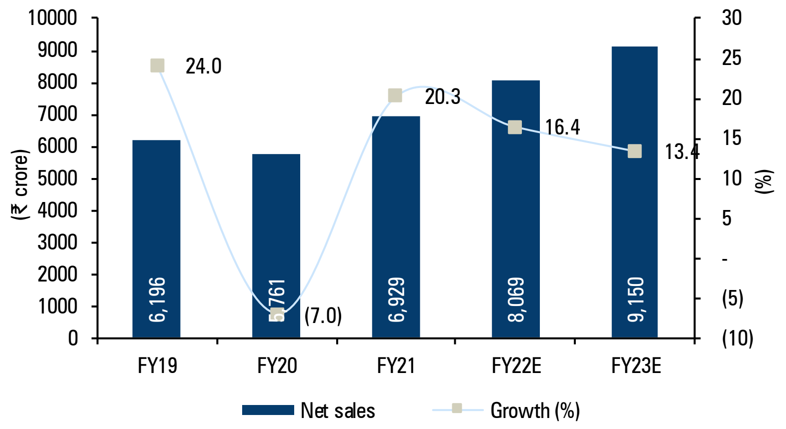
Exhibit 4: Assumptions

					Current		Earlier		Comments
	FY18	FY19	FY20	FY21	FY22E	FY23E	FY22E	FY23E	
Tractor volumes (units)	80,417	96,412	86,018	1,06,741	1,10,995	1,18,765	1,15,259	1,23,327	We build 5.5% tractor volume CAGR over FY21-23E given muted management commentary around industry growth prospects
Average ASP (₹)	4,92,166	4,92,053	5,15,890	5,30,937	5,83,534	6,07,167	5,51,791	5,66,538	Tractor ASPs are seen growing at 6.9% CAGR till FY23E on the back of price hikes and product mix improvement (higher share of larger sized non-agri tractors)

Source: ICICI Direct Research

Financial story in charts

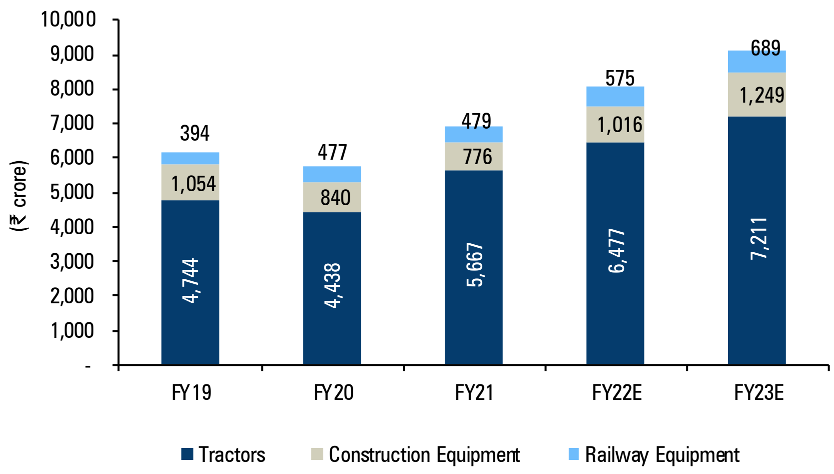
Exhibit 5: Trend in total operating income



Source: Company, ICICI Direct Research

We expect net sales to grow at 14.9% CAGR over FY21-23E

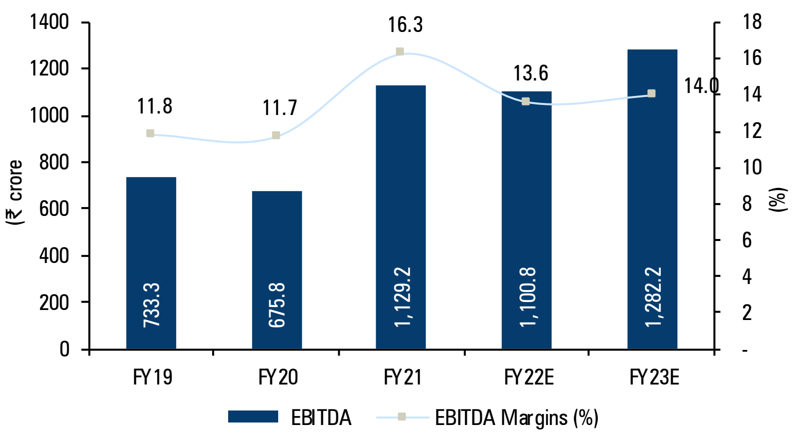
Exhibit 6: Trend in segment mix



Source: Company, ICICI Direct Research

Share of tractors within overall revenue mix is seen declining over the medium term amid muted 5.5% volume CAGR expectation. From a lower base, share of CE and RED is set to increase

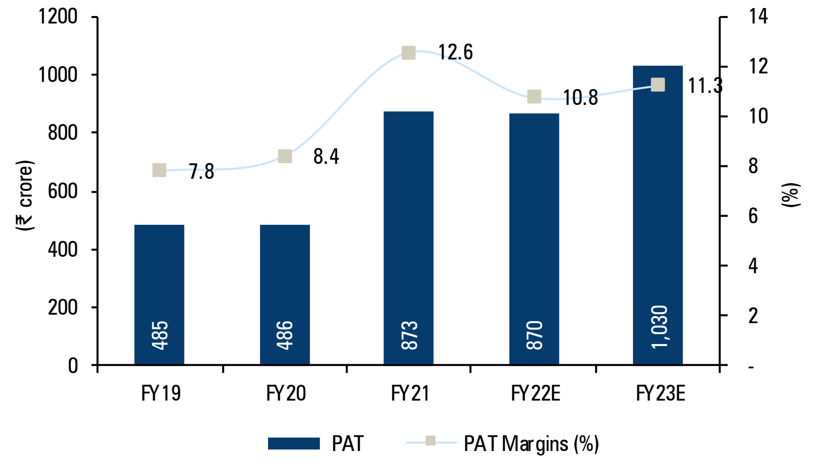
Exhibit 7: Trend in margins



Source: Company, ICICI Direct Research

Margins are seen declining to 14% by FY23E due to limited scope for further operating leverage gains and lower contribution from tractor segment going forward

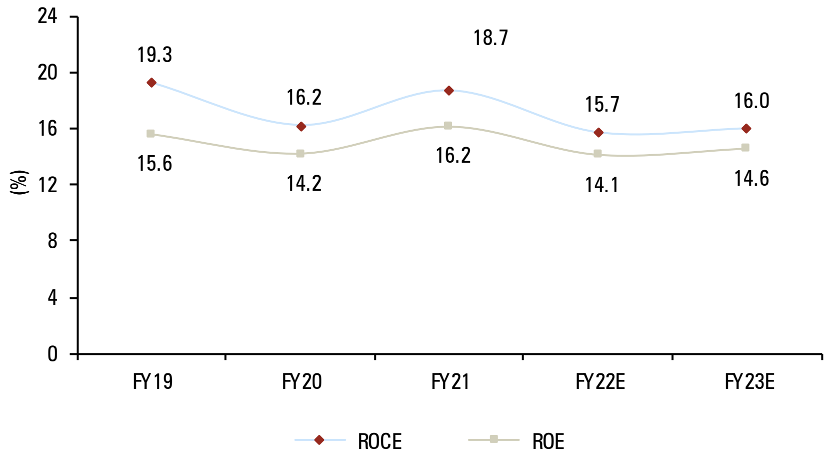
Exhibit 8: Trend in profitability



Source: Company, ICICI Direct Research

PAT is expected to grow at subdued 8.6% CAGR over FY21-23E amid high EBITDA margin base in FY21

Exhibit 9: Trend in return ratios



Source: Company, ICICI Direct Research

Return ratios are seen stabilising around 14-16% mark by FY23E

Exhibit 10: Valuation summary

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY18	4995	22.0	28.1	114.9	55.1	32.7	13.8	18.7
FY19	6196	24.0	39.6	40.6	39.2	25.5	15.6	19.3
FY20	5761	-7.0	39.6	0.1	39.1	26.7	14.2	16.2
FY21	6929	20.3	71.2	79.9	21.8	14.2	16.2	18.7
FY22E	8069	16.4	71.0	-0.4	21.8	14.3	14.1	15.7
FY22E	9150	13.4	84.0	18.4	18.4	11.7	14.6	16.0

Source: Company, ICICI Direct Research

Exhibit 11: SoTP based target price calculation

Particulars	Amount (₹)
FY23E EPS (₹/share, A)	84.0
P/E Multiple (x, B)	20.0
Value of Base Business (C =A*B)	**1,680**
No of Treasury Shares (crore)	2.1
Current Market Price (₹/share)	1,550
Value of Investments (₹ crore)	3,325
Holding company discount (%)	20
Revised value of Investments (₹ crore)	2,660
Contribution per share (₹/share, D)	**220**
Target Price (C+D)	**1,900**

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 12: Profit and loss statement ₹ crore

(Year-end March)	FY20	FY21	FY22E	FY23E
Total operating Income	5,761.0	6,929.3	8,069.2	9,149.8
Growth (%)	-7.0	20.3	16.4	13.4
Raw Material Expenses	3,449.3	4,153.6	4,881.7	5,581.4
Employee Expenses	510.3	534.6	578.4	622.7
Other expenses	755.2	671.8	875.2	977.3
Total Operating Expenditure	5,085.1	5,800.1	6,968.4	7,867.7
EBITDA	**675.8**	**1129.2**	**1100.8**	**1282.2**
Growth (%)	-7.8	67.1	-2.5	16.5
Depreciation	104.6	115.7	128.7	148.0
Interest	15.5	11.0	9.9	9.4
Other Income	92.3	154.6	198.6	229.1
PBT	638.9	1,157.1	1,160.9	1,353.9
Total Tax	153.3	283.1	292.3	341.2
Tax rate	*24.0*	*24.5*	*25.2*	*25.2*
PAT	**485.6**	**873.3**	**870.0**	**1029.9**
Growth (%)	0.1	79.9	-0.4	18.4
EPS (₹)	**39.6**	**71.2**	**71.0**	**84.0**

Source: Company, ICICI Direct Research

Exhibit 13: Cash flow statement ₹ crore

(Year-end March)	FY20	FY21	FY22E	FY23E
Profit after Tax	485.6	873.3	870.0	1,029.9
Add: Depreciation	104.6	115.7	128.7	148.0
(Inc)/dec in Current Assets	190.7	269.3	-482.7	-266.8
Inc/(dec) in CL and Provisions	112.4	-55.7	218.8	232.7
CF from operating activities	**893.1**	**1202.7**	**734.8**	**1143.8**
(Inc)/dec in Investments	-247.2	-1,013.3	-200.0	-500.0
(Inc)/dec in Fixed Assets	-210.4	-103.5	-250.0	-250.0
Others	-39.9	-119.2	-38.2	-61.8
CF from investing activities	**-497.5**	**-1235.9**	**-488.2**	**-811.8**
Issue/(Buy back) of Equity	0.0	12.2	-12.2	0.0
Inc/(dec) in loan funds	-280.1	-6.6	0.0	0.0
Dividend paid & dividend tax	-36.8	-91.9	-91.9	-122.6
Inc/(dec) in Sec. premium	0.0	1,029.8	0.0	0.0
Others	8.4	88.1	0.0	0.0
CF from financing activities	**-308.5**	**1031.6**	**-104.2**	**-122.6**
Net Cash flow	87.1	998.3	142.4	209.5
Opening Cash	231.1	318.3	1,316.6	1,459.0
Closing Cash	**318.3**	**1316.6**	**1459.0**	**1668.4**

Source: Company, ICICI Direct Research

Exhibit 14: Balance Sheet ₹ crore

(Year-end March)	FY20	FY21	FY22E	FY23E
Liabilities				
Equity Capital	122.6	134.8	122.6	122.6
Reserve and Surplus	3,357.5	5,256.8	6,034.8	6,942.1
Total Shareholders funds	**3480.1**	**5391.6**	**6157.4**	**7064.7**
Total Debt	**6.6**	**0.0**	**0.0**	**0.0**
Other non-current Liabilities	83.7	106.7	109.2	111.7
Long-term Provisions	30.1	49.0	67.8	86.6
Total Liabilities	**3600.5**	**5547.3**	**6334.4**	**7263.0**
Assets				
Gross Block	2,645.8	2,794.5	3,064.5	3,302.7
Less: Acc Depreciation	1,012.7	1,109.6	1,219.0	1,343.7
Net Block	1,633.0	1,684.9	1,845.4	1,959.0
Capital WIP	104.4	41.2	16.2	16.2
Total Fixed Assets	**1737.4**	**1726.0**	**1861.6**	**1975.1**
Net Intangible Asset	52.3	51.5	37.1	25.6
Investments	1,172.8	2,322.8	2,572.8	3,122.8
Inventory	822.2	674.5	884.3	1,002.7
Debtors	756.5	698.4	884.3	1,002.7
Loans and Advances	37.7	32.8	49.3	43.8
Other Current Assets	265.8	189.4	259.9	295.3
Cash	**318.3**	**1316.6**	**1459.0**	**1668.4**
Total Current Assets	2,200.4	2,911.6	3,536.7	4,013.0
Creditors	1,264.0	1,187.1	1,326.4	1,504.1
Provisions & Other Curr.Liab	447.7	468.9	548.3	603.4
Total Current Liabilities	1,711.7	1,656.0	1,874.8	2,107.5
Net Current Assets	**488.7**	**1255.6**	**1662.0**	**1905.5**
Net Deferred Tax Asset	-30.3	-23.0	-23.0	-23.0
Other non-current assets	119.0	154.5	164.0	197.1
Application of Funds	**3600.5**	**5547.3**	**6334.4**	**7263.0**

Source: Company, ICICI Direct Research

Exhibit 15: Key ratios

(Year-end March)	FY20	FY21	FY22E	FY23E
Per share data (₹)				
EPS	39.6	71.2	71.0	84.0
Cash EPS	48.1	80.7	81.5	96.1
BV	283.9	439.8	502.3	576.3
DPS	2.5	7.5	7.5	10.0
Cash Per Share	78.0	242.1	270.1	327.9
Operating Ratios				
EBITDA Margin (%)	11.7	16.3	13.6	14.0
PAT Margin (%)	8.4	12.6	10.8	11.3
Inventory days	52.1	35.5	40.0	40.0
Debtor days	47.9	36.8	40.0	40.0
Creditor days	80.1	62.5	60.0	60.0
Return Ratios (%)				
RoE	14.2	16.2	14.1	14.6
RoCE	16.2	18.7	15.7	16.0
RoIC	23.3	42.1	34.1	37.2
Valuation Ratios (x)				
P/E	39.1	21.8	21.8	18.4
EV / EBITDA	26.7	14.2	14.3	11.7
EV / Net Sales	3.1	2.3	1.9	1.6
Market Cap / Sales	3.3	2.7	2.4	2.1
Price to Book Value	5.5	3.5	3.1	2.7
Solvency Ratios				
Debt/ EBITDA	0.0	0.0	0.0	0.0
Debt / Equity	0.0	0.0	0.0	0.0
Current Ratio	1.4	1.2	1.4	1.4
Quick Ratio	**0.8**	**0.7**	**0.8**	**0.8**

Source: Company, ICICI Direct Research

Exhibit 16: ICICI Direct coverage universe (Auto & Auto Ancillary)

Sector / Company	CMP	TP		M Cap	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	(₹)	Rating	(₹ Cr)	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Apollo Tyre (APOTYR)	213	275	Buy	13,526	5.5	10.2	16.6	38.6	20.8	12.8	6.5	6.7	4.8	7.6	6.1	9.1	6.4	5.5	8.4
Ashok Leyland (ASHLEY)	142	160	Buy	41,565	-1.1	0.4	4.6	-132.9	321.1	30.5	83.2	37.1	15.3	-1.9	3.2	16.5	-4.4	1.9	17.7
Bajaj Auto (BAAUTO)	3,710	4,220	Hold	1,07,356	157.4	164.9	191.3	23.6	22.5	19.4	17.3	16.5	13.9	18.2	18.9	22.0	18.1	18.6	21.1
Balkrishna Ind. (BALIND)	2,460	2,825	Buy	47,556	59.8	67.0	78.4	41.2	36.7	31.4	26.9	23.6	20.5	19.3	19.9	21.0	19.2	18.7	19.0
Bharat Forge (BHAFOR)	768	1,000	Buy	35,756	-2.7	17.2	25.1	NM	44.7	30.6	44.3	20.9	16.3	2.2	9.3	12.7	3.3	14.0	16.8
Eicher Motors (EICMOT)	2,485	2,920	Buy	67,915	49.3	64.9	96.4	50.4	38.3	25.8	33.8	26.0	17.6	11.3	13.7	17.8	11.8	14.0	18.0
Escorts (ESCORT)	**1,550**	**1,900**	**Buy**	**19,000**	**71.2**	**71.0**	**84.0**	**21.8**	**21.8**	**18.4**	**14.2**	**14.3**	**11.7**	**18.7**	**15.7**	**16.0**	**16.2**	**14.1**	**14.6**
Hero Moto (HERHON)	2,660	3,115	Hold	53,120	148.4	155.9	188.8	17.9	17.1	14.1	11.1	10.5	8.5	20.8	20.1	22.3	19.5	18.6	20.3
M&M (MAHMAH)	884	1,000	Buy	1,09,899	2.3	33.6	39.1	392.6	26.3	22.6	16.4	15.4	13.5	9.5	9.8	10.9	2.7	10.9	11.4
Maruti Suzuki (MARUTI)	7,483	6,000	Sell	2,26,046	140.0	88.4	200.0	53.4	84.6	37.4	34.2	41.7	21.3	4.3	2.5	8.9	8.2	5.0	10.6
Minda Industries (MININD)	779	835	Buy	22,249	7.6	10.7	19.4	102.5	72.7	40.1	31.8	25.6	18.2	9.1	10.3	15.9	9.2	9.5	14.8
Motherson (MOTSUM)	224	280	Buy	70,738	3.3	5.5	9.3	NM	40.5	24.1	15.6	11.2	8.0	6.7	12.6	19.9	8.8	12.9	19.4
Tata Motors (TATMOT)	484	515	Buy	1,85,324	-35.0	-2.6	36.2	NM	-189.6	13.4	7.1	7.0	4.6	6.3	7.1	14.6	-23.6	-1.8	19.9

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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