

## Kubota takes a co-driver seat, now a joint promoter ...

**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

**Company Update:** Escorts to issue 93.64 lakh equity shares via preferential allotment to Kubota at a price of ₹2,000/share with total inflow pegged at ₹1873 crore.

- Kubota's shareholding in Escorts to increase from 10% to 16.4%. Kubota to launch open offer for minority shareholders of Escorts at ₹2000/share.
- Kubota will now be a joint promoter of the company.
- Company name proposed to be changed to Escorts Kubota Ltd.
- All existing JV's proposed to be merged, thereby simplifying the structure
- Nanda family to retain its holding, Mr. Nikhil Nanda to continue as CMD

**What should investors do?** The share price of Escorts has grown 6x over last five years from ~₹ 300 levels in November 2016, vastly outperforming Nifty Auto Index.

- We retain **BUY** on Escorts with Kubota now a co-promoter with expectations of enhanced product offerings and increased global sourcing from India

**Target Price and Valuation:** We value Escorts at revised SOTP-based TP of ₹ 2,200 (23x P/E on core FY23E EPS, 15% discount on treasury shares; previous TP ₹ 1,900)

### Key triggers for future price performance:

- New product launches in the farm mechanisation side (ex-tractors)
- Optimum utilisation of surplus cash on b/s (now nearly at ₹5,000 crore)
- Expect ~13% tractor revenue CAGR over FY21-23E (5.5% volume CAGR)
- Construction equipment, railways growth to be faster amid expected pickup in economic activity and positive outlook for user segments

**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 ₹ 1,125



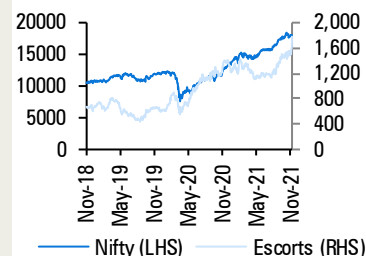
#### Particulars

Particular	₹ crore
Market Capitalization	23,749
Total Debt (FY22E)	0
Cash & Investments (FY22E)	5,230
EV	18,519
52 week H/L (₹)	1825 / 1100
Equity capital (₹crore)	131.9
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

- Preferential allotment to Kubota
- **Key Risk:** (i) Slower than expected introduction of new product offerings with the help of Kubota's tech edge (ii) pressure on margins due to commodity cost increase

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### 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%	917.0	1,117.7	13.1%
EPS (₹)	36.8	36.8	66.2		69.5	84.7	
P/E	49.0	48.9	27.2		25.9	21.2	
RoNW (%)	15.6	14.2	16.2		11.4	12.3	
RoCE (%)	19.3	16.2	18.7		12.0	12.5	

Source: Company, ICICI Direct Research

## Key takeaways of transaction

### Escorts allocates fresh equity shares to Kubota, reclassifies it as co-promoter

- The board of directors of Escorts Ltd have approved preferential allotment of shares (93.64 lakh shares) to Kubota Corporation at a price of ₹2,000/share, amounting to ₹1,873 crore. Consequent to this fund infusion, Kubota will now be a joint promoter of the company. This transaction will trigger an open offer for the minority shareholders of Escorts Ltd from Kubota Corporation at a price of ₹ 2,000/share.
- We see this as a positive development for the company, wherein Escorts will now be renamed as Escorts Kubota Ltd. With Kubota's know how in the farm equipment, mechanisation and construction equipment space, we see this as a winning combination and shall expand the product offerings at Escorts. It shall also entail greater sourcing by Kubota from its Indian arm for its other global markets.

Kubota's shareholding is slated to increase from ~10% to ~16.4% post preferential allotment and can further increase to > 25% depending upon the response to the open offer as well as cancellation of treasury shares

### Exhibit 1: Change in estimates

₹ Crore)	FY22E			FY23E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	8,069.2	8,069.2	0.0	9,149.8	9,149.8	0.0	No change in operational parameters
EBITDA	1,100.8	1,100.8	0.0	1,282.2	1,282.2	0.0	
EBITDA Margin (%)	13.6	13.6	-	14.0	14.0	-	No change in operational parameters
PAT	870.0	917.0	5.4	1,029.9	1,117.7	8.5	Upward revision in PAT estimates is tracking higher other income due to infusion of cash via preferential allotment
EPS (₹)	71.0	69.5	-2.1	84.0	84.7	0.9	EPS change is different from PAT change with equity capital base assumed at 13.2 crore shares post preferential allotment & cancellation of first tranche of treasury shares

Source: ICICI Direct Research

- From the financial modelling perspective, we have modelled fresh shares issuance with consequent addition to share capital and securities premium account. The same gets reflected through higher cash on books and consequent higher other income. Rest of the operational parameters (volume growth across segments, margins) remain unchanged.

## Shareholding Scenario's

### Exhibit 2: Likely shareholding post preferential allotment, open offer, cancellation of treasury shares

1. After Kubota's Initial Stake Purchase (March 2020) & Equivalent Cancellation of Treasury Shares			2. Shareholding after preferential allotment of equity shares to Kubota as of November 2021		
Particulars	No of Shares	% Stake	Particulars	No of Shares	% Stake
Nanda Family	1,56,33,649	12.8%	Nanda Family (Co-Promoter)	1,56,33,649	11.8%
Treasury Book	2,14,42,343	17.5%	Treasury Book	2,14,42,343	16.3%
<b>Total Promoter Group</b>	<b>3,70,75,992</b>	<b>30.2%</b>	<b>Total Promoter Group</b>	<b>3,70,75,992</b>	<b>28.1%</b>
Kubota	1,22,57,688	10.0%	Kubota (Co-Promoter)	2,16,21,414	16.4%
<b>Total</b>	<b>12,25,76,878</b>	<b>100.0%</b>	<b>Total</b>	<b>13,19,40,604</b>	<b>100.0%</b>
3. Likely shareholding post open offer if open offer is a 100% success i.e. Kubota buy's ~3.75 crore shares in open offer			4. Likely shareholding if open offer is a 100% success and all residual treasury shares are cancelled by the board		
Particulars	No of Shares	% Stake	Particulars	No of Shares	% Stake
Nanda Family (Co-Promoter)	1,56,33,649	11.8%	Nanda Family (Co-Promoter)	1,56,33,649	14.1%
Treasury Book	2,14,42,343	16.3%	Treasury Book	0	0.0%
<b>Total Promoter Group</b>	<b>3,70,75,992</b>	<b>28.1%</b>	<b>Total Promoter Group</b>	<b>1,56,33,649</b>	<b>14.1%</b>
Kubota (Co-Promoter)	5,91,12,970	44.8%	Kubota (Co-Promoter)	5,91,12,970	53.5%
<b>Total</b>	<b>13,19,40,604</b>	<b>100.0%</b>	<b>Total</b>	<b>11,04,98,261</b>	<b>100.0%</b>

Source: ICICI Direct Research; Table 1 in the above exhibit is true shareholding as on date (inclusive of treasury shares reduction which is expected anytime soon)

Exhibit 3: Joint Control benefits to each party

Escorts-Kubota: a Stronger Partnership



- Escorts to be the exclusive vehicle for manufacture and sale of certain products in India and for sourcing from India
- Enhanced R&D capabilities to offer cutting-edge products
- Addition of a complementary & attractive product portfolio
- Access to global supply chain & network
- Primary Infusion to accelerate growth & expansion initiatives



- Increased exposure to a Large & Growing Indian Market
- Strong Brand with legacy & diversified portfolio
- Ability to leverage Pan-India dealer network
- Assured supply of low-cost value-added agriculture machinery
- Value consciousness and engineering excellence of Escorts
- Frugal Manufacturing expertise of Escorts

"Escorts Kubota Limited" to be one of the largest Indo-Japan agriculture collaboration, establishing unparalleled commercial reach

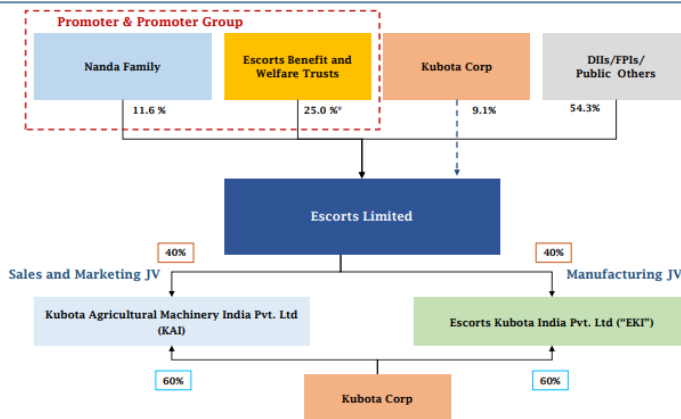
Source: Company, ICICI Direct Research

Conference Call Highlights

- Management structure would remain same post the transaction. With Kubota nominating 2 more directors on the board such that Nanda family and Kubota will have equal participation with 4 directors each. Rest there would be 8 independent directors taking the total board count to 16
- With regards to cash on B/S, both companies will sit together to chalk out a medium term plan to be executed over 6-7 years and utilise the same for growth opportunities. Management expects to share the fine prints on the same by June-July 2022
- In terms of new product offering the company will look to make a mark in the farm mechanisation space with combine harvesters, rice trans planters and implements. While on the construction equipment side it is most likely to introduce mini excavators
- Post the preferential allotment both Kubota's and Nanda family's stake has a lock-in for 5 years
- On the tractor front, company will look to leverage the strength of all three brands (Farmtrac, Powertrac, Kubota) in the domestic markets with distribution envisaged to be separate for them
- Global farm mechanisation market is >2x of tractor market while in India farm mechanisation market is <5% of tractor market
- All the domestic sales from Kubota Agricultural Machinery India Pvt Ltd & Escorts would be eventually merged.
- They may look at augmenting the research capabilities with R&D centre in India envisaged as Kubota's biggest R&D centre outside Japan
- There are no thoughts given on leveraging water treatment products of Kubota as on date

Exhibit 4: Current structure

Current Structure

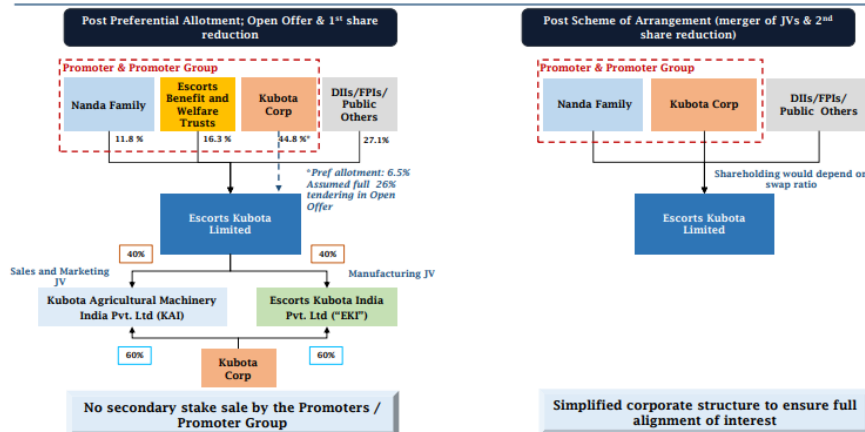


9.1% of the Shares held by Escorts Benefit and Welfare Trust, are under the ongoing scheme of capital reduction.

Source: Company, ICICI Direct Research

Exhibit 5: Resulting Structure

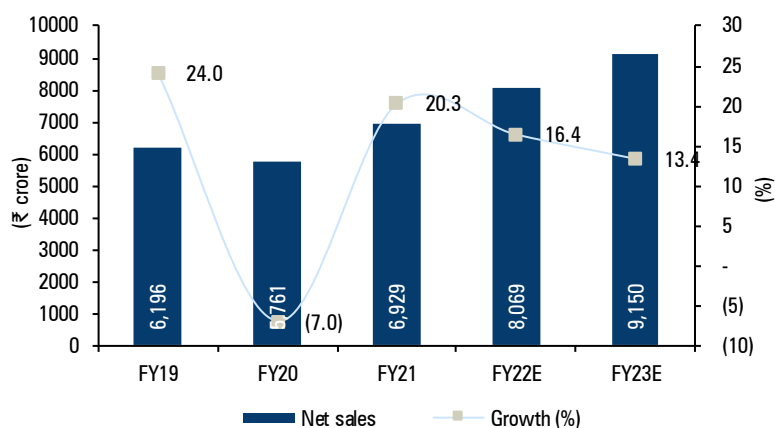
Resulting Structure



Source: Company, ICICI Direct Research

## Financial story in charts

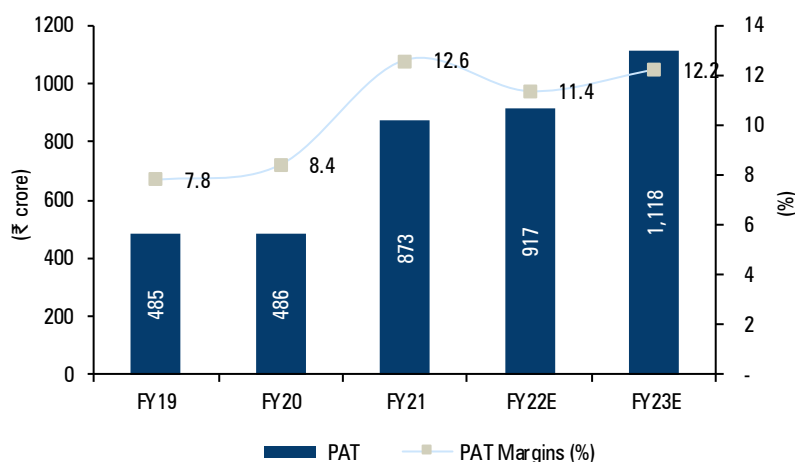
Exhibit 6: Trend in total operating income



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

Source: Company, ICICI Direct Research

Exhibit 7: Trend in profitability



PAT is expected to grow at 13.1% CAGR over FY21-23E amid high EBITDA margin base in FY21

Source: Company, ICICI Direct Research

Exhibit 8: Valuation summary

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY18	4995	22.0	26.1	99.7	68.9	41.2	13.8	18.7
FY19	6196	24.0	36.8	40.6	49.0	31.9	15.6	19.3
FY20	5761	-7.0	36.8	0.1	48.9	33.7	14.2	16.2
FY21	6929	20.3	66.2	79.9	27.2	18.4	16.2	18.7
FY22E	8069	16.4	69.5	5.0	25.9	16.8	11.4	12.0
FY23E	9150	13.4	84.7	21.9	21.2	13.8	12.3	12.5

Source: Company, ICICI Direct Research

Exhibit 9: SoTP based target price calculation

Particulars	Amount (₹)
FY23E EPS (₹/share, A)	84.7
P/E Multiple (x, B)	23.0
<b>Value of Base Business (C = A*B)</b>	<b>1,950</b>
No of Treasury Shares (crore)	2.1
Current Market Price (₹/share)	1,800
Value of Investments (₹ crore)	3,861
Holding company discount (%)	15
Revised value of Investments (₹ crore)	3,282
<b>Contribution per share (₹/share, D)</b>	<b>250</b>
<b>Target Price (C+D)</b>	<b>2,200</b>

Source: Company, ICICI Direct Research

## Financial Summary

Exhibit 10: 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	
<b>EBITDA</b>	<b>675.8</b>	<b>1129.2</b>	<b>1100.8</b>	<b>1282.2</b>	
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	261.5	346.6	
PBT	638.9	1,157.1	1,223.8	1,471.4	
Total Tax	153.3	283.1	308.2	370.8	
Tax rate	24.0	24.5	25.2	25.2	
<b>PAT</b>	<b>485.6</b>	<b>873.3</b>	<b>917.0</b>	<b>1117.7</b>	
Growth (%)	0.1	79.9	5.0	21.9	
<b>EPS (₹)</b>	<b>36.8</b>	<b>66.2</b>	<b>69.5</b>	<b>84.7</b>	

Source: Company, ICICI Direct Research

Exhibit 11: Cash flow statement					₹ crore
(Year-end March)	FY20	FY21	FY22E	FY23E	
Profit after Tax	485.6	873.3	917.0	1,117.7	
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	
<b>CF from operating activities</b>	<b>893.1</b>	<b>1202.7</b>	<b>781.8</b>	<b>1231.7</b>	
(Inc)/dec in Investments	-247.2	-1,013.3	-2,000.0	-500.0	
(Inc)/dec in Fixed Assets	-210.4	-103.5	-250.0	-250.0	
Others	-39.9	-119.2	-38.2	-61.8	
<b>CF from investing activities</b>	<b>-497.5</b>	<b>-1235.9</b>	<b>-2288.2</b>	<b>-811.8</b>	
Issue/(Buy back) of Equity	0.0	12.2	-2.9	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	1,863.4	0.0	
Others	8.4	88.1	0.0	0.0	
<b>CF from financing activities</b>	<b>-308.5</b>	<b>1031.6</b>	<b>1768.6</b>	<b>-122.6</b>	
Net Cash flow	87.1	998.3	262.2	297.3	
Opening Cash	231.1	318.3	1,316.6	1,578.7	
<b>Closing Cash</b>	<b>318.3</b>	<b>1316.6</b>	<b>1578.7</b>	<b>1876.1</b>	

Source: Company, ICICI Direct Research

Exhibit 12: Balance Sheet					₹ crore
(Year-end March)	FY20	FY21	FY22E	FY23E	
<b>Liabilities</b>					
Equity Capital	122.6	134.8	131.9	131.9	
Reserve and Surplus	3,357.5	5,256.8	7,945.3	8,940.4	
<b>Total Shareholders funds</b>	<b>3480.1</b>	<b>5391.6</b>	<b>8077.2</b>	<b>9072.4</b>	
<b>Total Debt</b>	<b>6.6</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	
Other non-current Liabilities	83.7	106.7	109.2	111.7	
Long-term Provisions	30.1	49.0	67.8	86.6	
<b>Total Liabilities</b>	<b>3600.5</b>	<b>5547.3</b>	<b>8254.2</b>	<b>9270.6</b>	
<b>Assets</b>					
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	
<b>Total Fixed Assets</b>	<b>1737.4</b>	<b>1726.0</b>	<b>1861.6</b>	<b>1975.1</b>	
Net Intangible Asset	52.3	51.5	37.1	25.6	
Investments	1,172.8	2,322.8	4,372.8	4,922.8	
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	
<b>Cash</b>	<b>318.3</b>	<b>1316.6</b>	<b>1578.7</b>	<b>1876.1</b>	
Total Current Assets	2,200.4	2,911.6	3,656.5	4,220.6	
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	
<b>Net Current Assets</b>	<b>488.7</b>	<b>1255.6</b>	<b>1781.8</b>	<b>2113.1</b>	
Net Deferred Tax Asset	-30.3	-23.0	-23.0	-23.0	
Other non-current assets	119.0	154.5	164.0	197.1	
<b>Application of Funds</b>	<b>3600.5</b>	<b>5547.3</b>	<b>8254.2</b>	<b>9270.6</b>	

Source: Company, ICICI Direct Research

Exhibit 13: Key ratios				
(Year-end March)	FY20	FY21	FY22E	FY23E
<b>Per share data (₹)</b>				
EPS	36.8	66.2	69.5	84.7
Cash EPS	48.1	80.7	79.3	95.9
BV	283.9	439.8	612.2	687.6
DPS	2.5	7.5	7.0	9.3
Cash Per Share	78.0	242.1	396.4	456.8
<b>Operating Ratios</b>				
EBITDA Margin (%)	11.7	16.3	13.6	14.0
PAT Margin (%)	8.4	12.6	11.4	12.2
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
<b>Return Ratios (%)</b>				
RoE	14.2	16.2	11.4	12.3
RoCE	16.2	18.7	12.0	12.5
RoIC	23.3	42.1	34.1	37.2
<b>Valuation Ratios (x)</b>				
P/E	45.4	25.3	25.9	21.2
EV / EBITDA	33.7	18.4	16.8	13.8
EV / Net Sales	4.0	3.0	2.3	1.9
Market Cap / Sales	4.1	3.4	2.9	2.6
Price to Book Value	6.3	4.1	2.9	2.6
<b>Solvency Ratios</b>				
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
<b>Quick Ratio</b>	<b>0.8</b>	<b>0.7</b>	<b>0.8</b>	<b>0.8</b>

Source: Company, ICICI Direct Research

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Sell: < -15%



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