Escorts Kubota (ESCORT)

CMP: ₹ 1,965 Target: ₹ 2,390 (22%)

Target Period: 12 months

12 months

September 16, 2022

Structure simplified, merged entity well placed to grow

About the stock: The company is a prominent tractor maker domestically (10.3% FY22 market share). It also serves domestic construction equipment, railways space.

- FY22 sales mix tractors 77%, construction equipment 14%, railways 9%
- Past five year CAGR: 24.1%, 35.6% in EBITDA, PAT; cash positive b/s

Key Highlights:

- Escorts Kubota passed a resolution to amalgamate Escorts Kubota India Pvt Ltd (EKI, JV between Escorts & Kubota in 40:60 ratio, tractor manufacturing entity) & Kubota Agriculture Machinery Pvt Ltd (KAI, JV between Escorts & Kubota in 40:60 ratio, including all farm machinery presence of Kubota in India) into Escorts Kubota Ltd for swap ratio of 5:129 & 5:220, respectively
- In FY22, EKI & KAI had revenue of ₹ 689 crore & ₹ 1820 crore, respectively.
 EKI incurred a loss of ₹ 96 crore while KAI generated profit of ₹ 53 crore
- This comes in line with the earlier announcement made at the time of Kubota acquiring a further stake in the company and joining as co-promoter.
 It is aimed at simplifying the group structure with listed entity now including Kubota's complete presence in India
- Our View: Swap ratio & consequent value assigned to the residual stake is fair in our opinion thereby protecting the interest of minority shareholders
- The stakes are being acquired at ~1.2x P/B with effective cost of acquisition pegged at ~₹ 276 crore (i.e. 13.8 lakh shares multiplied by CMP of 2,000)

What should investors do? The stock price has grown at ~26% CAGR over last five years from ~₹ 636 in September 2017, vastly outperforming the Nifty Auto Index.

• We upgrade the stock from HOLD to **BUY** tracking Kubota's strength in farm machinery space with key monitorable being medium term growth plan

Target Price and Valuation: We await b/s of merged entity before incorporating the same in our financials. Keeping the standalone financials intact (erstwhile Escorts) & assuming to be merged entities operating unchanged, we value Escorts-Kubota on SOTP basis at ₹ 2,390; valuing it at 25x PE on combined PAT in FY24

Key triggers for future price performance:

- Formal plan on scaling up operations of the company and leveraging channels using expertise of new co-promoter Kubota
- We expect sales to grow at CAGR of 11% over FY22-24E, with consequent margins expected at 12.5% by FY24E
- RoIC profile of \sim 30% (RoCE is suppressed due to high cash on b/s)



BUY



Particulars	
Particular	₹ crore
Market Capitalization	25,926
Total Debt (FY22)	0
Cash & Investments (FY22)	4,843
EV	21,083
52 week H/L (₹)	2089 / 1307
Equity capital (₹crore)	131.9
Face value	₹ 10

Shareholding pattern						
	Sep-21	Dec-21	Mar-22	Jun-22		
Promoter	36.6	30.3	28.1	72.9		
FII	21.5	20.1	3.6	4.2		
DII	7.6	8.6	0.4	6.2		
Other	34.2	41.1	67.9	16.7		



Recent event & key risks

- Amalgamates JVs with Kubota
- Key Risk: (i) Lower than anticipated volume growth in the tractor segment (ii) Lower than anticipated margin recovery

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Key Financial Summary								
Key Financials	FY19	FY20	FY21	FY22	5 year CAGR (FY17-22)	FY23E	FY24E	2 year CAGR (FY22-24E)
Net Sales	6,196.4	5,761.0	6,929.3	7,152.6	11.8%	7,989.0	8,819.4	11.0%
EBITDA	733.3	675.8	1,129.2	951.4	24.1%	892.7	1,102.4	7.6%
EBITDA Margins (%)	11.8	11.7	16.3	13.3		11.2	12.5	
Net Profit	484.9	485.6	874.1	765.7	36.7%	742.8	931.5	10.3%
EPS (₹)	36.8	36.8	66.3	58.0		56.3	70.6	
P/E	53.5	53.4	29.7	33.9		34.9	27.8	
RoNW (%)	15.6	14.2	16.2	9.7		8.7	10.0	
RoCE (%)	19.3	16.2	18.7	10.4		8.8	10.1	

Source: Company, ICICI Direct Research

Key Takeaways from PPT ...

Exhibit 1: Transaction Summary

Amalgamation

Kubota Agriculture India Private Limited (60:40 Joint venture between KBT and EKL) and Escorts Kubota India Private Limited (60:40 Joint venture between KBT and EKL) amalgamation With Escorts Kubota Limited.

Swap Ratio

- The Shareholders of EKI, as on the Effective date will receive 5 shares of EKI (each of face value of Rs.10/), for 129 shares held in EKI (each of face value of Rs. 100/-), i.e. Share Exchange Ratio 1 of 5:129; and
- The Shareholders of KAI, as on the Effective date will receive 5 shares of EKL (each of face value of Rs. 10/-), for 220 shares held in KAI (each of face value of Rs. 10/-), i.e. Share Exchange Ratio 2 of 5:220
- Equity share(s) holding by EKL in KAI and EKI will be extinguished as per the Scheme.

The appointed date for the amalgamation shall be 1st April 2023.

Source: Company, ICICI Direct Research

Exhibit 2: Benefits from simplification

Dealer Partner

- High product quality: on the back of robust manufacturing and design processes.
- Global best practices on delivering delightful customer experience.
- Cost-competitiveness arising from our global scale of operations.

Human Resource

- Immense learning from standardization of process, experience and exposure across various geographies
- Optimized management structure and reduction in overlaps and associated costs due to operation of multiple companies.

Shareholders

- Strong Strategic Partnership to open opportunities at a global level.
- Optimization of the allocated capital and availability of funds which can be deployed more
 efficiently to pursue the operational growth opportunities.
- · Better returns with consolidation of funds and optimized working capital utilization

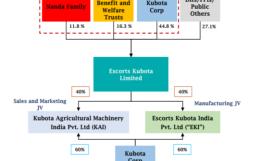
Post Scheme approval EKL will be 3rd leading* domestic player in India

Exhibit 3: Company Structure - simplified

1.7 Lacs Single Capacity & Common Supplier Base for cost optimization

Source: Company, ICICI Direct Research

Current Structure Post Scheme of Arrangement (m share reduction Promoter & Promoter Group Promoter & Promoter Group Escorts DIIs/FPIs/



Promoter & Promoter Group

Nanda Family Kubota Corp

14.0 % 54.1%

Escorts Kubota
Limited

Source: Company, ICICI Direct Research

Exhibit 4: SoTP based target price calculation	
Particulars	Amount (₹ crore)
FY24E Standalone PAT (pre-merger, erstwhile Escorts Ltd)	931.5
FY24E PAT of Escorts Kubota India Pvt. Ltd (separate tractor Manufacturing Unit)	13.6
FY24E PAT of Kubota Agriculture India Private Limited (sales & marketing arm of Kubota)	123.6
Total PAT (includes PAT of erstwhile Escorts + JV's PAT now 100% owned)	1,069
No of Shares post merger and cancellation of treasury shares (crore)	11.2
EPS (₹/share)	95.5
PE Multiple (x)	25
Target Price (₹/share)	2,390
Current Market Price (₹/share)	1,965
Potential Upside (%)	22%

Source: ICICI Direct Research

crane business and selling of residual stake in its JV in the crane domain i.e. Tadano Escorts India Pvt. Ltd to the JV partner at a fair value (Equity investment pegged at ~₹ 72 crore, reported loss of ₹21 crore in FY22)

The company also informed about purchase of RT

Post this arrangement & extinguishment of existing treasury shares total holding for Kubota will be revised to 54.07% vs. 44.8% currently with resultant total promoter pegged at 68%.

Financial Summary

Exhibit 5: Profit and loss statement				
(Year-end March)	FY21	FY22	FY23E	FY24E
Total operating Income	6,929.3	7,152.6	7,989.0	8,819.4
Growth (%)	20.3	3.2	11.7	10.4
Raw Material Expenses	4,153.6	4,424.1	5,191.2	5,644.4
Employee Expenses	534.6	528.2	544.4	573.3
Other expenses	671.8	740.3	846.5	926.0
Total Operating Expenditure	5,800.1	6,201.3	7,096.3	7,717.0
EBITDA	1129.2	951.4	892.7	1102.4
Growth (%)	67.1	-15.7	-6.2	23.5
Depreciation	115.7	129.8	140.8	159.8
Interest	11.0	12.7	11.4	10.3
Other Income	154.6	213.0	253.7	313.0
PBT	1,157.1	1,021.9	994.1	1,245.3
Total Tax	283.1	256.3	251.2	313.8
Tax rate	24.5	25.1	25.3	25.2
PAT	874.1	765.7	742.8	931.5
Growth (%)	80.0	-12.4	-3.0	25.4
EPS (₹)	66.2	58.0	56.3	70.6

Source: Company, ICICI Direct Research

Exhibit 6: Cash flow statem	₹	crore		
(Year-end March)	FY21	FY22	FY23E	FY24E
Profit after Tax	874.1	765.7	742.8	931.5
Add: Depreciation	115.7	129.8	140.8	159.8
(Inc)/dec in Current Assets	269.3	-320.0	-97.3	-266.0
Inc/(dec) in CL and Provisions	-55.7	-319.0	453.5	266.7
CF from operating activities	1203.4	256.5	1239.9	1092.0
(Inc)/dec in Investments	-1,013.3	-2,933.0	-750.0	-600.0
(Inc)/dec in Fixed Assets	-103.5	-189.6	-263.6	-260.0
Others	-119.2	87.1	-84.0	-77.8
CF from investing activities	-1235.9	-3035.5	-1097.6	-937.8
Issue/(Buy back) of Equity	12.2	-2.9	0.0	0.0
Inc/(dec) in loan funds	-6.6	0.0	0.0	0.0
Dividend paid & dividend tax	-91.9	-85.8	-98.1	-131.9
Inc/(dec) in Sec. premium	1,029.8	1,863.4	0.0	0.0
Others	87.4	-53.9	0.0	0.0
CF from financing activities	1030.9	1720.8	-98.1	-131.9
Net Cash flow	998.4	-1,058.2	44.3	22.3
Opening Cash	318.3	1,316.6	258.4	302.7
Closing Cash	1316.6	258.4	302.7	325.0

Source: Company, ICICI Direct Research

Exhibit 7: Balance Sheet				₹ crore
(Year-end March)	FY21	FY22	FY23E	FY24E
Liabilities				
Equity Capital	134.8	131.9	131.9	131.9
Reserve and Surplus	5,256.8	7,746.2	8,391.0	9,190.5
Total Shareholders funds	5391.7	7878.2	8523.0	9322.5
Total Debt	0.0	0.0	0.0	0.0
Other non-current Liabilities	106.7	114.5	112.9	111.3
Long-term Provisions	49.0	42.0	35.1	28.2
Total Liabilities	5547.3	8034.7	8670.9	9461.9
Assets				
Gross Block	2,794.5	2,942.3	3,192.3	3,442.3
Less: Acc Depreciation	1,109.6	1,215.4	1,333.1	1,465.8
Net Block	1,684.9	1,726.9	1,859.2	1,976.5
Capital WIP	41.2	56.3	81.3	71.3
Total Fixed Assets	1726.0	1783.2	1940.5	2047.8
Net Intangible Asset	51.5	54.1	19.5	12.4
Investments	2,322.8	5,150.0	5,950.0	6,600.0
Inventory	674.5	803.6	875.5	966.5
Debtors	698.4	827.6	875.5	966.5
Loans and Advances	32.8	25.5	39.6	32.3
Other Current Assets	189.4	281.1	244.4	335.7
Cash	1316.6	258.4	302.7	325.0
Total Current Assets	2,911.7	2,196.1	2,337.7	2,626.1
Creditors	1,187.1	877.7	1,203.8	1,449.8
Provisions & Other Curr.Liab	468.9	459.4	586.7	607.5
Total Current Liabilities	1,656.0	1,337.0	1,790.6	2,057.3
Net Current Assets	1255.7	859.1	547.2	568.8
Net Deferred Tax Asset	-23.0	-37.9	-37.9	-37.9
Other non-current assets	154.5	170.5	192.4	208.2
Application of Funds	5547.3	8034.7	8670.9	9461.9

Source: Company, ICICI Direct Research

Exhibit 8: Key ratios				
(Year-end March)	FY21	FY22	FY23E	FY24E
Per share data (₹)				
EPS	66.2	58.0	56.3	70.6
Cash EPS	80.7	67.9	67.0	82.7
BV	439.8	597.1	646.0	706.6
DPS	7.5	6.5	7.4	10.0
Cash Per Share	242.1	367.1	427.3	474.4
Operating Ratios				
EBITDA Margin (%)	16.3	13.3	11.2	12.5
PAT Margin (%)	12.6	10.7	9.3	10.6
Inventory days	35.5	41.0	40.0	40.0
Debtor days	36.8	42.2	40.0	40.0
Creditor days	62.5	44.8	55.0	60.0
Return Ratios (%)				
RoE	16.2	9.7	8.7	10.0
RoCE	18.7	10.4	8.8	10.1
RoIC	42.1	27.2	26.5	31.1
Valuation Ratios (x)				
P/E	27.6	33.9	34.9	27.8
EV / EBITDA	20.3	22.2	22.7	17.8
EV / Net Sales	3.3	2.9	2.5	2.2
Market Cap / Sales	3.7	3.6	3.2	2.9
Price to Book Value	4.5	3.3	3.0	2.8
Solvency Ratios				
Debt/ EBITDA	0.0	0.0	0.0	0.0
Debt / Equity	0.0	0.0	0.0	0.0
Current Ratio	1.2	2.0	1.5	1.4
Quick Ratio	0.7	1.2	0.9	0.8

Source: Company, ICICI Direct Research

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