

Escorts Kubota

Estimate changes

TP change

Rating change



Bloomberg	ESCORTS IN
Equity Shares (m)	135
M.Cap.(INRb)/(USDb)	262.7 / 3.2
52-Week Range (INR)	2190 / 1400
1, 6, 12 Rel. Per (%)	-11/18/29
12M Avg Val (INR M)	1599

Financials & Valuations (INR b)

INR million	2022	2023E	2024E
Sales	72.4	81.9	89.9
EBITDA	9.5	8.2	12.1
EBITDA Margin (%)	11.3	8.2	11.8
Adj. PAT	7.6	6.7	10.0
EPS (INR)	69.2	60.4	81.7
EPS Gr. (%)	-19.7	-12.7	35.2
BV/Sh. (INR)	687.8	734.3	734.6

Ratios

RoE (%)	12.1	8.5	11.7
RoCE (%)	16.4	11.5	15.8
Payout (%)	10.1	12.6	12.2

Valuations

P/E (x)	28.8	33.0	24.4
P/BV (x)	2.9	2.7	2.7
EV/EBITDA (x)	23.5	31.8	20.9
Div. Yield (%)	0.4	0.4	0.5
FCF yield (%)	-0.5	3.2	3.3

Shareholding pattern (%)

As On	Sep-22	Jun-22	Sep-21
Promoter	72.9	72.9	36.6
DII	7.7	6.2	7.6
FII	6.4	6.0	23.6
Others	13.0	14.9	32.2

FII Includes depository receipts

CMP: INR1,991

TP: INR1,875 (-6%)

Neutral

Below our estimate; widespread cost inflation hurts margin

Tractor growth guidance raised to mid-to-high single-digits in FY23

- ESCORTS' performance was severely impacted by inflationary pressures across all fronts in 2QFY23. While the outlook for 2HFY23 has improved, margin recovery will take a little longer, considering the largely unabsorbed cost inflation.
- We reduce our FY23E/FY24E estimate by 11%/2% to factor in higher cost pressures. We maintain our **Neutral** rating with a TP of INR1,875.

Earnings miss our estimate led by significant cost inflation

- Revenue grew by ~12% YoY to INR18.8b, while EBITDA/PAT fell by ~33%/20% to ~INR1.5b/INR1.4b in 2QFY23. Revenue grew by ~16% while EBITDA/PAT fell 23%/20% YoY in 1HFY23.
- Tractor volumes grew by ~13% YoY. Net realizations improved by ~3% YoY to INR613.8k (est. INR607k), driven by price hikes and mix. Revenue from Tractors/Railways grew 13%/7% YoY, but declined by 3% in the Construction Equipment segment.
- Gross margin contracted by 6.5pp YoY and 2.1pp QoQ to 27.6% (est. 29%). This, coupled with higher employee cost and other expenses, dragged EBITDA margin by 5.4pp YoY to 8.1% (est. 10.9%).
- The PBIT margin for the Tractor segment contracted by 6.5pp YoY to 8.4%. The same for the Railways segment stood at 14.6% (down 2.7pp YoY). CE was negative at the PBIT level.
- Adjusted PAT stood at INR1.42b (est. INR1.63b), a decline of 20% YoY.

Highlights from the management commentary

- **Tractor industry:** The management expects FY23 volumes to grow in mid-to-high single-digits (v/s its earlier guidance of low single digits). It is likely to surpass its previous volumes of ~900k units.
- **Inventory correction is likely to occur in Nov-Dec'22** across OEMs. ESCORTS' inventory is already down to 30-35 days.
- **Unabsorbed commodity cost stood at 4-5%** after the price hike of 2% in Jul'22. There is an anticipation of another price hike in 3QFY22. Commodity cost savings haven't been realized as expected (especially for castings). In fact, there has been an increase in the cost of tyres.
- **Capex guidance was reduced to INR2.5b in FY23** (from INR3-3.5b earlier) as there is a relook at certain projects, which may spill over to FY24.

Valuation and view

- We expect uncertainty in the Tractor cycle to continue, led by anticipation of a sharp correction in inventory in 3QFY23 and impact of the implementation of TREM IV norms for over 50HP Tractors from Jan'23. This, along with a high base of FY23, will keep volume growth under check in the foreseeable future. Faster recovery in other businesses and a ramp-up in its partnership with Kubota will dilute the impact of a weaker Tractor cycle on ESCORTS.

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

Motilal Oswal research is available on www.motilalosal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

- The stock trades at 24.4x consolidated FY24E EPS, which is at a premium to its 10-year average of ~12x, led by an improvement in its operating parameters as well as its partnership with Kubota. The Tractor cycle is nearing its peak, and valuations are already reflecting a volume recovery as well as the benefits accruing from its partnership with Kubota. Hence, we maintain our **Neutral** rating, with a TP of INR1,875 (20x Dec'24E consolidated EPS).

Standalone quarterly performance

Y/E March	(INR m)										
	FY22				FY23				FY22	FY23E	FY23E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			2QE
Net Sales	16,715	16,788	19,575	18,696	20,149	18,835	21,595	21,345	71,774	81,924	18,637
Change (YoY %)	57.4	2.4	-3.0	-15.4	20.5	12.2	10.3	14.2	3.6	14.1	12.1
Total Expenditure	14,383	14,522	16,929	16,181	18,133	17,308	19,444	18,847	62,014	73,731	16,610
EBITDA	2,332	2,267	2,646	2,515	2,016	1,527	2,151	2,499	9,760	8,192	2,026
Margin (%)	14.0	13.5	13.5	13.5	10.0	8.1	10.0	11.7	13.6	10.0	10.9
Depreciation	314	329	325	330	364	365	365	362	1,298	1,456	360
Interest	30	36	33	29	26	23	30	41	127	120	30
Other Income	472	473	400	538	354	776	575	595	1,883	2,300	550
PBT	2,461	2,374	2,688	2,695	1,981	1,187	2,331	2,690	10,219	8,189	2,186
Rate (%)	24.8	25.6	25.0	25.0	25.6	26.1	25.1	25.1	25.1	25.1	25.2
Adj. PAT	1,852	1,767	2,015	2,022	1,475	1,421	1,745	2,014	7,656	6,675	1,636
Change (YoY %)	101.0	-23.1	-28.2	-25.5	-20.4	-19.6	-13.4	-0.4	-12.4	-12.8	-7.4
Margin (%)	11.1	10.5	10.3	10.8	7.3	7.5	8.1	9.4	10.7	8.1	8.8

E: MOFSL estimates

Key performance indicators

	FY22				FY23				FY22	FY23E	FY23E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			2QE
Volumes ('000 units)	25,935	21,073	25,325	21,895	26,797	23,703	27,248	24,961	94,228	1,02,709	23,703
Change (%)	42.9	-13.8	-19.8	-32.8	3.3	12.5	7.6	14.0	-11.7	9.0	12.5
Net Realization (INR'000/unit)	544.2	596.5	594.5	626.1	595.5	613.8	613.8	620.6	585.9	610.7	607.4
Change (%)	3.6	10.3	13.5	17.3	9.4	2.9	3.2	-0.9	10.4	4.2	3.1
Cost break-up as a percentage of sales											
RM Cost	68.3	65.9	70.2	70.1	72.2	72.4	72.2	70.9	68.7	71.9	71.0
Staff Cost	8.2	8.3	6.8	6.4	6.8	7.9	7.0	6.7	7.4	7.1	7.4
Other Cost	9.6	12.3	9.5	10.1	11.0	11.6	10.8	10.7	10.3	11.0	10.8
Gross Margin (%)	31.7	34.1	29.8	29.9	27.8	27.6	27.8	29.1	37.4	28.1	29.0
EBITDA Margin (%)	14.0	13.5	13.5	13.5	10.0	8.1	10.0	11.7	13.6	10.0	10.9
EBIT Margin (%)	12.1	11.5	11.9	11.7	8.2	6.2	8.3	10.0	11.8	8.2	8.9
Segmental PBIT Margin (%)											
Agri Machinery	15.6	14.9	15.8	15.4	10.6	8.4	0.0	0.0	15.5	0.0	0.0
Railway Equipment	14.6	17.3	14.3	13.1	13.6	14.6	0.0	0.0	15.1	0.0	0.0
Construction Equipment	-2.3	3.6	2.5	3.6	1.0	-2.6	0.0	0.0	2.4	0.0	0.0

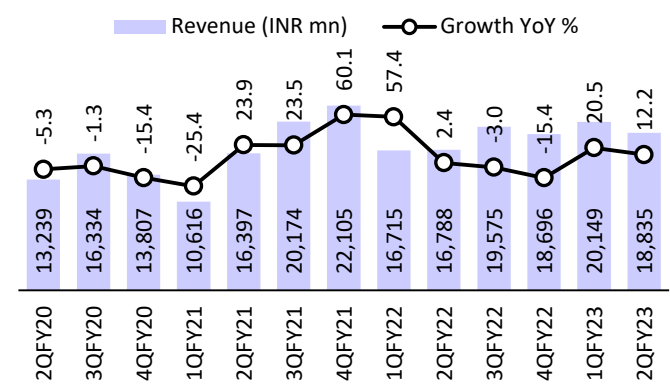
E: MOFSL estimates



Highlights from the management commentary

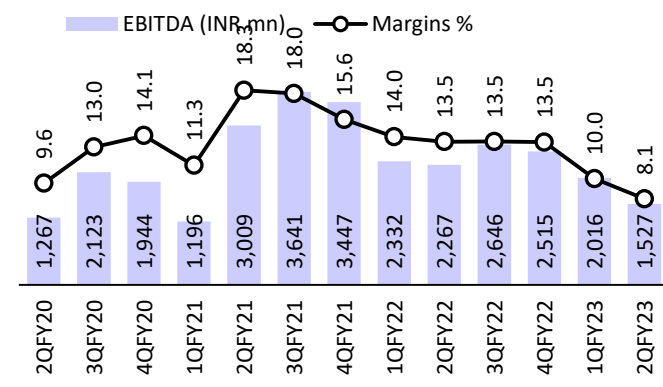
- **Tractor industry:** The management expects FY23 volumes to grow in mid-to-high single-digits (v/s its earlier guidance of low single digits). It is likely to surpass its previous volumes of ~900k units.
- **Inventory correction is likely to occur in Nov-Dec'22** across OEMs. ESCORTS' inventory is already down to 30-35 days.
- **Unabsorbed commodity cost stood at 4-5%** after the price hike of 2% in Jul'22. There is an anticipation of another price hike in 3QFY22. Commodity cost savings haven't been realized as expected (especially for castings). In fact, there has been an increase in the cost of tyres.
- ESCORTS have already started supplying to Europe, South Africa, and Sri Lanka through the Kubota channel. Currently, the Kubota channel contributes ~20% to total exports. A localization plan exists, but execution has not started yet. Export of components will also have a significant share.
- The TREM IV deadline for production of over 50HP Tractors has been extended till 31st Dec'22, with Retail sales allowed six months after that. The new norms will result in a price hike of INR60-100k, depending on the size of the Tractor.
- Its Tractor dealer count has increased to over 1,170, with large additions in South and West India.
- **Revenue from Construction Equipment** is expected to grow in single-digits in FY23, wherein margin is expected to improve in 2H, led by a growth in volumes and softening prices. Demand was impacted in 2Q as it has been passing on the inflation in raw material prices, while its peers are yet to pass on the same. So far, it has passed on 80-85% of the cost inflation.
- Revenue from the **Railways** business is expected to grow in double-digits in FY23, along with an improvement in margin. It currently has a record order book of over INR9b. It has successfully completed field trials for an indigenously developed rack pack for the Indian Railways and dampeners for the Chennai Metro. It is now developing a braking system and couplers.
- **Capex guidance was reduced to INR2.5b in FY23** (from INR3-3.5b earlier) as there is relook at certain projects, which may spill over to FY24.
- Net cash stood at INR42-43b as at the end of Sep'22, which is expected to increase to INR48-50b by the end of FY23.

Exhibit 1: Revenue and revenue growth trend



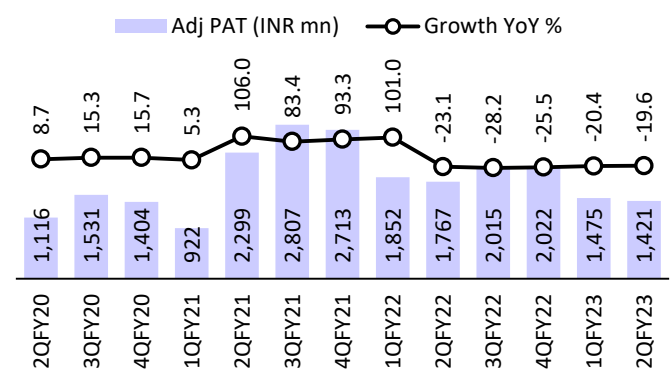
Source: MOFSL, Company

Exhibit 2: EBITDA and EBITDA margin trend



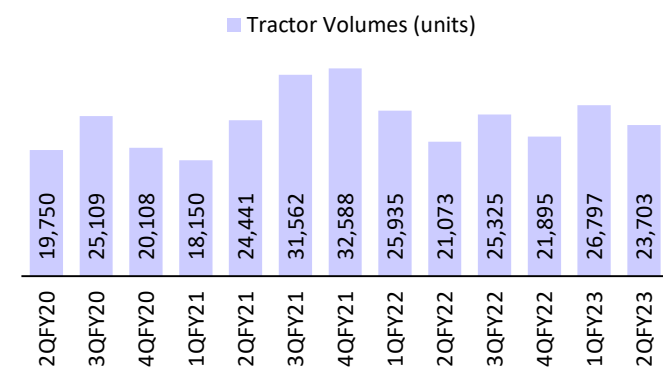
Source: MOFSL, Company

Exhibit 3: Adjusted PAT and growth trend



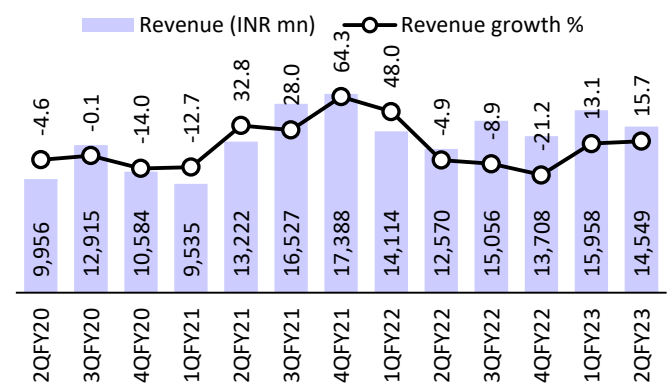
Source: MOFSL, Company

Exhibit 4: Trend in Tractor volumes



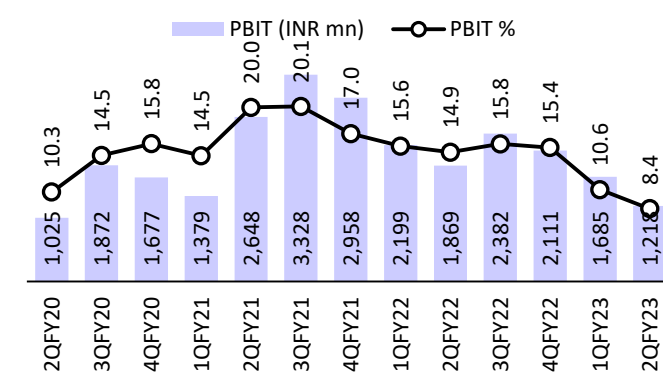
Source: MOFSL, Company

Exhibit 5: Revenue and revenue growth in the Tractor segment



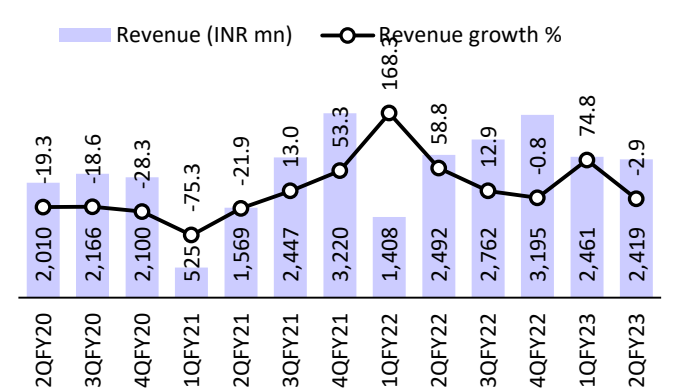
Source: MOFSL, Company

Exhibit 6: PBIT trend in the Tractor segment



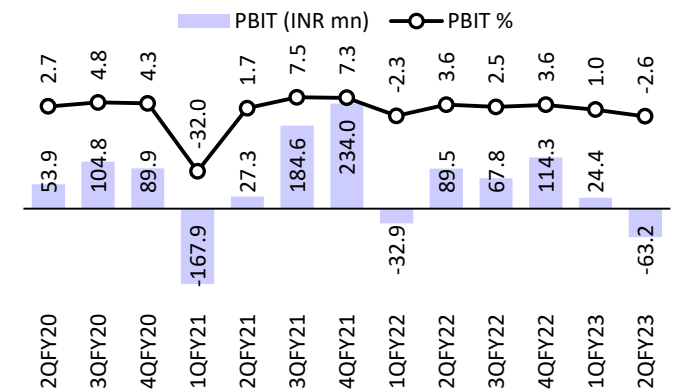
Source: MOFSL, Company

Exhibit 7: Revenue and revenue growth in Construction Equipment segment



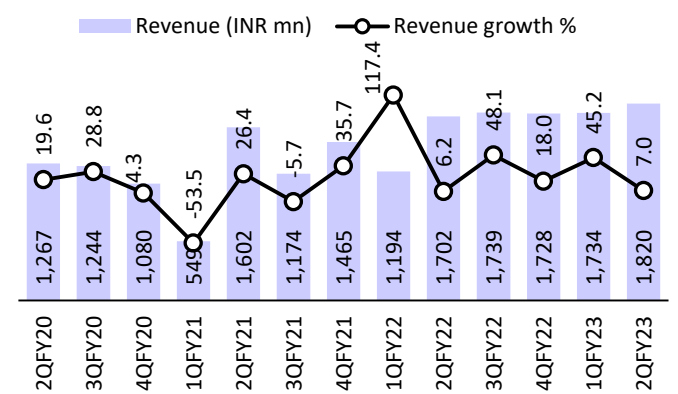
Source: MOFSL, Company

Exhibit 8: PBIT trend in the Construction Equipment segment



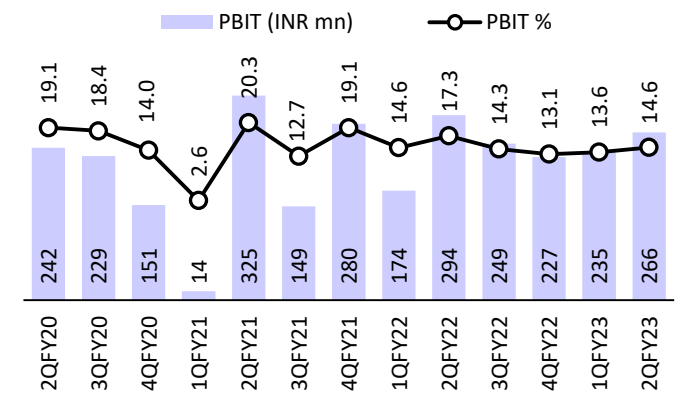
Source: MOFSL, Company

Exhibit 9: Revenue and revenue growth in the Railways segment



Source: MOFSL, Company

Exhibit 10: PBIT trend in the Railways segment



Source: MOFSL, Company

Valuation and view

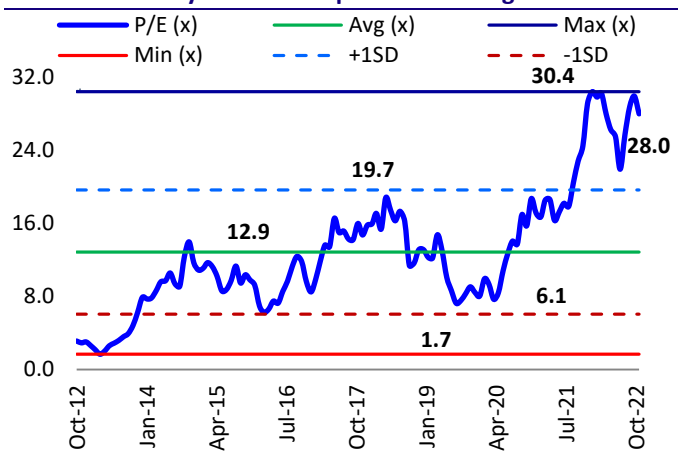
- Outlook improves, but uncertainty still prevails:** After a decline in Wholesales in FY22, ESCORTS expects the domestic industry to grow at mid-to-high single-digits. Volumes are expected to grow in FY23 as: a) agro-economic indicators and farm-level sentiment are still positive, and b) recovery in non-Agri applications is diluting the weakness in the Agri segment. We expect a 6-7% CAGR in Tractor industry volumes over FY22-25. However, uncertainty in the Tractor cycle will continue, led by the anticipation of a sharp correction in inventory in 3QFY23 and impact of the implementation of TREM IV norms for Tractors over 50HP from Jan'23. This, along with a high base of FY23, will keep volume growth under check in the foreseeable future.
- Kubota parentage can unleash many synergies:** Kubota's parentage will help ESCORTS improve its competitive positioning in: a) small Tractors (less than 30HP), b) the export market (by leveraging Kubota's distribution network), c) the Agri Implements business, d) component sourcing, and e) the Construction Equipment business (Kubota is a global leader in small Excavators). Through this partnership, ESCORTS gains access to Kubota's: a) global product know-how in Tractors and Implements, b) global distribution network, and c) global supply chain (by leveraging its India cost base).

- Healthy recovery in Railways and Construction Equipment to dilute the impact of a slowdown in Tractors:** We expect the Railways business to clock ~17% CAGR over FY22-25, benefitting from a ramp-up in new products. Revenue from Construction Equipment is estimated to grow at 14% over FY22-25. The benefits related to localization and cost savings will elevate its margin profile in both segments.
- Tractor cycle showing initial signs of a recovery:** With an expected recovery in its core Tractor business, we expect 11% revenue CAGR over FY22-25. This will result in a margin expansion of ~105bp (over FY22-25) to ~14.2% in FY25. We expect a 12% EPS CAGR, partly led by higher treasury income. Our estimates do not factor in the merger of Kubota’s India businesses.
- Valuation and view:** We reduce our FY23/FY24 estimate by 11%/2% to factor in higher cost pressures. While the near term outlook has improved, recovery in margin is getting delayed. Exports, a leaner cost structure, recovery in the Railways and Construction Equipment segments, and a strong Balance Sheet will dilute the impact on the P&L. After Kubota’s first acquisition of a stake in ESCORTS, the stock got substantially re-rated. The stock trades at 24.4x consolidated FY24E EPS, which is at a premium to its 10-year average of ~12x, led by an improvement in operating parameters as well as its partnership with Kubota. As the Tractor cycle is nearing its peak and given the fairly rich valuations, we maintain our **Neutral** rating, with a TP of INR1,875 (20x Dec’24E consolidated EPS).

Exhibit 11: Revisions in our estimates

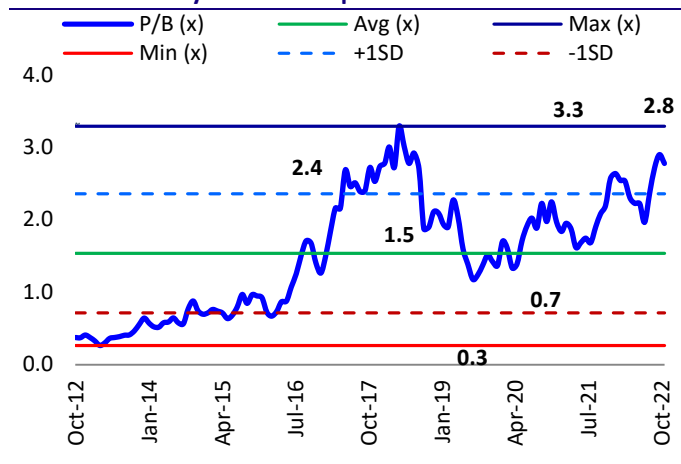
(INR m)	FY23			FY24		
	Revised	Old	Change (%)	Revised	Old	Change (%)
Net Sales	81,924	79,537	3.0	89,910	87,341	2.9
EBITDA	8,192	9,544	-14.2	12,138	12,140	0.0
EBITDA (%)	10.0	12.0	-200bp	13.5	13.9	-40bp
Adj. PAT	6,675	7,524	-11.3	10,009	10,253	-2.4
EPS (INR)	60.4	68.1	-11.3	81.7	83.6	-2.4

Exhibit 12: One-year forward price-to-earnings ratio



Source: MOFSL, Company

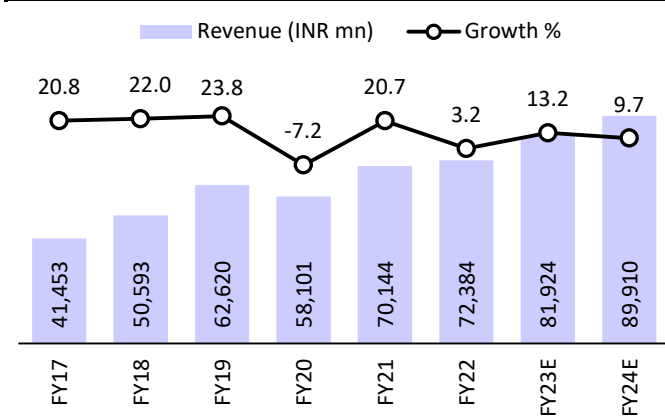
Exhibit 13: One-year forward price-to-book ratio



Source: MOFSL, Company

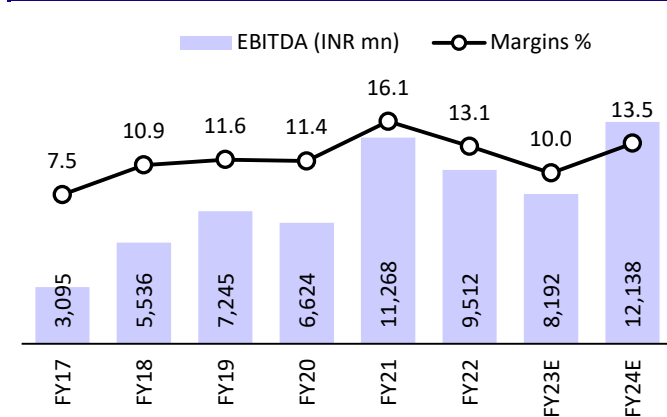
Story in charts

Exhibit 14: Trend in revenue and revenue growth



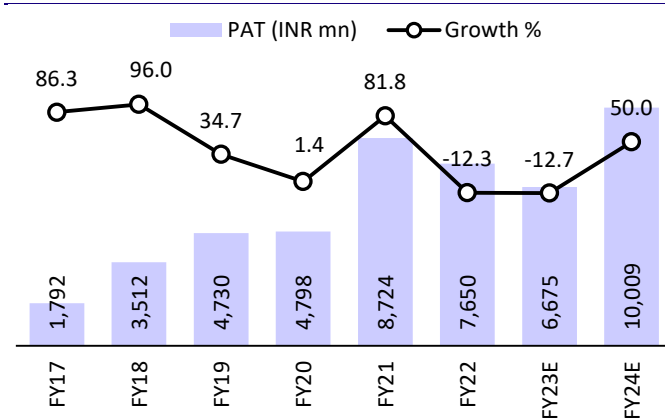
Source: MOFSL, Company

Exhibit 15: EBITDA and EBITDA margin trajectory



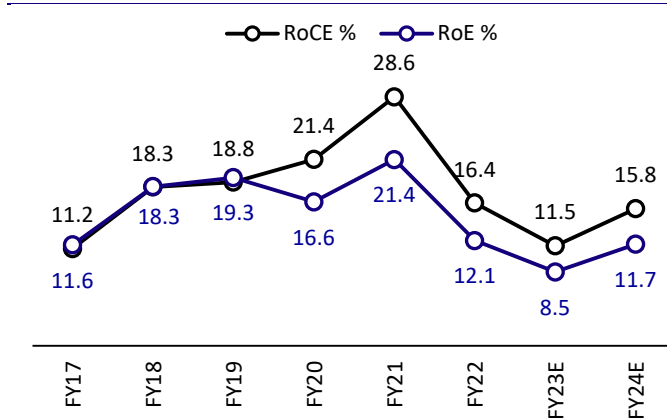
Source: MOFSL, Company

Exhibit 16: PAT and PAT growth trend



Source: MOFSL, Company

Exhibit 17: Trend in RoE and RoCE



Source: MOFSL, Company

Financials and valuations

Consolidated - Income Statement

(INR Million)

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
Total Income from Operations	50,593	62,620	58,101	70,144	72,384	81,924	89,910	99,874
Change (%)	22.0	23.8	-7.2	20.7	3.2	13.2	9.7	11.1
EBITDA	5,536	7,245	6,624	11,268	9,512	8,192	12,138	14,182
Margin (%)	10.9	11.6	11.4	16.1	13.1	10.0	13.5	14.2
Depreciation	732	872	1,072	1,183	1,321	1,456	1,559	1,689
EBIT	4,804	6,373	5,552	10,085	8,191	6,736	10,579	12,493
Int. and Finance Charges	295	195	172	133	150	120	120	120
Other Income	653	924	976	1,604	2,180	2,300	2,915	3,600
PBT bef. EO Exp.	5,162	7,102	6,356	11,555	10,222	8,916	13,374	15,973
EO Items	-68	56	-92	0	0	-728	0	0
PBT after EO Exp.	5,094	7,157	6,263	11,555	10,222	8,189	13,374	15,973
Current Tax	1,625	2,371	1,535	2,832	2,572	2,059	3,364	4,018
Deferred Tax	0	0	0	0	0	0	0	0
Tax Rate (%)	31.9	33.1	24.5	24.5	25.2	25.1	25.2	25.2
Less: Mionrity Interest	4	20	0	0	0	0	0	0
Reported PAT	3,466	4,767	4,728	8,724	7,650	6,130	10,009	11,955
Adjusted PAT	3,512	4,730	4,798	8,724	7,650	6,675	10,009	11,955
Change (%)	96.0	34.7	1.4	81.8	-12.3	-12.7	50.0	19.4
Margin (%)	6.9	7.6	8.3	12.4	10.6	8.1	11.1	12.0

Consolidated - Balance Sheet

(INR Million)

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
Equity Share Capital	1,226	1,226	1,226	1,348	1,319	1,105	1,226	1,226
Total Reserves	20,926	25,509	29,948	48,913	74,680	80,036	88,820	99,549
Net Worth	22,151	26,735	31,174	50,261	75,999	81,141	90,045	1,00,774
Minority Interest	-4	56	51	-9	-38	-38	-38	-38
Deferred Liabilities	197	529	307	233	373	373	373	373
Total Loans	147	2,810	192	17	0	0	0	0
Capital Employed	22,492	30,130	31,724	50,502	76,334	81,476	90,381	1,01,110
Gross Block	24,960	26,213	27,402	29,350	30,799	33,194	36,098	38,979
Less: Accum. Deprn.	9,082	9,741	10,608	11,388	12,389	13,845	15,404	17,093
Net Fixed Assets	15,878	16,472	16,795	17,962	18,411	19,350	20,695	21,886
Capital WIP	657	800	1,044	647	878	983	1,079	1,198
Total Investments	5,490	4,908	7,974	19,380	48,358	48,358	48,358	48,358
Curr. Assets, Loans&Adv.	17,700	24,890	23,895	30,792	23,431	31,206	40,465	52,124
Inventory	5,657	8,574	8,834	7,182	8,466	9,683	10,198	11,328
Account Receivables	5,920	9,311	7,319	6,576	7,926	8,305	9,114	10,124
Cash and Bank Balance	3,173	2,433	3,249	13,218	2,718	8,034	14,932	23,206
Loans and Advances	2,949	4,572	4,494	3,817	4,320	5,184	6,221	7,465
Curr. Liability & Prov.	17,242	16,952	18,430	18,279	14,743	18,421	20,216	22,457
Account Payables	15,746	15,495	16,867	16,771	13,341	16,834	18,475	20,522
Provisions	1,495	1,458	1,563	1,508	1,402	1,587	1,742	1,935
Net Current Assets	458	7,938	5,465	12,513	8,687	12,785	20,249	29,667
Deferred Tax assets	8	12	14	0	0	0	0	0
Misc Expenditure	0	0	0	0	0	0	0	0
Appl. of Funds	22,493	30,130	31,292	50,502	76,334	81,476	90,381	1,01,110

E: MOSL Estimates

Financials and valuations

Ratios

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
Basic (INR)								
EPS (ex treasury)	39.5	53.2	54.0	86.3	69.2	60.4	81.7	97.5
BV/Share	249.2	300.8	350.7	497.0	687.8	734.3	734.6	822.1
DPS	2.0	2.5	2.5	7.5	7.0	7.0	10.0	10.0
Payout (%)	6.2	5.6	5.7	8.7	10.1	12.6	12.2	10.3
Valuation (x)								
P/E	50.5	37.5	37.0	23.1	28.8	33.0	24.4	20.5
P/BV	8.0	6.6	5.7	4.0	2.9	2.7	2.7	2.4
EV/Sales	3.9	3.2	3.4	3.6	3.7	3.2	2.8	2.5
EV/EBITDA	35.9	27.9	30.0	16.7	23.5	31.9	20.9	17.3
Dividend Yield (%)	0.1	0.1	0.1	0.4	0.4	0.4	0.5	0.5
FCF per share	28.9	-31.6	50.2	75.3	-10.7	58.1	66.3	78.5
Return Ratios (%)								
RoE	18.3	19.3	16.6	21.4	12.1	8.5	11.7	12.5
RoCE	18.3	18.8	21.4	28.6	16.4	11.5	15.8	16.9
RoIC	24.5	24.2	20.2	41.5	29.4	20.8	31.6	34.4
Working Capital Ratios								
Asset Turnover (x)	2.2	2.1	1.9	1.4	0.9	1.0	1.0	1.0
Inventory (Days)	61	73	84	56	62	60	60	60
Debtor (Days)	43	54	46	34	40	37	37	37
Creditor (Days)	114	90	106	87	67	75	75	75
Leverage Ratio (x)								
Net Debt/Equity	-0.4	-0.1	-0.3	-0.6	-0.6	-0.7	-0.7	-0.7

Consolidated - Cash Flow Statement

(INR Million)

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
OP/(Loss) before Tax	5,091	7,157	6,253	11,548	9,928	8,916	13,374	15,973
Depreciation	732	872	1,072	1,183	1,321	1,456	1,559	1,689
Interest & Finance Charges	-26	-301	0	0	0	120	120	120
Direct Taxes Paid	-1,021	-2,166	-1,748	-2,527	-2,547	-2,059	-3,364	-4,018
(Inc)/Dec in WC	-181	-7,449	3,272	2,748	-6,526	1,218	-566	-1,144
Others	5	-456	-877	-1,639	-1,853	-728	0	0
CF from Operating incl EO	4,601	-2,343	7,972	11,313	323	8,924	11,122	12,620
(inc)/dec in FA	-1,059	-1,529	-1,822	-1,157	-1,732	-2,500	-3,000	-3,000
Free Cash Flow	3,541	-3,873	6,150	10,155	-1,409	6,424	8,122	9,620
(Pur)/Sale of Investments	-2,934	994	-2,390	-20,778	-16,804	0	0	0
Others	252	362	0	0	-28	0	0	0
CF from Investments	-3,742	-174	-4,212	-21,936	-18,564	-2,500	-3,000	-3,000
Issue of Shares	2,501	28	0	10,576	19,021	-214	121	0
Inc/(Dec) in Debt	-2,134	2,309	-2,644	-221	-87	0	0	0
Interest Paid	-216	-138	-100	-76	-98	-120	-120	-120
Dividend Paid	-161	-289	-260	-245	-737	-773	-1,226	-1,226
CF from Fin. Activity	-10	1,906	-3,001	9,991	18,099	-1,108	-1,225	-1,346
Inc/Dec of Cash	849	-611	758	-632	-142	5,316	6,897	8,274
Opening Balance	693	1,542	931	1,689	1,057	915	6,231	13,128
Closing Balance	1,542	931	1,689	1,057	915	6,231	13,128	21,403

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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