

Escorts Kubota (ESCORT)

CMP: ₹ 2,030

Target: ₹ 2,365 (17%)

Target Period: 12 months

November 20, 2022

Transforming for enduring growth, reveals mid-term growth plan largely leveraging Kubota's strengths...

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%
- Kubota (Japanese company), a co-promoter with effective stake at 53.5%

Key Highlights:

- We recently attended Escorts Kubota's (EKL) analyst meet in Faridabad wherein the company revealed its mid-term business plan (MTBP)
- MTBP key highlights, FY28 targets: (i) aspiration to grow **revenues to >2.5x** of FY22 levels (i.e. ~₹ 22,500+ crore in FY28E, implied CAGR of 16.5%+); (ii) increase **share of exports** from ~6.4% in FY22 to **~15-20% in FY28E**; (iii) target **EBITDA margins to mid-teens**; (iv) **RoCE at 25-30%** and **RoE > 18%**
- Within segments, agri segment is expected to grow by 2.5x; construction equipment is expected to grow by 2x; whereas railway division is expected to grow by 3x by FY28E riding on new products under development
- It also shared firm capital allocation strategy wherein EKL will invest up-to **5% of net profit for R&D, innovation** for new technologies; cash return to shareholders in the form of **dividend + buyback at up-to 40% of net profit**
- On the cash application part, it envisages **~₹ 3,500-4,000 crore as growth capex** for MTBP for augmenting capacities including greenfield expansion, **debt repayment** at to be merged entity (~₹ 400-500 crore), **inorganic opportunities (start-up investments)** and return of cash to shareholders
- We came impressed with cultural shift, which EKL is seeing imbibing the best practices at Kubota and leverage opportunities that it sees to cross sell as well as development of EKL as one of the sourcing hubs for Kubota

What should investors do? The company's stock price has grown ~24% CAGR in last five years from ~₹ 700 in November 2017, vastly outperforming Nifty Auto Index.

- We retain **BUY** rating amid wider opportunity at play with Kubota coming on board as co-promoter and strong financials amid healthy RoCE targets

Target Price and Valuation: Revising our estimates, we now value Escorts Kubota at SOTP-based TP of ₹ 2,365 (25x P/E on core FY24E EPS; earlier TP of ₹ 2,330).

Key triggers for future price performance:

- Incorporating the positives, we expect sales to grow at a CAGR of 14.4% over FY22-24E, with consequent operating margins seen at 12.0% by FY24

Alternate Stock Idea: Apart from Escorts Kubota, we like M&M in the auto space.

- UV differentiation & EV proactiveness. BUY with target price of ₹ 1,590

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%	8,221.2	9,360.1	14.4%
EBITDA	733.3	675.8	1,129.2	951.4	24.1%	807.5	1,123.2	8.7%
EBITDA Margins (%)	11.8	11.7	16.3	13.3		9.8	12.0	
Net Profit	484.9	485.6	874.1	765.7	36.7%	630.8	972.4	12.7%
EPS (₹)	36.8	36.8	66.3	58.0		47.8	73.7	
P/E	55.2	55.1	30.6	35.0		42.4	27.5	
RoNW (%)	15.6	14.2	16.2	9.7		8.4	10.5	
RoCE (%)	19.3	16.2	18.7	10.4		7.8	10.4	

Source: Company, ICICI Direct Research

BUY



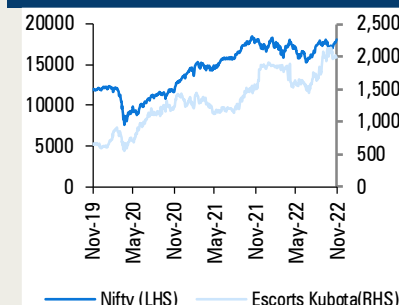
Particulars

Particular	₹ crore
Market Capitalization	26,256
Total Debt (FY22)	0
Cash & Investments (FY22)	4,843
EV	21,413
52 week H/L (₹)	2,190 / 1,307
Equity capital (₹crore)	131.9
Face value	₹ 10

Shareholding pattern

	Dec-21	Mar-22	Jun-22	Sep-22
Promoter	30.3	28.1	72.9	72.9
FII	20.1	3.6	4.2	4.7
DII	8.6	0.4	6.2	7.7
Other	41.1	67.9	16.7	14.7

Price Chart



Recent event & key risks

- Concluded MTBP event
- Key Risk:** (i) Lower than anticipated sales growth and consequent margin recovery (ii) Any delay in executing MTBP

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Other key highlights from Analyst Meet and presentation

Exhibit 1: Key synergies on table for EKL



Source: Company, ICICI Direct Research

Exhibit 2: Increase in manufacturing prints

Manufacturing Footprints

Manufacturing Footprint	Current-2022	Aspiration-2028	Enablers
Manufacturing Plant	5	6	Greenfield
Capacity (Tractor & Engine)	~1.7 Lacs	~3.0 Lacs	

- State-of-art Engine Manufacturing Facility for Domestic & Export by 2024
- BS V readiness to meet the emission regulation
- Global hub for affordable manufacturing



Source: Company, ICICI Direct Research

Exhibit 3: Tractor brands positioning and product profile outlook

Brand & Product Enhancement

Right Positioning of Brands to Cover all Segments

Brands	Powertrac*	Farmtrac	Kubota
Customer Positioning	Entry Level	Mass Segment	Entry Level Premium
Portfolio Expansion	1.5~3X across brands		

Source: Company, ICICI Direct Research

Other highlights

➤ EKL is likely to benefit from frugal manufacturing operations at Escorts coupled with its distribution pan India and technology leadership at Kubota in the farm machinery as well as industrial side coupled with its presence globally

➤ Key fundamental drivers for farm mechanisation remains desire for increasing farm efficiency (output) amid growing population and consequent food grain demand as well as shortage of skilled labour in future

➤ In the tractor segment by FY28E, EKL aspires to be a challenger brand domestically i.e. second largest player with eventual market share aspiration of ~18-20% vs. Escorts + Kubota current share of ~14-15%. It is largely aimed at better product offerings as well as cross selling across each other's distribution strongholds. It is also aimed through dealership expansion as well as captive credit offering unit

➤ EKL also aims to strengthen its exports play and be the largest exporter of tractors from India by FY28E with large part of it to be driven by development of India as a global sourcing hub for Kubota

➤ In the manufacturing operations domain, EKL intends to bring in KPS i.e. Kubota's production system and realise efficiencies

➤ It intends to add one greenfield manufacturing plant and augment its tractor and engine manufacturing capacity from ~1.7 lakh units to ~3 lakh units by FY28

➤ EKL also intends to attain leadership position in the combine harvesters and rice transplanters utilising the product profile at Kubota

➤ It intends to retain three brands in the tractor space- Powertrac (value for money mass offering); Farmtrac (entry level premium offering, utility based) and Kubota (premium only offerings)

➤ It intends to expand its dealership footprint by 50% pan-India by FY28E vs. ~1,100 dealers for Farmtrac & Powertrac brand of tractors & ~300 dealers for Kubota

➤ EKL intends to grow its spare parts business to 2.4x of current levels by FY28E

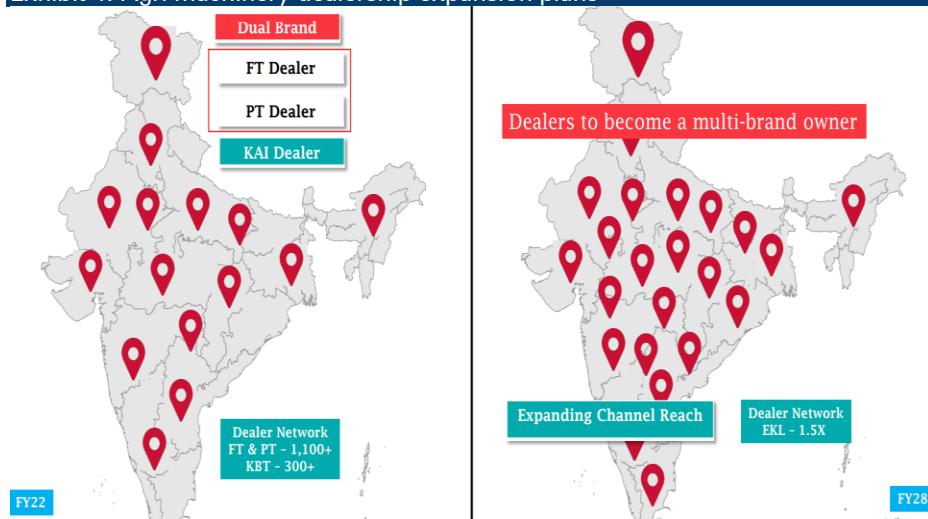
➤ EKL is witnessing good traction of its electric tractor in overseas markets with domestic launch expected soon. Also it intends to roll out CNG & hybrids as well

➤ In the railways segment, EKL primarily operates in the braking segment and is witnessing good demand traction in this space. Present order book at ~₹ 800-900x is ~2x the previous run-rate (~₹ 400-450 crore)

➤ EKL expects 2% margin dilution in the near term as it amalgamates its two JV entities as part of simplification of its corporate structure & business

➤ Kubota sees sourcing from India as ~20% more cost competitive vs. its present sourcing, a strong thrust area to develop India as a global sourcing hub

Exhibit 4: Agri machinery dealership expansion plans



Source: Company, ICICI Direct Research

Exhibit 5: Strengthening product offering for export markets

Product & Channel Enhancement



Expand Farmtrac/ Powertrac Brand via EKL Channel & E-KUBOTA Brand via KBT Global Channel

Compact Segment

Utility Segment

Narrow Segment

Electric Segment

X → 2X new Products across Segment

Strengthen EV portfolio for mature markets and Expand product range in all tractor segments up to 110 HP

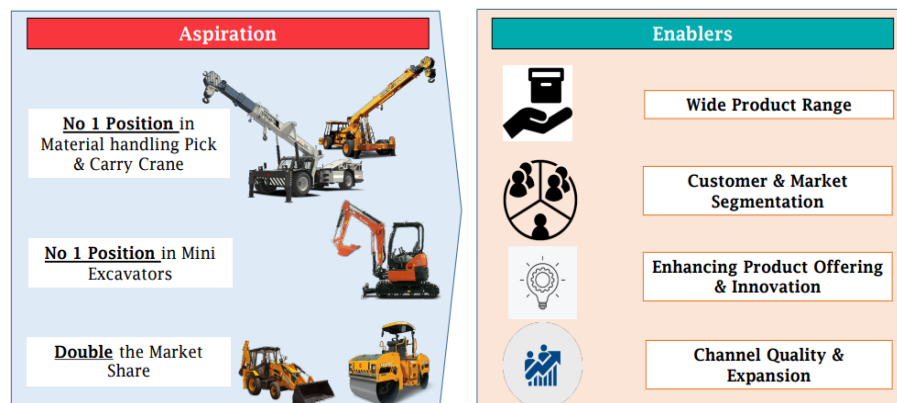
Source: Company, ICICI Direct Research

Exhibit 6: Construction equipment segment – way forward

EKL Construction Equipment's Way Forward



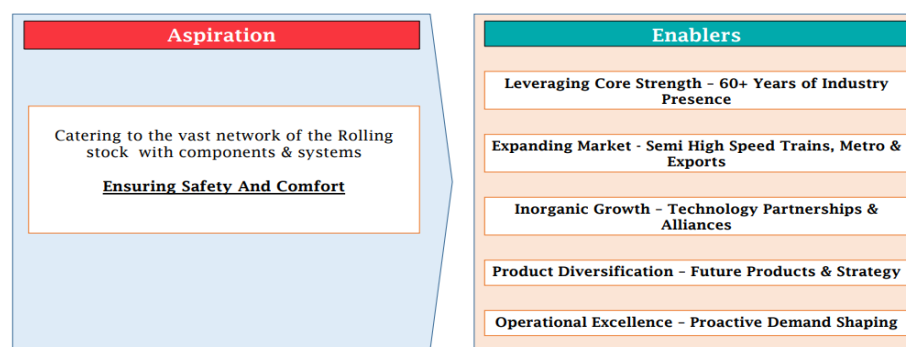
No.1 Brand that contributes to Nation-Building and Urbanization.



Source: Company, ICICI Direct Research

Exhibit 7: Railway segment – way forward

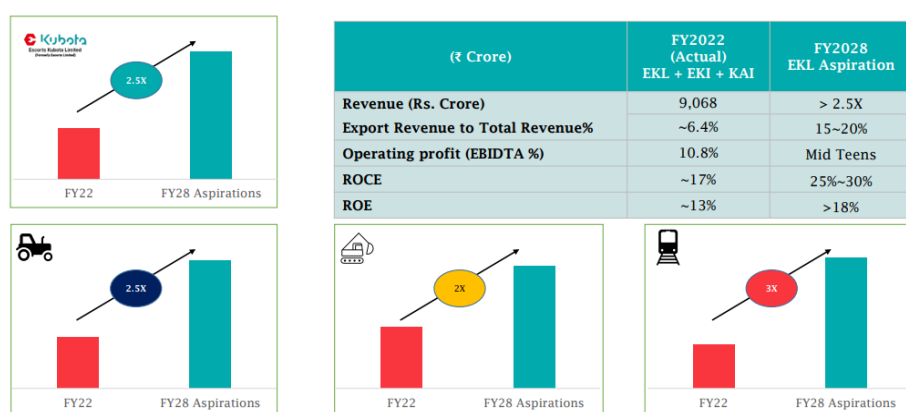
Railway Business Way forward



Source: Company, ICICI Direct Research

Exhibit 8: Mid term business plan aspirations (financials)

Mid-term Business Plan - Aspirations



Source: Company, ICICI Direct Research

Exhibit 9: Capital allocation strategy

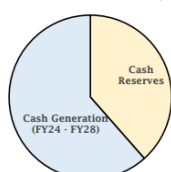
Capital Allocation Strategy > Profitable Growth



EKL is focused on its key priorities for Cash Deployment Strategy through Mid-Term Business Plan

Particulars	Aspiration
Investment in R&D & Innovation	Upto 5% of Net Profit
Shareholder return (including buyback)	Upto 40% of Net profit

Total Capital (Reserves + New Cash Generation)



Cash Applications

- Core Business Growth** (₹ 3,500 ~ ₹ 4,000 crore)
 - Products, Innovation & Technology
 - Green field Expansion
- Debt Repayment** (for merging entities)
- Inorganic Opportunities**
- Buy back & Distribution**

Source: Company, ICICI Direct Research

Exhibit 10: SoTP (target price calculation)

Particulars	Amount (₹ crore)
FY24E Standalone PAT (pre-merger, erstwhile Escorts Ltd)	972.4
FY24E PAT of Escorts Kubota India Pvt. Ltd (separate tractor Manufacturing Unit)	-5.1
FY24E PAT of Kubota Agriculture India Private Limited (sales & marketing arm of Kubota)	90.8
Total PAT (includes PAT of erstwhile Escorts + JV's PAT now 100% owned)	1,058
No of Shares post merger and cancellation of treasury shares (crore)	11.2
EPS (₹/share)	94.6
PE Multiple (x)	25
Target Price (₹/share)	2,365
Current Market Price (₹/share)	2,030
Potential Upside (%)	17%

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 11: Profit and loss statement ₹ crore				
(Year-end March)	FY21	FY22	FY23E	FY24E
Total operating Income	6,929.3	7,152.6	8,221.2	9,360.1
Growth (%)	20.3	3.2	14.9	13.9
Raw Material Expenses	4,153.6	4,424.1	5,371.0	5,990.5
Employee Expenses	534.6	528.2	588.4	655.2
Other expenses	671.8	740.3	925.9	982.8
Total Operating Expenditure	5,800.1	6,201.3	7,413.7	8,236.9
EBITDA	1129.2	951.4	807.5	1123.2
Growth (%)	67.1	-15.7	-15.1	39.1
Depreciation	115.7	129.8	148.3	159.8
Interest	11.0	12.7	11.4	10.3
Other Income	154.6	213.0	270.8	346.9
PBT	1,157.1	1,021.9	918.6	1,300.0
Total Tax	283.1	256.3	215.0	327.6
<i>Tax rate</i>	<i>24.5</i>	<i>25.1</i>	<i>23.4</i>	<i>25.2</i>
PAT	874.1	765.7	630.8	972.4
Growth (%)	80.0	-12.4	-17.6	54.1
EPS (₹)	66.2	58.0	47.8	73.7

Source: Company, ICICI Direct Research

Exhibit 12: Cash flow statement ₹ crore				
(Year-end March)	FY21	FY22	FY23E	FY24E
Profit after Tax	874.1	765.7	630.8	972.4
Add: Depreciation	115.7	129.8	148.3	159.8
(Inc)/dec in Current Assets	269.3	-320.0	-278.0	-354.8
Inc/(dec) in CL and Provisions	-55.7	-319.0	516.1	334.4
CF from operating activities	1203.4	256.5	1017.2	1111.7
(Inc)/dec in Investments	-1,013.3	-2,933.0	-500.0	-350.0
(Inc)/dec in Fixed Assets	-103.5	-189.6	-263.6	-520.0
Others	-119.2	87.1	-94.6	-81.3
CF from investing activities	-1235.9	-3035.5	-858.1	-951.3
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	-85.8	-145.1
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	-85.8	-145.1
Net Cash flow	998.4	-1,058.2	73.3	15.3
Opening Cash	318.3	1,316.6	258.4	331.7
Closing Cash	1316.6	258.4	331.7	347.1

Source: Company, ICICI Direct Research

Exhibit 13: 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	8,291.3	9,118.5
Total Shareholders funds	5391.7	7878.2	8423.2	9250.5
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	8571.2	9390.0
Assets				
Gross Block	2,794.5	2,942.3	3,192.3	3,442.3
Less: Acc Depreciation	1,109.6	1,215.4	1,340.5	1,473.2
Net Block	1,684.9	1,726.9	1,851.8	1,969.1
Capital WIP	41.2	56.3	81.3	331.3
Total Fixed Assets	1726.0	1783.2	1933.1	2300.5
Net Intangible Asset	51.5	54.1	19.5	12.4
Investments	2,322.8	5,150.0	5,700.0	6,100.0
Inventory	674.5	803.6	1,013.6	1,154.0
Debtors	698.4	827.6	901.0	1,025.8
Loans and Advances	32.8	25.5	41.5	34.8
Other Current Assets	189.4	281.1	259.7	356.0
Cash	1316.6	258.4	331.7	347.1
Total Current Assets	2,911.7	2,196.1	2,547.5	2,917.6
Creditors	1,187.1	877.7	1,238.8	1,538.6
Provisions & Other Curr.Liab	468.9	459.4	614.3	648.9
Total Current Liabilities	1,656.0	1,337.0	1,853.1	2,187.5
Net Current Assets	1255.7	859.1	694.3	730.1
Net Deferred Tax Asset	-23.0	-37.9	-37.9	-37.9
Other non-current assets	154.5	170.5	203.0	222.2
Application of Funds	5547.3	8034.7	8571.2	9390.0

Source: Company, ICICI Direct Research

Exhibit 14: Key ratios				
(Year-end March)	FY21	FY22	FY23E	FY24E
Per share data (₹)				
EPS	66.2	58.0	47.8	73.7
Cash EPS	80.7	67.9	59.1	85.8
BV	439.8	597.1	638.4	701.1
DPS	7.5	7.0	7.0	11.0
Cash Per Share	242.1	367.1	410.5	438.2
Operating Ratios				
EBITDA Margin (%)	16.3	13.3	9.8	12.0
PAT Margin (%)	12.6	10.7	7.7	10.4
Inventory days	35.5	41.0	45.0	45.0
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	8.4	10.5
RoCE	18.7	10.4	7.8	10.4
RoIC	42.1	27.2	22.2	30.3
Valuation Ratios (x)				
P/E	28.5	35.0	42.5	27.5
EV / EBITDA	21.1	23.1	26.5	18.7
EV / Net Sales	3.4	3.1	2.6	2.2
Market Cap / Sales	3.9	3.7	3.3	2.9
Price to Book Value	4.6	3.4	3.2	2.9
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	1.6	1.5
Quick Ratio	0.7	1.2	0.9	0.8

Source: Company, ICICI Direct Research

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Sell: <-15%



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