

Escorts Kubota

BSE SENSEX
61,663

S&P CNX
18,308

CMP: INR2,032

TP: INR1,875 (-8%)

Neutral



Bloomberg	ESCORTS IN
Equity Shares (m)	135
M.Cap.(INRb)/(USDb)	268.1 / 3.3
52-Week Range (INR)	2190 / 1400
1, 6, 12 Rel. Per (%)	-2/11/9
12M Avg Val (INR M)	1500
Free float (%)	27.1

Financials & Valuations (INR b)

Y/E MARCH	FY22	FY23E	FY24E
Sales	72.4	81.9	89.9
EBITDA	9.5	8.2	12.1
Adj. PAT	7.7	6.7	10.0
Adj EPS (INR)	69.2	60.4	81.7
EPS Gr (%)	-12.3	-12.7	50.0
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

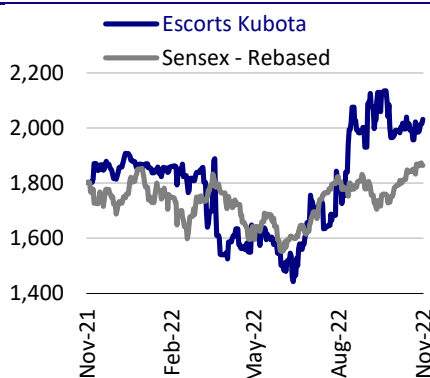
P/E (x)	29.3	33.6	24.9
P/BV (x)	3.0	2.8	2.8
Div. Yield (%)	0.3	0.3	0.5
FCF Yield (%)	-0.5	3.2	3.3

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

Stock Performance (1-year)



Focus on comprehensive growth through synergies

Market share gains, product launches, and exports to be the key focus areas

Escorts Kubota (ESCORTS) hosted the investing community, followed by the plant visit at its Faridabad facility, where the entire senior management presented their mid-term strategy (till FY28E) and focus areas ([link to the presentation](#)). The company is now focusing on leveraging strong synergy benefits for a comprehensive growth across business areas. The company's focus would revolve around a) growing market share in India (through new product launches and channel expansion), b) attaining leadership position in exports (through product developments), c) continuing with the ramp-up of other businesses, and d) improving profitability.

- **Aims to increase market share:** ESCORTS targets to achieve a market share of 18-20% (including Kubota) by FY28E, up from its current 12-13%. This will be driven by i) product expansions (1.5x to 3x) across all three brands (Powertrac, Farmtrac, and Kubota) ranging between 15HP and 110HP and ii) channel expansion by 50% from its current network of ~1,400 dealers (including ~300 for Kubota brand) along with an opportunity for existing dealers to become multi-brand retailers. Kubota has manufacturing plants in Japan, Thailand, America, and EU. The company is of the opinion that there is still some scope for improvement in the quality of products placed in domestic markets.
- **Attain leadership position in exports:** ESCORTS aims to increase its exports contribution to 15-20% of the overall revenue by FY28E from its current ~6.4%. The company is targeting four key high volume markets - USA, Europe, Thailand, and Brazil and intends to leverage Kubota's strong presence in key markets such as North America (~1200 dealers) and Europe (~300 dealers). It will also work with multi-brand vendors in markets such as Africa and South America. The company plans to strengthen its EV portfolio for mature markets and channel expansion will be further complemented by product expansion (~2x) across all the brands.
- **Aims to be the challenger brand in domestic tractor market:** The management indicated a huge scope for growth in the domestic agri-machinery market. Kubota can launch some of its major brands in India going forward. Penetration of rice transplanter in India is at less than 20%. Kubota has launched rice transplanter of ~70HP, which is suitable for the Indian market due to smaller size farms. It has launched only two products so far and multiple launches can be expected in the future.

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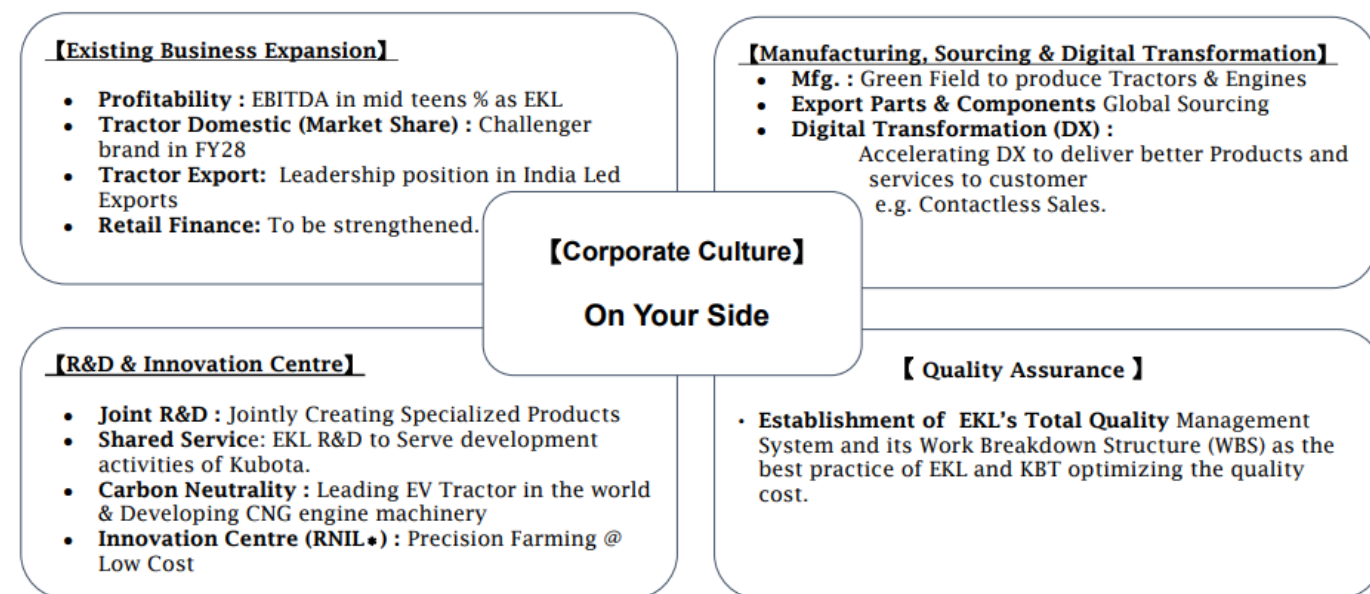
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- **Expect EBITDA to improve to mid-teens by FY28:** The management expects EBITDA to improve driven by i) softening of RM basket and ii) benefits of scale after the Escorts-Kubota tie-up. However, the company expects EBITDA margin to dilute by ~2%, post the merger of two JVs (manufacturing and marketing JVs) as their margins still remain subdued. However, once the integration is completed, margins are expected to improve, led by cost savings. Further, it expects return ratios such as ROCE (pre-tax) and ROE to improve to 25-30% and 18%, respectively, by FY28 from 17% and 13% now.
- **Global sourcing to create new opportunities for India:** Worldwide value of components purchased by Kubota stands at USD8.7b, wherein major sourcing is from China and Thailand. Even sourcing just 5% of its total components from India would mean USD500m of potential exports for the country. Most of the sourcing for Kubota is localized, except engine (~33% of the product). Other target items would be i) in-house fabricated assembly items such as transmission, gears, and assemblies, and ii) castings, gears, and function parts.
- **Construction Equipment (CE) - Aspire to double market share:** ESCORTS currently addresses ~54% of the total CE industry. It aspires to be the market leader in Material handling and Mini excavator segments by doubling its domestic market share. Also, it plans to expand geographically by i) doubling its domestic channel and ii) expanding to ~35 countries (from its current ~20 countries).
- **Railways - Targeting ~3x revenue growth over the next six years:** The company expects revenue to be driven by i) current product expansion (largely in exports), and commercializing many products, under field trial, over the next one to two years, ii) increasing capacity to cater to the new demand, and iii) targeting new segments such as semi-high speed (Vande Bharat), metro, and private wagon builder. The segment currently has a record order book of INR9B in Sep-22 (v/s INR4.4B in Mar-22).
- **Retail finance to be strengthened:** ESCORTS aspires to establish its own captive NBFC arm. It has partnered with most of the leading banks and NBFCs including key regional players and will continue to add new partners at both national and regional levels. Going forward, it might try a tie-up model or opt for separate financing. It currently has over 35 MoUs and most of them are with public banks.
- **Focus on emerging business intensifies:** The company aims to grow its i) industrial engine revenues by 9x and ii) spares sales by ~2.4x. Within engine application, the company looks to grow in the 5-25HP segment and increase its manufacturing capacity to 3L from 1.7L engines. Also, it plans to introduce hybrid and alternate fuel engine with Japanese and Indian technology coming together. Also, it is planning to enhance capacity by setting up a huge global parts center in India and setting up regional distribution center.
- **Capital allocation - Aims dividend payout of ~40% by FY28:** The management has guided capex of INR35-40b (over FY23-28E) for its core business, which will be utilized toward i) greenfield capacity expansion, ii) expanding vendor capabilities, and iii) product innovation & technology. Moreover, the annual capex target has been revised to INR3B for FY23 (from INR2-2.5B) and should increase further in FY24. About 5% of the net profit will be utilized toward R&D and innovation (over and above normal R&D) largely for new startups. Since the

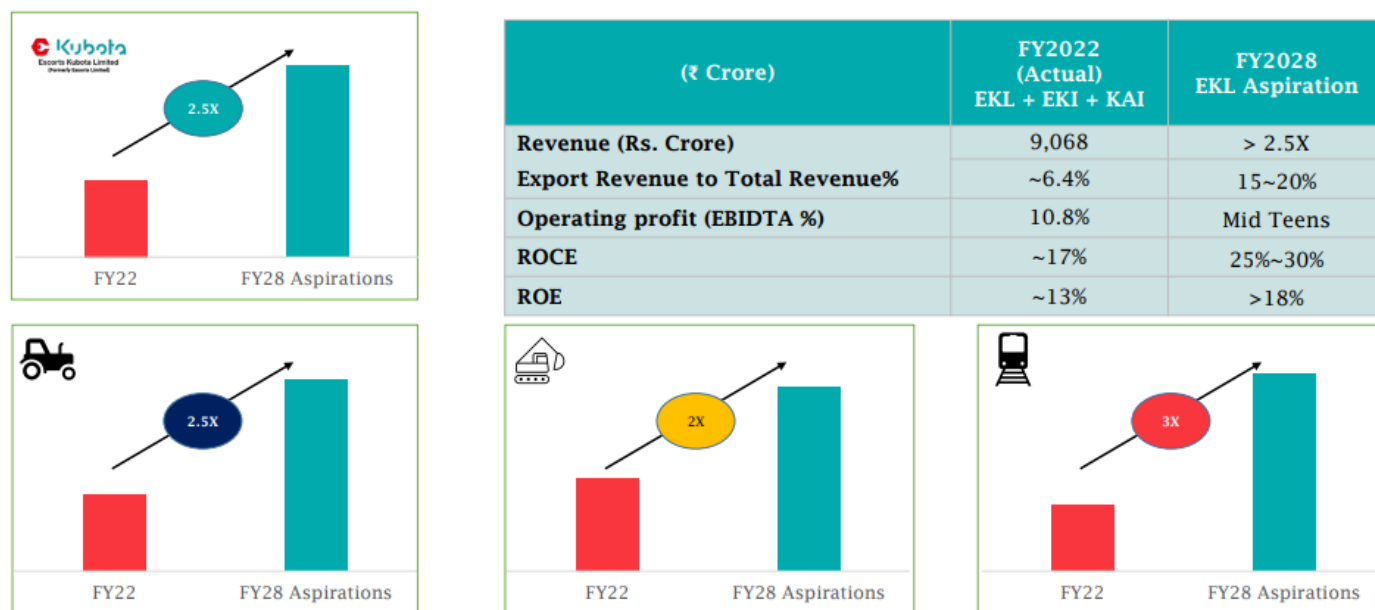
merged entity would have a debt component of INR4-5b at the time of merger, and it would be repaid soon. ESCORTS targets a dividend payout (including buyback) of ~40% of net profit by FY28 (v/s its current ~20%). Globally, Kubota's dividend payout stands at ~40% and it aspires a ~50% by FY25.

- **Valuation & view:** ESCORTS has intensified its focus on comprehensive growth across its business verticals. While the mid-term growth strategy seems to be in the right direction, we would watch for its effective execution. Seamless execution in targeted areas such as i) market share gains in the domestic tractor industry, ii) growth in exports through Kubota channel, iii) benefits of sourcing/localization, and iv) recovery in margins (in-turn) would be the key monitorables. However, in the near term, we believe uncertainty in the tractor cycle would continue, led by an anticipation of a sharp inventory correction in 3Q and the adverse impact of implementation of TREM-4 norms for >50HP tractors from Jan-23. This, along with a high base of FY23, would keep volume growth under check in the foreseeable future. Faster recovery in other businesses and a ramp-up in its partnership with Kubota would dilute the impact of a weaker Tractor cycle on ESCORTS. The stock trades at ~24.9x consolidated FY24E EPS, at a premium to its 10-year average of ~12.6x, driven by an improvement in operating parameters as well as the Kubota partnership. While the tractor cycle seems to be uncertain, the valuations are already reflecting volume recovery as well as the benefit of Kubota partnership. We reiterate our Neutral rating with a TP of INR1,875 (20x Dec'24E consolidated EPS).

Exhibit 1: Major aspirations and enablers for its FY23-28 mid-term plan



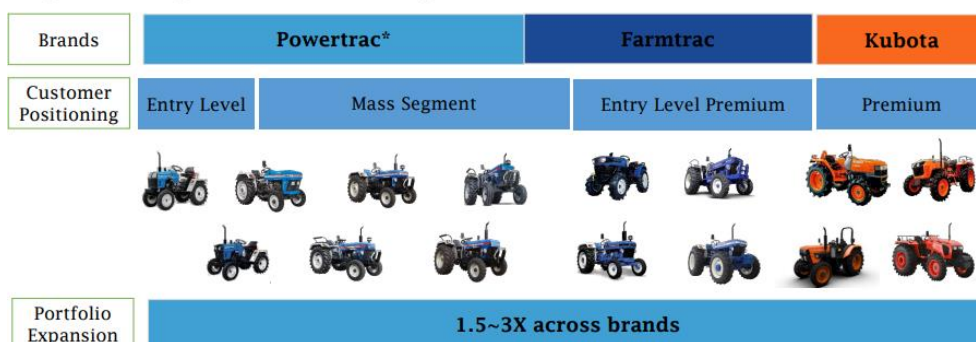
Source: Company, MOFSL

Exhibit 2: ESCORTS - Growth aspirations till FY28

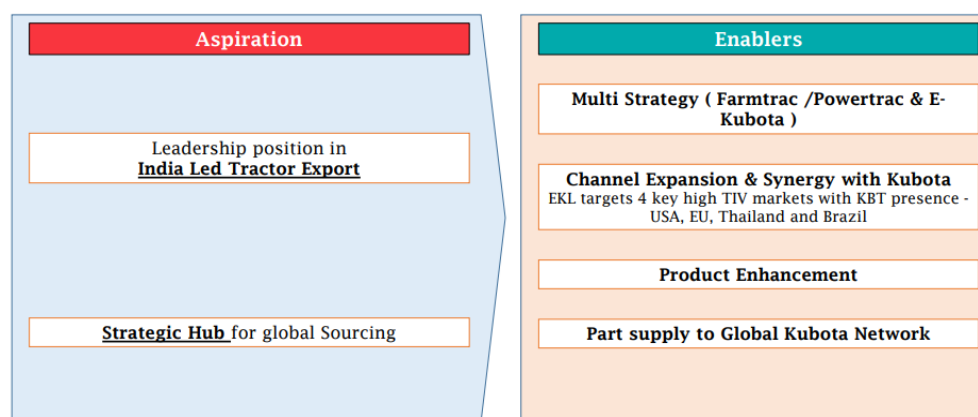
Source: Company, MOFSL

Exhibit 3: Brand & product Enhancement - Aims product expansion of 1.5-3x across brands

Right Positioning of Brands to Cover all Segments



Source: Company, MOFSL

Exhibit 4: Leverage Kubota's network in the exports market

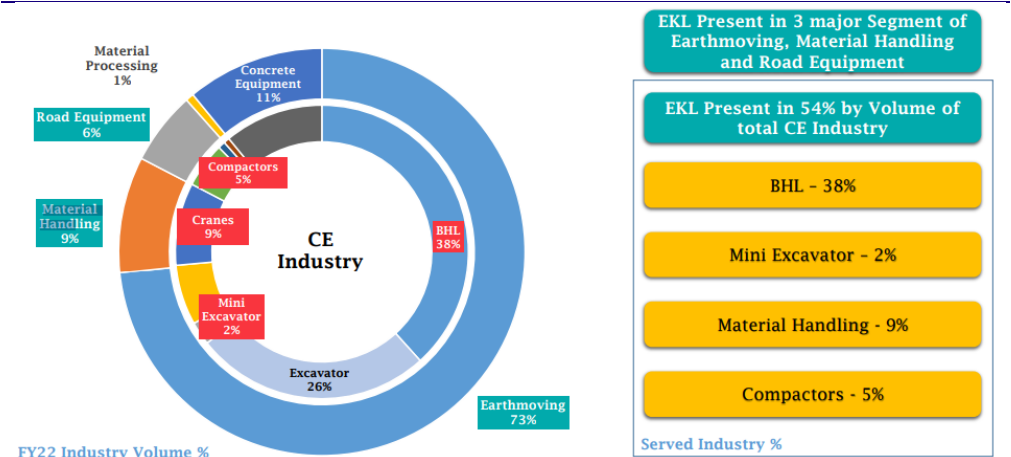
Source: Company, MOFSL

Exhibit 5: ...and expand product portfolio in the exports markets



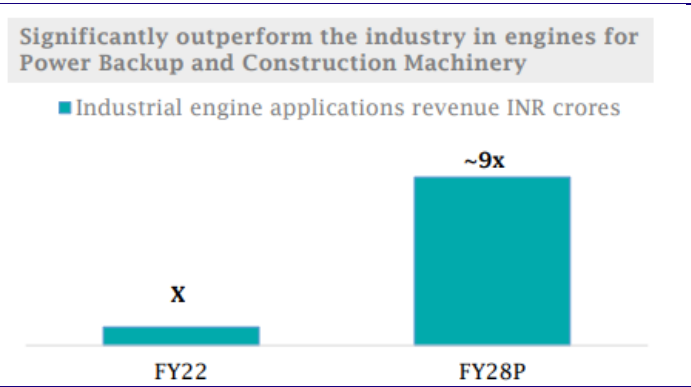
Source: Company, MOFSL

Exhibit 6: ESCORTS has a presence in ~54% of the CE industry



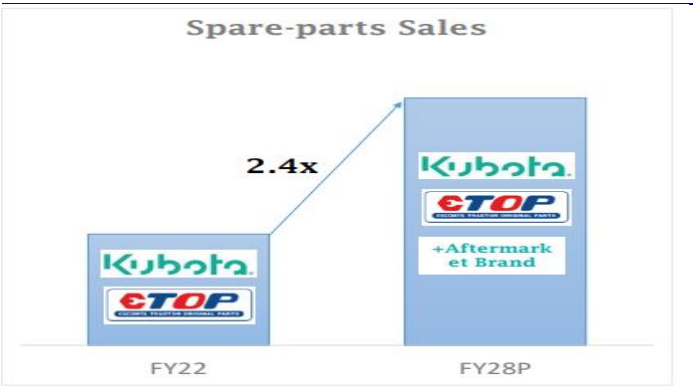
Source: Company, MOFSL

Exhibit 7: Expect industrial engines revenue to grow to ~9x



Source: Company, MOFSL

Exhibit 8: Expect spare parts sales to grow to 2.4x by FY28P



Source: Company, MOFSL

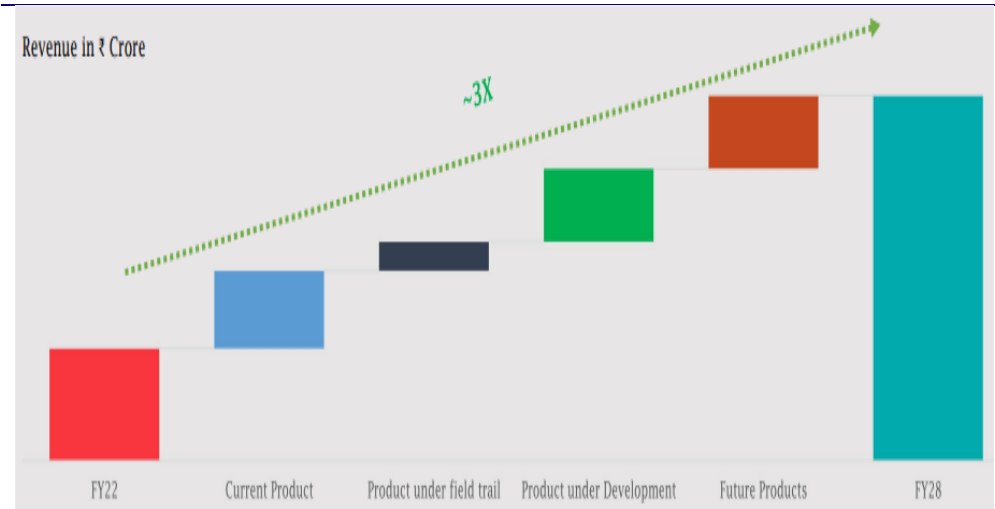
Exhibit 9: ESCORTS is working on hybrid and alternate fuel technologies

ALTERNATE FUEL



Source: Company, MOFSL

Exhibit 10: Railways division - Aims revenue growth of ~3x over FY22-FY28E



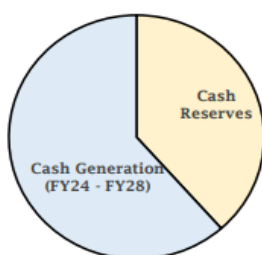
Source: Company, MOFSL

Exhibit 11: Product expansion plans for Railway division

Source: Company, MOFSL

Exhibit 12: ESCORTS - Focusing on its key priorities for cash deployment strategy through mid-term business plan

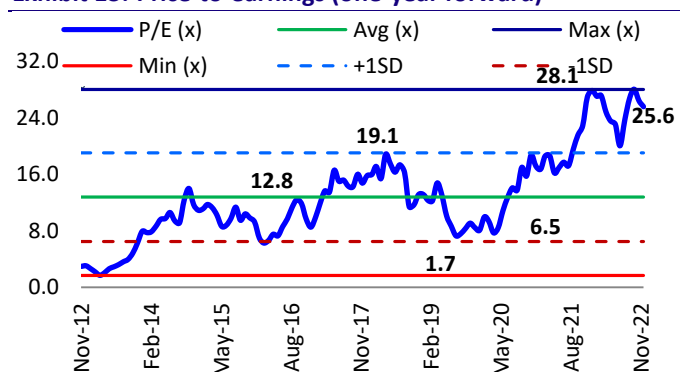
Particulars	Aspiration
Investment in R&D & Innovation	Upto 5% of Net Profit
Shareholder return (including buyback)	Upto 40% of Net profit

Total Capital (Reserves + New Cash Generation)**Cash Applications**

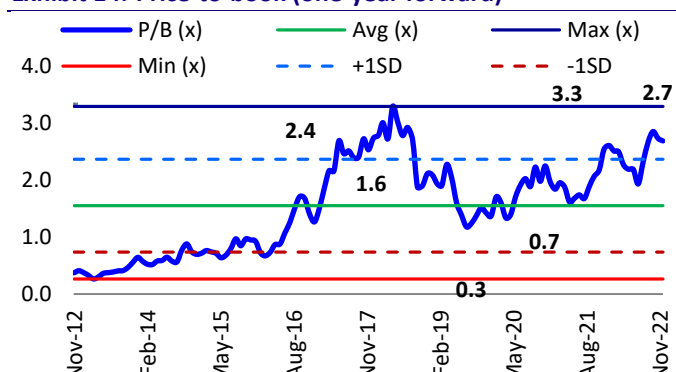
- 1. Core Business Growth (₹ 3,500 ~ ₹ 4,000 crore)**
 - Products, Innovation & Technology
 - Green field Expansion
- 2. Debt Repayment (for merging entities)**
- 3. Inorganic Opportunities**
- 4. Buy back & Distribution**

* Illustrative Cash Generation chart

Source: Company, MOFSL

Exhibit 13: Price-to-earnings (one-year forward)

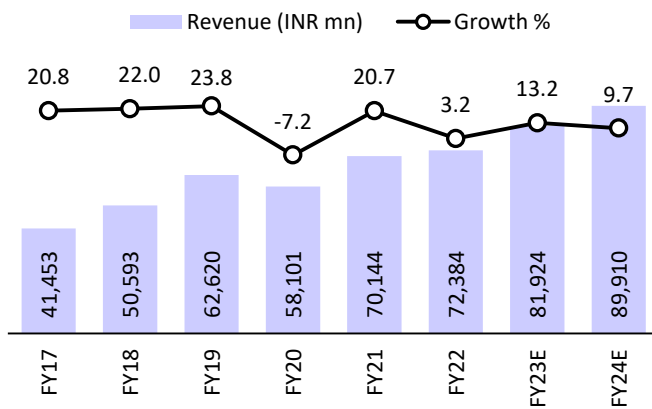
Source: MOFSL, Company

Exhibit 14: Price-to-book (one-year forward)

Source: MOFSL, Company

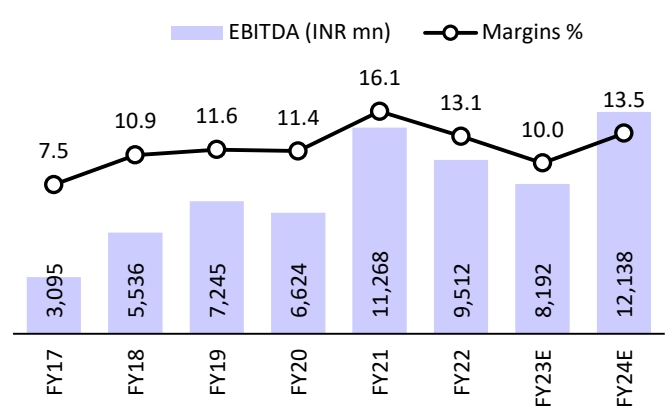
Story in charts

Exhibit 15: Revenue and revenue growth trend



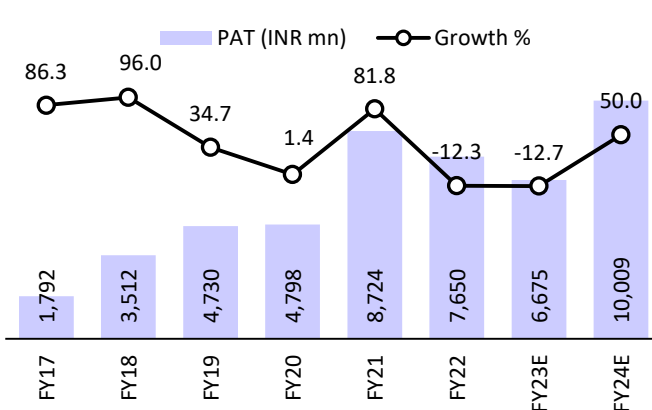
Source: MOFSL, Company

Exhibit 16: EBITDA and EBITDA margin trajectory



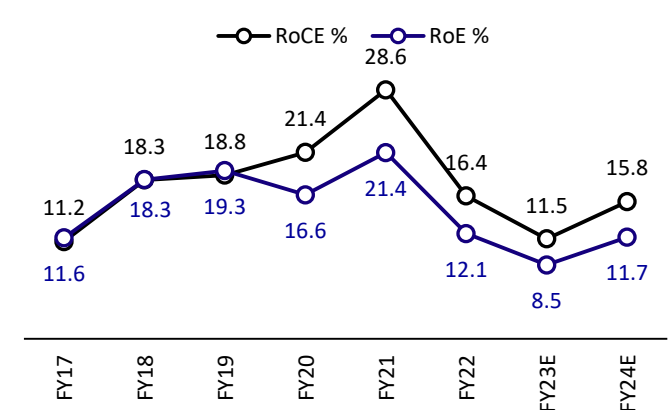
Source: MOFSL, Company

Exhibit 17: PAT and PAT growth trend



Source: MOFSL, Company

Exhibit 18: RoE and RoCE trend



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: Minority 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

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	43.6	32.4	31.9	20.0	24.9	33.0	24.4	20.5
P/BV	6.9	5.7	4.9	3.5	2.5	2.7	2.7	2.4
EV/Sales	3.4	2.8	2.9	3.1	3.2	3.2	2.8	2.5
EV/EBITDA	30.9	24.1	25.8	14.3	20.2	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

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall be within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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