

Escorts Kubota

Estimate changes

TP change

Rating change



CMP: INR1,981

TP: INR1,900 (-4%)

Neutral

Limited RM cost correction to delay margin recovery

Near-term demand outlook positive

- 3QFY23 performance was severely affected by lower production (due to high inventory at 2Q end) and unabsorbed cost inflation of 1-1.5%, resulting in lower margin at 8.4% (est 10.5%).
- While the near-term demand outlook is positive, a limited correction in RM costs should delay recovery in overall EBITDA margin. We reduce our FY23/FY24 estimates by 6%/10% to factor in higher RM cost pressure. Maintain **Neutral** with a TP of INR1,900.

Weak margin due to lower production in 3Q and RM pressure

- Revenue grew ~16% YoY to INR22.6b, while EBITDA/PAT declined ~28%/7.5% YoY to ~INR1.9b/INR1.86b in 3QFY23. 9MFY23 revenue grew ~16% YoY to INR61.6b, while EBITDA/PAT declined 25%/15.5% YoY at INR5.4b/INR4.8b.
- Tractor volumes grew ~11% YoY, while net realizations improved ~2.5% YoY to INR609.5k (est. INR614k), driven by a price hike and mix. Tractor/construction equipment/railways revenue grew 13%/11%/ 43% YoY.
- Gross margins contracted 4.3pp YoY (2.1pp QoQ) to 25.5% (v/s est.28.1%). Consequently, EBITDA fell 28% YoY to INR1.9b (est. INR2.3b). EBITDA margin was down 510bp YoY/up 30bp QoQ at 8.4% (est. 10.5%).
- PBIT margins for tractors stood at 8.3% (-7.5pp YoY), Railways at 13.1% (-1.2pp YoY) and CE at 2.2% (-30bps YoY).
- Other income of INR913m (est. INR575m) included a non-recurring item of INR125m related to contract termination recovery from erstwhile Tadano JV. Adj. PAT fell 7.5% YoY to INR1.86b (in line).

Highlights from management commentary

- Growth trend to continue in 4Q; industry volumes to cross 900k units in FY23E:** The benefits of healthy crop output, better prices and good water levels should boost farmers' sentiment. Demand from construction-led activities has been reasonably good, except in regions like UP and Bihar.
- Commodity price may drop marginally by <1% in 4QFY23,** as the RM basket specific to tractors has still not moderated much. There is 1-1.5% unabsorbed cost inflation at the end of Dec'22. The company does not expect any price hike in 4Q.
- The company plans to set up a greenfield plant for engine** manufacturing for both tractor engines, which are currently being imported. Kubota is selling these engines and it could be an incremental opportunity. It expects the plant to be operational by Apr'26.
- Inventory stands at a normal level of 4-4.5 weeks, which is lower than the industry levels.

Bloomberg	ESCORTS IN
Equity Shares (m)	135
M.Cap.(INRb)/(USDb)	261.3 / 3.2
52-Week Range (INR)	2359 / 1400
1, 6, 12 Rel. Per (%)	-9/18/4
12M Avg Val (INR M)	1152

Financials & Valuations (INR b)

INR million	2023E	2024E	2025E
Sales	84.0	92.8	102.8
EBITDA	7.4	10.8	13.9
EBITDA Margin (%)	7.0	9.9	11.9
Adj. PAT	6.4	9.1	11.6
EPS (INR)	58.2	74.3	94.9
EPS Gr. (%)	-15.9	27.6	27.8
BV/Sh. (INR)	732	725	810

Ratios

RoE (%)	8.2	10.7	12.4
RoCE (%)	11.0	14.5	16.6
Payout (%)	13.1	13.5	10.5

Valuations

P/E (x)	34.0	26.7	20.9
P/BV (x)	2.7	2.7	2.4
EV/EBITDA (x)	35.1	23.5	17.7
Div. Yield (%)	0.4	0.5	0.5
FCF yield (%)	2.7	2.9	3.9

Shareholding pattern (%)

As On	Dec-22	Sep-22	Dec-21
Promoter	72.9	72.9	30.3
DII	8.5	7.7	8.6
FII	5.6	6.4	22.3
Others	13.0	13.0	38.9

FII Includes depository receipts

Valuation and view

- The near-term demand outlook remains positive, led by healthy agri sentiments. Lower channel inventory and the company's focus on market share gains should further boost volume growth. Hence, we expect a ~7% volume CAGR over FY23-25. However, a high base of FY23, monsoon forecast for CY23 and the impact of the implementation of TREM-4 norms for >50HP tractors (likely in FY25) are key monitorable. A faster recovery in other businesses and a ramp-up in its partnership with Kubota would partially dilute the cyclical impact of the tractor industry on ESCORTS.
- The stock trades at ~26.7x/20.9x consolidated FY24E/25E EPS, which is at a premium to its 10-year average of ~13.3x, driven by an improvement in operating parameters and the Kubota partnership. The valuations are already reflecting the positive tractor industry outlook and the benefits of Kubota partnership. Maintain **Neutral** with a TP of INR1,900/share (20x Mar'25E consolidated EPS).

Standalone Quarterly Performance

Y/E March	FY22				FY23E				FY22	FY23E	(INR m)
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		3QE	
Net Sales	16,715	16,788	19,575	18,696	20,149	18,835	22,637	22,374	71,774	83,994	22,072
YoY Change (%)	57.4	2.4	-3.0	-15.4	20.5	12.2	15.6	19.7	3.6	17.0	12.8
Total Expenditure	14,383	14,522	16,929	16,181	18,133	17,308	20,733	20,429	62,014	76,603	19,754
EBITDA	2,332	2,267	2,646	2,515	2,016	1,527	1,903	1,946	9,760	7,391	2,318
Margins (%)	14.0	13.5	13.5	13.5	10.0	8.1	8.4	8.7	13.6	8.8	10.5
Depreciation	314	329	325	330	364	365	376	383	1,298	1,487	365
Interest	30	36	33	29	26	23	26	30	127	105	30
Other Income	472	473	400	538	354	776	913	707	1,883	2,750	575
PBT	2,461	2,374	2,688	2,695	1,981	1,187	2,414	2,240	10,219	7,822	2,498
Rate (%)	24.8	25.6	25.0	25.0	25.6	26.1	22.8	25.5	25.1	24.8	25.1
Adj. PAT	1,852	1,767	2,015	2,022	1,475	1,424	1,864	1,668	7,656	6,431	1,870
YoY Change (%)	101.0	-23.1	-28.2	-25.5	-20.4	-19.4	-7.5	-17.5	-12.4	-16.0	-7.2
Margins (%)	11.1	10.5	10.3	10.8	7.3	7.6	8.2	7.5	10.7	7.7	8.5

E: MOFSL Estimates

Key Performance Indicators

	FY22				FY23E				FY22	FY23E	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		3QE	
Volumes ('000 units)	25,935	21,073	25,325	21,895	26,797	23,703	28,025	25,126	94,228	1,03,651	28,025
Change (%)	42.9	-13.8	-19.8	-32.8	3.3	12.5	10.7	14.8	-11.7	10.0	10.7
Net Realn (INR '000/unit)	544.2	596.5	594.5	626.1	595.5	613.8	609.5	637.5	585.9	613.6	613.8
Change (%)	3.6	10.3	13.5	17.3	9.4	2.9	2.5	1.8	10.4	4.7	3.2
Cost Break-up											
RM Cost (% of sales)	68.3	65.9	70.2	70.1	72.2	72.4	74.5	73.8	68.7	73.3	71.9
Staff Cost (% of sales)	8.2	8.3	6.8	6.4	6.8	7.9	6.7	6.9	7.4	7.1	6.8
Other Cost (% of sales)	9.6	12.3	9.5	10.1	11.0	11.6	10.3	10.6	10.3	10.9	10.8
Gross Margins (%)	31.7	34.1	29.8	29.9	27.8	27.6	25.5	26.2	37.4	26.7	28.1
EBITDA Margins (%)	14.0	13.5	13.5	13.5	10.0	8.1	8.4	8.7	13.6	8.8	10.5
EBIT Margins (%)	12.1	11.5	11.9	11.7	8.2	6.2	6.7	7.0	11.8	7.0	8.9
Segmental PBIT Margin (%)											
Agri Machinery	15.6	14.9	15.8	15.4	10.6	8.4	8.3	0.0	15.5	0.0	0.0
Railway Equipments	14.6	17.3	14.3	13.1	13.6	14.6	13.1	0.0	15.1	0.0	0.0
Construction Equipments	-2.3	3.6	2.5	3.6	1.0	-2.6	2.2	0.0	2.4	0.0	0.0

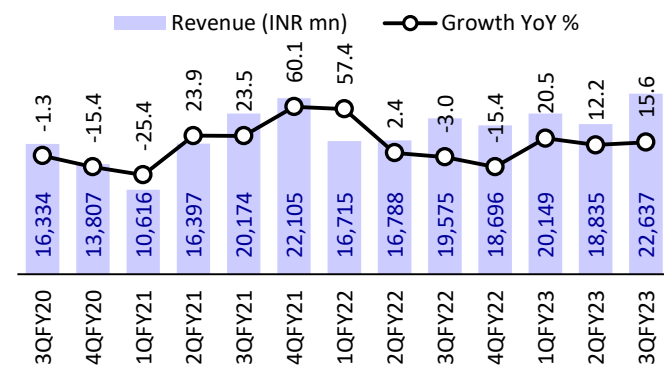
E:MOFSL Estimates



Highlights from management commentary

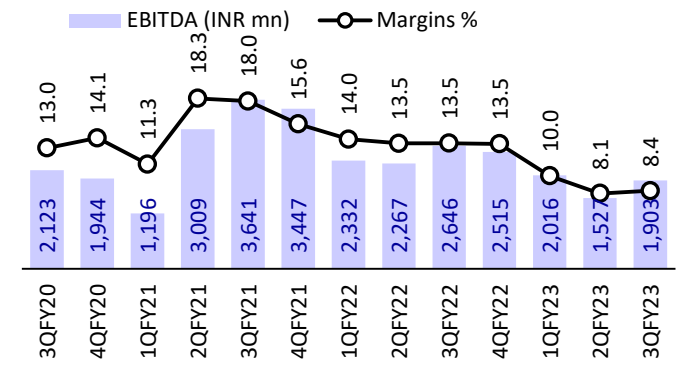
- **Growth trend to continue in 4Q and industry volumes to cross 900k units in FY23E:** The benefits of healthy crop output, better prices and good water levels should boost farmers' sentiment. Demand from construction-led activities has been reasonably, good except in regions like UP and Bihar.
- **Margins remained under pressure sequentially:** 2Q production was higher for the purpose of building inventory before the festive season, resulting in 1-1.25pp higher margin in 2Q due to operating leverage. Also, the impact of the price hike was negligible as it only happened after the festive season in Nov'22.
- **Commodity price may drop marginally by <1% in 4QFY23,** as the RM basket specific to tractors has still not moderated much.
 - There is 1-1.5% unabsorbed cost inflation at the end of Dec'22. The company does not expect any price hike in 4Q.
 - The mix has increased in the <30HP segment, which also hampers margins.
 - There were price rationalization measures in 2QFY23 (in Aug-22), particularly in lower HP tractors, which helped the company gain market share, but hit margins.
- **TREM-4 for <50hp is expected to be from Sep'24 (earlier Apr'24):** The company hinted at a 10-15% increase in prices of TREM-4 >50HP tractors, and hence there could be re-alignment of HP. Moreover, going forward, there could be an 8-13% increase in prices of >25HP tractors.
- **The domestic tractor industry grew 10.5% YoY to 250k units.** ESCORTS outperformed the underlying domestic tractor industry in 3QFY23.
 - In 3Q, the industry posted 7.6% YoY growth in in strong regions, while EKL-Tractor posted 16.7% growth.
 - In 3Q, the industry saw 13.5% YoY growth in the remaining regions, while ELK-Tractor reported 15.2% growth.
- **Exports through Kubota channel account for 30%+ of total export volume.**
 - 6.3% market share in Q3FY23, up 44bp YoY
 - The company plans to set up a greenfield plant for engine manufacturing for both tractor engines, which are currently being imported. Kubota is selling these engines and it could be an incremental opportunity. It expects the plant to be operational by Apr'26.
- **Agri segment capacity utilization stood at 85% in 3QFY23.** Inventory stands at the normal level of 4-4.5 weeks, which is lower than the industry levels.
- It added dealers in the opportunity market, taking the total to 1,200+ dealers at the end of Dec'22.
- **Construction Equipment-** The company witnessed good growth in the second half of 3Q and expects to sustain the momentum, driven by higher infra investments (many projects might be needed to be completed before elections). Capacity utilization stood at ~45% in 3QFY23. However, there could be an adverse impact of rising steel prices in 4Q.
- **Railways-** Management expects double-digit growth in FY24. The order book stands at over INR10b. New products contributed 69% of sales in 3Q. The company has won Split disk brake and HVAC. The current products under the field trial are expected to be completed in 4Q and commercialize by FY24.

Exhibit 1: Revenue and revenue growth trends



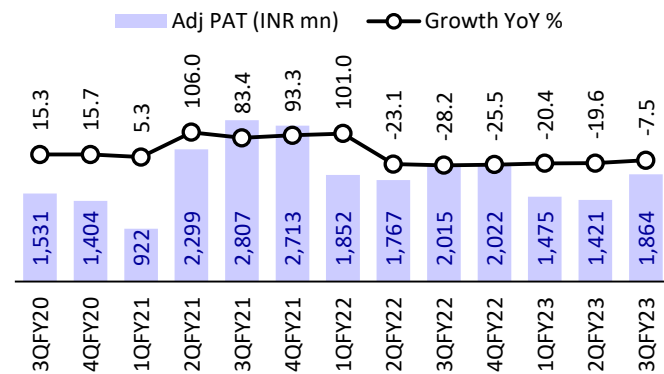
Source: MOFSL, Company

Exhibit 2: EBITDA and EBITDA margin trends



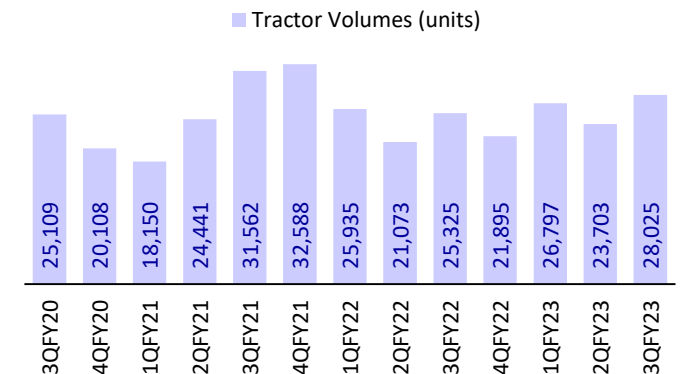
Source: MOFSL, Company

Exhibit 3: Adjusted PAT and growth trends



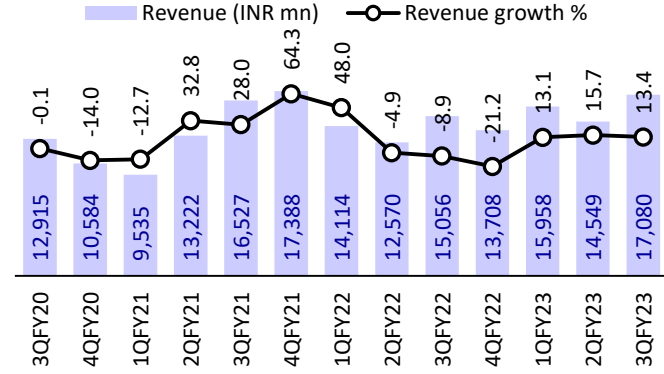
Source: MOFSL, Company

Exhibit 4: Trend in Tractor volumes



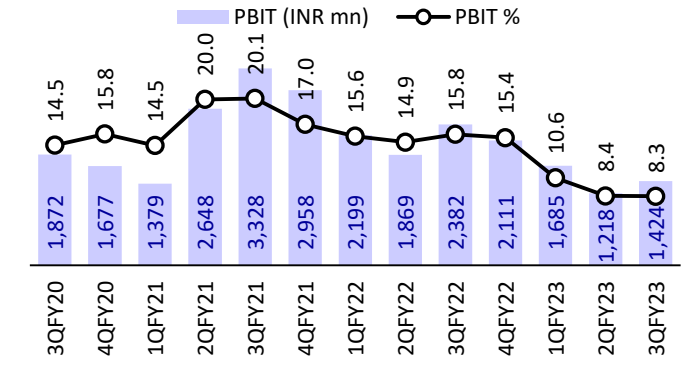
Source: MOFSL, Company

Exhibit 5: Revenue and growth in Tractor segment



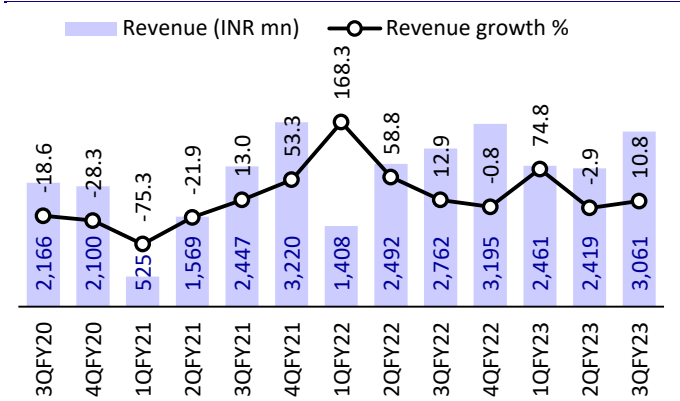
Source: MOFSL, Company

Exhibit 6: PBIT trend in Tractor segment



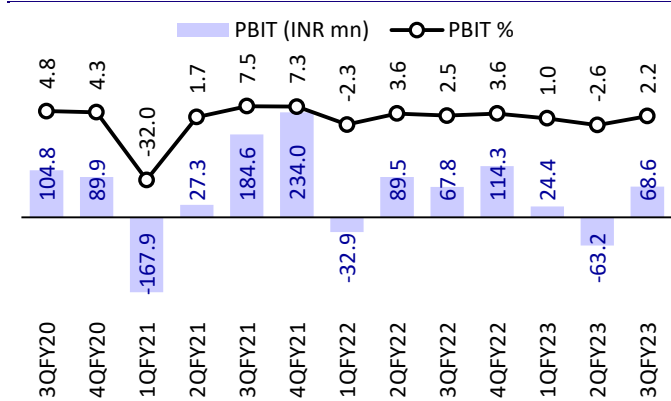
Source: MOFSL, Company

Exhibit 7: Revenue and growth in Construction Equipment segment



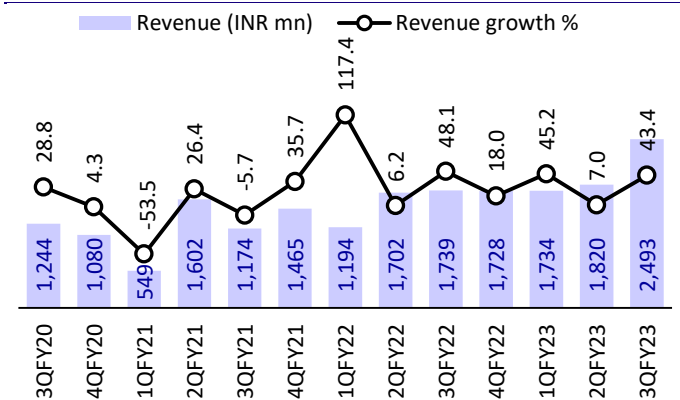
Source: MOFSL, Company

Exhibit 8: PBIT trend in Construction Equipment segment



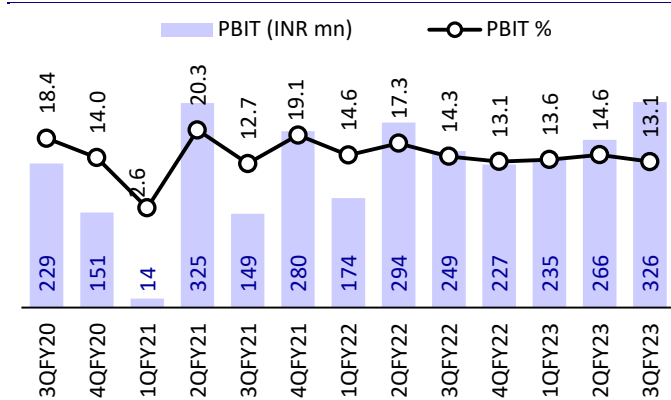
Source: MOFSL, Company

Exhibit 9: Revenue and growth in Railways segment



Source: MOFSL, Company

Exhibit 10: PBIT trend in Railways segment



Source: MOFSL, Company

Valuation and view

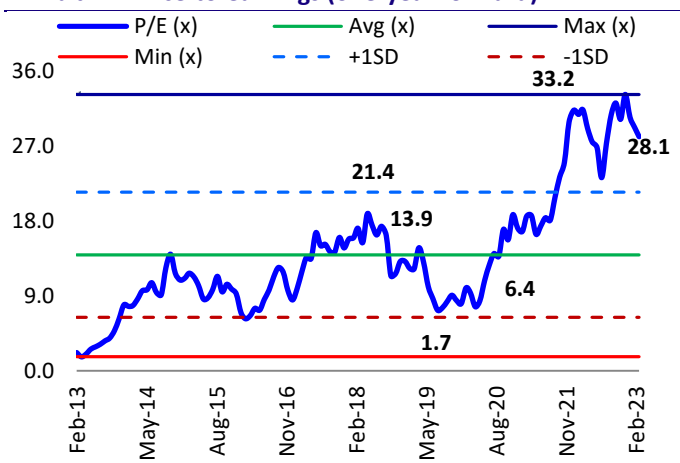
- **Near-term demand outlook positive:** Industry volumes in FY23 are expected to cross 9L units (+6-8% YoY growth), driven by 1) positive agro-economic indicators and farm-level sentiment, and 2) a recovery in non-agri applications. We estimate a 6-7% CAGR in Tractor industry volumes over FY23E–25E. However, we believe uncertainty in the tractor cycle would continue, led by the monsoon forecast for this year (still awaited) and the impact of the implementation of TREM-4 norms for >50HP tractors (likely in FY25). This, along with a high base of FY23, may keep volume growth under check in the near term.
- **Kubota parentage can unleash many synergies:** Kubota’s parentage would help ESC improve its competitive positioning in 1) small tractors (less than 30HP), 2) export markets (through leveraging Kubota’s distribution network), 3) the Agri Implements business, 4) component sourcing, and 5) the Construction Equipment business (Kubota is a global leader in small excavators). Through this partnership, ESC gains access to 1) global product know-how (in Tractors and Implements), 2) a global distribution network, and 3) a global supply chain (by leveraging its India cost base).
- **Healthy recovery in Railways, Construction Equipment to dilute cyclical impact of Tractor:** We expect the Railways business to deliver a ~16% CAGR over FY23–25, benefitting from the ramp-up in new products. Revenue from

Construction Equipment is estimated to grow at 14% over FY23E–25E. The benefits related to localization and cost savings would elevate its margin profile in both segments.

- **Tractor cycle showing initial signs of recovery:** With an expected recovery in its core Tractor business, we estimate an 11% revenue CAGR over FY23-25. This would result in margin expansion of ~470bp (over FY23E–25E) to ~13.5% in FY25E and a 28% EPS CAGR. Our estimates do not factor in the merger of Kubota’s India businesses.
- **Valuation and view:** We reduce our FY24/FY25 estimates by 6%/10% to factor in delays in EBITDA margin recovery due to commodity cost pressure. While the near-term outlook has improved, a recovery in margins is getting delayed. Exports, a leaner cost structure, recovery in Railways / Construction Equipment, and a strong balance sheet would dilute the impact on the P&L. After Kubota’s first acquisition of a stake in ESC, the stock saw substantially re-rating. The stock trades at ~26.7x/20.9x consolidated FY24E/25E EPS, which is at a premium to its 10-year average of ~13.3x, driven by an improvement in operating parameters as well as the Kubota partnership. The valuations already reflect the positive tractor industry outlook as well as benefits of Kubota partnership. Maintain Neutral with a TP of INR1,900/share (20x Mar’25E consolidated EPS).

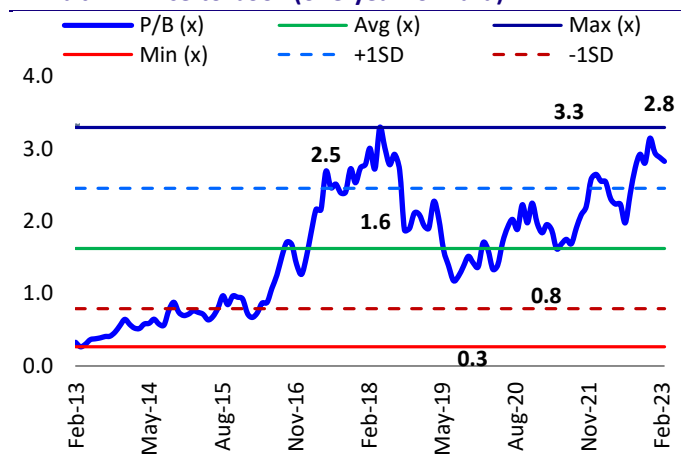
(INR M)	FY23E			FY24E		
	Rev	Old	Chg (%)	Rev	Old	Chg (%)
Net Sales	83,994	82,211	2.2	92,847	90,863	2.2
EBITDA	7,391	8,386	-11.9	10,770	12,267	-12.2
EBITDA (%)	8.8	10.2	-140bp	11.6	13.5	-190bp
Adj. PAT	6,431	6,819	-5.7	9,107	10,106	-9.9
EPS (INR)	58.2	61.7	-5.7	74.3	82.4	-9.9

Exhibit 11: Price-to-earnings (one-year forward)



Source: MOFSL, Company

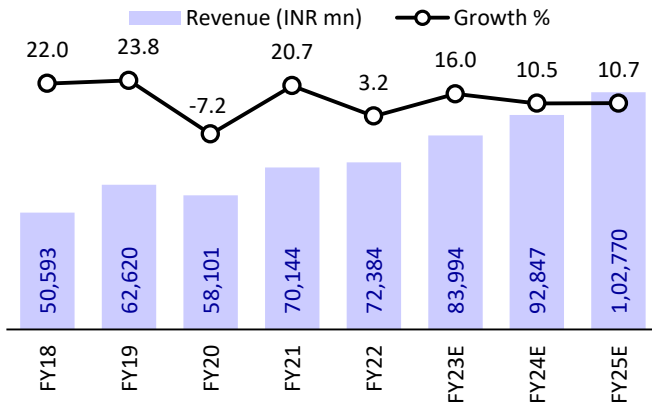
Exhibit 12: Price-to-book (one-year forward)



Source: MOFSL, Company

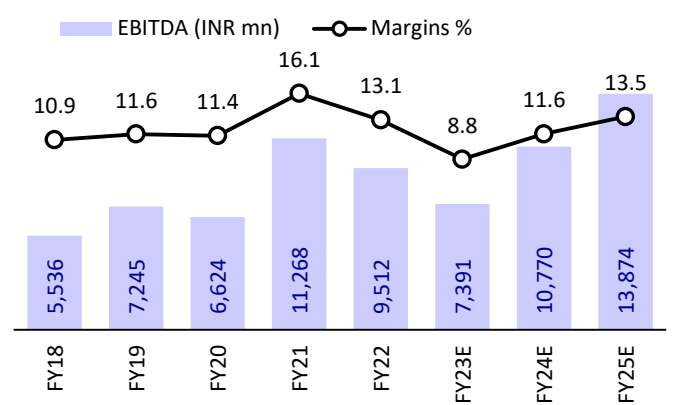
Story in charts

Exhibit 13: Revenue and revenue growth trend



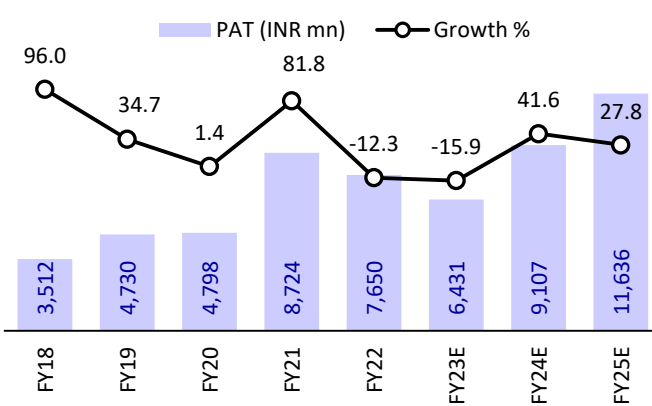
Source: MOFSL, Company

Exhibit 14: EBITDA and EBITDA margin trajectory



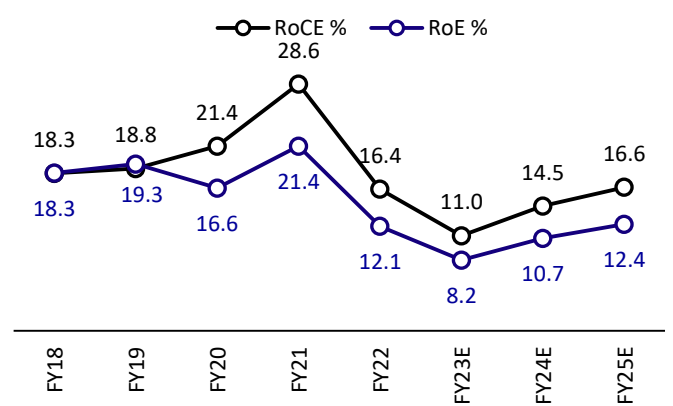
Source: MOFSL, Company

Exhibit 15: PAT and PAT growth trend



Source: MOFSL, Company

Exhibit 16: RoE and RoCE trend



Source: MOFSL, Company

Financials and valuations

Consolidated - Income Statement								(INR m)
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	83,994	92,847	1,02,770
Change (%)	22.0	23.8	-7.2	20.7	3.2	16.0	10.5	10.7
EBITDA	5,536	7,245	6,624	11,268	9,512	7,391	10,770	13,874
Margin (%)	10.9	11.6	11.4	16.1	13.1	8.8	11.6	13.5
Depreciation	732	872	1,072	1,183	1,321	1,487	1,558	1,688
EBIT	4,804	6,373	5,552	10,085	8,191	5,904	9,213	12,186
Int. and Finance Charges	295	195	172	133	150	105	120	120
Other Income	653	924	976	1,604	2,180	2,750	3,074	3,480
PBT bef. EO Exp.	5,162	7,102	6,356	11,555	10,222	8,549	12,167	15,546
EO Items	-68	56	-92	0	0	-728	0	0
PBT after EO Exp.	5,094	7,157	6,263	11,555	10,222	7,822	12,167	15,546
Current Tax	1,625	2,371	1,535	2,832	2,572	1,938	3,060	3,911
Tax Rate (%)	31.9	33.1	24.5	24.5	25.2	24.8	25.1	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	5,884	9,107	11,636
Adjusted PAT	3,512	4,730	4,798	8,724	7,650	6,431	9,107	11,636
Change (%)	96.0	34.7	1.4	81.8	-12.3	-15.9	41.6	27.8
Margin (%)	6.9	7.6	8.3	12.4	10.6	7.7	9.8	11.3

Consolidated - Balance Sheet								(INR m)
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	79,790	87,671	98,080
Net Worth	22,151	26,735	31,174	50,261	75,999	80,895	88,896	99,306
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	81,230	89,232	99,641
Gross Block	24,960	26,213	27,834	29,350	30,799	33,169	36,063	38,944
Less: Accum. Deprn.	9,082	9,741	10,608	11,388	12,389	13,876	15,434	17,122
Net Fixed Assets	15,878	16,472	17,227	17,962	18,411	19,293	20,629	21,823
Capital WIP	657	800	1,044	647	878	1,008	1,114	1,233
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	31,457	40,007	51,335
Inventory	5,657	8,574	8,834	7,182	8,466	10,121	10,836	11,741
Account Receivables	5,920	9,311	7,319	6,576	7,926	8,514	9,412	10,418
Cash and Bank Balance	3,173	2,433	3,249	13,218	2,718	7,637	13,537	21,711
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	18,886	20,877	23,108
Account Payables	15,746	15,495	16,867	16,771	13,341	17,259	19,078	21,117
Provisions	1,495	1,458	1,563	1,508	1,402	1,627	1,799	1,991
Net Current Assets	458	7,938	5,465	12,513	8,687	12,570	19,130	28,227
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	31,724	50,502	76,334	81,230	89,232	99,641

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	58.2	74.3	94.9
BV/Share	249.2	300.8	350.7	497.0	687.8	732.1	725.2	810.1
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	13.1	13.5	10.5
Valuation (x)								
P/E	50.1	37.2	36.7	23.0	28.6	34.0	26.7	20.9
P/BV	7.9	6.6	5.6	4.0	2.9	2.7	2.7	2.4
EV/Sales	3.9	3.2	3.4	3.6	3.7	3.1	2.7	2.4
EV/EBITDA	35.6	27.7	29.8	16.6	23.3	35.1	23.5	17.7
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	54.4	58.1	77.7
Return Ratios (%)								
RoE	18.3	19.3	16.6	21.4	12.1	8.2	10.7	12.4
RoCE	18.3	18.8	21.4	28.6	16.4	11.0	14.5	16.6
RoIC	24.5	24.2	20.2	41.5	29.4	18.3	27.3	33.4
Working Capital Ratios								
Asset Turnover (x)	2.2	2.1	1.8	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 M)
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	8,549	12,167	15,546
Depreciation	732	872	1,072	1,183	1,321	1,487	1,558	1,688
Interest & Finance Charges	-26	-301	0	0	0	105	120	120
Direct Taxes Paid	-1,021	-2,166	-1,748	-2,527	-2,547	-1,938	-3,060	-3,911
(Inc)/Dec in WC	-181	-7,449	3,272	2,748	-6,526	1,036	-659	-924
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	8,511	10,125	12,520
(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	6,011	7,125	9,520
(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	-105	-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	-1,093	-1,225	-1,346
Inc/Dec of Cash	849	-611	758	-632	-142	4,919	5,900	8,174
Opening Balance	693	1,542	931	1,689	1,057	915	5,834	11,734
Closing Balance	1,542	931	1,689	1,057	915	5,834	11,734	19,908

NOTES

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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