

Escorts Kubota (ESCORT)

CMP: ₹ 1,625

Target: ₹ 1,650 (2%)

Target Period: 12 months

HOLD

August 2, 2022

Muted margins, decline in market share; await green shoots, long term growth plan...

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

Q1FY23 Results: The company posted a muted Q1FY23 performance.

- Total operating income at ₹ 2,014.9 crore up 20.5% YoY
- EBITDA margins for the quarter came in at 10%, down 307 bps QoQ
- PAT declined 27.8% QoQ to ₹ 139.9 crore (includes loss from associates)

What should investors do? The stock price has grown at ~19% CAGR over last five years from ~₹ 670 in August 2017, vastly outperforming the Nifty Auto Index.

- We retain **HOLD** rating on Escorts amid muted tractor growth prospects over FY22-24E & decline in market share as well as pressure on margins

Target Price and Valuation: We value Escorts Kubota Ltd at SOTP-based target price of ₹ 1,650 (20x P/E on core FY24E EPS, 20% discount on treasury shares).

Key triggers for future price performance:

- Timely disclosure of detailed working on scaling up the company using expertise of new co-promoter Kubota
- Steady rainfall prospects amid healthy reservoir levels. We expect tractor sales at Escorts to grow at ~6% CAGR over FY22-24E
- Construction equipment (CE) and railways (RED) segments to perform well over FY22-24E amid pickup in economic activity and strong order book
- We expect sales at Escorts to grow at CAGR of 11% over FY22-24E, with consequent margins expected at 12.5% by FY24E

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

- Focused on prudent capital allocation, UV differentiation & EV proactiveness
- BUY with target price of ₹ 1,500



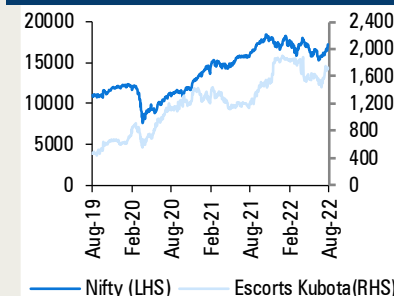
Particulars

Particular	₹ crore
Market Capitalization	21,440
Total Debt (FY22)	0
Cash & Investments (FY22)	4,843
EV	16,597
52 week H/L (₹)	1934 / 1113
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

Price Chart



Recent event & key risks

- Reported muted Q1FY23 results
- Key Risk:** (i) Higher than anticipated volume growth in tractor segment (ii) Inability to recapture lost market share

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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	873.3	736.3	35.6%	743.5	948.3	13.5%
EPS (₹)	36.8	36.8	66.2	55.8		56.4	71.9	
P/E	44.2	44.1	24.5	29.1		28.8	22.6	
RoNW (%)	15.6	14.2	16.2	9.3		8.7	10.2	
RoCE (%)	19.3	16.2	18.7	10.4		8.8	10.1	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

Q1FY23 Results: Muted numbers on the plate

- Among segments, EAM (i.e. tractor) revenues rose 13.1% YoY to ₹ 1,596 crore amid 3.3% volume jump to 26,797 units. Tractor ASPs surprised negatively at ₹ 5.95 lakh
- CE revenue de-grew 22.9% QoQ to ₹ 246 crore in while railway equipment division was flat QoQ at ₹ 173 crore. Present railway order book is at >₹ 850 crore
- Margin performance was lower than our expectation. Gross margins contracted ~178 bps QoQ. EAM EBIT margins declined a massive ~490 bps sequentially to 10.6% while the same for the construction equipment and railways division was at 1% (down 260 bps), 13.6% (up 42 bps), respectively
- Consequent PAT in Q1FY23 was down 27.8% QoQ and 20% YoY at ₹ 139.9 crore. It includes loss of associates amounting to ₹ 7.6 crore for the quarter

Q1FY23 Earnings Conference Call highlights

- Margins came in muted due to (i) inflationary scenario kicking in with quarterly lag, (ii) adverse product mix, (iii) lower than industry growth
- The company reported a market share decline in its major market in northern & central region and in <40 Hp segment
- Management expected tractor industry to grow in mid-single digit in FY23E
- Railway equipment is expected to grow in double digits in FY23 riding on ~₹ 850 crore order book
- The company lost market share in a price sensitive market to balance out profitability. However, as on date it has done a detailed study on market wise & segment wise loss and will focus on dealer profitability, brand building, new product offering, among others, to regain lost market share. However, it will not opt for price reduction
- To tackle the inflationary scenario, the company has taken ~2% hike during Q1FY23 and a further ~1.5-2% In July
- It remains on track on disclosing its mid-term plan with Kubota
- Channel inventory is at normal levels ~1 month vs industry average of 1.5 months.
- Management guided about 4-5 months' period to regain sustainable profit margins and drain out inflation related impact as still ~3-3.5% under recovery persists.
- Escorts Kubota market share declined from 10.7% in Q1FY22 to 9.3% in Q1FY23
- For Q1FY23, total domestic tractor industry grew 15.8% YoY, whereas Escorts was flat YoY. Industry in North & Central Regions grew by 22% YoY, whereas EKL-Tractor in North & Central Region grew by 4% YoY.

Peer comparison

Exhibit 1: ICICI Direct coverage universe (tractors)

Company	CMP	TP	Rating	Mcap	Total lakh volumes			EBITDA margin (%)			RoCE (%)			P/E		
	₹	₹		₹ crore	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Escorts Kubota (ESCORT)	1,625	1,650	Hold	21,440	0.9	1.0	1.1	13.3	11.2	12.5	10.4	8.8	10.1	29.1	28.8	22.6
M&M (MAHMAH)	1,236	1,500	Buy	1,47,917	3.5	3.8	4.1	12.3	12.3	13.0	9.3	11.9	13.6	30.0	24.8	20.9

Source: Company, ICICI Direct Research

Note – Volume data above is specific to tractor divisions for both companies

Exhibit 2: Variance Analysis

Particulars	Q1FY23	Q1FY23E	Q1FY22	YoY (Chg %)	Q4FY22	QoQ (Chg %)	Comments
Total Operating Income	2,014.9	2,061.9	1,671.5	20.5	1,861.4	8.2	Topline came in below our estimates tracking lower than anticipated ASP's in the tractor segment amidst adverse product mix
Raw Material Expenses	1,328.8	1,329.9	1,027.7	29.3	1,184.7	12.2	
Purchase of Traded Goods	125.8	134.0	113.4	11.0	126.0	-0.2	RM costs came in higher than anticipated with RM as a % of sales coming in at 72.2%
Employee Expenses	136.9	134.0	137.1	-0.2	119.2	14.8	
Other Expenditure	221.7	206.2	160.1	38.5	188.1	17.9	Other expenses stood at 11% of sales, up 90 bps QoQ vs. our estimates of ~10%
EBITDA	201.6	257.7	233.2	-13.5	243.4	-17.2	
EBITDA Margin (%)	10.0	12.5	14.0	-395 bps	13.1	-307 bps	Margins came in much lower than our estimates tracking costs rise in all line items
Interest	2.6	2.9	3.0	-12.2	2.9	-10.4	
Depreciation	36.4	35.2	31.4	16.0	33.0	10.3	Depreciation came in on expected lines
Total Tax	50.6	73.5	60.9	-16.9	67.3	-24.8	
PAT	139.9	218.4	174.8	-20.0	193.7	-27.8	PAT came in lower than estimates tracking pressure on o/p margins & lower other income
Key Metrics (₹ crore)							
Tractor Segment revenue	1,596	1,677	1,411	13.1	1,363	17.1	Tractor segment revenues came in lower due to lower ASP's (₹ 5.95 lakh/unit, down 4.3% QoQ)
CE revenue	246	242	141	75.0	319	-22.9	
RED revenue	173	143	119	45.2	173	0.3	Railway segment revenues came in higher than estimates at ₹ 173 crore

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

(₹ Crore)	FY23E			FY24E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	8,583.0	7,989.0	-6.9	9,410.6	8,819.4	-6.3	Topline estimates get revised downward tracking downward revision in sales volume and ASP's estimates in the tractor segment. We expect total sales at the company to grow at a CAGR of 11% over FY22-24E
EBITDA	1,094.4	892.7	-18.4	1,270.4	1,102.4	-13.2	
EBITDA Margin (%)	12.8	11.2	-158 bps	13.5	12.5	-100 bps	Lowered margin estimates tracking muted performance in Q1FY23 and conservative management commentary
PAT	924.6	743.5	-19.6	1,085.1	948.3	-12.6	
EPS (₹)	70.1	56.4	-19.6	82.2	71.9	-12.6	Earnings estimates get revised downward in high teens tracking decline in sales and margin estimates. We expect PAT at the company to grow at a CAGR of 13.5% over FY22-24E

Source: ICICI Direct Research

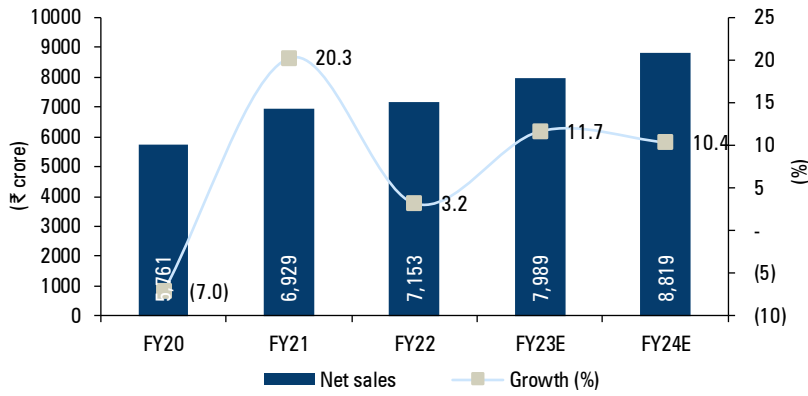
Exhibit 4: Assumptions

	Current				Earlier				Comments
	FY19	FY20	FY21	FY22	FY23E	FY24E	FY23E	FY24E	
Tractor volumes (units)	96,412	86,018	1,06,741	94,228	98,977	1,05,905	1,03,642	1,10,897	Marginally revised downward our volume estimates tracking muted management commentary for FY23E. We expect tractor volumes at the company to grow at a CAGR of 6% over FY22-24E to 1.06 lakh units in FY24E
Average ASP (₹)	4,92,053	5,15,890	5,30,937	5,85,919	6,00,547	6,09,020	6,34,972	6,39,687	ASP's also witness a decline in estimates tracking adverse product mix in Q1FY23

Source: ICICI Direct Research

Financial story in charts

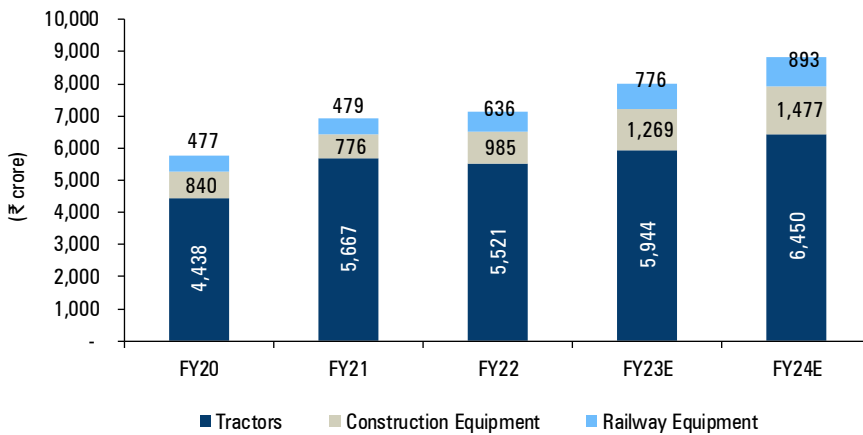
Exhibit 5: Trend in total operating income



We expect net sales to grow at 11% CAGR over FY22-24E

Source: Company, ICICI Direct Research

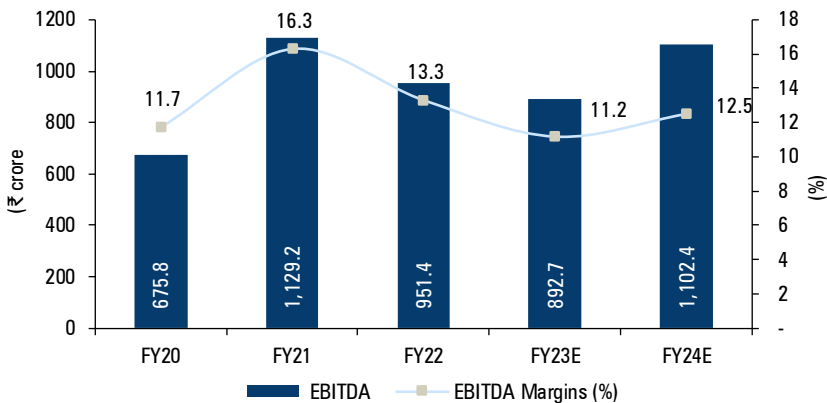
Exhibit 6: Trend in segment mix



Share of tractors within overall revenue mix is seen declining over the medium term amid muted 6% volume CAGR expectation over FY22-24E & strong order book at railway division

Source: Company, ICICI Direct Research

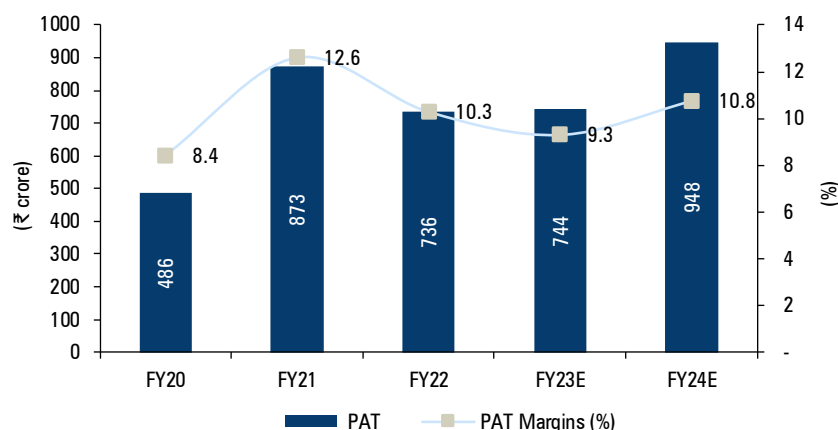
Exhibit 7: Trend in margins



Margins are seen declining to 12.5% by FY24E due to elevated commodity prices, lower contribution from tractor segment, going forward

Source: Company, ICICI Direct Research

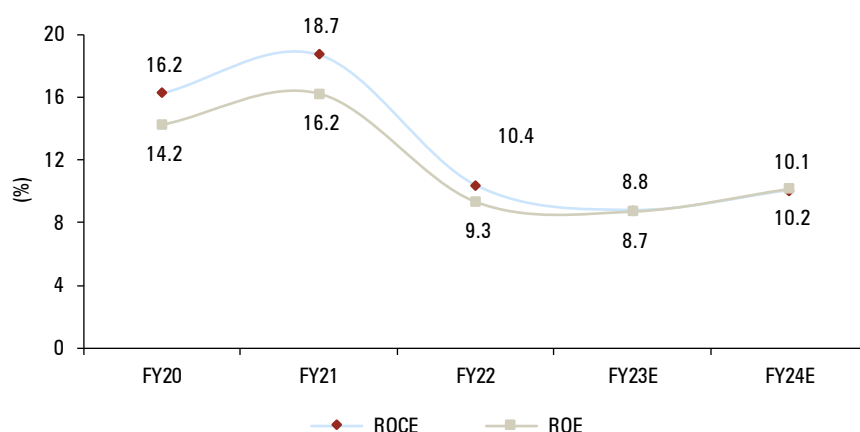
Exhibit 8: Trend in profitability



PAT is expected to grow at 13.5% CAGR over FY22-24E. PAT margins are seen steady in double digit

Source: Company, ICICI Direct Research

Exhibit 9: Trend in return ratios



Return ratios (RoE, RoCE) are seen stabilising around ~10% mark by FY24E. Given high cash on b/s, RoIC's is seen healthy at >25%

Source: Company, ICICI Direct Research

Exhibit 10: Valuation summary

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY18	4995	22.0	26.1	99.7	68.9	37.1	13.8	18.7
FY19	6196	24.0	36.8	40.6	49.0	28.8	15.6	19.3
FY20	5761	-7.0	36.8	0.1	48.9	30.3	14.2	16.2
FY21	6929	20.3	66.2	79.9	27.2	16.4	16.2	18.7
FY22	7153	3.2	55.8	-15.7	32.2	17.4	9.3	10.4
FY23E	7989	11.7	56.4	1.0	31.9	17.7	8.7	8.8
FY24E	8819	10.4	71.9	27.5	25.0	13.8	10.2	10.1

Source: Company, ICICI Direct Research

Exhibit 11: SoTP based target price calculation

Particulars	Amount (₹)
FY24E EPS (₹/share, A)	71.9
P/E Multiple (x, B)	20.0
Value of Base Business (C = A*B)	1,438
No of Treasury Shares (crore)	2.1
Current Market Price (₹/share)	1,625
Value of Investments (₹ crore)	3,486
Holding company discount (%)	20
Revised value of Investments (₹ crore)	2,789
Contribution per share (₹/share, D)	212
Target Price (C+D)	1,650
Potential Upside (%)	2

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 12: Profit and loss statement				
	₹ crore			
(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	313.9
PBT	1,157.1	1,021.9	994.1	1,246.2
Total Tax	283.1	256.3	251.2	314.0
Tax rate	24.5	25.1	25.3	25.2
PAT	873.3	736.3	743.5	948.3
Growth (%)	79.9	-15.7	1.0	27.5
EPS (₹)	66.2	55.8	56.4	71.9

Source: Company, ICICI Direct Research

Exhibit 13: Cash flow statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Profit after Tax	873.3	736.3	743.5	948.3
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	1202.7	227.1	1240.6	1108.9
(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	88.1	-24.5	0.0	0.0
CF from financing activities	1031.6	1750.2	-98.1	-131.9
Net Cash flow	998.3	-1,058.2	45.0	39.2
Opening Cash	318.3	1,316.6	258.4	303.4
Closing Cash	1316.6	258.4	303.4	342.6

Source: Company, ICICI Direct Research

Exhibit 14: 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	8,391.7	9,208.1
Total Shareholders funds	5391.6	7878.2	8523.7	9340.1
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	8671.6	9479.5
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	303.4	342.6
Total Current Assets	2,911.6	2,196.2	2,338.4	2,643.6
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	1255.6	859.1	547.9	586.3
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	8671.6	9479.5

Source: Company, ICICI Direct Research

Exhibit 15: Key ratios				
(Year-end March)	FY21	FY22	FY23E	FY24E
Per share data (₹)				
EPS	66.2	55.8	56.4	71.9
Cash EPS	80.7	65.6	67.0	84.0
BV	439.8	597.1	646.0	707.9
DPS	7.5	6.5	7.4	10.0
Cash Per Share	242.1	367.1	427.3	475.8
Operating Ratios				
EBITDA Margin (%)	16.3	13.3	11.2	12.5
PAT Margin (%)	12.6	10.3	9.3	10.8
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	9.3	8.7	10.2
RoCE	18.7	10.4	8.8	10.1
RoIC	42.1	27.2	26.5	31.1
Valuation Ratios (x)				
P/E	22.8	29.1	28.8	22.6
EV / EBITDA	16.4	17.4	17.7	13.8
EV / Net Sales	2.7	2.3	2.0	1.7
Market Cap / Sales	3.1	3.0	2.7	2.4
Price to Book Value	3.7	2.7	2.5	2.3
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

Exhibit 16: ICICI Direct coverage universe (Auto & Auto Ancillary)

Sector / Company	CMP	TP	Rating	M Cap	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	(₹)		(₹ Cr)	FY22P	FY23E	FY24E	FY22P	FY23E	FY24E	FY22P	FY23E	FY24E	FY22P	FY23E	FY24E	FY22P	FY23E	FY24E
Apollo Tyre (APOTYR)	222	230	Buy	14,114	10.1	12.7	19.4	22.1	17.5	11.4	7.3	6.3	4.8	6.3	7.3	10.3	5.4	6.6	9.4
Ashok Leyland (ASHLEY)	154	180	Buy	45,077	1.8	1.7	4.8	83.4	90.1	32.3	46.5	28.3	16.1	2.1	7.6	17.7	0.2	6.5	17.1
Bajaj Auto (BAAUTO)	3,975	4,180	Hold	1,15,038	173.4	218.4	247.2	22.9	18.2	16.1	17.8	13.2	11.5	18.4	27.1	29.3	17.6	24.5	26.3
Balkrishna Ind. (BALIND)	2,384	2,475	Buy	46,077	73.0	81.4	103.2	32.7	29.3	23.1	24.2	19.6	15.3	15.9	18.0	21.7	20.4	19.4	20.7
Bharat Forge (BHAFOR)	750	840	Buy	34,904	23.1	23.9	30.0	32.4	31.4	25.0	18.9	16.6	13.9	9.6	10.7	12.6	15.2	15.1	16.8
Eicher Motors (EICMOT)	3,089	2,480	Hold	84,418	61.3	87.6	107.2	50.4	35.3	28.8	35.0	24.9	20.3	13.3	17.3	18.7	13.3	16.9	18.2
Escorts Kubota (ESCORT)	1,625	1,650	Hold	21,440	55.8	56.4	71.9	29.1	28.8	22.6	17.4	17.7	13.8	10.4	8.8	10.1	9.3	8.7	10.2
Hero Moto (HERHON)	2,841	2,495	Hold	56,730	123.8	156.1	176.3	22.9	18.2	16.1	14.5	11.3	9.9	16.3	20.7	22.2	15.7	18.7	19.9
M&M (MAHMAH)	1,236	1,500	Buy	1,47,917	41.2	49.9	59.3	30.0	24.8	20.9	20.3	15.8	13.1	9.3	11.9	13.6	13.1	13.8	14.6
Maruti Suzuki (MARUTI)	9,004	10,000	Buy	2,71,993	124.7	236.8	333.3	72.2	38.0	27.0	40.7	22.8	16.6	5.1	11.5	15.2	7.0	12.1	15.3
Minda Industries (MININD)	524	575	Buy	29,928	6.2	9.6	12.5	84.1	54.8	42.0	34.4	26.7	21.6	10.2	13.1	15.9	10.3	13.9	15.6
Tata Motors (TATMOT)	479	530	Buy	1,83,505	-29.9	-9.5	17.9	-16.0	-50.2	26.8	7.6	6.3	4.7	4.8	8.2	14.5	-23.5	-8.1	13.2

Source: Company, ICICI Direct Research

RATING RATIONALE

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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