

CMP: ₹ 2,050

Target: ₹ 2,450 (20%)

Target Period: 12 months

BUY

May 11, 2023

Upbeat performance, margin recovery to drive strong earnings growth over FY23-25E, upgrades imminent...

About the stock: The company is a prominent tractor maker domestically (10.1% FY23 market share). It also serves domestic construction equipment, railways space.

- FY23 sales mix – tractors 76%, construction equipment 14%, railways 10%
- Larger play in export market amid onboarding of new co-promoter

Q4FY23 Results: The company posted healthy Q4FY23 performance.

- Total operating income was at ₹ 2,183 crore, up 17.3% YoY
- EBITDA margins for the quarter came in at 10.8%, up 240 bps QoQ and were a positive surprise with gross margins expanding 300 bps QoQ
- PAT declined 8.3% YoY to ₹ 185.5 crore, which includes one-time exceptional loss of ₹ 24.4 crore on account of impairment charge

What should investors do? The stock price has grown at ~17% CAGR over the last five years from ~₹ 947 in May 2018, vastly outperforming the Nifty Auto Index.

- We upgrade the stock from HOLD to **BUY** tracking a sharp uptick in margin profile and management commentary of further benefits flowing out of RM price decline, healthy cash surplus b/s and double-digit return ratio profile

Target Price and Valuation: Upgrading our margin and earnings estimates, we now value the company at SOTP-based TP of ₹ 2,450 (22x P/E on FY25E EPS).

Key triggers for future price performance:

- Onboarding Kubota as majority shareholder & strategic decision to leverage its channel for exports of higher hp models, we expect tractor volumes of the company to grow at ~9.7% CAGR over FY23-25E. Consequently, we expect sales to grow at a CAGR of 13.2% over FY23-25E
- Construction equipment (CE) and railways (RED) segments to perform well over FY23-25E amid pick-up in economic activity, strong order book & strong support from government in terms of robust budgetary allocation
- Key MTPB targets (i) grow revenues to >2.5x of FY22 levels (i.e. ~₹ 22,500+ crore in FY28E); (ii) increase share of exports to ~15-20% in FY28E; (iii) target EBITDA margins to mid-teens; (iv) RoCE at 25-30% and RoE > 18%
- With benign raw material prices, operating leverage at play and greater share of exports; operating margins are seen improving to 13% by FY25E

Alternate Stock Idea: In our auto ancillary coverage, we like Mahindra CIE.

- Focused on growth capex in India and efficiencies at European operations
- BUY with target price of ₹ 520



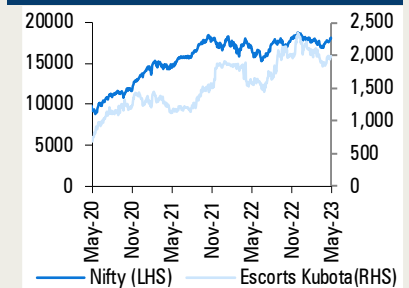
Particulars

Particular	₹ crore
Market Capitalization	27,048
Total Debt (FY23P)	0
Cash & Investments (FY23P)	5,005
EV	22,042
52 week H/L (₹)	2,359 / 1,400
Equity capital (₹crore)	131.9
Face value	₹ 10

Shareholding pattern

	Jun-22	Sep-22	Dec-22	Mar-23
Promoter	72.9	72.9	72.9	72.9
FII	4.2	4.7	4.0	4.7
DII	6.2	7.7	8.5	8.1
Other	16.7	14.7	14.7	14.3

Price Chart



Recent event & key risks

- Reported healthy Q4FY23 result; gross margins up 300 bps QoQ
- Key Risk:** (i) Slower than expected volume growth especially in export markets (ii) Delayed margin profile recovery

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Key Financial Summary

Key Financials	FY20	FY21	FY22	FY23P	5 year CAGR (FY18-23P)	FY24E	FY25E	2 year CAGR (FY23P-25E)
Net Sales	5,761.0	6,929.3	7,152.6	8,345.0	10.8%	9,406.4	10,686.5	13.2%
EBITDA	675.8	1,129.2	951.4	780.4	7.0%	1,127.0	1,389.2	33.4%
EBITDA Margins (%)	11.7	16.3	13.3	9.4		12.0	13.0	
Net Profit	485.6	874.1	765.7	607.0	12.0%	960.6	1,142.2	37.2%
EPS (₹)	36.8	66.3	58.0	46.0		72.8	86.6	
P/E	55.7	30.9	35.3	44.5		28.1	23.7	
RoNW (%)	14.2	16.2	9.7	8.3		10.4	11.3	
RoIC (%)	23.3	42.1	27.2	10.2		15.3	17.5	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

Q4FY23 Results: Margins surprise positively

- Among segments, revenue from agri machinery (EAM) i.e. tractors were at ₹ 1,558 crore, up 14.3% YoY amid 13.1% YoY tractor volume jump to 24,765 units. ASPs came in at ₹ 6.28 lakh/unit (up 3.2% QoQ)
- Gross revenue from construction equipment grew 25.7% QoQ to ₹ 385 crore in Q4FY23 while railway equipment division was down 4.8% QoQ at ₹ 385 crore. Present railway order book was at ~>=₹ 1,050 crore as of March 2023 end vs ~₹ 1,000 crore as of December 2022
- Gross margins expanded ~300 bps QoQ. EAM EBIT margins were up 160 bps sequentially to 9.9% while the same for the construction equipment and railways division was at 8% (up 585 bps) and 14% (up 87 bps), respectively
- Consequent PAT in Q4FY23 was down 8.3% YoY at ₹ 185.5 crore. PAT outperformance was due to higher-than-expected margins but was impacted by onetime exceptional loss related to impairment loss booked during Q4FY23. Excluding this, PAT was >₹ 200 crore
- The company also declared a final dividend of ₹ 7 per share

Q4FY23 Earnings Conference Call highlights

- The management expects the industry to grow in low mid-single digit in FY24E aided by increased use of tractor on non-auto side (i.e. for construction) with Q1FY24 expected to be flat tracking preponing of festivals in March 2023
- The management said it was closing FY23 with 10.1% market share vs. ~10.3% in FY22. Also, they added that loss in market share was primarily due to muted Q1FY23 post which the company has witnessed a sequential gain in market share every quarter. Further market share in Q4FY23 was at 10.9% vs. 10.6% in Q3FY23 vs. 11.4% in Q4FY22
- The management informed about exports touching all-time high with ~30% of total exports being done through Kubota channel. Further, they expect exports from Kubota channel to remain at ~40% of total exports
- On the construction equipment side, the management said demand remained strong on the back of increased infra spend by the government and is expected to grow by a similar quantum on a YoY basis (~10-12% in FY24) with margins to gradually improve in this space
- On the railway division front, the management continued its aspiration of double digit growth in FY24E on back of ~₹ 1,050 crore pending orderbook
- On the margins front, the management expects minimal operating leverage tracking single digit industry growth but expects RM benefit to continue in coming quarter tracking softening prices of steel castings, rubber, pig iron, etc, which cumulatively forms ~50-60% of overall cost of tractor. Further, the management do not foresee any fresh price hike in the coming quarters
- Overall management guided for ~13-14% EBIT margin on the tractors front (pre-Covid levels) as of FY24E end i.e. Q4FY24 vs. ~10% in Q4FY23

Escorts Kubota- ESG Disclosure Score*			
Score	FY20	FY21	FY22
Environmental	31.9	49.0	49.9
Social	30.8	29.0	29.3
Governance	84.9	84.9	84.9
Overall ESG Score	49.2	54.3	54.7

Source: Bloomberg, ICICI Direct Research, *Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures

The management said pending export orderbook of ~800 tractors to be executed in coming quarters

Inventory on agriculture front remained at normal levels of ~4-4.5 weeks

Peer comparison

Exhibit 1: ICICI Direct coverage universe (tractors)

Company	CMP	TP	Rating	Mcap	Total lakh volumes			EBITDA margin (%)			RoCE (%)			P/E		
	₹	₹		₹ crore	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E
Escorts Kubota (ESCORT)	2,050	2,450	Buy	27,048	1.0	1.1	1.2	9.4	12.0	13.0	7.4	10.4	11.8	44.6	28.2	23.7
M&M (MAHMAH)	1,245	1,665	Buy	1,54,741	4.0	4.2	4.5	12.2	12.1	12.5	13.1	14.3	15.4	22.7	18.8	16.5

Source: Company, ICICI Direct Research

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

Exhibit 2: Variance Analysis

Particulars	Q4FY23	Q4FY23E	Q4FY22 (oY (Chg %)	Q3FY23	Q3FY23 loQ (Chg %)	Comments	
Total Operating Income	2,183.0	2,170.9	1,861.4	17.3	2,263.7	-3.6	Topline came in broadly on expected lines with tractor segment reporting sequential rise in ASPs; a key positive surprise
Raw Material Expenses	1,446.1	1,469.7	1,184.7	22.1	1,540.9	-6.2	Savings were realised on the raw material front with RM as a percentage of sales down 300 bps QoQ at 71.5% vs. our estimates of 74.2%
Purchase of Traded Goods	115.4	141.1	126.0	-8.4	146.2	-21.1	
Employee Expenses	156.5	152.0	119.2	31.3	152.7	2.5	Employee costs was on expected lines
Other Expenditure	229.1	227.9	188.1	21.8	233.6	-1.9	
EBITDA	235.8	180.2	243.4	-3.1	190.3	23.9	
EBITDA Margin (%)	10.8	8.3	13.1	-227 bps	8.4	240 bps	EBITDA margins surprised positively on the back of substantial savings realised in RM costs
Interest	2.8	2.7	2.9	-4.8	2.6	4.2	
Depreciation	38.0	37.9	33.0	15.3	37.6	1.2	Depreciation came in on expected lines
Total Tax	61.5	57.5	67.3	-8.7	55.0	11.8	
PAT	185.5	170.6	202.2	-8.3	186.4	-0.5	PAT was above our estimates tracking margin beat with gains limited by exceptional loss of ~₹ 24 crore booked during the quarter

Key Metrics (₹ crore)							
Tractor Segment revenue	1,558	1,532	1,363	14.3	1,708	-8.8	Tractor ASPs were at ₹ 6.3 lakh/unit, up 3% QoQ vs. our estimates of ₹ 6.2 lakh/unit
CE revenue	385	387	319	20.6	306	25.7	
RED revenue	237	251	173	37.3	249	-4.8	Railway order book as of March end was in excess of ₹ 1050 crore

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

₹ Crore)	FY24E			FY25E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	9,594.5	9,406.4	-2.0	10,897.1	10,686.5	-1.9	Broadly retained topline estimates. We expect revenues at the company to grow at a CAGR of 13.2% over FY23-25E
EBITDA	911.5	1,127.0	23.6	1,144.2	1,389.2	21.4	
EBITDA Margin (%)	9.5	12.0	248 bps	10.5	13.0	250 bps	Upgraded margin estimates tracking management commentary of RM price decline benefits and aim to revert tractor segment EBIT margins back to pre-Covid levels
PAT	800.5	960.6	20.0	955.0	1,142.2	19.6	
EPS (₹)	60.7	72.8	20.0	72.4	86.6	19.6	Our earning estimates witness a smart upgrade on the back of upward revision in margin estimates for FY24-25E. Earnings are expected to grow at a CAGR of 37% over FY23-25E

Source: ICICI Direct Research

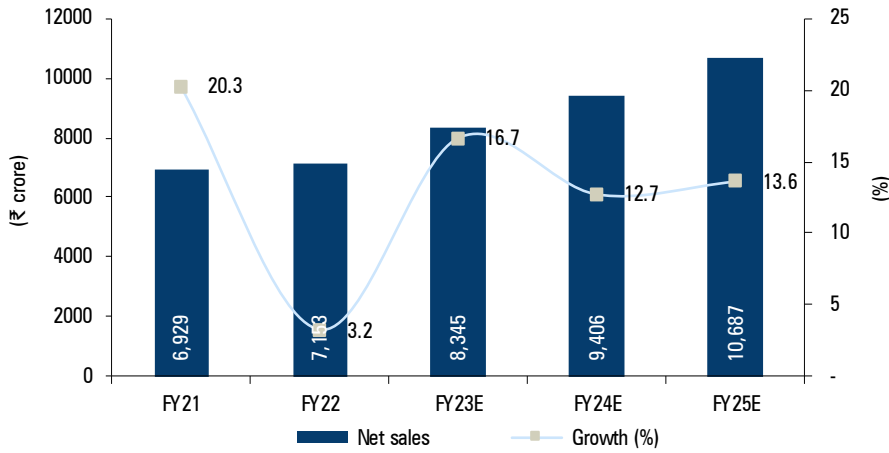
Exhibit 4: Assumptions

	Current								Earlier		Comments
	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY24E	FY25E		
Tractor volumes (units)	96,412	86,018	106,741	94,228	103,290	111,058	124,385	116,051	129,977	Revise downward our tractor volume estimates tracking high base of FY23. Over FY23-25E, tractor volumes are seen growing at a CAGR of 9.7%, aided by better exports	
Average ASP (₹)	492,053	515,890	530,937	585,919	611,493	633,709	640,062	620,210	626,428	Upgraded ASP estimates tracking recent quarterly performance	

Source: ICICI Direct Research

Financial story in charts

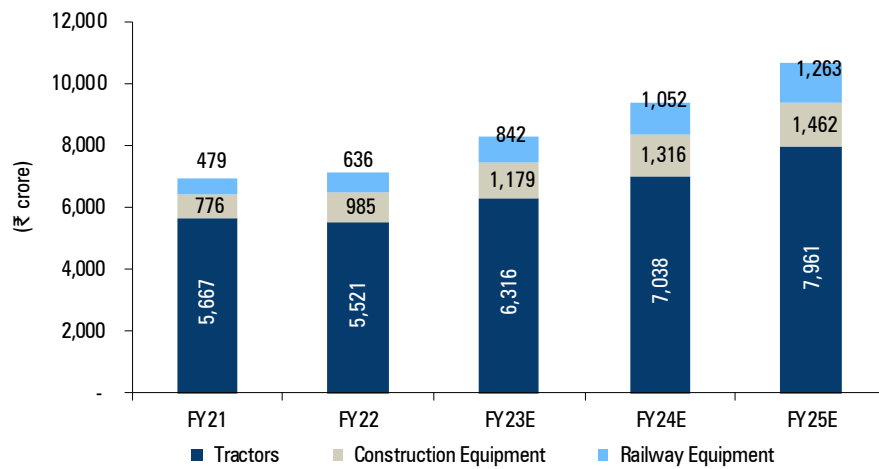
Exhibit 5: Trend in total operating income



We expect net sales to grow at 13.2% CAGR over FY23-25E

Source: Company, ICICI Direct Research

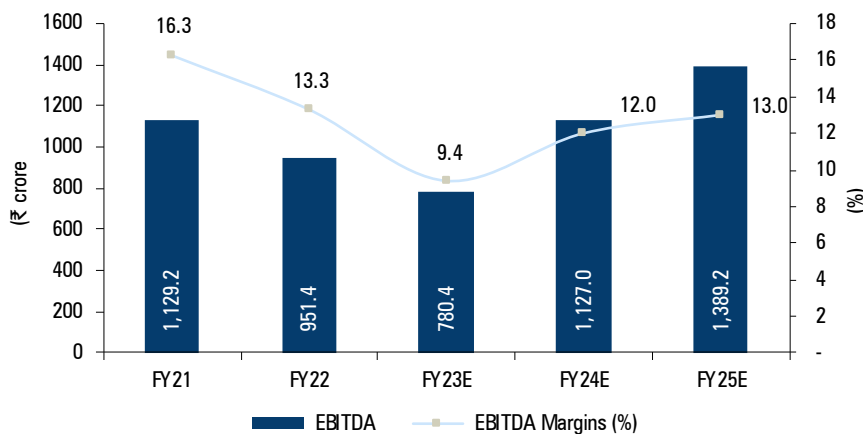
Exhibit 6: Trend in segment mix



Share of tractors within overall revenue mix is seen marginally declining over the medium term amid steady 9.7% volume CAGR expectation over FY23-25E & strong order book at railway division

Source: Company, ICICI Direct Research

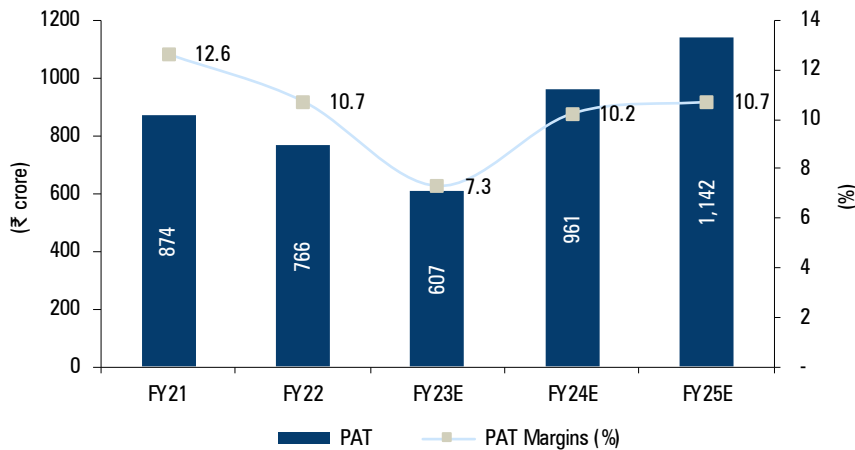
Exhibit 7: Trend in margins



Post a low in FY23 at 9.4%, margins are seen improving to 13% in FY25E amid RM price decline and operating leverage at play

Source: Company, ICICI Direct Research

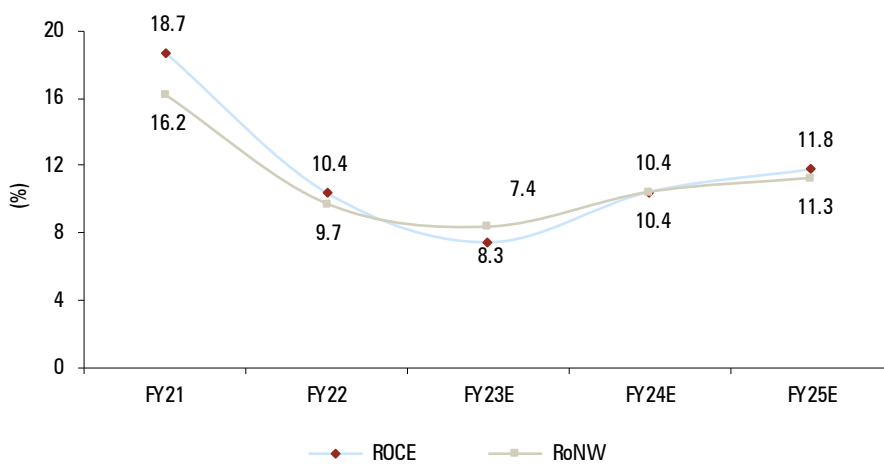
Exhibit 8: Trend in profitability



PAT is expected to grow at 37% CAGR over FY23-25E. PAT margins are seen regaining the double-digit mark starting FY24E

Source: Company, ICICI Direct Research

Exhibit 9: Trend in return ratios



Return ratios (RoE, RoCE) are seen stabilising around ~10% mark by FY25E. Given high cash on b/s, RoICs are seen healthy at ~25% over FY24-25E

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	78.4	47.2	13.8	18.7
FY19	6196	24.0	36.8	40.6	55.8	36.4	15.6	19.3
FY20	5761	-7.0	36.8	0.1	55.7	38.6	14.2	16.2
FY21	6929	20.3	66.3	80.0	30.9	21.3	16.2	18.7
FY22	7153	3.2	58.0	-12.4	35.3	23.3	9.7	10.4
FY23P	8345	16.7	46.0	-20.7	44.5	31.8	8.3	7.4
FY24E	9406	12.7	72.8	58.3	28.1	21.7	10.4	10.4
FY25E	10687	13.6	86.6	18.9	23.7	17.2	11.3	11.8

Source: Company, ICICI Direct Research

Exhibit 11: SoTP based target price calculation

Particulars	Amount (₹ crore)
FY25E Standalone PAT (pre-merger, erstwhile Escorts Ltd)	1,142.2
FY25E PAT of Escorts Kubota India Pvt. Ltd (separate tractor Manufacturing Unit)	4.3
FY25E PAT of Kubota Agriculture India Private Limited (sales & marketing arm of Kubota)	100.6
Total PAT (includes PAT of erstwhile Escorts + JV's PAT now 100% owned)	1,247
No of Shares post merger and cancellation of treasury shares (crore)	11.2
EPS (₹/share)	111.5
PE Multiple (x)	22
Target Price (₹/share)	2,450
Current Market Price (₹/share)	2,050
Potential Upside (%)	20%

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 12: Profit and loss statement					₹ crore
(Year-end March)	FY22	FY23P	FY24E	FY25E	
Total operating Income	7,152.6	8,345.0	9,406.4	10,686.5	
Growth (%)	3.2	16.7	12.7	13.6	
Raw Material Expenses	4,424.1	5,557.9	6,101.9	6,892.8	
Employee Expenses	528.2	595.0	634.9	694.6	
Other expenses	740.3	902.6	978.3	1,068.7	
Total Operating Expenditure	6,201.3	7,564.5	8,279.4	9,297.3	
EBITDA	951.4	780.4	1127.0	1389.2	
Growth (%)	-15.7	-18.0	44.4	23.3	
Depreciation	129.8	148.4	157.8	185.8	
Interest	12.7	10.3	9.2	8.3	
Other Income	213.0	280.6	324.3	331.9	
PBT	1,021.9	902.3	1,284.3	1,527.1	
Total Tax	256.3	198.2	323.6	384.8	
Tax rate	25.1	22.0	25.2	25.2	
PAT	765.7	607.0	960.6	1142.2	
Growth (%)	-12.4	-20.7	58.3	18.9	
EPS (₹)	58.0	46.0	72.8	86.6	

Source: Company, ICICI Direct Research

Exhibit 13: Cash flow statement					₹ crore
(Year-end March)	FY22	FY23P	FY24E	FY25E	
Profit after Tax	765.7	607.0	960.6	1,142.2	
Add: Depreciation	129.8	148.4	157.8	185.8	
Sub: Other Income	213.0	280.6	324.3	331.9	
(Inc)/dec in Current Assets	-320.0	-657.3	-164.4	-365.1	
Inc/(dec) in CL and Provisions	-319.0	349.6	149.4	208.5	
CF from operating activities	43.4	167.1	779.1	839.4	
(Inc)/dec in Investments	-2,933.0	2,789.7	-50.0	-400.0	
(Inc)/dec in Fixed Assets	-189.6	-233.3	-485.0	-290.0	
Others	300.2	-2,463.2	241.0	241.3	
CF from investing activities	-2822.5	93.2	-294.0	-448.7	
Issue/(Buy back) of Equity	-2.9	0.0	0.0	0.0	
Inc/(dec) in loan funds	0.0	0.0	0.0	0.0	
Dividend paid & dividend tax	-85.8	-92.4	-184.7	-211.1	
Inc/(dec) in Sec. premium	1,863.4	0.0	0.0	0.0	
Others	-53.9	42.0	0.0	0.0	
CF from financing activities	1720.8	-50.3	-184.7	-211.1	
Net Cash flow	-1,058.2	210.0	300.4	179.7	
Opening Cash	1,316.6	258.4	468.4	768.7	
Closing Cash	258.4	468.4	768.7	948.4	

Source: Company, ICICI Direct Research

Exhibit 14: Balance Sheet					₹ crore
(Year-end March)	FY22	FY23P	FY24E	FY25E	
Liabilities					
Equity Capital	131.9	131.9	131.9	131.9	
Reserve and Surplus	7,746.2	8,302.9	9,078.8	10,009.9	
Total Shareholders funds	7878.2	8434.8	9210.7	10141.9	
Total Debt	0.0	0.0	0.0	0.0	
Other non-current Liabilities	114.5	144.9	146.9	148.9	
Long-term Provisions	42.0	41.8	41.5	41.2	
Total Liabilities	8034.7	8621.5	9399.1	10332.0	
Assets					
Gross Block	2,942.3	3,118.3	3,318.3	3,768.3	
Less: Acc Depreciation	1,215.4	1,338.1	1,464.8	1,611.0	
Net Block	1,726.9	1,780.2	1,853.5	2,157.3	
Capital WIP	56.3	69.4	319.4	119.4	
Total Fixed Assets	1783.2	1849.5	2172.9	2276.7	
Net Intangible Asset	54.1	72.7	76.6	77.0	
Investments	5,150.0	5,037.0	5,137.0	5,587.0	
Inventory	803.6	1,159.0	1,159.7	1,317.5	
Debtors	827.6	1,207.6	1,288.5	1,463.9	
Loans and Advances	25.5	19.4	31.2	26.2	
Other Current Assets	281.1	200.6	271.5	308.4	
Cash	258.4	468.4	768.7	948.4	
Total Current Assets	2,196.1	3,054.9	3,519.7	4,064.5	
Creditors	877.7	1,232.9	1,288.5	1,463.9	
Provisions & Other Curr.Liab	459.4	453.8	547.6	580.6	
Total Current Liabilities	1,337.0	1,686.7	1,836.1	2,044.6	
Net Current Assets	859.1	1368.2	1683.6	2019.9	
Net Deferred Tax Asset	-37.9	-65.1	-65.1	-65.1	
Other non-current assets	170.5	276.1	311.2	353.6	
Application of Funds	8034.7	8621.5	9399.1	10332.0	

Source: Company, ICICI Direct Research

Exhibit 15: Key ratios				
(Year-end March)	FY22	FY23P	FY24E	FY25E
Per share data (₹)				
EPS	58.0	46.0	72.8	86.6
Cash EPS	67.9	57.3	84.8	100.7
BV	597.1	639.3	698.1	768.7
DPS	7.0	7.0	14.0	16.0
Cash Per Share	367.1	171.5	198.1	242.0
Operating Ratios				
EBITDA Margin (%)	13.3	9.4	12.0	13.0
PAT Margin (%)	10.7	7.3	10.2	10.7
Inventory days	41.0	50.7	45.0	45.0
Debtor days	42.2	52.8	50.0	50.0
Creditor days	44.8	53.9	50.0	50.0
Return Ratios (%)				
RoE	9.7	8.3	10.4	11.3
RoCE	10.4	7.4	10.4	11.8
RoIC	27.2	10.2	15.3	17.5
Valuation Ratios (x)				
P/E	35.3	44.6	28.2	23.7
EV / EBITDA	23.3	31.8	21.7	17.2
EV / Net Sales	3.1	3.0	2.6	2.2
Market Cap / Sales	3.8	3.2	2.9	2.5
Price to Book Value	3.4	3.2	2.9	2.7
Solvency Ratios				
Debt/ EBITDA	0.0	0.0	0.0	0.0
Debt / Equity	0.0	0.0	0.0	0.0
Current Ratio	2.0	1.9	2.0	2.0
Quick Ratio	1.2	1.1	1.1	1.1

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)	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Apollo Tyre (APOTYR)	370	420	Hold	23,497	17.4	28.5	33.1	21.3	13.0	11.2	8.4	6.0	5.3	9.8	14.8	15.6	8.6	12.7	13.3
Ashok Leyland (ASHLEY)	146	185	Buy	42,736	3.9	6.8	8.3	37.6	21.6	17.5	16.7	11.8	9.8	15.9	23.3	27.8	14.1	22.0	23.5
Bajaj Auto (BAAUTO)	4,520	4,530	Hold	1,30,795	198.9	246.2	280.9	22.7	18.4	16.1	17.3	13.7	11.7	24.3	29.4	32.3	22.1	26.1	28.1
Balkrishna Ind. (BALIND)	2,150	2,170	Hold	41,563	52.1	77.5	95.9	41.2	27.7	22.4	29.8	18.7	15.2	8.6	15.8	19.2	13.2	17.3	18.7
Bharat Forge (BHAFOR)	774	980	Buy	36,035	10.9	25.1	32.6	70.9	30.8	23.7	23.1	16.6	13.7	6.8	11.0	13.4	8.0	15.5	17.7
Eicher Motors (EICMOT)	3,392	4,065	Buy	92,698	101.5	123.4	141.8	33.4	27.5	23.9	24.1	20.1	16.8	19.8	20.2	27.3	19.2	20.3	20.2
Escorts Kubota (ESCORT)	2,050	2,450	Buy	27,048	46.0	72.8	86.6	44.6	28.2	23.7	31.8	21.7	17.2	7.4	10.4	11.8	8.3	10.4	11.3
Hero Moto (HERHON)	2,585	2,840	Hold	51,624	145.7	182.6	199.7	17.7	14.2	12.9	10.9	8.7	7.9	18.9	22.7	23.6	17.4	20.4	20.9
M&M (MAHMAH)	1,245	1,665	Buy	1,54,741	54.9	66.3	75.3	22.7	18.8	16.5	14.6	12.4	10.4	13.1	14.3	15.4	16.6	15.9	15.9
Maruti Suzuki (MARUTI)	9,110	11,000	Buy	2,75,195	266.5	354.9	422.5	34.2	25.7	21.6	21.0	16.0	13.2	12.8	16.0	17.4	13.3	15.9	16.7
Uno Minda (MININD)	552	630	Buy	31,549	11.5	15.6	18.6	48.1	35.3	29.7	25.0	19.8	17.0	15.2	18.0	19.2	16.3	18.4	18.2
Tata Motors (TATMOT)	505	530	Buy	1,93,230	-3.1	24.3	35.8	-164.8	20.8	14.1	7.0	4.8	3.8	7.9	15.1	18.6	-2.5	16.3	19.4

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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