



India

REDUCE (previously HOLD)

Consensus ratings*: Buy 7 Hold 9 Sell 8

Current price: Rs1,983
 Target price: ▼ Rs1,796
 Previous target: Rs2,039
 Up/downside: -9.4%
 InCred Research / Consensus: -12.5%

Reuters:
 Bloomberg: ESCORTS IN
 Market cap: US\$3,602m
 Rs261,572m
 Average daily turnover: US\$14.7m
 Rs1068.1m
 Current shares o/s: 110.5m
 Free float: 39.0%

*Source: Bloomberg

Key changes in this note

- Sales cut by 2-5% for FY23F-25F.
- EBITDA cut by 9-18% for FY23F-25F.
- PAT cut by 6-14% for FY23F-25F.



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	(8.4)	1.3	7.7
Relative (%)	(9.6)	2.1	2.6

Major shareholders	% held
Kubota Corporation	44.8
Escorts Welfare Trust	16.3
Nanda Family	11.9

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Escorts Kubota Ltd

Rich valuation factors in Kubota benefits

- 3QFY23 EPS dipped 8% yoy to Rs16.9, missing our/Bloomberg consensus estimates, due to sustained high raw material cost pressure.
- We cut EPS estimate by a sharp 14% for FY23F due to slow tractor division's profit recovery, while we limit it to 7% for FY24F-25F as the central government's capex push to help the company's railway/construction divisions.
- Downgrade to REDUCE as rich P/E valuation factors in Kubota medium-term benefit but undermines the risk of market share loss & tractor sector slowdown.

Profit margins of tractor and construction divisions disappoint

Escorts Kubota's 3QFY23 EBITDA rose 25% qoq to Rs1.9bn but missed our/Bloomberg consensus estimates by 25/19%, respectively, as operating leverage benefit failed to come through from a 20% qoq sales growth. EBITDA margin rose by just 30bp qoq to 8.4%. The rise in raw material cost by 200bp qoq to 74.5% disappoints. Barring railway division, other divisions disappointed on EBIT margins. However, high other income (+18% qoq) limited PAT miss to 15% at Rs1.9bn.

Management conference-call highlights

Management indicated that its retail sales in recent months have been better than wholesales and its consistently improving market share on a qoq basis. The company has started production of Trem-4 emission tractors in the above 50-HP segment, while dealer inventory is being consumed currently. Management expects below 50-HP tractor emission norms change by Oct 2024F. It feels easing commodity cost benefit will drive margin recovery, while price hikes may be difficult to come through soon.

EPS estimates cut by 6-14% for FY23F-25F

Considering the government's lower rural spending plan for FY24F (Figs. 4 and 5) and emissions norm upgrade in above-50HP tractors from Jan 2023, we feel the headwinds for the tractor industry's volume growth are high. Hence, we trim our sales estimates by 2-5% for FY23F-25F, despite factoring in a better growth for railway and construction equipment, on the back of the central government's recent capex push. Considering the slow EBITDA margin recovery from its lows, we cut our EBITDA estimates by 18% for FY23F and by 9-11% for FY24F-25F. Raised other income limits our EPS cut to 6-14% for FY23F-25F.

Downgrade to REDUCE rating as benefits from Kubota factored in

The next five-year plan released in Nov 2022 has raised medium-term hopes from exports potential and global outsourcing benefit, thereby lifting forward P/E valuation to near +1SD above five-year mean (Fig. 18). However, considering the tractor industry's challenges and its struggle in the short term to sustain market share, we feel there is the risk of disappointment in the coming quarters. We downgrade our rating on the stock to REDUCE (from HOLD) with a new target price of Rs1,796 (Rs2,039 earlier) at 16x one-year forward P/E. Key upside risk is better-than-expected synergy benefits from Kubota India's merger.

Financial Summary

	Mar-21A	Mar-22A	Mar-23F	Mar-24F	Mar-25F
Revenue (Rsm)	69,293	71,527	84,365	101,698	120,818
Operating EBITDA (Rsm)	11,292	9,513	7,841	11,803	15,034
Net Profit (Rsm)	8,740	7,656	6,289	10,212	12,760
Core EPS (Rs)	79.1	69.3	61.9	92.4	115.5
Core EPS Growth	77.5%	(12.4%)	11.5%	49.2%	24.9%
FD Core P/E (x)	25.06	28.61	34.83	21.45	17.17
DPS (Rs)	7.5	7.0	8.0	12.0	15.0
Dividend Yield	0.46%	0.42%	0.48%	0.72%	0.90%
EV/EBITDA (x)	18.23	22.76	27.68	18.47	14.46
P/FCFE (x)	20.15	(22.75)	472.01	358.79	85.56
Net Gearing	(24.4%)	(3.3%)	(2.4%)	(1.1%)	(1.5%)
P/BV (x)	4.06	2.78	2.61	2.36	2.12
ROE	19.7%	11.5%	8.4%	11.6%	13.0%
% Change In Core EPS Estimates			(13.92%)	(7.03%)	(5.78%)
InCred Research/Consensus EPS (x)					

SOURCE: INCRED RESEARCH, COMPANY REPORTS

Rich valuation factors in Kubota benefits

3QFY23 earnings-call highlights

Outlook: Management expects the domestic tractor industry to top 900,000 units in sales and hit a new peak in FY23F, with good growth expected in 4QFY23F on the back of favourable water levels at reservoirs and better crop prices. However, as per management, FY24F growth will be dictated by the monsoons. It expects some softening of commodity prices in 4QFY23F, although the agri segment had unabsorbed cost inflation of 1-1.5% which it is not able to pass on to the market. In the construction equipment segment, management expects the growth momentum to continue on the back of a pick-up in infrastructure works and the upcoming assembly and general elections. It expects the EBIT margin to improve further in 4QFY23F. In the railway segment, it expects double-digit growth in FY24F on the back of an order book of more than Rs10bn and with a focus on expansion and diversification.

Margins hit and the company not able to pass on cost inflation: Management indicated that the margins were hit on a yoy basis and were flattish on a qoq basis because of steep inflation, an adverse product mix and price rationalization. It indicated that 2QFY23 had registered higher production than 3QFY23 due to the festive season-led inventory build-up, which also explains the flattish margins. The company took a price hike at the end of Nov 2022, the full benefits of which are expected only in 4QFY23F. Major cost inflation was from tyres and castings, whose prices rose by 50-57%. The company is unable to pass on any more cost inflation to the market and had unabsorbed cost inflation of 1-1.5% as at end-Dec 2022.

Market share led by an adverse product mix: Management indicated that domestic market's share in the tractor segment improved by 900bp qoq to 10.6% in 3QFY23. More than 40bp (more than 1,000 units) of this was due to an increase in the sales mix towards the 21-30HP segment which has a lower margin. This was a deliberate attempt by the company to regain its lost market share in some regions. Management mentioned that in Jan 2023 the focus was on retail sales and hence, wholesales took a hit.

Business environment: Management stated the domestic tractor industry grew 10.5% yoy to ~247,000 units in 3QFY23 on the back of positive farmer sentiment led by normal monsoon, better crop prices, ample finance availability, and better rabi sowing (+4% yoy). The North and Central India markets (the company's stronghold) grew 7.6% yoy in 3QFY23, while the South and West markets (the company's opportunity markets) grew by 13.5% yoy. The inventory levels are ~4-4.5 weeks, which management claims are lower than that of its competitors. In the construction equipment segment, the backhoe loader, pick & carry cranes, and compactor industry grew (on a yoy basis) by 29%, 35% and 12%, respectively. In the railway segment, management is focusing on expansion and diversification and has launched new products like first split disc brake, HVAC system, and Train-18 damper. Some of its products are in field trials, and management expects to launch them in 4QFY23F.

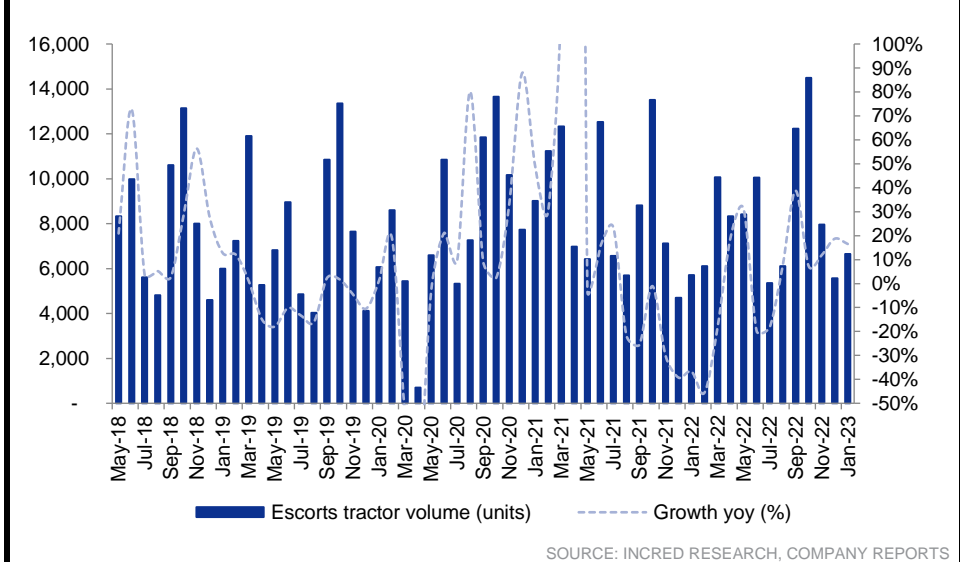
Trem-IV norms: The Trem-IV norms have already been implemented from 1 Jan 2023, which is applicable on the 50hp+ tractors. The norms are applicable on production, and new prices have yet not been announced considering the old inventory in the system. Management expects the price hike to be in the range of 10-15%. It expects a delay in the next set of norms applicable on the 25hp+ tractors which is scheduled for 1 Apr 2024 but could get delayed by six months or more, considering the upcoming elections. The price hike could be 8-13%, as per management.

Figure 1: Results comparison

FYE Mar (Rs m)	3QFY23	3QFY22	yoy % chg	2QFY23	qoq % chg	9MFY23	9MFY22	yoy % chg	Comments for the quarter
Revenue	22,637	19,715	14.8	18,835	20.2	61,620	53,053	16.1	In line with our estimates.
Raw Materials	16,871	13,748	22.7	13,638	23.7	45,055	36,221	24.4	
RM as % of revenue	74.5	69.7	479	72.4	212.0	73.1	68.3	484.4	223bp above our estimates.
EBITDA	1,903	2,786	(31.7)	1,527	24.7	5,447	7,220	(24.6)	23% below our estimates led by lower gross margin.
EBITDA margin (%)	8.4	14.1	(572.5)	8.1	30.3	8.8	13.6	(476.9)	239bp below our estimates.
Depn & amort.	376	325	15.5	365	3.0	1,104	968	14.1	1% lower than our estimates.
EBIT	1,528	2,461	(37.9)	1,162	31.5	4,343	6,252	(30.5)	
Interest expense	26	33	(18.8)	23	15.8	75	98	(23.4)	
Other income	913	260	251.6	776	17.7	2,043	1,370	49.1	14% higher than our estimates.
Pretax profit	2,414	2,688	(10.2)	1,915	26.1	6,310	7,524	(16.1)	15% below our estimates.
Tax	550	673	(18.3)	310	77.2	1,367	1,890	(27.7)	
Tax rate (%)	22.8	25.0	(225)	16.2	657	21.7	25.1	(345.6)	
Normalised Net profit	1,864	2,015	(7.5)	1,604	16.2	4,944	5,634	(12.3)	15% below our estimates.
Exceptionals	-	-		(728)	nm	(728)	-	nm	
Reported net profit	1,864	2,015	(7.5)	877	112.6	4,216	5,634	(25.2)	
Normalised EPS (Rs)	16.9	19.9	(15.3)	14.5	16.2	56.3	63.4	(11.3)	
Tractor Volumes (nos)	28,025	25,325	10.7	23,703	18.2	78,525	72,333	8.6	
Tractor realisation (Rs)	6,09,452	5,99,925	1.6	6,13,787	(0.7)	6,05,999	5,76,733	5.1	

SOURCES: INCRED RESEARCH, COMPANY REPORTS

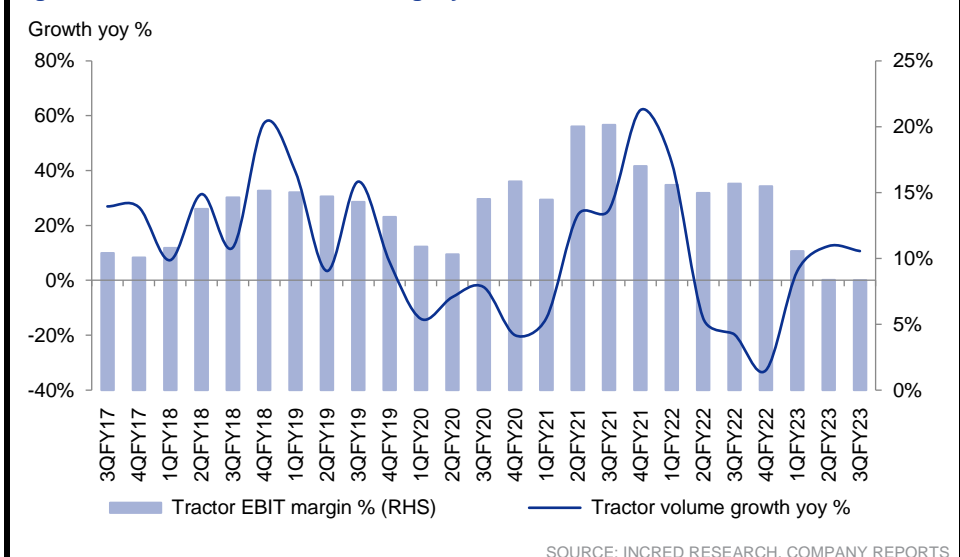
Figure 2: Tractor sales volume hit of late, as the company shifted its focus on retail sales



SOURCE: INCRED RESEARCH, COMPANY REPORTS

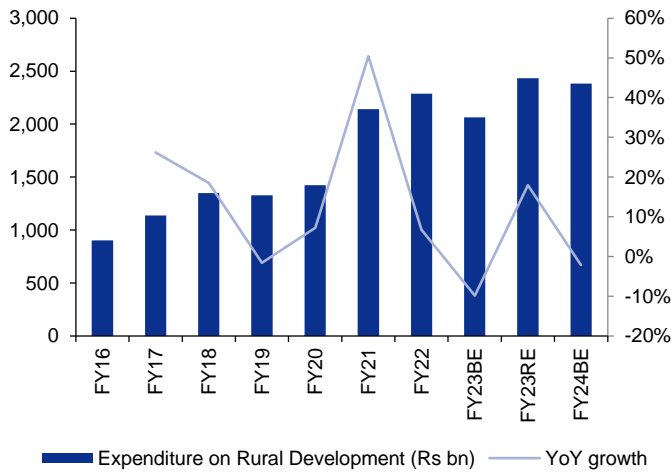
Margins remain subdued because of higher commodity inflation, delayed price hike and an adverse product mix.

Figure 3: Tractor division's EBIT margin yet to recover



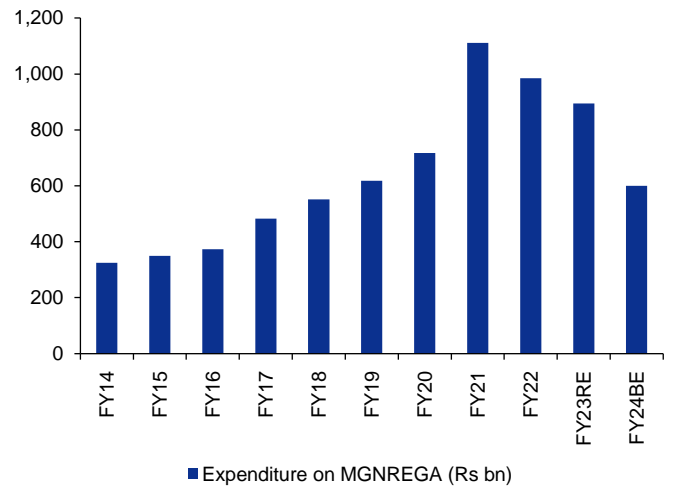
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 4: Rural development spending flattens



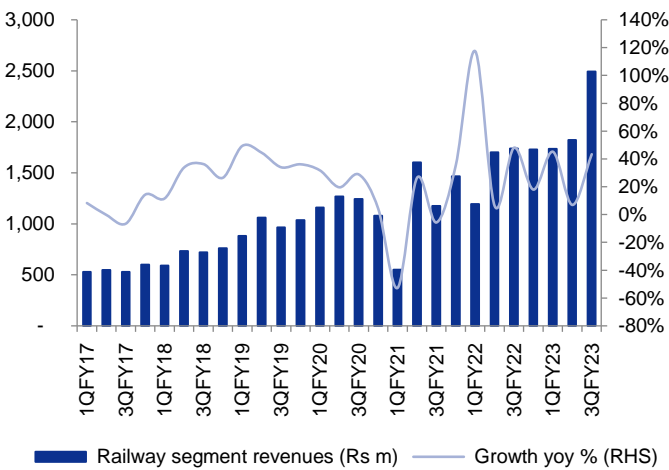
SOURCE: BUDGET DOCUMENTS, INCRED RESEARCH

Figure 5: Rural employment guarantee programme expenditure continues to ease from its Covid-19 peak levels



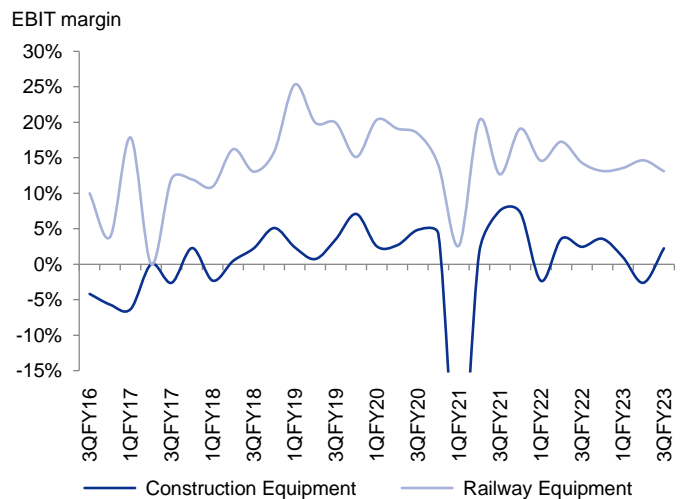
SOURCE: BUDGET DOCUMENTS, INCRED RESEARCH

Figure 6: Strong order book in the railway segment leaves its fate now on execution



SOURCE: INCRED RESEARCH, COMPANY REPORTS

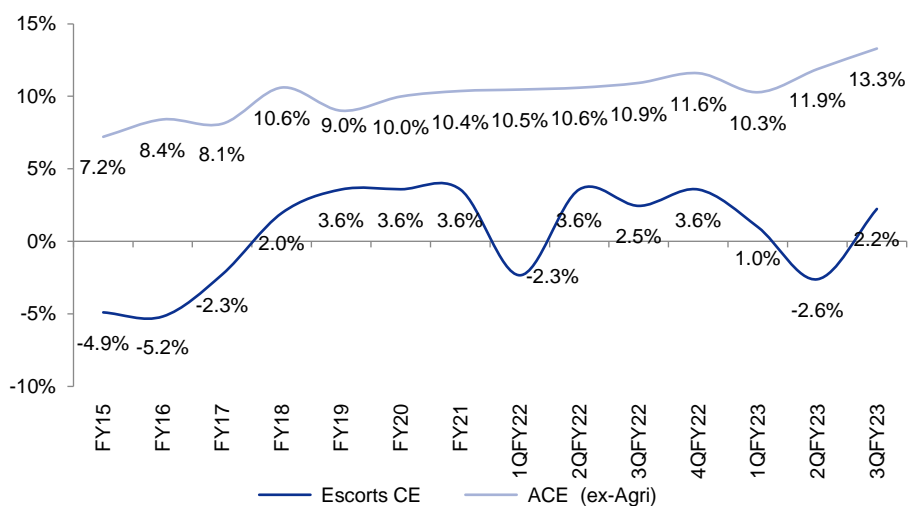
Figure 7: Construction equipment and railways equipment margin trend



SOURCE: INCRED RESEARCH, COMPANY REPORTS

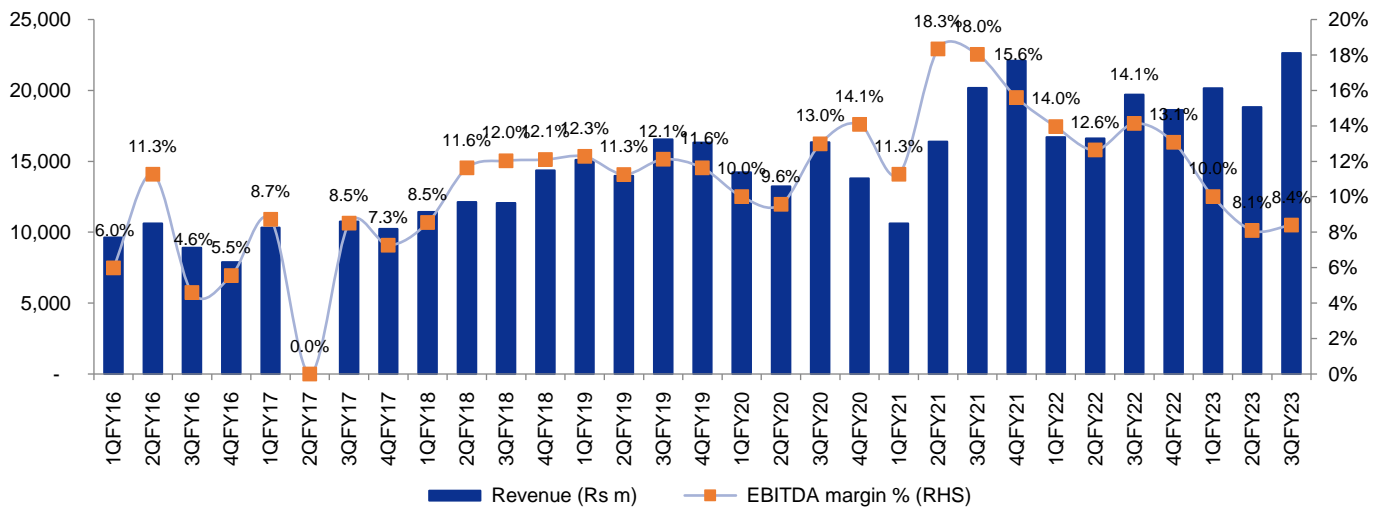
Escorts Kubota's construction equipment EBIT margin could remain low until the volume picks up substantially.

Figure 8: Escorts Kubota's construction equipment margins barely back in the positive territory



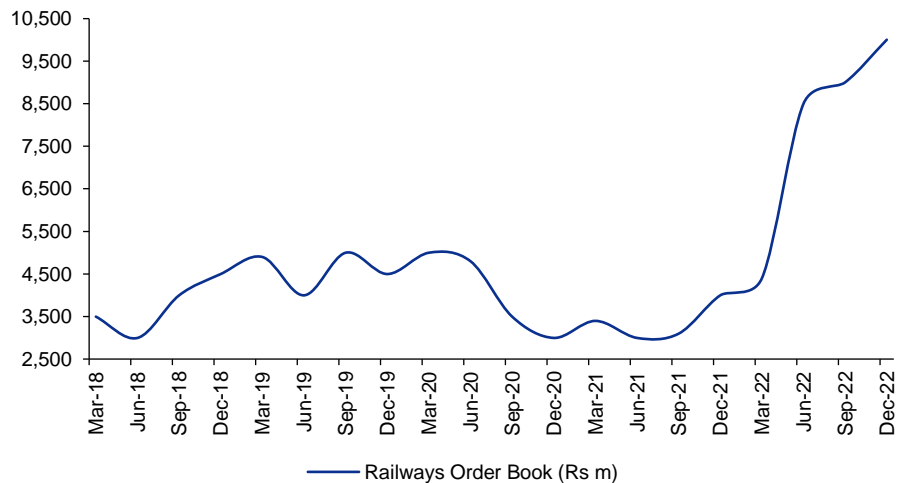
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 9: Standalone EBITDA margin has to overcome many headwinds before it stabilizes



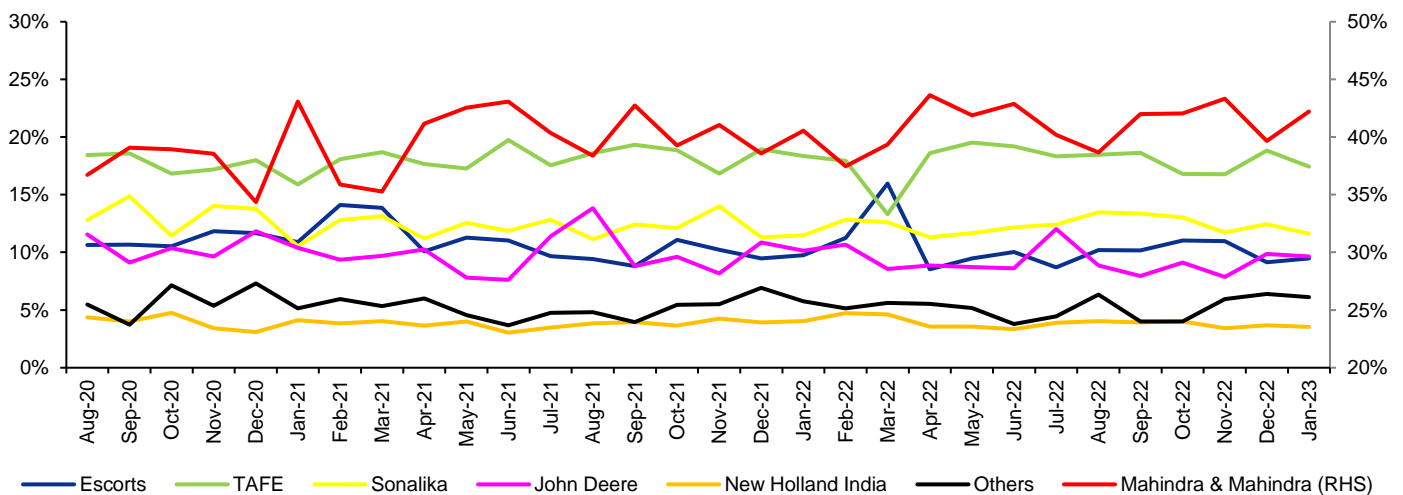
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 10: Railway equipment segment's orders grow further



SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 11: Tractor makers' domestic market share trend



SOURCE: TRACTOR AND MECHANIZATION ASSOCIATION (TMA), INCRED RESEARCH, COMPANY REPORTS

Figure 12: Our revised earnings estimates

Rs m	FY23F		FY24F		FY25F	
	Old	New	Old	New	Old	New
Tractor Volume (nos)	1,08,282	1,04,880	1,19,929	1,15,089	1,33,687	1,27,165
% change		-3.1%		-4.0%		-4.9%
Net Sales	88,704	84,365	1,05,889	1,01,698	1,23,479	1,20,818
% change		-4.9%		-4.0%		-2.2%
EBITDA	9,582	7,841	13,184	11,803	16,502	15,034
% change		-18.2%		-10.5%		-8.9%
EBITDA margin	10.8%	9.3%	12.5%	11.6%	13.4%	12.4%
bp change		(140)		(68)		(69)
PAT	8,133	7,017	10,984	10,212	13,543	12,760
% change		-13.7%		-7.0%		-5.8%

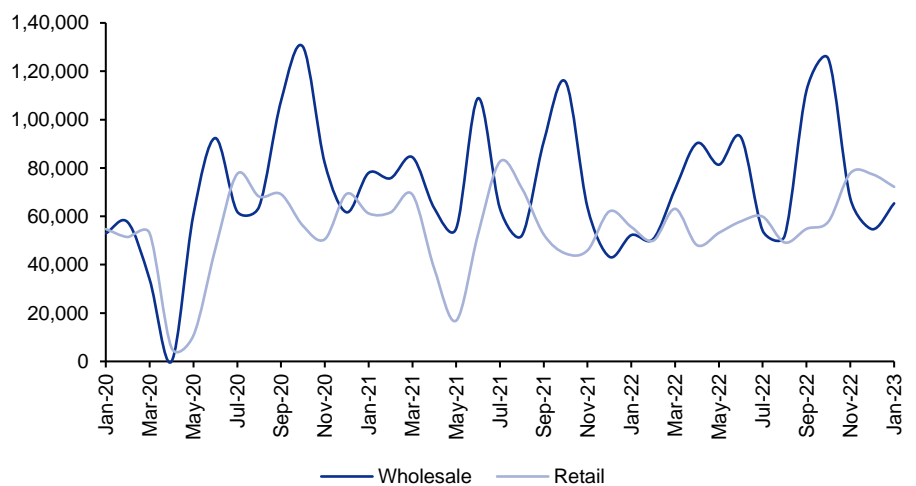
SOURCE: INCRED RESEARCH ESTIMATES, COMPANY REPORTS

Figure 13: Key assumptions

Volume Assumptions	Mar-21A	Mar-22A	Mar-23F	Mar-24F	Mar-25F
Tractor volume (units)	1,06,741	94,228	1,04,880	1,15,089	1,27,165
Growth yoy %	24.1%	-11.7%	11.3%	9.7%	10.5%
Construction Equipment volume (units)	3,913	4,117	4,611	5,994	7,493
Growth yoy %	-3.2%	5.2%	12.0%	30.0%	25.0%
Total Revenue (Rs m)	69,293	71,527	84,365	1,01,698	1,20,818
Growth yoy %	20.3%	3.2%	17.9%	20.5%	18.8%
EBITDA margin %	16.3%	13.5%	9.3%	11.6%	12.4%
Segment wise Assumptions					
Tractor Revenue (Rs m)	56,673	55,210	63,828	72,898	83,752
EBIT margin %	18.2%	15.5%	9.6%	12.0%	13.0%
Construction Equipment Revenue (Rs m)	7,761	9,853	12,139	17,043	22,369
EBIT margin %	3.6%	2.4%	1.5%	2.5%	3.2%
Railway Equipment Revenue (Rs m)	4,790	6,362	8,398	11,757	14,696
EBIT margin %	16.0%	14.8%	14.0%	16.0%	17.0%

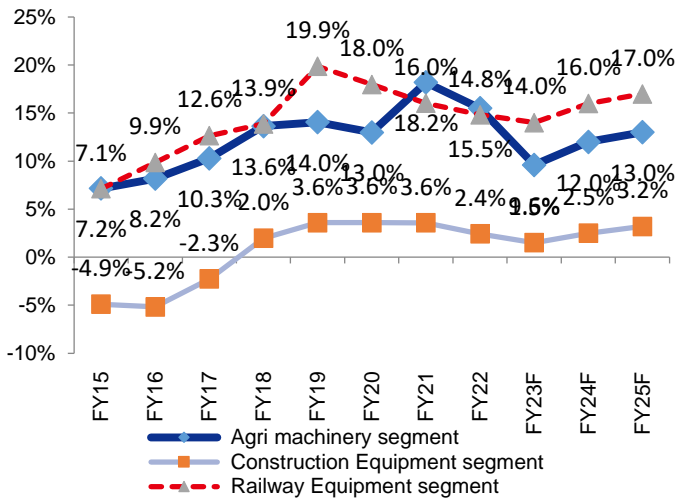
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 14: Tractor industry's wholesale vs. retail sales trend



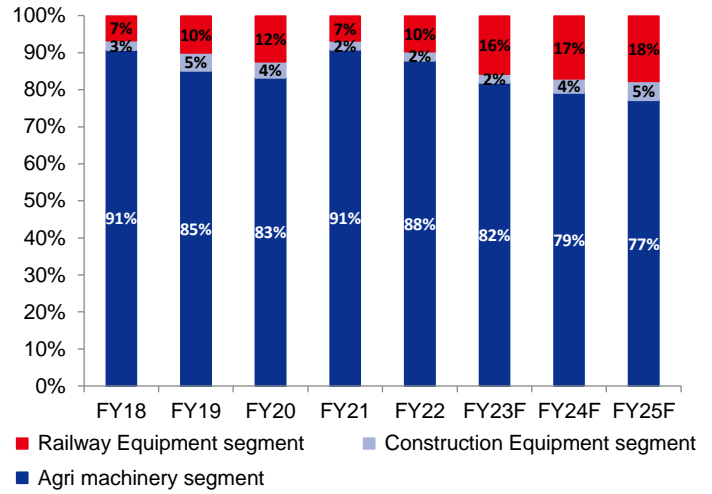
SOURCE: TMA, VAHAN, INCRED RESEARCH

Figure 15: EBIT margin trend by segment



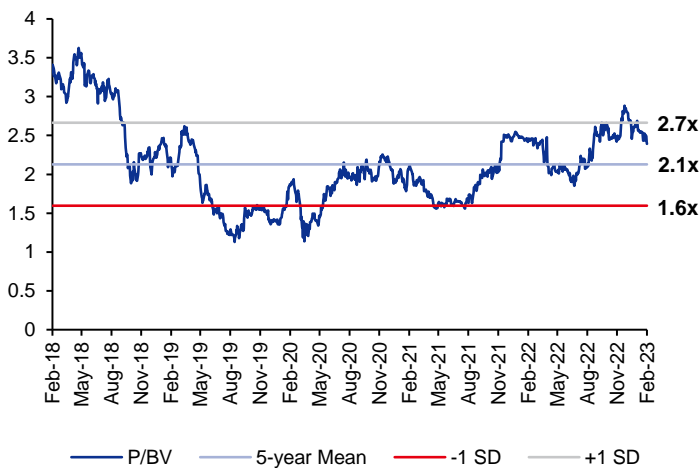
SOURCE: INCRED RESEARCH ESTIMATES, COMPANY REPORTS

Figure 16: Railway & construction equipment segments' contribution to improve



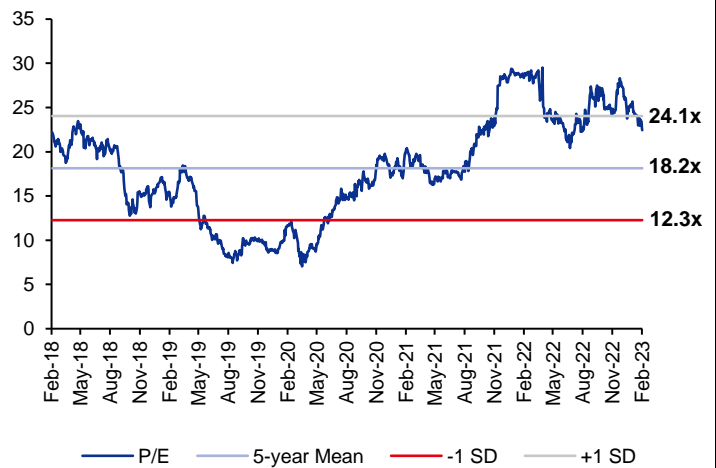
SOURCE: INCRED RESEARCH ESTIMATES, COMPANY REPORTS

Figure 17: One-year forward P/BV above mean level



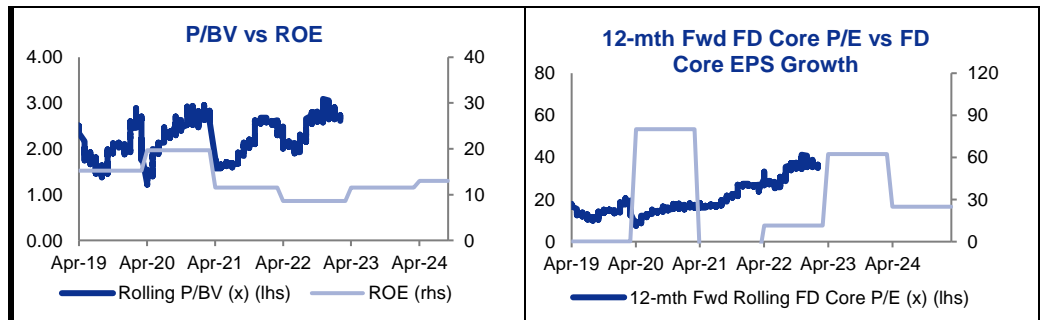
SOURCE: BLOOMBERG, INCRED RESEARCH ESTIMATES, COMPANY REPORTS

Figure 18: One-year forward P/E near +1SD level



SOURCE: BLOOMBERG, INCRED RESEARCH ESTIMATES, COMPANY REPORTS

BY THE NUMBERS



Profit & Loss

(Rs mn)	Mar-21A	Mar-22A	Mar-23F	Mar-24F	Mar-25F
Total Net Revenues	69,293	71,527	84,365	101,698	120,818
Gross Profit	23,356	22,199	22,863	29,493	35,641
Operating EBITDA	11,292	9,513	7,841	11,803	15,034
Depreciation And Amortisation	(1,157)	(1,298)	(1,508)	(1,602)	(1,805)
Operating EBIT	10,135	8,216	6,333	10,202	13,229
Financial Income/(Expense)	(110)	(127)	(105)	(100)	(100)
Pretax Income/(Loss) from Assoc.					
Non-Operating Income/(Expense)	1,546	2,130	2,769	2,991	3,230
Profit Before Tax (pre-EI)	11,571	10,219	8,997	13,092	16,359
Exceptional Items			(728)		
Pre-tax Profit	11,571	10,219	8,269	13,092	16,359
Taxation	(2,831)	(2,563)	(1,979)	(2,880)	(3,599)
Exceptional Income - post-tax					
Profit After Tax	8,740	7,656	6,289	10,212	12,760
Minority Interests					
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	8,740	7,656	6,289	10,212	12,760
Recurring Net Profit	8,740	7,656	6,843	10,212	12,760
Fully Diluted Recurring Net Profit	8,740	7,656	6,843	10,212	12,760

Cash Flow

(Rs mn)	Mar-21A	Mar-22A	Mar-23F	Mar-24F	Mar-25F
EBITDA	11,292	9,513	7,841	11,803	15,034
Cash Flow from Invt. & Assoc.					
Change In Working Capital	1,291	(5,678)	601	(1,703)	(1,955)
(Incr)/Decr in Total Provisions	1,135	(620)	508	350	350
Other Non-Cash (Income)/Expense					
Other Operating Cashflow			(728)		
Net Interest (Paid)/Received	1,436	2,003	2,664	2,891	3,130
Tax Paid	(2,831)	(2,420)	(1,979)	(2,880)	(3,599)
Cashflow From Operations	12,323	2,799	8,907	10,461	12,960
Capex	(1,367)	(2,023)	(2,750)	(4,250)	(4,800)
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments					
Other Investing Cashflow	(20)	(10,404)	(5,692)	(5,600)	(5,600)
Cash Flow From Investing	(1,387)	(12,427)	(8,442)	(9,850)	(10,400)
Debt Raised/(repaid)	(66)				
Proceeds From Issue Of Shares	123	18,162			
Shares Repurchased					
Dividends Paid	(1,011)	(924)	(1,056)	(1,583)	(1,979)
Preferred Dividends					
Other Financing Cashflow			(728)		
Cash Flow From Financing	(955)	17,239	(1,784)	(1,583)	(1,979)
Total Cash Generated	9,980	7,611	(1,319)	(973)	581
Free Cashflow To Equity	10,869	(9,628)	464	611	2,560
Free Cashflow To Firm	11,045	(9,501)	569	711	2,660

SOURCE: INCRED RESEARCH, COMPANY REPORTS

BY THE NUMBERS...cont'd

Balance Sheet

(Rs mn)	Mar-21A	Mar-22A	Mar-23F	Mar-24F	Mar-25F
Total Cash And Equivalents	13,165	2,585	1,993	1,020	1,602
Total Debtors	6,984	8,276	10,401	12,538	14,895
Inventories	6,745	8,036	9,246	11,981	14,895
Total Other Current Assets	3,615	4,287	4,780	5,180	5,580
Total Current Assets	30,509	23,183	26,420	30,719	36,972
Fixed Assets	18,474	19,200	20,441	23,090	26,084
Total Investments	23,050	51,335	56,835	62,335	67,835
Intangible Assets					
Total Other Non-Current Assets					
Total Non-current Assets	41,524	70,534	77,276	85,424	93,919
Short-term Debt					
Current Portion of Long-Term Debt					
Total Creditors	11,871	8,777	12,713	15,882	19,198
Other Current Liabilities	4,518	4,388	4,888	5,388	5,888
Total Current Liabilities	16,389	13,165	17,601	21,270	25,086
Total Long-term Debt					
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities					
Total Non-current Liabilities					
Total Provisions	1,727	1,771	2,079	2,229	2,379
Total Liabilities	18,116	14,936	19,680	23,499	27,466
Shareholders Equity	53,916	78,782	84,016	92,645	103,425
Minority Interests					
Total Equity	53,916	78,782	84,016	92,645	103,425

Key Ratios

	Mar-21A	Mar-22A	Mar-23F	Mar-24F	Mar-25F
Revenue Growth	20.3%	3.2%	17.9%	20.5%	18.8%
Operating EBITDA Growth	67.1%	(15.8%)	7.9%	50.5%	27.4%
Operating EBITDA Margin	16.3%	13.3%	9.3%	11.6%	12.4%
Net Cash Per Share (Rs)	119.14	23.39	18.04	9.24	14.49
BVPS (Rs)	487.93	712.96	760.32	838.41	935.98
Gross Interest Cover	92.22	64.69	60.31	102.02	132.29
Effective Tax Rate	24.5%	25.1%	23.9%	22.0%	22.0%
Net Dividend Payout Ratio	11.6%	12.1%	15.0%	15.5%	15.5%
Accounts Receivables Days	38.32	38.93	40.40	41.17	41.44
Inventory Days	59.46	54.68	51.28	53.65	57.59
Accounts Payables Days	97.38	76.39	63.77	72.27	75.16
ROIC (%)	35.0%	31.7%	18.5%	29.2%	32.7%
ROCE (%)	22.7%	12.3%	7.7%	11.5%	13.4%
Return On Average Assets	14.1%	9.4%	7.2%	9.4%	10.4%

Key Drivers

	Mar-21A	Mar-22A	Mar-23F	Mar-24F	Mar-25F
ASP (% chg, main prod./serv.)	2.9%	10.4%	3.9%	4.1%	4.0%
Unit sales grth (% , main prod./serv.)	24.1%	(11.7%)	11.3%	9.7%	10.5%
ASP (% chg, 2ndary prod./serv.)	(4.5%)	20.7%	10.0%	8.0%	5.0%
Unit sales grth (% ,2ndary prod/serv)	(3.2%)	5.2%	12.0%	30.0%	25.0%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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