

**SELL**

TP: Rs 2,343 | ▼ 24%

**ESCORTS**

| Automobiles

| 06 November 2023

**No major positive surprises; maintain SELL**

- Q2 tractor volumes dipped 7% YoY as sales flagged towards the quarter's end after an initial pickup
- Lower raw material cost aided gross/EBITDA margin expansion of ~470bps YoY each
- Lower volumes and market share remain concerns; maintain SELL with TP unchanged at Rs 2,343

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**Performance driven by realisations:** Escorts' Q2FY24 revenue grew 9% YoY (-12% QoQ) to Rs 20.5bn as realisation gains offset muted volumes. Tractor volumes dipped 7% YoY (-17% QoQ) owing to a weakening of sales towards the end of the quarter after an early pickup. Net realisation per vehicle (NRPV) in the tractor segment grew 1% YoY (+3% QoQ) to Rs 0.63mn on the back of price hikes aggregating 1.7% taken by the company towards the end of Q1 and Q2FY24.

**Rail and CE segments post strong growth:** Revenue from the railways and construction equipment (RE and CE) segments grew by a robust 29% and 72% YoY respectively. Agricultural machinery, however, fell 4% YoY. Segmental EBIT margin improved across the board, coming in at 12.2% for agri machinery (vs. 8.4% in the year-ago quarter), 10% for CE (1%) and 18.5% for RE (14.6%). The tractor, CE and RE businesses contributed 70%, 20% and 10% of revenue respectively.

**Receding raw material inflation aids margin gains:** Raw material cost (inventory adjusted) stayed flat YoY (-15% QoQ) at Rs 13.8bn as commodity price inflation was contained. As a result, gross margin jumped to 32.3% (+470bps YoY, +210bps QoQ) and EBITDA margin rose to 12.9% (+476bps YoY, -110bps QoQ). Adj. PAT grew 47% YoY (-17% QoQ) to Rs 2.4bn. After a 13.5% print in H1, management is targeting a 14-15% EBITDA margin by FY24-end if commodity prices stay stable.

**Amalgamation nod likely by Q4FY24:** The amalgamation of Escorts Kubota India and Kubota Agricultural Machinery India with Escorts Kubota has received National Company Law Tribunal (NCLT) approval and is awaiting shareholder approval.

**Maintain SELL:** Escorts' tractor volumes have fallen 4% YoY during H1FY24. This apart, the company has lost substantial market share in the high-end 31-40HP segment, from 14.5% in FY18 to 11.1% in FY23, and stagnated at ~10.5% in the 44-50HP segment, with only minimal gains seen in H1FY24. Exports too have been weak and though the amalgamation with Kubota is likely to boost sales, clarity will emerge only in late-FY25. We maintain SELL and continue to value the stock at 20x FY25E EPS at marginal premium to LT average – for an unchanged TP of Rs 2,343.

**Key changes**

Target	Rating
◀▶	◀▶

Ticker/Price	ESCORTS IN/Rs 3,080
Market cap	US\$ 4.9bn
Free float	63%
3M ADV	US\$ 17.3mn
52wk high/low	Rs 3,440/Rs 1,808
Promoter/FPI/DII	37%/22%/8%

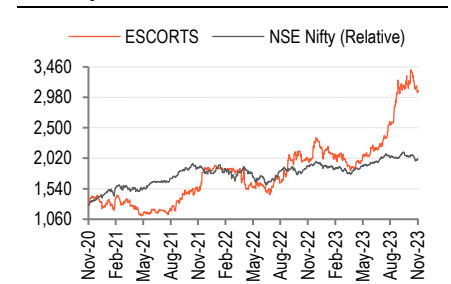
Source: NSE | Price as of 6 Nov 2023

**Key financials**

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	84,287	99,836	1,09,970
EBITDA (Rs mn)	7,775	12,125	14,324
Adj. net profit (Rs mn)	6,897	10,516	12,486
Adj. EPS (Rs)	52.3	95.2	113.0
Consensus EPS (Rs)	52.3	100.0	119.0
Adj. ROAE (%)	8.4	11.5	12.1
Adj. P/E (x)	58.9	32.4	27.3
EV/EBITDA (x)	51.2	33.7	27.7
Adj. EPS growth (%)	(6.4)	82.0	18.7

Source: Company, Bloomberg, BOBCAPS Research

**Stock performance**



Source: NSE



**Fig 1 – Earnings call highlights**

Parameter	Q2FY24	Q1FY24	Our view
Domestic Volumes	<p>The domestic tractor industry fell 5.8% YoY to ~209k units in Q2FY24 due to a delayed festive season. Escorts' domestic tractor volumes fell 4.3% YoY to 20.5k units.</p> <p>The company has gained market share of 15bps YoY to 9.8% in Q2 (H1 share up 0.3%)</p>	<p>The domestic tractor industry fell 1.9% YoY to ~261k units while Escorts' domestic volumes grew 2.5% YoY to 25.2k units in Q1FY24.</p> <p>The company has gained market share by 41bps YoY to 9.7%.</p>	Escorts is facing volume challenges in the domestic market.
Exports	<p>The export tractor industry was down 26.7% YoY to ~25.9k units and the company's export volumes fell 33% YoY to 1,551 units in Q2FY24. Management expects export volumes to fall by 10-15% YoY in FY24.</p> <p>Sales through Kubota's global network stood at ~31% of export volumes in Q2FY24.</p>	<p>The export tractor industry was down 31% YoY to ~24.2k units and the company's export volumes fell 38% YoY to 1,356 units in Q1FY24 due to sluggish markets.</p> <p>Sales through the Kubota global network were ~32% of total export volumes in Q1FY24.</p>	Formal amalgamation with Kubota will give the company a better presence in export markets.
Margins	<p>EBITDA grew 72% YoY to Rs 2.6bn and operating margin increased to 12.9% (+475bps YoY) on account of operating leverage in the CE and RE businesses, improved realisations, a better product mix and commodity price softening. Prices hikes were taken in Q1 and Q2 (mid-September) aggregating 1.7% and the full impact of the same shall be visible in Q3.</p> <p>Management does not expect commodity cost inflation to rise as much as in the last two years.</p>	<p>EBITDA grew 62% YoY to Rs 3.3bn and operating margins stood at 14% (+400bps YoY) on account of operating leverage in the CE and RE businesses and commodity price softening. A ~1% price hike was taken in Q1 and the impact would be visible in Q2/Q3FY24.</p> <p>As per management, the full impact of softening commodity prices is yet to be reflected in margins.</p>	Margins were driven by easing raw material cost and we expect management's 14-15% target by FY24-end to be met.
Other segments	<p>The served construction equipment industry grew 37% YoY aided by 73% growth in the crane business, 63% growth in the compactor industry and 28% growth in the backhoe loader industry. Escorts' total volumes grew 72% YoY to 1,577 units in Q2FY24 (highest ever Q2 volumes).</p> <p>For the RE division, revenue rose 29% YoY to Rs 2.3bn and new product contribution to the railway revenue segment was more than 50%. Management expects to maintain double-digit growth in FY24 aided by launches and developments in the Indian railway sector. EBITDA margin is guided to be +/- 100-200bps from current levels.</p> <p>The order book for the railway division was ~Rs 8.7bn at end-Q2FY24.</p>	<p>The served construction equipment industry grew 30% YoY in Q1FY24 aided by 59% growth in the crane business, 32% growth in the compactor industry and 23% growth in the backhoe loader industry. Escorts' total volumes were up 42% YoY to 1,373 units in Q1FY24.</p> <p>For the RE division, revenue rose 72% YoY to Rs 3bn as a result of higher spare sales and exports. Management expects double-digit revenue growth and 16-17% margins in FY24.</p>	<p>The performance of segments other than tractors continues to improve and they currently form ~30% of revenue.</p> <p>Rail order book execution is faster, which explains the apparent sequential decline.</p>
Regulations	<p>TREM-5 emission norms are expected to be applicable from Apr'24 (TREM-4 norms delayed by ~18 months). Implementation of TREM-5 for sub-50HP tractors (transitioning from TREM-3) would cause a ~Rs 125k rise in pricing (8-10%</p>	NA	Escorts has a lower presence in the high-end tractor segment and will see some pricing impact from the new norms.

Parameter	Q2FY24	Q1FY24	Our view
	impact at customer level). The pricing impact would be less for the 50HP and above segment (expected to be 4-5%) as TREM-4 norms are already implemented and pricing is absorbed.		
Captive financing	Escorts is currently in the process of setting up an independent captive financing arm (board approval received) and will apply to RBI in Q4FY24 for an NBFC license.	NA	This will help all the three business segments, but unlikely to have near-term impact.
Capex	Capex guidance for FY24 has been reduced to Rs 2bn-2.2bn. Escorts continues to be net debt-free with sufficient liquidity for growth and capacity expansion.	Management indicated that the balance sheet remains healthy for funding capex.	We do not see any challenge in meeting capex requirements.
Merger	For the Kubota amalgamation, Escorts has received the NCLT order to convene the shareholders' and creditors' meeting which it has scheduled for 2 Dec 2023. Management expects the final order from NCLT approving the merger by Q4FY24.	Escorts has got approval from stock exchanges and SEBI and has filed a petition with NCLT, the hearing of which will be followed by shareholders' and creditors' meeting and their approvals. Escorts expects a timeframe of another six months for the merger to conclude.	Clarity, particularly on export business, is likely to emerge post formal amalgamation.
Other information	Dealer count at the end of Q2FY24 was 1,200+ and current inventory at the dealer level is 4.5-5 weeks which management expects will reduce to ~4 weeks post Nov'23, along with a reduction in discounts which are normally higher during peak festive season.	Dealer count at the end of Q1FY24 was 1,200+ and current inventory at the dealer level is 4-4.5 weeks. The order book for the railway division was ~Rs 9.5bn at the end of Q1FY24. Escorts Kubota received approval in May'23 for a capital reduction scheme aggregating to ~16.3% of the company's the then paid-up share capital.	Tractor inventory is likely to revert to normal post festive season.

Source: Company, BOBCAPS Research

**Fig 2 – Quarterly performance (Standalone)**

(Rs mn)	Q2FY24	Q2FY23	YoY (%)	Q1FY23	QoQ (%)	H1FY24	H1FY23	YoY (%)
Volume	22,024	23,703	(7.1)	26,582	(17.1)	48,606	50,500	(3.8)
Avg. Realisation per Vehicle	929,068	794,617	16.9	875,683	6.1	899,872	771,947	16.6
<b>Net Revenues</b>	<b>20,462</b>	<b>18,835</b>	<b>8.6</b>	<b>23,277</b>	<b>(12.1)</b>	<b>43,739</b>	<b>38,983</b>	<b>12.2</b>
Total Income (A)	20,462	18,835	8.6	23,277	(12.1)	43,739	38,983	12.2
<b>Operating Expenses:</b>								
Raw materials consumed	13,846	13,638	1.5	16,252	(14.8)	30,098	28,184	6.8
Employee Expenses	1,675	1,489	12.5	1,484	12.8	3,159	2,858	10.5
Other Expenses	2,309	2,182	5.8	2,272	1.6	4,581	4,399	4.1
Total Expenditure (B)	17,829	17,308	3.0	20,008	(10.9)	37,837	35,441	6.8
<b>EBITDA (A-B)</b>	<b>2,633</b>	<b>1,527</b>	<b>72.4</b>	<b>3,269</b>	<b>(19.5)</b>	<b>5,902</b>	<b>3,543</b>	<b>66.6</b>
Other Income	950	776	22.5	945	0.5	1,895	1,130	67.7
Depreciation	407	365	11.5	402	1.3	809	729	11.0
EBIT	3,176	1,937	63.9	3,813	(16.7)	6,988	3,944	77.2
Finance Costs	24	23	2.6	27	(11.7)	50	49	2.7
PBT after excep items	3,152	1,187	165.6	3,786	(16.7)	6,938	3,168	119.0
Tax expense	802	310	158.4	958	(16.3)	1,760	817	115.5
Reported PAT	2,350	877	168.1	2,828	(16.9)	5,178	2,351	120.3
<b>Adjusted PAT</b>	<b>2,350</b>	<b>1,604</b>	<b>46.5</b>	<b>2,828</b>	<b>(16.9)</b>	<b>5,178</b>	<b>3,079</b>	<b>68.2</b>
Adj EPS (Rs)	21.3	12.2	74.9	25.6	(16.9)	46.9	23.3	100.8
<b>Key Ratios (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
Gross Margin (%)	32.3	27.6	474	30.2	215	31.2	27.7	349
EBITDA Margin (%)	12.9	8.1	476	14.0	(118)	13.5	9.1	441
EBIT Margin (%)	15.5	10.3	523	16.4	(86)	16.0	10.1	586
PBT Margin (%)	15.4	10.2	524	16.3	(86)	15.9	10.0	587
Tax Rate (%)	25.4	26.2	(70)	25.3	15	25.4	25.8	(41)
Adj PAT Margin (%)	11.5	8.5	297	12.1	(66)	11.8	7.9	394

Source: Company, BOBCAPS Research

## Valuation methodology

Escorts' tractor volumes have fallen 4% YoY during H1FY24. This apart, the company has lost substantial market share in the high-end 31-40HP segment, from 14.5% in FY18 to 11.1% in FY23, and stagnated at ~10.5% in the 44-50HP segment. Exports too have been weak and though the amalgamation with Kubota is likely to boost sales, clarity will emerge only in late-FY25. We maintain SELL and continue to value the stock at 20x FY25E EPS at marginal premium to long-term average – for an unchanged TP of Rs 2,343.

**Fig 3 – Key assumptions**

Parameter	FY22	FY23	FY24E	FY25E
Volumes	94,228	103,290	1,13,103	1,21,020
Blended Realisation (Rs)	5,53,136	6,11,215	6,31,080	6,50,012
EBITDA (Rs mn)	9,594	7,804	12,125	14,324
EBITDA margin (%)	13.4	9.4	11.5	13.0
Adj. PAT (Rs mn)	7,656	7,041	10,516	12,486
EPS (Rs)	58.6	53.4	95	113

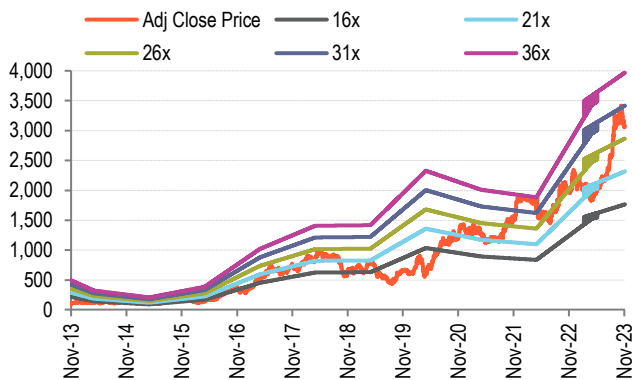
Source: Company, BOBCAPS Research

**Fig 4 – Peer comparison**

Company	Ticker	Rating	Target Price (Rs)	EPS (Rs)		ROE (%)	
				FY24E	FY25E	FY24E	FY25E
Escorts Kubota	ESCORTS IN	SELL	2,343	95.2	113.0	12.1	12.8
VST Tillers Tractors	VSTT IN	HOLD	3,464	146.6	173.2	13.6	14.1
Mahindra & Mahindra	MM IN	BUY	1,824	78.0	90.7	19.4	18.7

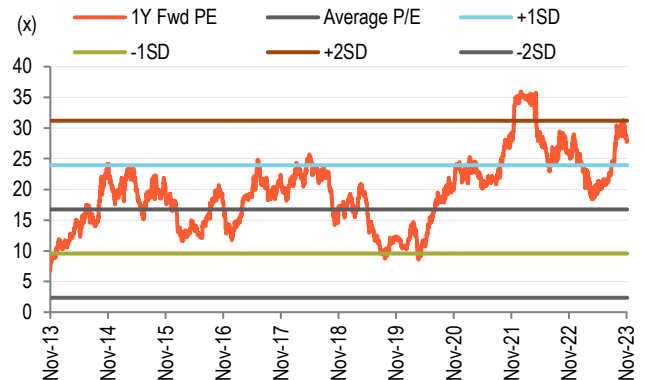
Source: BOBCAPS Research

**Fig 5 – Acquisition buzz pushed up valuations recently**



Source: Bloomberg, BOBCAPS Research

**Fig 6 – Valuations likely to revert to long-term average**



Source: Bloomberg, BOBCAPS Research

## Key risks

Key upside risks to our estimates are:

- faster-than-expected revival in export volumes,
- faster margin revival than anticipated owing to earnings-accretive price hikes, and
- quicker easing of commodity prices than anticipated.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ashok Leyland	AL IN	6.0	169	210	BUY
Bajaj Auto	BJAUT IN	19.0	5,407	5,139	HOLD
Eicher Motors	EIM IN	11.7	3,511	3,601	HOLD
Escorts	ESCORTS IN	4.9	3,080	2,343	SELL
Hero MotoCorp	HMCL IN	7.7	3,167	3,009	HOLD
Mahindra & Mahindra	MM IN	22.7	1,488	1,824	BUY
Maruti Suzuki	MSIL IN	37.8	10,285	11,562	HOLD
TVS Motor	TVSL IN	9.3	1,615	1,531	HOLD
VST Tillers Tractors	VSTT IN	0.4	3,584	3,464	HOLD

Source: BOBCAPS Research, NSE | Price as of 6 Nov 2023

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
<b>Total revenue</b>	<b>70,144</b>	<b>72,384</b>	<b>84,287</b>	<b>99,836</b>	<b>1,09,970</b>
EBITDA	11,268	9,512	7,775	12,125	14,324
Depreciation	1,183	1,218	1,399	1,352	1,436
EBIT	11,689	10,372	9,084	14,003	16,603
Net interest inc./(exp.)	(133)	(150)	(133)	(130)	(130)
Other inc./(exp.)	1,604	2,180	2,809	3,231	3,715
Exceptional items	0	0	(531)	0	0
EBT	11,548	9,928	8,346	13,873	16,473
Income taxes	2,832	2,572	1,979	3,357	3,986
Extraordinary items	0	(9)	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
<b>Reported net profit</b>	<b>8,716</b>	<b>7,365</b>	<b>6,367</b>	<b>10,516</b>	<b>12,486</b>
Adjustments	0	0	531	0	0
<b>Adjusted net profit</b>	<b>8,716</b>	<b>7,365</b>	<b>6,897</b>	<b>10,516</b>	<b>12,486</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Accounts payables	11,954	9,855	13,427	12,664	14,196
Other current liabilities	3,980	3,486	3,485	12,172	12,867
Provisions	2,958	1,402	1,466	1,613	1,774
Debt funds	17	0	0	0	0
Other liabilities	837	0	0	0	0
Equity capital	1,348	1,319	1,319	1,105	1,105
Reserves & surplus	48,904	74,642	80,509	90,058	1,01,947
Shareholders' fund	50,252	75,961	81,829	91,163	1,03,052
<b>Total liab. and equities</b>	<b>69,999</b>	<b>90,705</b>	<b>1,00,206</b>	<b>1,17,612</b>	<b>1,31,890</b>
Cash and cash eq.	14,844	2,718	4,719	8,647	8,090
Accounts receivables	6,576	7,926	11,797	11,488	12,955
Inventories	7,182	8,466	12,177	12,035	13,257
Other current assets	2,122	5,258	5,291	5,820	6,402
Investments	19,380	48,358	47,667	59,718	70,718
Net fixed assets	18,197	18,172	18,621	19,268	19,832
CWIP	412	563	694	500	500
Intangible assets	0	553	734	734	734
Deferred tax assets, net	(233)	(1,311)	(1,492)	(598)	(598)
Other assets	1,520	0	0	0	0
<b>Total assets</b>	<b>69,999</b>	<b>90,704</b>	<b>1,00,206</b>	<b>1,17,612</b>	<b>1,31,890</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
<b>Cash flow from operations</b>	<b>12,723</b>	<b>(2,927)</b>	<b>863</b>	<b>16,500</b>	<b>9,195</b>
Capital expenditures	(1,521)	(2,000)	(2,260)	(1,806)	(2,000)
Change in investments	(11,407)	(28,978)	692	(12,051)	(11,000)
Other investing cash flows	1,604	2,180	2,809	3,231	3,715
<b>Cash flow from investing</b>	<b>(11,324)</b>	<b>(28,798)</b>	<b>1,240</b>	<b>(10,626)</b>	<b>(9,285)</b>
Equities issued/Others	10,583	17,932	242	(456)	0
Debt raised/repaid	(175)	(17)	0	0	0
Interest expenses	(133)	(150)	(133)	(130)	(130)
Dividends paid	(245)	(737)	(763)	(663)	(663)
Other financing cash flows	(40)	2,199	185	(894)	0
<b>Cash flow from financing</b>	<b>9,989</b>	<b>19,226</b>	<b>(469)</b>	<b>(2,143)</b>	<b>(793)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>11,388</b>	<b>(12,499)</b>	<b>1,635</b>	<b>3,730</b>	<b>(883)</b>
<b>Closing cash &amp; cash eq.</b>	<b>14,844</b>	<b>2,718</b>	<b>4,719</b>	<b>8,647</b>	<b>8,090</b>

### Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23A	FY24E	FY25E
Reported EPS	79.0	68.6	52.3	95.2	113.0
Adjusted EPS	64.6	55.8	52.3	95.2	113.0
Dividend per share	1.8	5.6	5.8	6.0	6.0
Book value per share	372.8	576.0	620.5	825.9	932.9

### Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23A	FY24E	FY25E
EV/Sales	5.8	5.4	4.7	4.1	3.6
EV/EBITDA	35.8	41.1	51.2	33.7	27.7
Adjusted P/E	47.6	55.2	58.9	32.4	27.3
P/BV	8.3	5.3	5.0	3.7	3.3

### DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23A	FY24E	FY25E
Tax burden (Net profit/PBT)	75.5	74.2	82.6	75.8	75.8
Interest burden (PBT/EBIT)	98.8	95.7	91.9	99.1	99.2
EBIT margin (EBIT/Revenue)	16.7	14.3	10.8	14.0	15.1
Asset turnover (Rev./Avg TA)	168.9	113.9	106.8	115.4	113.2
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.0	1.0	1.0
Adjusted ROAE	21.4	11.7	8.7	12.1	12.8

### Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23A	FY24E	FY25E
<b>YoY growth (%)</b>					
Revenue	20.7	3.2	16.4	18.4	10.2
EBITDA	70.1	(15.6)	(18.3)	55.9	18.1
Adjusted EPS	64.2	(13.7)	(6.4)	82.0	18.7
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	16.1	13.1	9.2	12.1	13.0
EBIT margin	16.7	14.3	10.8	14.0	15.1
Adjusted profit margin	12.4	10.2	8.2	10.5	11.4
Adjusted ROAE	17.3	9.7	8.4	11.5	12.1
ROCE	21.2	12.1	8.8	12.3	13.0
<b>Working capital days (days)</b>					
Receivables	36	37	43	43	41
Inventory	42	39	45	44	42
Payables	98	80	69	67	63
<b>Ratios (x)</b>					
Gross asset turnover	0.4	0.4	0.4	0.3	0.3
Current ratio	1.6	1.7	1.8	1.4	1.4
Net interest coverage ratio	(87.6)	(69.3)	(68.5)	(107.7)	(127.7)
Adjusted debt/equity	0.0	0.0	0.0	0.0	0.0

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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### Recommendation scale: Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

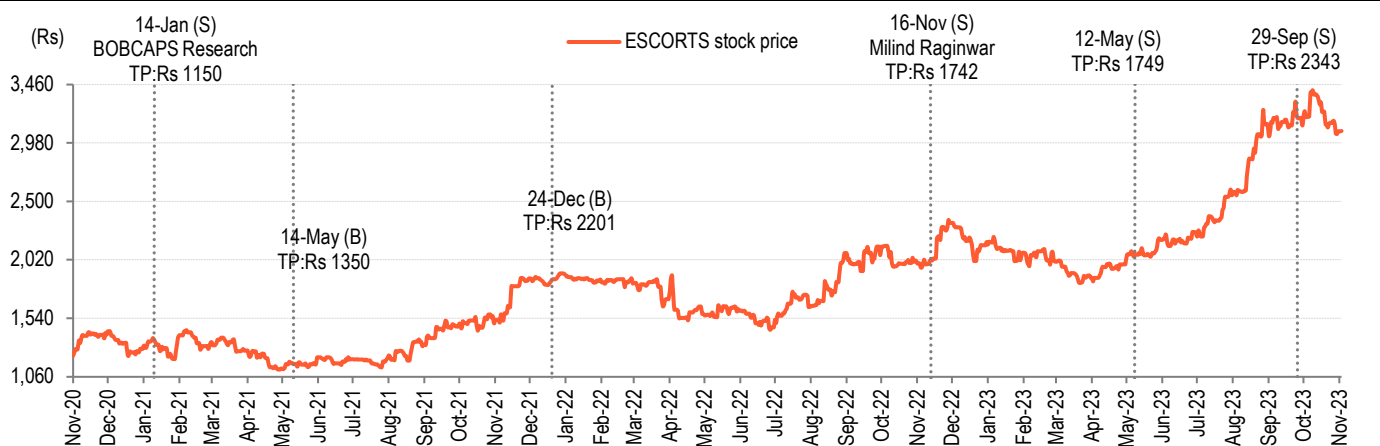
**HOLD** – Expected return from -6% to +15%

**SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

### Ratings and Target Price (3-year history): ESCORTS (ESCORTS IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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