

SELL
 TP: Rs 2,389 | ▼ 19%

ESCORTS

| Automobiles

| 09 February 2024

Weakness persists – maintain SELL

- Q3 tractor volumes dipped 7% YoY, with loss of domestic share as fall was higher than industry decline
- Lower commodity cost supported gross/EBITDA margin expansion despite tepid revenue growth of 3% YoY
- Expect volumes to remain weak; retain SELL with slight change in TP to Rs 2,389 (vs. Rs 2,343) on rollover

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Tractor volumes remain subdued: Escorts' Q3FY24 revenue grew only 3% YoY (+13% QoQ) to Rs 23.2bn as tractor volumes remained weak, largely offsetting realisation gains. Tractor volumes fell 7% YoY (+18% QoQ) to ~26k units, underperforming the industry which fell 6% YoY (+11% QoQ) to ~261.3k units due to deficient rains and a delayed crop harvest. Net realisation per vehicle in the segment grew 5%/1% YoY/QoQ to Rs 0.64mn on the back of price hikes taken by Escorts in Q1-Q2FY24.

AM, RE fall but CE segment robust YoY: Revenue from the agriculture machinery (AM) segment fell 3% YoY in Q3 due to weak tractor volumes. The railways equipment (RE) segment contracted 18% YoY due to a lower supply schedule from the railway department, while construction equipment (CE) grew 49%. Segmental EBIT margin stood at 13.8% for AM (8.3% in Q3FY23), 18.4% for RE (13.1%) and 8.3% for CE (2.2%). The three segments contributed 71%, 9% and 20% of revenue respectively.

Easing input cost aids margin gains: Raw material cost (inventory adjusted) fell 5%/+16% YoY/QoQ to Rs 16.1bn, but management sees little scope for further respite. Gross margin rose 520bps YoY (-170bps QoQ) to 30.6% and EBITDA margin expanded 460bps (+60bps) to 13.5%. Adj. PAT grew 41%/18% YoY/QoQ to Rs 2.8bn.

Amalgamation nod likely by Q1FY25: Amalgamation of Escorts Kubota India and Kubota Agricultural Machinery India has received all the necessary approvals and a final order from National Company Law Tribunal (NCLT) is expected in 2-3 months.

Maintain SELL: Escorts' tractor volumes have slipped 3% YoY in 9MFY24, and the company has ceded domestic market share in all tractor segments and two of three CE categories during the December quarter. The full benefit of Kubota integration on export sales is likely to flow only after 3-4 years. We pare FY24/FY25 EPS estimates by 2%/6% and introduce FY26 forecasts, baking in a revenue/EBITDA/PAT CAGR of 12%/27%/25% for Escorts over FY23-FY26. Given sustained growth headwinds, we retain SELL, while revising our TP to Rs 2,389 (vs. Rs 2,343) as we roll valuations over to FY26E. Our target P/E stays at 20x – in line with the stock's long-term mean.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	ESCORTS IN/Rs 2,933
Market cap	US\$ 4.7bn
Free float	63%
3M ADV	US\$ 11.6mn
52wk high/low	Rs 3,440/Rs 1,808
Promoter/FPI/DII	37%/22%/8%

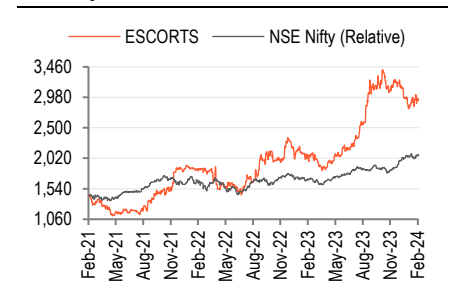
Source: NSE | Price as of 8 Feb 2024

Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	84,287	89,341	1,00,481
EBITDA (Rs mn)	7,775	12,257	13,921
Adj. net profit (Rs mn)	6,897	10,364	11,756
Adj. EPS (Rs)	52.3	93.8	106.4
Consensus EPS (Rs)	52.3	100.0	119.0
Adj. ROAE (%)	8.4	11.4	11.5
Adj. P/E (x)	56.1	31.3	27.6
EV/EBITDA (x)	48.7	31.7	27.2
Adj. EPS growth (%)	(6.4)	79.4	13.4

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Earnings call highlights

Parameter	Q3FY24	Q2FY24	Our view
Domestic volumes	<p>The domestic tractor industry fell 4.9% YoY to ~235k units in Q3FY24 due to erratic and deficient rainfall that led to delayed crop harvests and lower <i>rabi</i> (winter crop) sowing. Escorts' domestic tractor volumes fell 6% YoY to 24.6k units. Escorts' market share as on Q3FY24 was 10.5%.</p>	<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. Escorts' market share as on Q2FY24 was 9.8%.</p>	<p>Escorts is facing greater volume challenges in the domestic market than the industry, leading to loss of market share.</p>
Exports	<p>The export tractor industry declined 27% YoY to ~21.3k units and Escorts' export volumes fell 26% YoY to 1,371 units in Q3FY24. Management expects export volumes to reach 20-30k units in the next 2-3 years. Sales through Kubota's global network stood at ~47% of export volumes in Q3FY24.</p>	<p>The export tractor industry was down 26.7% YoY to ~25.9k units and Escorts' export volumes fell 33% YoY to 1,551 units in Q2FY24. Management expects export volumes to contract 10-15% YoY in FY24. Sales through Kubota's global network stood at ~31% of export volumes in Q2FY24.</p>	<p>Formal amalgamation with Kubota will give Escorts a better foothold in export markets.</p>
Margins	<p>Operating margin expanded on account of improved realisation, effective cost control and softening commodity prices. Price hikes taken in the previous quarter also contributed to margins. Management expects commodity prices to increase slightly in Q4FY24.</p>	<p>Operating margin grew 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 to 1.7%, and the full impact of the same shall be visible in Q3. Management does not expect commodity cost inflation to rise as much as in the last two years.</p>	<p>Margins benefitted from easing raw material cost, but we see little scope for improvement hereon.</p>
Other segments	<p>Served construction equipment industry volumes grew 31% YoY, aided by 47% growth in crane volumes, 49% growth in the compactor segment and 25% growth in backhoe loaders. Escorts' total volumes grew 49% YoY to ~1,800 units in Q3FY24. For the RE division, revenue fell 18% YoY to Rs 2bn as the supply schedule from the railway department was lower in Q3FY24. Management expects the railway division to pick up, with good traction expected from both the freight wagon and passenger wagon divisions. The order book for the railway division was at Rs 9bn+ at end-Q3FY24.</p>	<p>Served construction equipment industry volumes 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). 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. Segment EBITDA margin is guided to be +/-100-200bps from current levels. The order book for the railway division was ~Rs 8.7bn at end-Q2FY24.</p>	<p>The performance of segments other than tractors continues to improve and they currently form ~30% of revenue. CE segment performance is likely to improve given the government's thrust on infrastructure.</p>
Regulations	<p>TREM-5 emission norms will be applicable from 1 Apr 2026, as per formal communication from the government to the company. Implementation of TREM-4 norms led to a decrease in industry size for the 41-50HP segment to 2% of the total</p>	<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>	<p>Escorts has a lower presence in the high-end tractor segment and will see limited pricing impact from the new norms.</p>

Parameter	Q3FY24	Q2FY24	Our view
	tractor market as on Q3FY24 (from 7% in FY23), translating into total sales of 20k-22k units for the segment (down by ~30k units in 9MFY24).	impact at customer level). The pricing impact would be less for the 50HP-and-above segment, at an estimated 4-5%, as TREM-4 norms are already implemented and pricing is absorbed.	
Captive financing	Escorts has incorporated its non-banking finance company (NBFC) in Jan'24 and intends to apply to the RBI for a licence in February. Post RBI approval (expected in 6-8 months), management intends to launch the NBFC arm in FY25 and commence financing.	Escorts is currently in the process of setting up an independent captive financing arm (board approval received) and will apply to RBI for an NBFC licence in Q4FY24.	This is unlikely to have a near-term impact but may help all the three business segments in the medium term.
Capex	No comments in Q3FY24 earnings call.	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.	We do not see any challenge to meeting capex requirements.
Merger	For the Kubota amalgamation, all the required approvals are in place and the matter is now pending with NCLT for the final order. Management expects NCLT approval for the merger in the next 2-3 months.	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.	Clarity, particularly on export business, is likely to emerge in the next 3-4 years following a complete branding revamp.
Other information	Escorts' inventory levels is currently at 35-38 days and management does not intend to increase this level for FY24. Management indicated that it will be primarily focusing on western markets, namely Gujarat and Maharashtra (currently contributing ~21% of TIV), and to some extent on southern markets (15-16% of TIV).	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.	Tractor inventory is unlikely to change much.

Source: Company, BOBCAPS Research | TIV: Total Industry Volume

Fig 2 – Quarterly performance (Standalone)

(Rs mn)	Q3FY24	Q3FY23	YoY (%)	Q2FY24	QoQ (%)	9MFY24	9MFY23	YoY (%)
Volume	25,999	28,025	(7.2)	22,024	18.0	74,605	78,525	(5.0)
Avg. Realisation per Vehicle	892,477	807,732	10.5	929,068	(3.9)	897,295	784,718	14.3
Net Revenues	23,204	22,637	2.5	20,462	13.4	66,943	61,620	8.6
Total Income (A)	23,204	22,637	2.5	20,462	13.4	66,943	61,620	8.6
Operating Expenses:								
Raw materials consumed	16,092	16,871	(4.6)	13,846	16.2	46,190	45,055	2.5
Employee Expenses	1,635	1,527	7.1	1,675	(2.4)	4,794	4,384	9.3
Other Expenses	2,349	2,236	5.1	2,309	1.8	6,930	6,635	4.4
Total Expenditure (B)	20,077	20,633	(2.7)	17,829	12.6	57,914	56,074	3.3
EBITDA (A-B)	3,127	2,003	56.1	2,633	18.8	9,029	5,546	62.8
Other Income	1,035	913	13.3	950	8.9	2,930	2,043	43.4
Depreciation	415	376	10.5	407	2.0	1,224	1,104	10.8
EBIT	3,746	2,540	47.5	3,176	18.0	10,735	6,484	65.5
Finance Costs	24	26	(9.8)	24	1.3	74	75	(1.7)
PBT after excep items	3,723	2,514	48.1	3,152	18.1	10,661	6,409	66.3
Tax expense	950	550	72.7	802	18.4	2,710	1,367	98.3
Reported PAT	2,773	1,964	41.2	2,350	18.0	7,951	5,135	54.8
Adjusted PAT	2,773	1,964	41.2	2,350	18.0	7,951	5,043	57.7
Adj EPS (Rs)	25.1	14.9	68.6	21.3	18.0	72.0	38.2	88.3
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin (%)	30.6	25.5	518	32.3	(168)	31.0	26.9	412
EBITDA Margin (%)	13.5	8.8	463	12.9	61	13.5	9.0	449
EBIT Margin (%)	16.1	11.2	492	15.5	63	16.0	10.5	551
PBT Margin (%)	16.0	11.1	494	15.4	64	15.9	10.4	552
Tax Rate (%)	25.5	21.9	364	25.4	7	25.4	21.0	440
Adj PAT Margin (%)	11.9	8.7	327	11.5	46	11.9	8.2	369

Source: Company, BOBCAPS Research

Valuation methodology

Escorts' tractor volumes have slipped 3% YoY in 9MFY24, and the company has ceded domestic market share in all tractor segments and two of three CE categories during the December quarter. The full benefit of Kubota integration on export sales is likely to flow only after 3-4 years.

We pare FY24/FY25 EPS estimates by 2%/6% and introduce FY26 forecasts, baking in a revenue/EBITDA/PAT CAGR of 12%/27%/25% for Escorts over FY23-FY26. Given sustained growth headwinds, we retain SELL, while revising our TP to Rs 2,389 (vs. Rs 2,343) as we roll valuations over to FY26E. Our target P/E stays at 20x – in line with the stock's long-term mean.

Fig 3 – Revised estimates

(Rs mn)	New			Old			Change (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	89,341	100,481	118,869	99,836	109,970	NA	(10.5)	(8.6)	NA
EBITDA	12,257	13,921	15,934	12,125	14,324	NA	1.1	(2.8)	NA
Adj PAT	10,364	11,756	13,470	10,516	12,486	NA	(1.4)	(5.8)	NA
Adj EPS (Rs)	93.8	106.4	121.9	95.2	113.0	NA	(1.5)	(5.8)	NA

Source: BOBCAPS Research

Fig 4 – Key assumptions

Parameter	FY23	FY24E	FY25E	FY26E
Volumes	103,290	97,093	101,947	107,554
Blended Realisation (Rs)	611,215	641,776	661,029	694,081
EBITDA (Rs mn)	7,775	12,257	13,921	15,934
EBITDA margin (%)	9.2	13.7	13.9	13.4
Adj. PAT (Rs mn)	6,897	10,364	11,756	13,470
EPS (Rs)	52.3	93.8	106.4	121.9

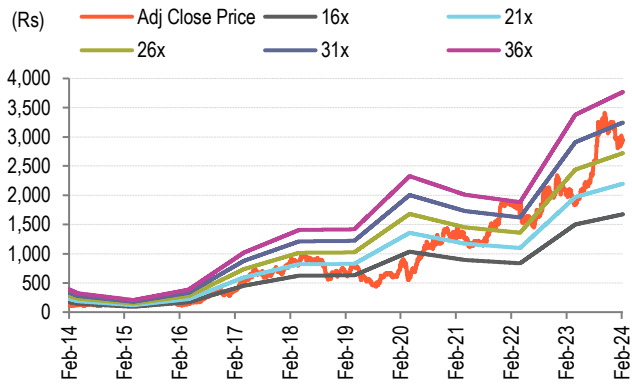
Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EPS (Rs)		ROE (%)	
				FY24E	FY25E	FY24E	FY25E
Escorts Kubota	ESCORTS IN	SELL	2,389	93.8	106.4	11.4	11.5
VST Tillers Tractors	VSTT IN	HOLD	3,213	128.7	144.6	12.1	12.1
Mahindra & Mahindra	MM IN	BUY	1,849	78.2	92.1	19.4	19.0

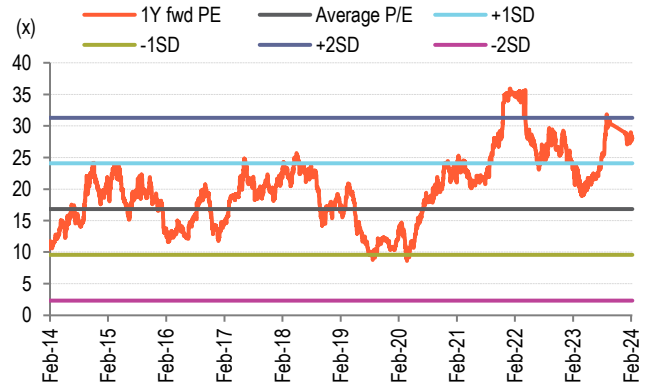
Source: BOBCAPS Research

Fig 6 – P/E band: Expect valuations to soften, in line with performance



Source: Bloomberg, BOBCAPS Research

Fig 7 – P/E 1Y fwd: Expect reversal to mean



Source: Bloomberg, BOBCAPS Research

Key risks

Key upside risks to our estimates are:

- faster-than-expected revival in industry and 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	6.3	176	226	BUY
Bajaj Auto	BJAUT IN	27.3	7,757	6,272	SELL
Eicher Motors	EIM IN	12.7	3,807	3,601	HOLD
Escorts	ESCORTS IN	4.7	2,933	2,389	SELL
Mahindra & Mahindra	MM IN	25.7	1,686	1,849	BUY
Maruti Suzuki	MSIL IN	39.5	10,744	12,234	BUY
TVS Motor	TVSL IN	11.8	2,034	2,242	BUY
VST Tillers Tractors	VSTT IN	0.3	3,159	3,213	HOLD

Source: BOBCAPS Research, NSE | Price as of 8 Feb 2024

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Total revenue	72,384	84,287	89,341	1,00,481	1,18,869
EBITDA	9,512	7,775	12,257	13,921	15,934
Depreciation	1,218	1,399	1,352	1,507	1,624
EBIT	10,372	9,084	14,135	16,036	18,372
Net interest inc./(exp.)	(150)	(133)	(130)	(150)	(170)
Other inc./(exp.)	2,180	2,809	3,231	3,622	4,063
Exceptional items	0	(531)	0	0	0
EBT	9,928	8,346	14,005	15,886	18,202
Income taxes	2,572	1,979	3,641	4,130	4,733
Extraordinary items	(9)	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	7,365	6,367	10,364	11,756	13,470
Adjustments	0	531	0	0	0
Adjusted net profit	7,365	6,897	10,364	11,756	13,470

Balance Sheet

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Accounts payables	9,855	13,427	11,735	12,460	6,596
Other current liabilities	3,486	3,485	9,898	11,865	22,486
Provisions	1,402	1,466	1,613	1,774	1,951
Debt funds	0	0	0	0	0
Other liabilities	0	0	0	0	0
Equity capital	1,319	1,319	1,105	1,105	1,105
Reserves & surplus	74,642	80,509	89,906	1,01,065	1,13,871
Shareholders' fund	75,961	81,829	91,011	1,02,170	1,14,976
Total liab. and equities	90,705	1,00,206	1,14,257	1,28,269	1,46,010
Cash and cash eq.	2,718	4,719	7,765	6,702	8,156
Accounts receivables	7,926	11,797	10,280	11,838	14,167
Inventories	8,466	12,177	10,770	12,113	14,655
Other current assets	5,258	5,291	5,820	6,402	7,042
Investments	48,358	47,667	59,718	70,718	80,718
Net fixed assets	18,172	18,621	19,268	19,862	20,637
CWIP	563	694	500	500	500
Intangible assets	553	734	734	734	734
Deferred tax assets, net	(1,311)	(1,492)	(598)	(598)	(598)
Other assets	0	0	0	0	0
Total assets	90,704	1,00,206	1,14,257	1,28,269	1,46,010

Cash Flows

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Cash flow from operations	(2,927)	863	15,618	8,862	10,284
Capital expenditures	(2,000)	(2,260)	(1,806)	(2,100)	(2,400)
Change in investments	(28,978)	692	(12,051)	(11,000)	(10,000)
Other investing cash flows	2,180	2,809	3,231	3,622	4,063
Cash flow from investing	(28,798)	1,240	(10,626)	(9,478)	(8,337)
Equities issued/Others	17,932	242	(456)	0	0
Debt raised/repaid	(17)	0	0	0	0
Interest expenses	(150)	(133)	(130)	(150)	(170)
Dividends paid	(737)	(763)	(663)	(663)	(663)
Other financing cash flows	2,199	185	(894)	0	0
Cash flow from financing	19,226	(469)	(2,143)	(813)	(833)
Chg in cash & cash eq.	(12,499)	1,635	2,848	(1,429)	1,114
Closing cash & cash eq.	2,718	4,719	7,765	6,702	8,156

Per Share

Y/E 31 Mar (Rs)	FY22A	FY23A	FY24E	FY25E	FY26E
Reported EPS	68.6	52.3	93.8	106.4	121.9
Adjusted EPS	55.8	52.3	93.8	106.4	121.9
Dividend per share	5.6	5.8	6.0	6.0	6.0
Book value per share	576.0	620.5	824.6	924.9	1,040.8

Valuations Ratios

Y/E 31 Mar (x)	FY22A	FY23A	FY24E	FY25E	FY26E
EV/Sales	5.1	4.5	4.4	3.8	3.2
EV/EBITDA	39.1	48.7	31.7	27.2	23.8
Adjusted P/E	52.5	56.1	31.3	27.6	24.1
P/BV	5.1	4.7	3.6	3.2	2.8

DuPont Analysis

Y/E 31 Mar (%)	FY22A	FY23A	FY24E	FY25E	FY26E
Tax burden (Net profit/PBT)	74.2	82.6	74.0	74.0	74.0
Interest burden (PBT/EBIT)	95.7	91.9	99.1	99.1	99.1
EBIT margin (EBIT/Revenue)	14.3	10.8	15.8	16.0	15.5
Asset turnover (Rev./Avg TA)	113.9	106.8	103.4	104.0	109.5
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.0	1.0	1.0
Adjusted ROAE	11.7	8.7	12.0	12.2	12.4

Ratio Analysis

Y/E 31 Mar	FY22A	FY23A	FY24E	FY25E	FY26E
YoY growth (%)					
Revenue	3.2	16.4	6.0	12.5	18.3
EBITDA	(15.6)	(18.3)	57.6	13.6	14.5
Adjusted EPS	(13.7)	(6.4)	79.4	13.4	14.6
Profitability & Return ratios (%)					
EBITDA margin	13.1	9.2	13.7	13.9	13.4
EBIT margin	14.3	10.8	15.8	16.0	15.5
Adjusted profit margin	10.2	8.2	11.6	11.7	11.3
Adjusted ROAE	9.7	8.4	11.4	11.5	11.7
ROCE	12.1	8.8	12.1	12.3	12.5
Working capital days (days)					
Receivables	37	43	45	40	40
Inventory	39	45	47	42	41
Payables	80	69	75	64	42
Ratios (x)					
Gross asset turnover	0.4	0.4	0.4	0.4	0.3
Current ratio	1.7	1.8	1.5	1.4	1.4
Net interest coverage ratio	(69.3)	(68.5)	(108.7)	(106.9)	(108.1)
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%

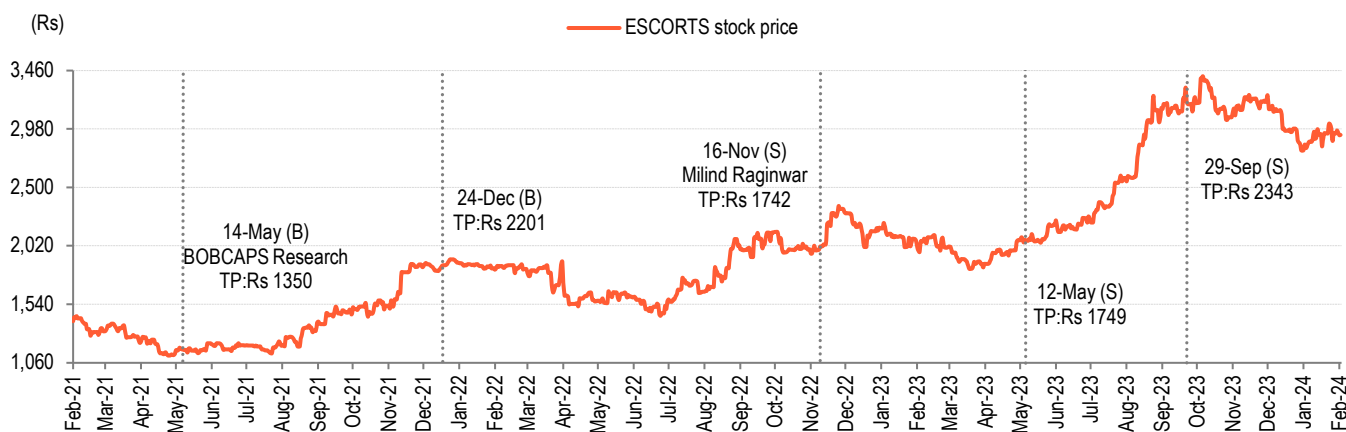
HOLD – Expected return from -6% to +15%

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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