

**RESEARCH**
**ESCORTS | TARGET: Rs 1,742 | -13% | SELL**

Earnings lag behind valuations

**SUMMARY**
**ESCORTS**

- Q2 revenue at Rs 18.8bn with tractor realisations up 4% YoY and healthy volume growth of 13% supported by normal monsoons
- Raw material cost spiked 23% YoY, inducing a 590bps/450bps drop in gross/EBITDA margins to 28%/8.1%
- Valuations expensive given narrow market focus and stiff competition; we assume coverage with SELL and a TP of Rs 1,742

[Click here for the full report.](#)
**Daily macro indicators**

Indicator	14-Nov	15-Nov	Chg (%)
US 10Y yield (%)	3.85	3.77	(8bps)
India 10Y yield (%)	7.29	7.26	(3bps)
USD/INR	81.26	81.10	0.2
Brent Crude (US\$/bbl)	93.1	93.9	0.8
Dow	33,537	33,593	0.2
Hang Seng	17,620	18,343	4.1
Sensex	61,624	61,873	0.4
India FII (US\$ mn)	11-Nov	14-Nov	Chg (\$ mn)
FII-D	39.9	10.3	(29.7)
FII-E	857.6	368.5	(489.1)

Source: Bank of Baroda Economics Research

**BOBCAPS Research**

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**SELL**

TP: Rs 1,742 | ▼ 13%

**ESCORTS**

| Auto Components

| 16 November 2022

## Earnings lag behind valuations

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## Key changes

Target	Rating
▼	▼

Ticker/Price	ESCORTS IN/Rs 2,013
Market cap	US\$ 3.4bn
Free float	0%
3M ADV	US\$ 15.2mn
52wk high/low	Rs 2,190/Rs 1,307
Promoter/FPI/DII	37%/22%/8%

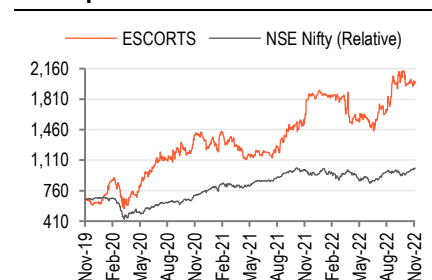
Source: NSE | Price as of 15 Nov 2022

## Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	72,384	78,910	89,033
EBITDA (Rs mn)	9,512	8,041	10,957
Adj. net profit (Rs mn)	7,365	6,824	9,215
Adj. EPS (Rs)	68.6	63.5	85.8
Consensus EPS (Rs)	68.6	62.4	88.1
Adj. ROAE (%)	9.7	8.3	10.2
Adj. P/E (x)	29.4	31.7	23.5
EV/EBITDA (x)	27.0	32.7	25.2
Adj. EPS growth (%)	(13.7)	(7.3)	35.0

Source: Company, Bloomberg, BOBCAPS Research

## Stock performance



Source: NSE

**Healthy volumes:** Escorts' Q2FY23 net sales came in at Rs 18.8bn driven by volume growth of 13% supported by a normal monsoon. Net realisation per vehicle (NRPV) grew 4% YoY in the tractor segment to Rs 0.61mn. Revenue contribution from other segments, including railways (RE) and construction equipment (CE), was steady, though CE segment earnings declined. Per management, the demand outlook for tractors is healthy given normal monsoons in India this year. Further, the contribution of higher HP (50HP) products is aiding realisation gains.

**High raw material cost dents profitability:** Raw material cost spiked 23% YoY to Rs 15.6bn, dragging the gross margin down by 590bps YoY to 28%. EBITDA fell 27% YoY to Rs 1.5bn due to an 7%/6% rise in staff cost/other expenses. Operating margin contracted 450bps YoY to 8.1% and is guided to remain in single digits. PAT dropped 50% YoY to Rs 877mn however adj. PAT was down 9% to Rs 1.6bn owing to a provision of Rs 728mn on stake sale in a joint venture company.

**Margin improvement to be gradual:** Escorts has been unable to pass through a 5% increase in costs as the competitive environment has pushed up discounts despite raw material inflation. Thus, even though commodity prices are now softening, the positive effect on margins will be gradual. Management expects margins to move up during the next 3-4 quarters. We have assumed a return to normalcy only by FY24, followed by steady margins in FY25.

**Earnings trail valuations – SELL:** We assume coverage on Escorts with a SELL rating, valuing the core business at 20x FY24E EPS of Rs 85.8 (ex-treasury stocks) to arrive at a TP of Rs 1,742. In our view, current valuations of 23.5x FY24E EPS appear unjustified given our expectations of a slow slog to margin expansion, fierce competition in the core tractor business, the company's narrow focus on the compact tractor segment, and uncertainty over business modalities with global partner Kubota Corp as well as the impact of the Kubota merger with Escorts.



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**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

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