

Escorts Ltd

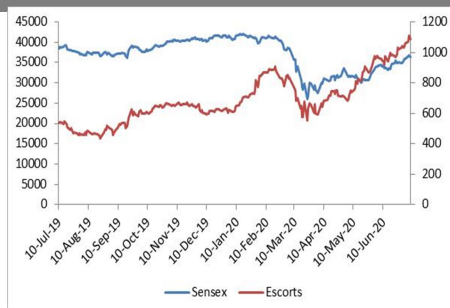
Analyst Recommendation: BUY

BSE Code: 500495 NSE: ESCORTS Reuters Code: ESCO.NS Bloomberg Code: ESC:IN

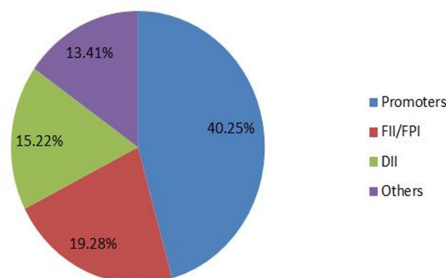
CMP: Rs 1088
2 Year Target - Rs 1378

Face Value	10.0
Market Cap (Rs cr)	13,337
52 week high/low	1118/423
Beta	1.08
Shares O/S (Cr)	12.3
Book Value per Share (Rs)	283.91
Sensex	36,329
Nifty	10,706

1 yr. Price Chart of Stock and BSE



Shareholding pattern as on 31st Dec 2019



Investor's Rationale

➤ Escorts best placed to reap benefits of this cycle

We expect its tractor business to grow around 11-12% during FY20-23E due to the company's strong focus on exports, coupled with near-term expectations of healthy growth in the domestic market.

Given its successful past record in delivering on commitments, we are sure the management will fulfil its assurance of further scaling up margin from current levels through cost reduction and by improving efficiencies.

➤ Diversifying into new business segments to create next leg of growth

The next leg of growth for Escorts can emerge from the non-tractor business. Railways and construction equipment (CE) currently account for 23% of its topline, a modest growth from 19% in FY16. The share of these businesses in overall EBIT has grown considerably to 18% from negative contribution in FY16. Improving profitability and growing topline of these businesses will pose a significant advantage to Escorts as it provides a cushion from the cyclicity of the tractor business..

We expect an economic revival after the COVID slowdown to fuel growth across all business segments for Escorts. The management's confidence on improving margin across businesses through efficiencies and cost reduction is comforting and will further scale up RoCEs. No major near-term capex and purchase of stake from Kubota will improve cash flows and strengthen its Balance Sheet. We initiate coverage with a BUY rating and a target price of INR 1,378 per share, valuing the company at 18x (adjusting to treasury share/without treasury shares) on FY22E EPS.

	FY19	FY20	FY21E	FY22E
Revenue (Rs.Cr)	6,265.00	5,810.00	5,883.00	6,942.00
EBITDA (Rs. cr)	701.00	658.00	723.00	867.00
Adj. profit (Rs.Cr)	474.00	469.00	563.00	681.00
Adj. EPS (Rs.)	53.4	52.6	63.3	76.6
P/E (x)	20.0	20.3	19.2	15.9
EV/Sales (x)	2.1	2.3	2.2	1.8
EV/EBITDA (x)	19.0	20.0	17.6	14.7
ROE (%)	19.20%	16.50%	14.40%	13.70%
ROCE (%)	37.50%	29.50%	31.30%	34.40%

Journey from turnaround to excellence

Focussed approach towards bettering profitability, lean Balance Sheet, raising market share, improving product quality and access to technology from the world's leading farm equipment manufacturer has led Escorts to forge one of the most extraordinary turnaround stories in the domestic automobile industry in the last 10 years. Despite being one of the leading player in the agriculture equipment business since independence and a flagship company of well-known industrial houses from the pre-liberalisation era, Escorts faced its toughest phase in its corporate history during the early 2000. This warranted a structured approach from the management team to address the problems which emerged on almost all strategic fronts.

Innovative techniques to connect with customers – Need of the hour

The management's focus is on expanding tie-ups with local mechanics across all regions to reduce turnaround time in case of a service requirement or break down. Recently, the company launched an innovative service feature '24X7 Care Button' which has been installed on all its Farmtrac and Powertrac models. On pressing this special button in case of breakdown or service requirement, the company's service engineer will respond within 2 minutes. This is an innovative service and is first of its kind in the industry. This will help reduce its turnaround time significantly and plays an important role during peak seasons

Escorts best placed to reap benefits of this cycle given the hard work done over the last 10 years

Escorts is best placed to reap the benefits of this cycle given the management's focus over the past decade on strengthening its offerings and product technology as well as improving quality and reach of distribution in both strong and weak markets. We expect its tractor business to grow around 11-12% during FY20-23E due to the company's strong focus on exports, coupled with near-term expectations of healthy growth in the domestic market.

Given its successful past record in delivering on commitments, we are sure the management will fulfil its assurance of further scaling up margin from current levels through cost reduction and by improving efficiencies.

Partnership with Kubota will help Escorts scale up

Escorts have always been a domestic players with a strong presence in higher hp tractors. This reflects in its higher market share in central and north India, which are traditionally higher hp tractor markets.

The deal with Kubota addresses 3 gap areas, which it has been grappling off late: 1) Export market; 2) Advanced product technology; and 3) Lower hp tractors."

Escorts and Kubota signed a joint venture (JV) in February 2019 for manufacturing higher hp tractors, equipped with the latest technology. Escorts hold 40% stake in the JV, and the total investment in the project is ~INR 300 crore contributed by both the partners. The plant, with a manufacturing capacity of 50,000 units, was expected to be commissioned in June 2020, but due to COVID-19, led lockdown, it is expected to start from Q3FY21.

- In March 2020, Escorts acquired Sumitomo Corporation's 40% stake in the Kubota-Sumitomo marketing JV for INR 90 crore. This deal will help expand its exports business by accessing Kubota's international network.
- Kubota invested INR 1,042 crore for 10% stake in Escorts. This tie-up strengthens the Escorts- Kubota relationship, which will help the former access the latter's latest technologies and manufacturing practices.

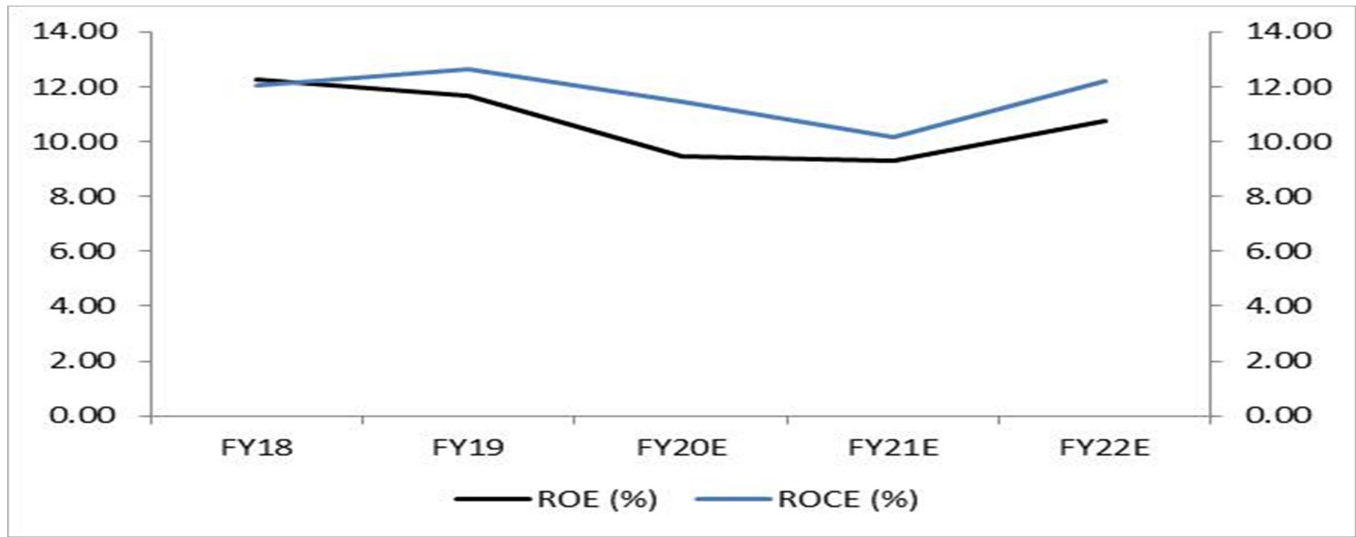
Limited capex and healthy cash provides enough arsenal to drive growth

Escorts plans to incur a capex of INR 200-250 crore, which has been trimmed due to COVID-19 related uncertainties. This capex will be mainly towards new product development and localisation efforts relating to new products in the railways business.

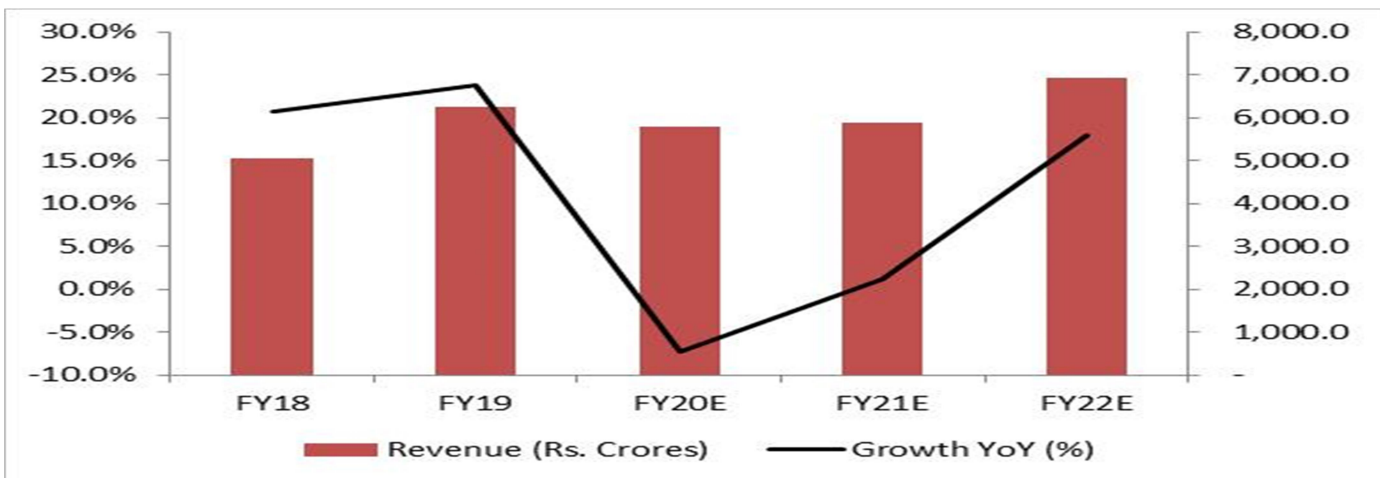
Ability to improve FCF and EBITDA margin even in testing times of FY20 provides us confidence in the resilience of this business. With the tractor business expected to observe marginal growth momentum, improvement in profitability will continue, which is encouraging.

Surplus cash balance on the back of healthy profitability during the last 2-3 years, coupled with INR 1,042 crore from the Kubota deal, places Escorts in a strong position to push for growth capex/investment without RoCE deteriorating.

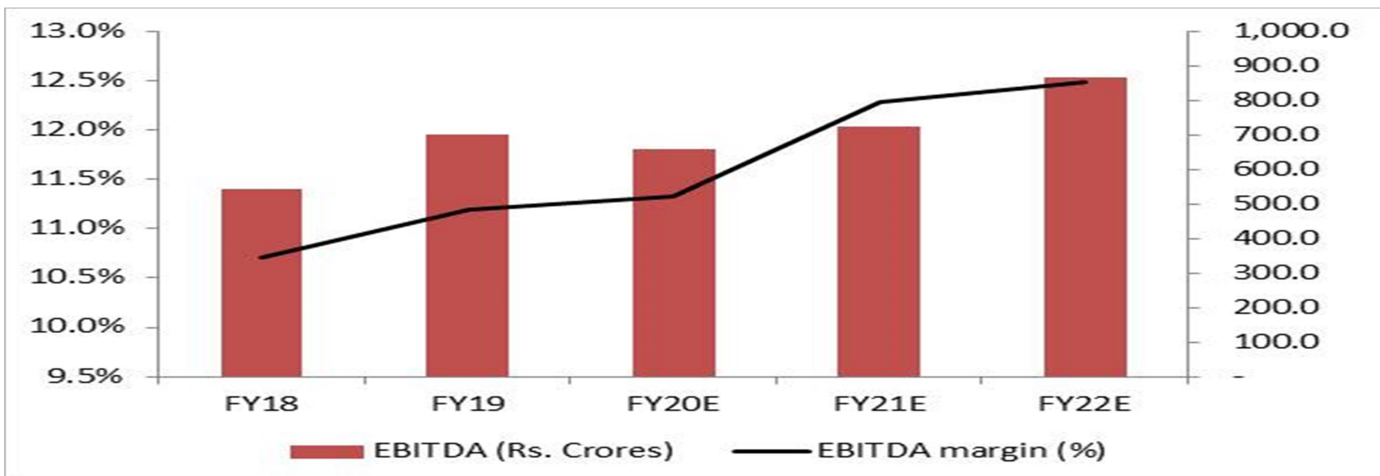
Return ratios on growth track



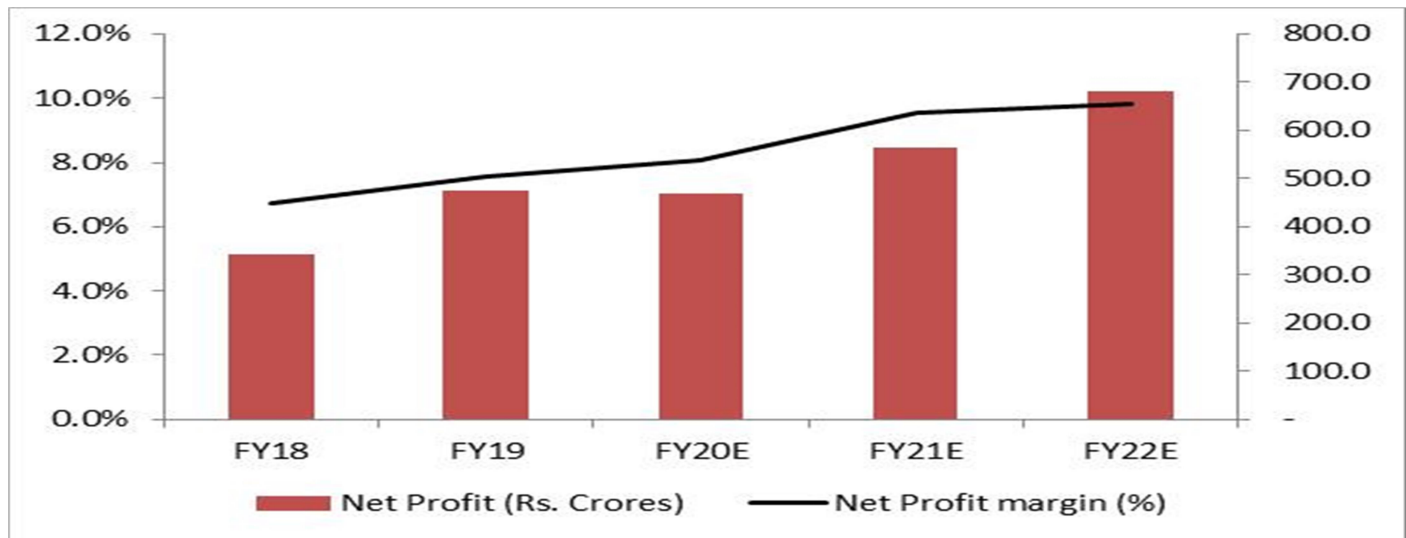
Revenue growth to be steady



EBITDA to grow going ahead



Net profit to surge going ahead



Outlook and Valuation

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Escorts Ltd - Company Overview

Escorts Group, is an Indian multinational conglomerate and automotive engineering company that operates in the sectors of agri-machinery, construction and material handling equipment, and railway equipment. Headquartered in Faridabad, Haryana, the company was launched in 1944 and has marketing operations in more than 40 countries. Escorts Group's management team includes Nikhil Nanda as the Chairman and Managing Director. Escorts manufactures a wide range of tractors, automotive components, railway equipment and construction & material handling equipment.

Key Risks

- Synergies not established from Joint Ventures
- Slowdown in the economy

Balance sheet (Consolidated)

Profit & Loss Account (Consolidated)

(Rs crore)	FY19	FY20	FY21E	FY22E	(Rs crore)	FY19	FY20	FY21E	FY22E
Liabilities					Total operating Income	6265	5810	5883	6942
Paid up capital	123	123	123	123	Raw Material cost	4322	3841	3860	4548
Reserves and Surplus	2547	2995	4555	5174	Employee cost	485	521	500	625
Net worth	2670	3118	4678	5297	Other operating expenses	757	790	800	902
Minority interest	6	5	0	0	EBITDA	701	658	723	867
Total Debt	58	19	10	10	Depreciation	87	107	123	133
Other non-current liabilities	0	0	0	0	EBIT	614	551	600	734
Total Liabilities	2734	3142	4688	5307	Interest cost	20	17	2	2
Assets					Other Income	118	89	153	176
Total fixed assets	1624	1679	1881	1997	Profit before tax	712	623	751	908
Capital WIP	80	125	0	100	Tax	238	154	188	227
Goodwill					Profit after tax	474	469	563	681
Investments	637	937	1979	2279	Minority Interests	0	0	0	0
Net Current assets	393	401	828	931	P/L from Associates	0	0	0	0
Deferred tax assets (Net)	0	0	0	0	Adjusted PAT	474	469	563	681
Other non-current assets	-	-	-	-					
Total Assets	2734	3142	4688	5307					

Cash Flow (Consolidated)

Key Ratios & Valuations (Consolidated)

Y.E March (Rs crore)	FY19	FY20	FY21E	FY22E	Y.E March (l)	FY19	FY20	FY21E	FY22E
Pretax profit	474	469	563	681	Growth (%)				
Depreciation	87	107	123	133	Net Sales	23.8%	-7.3%	1.3%	18.0%
Chg in Working Capital	469	-8	0	152	EBITDA	29.3%	-6.1%	9.9%	19.9%
Others	-383	-385	-435	-493	Net profit	39.4%	-1.1%	20.0%	21.0%
Tax paid	238	154	188	227	Margin (%)				
Cash flow from operating activities	63	601	687	662	EBITDA	11.2%	11.3%	12.3%	12.5%
Capital expenditure	-138	-207	-200	-350	NPM	7.6%	8.1%	9.6%	9.8%
Chg in investments					Return Ratios (%)				
Other investing cashflow	0	0	0	0	RoE	19.2%	16.5%	14.4%	13.7%
Cash flow from investing activities	-138	-207	-200	-350	RoCE	37.5%	29.5%	31.3%	34.4%
Cash flow from financing activities	0	0	0	0	Valuation(x)				
Net chg in cash	-75	394	487	312	P/E	20.0	20.3	19.2	15.9
					EV/EBITDA	19.0	20.0	17.6	14.7
					EV/Net Sales	2.1	2.3	2.2	1.8
					Per share data (Rs.)				
					EPS	53.4	52.6	63.3	76.6

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	Buy	More than equal to 15%
Hold	Between 10% & -5%	Accumulate*	Upside between 10% & 15%
Reduce	Less than -5%	Hold	Between 0% & 10%
		Reduce/sell	Less than 0%

* To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.



Member: BSE, NSE, MCX, MCX-SX, CDSL

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