BUY

Escorts

Soft Q2; long-term growth prospects intact

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Auto & Auto Ancillaries ▸ Result Update ▸ **November 5, 2023**

TARGET PRICE (Rs): 3,430

Escorts' Q2 margin performance was below estimates (down by 118bps QoQ to 12.9%; Emkay: 13.5%), largely owing to operating de-leverage in Tractors. While near-term tractor industry prospects appear benign (given the high base), we remain positive on the medium-to-long term growth prospects, driven by planned product/network expansion and strong opportunity for vehicle exports (by leveraging co-parent Kubota's global network) as well as component exports (as part of Kubota's global supply-chain diversification). Our forward EPS estimates are unchanged (~22%/~37% revenue/EPS CAGR over FY23-26E driven partly by integration of Kubota entities from FY24E) and retain BUY with a revised TP of Rs3,430/share (vs. Rs3,020 earlier; rolled-over valuation to FY26E with unchanged 25x core PER + Rs220 cash/share.).

Escorts: Financial Snapshot (Standalone)

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Revenue	71,969	83,450	1,15,737	1,33,605	1,51,320
EBITDA	9,955	7,804	15,624	18,304	21,185
Adj. PAT	7,656	7,041	13,020	13,920	15,710
Adj. EPS (Rs)	58.0	53.4	116.4	124.4	140.4
EBITDA margin (%)	13.8	9.4	13.5	13.7	14.0
EBITDA growth (%)	(11.8)	(21.6)	100.2	17.1	15.7
Adj. EPS growth (%)	(32.9)	(20.7)	153.0	6.9	12.9
RoE (%)	11.6	8.6	14.6	13.9	14.2
RoIC (%)	32.7	19.2	34.0	29.3	29.7
P/E (x)	53.0	57.6	26.4	24.7	21.9
EV/EBITDA (x)	35.9	49.1	20.5	17.3	14.8
P/B (x)	5.2	4.8	3.6	3.3	3.0
FCFF yield (%)	(0.8)	(0.7)	(0.2)	1.2	1.9

Source: Company, Emkay Research

Operating de-leverage affects sequential margins in Q2

Revenue grew 8.6% YoY to Rs20.5bn, with EBITDA margin up by 476bps YoY (-118bps QoQ) to 12.9% (Emkay: 13.5%). Margin fell QoQ due to operating de-leverage, though gross margin was higher by ~210bps. Agri-related revenue declined 4% YoY to Rs13.9bn (ASPs up 3%); Agri margin dipped by ~100bps QoQ to 12.5%, on lower volumes. Construction equipment (CE) revenue grew 72% YoY to Rs4.1bn (volume-led); CE margin grew by 260bps QoQ to 10.2%. Railways revenue rose 29% YoY to Rs2.3bn, with margin down by 240bps QoQ to 18.5% (order book at Rs8.7bn vs. Rs9.5bn in Jun-23). Overall PAT grew 65% YoY to Rs2.35bn (above estimate), aided by higher 'other income'.

Earnings call KTAs

1) Expects FY24E tractor industry growth of -2% to +2% (vs. a low mid-single-digit guidance in Q1); Q3 to be positive owing to the festive season; Q4 to also be positive on a slightly-lower base, pre-election festive spends and pre-April festive inventory buildup. 2) Tractor industry festive growth was marginally higher YoY in retail terms during *Navratras*, and is seen strengthening during *Diwali*; Company's inventory to normalize to ~4 weeks by end-Nov vs. ~5-5.5 weeks at start of the festive season. 3) Tractor industry exports are down ~26% YoY, YTD (amid recessionary headwinds in markets like Europe), and could end the year lower by 10-15%; Escorts' exports could rebound by ~20% in FY25 and accelerate thereafter. 4) Expects growth in the CE segment to endure, driven by GoI thrust on infra; confident of double-digit growth in Railways in coming years. 5) Talks are ongoing with regulators, for possible deferment of TREM-5/BS-5 emission norms (presently slated for Apr-24); could possibly imply ~Rs125K/unit cost impact in sub-50hp tractors and 8-10% cost impact on BS-3 CE. 6) Cumulative 1.7% price hike taken in Tractors in H1; full benefit to be realized in H2; while commodities would harden a bit in Q3, Escorts does not expect it to be a major headwind. 7) Confident of sustaining H1 CE margin; Railways to sustain margin at current ~200bps. 8) Expects NCLT clearance for the Kubota entity merger in Q4. 9) FY24 capex seen at Rs2-2.25bn.

Target Price – 12M	Sep-24
Change in TP (%)	**13.6**
Current Reco.	BUY
Previous Reco.	BUY
Upside/(Downside) (%)	11.5
CMP (03-Nov-23) (Rs)	3,076.5

Stock Data	Ticker
52-week High (Rs)	3,440
52-week Low (Rs)	1,808
Shares outstanding (mn)	110.5
Market-cap (Rs bn)	340
Market-cap (USD mn)	4,082
Net-debt, FY24E (Rs mn)	-23,113
ADTV-3M (mn shares)	-
ADTV-3M (Rs mn)	1,511.4
ADTV-3M (USD mn)	18.1
Free float (%)	30.4
Nifty-50	19,231
INR/USD	83.3
Shareholding, Sep-23	
Promoters (%)	67.7
FPIs/MFs (%)	6.7/9.4

Price Performance

(%)	1M	3M	12M
Absolute	(1.5)	20.7	52.8
Rel. to Nifty	-	21.6	43.5

1-Year share price trend (Rs)

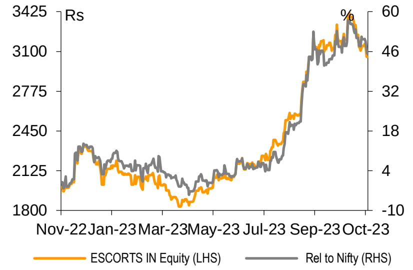

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Exhibit 1: Quarterly results snapshot — Revenue up 8.6% YoY, with margins down ~118bps sequentially

(Rs mn)	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Change YoY (%)	Change QoQ (%)
Revenue	**18,835**	**22,637**	**21,830**	**23,277**	**20,462**	**8.6**	**(12.1)**
Expenditure	**17,308**	**20,733**	**19,471**	**20,008**	**17,829**	**3.0**	**(10.9)**
as % of sales	*91.9*	*91.6*	*89.2*	*86.0*	*87.1*		
Consumption of RM	13,638	16,871	15,615	16,252	13,846	1.5	(14.8)
as % of sales	*72.4*	*74.5*	*71.5*	*69.8*	*67.7*		
Employee Cost	1,489	1,527	1,565	1,484	1,675	12.5	12.8
as % of sales	*7.9*	*6.7*	*7.2*	*6.4*	*8.2*		
Other expenditure	2,182	2,336	2,291	2,272	2,309	5.8	1.6
as % of sales	*11.6*	*10.3*	*10.5*	*9.8*	*11.3*		
EBITDA	1,527	1,903	2,358	3,269	2,633	72.4	(19.5)
EBITDA margin (%)	**8.1**	**8.4**	**10.8**	**14.0**	**12.9**		
Depreciation	365	376	380	402	407	11.5	1.3
EBIT	1,162	1,528	1,978	2,868	2,226	91.6	(22.4)
Other Income	776	913	763	945	950	22.5	0.5
Interest	23	26	28	27	24	3.1	(11.7)
PBT	1,915	2,414	2,714	3,786	3,152	64.6	(16.7)
Total Tax	494	550	676	958	802	62.6	(16.3)
Adjusted PAT	1,421	1,864	2,038	2,828	2,350	65.4	(16.9)
Extra ordinary items Loss/(Gain)	545	0	183	0	0		
Reported PAT	877	1,864	1,855	2,828	2,350	168.1	(16.9)
Adjusted EPS (Rs)	10.8	14.1	18.2	25.3	21.0	95.0	(16.9)

(%)	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Change YoY (bps)	Change QoQ (bps)
EBITDAM	8.1	8.4	10.8	14.0	12.9	476	(118)
EBITM	6.2	6.7	9.1	12.3	10.9	471	(144)
EBTM	10.2	10.7	12.4	16.3	15.4	524	(86)
PATM	7.5	8.2	9.3	12.1	11.5	394	(66)
Effective Tax rate	25.8	22.8	24.9	25.3	25.4	(33)	15

Source: Company, Emkay Research

Exhibit 2: EBITDA margin sequential decline, despite the 215bps higher gross margin due to operating de-leverage

Year to March (%)	Q2FY24	Q2FY22	bps change	Q1FY24	bps change
Raw material cost	67.7	72.4	(474)	69.8	(215)
Staff cost	8.2	7.9	28	6.4	181
Other expenses	11.3	11.6	(30)	9.8	152
EBITDA	**12.9**	**8.1**	**476**	**14.0**	**(118)**
Reported PAT	11.5	7.5	394	12.1	(66)
Tax rate (%)	25.4	25.8	(33)	25.3	15

Source: Company, Emkay Research

Exhibit 3: Tractors — EBIT margin down by ~120bps QoQ; Railways margin down by ~240bps; CE margin up by ~260bps

Segment EBIT	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24
Agri Machinery Products (EBIT)	1,218	1,424	1,547	2,236	1,698
Agri Machinery Products (EBITM)	8.4	8.3	9.9	13.4	12.2
Agri Machinery Products (EBIT Cont.)	85.7	78.3	70.6	71.4	66.5
Railway Equipments (EBIT)	266	326	331	623	433
Railway Equipments (EBITM)	14.6	13.1	14.0	20.9	18.5
Railway Equipments (EBIT Cont.)	18.7	17.9	15.1	19.9	16.9
Construction Equipment (EBIT)	(63)	69	312	273	424
Construction Equipment (EBITM)	(2.6)	2.2	8.1	7.6	10.2
Construction Equipment (EBIT Cont.)	(4.4)	3.8	14.2	8.7	16.6

Source: Company, Emkay Research

Exhibit 4: Actual vs Estimates (Q2FY24)

(Rs mn)	Actual	Emkay Est	Var (%)	Consensus	Var (%)
Net sales	20,462	21,204	(3.5)	20,853	(1.9)
EBITDA	2,633	2,863	(8.0)	2,672	(1.5)
EBITDA Margin (%)	*12.9*	*13.5*	*(63) bps*	*12.8*	*5 bps*
Adj net income	2,350	2,148	9.4	2,289	2.7
FDEPS (Rs)	21.0	19.2	9.4	20.5	2.7

Source: Company, Emkay Research

Exhibit 5: We expect 37% EPS CAGR over FY23-26E

(Rs mn)	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Tractor volumes (units)	86,018	106,742	94,228	103,290	132,715	143,156	153,394
Growth (%) (RHS)	(10.8)	24.1	(11.7)	9.6	28.5	7.9	7.2
Construction Equip.	4,042	3,913	4,117	4,620	5,571	6,254	6,896
YoY %	(27.1)	(3.2)	5.2	12.2	20.6	12.3	10.3
Segmental revenues							
Tractors	44,376	56,673	56,293	63,971	89,729	99,337	108,741
Growth (%)	(6.5)	27.7	(0.7)	13.6	40.3	10.7	9.5
Railways revenues	4,772	4,790	6,362	8,419	11,365	12,502	13,721
Growth (%)	21.1	0.4	32.8	32.3	35.0	10.0	9.7
Construction equipment	8,398	7,761	9,868	11,790	14,642	16,766	18,859
Growth (%)	(20.3)	(7.6)	27.1	19.5	24.2	14.5	12.5
Segmental EBIT margins (%)							
Tractors	13.0	18.2	15.3	9.3	14.0	14.5	15.0
Railways	18.0	16.0	14.8	13.8	20.0	21.0	21.5
Construction equipment	3.6	3.6	2.4	2.9	6.4	6.9	7.4
Total revenues	**57,610**	**69,293**	**71,969**	**83,450**	**115,737**	**133,605**	**151,320**
Growth (%)	(7.0)	20.3	3.9	16.0	38.7	15.4	13.3
EBITDA	6,758	11,292	9,955	7,804	15,624	18,304	21,185
EBITDA margin (%)	**11.7**	**16.3**	**13.8**	**9.4**	**13.5**	**13.7**	**14.0**
EBITDA growth (%)	(7.8)	67.1	(11.8)	(21.6)	100.2	17.1	15.7
EBITDA/unit (Rs)	78,567	105,791	105,651	75,556	117,730	127,859	138,108
EBIT	5,816	10,335	9,902	7,508	14,767	16,576	19,210
EBIT margin (%)	10.1	14.9	13.8	9.0	12.8	12.4	12.7
EPS (Rs)	**40**	**65**	**58**	**53**	**116**	**124**	**140**

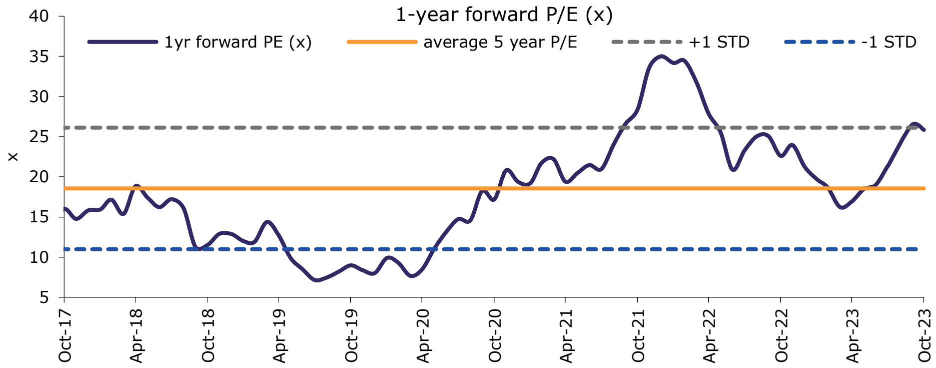
Source: Company, Emkay Research; Note: Kubota machinery volumes considered from FY24

Exhibit 6: Our forward EPS estimates are unchanged

(Rs mn)	FY24E				FY25E				FY26E			
	Earlier	Revised	% Change	% YoY	Earlier	Revised	% Change	% YoY	Earlier	Revised	% Change	% YoY
Volumes	1,34,319	1,32,715	(1.2)	28.5	1,44,095	1,43,156	(0.7)	7.9	1,53,957	1,53,394	(0.4)	7.2
Net Sales	1,17,386	1,15,737	(1.4)	38.7	1,34,602	1,33,605	(0.7)	15.4	1,52,080	1,51,320	(0.5)	13.3
EBITDA	15,847	15,624	(1.4)	100.2	18,440	18,304	(0.7)	17.1	21,291	21,185	(0.5)	15.7
Margin (%)	*13.5*	*13.5*	*0 bps*	*415 bps*	*13.7*	*13.7*	*(0) bps*	*20 bps*	*14.0*	*14.0*	*(0) bps*	*30 bps*
APAT	13,034	13,020	(0.1)	84.9	13,925	13,920	(0.0)	6.9	15,705	15,710	0.0	12.9
Adj. EPS (Rs)	116.5	116.4	(0.1)	118.1	124.5	124.4	(0.0)	6.9	140.4	140.4	0.0	12.9

Source: Emkay Research

Exhibit 7: Company trades at ~1SD above is 5-year average forward PER



Source: Bloomberg, Emkay Research

Escorts: Standalone Financials and Valuations

Profit & Loss

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Revenue	**71,969**	**83,450**	**1,15,737**	**1,33,605**	**1,51,320**
Revenue growth (%)	3.9	16.0	38.7	15.4	13.3
EBITDA	**9,955**	**7,804**	**15,624**	**18,304**	**21,185**
EBITDA growth (%)	(11.8)	(21.6)	100.2	17.1	15.7
Depreciation & Amortization	1,298	1,484	1,807	2,678	2,924
EBIT	**8,658**	**6,320**	**13,817**	**15,626**	**18,260**
EBIT growth (%)	(14.6)	(27.0)	118.6	13.1	16.9
Other operating income	0	0	0	0	0
Other income	1,688	2,806	2,643	2,996	2,723
Financial expense	127	103	185	185	175
PBT	**10,219**	**9,023**	**16,275**	**18,437**	**20,808**
Extraordinary items	0	(972)	0	0	0
Taxes	2,563	1,982	3,255	4,517	5,098
Minority interest	0	0	0	0	0
Income from JV/Associates	0	0	0	0	0
Reported PAT	**7,656**	**6,070**	**13,020**	**13,920**	**15,710**
PAT growth (%)	(12.4)	(20.7)	114.5	6.9	12.9
Adjusted PAT	**7,656**	**7,041**	**13,020**	**13,920**	**15,710**
Diluted EPS (Rs)	**58.0**	**53.4**	**116.4**	**124.4**	**140.4**
Diluted EPS growth (%)	(32.9)	(20.7)	153.0	6.9	12.9
DPS (Rs)	**7.0**	**7.0**	**23.3**	**31.1**	**42.1**
Dividend payout (%)	**12.1**	**15.2**	**20.0**	**25.0**	**30.0**
EBITDA margin (%)	13.8	9.4	13.5	13.7	14.0
EBIT margin (%)	12.0	7.6	11.9	11.7	12.1
Effective tax rate (%)	25.1	22.0	20.0	24.5	24.5
NOPLAT (pre-IndAS)	**6,487**	**4,932**	**11,054**	**11,798**	**13,787**
Shares outstanding (mn)	131.9	131.9	111.9	111.9	111.9

Source: Company, Emkay Research

Balance Sheet

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Share capital	1,319	1,319	1,119	1,119	1,119
Reserves & Surplus	77,462	83,029	93,659	1,04,099	1,15,096
Net worth	**78,782**	**84,348**	**94,778**	**1,05,218**	**1,16,215**
Minority interests	0	0	0	0	0
Deferred tax liability (net)	379	651	635	616	596
Total debt	**0**	**0**	**1,820**	**0**	**0**
Total liabilities & equity	**79,161**	**84,999**	**97,233**	**1,05,834**	**1,16,811**
Net tangible fixed assets	16,922	17,299	25,007	29,329	0
Net intangible assets	227	284	284	284	0
Net ROU assets	346	502	502	502	0
Capital WIP	878	1,137	1,400	1,400	1,400
Goodwill	0	0	0	0	0
Investments [JV/Associates]	6,315	33,154	33,654	34,154	34,654
Cash & equivalents	**48,431**	**22,634**	**24,933**	**26,674**	**31,223**
Current assets (ex-cash)	20,509	27,896	38,785	44,773	50,710
Current Liab. & Prov.	14,557	18,082	27,509	31,459	35,544
NWC (ex-cash)	**5,952**	**9,814**	**11,276**	**13,315**	**15,166**
Total assets	**79,161**	**84,999**	**97,233**	**1,05,834**	**1,16,811**
Net debt	(48,431)	(22,634)	(23,113)	(26,674)	(31,223)
Capital employed	79,071	84,824	97,057	1,05,659	1,16,635
Invested capital	**23,448**	**27,899**	**37,070**	**43,431**	**49,358**
BVPS (Rs)	596.4	638.0	845.6	938.9	1,037.2
Net Debt/Equity (x)	(0.6)	(0.3)	(0.2)	(0.3)	(0.3)
Net Debt/EBITDA (x)	(4.9)	(2.9)	(1.5)	(1.5)	(1.5)
Interest coverage (x)	0.0	0.0	0.0	0.0	0.0
RoCE (%)	**11.6**	**8.3**	**13.5**	**13.8**	**14.1**

Source: Company, Emkay Research

Cash flows

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
PBT	10,219	9,023	16,275	18,437	20,808
Others (non-cash items)	0	0	0	0	0
Taxes paid	(2,539)	(1,864)	(3,271)	(4,536)	(5,119)
Change in NWC	(6,538)	(3,447)	(3,188)	(2,983)	(3,161)
Operating cash flow	**(1,277)**	**(442)**	**10,008**	**10,854**	**12,982**
Capital expenditure	(1,593)	(2,110)	(10,577)	(7,000)	(7,000)
Acquisition of business	918	(26,840)	(500)	(500)	(500)
Interest & dividend income	1,046	114	0	0	0
Investing cash flow	**(27,429)**	**3,242**	**(8,434)**	**(5,504)**	**(8,777)**
Equity raised/(repaid)	(29)	0	(201)	0	0
Debt raised/(repaid)	0	0	1,820	(1,820)	0
Payment of lease liabilities	(61)	(70)	0	0	0
Interest paid	(127)	(103)	(185)	(185)	(175)
Dividend paid (incl tax)	(924)	(924)	(2,604)	(3,480)	(4,713)
Others	19,205	326	1,895	876	1,233
Financing cash flow	**18,126**	**(700)**	**726**	**(4,609)**	**(3,655)**
Net chg in Cash	(10,581)	2,100	2,299	741	549
OCF	(1,277)	(442)	10,008	10,854	12,982
Adj. OCF (w/o NWC chg.)	5,261	3,005	13,196	13,837	16,142
FCFF	(2,870)	(2,552)	(569)	3,854	5,982
FCFE	(1,951)	(2,541)	(754)	3,669	5,806
OCF/EBITDA (%)	(12.8)	(5.7)	64.1	59.3	61.3
FCFE/PAT (%)	(25.5)	(41.9)	(5.8)	26.4	37.0
FCFF/NOPLAT (%)	**(44.2)**	**(51.7)**	**(5.1)**	**32.7**	**43.4**

Source: Company, Emkay Research

Valuations and key Ratios

Y/E Mar	FY22	FY23	FY24E	FY25E	FY26E
P/E (x)	53.0	57.6	26.4	24.7	21.9
P/CE(x)	45.3	47.6	23.2	20.7	18.5
P/B (x)	5.2	4.8	3.6	3.3	3.0
EV/Sales (x)	5.0	4.6	2.8	2.4	2.1
EV/EBITDA (x)	35.9	49.1	20.5	17.3	14.8
EV/EBIT(x)	41.3	60.6	23.2	20.3	17.1
EV/IC (x)	15.2	13.7	8.7	7.3	6.3
FCFF yield (%)	(0.8)	(0.7)	(0.2)	1.2	1.9
FCFE yield (%)	(0.5)	(0.6)	(0.2)	1.1	1.7
Dividend yield (%)	0.2	0.2	0.8	1.0	1.4
DuPont-RoE split					
Net profit margin (%)	10.6	8.4	11.2	10.4	10.4
Total asset turnover (x)	1.1	1.0	1.3	1.3	1.4
Assets/Equity (x)	1.0	1.0	1.0	1.0	1.0
RoE (%)	**11.6**	**8.6**	**14.6**	**13.9**	**14.2**
DuPont-RoIC					
NOPLAT margin (%)	9.0	5.9	9.6	8.8	9.1
IC turnover (x)	0.0	0.0	0.0	0.0	0.0
RoIC (%)	**32.7**	**19.2**	**34.0**	**29.3**	**29.7**
Operating metrics					
Core NWC days	30.2	42.9	35.6	36.4	36.6
Total NWC days	**30.2**	**42.9**	**35.6**	**36.4**	**36.6**
Fixed asset turnover	2.5	2.7	3.1	2.9	2.9
Opex-to-revenue (%)	17.6	17.9	16.5	16.3	16.0

Source: Company, Emkay Research

RECOMMENDATION HISTORY - DETAILS

Date	Closing Price (INR)	TP (INR)	Rating	Analyst
01-Aug-23	2,564	3,020	Buy	Chirag Jain
11-May-23	2,070	2,420	Buy	Chirag Jain

Source: Company, Emkay Research

RECOMMENDATION HISTORY - TREND

Source: Company, Bloomberg, Emkay Research

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HOLD	Between -5% to 15%
SELL	Below -5%

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