

SELL

TP: Rs 1,030 | ▼ 16%

ESCORTS

| Auto Components

| 02 November 2020

Strong Q2; optimism priced in – SELL

Escorts (ESC) reported strong Q2FY21 revenue at Rs 16.4bn (+24% YoY) with sharp 880bps operating margin expansion to 18.4%. Despite robust volumes, the company lost 140bps market share in Q2 (from 11.2% to 9.8%) due to supply constraints at its end. Recent untimely rains have been a dampener in West and North India, though we believe agriculture sector growth momentum will continue, aiding a 7% tractor volume CAGR over FY20-FY23. In our view, positives are in the price. Maintain SELL with an unchanged Sep'21 TP of Rs 1,030.

Mayur Milak | Nishant Chowhan, CFA
research@bobcaps.in

Strong Q2: A favourable product mix (two-third share of >40HP tractors) supported above-expected ASP, leading to 24% YoY revenue growth to Rs 16.4bn (Rs 14.8bn est.). Operating margin also surprised positively, expanding 880bps YoY to 18.4% (~500bps above our estimate) owing to better operating leverage and softer commodity costs. However, Management guided that the margins are not sustainable due to adverse product-mix and normalization of costs going ahead. Adj. PAT grew 102% YoY to Rs 2.3bn.

Ticker/Price	ESC IN/Rs 1,228
Market cap	US\$ 2.0bn
Shares o/s	123mn
3M ADV	US\$ 38.3mn
52wk high/low	Rs 1,343/Rs 526
Promoter/FPI/DII	40%/20%/10%

Source: NSE

Optimism factored into estimates: The recent peak season for tractor sales ended strongly. However, we now enter the dull phase for sales. Our channel checks suggest that the recent untimely rains have affected farm produce in West and North India, although we believe that agriculture sector growth momentum could continue with the onset of the next season in January. We maintain our tractor volume growth estimate of 7% CAGR over FY20-FY23.

STOCK PERFORMANCE



Maintain SELL: We expect ESC to clock a revenue/EBITDA/PAT CAGR of 8%/13%/15% over FY20-FY23. Despite the recent stock price correction, valuations appear to be pricing in most of the positives at 23.7x/20.4x FY22E/FY23E EPS. We continue to value the stock at 19x Sep'22E EPS and maintain our TP at Rs 1,030. SELL.

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	62,620	58,101	58,468	65,217	72,276
EBITDA (Rs mn)	7,226	6,624	7,531	8,445	9,478
Adj. net profit (Rs mn)	4,789	4,825	5,401	6,256	7,264
Adj. EPS (Rs)	39.1	39.4	44.1	51.0	59.3
Adj. EPS growth (%)	38.0	0.8	11.9	15.8	16.1
Adj. ROAE (%)	17.9	15.5	14.8	14.8	14.7
Adj. P/E (x)	31.4	31.2	27.9	24.1	20.7
EV/EBITDA (x)	20.5	22.4	19.6	17.7	15.9

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
Volume (nos)	24,441	19,750	23.8	18,150	34.7	42,591	40,801	4.4
Avg. Realisation per Vehicle (Rs)	670,881	670,309	0.1	584,920	14.7	634,249	673,226	(5.8)
Net Revenues	16,397	13,239	23.9	10,616	54.5	27,013	27,468	(1.7)
Total Income (A)	16,397	13,239	23.9	10,616	54.5	27,013	27,468	(1.7)
Operating Expenses:								
Raw materials consumed	10,422	8,871	17.5	7,128	46.2	17,550	18,688	(6.1)
Employee Expenses	1,256	1,253	0.2	1,262	(0.5)	2,518	2,479	1.6
Other Expenses	1,710	1,847	(7.4)	1,031	65.9	2,741	3,610	(24.1)
Total Expenditure (B)	13,388	11,972	11.8	9,420	42.1	22,808	24,777	(7.9)
EBITDA (A-B)	3,009	1,267	137.5	1,196	151.6	4,205	2,691	56.3
Other Income	376	211	78.4	298	25.9	674	378	78.5
Depreciation	274	260	5.2	264	3.5	538	501	7.3
EBIT	3,111	1,218	155.5	1,230	152.9	4,341	2,568	69.1
Finance Costs	32	39	(16.6)	19	66.3	51	97	(47.1)
PBT before excep items	3,079	1,179	161.1	1,211	154.3	4,290	2,471	73.6
Exceptional items	-	(92)	(100.0)	-	NA	-	(92)	(100.0)
PBT after excep items	3,079	1,271	142.2	1,211	154.3	4,290	2,563	67.4
Tax expense	779	41	1805.4	289	169.4	1,069	457	133.6
Reported PAT	2,300	1,230	86.9	922	149.5	3,221	2,105	53.0
Adjusted PAT	2,300	1,138	102.0	922	149.5	3,221	2,013	60.0
EPS (Rs)	18.8	9.3	102.0	7.5	149.5	26.3	16.4	60.0

Source: Company, BOBCAPS Research

FIG 2 – KEY PARAMETERS

(%)	Q2FY21	Q2FY20	YoY (bps)	Q1FY21	QoQ (bps)	H1FY21	H1FY20	YoY (bps)
Gross Margin	36.4	33.0	345	33	358	35.0	32.0	307
EBITDA Margin	18.4	9.6	878	11	708	15.6	9.8	577
EBIT Margin	19.0	9.2	978	12	739	16.1	9.3	672
PBT Margin	18.8	8.9	987	11	737	15.9	9.0	689
Tax Rate	25.3	3.2	2209	24	142	24.9	17.8	706
Adj PAT Margin	14.0	8.6	543	9	534	11.9	7.3	460

Source: Company, BOBCAPS Research

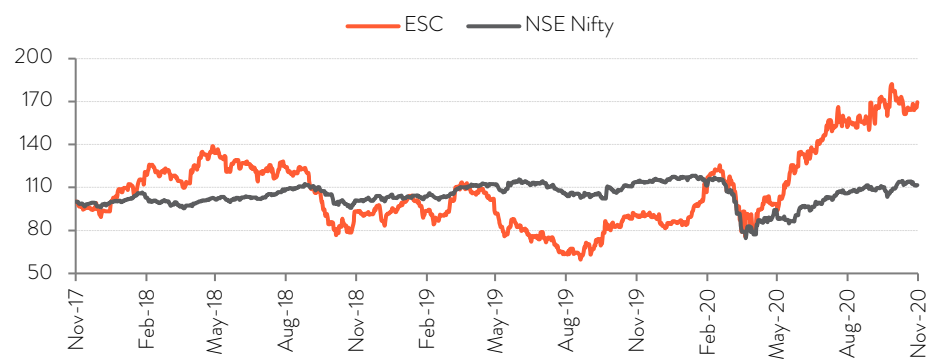
Earnings call highlights

- In Q2FY21, two-thirds of tractors sold by ESC were in the >40hp category (vs. 45% in Q2FY20 and 62% in Q1FY21), leading to better ASPs. However, per management, the product mix could turn adverse.
- Apart from ASPs, other factors leading to better operating margins in Q2 were: (a) near-full capacity utilisation, (b) rationalisation of travelling and marketing spends, and (c) softer commodity prices during Q2 (though these have started inching up since Sep'20-end and could rise 1.5-2% in the next three months).
- ESC lost ~140bps of market share during the quarter mainly due to supply constraints at its end. Lean inventory before the lockdown also impacted its ability to service high demand.
- Management has guided for lower-double-digit YoY growth for tractors in FY21 led by strong fundamentals such as a normal monsoon, increasing financing penetration, and good price realisation for crops harvested. Most of the pent-up demand has been catered to now.
- ESC intends to incur additional capex of ~ Rs 90mn in order to add capacity of 1,500 tractors/month to its existing capacity of 10k units/month. The capacity should be in place by FY22. Capex guidance for FY21 stands at Rs 3bn-3.5bn (but cash outflow would be Rs 2bn-2.5bn).
- The company intends to utilise excess cash on its books toward upcoming projects with Kubota and on opportunities in the railway segment. Cash would also be deployed to strengthen the distribution channel.

Valuation methodology

We expect ESC to clock a revenue/EBITDA/PAT CAGR of 8%/13%/15% over FY20-FY23. Despite the recent stock price correction, valuations appear to be pricing in most of the positives at 23.7x/20.4x FY22E/FY23E EPS. We continue to value the stock at 19x Sep'22E EPS and maintain our target price at Rs 1,030. Reiterate SELL.

FIG 3 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Above-anticipated volume growth
- Stronger margins in the construction equipment business

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	62,620	58,101	58,468	65,217	72,276
EBITDA	7,226	6,624	7,531	8,445	9,478
Depreciation	872	1,072	1,089	1,149	1,229
EBIT	7,345	6,528	7,360	8,494	9,832
Net interest income/(expenses)	(195)	(172)	(140)	(130)	(120)
Other income/(expenses)	992	976	918	1,198	1,583
Exceptional items	(131)	(103)	0	0	0
EBT	7,019	6,252	7,220	8,364	9,712
Income taxes	2,371	1,535	1,820	2,108	2,447
Extraordinary items	(10)	(5)	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	4,658	4,722	5,401	6,256	7,264
Adjustments	131	103	0	0	0
Adjusted net profit	4,789	4,825	5,401	6,256	7,264

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	11,055	12,929	12,686	12,918	13,736
Other current liabilities	4,156	3,403	3,502	3,713	3,073
Provisions	1,201	1,563	1,256	1,256	1,256
Debt funds	2,810	192	192	192	192
Other liabilities	540	535	535	535	535
Equity capital	1,226	1,226	1,226	1,226	1,226
Reserves & surplus	25,509	29,948	35,219	41,108	48,066
Shareholders' fund	26,735	31,174	36,445	42,334	49,292
Total liabilities and equities	46,497	49,796	54,616	60,948	68,084
Cash and cash eq.	2,433	3,249	1,193	793	887
Accounts receivables	9,311	7,319	8,810	8,934	9,703
Inventories	8,574	8,834	8,810	8,576	9,109
Other current assets	3,206	3,199	3,691	3,883	4,052
Investments	4,908	7,974	12,974	18,974	23,974
Net fixed assets	16,472	17,024	16,935	17,786	18,557
CWIP	800	1,247	1,200	1,000	800
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(517)	(307)	(307)	(307)	(307)
Other assets	1,366	1,310	1,310	1,310	1,310
Total assets	46,553	49,847	54,616	60,948	68,084

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	5,661	5,898	6,490	7,405	8,493
Interest expenses	(195)	(172)	(140)	(130)	(120)
Non-cash adjustments	(992)	(976)	(918)	(1,198)	(1,583)
Changes in working capital	(7,856)	3,274	(2,411)	362	(1,292)
Other operating cash flows	(70)	(158)	0	0	0
Cash flow from operations	(3,452)	7,865	3,021	6,439	5,498
Capital expenditures	(1,609)	(2,071)	(953)	(1,800)	(1,800)
Change in investments	583	(3,066)	(5,000)	(6,000)	(5,000)
Other investing cash flows	992	976	918	1,198	1,583
Cash flow from investing	(34)	(4,161)	(5,036)	(6,602)	(5,217)
Equities issued/Others	(30)	(8)	0	0	0
Debt raised/repaid	2,299	(2,618)	0	0	0
Interest expenses	(195)	(172)	(140)	(130)	(120)
Dividends paid	(239)	(260)	(123)	(368)	(306)
Other financing cash flows	461	(170)	(7)	0	0
Cash flow from financing	2,296	(3,228)	(270)	(498)	(426)
Changes in cash and cash eq.	(1,191)	477	(2,285)	(660)	(146)
Closing cash and cash eq.	2,433	3,249	1,193	793	887

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	39.1	39.4	44.1	51.0	59.3
Adjusted EPS	39.1	39.4	44.1	51.0	59.3
Dividend per share	1.9	1.7	1.0	3.0	2.5
Book value per share	218.1	254.3	297.3	345.4	402.1

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	2.4	2.6	2.5	2.3	2.1
EV/EBITDA	20.5	22.4	19.6	17.7	15.9
Adjusted P/E	31.4	31.2	27.9	24.1	20.7
P/BV	5.6	4.8	4.1	3.6	3.1

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	68.2	77.2	74.8	74.8	74.8
Interest burden (PBT/EBIT)	95.6	95.8	98.1	98.5	98.8
EBIT margin (EBIT/Revenue)	11.7	11.2	12.6	13.0	13.6
Asset turnover (Revenue/Avg TA)	235.4	187.1	169.2	162.6	155.3
Leverage (Avg TA/Avg Equity)	1.1	1.1	1.0	1.0	1.0
Adjusted ROAE	19.6	16.7	16.0	15.9	15.9

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

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	23.8	(7.2)	0.6	11.5	10.8
EBITDA	32.2	(8.3)	13.7	12.1	12.2
Adjusted EPS	38.0	0.8	11.9	15.8	16.1
Profitability & Return ratios (%)					
EBITDA margin	11.5	11.4	12.9	12.9	13.1
EBIT margin	11.7	11.2	12.6	13.0	13.6
Adjusted profit margin	7.6	8.3	9.2	9.6	10.1
Adjusted ROAE	17.9	15.5	14.8	14.8	14.7
ROCE	18.3	15.9	15.9	15.8	15.8
Working capital days (days)					
Receivables	44	52	50	50	47
Inventory	41	55	55	49	45
Payables	93	114	121	108	102
Ratios (x)					
Gross asset turnover	0.4	0.5	0.5	0.5	0.4
Current ratio	1.4	1.3	1.3	1.2	1.3
Net interest coverage ratio	(37.6)	(37.9)	(52.6)	(65.3)	(81.9)
Adjusted debt/equity	0.1	0.0	0.0	0.0	0.0

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): ESCORTS (ESC IN)



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

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