

SELL

TP: Rs 2,514 | ▼ 36%

ESCORTS KUBOTA

| Automobiles

| 03 August 2024

Weakness persists, maintain SELL

- Q1 tractors volume dipped 3.2% YoY as weakness persisted in export markets and domestic market lost market share
- Softening commodity prices supported gross margin expansion by 173bps to 31.9% YoY. EBITDA margin increased by 20bps YoY
- We cut our FY26 EPS estimate by 4% and introduce FY27 estimates. We revise TP to Rs 2,514 (from Rs 2,530) and retain SELL

Milind Raginwar

research@bobcaps.in

Volume weakness persists: ESCORTS's Q1FY25 revenue fell 1.5% YoY to Rs 22.9bn (+10.1% QoQ) as tractor volumes fell by 3.2% YoY to ~25.7k units (+21% QoQ). This included domestic volume of 24.7k units versus 25.2k units in Q1FY24, a decline of 1.8%. The pain in exports was even higher with volume slide at 0.96k units, against 1.35k units fall of 29% YoY. Net realisation per vehicle in the segment grew 3.9% YoY but was flat QoQ to Rs 0.65mn and was the only respite.

CE segment stood strong YoY, AM stayed flat but RE declined: Revenue from the Agriculture Machinery (AM) segment stayed flat YoY in Q1FY25. The Railways Equipment (RE) segment contracted 17.8% YoY, while Construction Equipment (CE) grew 2.7%. Segmental EBIT margin was 13.2%/20.5%/10.4% for the AM/RE/CE segments with only CE showing improvement. The three segments contributed 73%, 11% and 16% to revenue, respectively.

Easing input cost aided margin expansion: Raw material cost (inventory adjusted) fell 4%YoY (+10.1% QoQ) to Rs 15.5bn as commodity softening aided relief. Gross margin rose 173bps YoY (flat QoQ) to 31.9% aided by better product mix and cost control. Other expenditure grew 7.3%/1.3% YoY/QoQ. However, EBITDA margin only expanded 20bps YoY (150bps QoQ) to 14.3%. APAT grew 2.4%/19.6% YoY/QoQ to Rs 2.9bn.

Amalgamation nod likely by Q2FY25: The amalgamation of Escorts Kubota India and Kubota Agricultural Machinery India has been reserved by National Company Law Tribunal (NCLT) and a final order from NCLT is expected in 1-2 months.

Maintain SELL: ESCORTS' tractor volumes YTD FY25 stayed muted, though MM grew by ~6% in the domestic market – indicating ESCORTS has lost domestic market share. The exports volume is even weaker by 22%. The full benefit of the Kubota integration on export sales is likely to flow in only after 12-24 months. We lower our FY26E EPS estimate by 4% and introduce FY27 estimates. Given sustained growth headwinds, we retain SELL and revise our TP to Rs 2,514 (from 2,530). 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 3,905
Market cap	US\$ 6.2bn
Free float	63%
3M ADV	US\$ 14.0mn
52wk high/low	Rs 4,410/Rs 2,530
Promoter/FPI/DII	37%/22%/8%

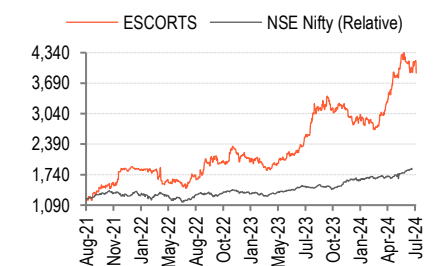
Source: NSE | Price as of 2 Aug 2024

Key financials

Y/E 31 Mar	FY24A	FY25E	FY26E
Total revenue (Rs mn)	88,496	1,00,054	1,18,119
EBITDA (Rs mn)	11,667	13,831	15,779
Adj. net profit (Rs mn)	10,491	11,814	13,239
Adj. EPS (Rs)	94.9	106.9	119.8
Consensus EPS (Rs)	94.9	108.9	125.0
Adj. ROAE (%)	11.4	11.3	11.3
Adj. P/E (x)	41.1	36.5	32.6
EV/EBITDA (x)	44.3	36.4	31.2
Adj. EPS growth (%)	81.6	12.6	12.1

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Earnings call highlights

Parameter	Q1FY25	Q4FY24	Our view
Domestic volumes	The tractor industry volume in Q1FY25 was 0.26mn tractors. ESCORTS's domestic tractor volume stood at 24.7k tractors against 25.2k in Q1FY24. For FY25, management anticipates the domestic tractor industry may experience mid-single-digit growth.	In FY24, the domestic tractor industry fell 7.4% YoY to ~876k units due to erratic and deficient rainfall that led to delayed crop harvests and lower rabi (winter crop) sowing. ESCORTS's domestic tractor volume fell 5% YoY to 90k units. ESCORTS's market share as on Q4FY24 was 11.6%.	ESC is losing market share consistently to its peers and will continue to face challenges.
Exports	In Exports, the tractor industry sold 24.6k tractors in Q1FY25 as against 24.2k in Q1FY24. ESCORTS exports volume was at 0.96k tractors in Q1FY25 against 1.35k tractors in Q1FY24. Correction in inventories is underway and demand has been subdued for multiple quarters because of which exports to Kubota for Europe have been impacted. Management expects pickup towards the end of FY25.	The export tractor industry declined 21% YoY to ~98k units and ESCORTS's export volume fell 30% YoY to 5,619 units in FY24. Management expects exports volume to reach 20k-30k units in the next two to three years for ESCORTS.	Formal amalgamation with Kubota will give ESCORTS a better foothold in export markets.
Margins	EBITDA margin stood at 14.3%, up 22bps YoY on account of better product mix, price realisation, and softening commodity prices. Management expects margins to remain within a certain range in H1FY25, with price increases taken in Q1 to offset cumulative material cost impact. Further, operating leverage is expected to drive improvement in margins as volumes pick up.	Operating margin expanded on account of improved realisation, effective cost control and softening commodity prices. However, QoQ margins were under stress. Management expects commodity prices to increase slightly in H1FY25.	Margins benefitted from easing raw material costs. The continuation of the same can be challenging.
Other segments	Construction equipment volume at 1,325 machines was down 3.5% YoY. ESCORTS's total volume grew 21% YoY for Q1FY25. Railway equipment revenue at Rs 2.44bn was down by 18% YoY. During Q1FY25, the company successfully supplied the first-ever electric control panel order to prominent metro organisations. Order book for the division at the end of Jun'24 stood at Rs 8.80bn. Industry demand is growing for Vande Bharat passenger coaches. The company is in the development stage for these components and will be able to supply them for Vande Bharat coaches.	Construction equipment industry volumes grew 18% YoY, aided by 48% growth in crane volumes, 40% growth in the compactor segment and 2% growth in backhoe loaders. ESCORTS's total volume grew 43% YoY Q4FY24. For the RE division, revenue fell 10% YoY to Rs 2bn due to election protocol impacting orders from the Railway department in Q4FY24. 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 9.5bn at end-Q4FY24.	The performance of segments other than Tractors will improve and it currently forms ~30% of revenue. CE segment performance is likely to improve given the government's thrust on infrastructure. Railway pickup will come from 2HFY24.
Regulations	Date for emission norms remains fixed, i.e., 1 April 2026, and there are no changes.	No clarity or commentary from management.	ESCORTS has a lower presence in the high-end tractor segment and will see limited pricing impact from new norms.
Capex	No comments in Q1FY25 earnings call.	Capex of Rs 3bn in FY25 and no clear comments on long-term plan of Rs 40bn.	Limited visibility on the capex for one year.
Merger	For the Kubota amalgamation, merger has been reserved by the NCLT bench in the first week of	For the Kubota amalgamation, all the required approvals are in place and the matter is now	Clarity, particularly on the exports business, is likely to emerge in the next three to

Parameter	Q1FY25	Q4FY24	Our view
	Jul'24. ESCORTS expects to get this order and make it effective from 1 September 2024.	pending with the NCLT for the final order. Management expects NCLT approval shortly.	four years following a complete branding revamp.
Other Information	Inventory creation was seen across the organisation leading to lower production numbers in Q1FY25. ESCORTS saw inventory correction across Europe due to recessionary conditions and higher interest rates.	ESCORTS's inventory level is currently at 37-39 days and management does not intend to increase this level for FY25. Management indicated that it will be primarily focusing on western (Gujarat and Maharashtra) and northern India markets.	No major change is expected.

Source: Company, BOBCAPS Research

Fig 2 – Quarterly performance (Standalone)

(Rs mn)	1QFY25	1QFY24	YoY (%)	4QFY24	QoQ (%)
Volume (units)	25,720	26,582	(3.2)	21,253	21.0
Avg. Realisation per Vehicle (Rs)	8,91,345	8,75,683	1.8	9,79,848	(9.0)
Net Revenues	22,925	23,277	(1.5)	20,825	10.1
Total Income (A)	22,925	23,277	(1.5)	20,825	10.1
Operating Expenses:					
Raw materials consumed	15,610	16,252	(4.0)	14,181	10.1
Employee Expenses	1,606	1,484	8.2	1,577	1.9
Other Expenses	2,439	2,272	7.3	2,408	1.3
Total Expenditure (B)	19,654	20,008	(1.8)	18,166	8.2
EBITDA (A-B)	3,271	3,269	0.1	2,659	23.0
Other Income	1,058	945	12.0	1,053	0.5
Depreciation	433	402	7.8	441	(1.7)
EBIT	3,896	3,813	2.2	3,272	19.1
Finance Costs	16	27	(41.7)	35	(55.1)
PBT after excep items	3,881	3,786	2.5	3,237	19.9
Tax expense	985	958	2.8	817	20.6
Reported PAT	2,896	2,828	2.4	2,421	19.6
Adjusted PAT	2,896	2,828	2.4	2,421	19.6
Adj EPS (Rs)	26.2	25.6	2.4	21.9	19.6
Key Ratios (%)			(bps)		(bps)
Gross Margin	31.9	30.2	173	31.9	1
EBITDA Margin	14.3	14.0	22	12.8	150
EBIT Margin	17.0	16.4	62	15.7	128
PBT Margin	16.9	16.3	66	15.5	138
Tax Rate	25.4	25.3	8	25.2	16
Adj PAT Margin	12.6	12.1	48	11.6	101

Source: Company, BOBCAPS Research

Valuation methodology

ESCORTS's tractor volumes YTD FY25 stayed muted though the market leader MM grew by ~6% in the domestic market, indicating ESCORTS had lost domestic market share. The exports volume is even weaker by 22% YTD FY25. The full benefit of the Kubota integration on export sales is likely to flow in only after 12-24 months. The other segment contribution was expectedly weak in 1QFY25 but is set for revival.

We lower our FY26 EPS estimates by 4% and introduce FY27 estimates baking in a revenue/EBITDA/PAT CAGR of 15%/15%/12% for ESCORTS over FY24-FY27. Given sustained growth headwinds, clarity on global sales and weak performance is awaited. We retain our SELL rating, while revising our TP to Rs 2,514 (from 2,530). 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 (%)		
	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E
Revenue	1,00,054	1,18,119	1,35,870	1,00,738	1,21,299	NA	(0.7)	(2.6)	NA
EBITDA	13,831	15,779	17,922	13,976	16,433	NA	(1.0)	(4.0)	NA
Adj PAT	11,814	13,239	14,642	11,796	13,839	NA	0.2	(4.3)	NA
Adj EPS (Rs)	107	120	133	107	125	NA	(0.1)	(4.2)	NA

Source: BOBCAPS Research

Fig 4 – Key assumptions

Parameter	FY24P	FY25E	FY26E	FY27E
Volumes	95,858	1,00,976	1,07,540	1,14,207
Blended Realisation (Rs)	6,41,776	6,61,029	6,94,081	7,23,579
EBITDA (Rs mn)	11,667	13,831	15,779	17,922
EBITDA margin (%)	13.2	13.8	13.4	13.2
Adj. PAT (Rs mn)	10,491	11,814	13,239	14,642
EPS (Rs)	94.94	106.92	119.81	132.51

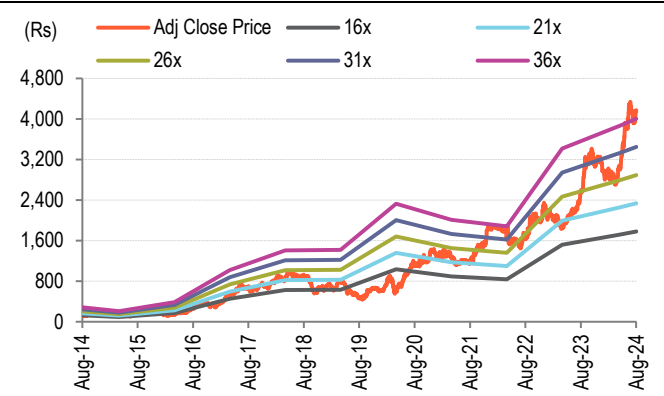
Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EPS (Rs)		ROE (%)	
				FY25E	FY26E	FY25E	FY26E
Escorts Kubota	ESCORTS IN	SELL	2,514	12.6	12.1	12.0	11.9
VST Tillers Tractors	VSTT IN	HOLD	3,167	1.8	12.8	12.6	12.7
Mahindra & Mahindra	MM IN	BUY	3,279	100.1	118.8	21.1	21.1

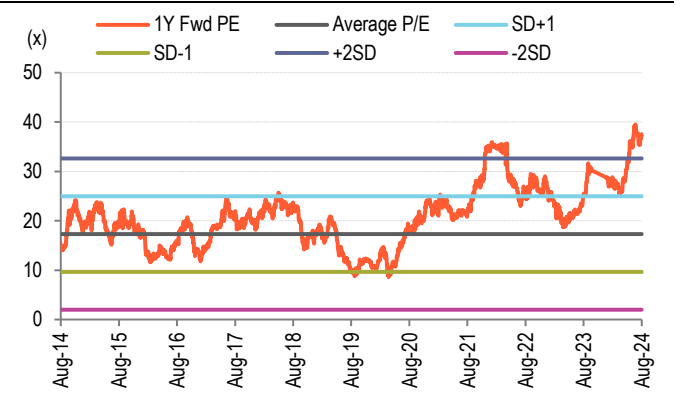
Source: BOBCAPS Research

Fig 6 – P/E band: We value Escorts at 17x FY26E P/E based on core business earnings



Source: Company, Bloomberg, BOBCAPS Research

Fig 7 – P/E 1Y fwd: The run up in the stock is far ahead of its earnings and is clearly unjustified



Source: Company, Bloomberg, BOBCAPS Research

Key risks

Key upside risks to our estimates are:

- faster-than-expected revival in export volumes,
- faster-than-anticipated margin revival owing to earnings-accretive price hikes, and
- quicker-than-anticipated easing of commodity prices.

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY23A	FY24A	FY25E	FY26E	FY27E
Total revenue	84,287	88,496	1,00,054	1,18,119	1,35,870
EBITDA	7,775	11,667	13,831	15,779	17,922
Depreciation	1,399	1,669	1,799	1,923	2,154
EBIT	9,084	13,984	16,115	18,060	20,041
Net interest inc./(exp.)	(133)	(137)	(150)	(170)	(187)
Other inc./(exp.)	2,809	3,986	4,084	4,204	4,273
Exceptional items	(531)	0	0	0	0
EBT	8,346	14,010	15,965	17,890	19,854
Income taxes	1,979	3,519	4,151	4,652	5,212
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	6,367	10,491	11,814	13,239	14,642
Adjustments	531	0	0	0	0
Adjusted net profit	6,897	10,491	11,814	13,239	14,642

Balance Sheet

Y/E 31 Mar (Rs mn)	FY23A	FY24A	FY25E	FY26E	FY27E
Accounts payables	13,427	12,746	12,405	6,568	7,700
Other current liabilities	3,485	5,409	11,834	22,352	25,731
Provisions	1,466	1,599	1,758	1,934	2,128
Debt funds	0	42	45	47	49
Other liabilities	0	0	0	0	0
Equity capital	1,319	1,105	1,105	1,105	1,105
Reserves & surplus	80,509	90,619	1,03,384	1,15,960	1,29,939
Shareholders' fund	81,829	91,724	1,04,489	1,17,065	1,31,044
Total liab. and equities	1,00,206	1,11,520	1,30,532	1,47,967	1,66,652
Cash and cash eq.	4,719	11,790	19,149	22,114	26,331
Accounts receivables	11,797	11,732	12,884	14,077	15,634
Inventories	12,177	12,181	12,061	14,563	16,379
Other current assets	5,291	4,528	4,981	5,479	6,027
Investments	47,667	52,199	62,229	72,229	82,229
Net fixed assets	18,621	18,308	18,609	19,086	19,532
CWIP	694	1,163	1,000	800	900
Intangible assets	734	754	754	754	754
Deferred tax assets, net	(1,492)	(1,135)	(1,135)	(1,135)	(1,135)
Other assets	0	0	0	0	0
Total assets	1,00,206	1,11,520	1,30,532	1,47,967	1,66,652

Cash Flows

Y/E 31 Mar (Rs mn)	FY23A	FY24A	FY25E	FY26E	FY27E
Cash flow from operations	863	10,236	14,138	11,452	13,119
Capital expenditures	(2,260)	(1,846)	(1,937)	(2,200)	(2,700)
Change in investments	692	(4,532)	(10,030)	(10,000)	(10,000)
Other investing cash flows	2,809	3,986	4,084	4,204	4,273
Cash flow from investing	1,240	(2,393)	(7,883)	(7,996)	(8,427)
Equities issued/Others	242	(1,824)	1,610	0	0
Debt raised/repaid	0	42	3	2	2
Interest expenses	(133)	(137)	(150)	(170)	(187)
Dividends paid	(763)	(763)	(663)	(663)	(663)
Other financing cash flows	185	1,637	0	0	0
Cash flow from financing	(469)	(1,046)	800	(831)	(848)
Chg in cash & cash eq.	1,635	6,797	7,055	2,625	3,844
Closing cash & cash eq.	4,719	11,790	19,149	22,114	26,331

Per Share

Y/E 31 Mar (Rs)	FY23A	FY24A	FY25E	FY26E	FY27E
Reported EPS	52.3	94.9	106.9	119.8	132.5
Adjusted EPS	52.3	94.9	106.9	119.8	132.5
Dividend per share	5.8	6.9	6.0	6.0	6.0
Book value per share	620.5	830.5	945.9	1,059.8	1,186.3

Valuations Ratios

Y/E 31 Mar (x)	FY23A	FY24A	FY25E	FY26E	FY27E
EV/Sales	6.0	5.8	5.0	4.2	3.6
EV/EBITDA	65.2	44.3	36.4	31.2	27.3
Adjusted P/E	74.7	41.1	36.5	32.6	29.5
P/BV	6.3	4.7	4.1	3.7	3.3

DuPont Analysis

Y/E 31 Mar (%)	FY23A	FY24A	FY25E	FY26E	FY27E
Tax burden (Net profit/PBT)	82.6	74.9	74.0	74.0	73.8
Interest burden (PBT/EBIT)	91.9	100.2	99.1	99.1	99.1
EBIT margin (EBIT/Revenue)	10.8	15.8	16.1	15.3	14.8
Asset turnover (Rev./Avg TA)	106.8	102.0	101.9	106.6	109.5
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.0	1.0	1.0
Adjusted ROAE	8.7	12.1	12.0	11.9	11.8

Ratio Analysis

Y/E 31 Mar	FY23A	FY24A	FY25E	FY26E	FY27E
YoY growth (%)					
Revenue	16.4	5.0	13.1	18.1	15.0
EBITDA	(18.3)	50.1	18.5	14.1	13.6
Adjusted EPS	(6.4)	81.6	12.6	12.1	10.6
Profitability & Return ratios (%)					
EBITDA margin	9.2	13.2	13.8	13.4	13.2
EBIT margin	10.8	15.8	16.1	15.3	14.8
Adjusted profit margin	8.2	11.9	11.8	11.2	10.8
Adjusted ROAE	8.4	11.4	11.3	11.3	11.2
ROCE	8.8	12.1	12.2	12.1	11.9
Working capital days (days)					
Receivables	43	49	45	42	40
Inventory	45	50	44	41	42
Payables	69	78	67	43	28
Ratios (x)					
Gross asset turnover	0.4	0.4	0.3	0.3	0.3
Current ratio	1.8	2.0	1.9	1.8	1.8
Net interest coverage ratio	(68.5)	(101.9)	(107.4)	(106.2)	(107.2)
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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Name of the Research Entity: **BOB Capital Markets Limited**
 Registered office Address: **1704, B Wing, Parinee Crescenzo, G Block, BKC, Bandra East, Mumbai 400051**
 SEBI Research Analyst Registration No: **INH000000040 valid till 03 February 2025**
 Brand Name: **BOBCAPS**
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BUY – Expected return >+15%

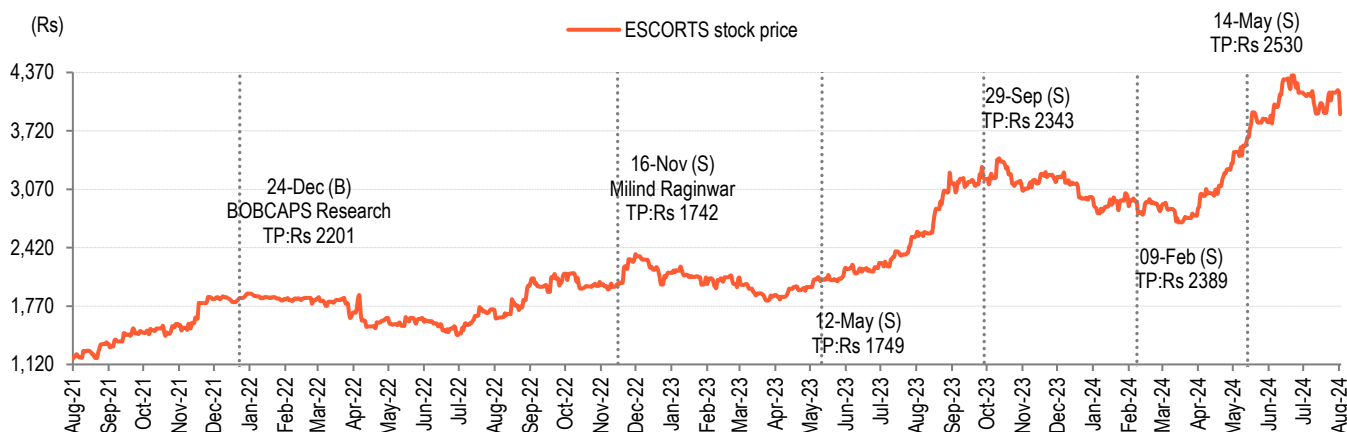
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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 KUBOTA (ESCORTS IN)



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

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