RESULT REVIEW

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

SELL
TP: Rs 2,426 | ∀ 33%

ESCORTS KUBOTA | Automobiles | 08 November 2024

No major respite from weakness; maintain SELL

- **Q2 tractors volume fell by 1% YoY (combined volume from JV partners post amalgamation) despite healthy industry growth**
- **Benign commodity prices support steady gross margin ~30%, high-cost structure post amalgamation leads to EBITDA margin weakness**
- **We cut FY25/FY26/FY27 EPS estimates by 10%/10%/3%, maintain 20x P/E multiple and revise our TP to Rs 2,426 (from Rs 2,514). Retain SELL**

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Volume weakness persists: ESCORTS amalgamated Escorts Kubota India and Kubota Agricultural Machinery India with Escorts Kubota. The performance has been adjusted since FY24 to reflect the performance of the amalgamated entity. The Q2FY25 revenue was flat YoY at Rs 24.8bn (-12 QoQ) as tractor volumes fell by ~1% YoY to ~25.9k units (14% QoQ). Net realisation/vehicle in the segment was flat YoY (+3% QoQ) at Rs 0.95mn.

Only AM delivered growth, CE/RE declined: Revenue from the Agriculture Machinery (AM) segment grew 5% YoY in Q2FY25. The Railways Equipment (RE) segment contracted ~10% YoY, while Construction Equipment (CE) fell 14%. Segmental EBIT margin was 9%/15%/9% for the AM/RE/CE segments, all declining YoY. The three segments contributed 76%, 8% and 16% to revenue, respectively.

Margin contracts on elevated cost structure: Raw material cost (inventory adjusted) stayed flat YoY at Rs 21.1bn that kept gross margin steady ~30%, contributed by the elevated cost of the JV companies. Employee cost and other expenditure inflated by 5% each due to the impact of amalgamation that impacted EBITDA margin by 10bps YoY but fell sharply by (240bps QoQ) to 10.6%. APAT grew sharply to Rs 3.2bn only due to tax adjustments.

Amalgamation approved by NCLT: The amalgamation of Escorts Kubota India and Kubota Agricultural Machinery India has been approved by National Company Law Tribunal (NCLT) and was filed with the ROC on 1 September 2024.

Maintain SELL: ESCORTS's tractor volume stayed muted by ~1% YoY, though MM grew by 4% YoY – indicating ESCORTS has lost domestic market share. The amalgamation impact on margins due to higher cost structure will stay. The full benefit of the Kubota integration on export sales is likely to flow in only after 12-24 months. We lower our FY25E/FY26E/FY27E EPS estimate by 10%/10%/3%. Effectively, we retain our SELL rating and revise our TP to Rs 2,426 (from Rs 2,514). Our target P/E stays at 20x – a marginal premium to the stock's LT mean. The hiving-off impact of the RE division is factored into our FY26/FY27 earnings.

Key changes

Target	Rating
▼	◄ ►

Ticker/Price	ESCORTS IN/Rs 3,644
Market cap	US$ 5.7bn
Free float	63%
3M ADV	US$ 12.3mn
52wk high/low	Rs 4,420/Rs 2,648
Promoter/FPI/DII	37%/22%/8%

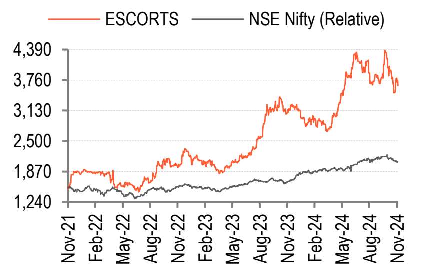
Source: NSE | Price as of 7 Nov 2024

Key financials

Y/E 31 Mar	FY24A	FY25E	FY26E
Total revenue (Rs mn)	88,496	1,07,756	1,14,140
EBITDA (Rs mn)	11,667	12,107	13,632
Adj. net profit (Rs mn)	10,491	10,681	11,965
Adj. EPS (Rs)	94.9	96.7	108.3
Consensus EPS (Rs)	94.9	108.9	125.0
Adj. ROAE (%)	11.4	10.3	10.4
Adj. P/E (x)	38.4	37.7	33.7
EV/EBITDA (x)	41.4	38.7	33.6
Adj. EPS growth (%)	81.6	1.8	12.0

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

Fig 1 – Earnings call highlights

Parameter	Q2FY25	Q1FY25	Our view
Domestic volumes	ESCORTS indicated growth for FY25 will be at a mid-single digit. H1 volumes were flat and the company expects H2 to grow at double digits with growth momentum starting from Oct'24. Growth in H2FY25 is fuelled by healthy rainfall, high reservoir levels, increase in MSP for rabi crops.	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. Management anticipates the domestic tractor industry may experience mid-single-digit growth in FY25.	ESC is losing market share consistently compared to its larger peers (that have grown in volume) and will continue to face challenges.
Exports	The tractor industry exported 24.5k tractors in Q2FY25 as against 25.9k in Q2FY24. ESCORTS's exports volume was at 1.23k tractors in Q2FY25 against 1.5k tractors in Q2FY24. Currently most of its exports are to Europe, which is facing recessionary pressures, with a revival expected from Q4FY25. ESCORTS will prioritise Mexican and Southeast Asian markets for which products are being developed. Further exports to the USA will depend on the commissioning of its greenfield project.	The tractor industry exported 24.5k tractors in Q1FY25 as against 24.2k in Q1FY24. ESCORTS's exports volume was at 0.96k tractors in Q1FY25 vs 1.35k 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 formal amalgamation with Kubota will give ESCORTS a better foothold in export markets. According to management, tapping US markets will be dependent on the availability of the greenfield capacity that is under expansion currently.
Margins	EBITDA margin was at 10.8% flat YoY, but fell QoQ. Q2FY25 represents post-merger impact due to which there is a 2% drag on the margins for 2QFY25. The bottomline was also impacted due to a one-time impact (Rs 0.91bn) resulting from change in long-term capital gain provision and impact of brought forward losses. Going forward there will not be any additional tax benefit. Employee expenses have increased due to increase in contractual labour for inventory buildup to cater to the festive demand.	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. Operating leverage is expected to drive improvement in margins as volumes pick up.	Margins will be impacted due to the elevated cost structure of the JV companies amalgamated with Escort Kubota in the near term. The hiving off of the Railway Equipment business will also impact the performance.
Other segments	Construction equipment volume at 1,394 machines was down 18.4% YoY, however marginally up QoQ by 0.9%. ESCORTS expects H2FY25 to turn around fuelled by the ESI Norms starting in Jan'25. The Railway Equipment business sold at 12x of profit for a consideration of Rs 16bn. ESCORTS had approached 34 bidders including overseas purchasers.	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. The 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.	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. However, hiving off the Railway Equipment business at below-par valuations will have an impact in the short term.
Regulations	ESI Norms expected to start in Jan'25 will not have a major impact on ESC volume.	Date for emission norms remains fixed, i.e, 1 April 2026, and there are no changes	ESCORTS has a lower presence in the high-end tractor segment and will see limited pricing impact from new norms.
Capex	Volume sales of 125k-130k units and can cater to demand of up to 175k units. However, ESCORTS is setting up a greenfield project and has submitted an expression of interest to the	No comments in Q1FY25 earnings call.	The ongoing capex is likely to be commissioned by FY27/28. Any meaningful reflection on the

Parameter	Q2FY25	Q1FY25	Our view
	Uttar Pradesh Government for capacity expansion to cater to future demand.		volume is visible only post the availability of extra capacity.
Merger	Q2FY25 also includes the merger with Escorts Kubota India and Kubota Agriculture Machinery, due to which there is a 2% drag in the margins for FY25 as these are operating at break-even level.	For the Kubota amalgamation, the merger has been reserved by the NCLT bench for the first week of Jul'24. ESCORTS expects to get this order and make it effective from 1 September 2024.	In the medium term margins are likely to be under pressure. Clarity, particularly on the exports business, is likely to emerge in the next three to four years following a complete branding revamp.
Other Information	ESCORTS repaid debt of ~Rs 3.5bn upon the merger. ESCORTS dealers have inventory levels of 35-37 days. Surplus cash management: Rs 0.35bn of debt repaid for JVs, greenfield project outflow of about Rs 45bn over four years, infusion of Rs 7bn in the finance arm. Other general capex and dividend increased to 40% of retained earnings.	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.	The capacity expansion is driven by healthy cash flows in the next two to three years. Any adverse impact may lead to debt funding to the project.

Source: Company, BOBCAPS Research

Fig 2 – Quarterly performance (Standalone)

(Rs mn)	Q2FY25	Q2FY24	YoY (%)	Q1FY25	QoQ (%)
Volume (units)	25,995	26,241	(0.9)	30,370	(14.4)
Avg. Realisation per Vehicle (Rs)	9,57,296	9,44,213	1.4	9,28,018	3.2
Net Revenues	24,885	24,777	0.4	28,184	(11.7)
Total Income (A)	**24,885**	**24,777**	**0.4**	**28,184**	**(11.7)**
Operating Expenses:					
Raw materials consumed	17,221	17,338	(0.7)	19,764	(12.9)
Employee Expenses	2,057	1,965	4.7	1,913	7.5
Other Expenses	2,960	2,832	4.5	2,830	4.6
Total Expenditure (B)	**22,238**	**22,135**	**0.5**	**24,507**	**(9.3)**
EBITDA (A-B)	**2,647**	**2,642**	**0.2**	**3,677**	**(28.0)**
Other Income	1,161	937	23.9	1,030	12.7
Depreciation	637	583	9.3	616	3.4
EBIT	3,171	2,996	5.8	4,091	(22.5)
Finance Costs	98	94	4.1	107	(8.5)
PBT after excep items	3,072	2,901	5.9	3,984	(22.9)
Tax expense	(171)	797	(121.5)	964	(117.7)
Reported PAT	**3,244**	**2,105**	**54.2**	**3,022**	**7.4**
Adjusted PAT	**3,243**	**2,105**	**54.1**	**3,020**	**7.4**
Adj EPS (Rs)	29.4	19.0	54.1	27.3	7.4
Key Ratios (%)			**(bps)**		**(bps)**
Gross Margin	30.8	30.0	77	29.9	92
EBITDA Margin	10.6	10.7	(3)	13.0	(241)
EBIT Margin	12.7	12.1	65	14.5	(177)
PBT Margin	12.3	11.7	64	14.1	(179)
Tax Rate	(5.6)	27.5	(3,302)	24.2	(2,975)
Adj PAT Margin	13.0	8.5	454	10.7	232

Source: Company, BOBCAPS Research | Note: Includes impact of amalgamation with the JV partners

Valuation methodology

ESCORTS' tractor volumes stayed muted by ~1% YoY, though MM grew by 4% YoY – indicating ESCORTS has lost domestic market share. The amalgamation impact on margins due to higher cost structure will remain for the medium term. The margin impact will be ~1-2% in the medium term. Further, we believe the hiving-off impact of the remunerative Railway Equipment (RE) division will also impact the FY26/FY27 earnings trajectory. The combined impact is reflected in our earnings revisions for FY25/FY26/FY27. The full benefit of the Kubota integration on export sales is likely to flow in only after 12-24 months.

To reflect the same, we lower our FY25/FY26/FY27 EPS estimates by 10%/10%/3%, now baking in a Revenue/EBITDA/PAT CAGR of 15%/12%/11% for ESCORTS over FY24-FY27E. Effectively, we retain our SELL rating and revise our TP to Rs 2,426 (from Rs 2,514). Our target P/E stays at 20x – at a marginal premium to 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	1,07,756	1,14,140	1,33,584	1,00,054	1,18,119	1,35,870	7.7	(3.4)	(1.7)
EBITDA	12,107	13,632	16,555	13,831	15,779	17,922	(12.5)	(13.6)	(7.6)
Adj PAT	10,681	11,965	14,266	1,00,054	1,18,119	1,35,870	(9.6)	(9.6)	(2.6)
Adj EPS (Rs)	97	108	129	13,831	15,779	17,922	(9.7)	(9.8)	(2.9)

Source: BOBCAPS Research

Fig 4 – Key assumptions

Parameter	FY24A	FY25E	FY26E	FY27E
Volumes	1,00,075	1,12,627	1,22,764	1,33,813
Blended Realisation (Rs)	6,41,776	6,61,029	6,89,123	7,20,133
EBITDA (Rs mn)	11,667	12,107	13,632	16,555
EBITDA margin (%)	13.3	13.9	13.5	13.5
Adj. PAT (Rs mn)	10,491	10,681	11,965	14,266
EPS (Rs)	94.0	97.0	108.0	129.0

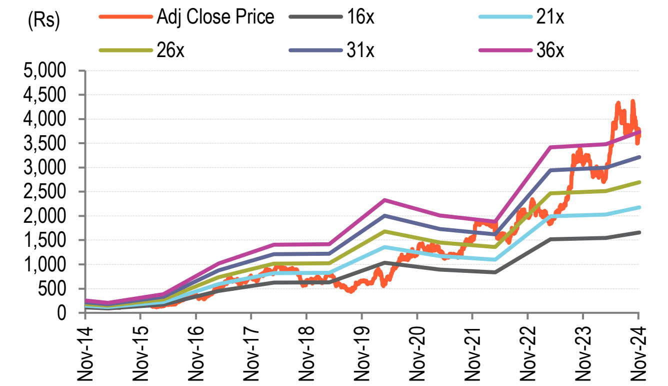
Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EPS (Rs)		ROE (%)	
				FY26E	FY27E	FY26E	FY27E
Escorts Kubota	ESCORTS IN	SELL	2,426	12.6	12.1	12.0	11.9
VST Tillers Tractors	VSTT IN	SELL	3,420	158.5	183.5	11.9	12.3
Mahindra & Mahindra	MM IN	BUY	3,344	118.8	129.7	21.1	19.4

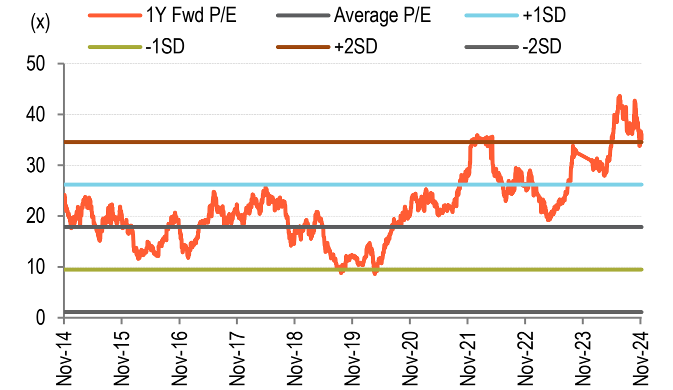
Source: BOBCAPS Research

Fig 6 – P/E band: We value Escorts at 20x FY27E 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 easing of commodity prices than anticipated.

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY23A	FY24A	FY25E	FY26E	FY27E
Total revenue	**84,287**	**88,496**	**1,07,756**	**1,14,140**	**1,33,584**
EBITDA	7,775	11,667	12,107	13,632	16,555
Depreciation	1,399	1,669	1,799	1,923	2,060
EBIT	9,084	13,984	14,392	15,913	18,836
Net interest inc./(exp.)	(133)	(137)	(150)	(170)	(187)
Other inc./(exp.)	2,809	3,986	4,084	4,204	4,342
Exceptional items	(531)	0	0	0	0
EBT	8,346	14,010	14,242	15,743	18,649
Income taxes	1,979	3,519	3,560	3,778	4,382
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	**6,367**	**10,491**	**10,681**	**11,965**	**14,266**
Adjustments	531	0	0	0	0
Adjusted net profit	**6,897**	**10,491**	**10,681**	**11,965**	**14,266**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY23A	FY24A	FY25E	FY26E	FY27E
Accounts payables	13,427	12,746	12,756	6,919	7,224
Other current liabilities	3,485	5,409	14,323	21,449	25,929
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	1,02,251	1,13,553	1,27,156
Shareholders' fund	81,829	91,724	1,03,356	1,14,658	1,28,261
Total liab. and equities	**1,00,206**	**1,11,520**	**1,32,239**	**1,45,007**	**1,63,592**
Cash and cash eq.	4,719	11,790	18,936	20,119	23,717
Accounts receivables	11,797	11,732	13,875	13,603	15,371
Inventories	12,177	12,181	12,990	14,072	16,103
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	19,626
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**	**1,32,239**	**1,45,007**	**1,63,592**

Cash Flows

Y/E 31 Mar (Rs mn)	FY23A	FY24A	FY25E	FY26E	FY27E
Cash flow from operations	**863**	**10,236**	**13,925**	**9,670**	**12,430**
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	4,342
Cash flow from investing	**1,240**	**(2,393)**	**(7,883)**	**(7,996)**	**(8,358)**
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**	**6,842**	**843**	**3,223**
Closing cash & cash eq.	**4,719**	**11,790**	**18,936**	**20,119**	**23,717**

Per Share

Y/E 31 Mar (Rs)	FY23A	FY24A	FY25E	FY26E	FY27E
Reported EPS	52.3	94.9	96.7	108.3	129.1
Adjusted EPS	52.3	94.9	96.7	108.3	129.1
Dividend per share	5.8	6.9	6.0	6.0	6.0
Book value per share	620.5	830.5	935.7	1,038.0	1,161.1

Valuations Ratios

Y/E 31 Mar (x)	FY23A	FY24A	FY25E	FY26E	FY27E
EV/Sales	5.6	5.5	4.3	4.0	3.4
EV/EBITDA	60.8	41.4	38.7	33.6	27.6
Adjusted P/E	69.7	38.4	37.7	33.7	28.2
P/BV	5.9	4.4	3.9	3.5	3.1

DuPont Analysis

Y/E 31 Mar (%)	FY23A	FY24A	FY25E	FY26E	FY27E
Tax burden (Net profit/PBT)	82.6	74.9	75.0	76.0	76.5
Interest burden (PBT/EBIT)	91.9	100.2	99.0	98.9	99.0
EBIT margin (EBIT/Revenue)	10.8	15.8	13.4	13.9	14.1
Asset turnover (Rev./Avg TA)	106.8	102.0	110.4	104.7	109.9
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.0	1.0	1.0
Adjusted ROAE	8.7	12.1	10.9	11.0	11.7

Ratio Analysis

Y/E 31 Mar	FY23A	FY24A	FY25E	FY26E	FY27E
YoY growth (%)					
Revenue	16.4	5.0	21.8	5.9	17.0
EBITDA	(18.3)	50.1	3.8	12.6	21.4
Adjusted EPS	(6.4)	81.6	1.8	12.0	19.2
Profitability & Return ratios (%)					
EBITDA margin	9.2	13.2	11.2	11.9	12.4
EBIT margin	10.8	15.8	13.4	13.9	14.1
Adjusted profit margin	8.2	11.9	9.9	10.5	10.7
Adjusted ROAE	8.4	11.4	10.3	10.4	11.1
ROCE	8.8	12.1	11.1	11.1	11.9
Working capital days (days)					
Receivables	43	49	43	44	40
Inventory	45	50	43	43	41
Payables	69	78	65	47	29
Ratios (x)					
Gross asset turnover	0.4	0.4	0.3	0.3	0.3
Current ratio	1.8	2.0	1.8	1.8	1.7
Net interest coverage ratio	(68.5)	(101.9)	(95.9)	(93.6)	(100.7)
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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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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