

Industry  
Bloomberg  
BSE CODE

Automobiles  
ESC IN  
500495

## Challenging demand environment for tractor industry; robust guidance for exports

RATING	BUY
CMP	469
Price Target	607
Potential Upside	29%
Rating Change	
Estimate Change	
Target Change	

STOCK INFO	
52wk Range H/L	944/459
Mkt Capital (Rs Cr)	5748
Free float (%)	60%
Avg. Vol 1M (,000)	2359
No. of Shares (Crs)	12
Promoters Pledged %	0%

### 1QFY20 Result Update

- ESCORTS reported a decline in sales by 5.8% YoY to Rs.1423 crores (vs our estimates of Rs.1415 crores) in 1QFY20.
- Agri Machinery segments revenue de-grew by 7%YoY to Rs.1092 crores on account of 14%YoY decline in volume growth. However, realization grew by 8% YoY on account of price hikes taken to pass on the commodity pressure.
- Construction equipment segments revenue de-grew by 14% YoY to Rs.212 crores largely on the back of 21% YoY decline in volumes. However, realization grew by 9% YoY.
- On the other hand, railways business revenue grew by 34%YoY to Rs.118 crores on the back of strong order book execution.
- Gross margins declined by 18 bps to 31% despite softening of commodity prices. EBITDA margin declined by 162 bps QoQ to 10% due to weaker operating leverage. There was inventory correction made by the company during the quarter which impacted margins.
- PAT declined by 26.8% YoY to Rs.88 crores (vs our estimates of Rs.105 crores). PAT margin declined by 129 bps QoQ to 6.1% due to higher depreciation expense and decline in EBITDA margins.
- On the railway equipment side the company has an order book of more than Rs.400 crores and it will be executed in the next 13-15 months.

### View and Valuation

The management expects demand scenario for the tractor industry to be subdued for FY20. However the company is expected to perform better than industry. On the export front management seemed confident with minimum 20%YoY growth guidance. Going ahead we expect margins to remain under pressure in FY20 due to weaker operating leverage. However 70-80bps margin expansion can be seen in FY21 based on better growth prospects across segments. Construction equipment and railways division may see uptick in demand with new product launches and government spending. Factoring the near to mid-term demand weakness and margin compression on tractor side we reduce our FY20/21 EPS estimate by 7/3%. We value ESCORTS at 14x (earlier 15x) FY21e EPS to arrive at target price of Rs.607 and maintain BUY.

### Key Risks to our rating and target

- Slowdown in tractor industry
- Sharp increase in commodity prices

### RESEARCH ANALYST

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Fig in Rs Cr

KEY FINANCIAL/VALUATIONS	FY17	FY18	FY19	FY20E	FY21E
Net Sales	4145	5059	6262	6624	7106
EBITDA	309	554	725	724	833
EBIT	246	480	637	634	727
PAT	131	347	477	460	531
EPS (Rs)	11	28	39	38	43
EPS growth (%)	86	166	38	(3)	15
ROE (%)	8	16	18	15	15
ROCE (%)	15	22	24	21	20
BV	132	181	218	251	291
P/B (X)	4.1	4.9	3.0	1.9	1.6
P/E (x)	50.6	31.1	16.6	12.5	10.8

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## Result below expectation

### 1QFY20 Results

Fig in Rs Cr

FINANCIALS	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	YoY %	QoQ%	FY18	FY19	YoY %
Net Sales	1,511	1,398	1,655	1,632	1,423	-6%	-13%	5,059	6,262	24%
Other Income	17	22	24	17	17	-2%	-4%	65	92	41%
Total Income	1,528	1,420	1,679	1,649	1,440	-6%	-13%	5,125	6,354	24%
COGS	1,022	944	1,151	1,123	982	-4%	-13%	3,397	4,277	26%
Staff Cost	121	113	120	118	123	1%	4%	442	485	10%
Other Exp.	183	184	184	201	176	-4%	-12%	666	776	16%
Expenditure	1,326	1,241	1,455	1,442	1,281	-3%	-11%	4,506	5,537	23%
EBITDA	186	157	200	190	142	-23%	-25%	554	725	31%
Depreciation	21	21	22	22	24	17%	11%	73	87	19%
EBIT	165	136	179	168	118	-28%	-30%	480	637	33%
Interest	3	4	4	7	6	104%	-22%	29	20	-34%
PBT	179	154	199	178	129	-28%	-27%	516	710	38%
Excpt. Item	-	-	(11)	-	-	0%	0%	7	(6)	0%
Tax	60	52	70	56	42	-30%	-26%	162	237	46%
PAT	120	103	140	121	88	-27%	-28%	347	477	38%

#### Decline in revenue growth led by lower volumes

The company reported a decline in sales by 5.8% YoY to Rs.1423 crores in 1QFY20. Agri Machinery segments revenue de-grew by 7%YoY to Rs.1092 crores on account of 14%YoY decline in volume growth led by slowdown in tractor industry. However, realization grew by 8% YoY. EBIT margin stood at 10.9%. Construction equipment segments revenue de-grew by 14% YoY to Rs.212 crores largely on the back of 21% YoY decline in volumes due to slow down in the infrastructure industry. However, realization grew by 9% YoY. The segment EBIT margin was correspondingly up by 13 bps and stood at 2.5%.

The railways business revenue grew by 34%YoY to Rs.118 crores on the back of strong order book execution. The company's order book stands at Rs.400 crores which will get executed over next 13-15 months. Railways division margins stand at 20% during 1QFY20.

#### Weaker operating leverage led to decline in margins

Gross margins declined by 18 bps to 31% despite softening of commodity prices. EBITDA margin have declined by 162 bps QoQ to 10% due to weaker operating leverage. There was inventory correction made by the company during the quarter which impacted margins.

#### PAT margin declined due to decline in EBITDA margins

PAT declined by 26.8% YoY to Rs.88 crores. PAT margin declined by 129 bps QoQ to 6.1% due to higher depreciation expense and decline in EBITDA margins.

## Concall Highlights

### Tractor Industry :-

- The industry is expected to see decline in growth in FY20. In Q1FY20, domestic industry was down by 15% YoY.
- The overall sentiment continue to remain negative due to delayed monsoon, lower sowing, lower construction activities, lower reservoir level and lower subsidy based sales in Southern and Western regions.
- 2QFY20 is expected to be better from September month led by festive season demand.
- Industry in Q1FY20 on Y-o-Y basis in North and central region de-grew by 2%, whereas industry de-grew by 31% in South and west region.
- The new regulation of registration of tractors started in Bihar is expected to be enforced in other states as well going forward.

### Agri Machinery Business :-

- The company is expected to grow better than the industry in FY20.
- 2QFY20 is expected to improve from September led by festive season which may improve the demand. In July and August, no revival is expected; only marginal improvement in demand is expected to be seen in some parts of the country.
- Tractor exports guidance for FY20 is expected to be minimum 20%YoY.
- There will be no major subsidy scheme coming in 2QFY20 except in Assam and Gujarat; the impact on volumes will come in from 3QFY20 and 4QFY20.
- The company has made channel inventory correction during the quarter which has impact on margins.
- The domestic market share stands at 10.5% in 1QFY20 which was down from 10.7% due to lower sentiments.
- The non tractor based (spare parts and implements) segment grew by 8% YoY in 1QFY20. The company is focusing on increasing its product portfolio in farm implements.
- The company has not taken discounts in 1QFY20. Some discounts have been provided, especially in the northern markets due to lower demand sentiments.
- There was a price increase of 1% taken in April in this segment.
- The company has made new launches in smaller compact segment tractors which are receiving good customer response and will further help to improve demand.
- Dealer inventory level stands at 2-3 weeks. There will be temporary increase in inventory level in September during festive season.

### Construction Equipment Business:-

- The construction equipment segment has seen some slowdown on account of financing issues and delayed payments for ongoing infra projects. However, further spending on infrastructural development will help the industry to revive soon.
- The total volumes, traded and manufacturing products were correspondingly down by 20.7% in 1QFY20.
- The company is planning to expand its product portfolio in this segment.
- There will be 3 new launches in cranes and 1 new launch in earth moving in October 2019.

### Railway Business

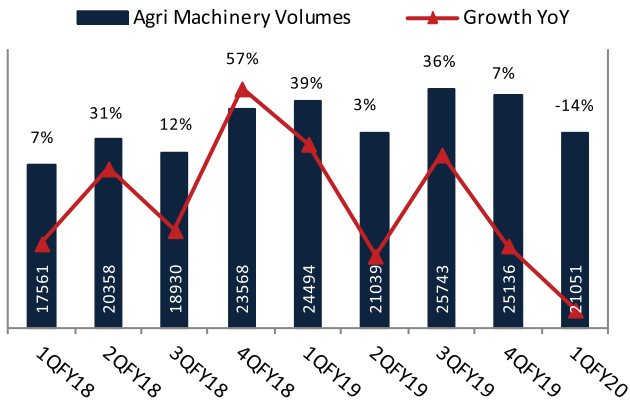
- The management expects to post 15-20% growth in railways business in FY20.
- Order book during the quarter is more than Rs.400 crores and will be executed in the next 13-15 months.
- Margins are expected to come down going forward due to higher share of new products.
- The company has received orders for brake systems and couplers which is expected to be commercialized next year.

### Other Highlights:-

- Capex guidance - Rs.250-300 crores for FY20 (Rs.150 crores towards product development and capacity expansion and rest to be spent as routine capex).
- Production level in 1QFY20 was down by 15-20%. For full year FY20, the capacity utilization is expected to be in the range of 80-85%.
- Average debtor days are expected to be 28-29 days during the festive season.

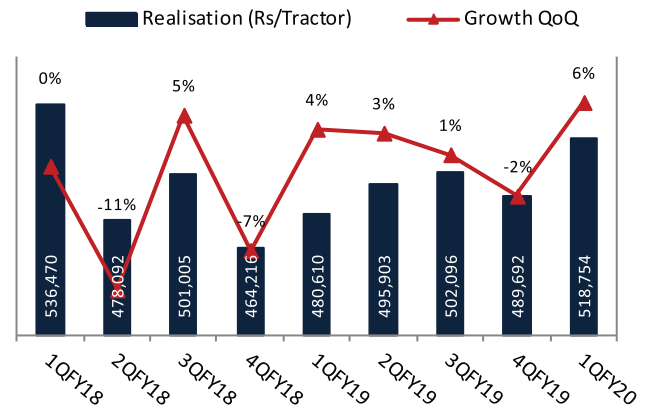
## Exhibit: Escorts Agri-Machinery Volume Trend

Volume growth declined by 14% YoY due to slowdown in demand sentiments across various markets



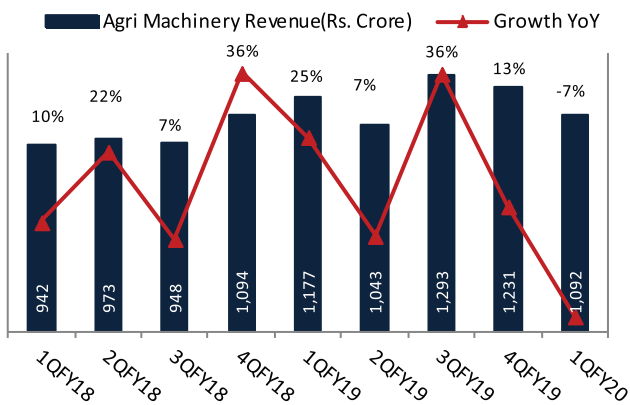
## Exhibit: Escorts Agri-Machinery Realisation Trend

Realization improved by 6% QoQ due to price hikes taken by the company



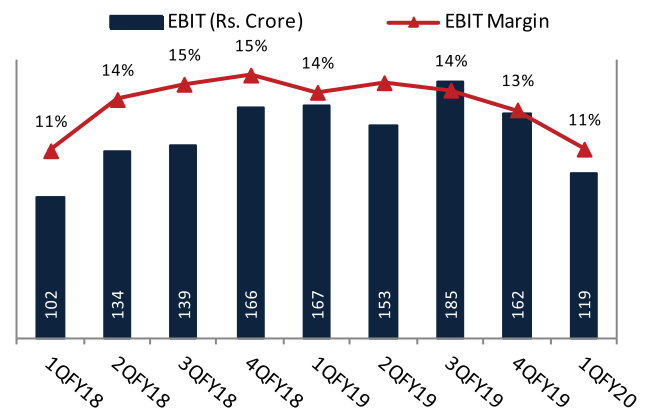
## Exhibit: Escorts Agri-Machinery Revenue Trend

Revenue growth declined due to lower sales in exports and domestic market



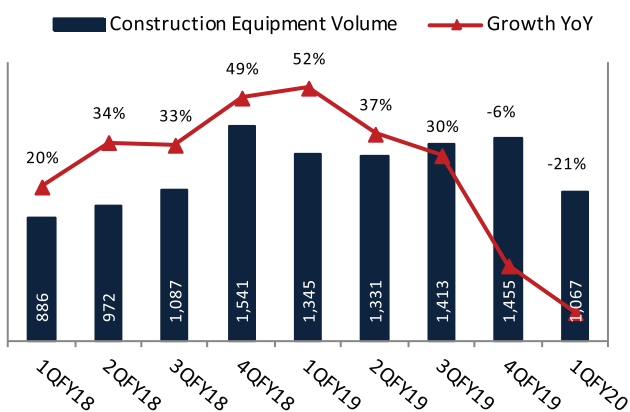
## Exhibit: Escorts Agri-Machinery EBIT & EBIT Margin

Margins declined due to foreign exchange fluctuation and inventory corrections made



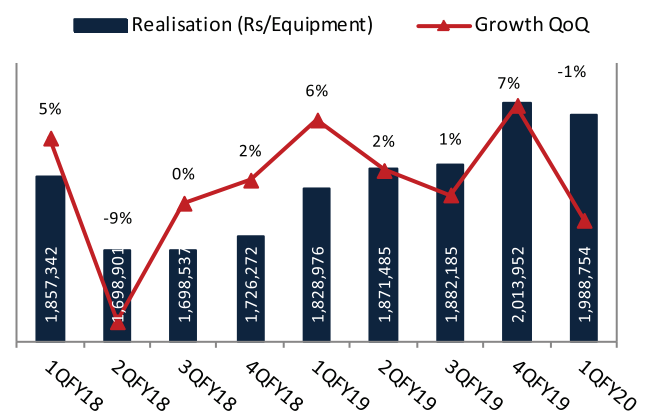
## Exhibit: Escorts Construction Equipment Volume Trend

Construction equipment volumes declined by 6% YoY due to liquidity crisis and pending payments on infra projects



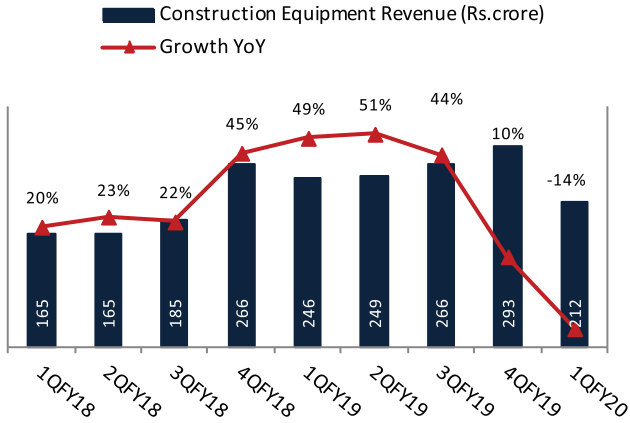
## Exhibit: Escorts Construction Equipment Realisation

Shift in product mix towards lower realisation products led to 1% QoQ decrease.



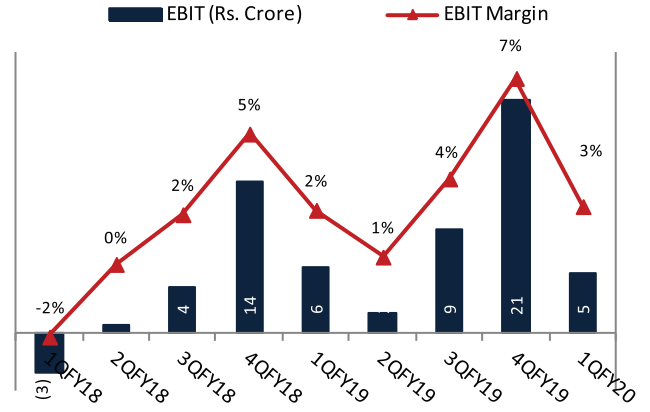
## Exhibit: Escorts Construction Equipment (ECE) Revenue

Revenue de-grew by 14%YoY due to slowdown led by liquidity crisis and pending payments on infra projects



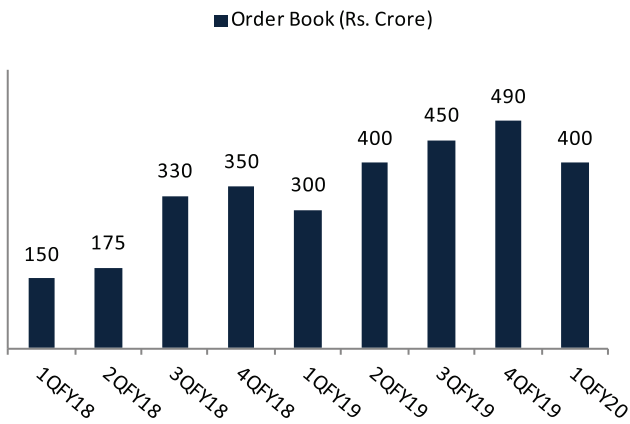
## Exhibit: ECE EBIT Margin

Margins declined due to weaker operating leverage



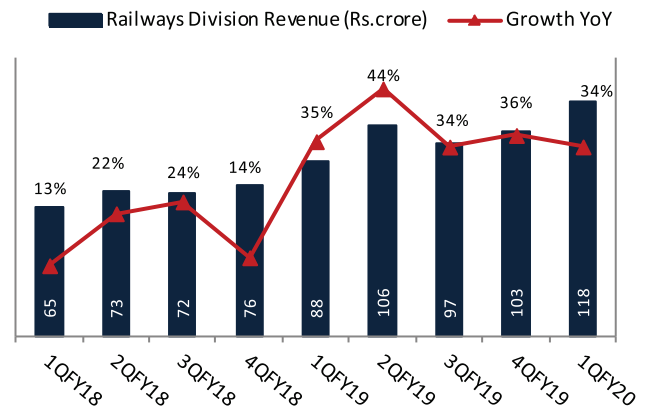
## Exhibit: Escorts Railway Division Order Book

The company's order book stands at Rs.400 crores which will get executed over a period of 13-15 months



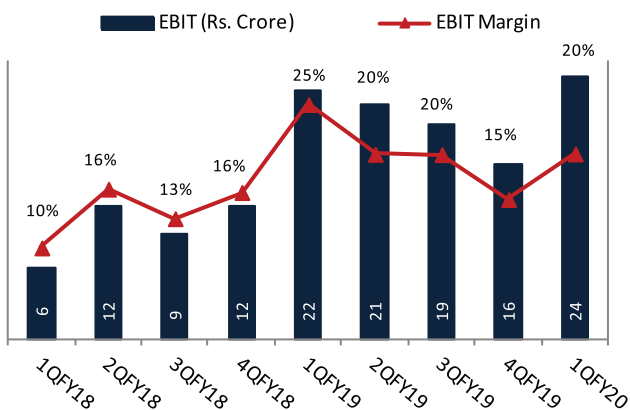
## Exhibit: Escorts Railway Division Revenue Trend

Higher revenue on account of higher order execution during the quarter



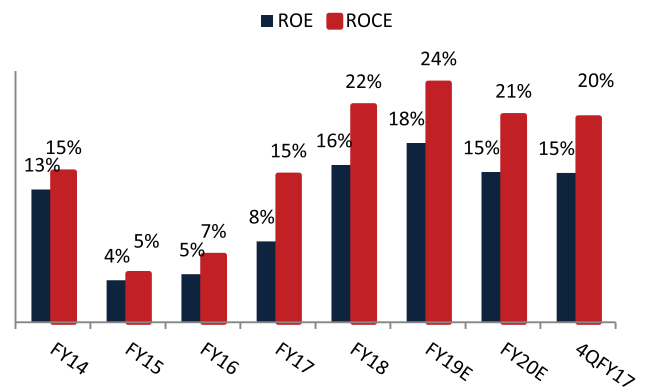
## Exhibit: Escorts Railway Division EBIT and EBIT Margin

Margins remained at 20% level due to introduction of higher margin products



## Exhibit: RoE and RoCE Trend

Increase in profitability will lead to expansion in return ratios going ahead



## Financial Details

### Balance Sheet

Fig in Rs Cr

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Share Capital	119	119	123	123	123	123	123	123
Reserves	1,746	1,711	1,344	1,498	2,093	2,551	2,958	3,448
Networth	1,866	1,831	1,466	1,621	2,215	2,673	3,081	3,571
Debt	352	411	315	218	15	273	202	151
Other Non Cur Liab	191	163	57	51	60	107	108	110
Total Capital Employed	2,011	1,937	1,556	1,680	2,230	2,677	3,081	3,571
Net Fixed Assets (incl CWIP)	1,692	1,651	1,597	1,592	1,630	1,704	1,904	2,068
Non Cur Investments	368	367	30	38	50	2	2	2
Other Non Cur Asst	94	96	118	109	141	232	232	232
Non Curr Assets	2,154	2,115	1,746	1,739	1,820	1,938	2,138	2,302
Inventory	587	453	433	450	566	857	871	934
Debtors	372	414	375	456	592	931	907	973
Cash & Bank	271	251	253	244	317	243	370	579
Other Curr Assets	10	13	103	103	151	300	317	340
Curr Assets	1,488	1,388	1,189	1,445	2,144	2,756	3,028	3,425
Creditors	870	738	751	910	1,234	1,249	1,361	1,460
Provisons (both)	82	89	133	132	133	120	127	136
Other Curr Liab	263	256	89	118	125	132	140	150
Curr Liabilities	1,215	1,083	1,103	1,308	1,684	1,649	1,776	1,895
Net Curr Assets	273	305	86	138	460	1,107	1,252	1,530
Total Assets	3,642	3,503	2,944	3,199	3,973	4,708	5,166	5,727

### Income Statement

Fig in Rs Cr

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
<b>Revenue from Operation</b>	<b>6,502</b>	<b>4,113</b>	<b>3,432</b>	<b>4,145</b>	<b>5,059</b>	<b>6,262</b>	<b>6,624</b>	<b>7,106</b>
Change (%)	61	(37)	(17)	21	22	24	6	7
Other Income	83	65	61	47	65	92	69	75
<b>EBITDA</b>	<b>387</b>	<b>163</b>	<b>161</b>	<b>309</b>	<b>554</b>	<b>725</b>	<b>724</b>	<b>833</b>
Change (%)	104	(58)	(1)	92	79	31	(0)	15
<b>Margin (%)</b>	<b>6.0</b>	<b>4.0</b>	<b>4.7</b>	<b>7.5</b>	<b>10.9</b>	<b>11.6</b>	<b>10.9</b>	<b>11.7</b>
Depr & Amor.	86	69	58	63	73	87	90	106
EBIT	301	94	103	246	480	637	634	727
Int. & other fin. Cost	112	58	51	32	29	20	21	15
<b>EBT</b>	<b>272</b>	<b>101</b>	<b>113</b>	<b>261</b>	<b>516</b>	<b>710</b>	<b>682</b>	<b>787</b>
Exp Item	(3)	31	(5)	(29)	7	(6)	-	-
Tax	28	(6)	12	77	162	237	222	256
Minority Int & P/L share of Ass.	(0)	0	-	-	-	-	-	-
<b>Reported PAT</b>	<b>247</b>	<b>76</b>	<b>70</b>	<b>131</b>	<b>347</b>	<b>477</b>	<b>460</b>	<b>531</b>
<b>Adjusted PAT</b>	<b>247</b>	<b>76</b>	<b>70</b>	<b>131</b>	<b>347</b>	<b>477</b>	<b>460</b>	<b>531</b>
Change (%)	234	(69)	(8)	86	166	38	(3)	15
<b>Margin(%)</b>	<b>3.8</b>	<b>1.9</b>	<b>2.0</b>	<b>3.1</b>	<b>6.9</b>	<b>7.6</b>	<b>7.0</b>	<b>7.5</b>

## Financial Details

### Key Ratios

Fig in Rs Cr

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
ROE	13%	4%	5%	8%	16%	18%	15%	15%
ROCE	15%	5%	7%	15%	22%	24%	21%	20%
Asset Turnover	1.79	1.17	1.17	1.30	1.27	1.33	1.28	1.24
Debtor Days	21	37	40	40	43	54	50	50
Inv Days	33	40	46	40	41	50	48	48
Payable Days	49	66	80	80	89	73	75	75
Int Coverage	3	2	2	8	16	33	-	-
P/E	6	20	24	51	31	17	13	11
Price / Book Value	1	1	1	4	5	3	2	2
EV/EBITDA	3	8	12	22	20	11	8	7
FCF/Share	38	5	21	30	46	(10)	81	73

### Cash Flow Statement

Fig in Rs Cr

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
PBT	275	70	73	190	509	710	682	787
(inc)/Dec in Working Capital	3	(119)	37	55	(18)	(894)	121	(32)
Non Cash Op Exp	86	69	61	65	73	87	90	106
Int Paid (+)	93	50	54	36	22	20	21	15
Tax Paid	(62)	(21)	7	(44)	(102)	(237)	(222)	(256)
others	(71)	(45)	(20)	2	(15)	1	14	-
CF from Op. Activities	324	5	212	304	460	(280)	706	620
(inc)/Dec in FA & CWIP	(125)	(55)	(49)	(66)	(105)	(161)	(290)	(270)
Free Cashflow	200	(50)	164	238	355	(441)	416	350
(Pur)/Sale of Inv	1	(0)	(3)	(161)	(311)	95	(138)	(35)
others	54	30	7	73	34	-	-	-
CF from Inv. Activities	(70)	(26)	(45)	(155)	(374)	(18)	(428)	(305)
inc/(dec) in NW	-	0	-	-	-	-	-	-
inc/(dec) in Debt	(115)	59	(132)	(103)	(213)	258	(71)	(50)
Int. Paid	(94)	(50)	(46)	(29)	(22)	(20)	(21)	(15)
Div Paid (inc tax)	(25)	(6)	(13)	(13)	(16)	(36)	(35)	(41)
others	5	(1)	(1)	31	250	-	-	-
CF from Fin. Activities	(230)	1	(191)	(113)	(1)	202	(127)	(106)
Inc(Dec) in Cash	24	(19)	(24)	36	85	(96)	151	209
Add: Opening Balance	145	271	56	33	69	317	243	370
Closing Balance	170	251	32	69	154	239	376	561

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Disclosure of Interest Statement-

Analyst's ownership of the stocks mentioned in the Report	NIL
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Registration details of Company: Narnolia Financial Advisors Ltd. (NFAL): SEBI Stock Broker Registration: INZ000166737 (NSE/BSE/MSEI); NSDL/CDSL: IN-DP-380-2018; Research Analyst: INH300006500, Merchant Banking: (Registration No.: INM000010791), PMS: (Registration No.: INP000002304), AMFI Registered Mutual Fund distributor: ARN 3087

Registration Details of Group entities: G. Raj & Company Consultants Ltd (G RAJ)-BSE Broker INZ260010731; NSDL DP: IN-DP-NSDL-371-2014 || Narnolia Commerze Limited (Formerly Microsec Commerze Ltd.)-MCX/NCDEX Commodities Broker: INZ000051636 || NarnoliaVeloX Advisory Ltd.- SEBI Registered PMS: INP000005109 || Eastwind Capital Advisors Pvt Ltd. (EASTWIND)-SEBI Registered Investment Adviser: INA300005439 || Narnolia Insurance Brokers Limited (Formerly Microsec Insurance Brokers Ltd.)-IRDA Licensed Direct Insurance Broker (Life & Non-Life) Certificate No. 134, License No. DB046/02 || Narnolia Securities Ltd. (NSL)-AMFI Registered Mutual Fund distributor: ARN 20558, PFRDA NPS POP: 27092018 || Narnolia Capital Advisors Pvt. Ltd. - RBI Registered NBFC:B.05.02568.

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