BP Wealth | STOXBOX

Result Update

Q2 FY24

Escorts Kubota Ltd.

Institutional Research

Escorts Kubota Ltd.

Automobiles | Q2FY24 Result Update **06th November, 2023**

Result Highlights

Escorts Kubota Limited (EKL) released Q2FY24 results that were largely in line with market expectations, albeit with slight discrepancies in key efficiency indicators. During the second quarter, EKL observed a 12.1% QoQ decline in revenue to Rs. 2,046 crores, compared to an estimated figure of Rs. 2,080 crores. This dip was primarily driven by 16.4% and 21.3% sequential decline in revenue from the agri machinery products (AMP) and railway equipment segments, respectively, with the fall limited by a 15.5% rise in revenue from the construction equipment segment. The 17.1% QoQ / 7.1% YoY decline in tractor volumes can be attributed to the delayed monsoon, a high base effect, and a shift in the timing of the festive season. Despite a 21.3% QoQ decrease in EBITDA to Rs. 261 crores (versus market estimates of Rs. 268 crores), EKL managed to achieve a 210 bps expansion in gross margin to 30.2%. However, the EBITDA margin witnessed a contraction of 120 bps to 12.9% due to limited operating leverage. EKL's construction equipment division showed a turnaround and posted its highest-ever volume, revenue, and EBIT owing to better operating leverage in the segment and the softening of commodity prices. Meanwhile, the company's PAT registered a 16.9% QoQ decline, amounting to Rs. 235 crores, exceeding the estimated figure of Rs. 228 crores. Looking ahead, EKL's management has guided a modest +/-2% growth in the tractor industry for FY24, with optimism surrounding the prospects of a promising festive season in 2023. The ongoing amalgamation process with Kubota's local entities is progressing as planned, while the establishment of an in-house financing arm anticipated to bolster the company's market presence in certain areas. EKL remains reliant on the Kubota channel for 30-32% of its export activities.

Key Highlights

Particulars (Rs. mn)	Q2FY23	Q1FY24	Q2FY24	YoY (%)	QoQ (%)
Net Sales	18,835	23,277	20,462	8.6%	-12.1%
Gross profit	5,198	7,030	6,609	27.1%	-6.0%
Gross margin (%)	27.6%	30.2%	32.3%	470bps	210bps
EBITDA	1,527	3,269	2,633	72.4%	-19.5%
OPM (%)	8.1%	14.0%	12.9%	476bps	(118bps)
Adj. PAT	877	2,828	2,350	168.1%	-16.9%
EPS (Rs.)	6.8	23.2	21.7	220.9%	-6.4%

Source: Company, BP Equities Research

Sector Outlook	Positive

Stock

CMP (Rs.)	3,078
BSE code	500495
NSE Symbol	ESCORTS
Bloomberg	ESCORTS IN
Reuters	ESCO.BO

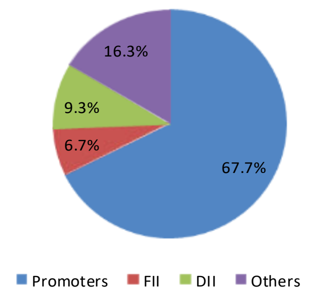
Key Data

Nifty	19,412
52 Week H/L (Rs.)	3,435 / 1,810
O/s Shares (Mn)	110.5
Market Cap (Rs. bn)	340
Face Value (Rs.)	10

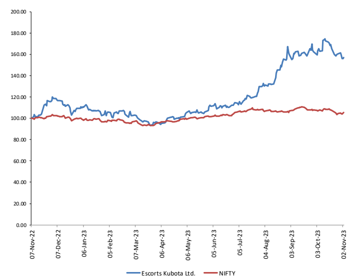
Average Volume

3 months	528,070
6 months	402,420
1 year	392,540

Share Holding (%)



Relative Price Chart



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Valuation and Outlook

Escorts Kubota Limited (EKL) is anticipated to witness a favourable growth trajectory in the upcoming quarters, primarily propelled by several strategic initiatives. Notably, the company's decision to implement a price hike in Q2FY24, resulting in a cumulative increase of 1.7% in the first half of the year, is expected to have a substantial impact in the upcoming quarter. Moreover, the company's exports are projected to exhibit robust performance in FY26 , especially with the entry into the US markets. In the context of the competitive landscape, EKL is proactively planning the introduction of new product lines, positioning itself to compete effectively across major markets and key segments. The expected shortening of the replacement cycle in the tractor industry is predicted to drive volume growth in the medium term, and the establishment of an in-house NBFC is poised to fortify EKL's sales performance. Moreover, the anticipated rise in infrastructure spending is expected to drive the company's construction equipment business, ultimately bolstering non-agricultural tractor sales. Additionally, the railway division is poised for double-digit growth, aided by the introduction of new product lines. Leveraging Kubota's global distribution network is bound to enhance EKL's export potential, especially considering the substantial contribution of 30-32% of exports through Kubota's global network in FY23. EKL's access to global best practices and research and development facilities via its partnership with Kubota is set to reinforce its capacity to produce and deliver innovative products at competitive propositions. With a comprehensive view of the company's prospects, we maintain a positive stance on EKL, considering the synergy benefits arising from the collaboration with Kubota, the strategic emphasis on margin expansion, the multinational corporation (MNC) strategy, and the envisaged momentum in the railway and construction segments.

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Key Concall Highlights

Agri Machinery Products (AMP) Segment:

- The tractor industry was weak in Q2FY24 due to a high base, erratic monsoon, and a shift in the festive season. Although a declining trend in commodity prices is beneficial, profitability was hampered by a lack of operating leverage.
- Management has guided for +/- 2% growth for the tractor industry in FY24 (-3.7% in H1FY24) and expects that the industry to grow by 2-3% YoY in Q3FY24 and register marginal growth in Q4FY24.
- The timeline for the implementation of TREM 4 norms may extend from the current timeline of April 24. The new norms would increase the costs significantly in the below 40 HP segment.
- The merger of Kubota's local entities would result in an expansion of the overall margin due to the increase in localization and other synergy benefits including a rise in the efficient procurement of raw materials.
- Dealer inventory is expected to come down to 4-4.5 weeks at the end of the festive season from 5 -5.5 weeks at the start of the festive season. Escorts is focussing more on the retail market's share and claims that its retail market share is higher than that of the wholesale market share.
- Greater than 40 HP tractors constituted 61% (similar to Q1) of its domestic sales.
- Discount levels remain high during the festive period and would normalize post the festive season. EKL is not planning to extend discount benefits to clear out inventory post the festive season.
- Higher festival spending observed in the Central and Northern regions augurs well for EKL as they have a strong presence in those areas.
- Given that FY25 would be an election year, the management is hoping for some kind of sops/ benefits to be announced by the government for the rural segment before the elections, which would be supportive for the tractor segment.
- Export volumes are expected to be strong in FY26 on possible entry into the US.

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Construction Equipment (CE) Segment:

- The CE segment continues to benefit from the government's expenditure on the infra segment.
- EBIT margin improvement can largely be attributed to the declining raw material cost trend.
- Management expects its H1FY24 performance to sustain in H2FY24.

Railway Equipment (RE) Segment:

- New product introduction is driving the performance of the segment.
- The order book in the segment has come down to Rs. 870 crores in Q2FY24 from Rs. 950 crores in Q1FY24 on higher execution of orders.
- RE segment is getting the benefit of the introduction of new products as new products constitute a significant portion of its revenue.
- The company is aiming for double-digit growth and expects to maintain margins within a range of +/-200 bps from the current level of 18.5%.

Key Financials					
YE March (Rs. mn)	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**
Net Sales	67,921	69,957	81,726	97,343	1,10,593
Growth %	20.2%	3.0%	16.8%	19.1%	13.6%
EBIDTA	11,299	9,513	7,804	12,861	15,009
Growth%	67.1%	-15.8%	-18.0%	64.8%	16.7%
Net Profit	8,290	6,851	5,395	11,011	12,700
Growth %	-35.6%	-17.4%	-21.3%	104.1%	15.3%
Diluted EPS	64.54	52.54	41.49	99.49	118.09
Profitability & Valuation					
EBIDTA (%)	16.6%	13.6%	9.5%	13.2%	13.6%
NPM (%)	12.2%	9.8%	6.6%	11.3%	11.5%
ROE (%)	19.7%	11.5%	7.4%	12.3%	12.7%
ROA (%)	14.0%	9.2%	6.2%	8.7%	9.8%
P/E (x)	47.7	58.6	74.2	30.9	26.1
EV/EBITDA (x)	12.8	18.4	29.1	24.4	20.9
Net Debt/EBITDA (x)	-2.6	-5.0	-2.8	-2.5	-2.3

Source: Company, BP Equities Research

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Disclaimer Appendix

Analyst (s) holding in the Stock : Nil

Analyst (s) Certification:

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