

## Kubota on-board, cash utilisation plans awaited...

Escorts Ltd has announced that Kubota Corporation of Japan (global leader in farm mechanisation) would be acquiring a 10% stake in the company (on a post-dilution basis) via preferential allotment for a total sum of ₹ 1,042 crore (1.23 crore shares @ ₹ 850/share). The company would be extinguishing an equivalent number of treasury shares (1.23 crore) currently held on the books by Escorts Benefit and Welfare Trust such that total shares outstanding remain unchanged at 12.25 crore shares. Post-dilution, the promoter group (Nanda family) would continue to hold ~13% stake in the company while holding of Escorts Benefit and Welfare Trust would be reduced by 10% to 17.5%. In addition to the investment, Kubota would get two board seats in Escorts. In a separate development, the company would be purchasing 40% stake in Kubota's India sales and distribution arm i.e. Kubota Agri Machinery India Pvt Ltd (KAI) for a total outgo of ₹ 90 crore. The transactions are expected to be completed by H1FY21.

### Conference call takeaways

- The deals announced signal a deepening of ties between the two players, who are already JV partners for manufacture and export of tractors (initial combined investment of ₹ 300 crore for total capacity 50,000 units per annum; to be operational by Q2FY21)
- Escorts envisages inheriting the following synergies from the recent collaboration and investment ; (1) presence of a strategic partner on board with R&D and technology expertise, (2) access to production knowledge of global <120 hp tractor leader, (3) opportunity to serve sourcing needs of Kubota's global operations
- Kubota, on the other hand, tends to benefit from: (1) direct presence in one of the faster-growing players in a large agri market like India and (2) access to lower-cost but quality manufacturing and sourcing
- Escorts does not intend to distribute the stake sale proceeds with shareholders, with future dividends to come from future profitability
- On the cash utilisation front, the management guided that it is currently drawing up a five year plan and will finalise the same in a few months
- In due course of time, Kubota may transfer and start procuring its components manufactured at Escorts while at some point in time it may also look at joint development of some construction equipment

### Valuation & Outlook

We are enthused by Kubota's entry as a strategic investor in Escorts, especially given its leadership in the farm implement space. Kubota brings a global presence, significant technological prowess and production excellence. However, we await cash utilisation plans at Escorts before any meaningful change in stance on the company. We are constrained by limited dividend payouts by Escorts in the past with no firm outlook, going forward. We value Escorts on an SOTP valuation basis and maintain our **HOLD** rating on the stock with a revised target price of ₹ 715.

### Key Financial Summary

Key Financials	FY18	FY19	FY20E	FY21E	FY22E	CAGR (FY19-22E)
Net Sales	4,995.1	6,196.4	6,015.6	6,275.8	6,946.8	3.9%
EBITDA	557.2	733.3	677.7	720.6	835.5	4.4%
EBITDA Margins (%)	11.2	11.8	11.3	11.5	12.0	
Net Profit	344.8	484.9	472.8	557.0	660.9	10.9%
EPS (₹)	28.1	39.6	38.6	45.4	53.9	
P/E	22.2	15.8	16.2	13.8	11.6	
RoNW (%)	13.8	15.6	13.9	11.1	11.8	
RoCE (%)	21.0	21.7	17.7	14.5	14.9	

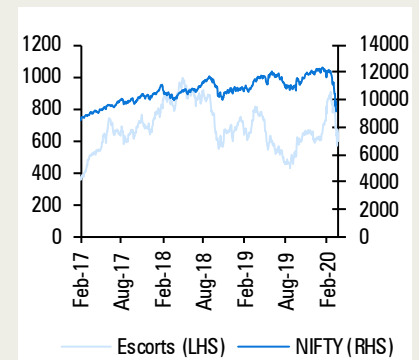
Source: Company, ICICI Direct Research



### Particulars

Particular	Amount
Market Capitalization (₹ Crore)	7,656.3
Total Debt (FY19) (₹ Crore)	286.7
Cash & Investments (FY19) (₹ Crore)	622.2
EV (₹ Crore)	7,320.7
52 week H/L (₹)	914 / 423
Equity capital (₹ crore)	122.6
Face value	₹ 10

### Price Chart



### Research Analyst

Shashank Kanodia, CFA  
shashank.kanodia@icicisecurities.com

Jaimin Desai  
jaimin.desai@icicisecurities.com

**Exhibit 1: Target price calculation**

Particulars	Amount (₹)
FY22E EPS (₹/share, A)	54
P/E Multiple (x, B)	12.0
<b>Value of Base Business (C = A*B)</b>	<b>648</b>
No of Treasury Shares (crore)	2.1
Current Market Price (₹/share)	625
Value of Investments (₹ crore)	1,341
Holding company discount (%)	40
Revised value of Investments (₹ crore)	804
<b>Contribution per share (₹/share, D)</b>	<b>67</b>
<b>Target Price (C+D)</b>	<b>715</b>
Potential Upside (%)	14

Source: ICICI Direct Research

**Exhibit 2: Excerpts from company presentation**

**Escorts-Kubota Partnership - A win-win Collaboration**

*A win-win Collaboration to achieve Global Aspirations!*

- ✓ Integrate product technology, production systems excellence, sales & distribution strengths alongside component sourcing and advanced supply chain
- ✓ Create differentiated product lines through cutting edge technology, efficiency & superior customer service
- ✓ Explore new avenues of growth in construction equipment & agriculture implements leveraging on market leadership across categories (including earth moving equipment & smart agriculture implements)
- ✓ Create one of the largest Indo-Japan agriculture association aligned to Indian Government's "make-in-India" vision
- ✓ Aims at global leadership in farm mechanization solutions

**Escorts & Kubota together, with their thought leadership in respective geographies to emerge as a Global leader in farm mechanization sector**

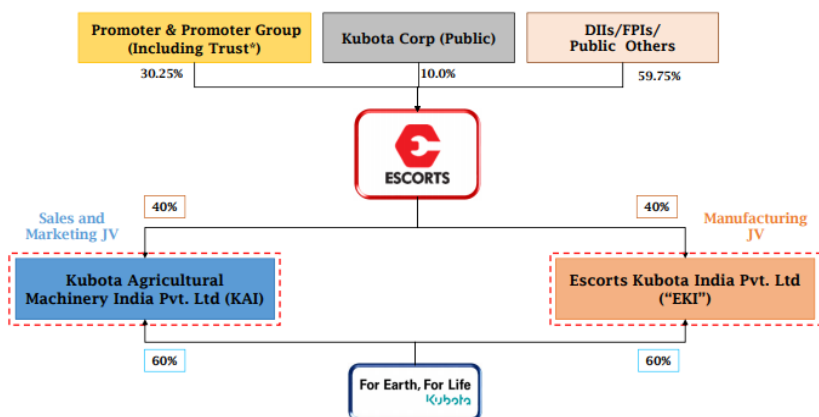
Source: Company, ICICI Direct Research

- Established in 1890, Kubota Corporation has a large manufacturing presence in areas of farm mechanisation equipment, construction equipment, engines, pipes, pumps, water purification equipment, sewage treatment equipment, etc

- Farm and construction equipment contributed 82.6% to consolidated revenues in FY18, with water & environment forming 15.8%. With a footprint in over 120 countries (chiefly Japan, Asia, Europe, and North America), its consolidated revenues as of CY19 were at ₹1.9 trillion (~₹ 1.3 lakh crore), with ~67% revenues contributed by exports

**Exhibit 3: Excerpts from company presentation**

**Resulting Relevant Structure**



Source: Company, ICICI Direct Research

## Financial Summary

Exhibit 4: Profit and loss statement		₹ crore			
(Year-end March)	FY19	FY20E	FY21E	FY22E	
Total operating Income	6,196.4	6,015.6	6,275.8	6,946.8	
Growth (%)	24.0	-2.9	4.3	10.7	
Raw Material Expenses	4,040.3	3,683.4	3,851.4	4,247.5	
Employee Expenses	471.7	511.7	531.5	573.4	
Other expenses	750.7	762.1	795.7	873.6	
Total Operating Expenditure	5,463.1	5,338.0	5,555.2	6,111.3	
<b>EBITDA</b>	<b>733.3</b>	<b>677.7</b>	<b>720.6</b>	<b>835.5</b>	
Growth (%)	44.1	-7.6	6.3	16.0	
Depreciation	85.4	102.7	119.6	140.9	
Interest	18.5	16.4	13.7	8.7	
Other Income	80.8	80.3	152.3	164.0	
PBT	722.4	629.6	739.6	850.0	
Total Tax	237.5	156.8	186.4	214.2	
<b>PAT</b>	<b>484.9</b>	<b>472.8</b>	<b>557.0</b>	<b>660.9</b>	
Growth (%)	40.6	-2.5	17.8	18.7	
<b>EPS (₹)</b>	<b>39.6</b>	<b>38.6</b>	<b>45.4</b>	<b>53.9</b>	

Source: Company, ICICI Direct Research

Exhibit 5: Cash flow statement		₹ crore			
(Year-end March)	FY19	FY20E	FY21E	FY22E	
Profit after Tax	484.9	472.8	557.0	660.9	
Add: Depreciation	85.4	102.7	119.6	140.9	
(Inc)/dec in Current Assets	-769.0	189.8	-242.4	-233.6	
Inc/(dec) in CL and Provisions	-49.9	-56.8	70.4	186.2	
<b>CF from operating activities</b>	<b>-248.7</b>	<b>708.5</b>	<b>504.6</b>	<b>754.5</b>	
(Inc)/dec in Investments	93.8	-250.0	-1,000.0	-280.0	
(Inc)/dec in Fixed Assets	-147.3	-247.0	-297.0	-300.0	
Others	0.0	0.0	0.0	0.0	
(Inc)/dec in Deferred Tax Asset	0.0	0.0	0.0	0.0	
<b>CF from investing activities</b>	<b>-80.9</b>	<b>-552.1</b>	<b>-1430.0</b>	<b>-651.6</b>	
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0	
Inc/(dec) in loan funds	258.9	-100.0	-50.0	-50.0	
Dividend paid & dividend tax	-36.8	-36.8	-42.9	-49.0	
Inc/(dec) in Sec. premium	0.0	0.0	1,029.8	0.0	
Others	26.7	0.0	0.0	0.0	
<b>CF from financing activities</b>	<b>248.9</b>	<b>-136.8</b>	<b>936.9</b>	<b>-99.0</b>	
Net Cash flow	-80.7	19.6	11.5	3.9	
Opening Cash	311.9	231.1	250.7	262.2	
<b>Closing Cash</b>	<b>231.1</b>	<b>250.7</b>	<b>262.2</b>	<b>266.1</b>	

Source: Company, ICICI Direct Research

Exhibit 6: Balance Sheet		₹ crore			
(Year-end March)	FY19	FY20E	FY21E	FY22E	
<b>Liabilities</b>					
Equity Capital	122.6	122.6	122.6	122.6	
Reserve and Surplus	2,900.3	3,336.4	4,880.2	5,492.2	
ESOP	0.0	0.0	0.0	0.0	
<b>Total Shareholders funds</b>	<b>3022.9</b>	<b>3458.9</b>	<b>5002.8</b>	<b>5614.7</b>	
<b>Total Debt</b>	<b>286.7</b>	<b>186.7</b>	<b>136.7</b>	<b>86.7</b>	
Other non-current Liabilities	63.7	63.7	63.7	63.7	
Long-term Provisions	24.5	24.5	24.5	24.5	
<b>Total Liabilities</b>	<b>3397.7</b>	<b>3733.8</b>	<b>5227.7</b>	<b>5789.6</b>	
<b>Assets</b>					
Gross Block	2,501.6	2,701.6	3,051.6	3,371.6	
Less: Acc Depreciation	924.7	1,014.4	1,120.7	1,247.0	
Net Block	1,577.0	1,687.2	1,931.0	2,124.6	
Capital WIP	53.1	103.1	53.1	28.1	
<b>Total Fixed Assets</b>	<b>1630.1</b>	<b>1790.3</b>	<b>1984.0</b>	<b>2152.7</b>	
Net Intangible Asset	53.8	37.8	21.5	11.9	
Investments	862.0	1,162.0	2,289.7	2,619.7	
Inventory	821.9	727.3	820.1	892.8	
Debtors	932.0	824.1	945.7	1,046.8	
Loans and Advances	20.0	29.0	34.7	49.7	
Other Current Assets	298.9	302.7	324.9	369.8	
<b>Cash</b>	<b>231.1</b>	<b>250.7</b>	<b>262.2</b>	<b>266.1</b>	
Total Current Assets	2,303.9	2,133.7	2,387.6	2,625.1	
Creditors	1,212.5	1,153.7	1,203.6	1,332.3	
Provisions & Other Curr.Liab	386.8	388.8	409.3	466.9	
Total Current Liabilities	1,599.3	1,542.5	1,612.9	1,799.1	
<b>Net Current Assets</b>	<b>704.6</b>	<b>591.2</b>	<b>774.7</b>	<b>826.0</b>	
Deferred Tax Asset	-52.9	-52.9	-52.9	-52.9	
Other non-current assets	117.7	122.9	128.1	149.7	
<b>Application of Funds</b>	<b>3397.7</b>	<b>3733.8</b>	<b>5227.7</b>	<b>5789.6</b>	

Source: Company, ICICI Direct Research

Exhibit 7: Key ratios					
(Year-end March)	FY19	FY20E	FY21E	FY22E	
<b>Per share data (₹)</b>					
EPS	39.6	38.6	45.4	53.9	
Cash EPS	46.5	47.0	55.2	65.4	
BV	246.6	282.2	408.1	458.0	
DPS	2.5	2.5	3.5	4.0	
Cash Per Share	75.4	82.8	91.4	101.7	
<b>Operating Ratios</b>					
EBITDA Margin (%)	11.8	11.3	11.5	12.0	
PAT Margin (%)	7.8	7.9	8.9	9.5	
Inventory days	48.4	44.1	47.7	46.9	
Debtor days	54.9	50.0	55.0	55.0	
Creditor days	71.4	70.0	70.0	70.0	
<b>Return Ratios (%)</b>					
RoE	15.6	13.9	11.1	11.8	
RoCE	21.7	17.7	14.5	14.9	
RoIC	23.2	20.4	17.8	18.7	
<b>Valuation Ratios (x)</b>					
P/E	15.8	16.2	13.8	11.6	
EV / EBITDA	10.0	10.3	8.2	6.7	
EV / Net Sales	1.2	1.2	0.9	0.8	
Market Cap / Sales	1.2	1.3	1.2	1.1	
Price to Book Value	2.5	2.2	1.5	1.4	
<b>Solvency Ratios</b>					
Debt/ EBITDA	0.4	0.3	0.2	0.1	
Debt / Equity	0.1	0.1	0.0	0.0	
Current Ratio	1.6	1.5	1.6	1.6	
Quick Ratio	0.9	0.9	1.0	1.0	

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



Pankaj Pandey

Head – Research

[pankaj.pandey@icicisecurities.com](mailto:pankaj.pandey@icicisecurities.com)

ICICI Direct Research Desk,  
ICICI Securities Limited,  
1st Floor, Akruti Trade Centre,  
Road No 7, MIDC,  
Andheri (East)  
Mumbai – 400 093  
[research@icicidirect.com](mailto:research@icicidirect.com)

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