INDIA RESEARCH

Rs175

Escorts

OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs14bn; US$316m

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Result: **Q2FY10**

Comment: **Strong performance across segments!**

Key valuation metrics

Year to September 30 (Rs m)	Net sales	yoy chg (%)	Net profit	EPS (Rs)	yoy chg (%)	PER (x)	EV/E (x)
2007	28,232	15.7	58	0.7	NM	222.7	13.9
2008	27,661	(2.0)	(131)	(1.5)	NM	NM	16.0
2009	26,617	(3.8)	645	7.4	NM	21.8	7.4
2010E	31,676	19.0	1,544	17.7	139.2	9.5	5.3
2011E	36,080	13.9	1,704	19.5	10.4	8.6	4.4
2012E	41,302	14.5	2,102	24.1	23.4	7.0	3.4

Highlights of Q2FY10 results

- Escorts Q2FY10 results have been ahead of estimates led by better than expected performance across business segments.
- Escorts net sales for the quarter were up 37%yoy to Rs6.8bn (we saw Rs6.4bn) led by an all round performance across all its business units. Topline growth was driven primarily by a 41%yoy growth by the agri-machinery division to Rs5.9bn. Tractor sales for the quarter were up 51%yoy at 14,584 units (up 7%qoq). The railway equipment business grew 6%yoy to Rs518mn (up 5%qoq). The ancillary business grew 56%yoy to Rs315mn (up 33%qoq).
- Led by a robust topline growth, margins for the quarter increased 280bps yoy to 9.8% (up 80bps qoq) – we saw margins at 9.4%. Absolute EBIDTA for the quarter was up 84%yoy to Rs661mn (and up 22%qoq).
- Escorts earned a net interest income during the quarter of Rs9mn (interest cost of Rs124mn in Q2FY09 and Rs68mn in Q1FY10) on account of benefits accrued from its channel financing initiatives for dealers resulting in substantial cost savings.
- As a result, adjusted for the Rs29mn exceptional charge (provision made for debtors > 6 months), Escorts Q2FY10 PAT was up 86%qoq to Rs435mn (significantly up from the Rs78mn in Q2FY09).

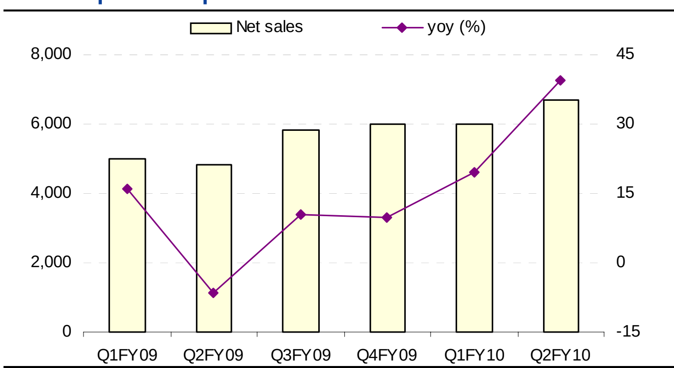
Other highlights

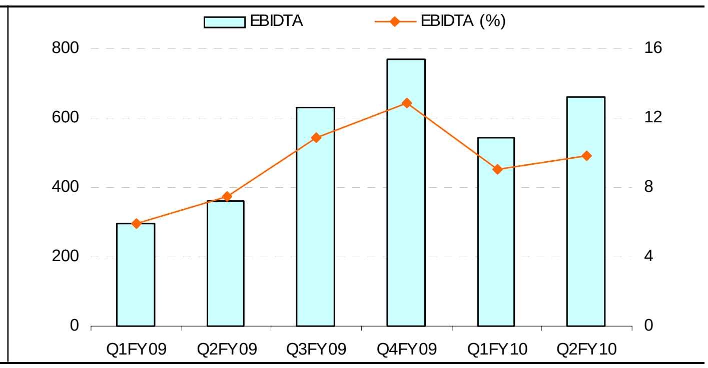
- ICRA has upgraded the rating assigned to the Rs.4.8bn bank facilities of Escorts from LBB+/ A4+ to LBBB-/ A3. The long term rating has been assigned a "Stable" outlook. The sharp improvement in earnings over the last few quarters, healthy cash flows and a substantially reduced debt burden would likely have prompted a rating upgrade.
- The Company has purchased the entire securities held by DAMFII Construction Equipment Holdings Limited (DARBY) in Escorts Construction Equipment Limited (ECEL), for a total consideration of ~ Rs 1.3bn (including accrued interest) on 15th April, 2010. DARBY had a mezannine debt of about Rs750mn due in 2011 on maturity of which DARBY would have been entitled for a stake in ECEL. This debt was taken when Escorts balance sheet was stretched (on account of the significant fund infusion for running businesses like telecom, hospitality etc) and hence enjoyed an IRR of ~20%. Given an extremely robust outlook for ECEL, Escorts management reached an agreement with DARBY and has now repaid their debt by taking a fresh loan of the same amount (average cost at 12%) thereby retaining complete control of ECEL.
- With the expiry of the non-compete clause with its erstwhile partner JCB, Escorts has begun to sell back hoe loaders in the Indian market. It has already sold about 32units of the equipment which have been very well received in the domestic market. New product launches is expected to substantially boost ECEL's earnings going forward.

Outlook

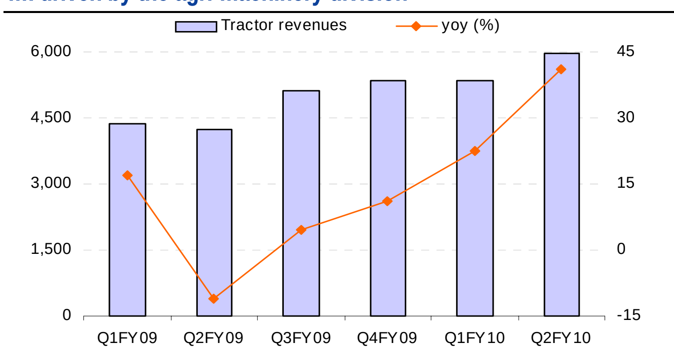
Escorts transformation is clearly evident in the robust operational performance that the company has been delivering over the last few quarters. Performance of tractor business has improved considerably over the last few quarters (EBIT of Rs557mn in Q2FY10 Vs Rs192mn in Q1FY09). Also with a much improved economic outlook and new model launches, momentum should sustain in the construction equipment as well as the most profitable railway equipment division. The reduced debt burden would also substantially aid earnings growth going forward. With renewed management focus, adequate capacity in place, immense growth potential across businesses, cost-cutting efforts and reduced interest burden, Escorts is expected to witness a sharp delta swing in earnings (estimated EPS at Rs24.1 for FY12 against Rs7.4 for FY09). Maintain Outperformer with a price target of Rs195.

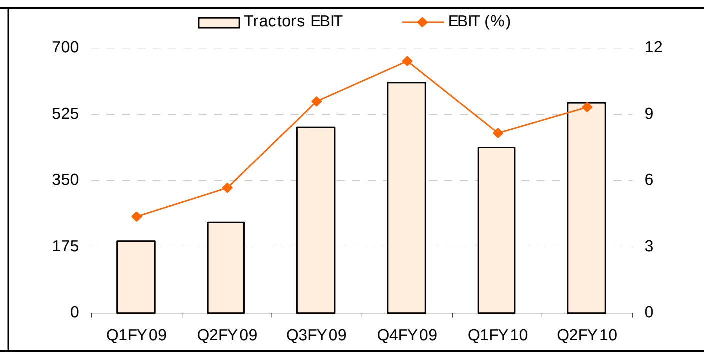
Robust operational performance ....





.... driven by the agri-machinery division





Quarterly results

	Q2FY09	Q3FY09	Q4FY09	FY09	Q1FY10	Q2FY10	Comments
Net Sales	**4,917**	**5,834**	**6,113**	**21,881**	**6,061**	**6,756**	Topline growth boosted by robust performance across business segments
yoy change (%)	*(7.5)*	*7.5*	*12.1*	*6.7*	*20.8*	*37.4*	
Operating profit	**359**	**632**	**770**	**2,061**	**541**	**661**	
yoy change (%)	*(21.8)*	*54.6*	*204.2*	*35.2*	*82.8*	*84.0*	
Other income	41	1	19	15	0	0	
Interest	124	99	129	516	68	(9)	Net interest income due to channel financing gains
Depreciation	119	119	128	492	119	124	
PBT	**157**	**414**	**532**	**1,113**	**355**	**546**	
Tax	79	192	-68	213	121	111	
Net Profit before extra ordinary items	78	223	600	899	234	435	
yoy change (%)	*(19.2)*	*139.3*	*NM*	*657*	*NM*	*456.4*	
Extraordinary items & Forex loss (gain)	20	0	0	0	0	20	
Net profit	**58**	**223**	**600**	**899**	**234**	**415**	
yoy change (%)	*(40.5)*	*137.6*	*471.3*	*657*	*NM*	*617.6*	
Cash profit	197	342	729	1,391	353	559	
OPM (%)	7.3	10.8	12.6	9.4	8.9	9.8	Robust volume offtake aids margin expansion
NPM (%)	1.6	3.8	9.8	4.1	3.9	6.4	
Other income/PBT (%)	26.0	0.1	3.5	1.4	0.0	0.0	
EPS (Rs)	0.9	2.5	6.6	9.9	2.5	4.6	
Cash EPS (Rs)	2.2	3.8	8.0	15.3	3.7	5.9	
Outstanding shares (m)	90.7	90.7	90.7	90.7	94.3	94.3	
PER (x)				17.6			

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Explanation of Ratings:

1. Outperformer: More than 5% to Index
2. Neutral: Within 0-5% to Index
3. Underperformer: Less than 5% to Index

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