November 30, 2011

Escorts (ESCORT)

₹ 79

Rating matrix

Rating	:	Hold
Target	:	₹ 86
Target Period	:	12 months
Potential Upside	:	9%

Key Financials (Standalone)

₹ Crore	SY10	SY11E	SY12E	SY13E
Net Sales	2,746	3,252.1	3,492.2	3,898.0
EBITDA	231.2	175.1	204.4	259.0
Net Profit	137.6	120.7	103.7	140.8
EPS (₹)	13.4	11.8	10.1	13.8

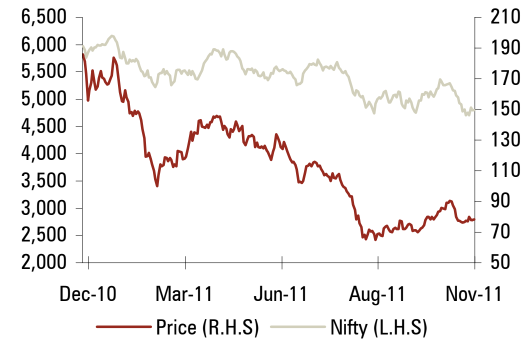
Valuation summary (Standalone)

	SY10	SY11E	SY12E	SY13E
P/E	5.8	6.6	7.7	5.7
Target P/E	6.4	7.3	8.5	6.2
EV / EBITDA	2.4	3.0	2.3	1.8
P/BV	0.5	0.4	0.4	0.4
RoNW	7.9	6.7	5.5	7.0
RoCE	8.9	6.3	7.0	8.8

Stock data

Market Capitalization	808.0
Total Debt (SY11E)	372.6
Cash and Investments (SY11E)	652.4
EV	528.2
52 week H/L	205/63
Equity capital	102.3
Face value	₹ 10
MF Holding (%)	17.5%
FII Holding (%)	20.6%

Price movement



Analyst's name

Karan Mittal
karan.mittal@icicisecurities.com

Nishant Vass
nishant.vass@icicisecurities.com

Aman Daga
aman.daga@icicisecurities.com

WHAT'S CHANGED...

PRICE TARGET........ Changed from ₹ 91 to ₹ 86

EPS (SY12E)........ Changed from ₹ 13.0 to ₹ 10.1

EPS (SY13E)........ Changed from ₹ 16.6 to ₹ 13.8

RATING........ Unchanged

When will winds of change beckon for Escorts?

Escorts announced its Q4SY11 results that were well below our expectations with the topline coming in at ₹ 773.0 crore reflecting a decline of 15.0% YoY (I-direct estimate: ₹ 811.3 crore). Tractor sales volumes were clocked at 15,203 units (up 8.7% YoY) while adjusted ASP rose ~8.4% YoY. EBITDA margins were below expectations at 5.1% due to expected higher other expenses of ₹ 110.5 crore as higher discounts, ad spends and director remuneration accounted for the same. On the positive front, it managed to control costs on the operations front after four consecutive quarters of cost rise as cost per vehicle declined ~2% QoQ to 3.3 lakh. The PAT came in at ₹ 8.8 crore, which was below our estimates owing to exceptional loss of ₹ 9.9 crore, which was created as a provision for doubtful debtors.

Highlights of the quarter

Escorts' tractor sales have witnessed a volume increase of ~8.7% YoY at 15,203 units, which is below par compared to its peers (M&M's tractor volumes were up ~26% YoY) mainly due to a limited presence in the fastest growing southern and western markets. Competitors like M&M and John Deere have higher penetration in these areas. In the past, the inability to control cost on the core business front has been a margin dampener. However, after four successive quarters, it has witnessed a trend reversal with cost per vehicle declining ~2% QoQ. The railway equipment business performed well in Q4SY11 posting revenue of ₹ 55.3 crore (flat YoY) and EBIT margins of 19.6% (up 810 bps YoY). The construction equipment business (ECEL) posted revenue growth of ~60% YoY at ₹ 251.5 crore and margin improvement of ~100 bps on EBITDA.

Valuation

We have factored in continuing market share pressures and slow growth in the next fiscal improving towards SY13E. The previous weak operating performance has led to multiples de-rating of the stock, which we do not expect to witness a change soon. The stock is currently trading at ₹ 79, 5.7x SY13E EPS of ₹ 13.8. We have valued the stock on an SOTP basis with a target price of ₹ 86. We have a **HOLD** rating on the stock.

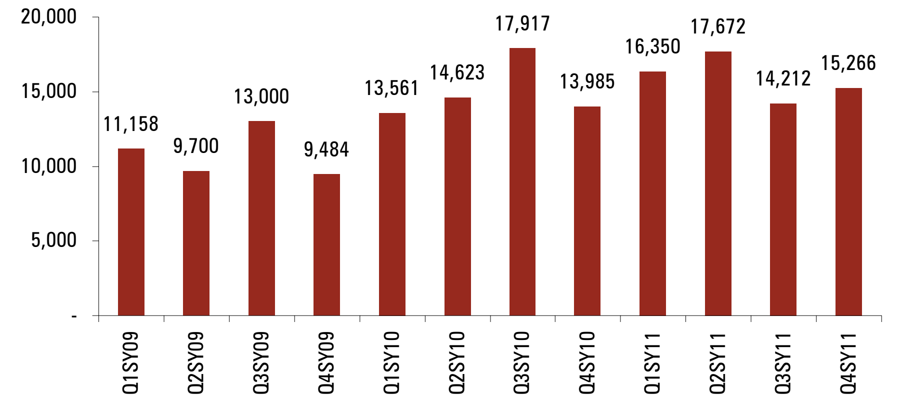
Exhibit 1: Valuation metrics

(₹ Crore)	Q4SY11	Q4SY11E	Q4SY10	Q3SY11	QoQ (Chg %)	YoY (Chg %)
Total Operating Income	773.0	811.3	672.1	739.6	4.5	15.0
EBITDA	39.3	42.9	32.6	34.3	14.8	20.4
EBITDA Margin (%)	5.1	5.3	4.9	4.6	46 bps	23 bps
Depreciation	9.7	10.4	9.6	9.1	7.3	0.8
Interest	8.0	6.6	6.1	7.6	5.5	31.1
Reported PAT	8.8	18.4	26.8	13.2	-33.6	-67.3
EPS (₹)	0.9	1.8	2.6	1.3	-33.6	-67.3

Source: Company, ICICIdirect.com Research

Tractor volumes have increased ~9.2% YoY and ~7.4% on a QoQ basis. This is sluggish in comparison to its peers (M&M tractor volumes were up ~26% YoY). M&M and John Deere have made specific improvements in market shares in both the slow growing northern region and rapidly growing western and eastern regions

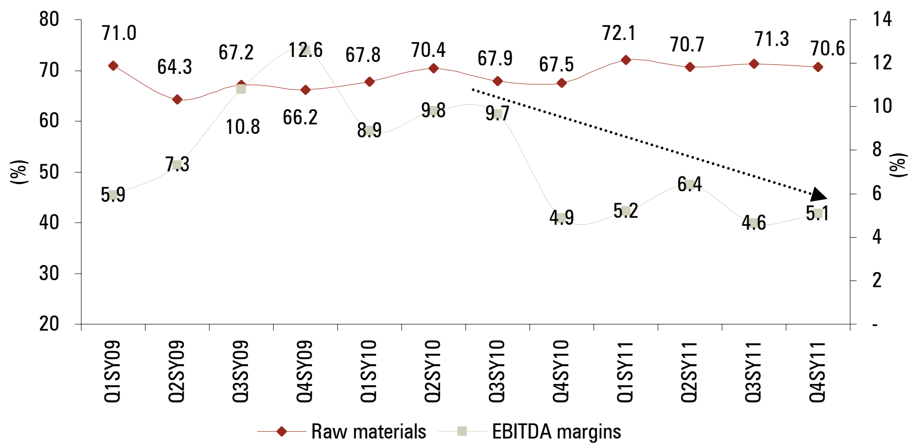
Exhibit 2: Tractor sales volume trend



Source: ICICIdirect.com Research

Escorts witnessed a margin rise of 46 bps QoQ due to better management of costs on the operation front with cost per vehicle down ~2% QoQ. The raw material costs as proportion of sales dipped ~70 bps QoQ. The coming few quarters would provide confirmation of the trend reversal on the margin front, if any

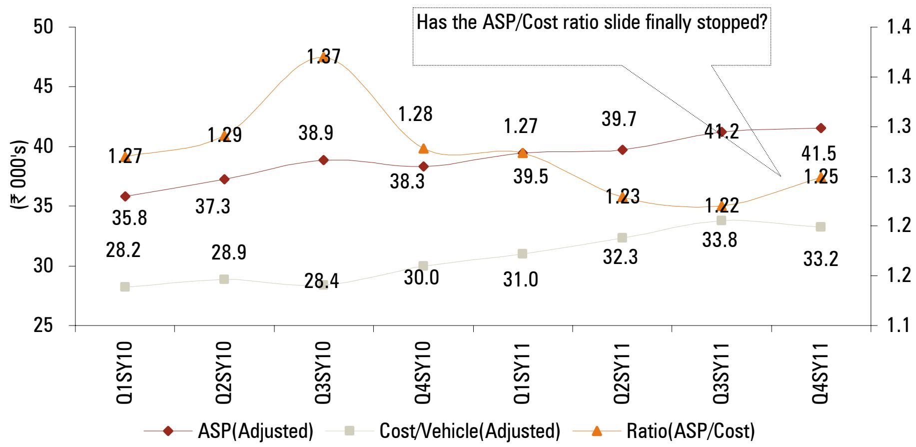
Exhibit 3: Margins, raw material cost trends as percentage of total income



Source: Company, ICICIdirect.com Research

The major reason for the decline in EBITDA margins had been the rise in costs in the core business since Q3SY10. However, Q4SY11 is the first quarter that has seen better costs management along with the full impact of price hikes. However, the main question remains as to whether this is a systemic trend. We would like to keep a close eye on the same to develop further conviction

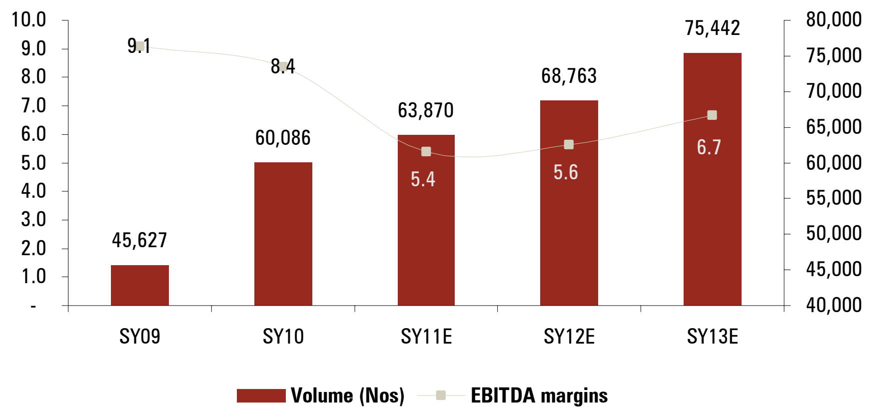
Exhibit 4: Costs and ASP trend analysis



*Source: Company, ICICIdirect.com Research * ASP ~Average selling prices*

We believe Escorts' tractor margins are dismal compared to M&M leaving headroom for improvement as utilisation levels improve, going ahead. We expect volumes to grow at a CAGR of 8.7% over SY11-13E and margins to improve to 6.7% levels by SY13E aided by the better performance of ECL

Exhibit 5: Volume and margins trends



Source: Company, ICICIdirect.com Research

Outlook

Escort has remained one of the few agri-segment plays, which has grossly underperformed its peers. This has been primarily led by its own internal inefficiencies on the operating front along with weak sales reach in the fast growing markets in the southern and western region. The low operating leverage has led the gross decline in EBITDA margins from ~10% in Q3SY10 to barely the ~5% mark at present. However, Q4SY11 has been the first quarter since the last year, which has witnessed costs decline (refer Exhibit 4), thus providing a ray of hope towards the establishment of better cost efficiencies, going ahead. The SY11 sales have been only 5.5% higher at 63,420 units even as the tractor industry has managed to witness a hugely promising year with H1FY12 clocking 20% plus growth rates.

We believe Escort will continue to face a stiff challenge on the market share front (180 bps market share loss in SY11). We expect the tractor industry to witness a certain degree of softness post stronger years in FY10, FY11 and FY12E. Thus, it could face the twin impact of lower market share with slowing sales in SY12E. However, SY13E could be a better year for the company with a better industry environment and better penetration.

On other businesses, consistent sales have been witnessed in the railways division with a strong margins profile. In contrast, the automotive components business continues to remain in the red with low capacity utilisations and lack of strong after-market network being main impediments.

ECEL, a 100% subsidiary of Escorts, has witnessed strong growth with 44% growth at ~₹ 830 crore and overall volume growth of ~37% at 6,244 units. The major revenue driver has continued to remain the pick-n-carry cranes with a ~61% contribution. However, the main positive came in from the backhoe loaders, which rose to ~15% of the total revenues for ECEL. The strong volume traction in the back-hoe loader segment is a reflection of growth in construction activity in both government and private business along with market share gains from market leader JCB. However, with domestic slowdown concerns looming large on fresh investments we have moderated our growth estimates for ECEL. However, in SY13E, a better margin performance is a reasonable estimate.

Valuation

We have factored in continuing market share pressures and slow growth in the next fiscal improving towards SY13E. The previous weak operating performance has led to multiples de-rating of the stock, which we do not expect to witness a change soon. The stock is currently trading at ₹ 79, 5.7x SY13E EPS of ₹ 13.8. We have valued it on an SOTP basis with Escorts valued at 6x SY13E EPS of ₹ 13.8 and the subsidiary valued at ₹ 3.2 with a target price of ₹ 86. We have a **HOLD** rating on the stock.

Exhibit 6: Revised financials (Standalone)

Particulars		SY12E			SY13E	
(₹ crore)	Old	New	% Change	Old	New	% Change
Net Sales	3,539.4	3492.2	(1.3)	3,722.4	3898.0	4.7
EBITDA	239.6	204.4	(14.7)	294.9	259.0	(12.2)
EBITDA Margin %	6.8	5.9	-92 bps	7.9	6.6	-128 bps
Net Profit	133.3	103.7	(22.2)	169.9	140.8	(17.2)
EPS(₹)	13.0	10.1	(22.1)	16.6	13.8	(17.1)

Source: Company, ICICIdirect.com Research

Exhibit 7: Financial metrics

	Sales	Growth	EPS	Growth	PE	EV/EBITDA	RoNW	RoCE
	(₹ cr)	(%)	(₹)	(%)	(x)	(x)	(%)	(%)
SY10	2745.7		13.4		5.8	2.4	7.9	8.9
SY11E	3252.1	18.4	11.8	-12.2	6.6	3.0	6.7	6.3
SY12E	3492.2	7.4	10.1	-14.1	7.7	2.3	5.5	7.0
SY13E	3898.0	11.6	13.8	35.7	5.7	1.8	7.0	8.8

Source: Company, ICICIdirect.com Research

ICICIdirect.com Research coverage universe (Auto)

Tata Motors					Sales (₹ cr)	EPS (₹)	PE(x)	EV/E (x)	RoNW (%)	RoCE (%)
Idirect Code	TELCO	CMP(₹)	176	FY10	92519.3	9.0	19.5	8.1	31.3	18.3
		Target(₹)	221	FY11	123133.3	29.1	6.1	4.3	46.0	24.2
Mcap (₹cr)	52196	% Upside	25.4	FY12E	145572.3	27.3	6.5	3.9	32.0	21.6
				FY13E	160227.1	30.8	5.7	3.3	27.5	21.8
Maruti Suzuki										
Idirect Code	MARUTI	CMP(₹)	966	FY10	28,958.5	88.2	11.0	8.5	24.1	31.7
		Target(₹)	1286	FY11	36,128.2	79.2	12.2	8.7	17.8	23.9
Mcap (₹cr)	27917	% Upside	33.2	FY12E	36,811.8	68.6	14.1	10.1	13.4	20.7
				FY13E	43,512.7	95.4	10.1	7.6	16.2	26.2
M&M										
Idirect Code	MAHMAH	CMP(₹)	724	FY10	18602.1	35.9	14.9	15.8	31.9	25.8
		Target(₹)	734	FY11	23493.7	40.6	13.2	13.8	29.3	26.0
Mcap (₹cr)	44381	% Upside	1.4	FY12E	29827.0	43.4	12.3	12.6	24.3	24.2
				FY13E	33776.9	49.4	10.9	10.6	24.0	25.6
Bajaj Auto										
Idirect Code	BAAUTO	CMP(₹)	1,656	FY10	12,043.5	58.8	28.1	18.0	58.1	55.0
		Target(₹)	1,572	FY11E	16,975.0	115.4	14.3	13.2	68.0	59.1
Mcap (₹cr)	47907	% Upside	-5.1	FY12E	20,130.2	102.1	16.2	10.3	46.8	56.9
				FY13E	22,555.8	108.4	15.3	9.3	42.3	52.9
Escorts										
Idirect Code	ESCORT	CMP(₹)	79	SY10	2,764.8	13.4	5.9	2.7	7.9	8.9
		Target(₹)	86	SY11E	3,252.1	11.8	6.7	3.4	6.7	6.3
Mcap (₹cr)	808	% Upside	8.6	SY12E	3,492.2	10.1	7.8	2.7	5.5	7.0
				SY13E	3,898.0	13.8	5.7	2.1	7.0	8.8
Hero MotoCorp										
Idirect Code	HERHON	CMP(₹)	2064	FY10	19,669.3	111.8	18.5	13.3	64.4	70.0
		Target(₹)	1919	FY11E	19,401.2	96.5	21.4	13.8	65.2	74.1
Mcap (₹cr)	41278	% Upside	-7.0	FY12E	23,447.9	118.1	17.5	10.1	85.9	88.9
				FY13E	25,959.1	132.4	15.6	8.9	93.8	99.0

Source: Company, ICICIdirect.com Research

Exhibit 8: Recommendation History

Source: ICICIdirect.com Research

Exhibit 9: Recent Releases

Date	Event	CMP	Target Price	Rating
10-Jan-11	Q1SY11 Preview	161	230	STRONG BUY
1-Feb-11	Q1SY11 Result Update	131	136	BUY
8-Apr-11	Q2SY11 Preview	145	154	HOLD
5-May-11	Q2SY11 Result Update	127	136	HOLD
5-Jul-11	Q3SY11 Preview	116	128	BUY
9-Aug-11	Q3SY11 Result Update	84	91	HOLD
5-Oct-11	Q4SY11 Preview	71	91	BUY

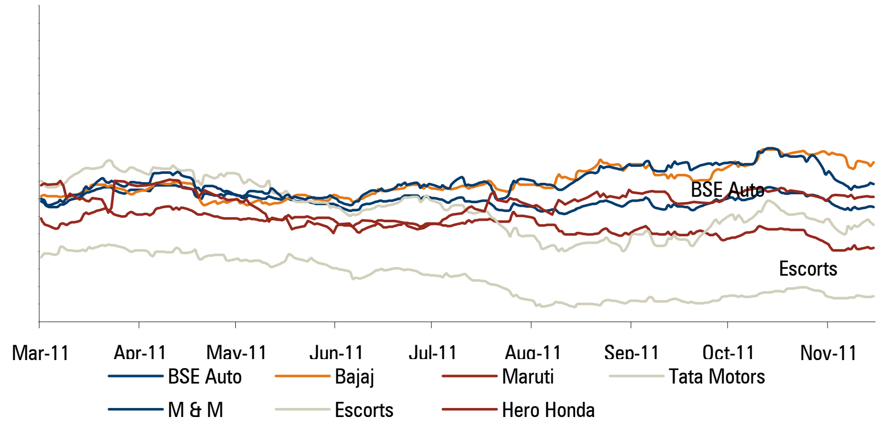
Source: Company, ICICIdirect.com Research

ICICIdirect.com Universe price movement vis-à-vis BSE Auto index

The chart compares the movement of OEM stocks in the ICICIdirect.com Universe with the BSE Auto index, thereby reflecting the degree of mimicking of the index

Since January 2011, Bajaj Auto and M&M have outperformed while Maruti Suzuki and Escorts have underperformed in comparison to the index by being divergent on the upside and downside, respectively

Exhibit 10: OEM comparison with BSE Auto

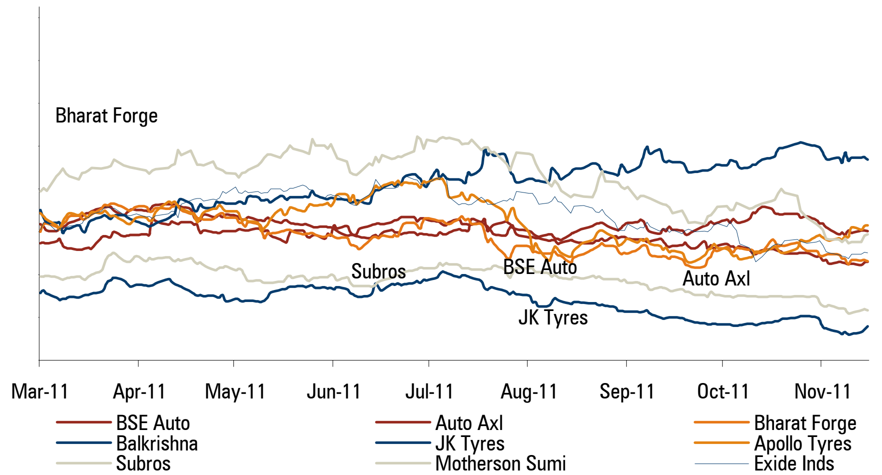


Source: Company, ICICIdirect.com Research

The chart compares the movement of auto ancillary stocks in the ICICIdirect.com universe with the BSE Auto index

The volatile nature of smaller ancillary companies is reflected. These have met with numerous fluctuations with the exception of larger market capitalisation companies like Exide Industries, which mimic the index greatly. JK Tyre and Subros have grossly underperformed due to the intense rubber price overhang and production disruption at Maruti respectively.

Exhibit 11: Ancillaries comparison with BSE Auto



Source: Company, ICICIdirect.com Research

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Hold: Up to +/-10%;
Sell: -10% or more;

Pankaj Pandey **Head – Research** **pankaj.pandey@icicisecurities.com**

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

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