April 20, 2022

Escorts Limited: Long-term rating removed from watch and upgraded to [ICRA]AA+(Stable); short-term rating reaffirmed; stable outlook assigned

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based – Working Capital Facilities	646.0	646.0	[ICRA]AA+ (Stable)/[ICRA]A1+; Long term rating removed from watch with developing implications and upgraded from [ICRA]AA; short term rating reaffirmed; Stable outlook assigned
Non-fund Based – Working Capital Facilities	281.0	281.0	[ICRA]A1+; Reaffirmed
Unallocated	23.0	23.0	[ICRA]AA+ (Stable)/[ICRA]A1+; Long term rating removed from watch with developing implications and upgraded from [ICRA]AA; short term rating reaffirmed; Stable outlook assigned
Total	**950.00**	**950.00**	

**Instrument details are provided in Annexure-1*

Rationale

ICRA had placed the long-term rating of Escorts Limited (Escorts) on rating watch with developing implications in November 2021, following the in-principle approval by the company's board to issue further equity stake on a preferential basis to Kubota Corporation (Kubota), for a consideration of Rs. 1,872.74 crore. Pursuant to the transaction, Kubota was expected to become a Joint Promoter of the entity along with existing promoters of Escorts, and consequently, make an open offer to the public shareholders of Escorts to acquire up to 26% of the share capital in accordance with SEBI regulations. The board had also given in-principle approval to other matters, such as evaluating and considering the feasibility of the merger of Escorts and Kubota's joint ventures in India (Escorts Kubota India Private Limited and Kubota Agricultural Machinery India Private Limited) into Escorts, and renaming the company to 'Escorts Kubota Limited', subject to regulatory approvals.

In February 2022, the company notified the completion of the preferential issue to Kubota; the open offer made by Kubota to acquire up to 26% of the share capital was oversubscribed and concluded on April 11, 2022. Given these developments, ICRA has removed the long-term ratings from watch with developing implications and upgraded the rating, while also assigning a Stable outlook to the same. The upgrade of the rating factors in the increase in shareholding of Kubota from ~10% in March 2021 to ~44.8% as on date[1], with Kubota becoming a joint promoter of Escorts. The enhanced ownership/ control of Kubota, which is a well-established global player in the farm equipment, mechanisation and construction equipment segments, is likely to aid in strengthening Escorts' product development capabilities and help the entity enrich its product profile over the medium term, thereby supporting its market share prospects. The enhanced collaboration with Kubota shall also entail greater sourcing by Kubota from Escorts for its other global markets, and aid the export prospects and earning profile of Escorts. Accordingly, the developments are a credit positive in ICRA's view.

[1] *Expected to increase to ~53.5% over the near-term, post cancellation of all the residual stake of Escorts held by the Escorts Benefit and Welfare Trust (subject to requisite approvals).*

In addition to strengthening the company's growth prospects, the preferential issue led to cash inflows of Rs. 1,872.74 crore into Escorts, further strengthening its already robust credit/ liquidity profile, characterised by negligible debt and strong return indicators. The ratings assigned continue to factor in the continuation of Escorts' healthy operational performance, particularly of its key business division of agri-machinery. Despite moderation in farm sentiments and industry volumes over the past few months, the growth prospects of the tractor industry over the medium to long-term continue to remain healthy. Escorts continues to be a leading tractor manufacturer in the country, aided by a well-entrenched dealer network, financing tie-ups, regular product launches/ refreshes and targeted marketing efforts. While the company's market share in the southern and western markets in India is limited, its efforts to expand its dealership network in these regions are likely to support volume growth in these regions over the medium term.

ICRA notes that inflationary pressures led to margin contraction for the entity in FY2022 and are likely to keep the margins under pressure over the near-term. Despite the inflationary pressures, the operating profitability of the company is expected to continue to remain at healthy levels, and help generate healthy cash accruals. ICRA also notes the inherent cyclicality in both the Escorts Agri-machinery (EAM) and Escorts construction equipment (ECE) divisions, which remain the company's key business segments. However, the ratings assigned continue to take comfort from the company's established market share (11.3% in FY2021 and ~10.0% in 9M FY2022) and strong brand franchise in the EAM division, and the Government of India's (GoI's) commitment to rural development and agri-mechanisation, while also focusing on improving the infrastructure with enhanced budgetary allocations.

As a part of its collaboration with Kubota, the company could also undertake significant investments in the agri-machinery/ construction equipment segments to enhance its product profile, going forward. More clarity on the same as well as on the organisation structure is expected to emerge in the near future, with the company expected to come out with a medium-term business plan after consultations with Kubota. The impact of any major investments/ inorganic growth steps by the company on its credit profile would continue to be monitored.

The Stable outlook on the long-term rating reflects ICRA's opinion that Escorts would be able to report a moderate-to-healthy revenue and earnings growth over the medium term, benefitting from its established market position, collaboration with Kubota and the Government's plans to increase agricultural income and promote infrastructure investment. The same is likely to help the company generate strong cash accruals and maintain a strong credit profile.

Key rating drivers and their description

Credit strengths

Leading Indian tractor OEM with strong brand franchise, vast dealership network and established track record; collaboration with Kubota to deepen technological capabilities and aid exports ramp up – Escorts is one of the leading tractor manufacturers in the country (domestic market share of 11.3% in FY2021 and ~10.0% in 9M FY2022), aided by regular product launches/ refreshes, an established dealership network, healthy financing tie-ups, and targeted marketing efforts. The company has an installed production capacity of 1,20,000 tractors/year and is in the midst of expanding its capacity. The EAM division offers a wide range of tractors, primarily under two brands, Farmtrac and Powertrac. Escorts also sells a low horsepower (HP) tractor (10-30 HP category) through a JV with the Rajkot-based Adico Group (under the Steeltrac brand). Over the past few fiscals, the company's EAM division has recorded healthy revenues and profits, benefitting from a healthy industry demand driven by favourable farm sentiments. The division recorded 20.7% YoY growth in revenues in FY2021 on the back of a good monsoon, stable crop prices, easy availability of finance, sufficient availability of water and healthy water reservoir levels. The division's prospects, however, moderated in 9M FY2022, led by the second wave of Covid-19 and its disruptions along with uneven monsoon leading to a delay in harvesting of kharif crop, consequently impacting the rural cashflows.

Kubota, Japan, picked up a stake in Escorts through a preferential share issue in 2020; it has further enhanced its stake (~44.8% as on date) in the entity through a preferential issue (February 2022) and a subsequent open offer (April 2022). Given Escorts' limited presence in the exports market till date, its collaboration with Kubota, a well-established global player, is likely to help ramp up the company's exports. The collaboration is also likely to strengthen Escorts' product development capabilities and help it improve its product portfolio over the medium term. Over the next 12-18 months, Kubota and Escorts' joint ventures in India are also likely to merge into Escorts, post the requisite approvals, leading to a simplified holding structure.

Presence in multiple product segments – Escorts has a presence across various product segments. These include agri-machinery equipment manufactured and marketed by its EAM division; construction equipment, such as cranes, compactors and back-hoe loaders, by its ECE division; and railway equipment (shock absorbers for railway coaches, centre buffer couplers and brake systems) by its RED division. Although the EAM division drives most of the company's revenues and profits, the company's presence in other businesses provides avenues for growth.

Strong financial risk profile characterised by negligible debt and superior liquidity profile – The financial risk profile of the company remains strong, characterised by a conservative capital structure and strong debt coverage indicators (TD/OPBITDA of 0.1 time and interest coverage of 84.5 times as on March 31, 2021). Additionally, the company continues to maintain healthy cash and bank balances (unencumbered cash and liquid investments of more than ~Rs. 4,500 crore as on March 31, 2022), resulting in a superior liquidity profile. Escorts has been able to maintain healthy profitability and return indicators over the past few years. The operating margin improved to 16.1% in FY2021, benefitting from the economies of scale, favourable product mix and various cost efficiency measures; the same has moderated a bit in 9M FY2022 impacted by inflationary pressures. Going forward, while Escorts has capex plans towards capacity expansion, the same are likely to be largely funded through existing cash balances and future cash accruals, keeping the credit profile robust.

Credit challenges

EAM and ECE divisions exposed to cyclicality – The company's leading business divisions, EAM and ECE, are inherently cyclical in nature. While the EAM division remains exposed to the fluctuations in demand with sensitivity to monsoons and farmer sentiments, growth in the ECE division is strongly correlated to the level of economic activity in the country. The Government of India (GoI), however, remains committed to rural development and agri-mechanisation, while focusing on improving the infrastructure with enhanced budgetary allocations. While Government focus is likely to aid growth in industry volumes across both divisions over the medium to long-term, the company is likely to remain exposed to periods of demand downturns in the key end-user industries.

Market presence of EAM division limited in southern and western India – Even as the company has strengthened its business position over the past few years, its market share in the western and southern regions remains limited, restricting it from ramping up its market share at a pan India level. The company has identified various markets in the western and southern regions, where the division has ramped up its management interaction efforts as well as dealership penetration to gain market share. Additionally, the management remains focussed on launching new application targeted products to plug any gaps in its product portfolio. Escorts' ability to gain market share in these regions is critical, given their high growth potential.

Limited market share in highly competitive construction equipment sector – The company has a limited product range in the construction equipment segment (cranes, compactors and backhoe loaders), constraining growth prospects in the sector. While various cost-control measures over the past few fiscals have helped the division report profit at the PBIT level, its ability to increase its scale of operations for it to contribute in a meaningful manner to the company's profitability remains to be seen. In FY2021, the disruptions caused by the lockdowns impacted the division's performance; the division's performance was also adversely impacted by the second wave of Covid-19 (Q1 FY2022) and inflationary pressures in FY2022. Escorts and the Tadano Group, Japan's biggest and the world's leading mobile crane manufacturer, entered into a JV in 2019 to manufacture rough terrain cranes and truck mounted cranes. The JV is likely to help strengthen Escorts' market presence in the material handling equipment space over the medium to long-term.

Liquidity position: Superior

Escorts' liquidity is superior**,** characterised by expectation of strong cash accruals (~Rs. 700-750 crore/annum), cash and liquid investments of more than ~Rs. 4,500 crore (funds infused through preferential issue from Kubota to be used for capacity expansion and product development under tractor/ construction equipment segments) and significant working capital buffer as on March 31, 2022. The company is expected to incur capex of Rs. 300-350 crore per year and does not have any material long-term debt on its books. Going forward, Escorts is expected to meet its capex requirements and debt obligations over the near term from internal sources, and yet be left with abundant cash surplus.

Rating sensitivities

Positive factors – The rating may be revised upwards if the company strengthens its business position by increasing its market share meaningfully in the domestic tractor and farm equipment segment, aided by product launches/ market share traction in geographies where it has a relatively limited presence, or through a meaningful ramp up in exports aided by diversification in geographies and technological support through the tie-up with Kubota. The company's ability to maintain comfortable profitability and credit metrics on a sustained basis will also be considered favourably.

Negative factors – The rating may be revised downwards if the company witnesses a material decline in its domestic market share or a material decline in its operating profitability, leading to a significant deterioration in its credit metrics. The adverse impact of any acquisition by the company on its financial risk profile could also exert downward pressure on the rating.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Tractor Manufacturers
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of Escorts Limited. As on March 31, 2021, the company had six subsidiaries, an associate company and four JVs, which are enlisted in Annexure-2.

About the company

Incorporated in 1944, Escorts Limited is a leading tractor and farm equipment OEM in India with ~10.0% market share in the domestic market (9M FY2022). The company generates business from its three key divisions—agri-machinery (EAM) involved in manufacturing tractors (~79% of revenues in 9M FY2022), construction equipment (ECE) involved in manufacturing and trading construction equipment products (~13%), and the railway equipment division (RED), which manufactures shock absorbers for railway coaches, centre buffer couplers and brake systems (~9%). The company has manufacturing facilities in Faridabad (Haryana) and Poland.

The EAM segment manufactures and markets its tractors under the Farmtrac, Powertrac and Steeltrac brands and commands a strong presence in northern and Central India, aided by strong brand recall and a well-entrenched dealership network. The company's product portfolio spans HP segments with healthy presence in the 31–50-HP category.

The company was promoted by the Delhi NCR-based Nanda family. Mr. Nikhil Nanda is the current chairman and managing director of the company. Escorts entered into a collaboration with Kubota Corporation, Japan, wherein after establishing two JVs, the latter acquired an equity stake in Escorts through a preferential issue and thereafter increased the same through a further preferential issue and mandatory open offer, taking Kubota's shareholding to ~44.8% as on date. The company's board comprises 12 members, of whom six are independent directors.

Escorts was incorporated as Escorts (Agents) Private Limited (EAPL) in Lahore in 1944. EAPL was converted into a public limited company and renamed as Escorts in January 1960. The company started off by manufacturing tractors under the Escorts brand in the 25–40 HP range. In 1969, the company promoted Escorts Tractors Limited (ETL) as a JV with Ford Motor Company (FMC), US, for manufacturing the Ford Series of tractors in the 40–50 HP range. Escorts acquired the entire equity stake of ETL in August 1995, making ETL its subsidiary (subsequently merged with the EAM division).

Over the years, the company diversified into other products to emerge as a multi-business entity with interests in agri-machinery, automotive components, railway equipment, construction equipment, and telecommunication equipment and services. However, some of its non-core businesses, such as telecommunications, healthcare, software and its JV stake with Carraro were divested during the mid-2000s. In December 2016, the company sold off its auto product assets, leading to the closure of the division.

Key financial indicators (audited)

Consolidated	FY2020	FY2021	9m FY2022*
Operating Income (Rs. crore)	5,810.1	7,014.4	5,359.9
PAT (Rs. crore)	472.8	872.4	566.5
OPBDIT/OI (%)	11.4%	16.1%	13.3%
PAT/OI (%)	8.1%	12.4%	10.6%
Total Outside Liabilities/Tangible Net Worth (times)	0.6	0.4	-
Total Debt/OPBDIT (times)	0.1	0.1	-
Interest Coverage (times)	38.5	84.5	62.3

*PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; * provisional financials*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the past 3 years					
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2022		Date & Rating in FY2021		Date & Rating in FY2020	
					Apr 20, 2022	Nov 29, 2021	Oct 25, 2021	Mar 31, 2021	Sep 17, 2020	Mar 30, 2020	Jul 19, 2019
1	Fund-based-Working Capital Facilities	Long Term/ Short Term	646.0	-	[ICRA]AA+ (Stable)/ [ICRA]A1+	[ICRA]AA&/ [ICRA]A1+	[ICRA]AA (stable)/ [ICRA]A1+	[ICRA]AA (stable)/ [ICRA]A1+	[ICRA]AA (stable)/ [ICRA]A1+	[ICRA]AA- &/ [ICRA]A1+	[ICRA]AA- (stable)/ [ICRA]A1+
2	Non-fund based-Working Capital Facilities	Short Term	281.0	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3	Unallocated Limits	Long Term/ Short Term	23.0	-	[ICRA]AA+ (Stable)/ [ICRA]A1+	[ICRA]AA&/ [ICRA]A1+	[ICRA]AA (stable)/ [ICRA]A1+	[ICRA]AA (stable)/ [ICRA]A1+	[ICRA]AA (stable)/ [ICRA]A1+	[ICRA]AA- &/ [ICRA]A1+	[ICRA]AA- (stable)/ [ICRA]A1+
4	Commercial Paper	Short Term	-	-	-	-	-	[ICRA]A1+ Withdrawn	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

&= Under watch with developing implications

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long Term/Short Term - Fund-based- Working Capital Facilities	Simple
Short Term - Non-fund based-Working Capital Facilities	Very Simple
Long Term/Short Term - Unallocated Limits	Not Applicable

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analyzing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No.	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Fund-based- Working Capital Facilities	-	-	-	646.0	[ICRA]AA+(stable)/[ICRA]A1+
NA	Non-fund based- Working Capital Facilities	-	-	-	281.0	[ICRA]A1+
NA	Unallocated Limits	-	-	-	23.0	[ICRA]AA+(stable)/[ICRA]A1+

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Company Name	Escorts Ownership	Consolidation Approach
Escorts Finance Limited	69.42%	Full Consolidation
Escorts Securities Limited	51.26%	Full Consolidation
Escorts Benefit & Welfare Trust	100.00%	Full Consolidation
Escorts Benefit Trust	100.00%	Full Consolidation
Farmtrac Tractors Europe Spolka z.o.o	100.00%	Full Consolidation
Escorts Crop Solution Limited	100.00%	Full Consolidation
Adico Escorts Agri Equipment Private Limited	40.00%	Equity Method
Tadano Escorts India Private Limited	49.00%	Equity Method
Escorts Kubota India Private Limited	40.00%	Equity Method
Kubota Agricultural Machinery India Private Limited	40.00%	Equity Method
Escorts Consumer Credit Limited	29.40%	Equity Method

Source: *Annual report FY2021*

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