March 14, 2017

Escorts Limited

Instrument*	Rated Amount (in crore)	Rating Action
Term Loans	202.5 (reduced from 257.0)	Rating upgraded from [ICRA]A- (stable) to [ICRA]A (positive)
Fund Based Facilities	478.0	Long term Rating upgraded from [ICRA]A- (stable) to [ICRA]A (positive); short term rating of [ICRA]A1 reaffirmed
Non Fund Based Facilities	419.0 (reduced from 613.0)	[ICRA]A1 reaffirmed
Unallocated	28.0 (reduced from 73.0)	Long term Rating upgraded from [ICRA]A- (stable) to [ICRA]A (positive); short term rating of [ICRA]A1 reaffirmed
Total	1127.5 (reduced from 1421.0)	
Commercial Paper	100.0 (enhanced from 50.0)	[ICRA]A1 reaffirmed

*Instrument Details are provided in Annexure-1

Rating Action

ICRA has upgraded the long term rating assigned to the bank facilities of Escorts Limited (Escorts) from [ICRA]A- (pronounced ICRA A minus) to [ICRA]A (pronounced ICRA A). The outlook on the long term rating has been revised from 'stable' to 'positive'. ICRA has also reaffirmed a short term rating of [ICRA]A1 (pronounced ICRA A one) for the bank facilities and commercial paper programme (enhancd from Rs. 50.0 crore to Rs. 100.0 crore) of the company[1]. The total rated bank facilities have been reduced from Rs. 1421.0 Crore to Rs. 1127.5 Crore[2].

Detailed Rationale

The rating upgrade and assignment of positive outlook takes into account the improvement in the operational performance of Escorts driven by robust volume growth in its agri machinery division and recovery in construction equipment business in the current fiscal, which is expected to continue in near future. Additionally, the company has also demonstrated a sustained improvement in cost structure, on the back of cost reduction exercise across various business segments. The company's volume growth in the agri machinery business has been supported by favourable farm sentiments on account of healthier southwest monsoon and estimates of a likely strong growth in crop production. A ramp up in volumes for the division, aided by an expanded product profile, coupled with rationalisation of material costs on account of various VA-VE efforts undertaken by the division have aided significant improvement in the division's profitability metrics. A continued strong demand for tractors coupled with further expansion in dealership network is likely to support volume growth in the near to medium term. Although the division

[1] For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications.
[2] 100 Lakh = 1 Crore = 10 million

derives modest volumes from exports, expansion in international markets has been a focus area identified by the management and provides opportunities for growth in the medium term.

While the agri machinery division remains the largest division, a robust growth in demand in the construction equipment industry has helped Escorts' construction equipment business to record a healthy growth in volumes; although the division continued to report loss during 9M FY2017, the division is expected to break even at the PBIT level over the short term, and thereby further aid the margin expansion for the company. The commonisation of engines for certain products across the agri machinery and the construction equipment divisions is also likely to aid margin improvement for the construction equipment division. The rating assigned also factors in favourably the divestment of the auto components division of Escorts in Q3 FY2017, despite one-time extraordinary loss that would adversely impact profit metrics in FY2017. The divestment of this loss making division augurs well for the company as this would support sustainable improvement in profitability over the medium term.

The ratings assigned continue to factor in the company's long operating history, strong brand franchise, vast dealer network, diversified business mix along with its healthy financial risk profile, characterized by negligible debt and strong debt coverage indicators. Notwithstanding the improvement in scale of operations of the agri machinery division, Escort' business position in the domestic tractor industry, however, continues to be hindered by its weak presence in the western and southern regions; the company has plans to improve its dealership network and introduce customised products in these regions to improve its market position. Additionally, the ratings continue to remain constrained by the inherent cyclicality in both the tractor and construction equipment industry, which remain the company's key business segments.

The long term rating assigned has a positive outlook, with the government's plans to double farm income by 2022 as well as enhanced focus on infrastructure development bode well for the tractors and construction equipment segments (both contribute around 90% of the company's sales revenue). The favourable demand outlook coupled with an improved cost structure (post the divestment of the loss making auto components division) would support continued improvement in the company's profitability and return indicators. Escorts ratings will remain linked to the company's ability to improve its market presence in the agri machinery business across the Southern and Western regions. The ROCE of the company has remained suppressed on account of moderate operating margin, weak performance of auto component business as well as non optimal capacity utilizations for both the agri machinery and construction equipment divisions; its ability to improve its capacity utilization levels in a profitable manner, and consequently improve return indicators, would remain a key rating sensitivity.

Although Escorts continues to have investment plans going forward (~Rs 100 crore in FY2018), the company's expected healthy cash accruals are expected to help support its strong financial risk profile going forward. Additionally, the impact of any inorganic growth steps undertaken by the company, on the credit profile of the company, would continue to be monitored.

Key rating drivers

Credit Strengths

- Strong brand franchise, vast dealer network and established track record of the company in the agri machinery business
- Presence in multiple product segments - manufacturing of agri machinery, construction equipment and railway equipment
- Sustainable improvement in cost structure driven by cost reduction across various divisions; Asset sale of loss making auto components' division to help improve profitability going forward
- Strong growth in demand in both agri machinery and construction equipment segments has led to healthy growth in revenues in current fiscal; improved profitability with benefits accruing from economies of scale and various cost rationalization initiatives

Credit Weakness

- Agri machinery division remains exposed to cyclicality, with sensitivity to monsoons and farmer sentiments and construction equipment business growth strongly correlated to level of economic activity in the country; focus of the government to revive these industries provides rating comfort
- Market presence of the agri machinery division in the Southern and Western regions continues to remain weak; success in improving remains critical given the high growth potential of the regions
- Limited product range (slew cranes, compactors and backhoe loaders) constrains the company's market share in the highly competitive construction equipment sector
- Exceptional losses on account of sale of auto products division has impacted profitability in the current fiscal; Significant write-offs from business reconstruction reserve (BRR) in the past

Detailed description of key rating drivers highlighted above:

Escorts has a presence across various product segments viz., tractors and agri machinery manufactured and marketed by Agri Machinery Division (EAM); Construction equipments such as cranes, compactors and back hoe loader under Construction Equipment Division (ECE) and equipments for railways (shock absorbers for railway coaches, centre buffer couplers and brake systems) under Railway Equipment Division. The company also had a presence in the auto products business; however the business and assets of the division were divested in December 2016.

The company is one of the leading tractor manufacturers in the country, offering a wide range of tractors, primarily under two brands - Farmtrac and Powertrac. In the current fiscal, the company's agri machinery division has recorded a healthy growth in volumes, benefitting from an improved industry demand scenario, greater management focus as well as favourable response for its new products. While the division's presence in the western and southern regions continues to remain weak, the division has identified various markets in the Western and Southern regions, where the division would be ramping up its management interaction efforts as well as dealership penetration with a view of gaining market share. Escorts constriction equipment division has also reported a healthy growth in volumes in the current fiscal (25% growth in 9M FY2017) led by an improvement in construction and infrastructure activities, which has led to an improvement in demand for segments catered.

Escorts has been focused on improving profitability and has implemented various cost rationalization exercises over the past few years; raw material costs have been reduced across divisions through vendor consolidation, price renegotiation, product re-designing and other VA-VE efforts. The company's operating profitability in the current fiscal has been significantly healthier than the corresponding previous, led by savings from various cost reduction measures, benign raw material prices and benefits from economies of scale. The profitability though continues to be impacted by the poor performance of the construction equipment business, which continues to report loss. The company reported a loss of Rs 41.1 crore in 9M FY2017 from the discontinued auto products division; notwithstanding this, the improved profitability of the agri machinery division has driven an increase in net profit during 9M FY2017.

Analytical approach:

Links to applicable Criteria

- Corporate Credit Rating –A Note on Methodology
- Rating Methodology for Tractor Industry

About the Company:

Escorts Limited (Escorts) was incorporated as Escorts (Agents) Private Limited (EAPL) in Lahore in 1944. EAPL was converted into a Public Limited Company and renamed Escorts Limited (Escorts) in January 1960. The company started off by manufacturing tractors under the Escorts brand name in the 25-40 horsepower (HP) range. In 1969, the company promoted Escorts Tractors Limited (ETL) as a joint venture with Ford Motor Company (FMC), USA for the manufacture of Ford Series of tractors in the 40-50 HP range. Escorts acquired the entire equity stake of ETL in August 1995, thus making ETL its subsidiary (subsequently merged with agri machinery 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, industrial and construction equipment, and telecom equipment and services. However, some of the non-core businesses viz., Telecom, Healthcare, Software and its stake in joint venture with Carraro in 2006 were divested during mid 2000s.

At present, Escorts is engaged in three major segments viz., Agri Machinery Division (EAM) engaged in manufacturing of tractors and agri-machinery; Construction equipment Division (ECL) engaged in manufacturing and trading of construction equipment products and Railway equipment comprising of shock absorbers for railway coaches, centre buffer couplers and brake systems. In December 2016, the company had sold of the assets of the auto products, thereby leading to the closure of the division. The company has six manufacturing facilities in Faridabad (Haryana) and one manufacturing facility each in Rudrapur (Uttaranchal) and Poland.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years:

Table: Rating History

S.No	Name of Instrument	Current Rating (2016)			Chronology of Rating History for the past 3 years		
		Type	Amount outstanding (Rs. Crores)	Date & Rating	Date & Rating in FY2017	Date & Rating in FY2016	Date & Rating in FY2015
				March 2017	October 2016	March 2016	November 2014
1	Term Loans	Long Term	202.5	[ICRA]A (Positive)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]BBB+ (Stable)
2	Fund Based Facilities	Long Term/Short Term	478.0	[ICRA]A (Positive)/ [ICRA]A1	[ICRA]A- (Stable)/ [ICRA]A1	[ICRA]A- (Stable)/ [ICRA]A1	[ICRA]BBB + (Stable) / [ICRA]A2
3	Non Fund Based Facilities	Short Term	419.0	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A2
4	Unallocated	Long Term/Short Term	28.0	[ICRA]A (Positive)/ [ICRA]A1	[ICRA]A- (Stable)/ [ICRA]A1	[ICRA]A- (Stable)/ [ICRA]A1	[ICRA]BBB + (Stable) / [ICRA]A2
5	Commercial paper	Short Term	100.0	[ICRA]A1	[ICRA]A1	[ICRA]A1	-

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1

Details of Instrument

Name of the instrument	Date of issuance	Coupon rate	Maturity Date	Size of the issue (Rs. Cr)	Current Rating and Outlook
Term Loan-1	April 2013	10.50%-10.75%	July 2018	52.5	[ICRA]A (Positive)
Term Loan-2	August 2015	10.50%-10.75%	September 2023	150.0	[ICRA]A (Positive)
Fund Based Facilities	-	-	-	478.0	[ICRA]A (Positive)/[ICRA]A1
Non Fund Based Facilities	-	-	-	419.0	[ICRA]A1
Unallocated	-	-	-	28.0	[ICRA]A (Positive)/[ICRA]A1
Commercial Paper	27th Jan 2017	6.35%-6.50%	30th March, 2017	25.0	[ICRA]A1
Commercial Paper	28th Dec 2016	6.35%-6.50%	28th March, 2017	25.0	[ICRA]A1
Commercial Paper	-	-	-	50.0	[ICRA]A1

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