Escorts Limited

March 28, 2019

Summary of rated instruments

Instrument*	Previous Rated Amount(Rs. crore)	Current Rated Amount(Rs. crore)	Rating Action
Term Loans	25.9	25.9	[ICRA]AA-(stable) outstanding
Fund-based – Working Capital Facilities	425.0	425.0	[ICRA]AA-(stable)/[ICRA]A1+ outstanding
Non-fund Based – Working Capital Facilities	400.0	400.0	[ICRA]A1+ outstanding
Unallocated	15.1	15.1	[ICRA]AA-(stable)/[ICRA]A1+ outstanding
Total	**866.0**	**866.0**	
Commercial Paper	150.0	200.0	[ICRA]A1+ assigned

*Instrument details are provided in Annexure-1

Rationale

The ratings assigned take into account the strong operational performance of Escorts, reflected in robust volume and profitability expansion in its key business divisions of agri-machinery and construction equipment. While a continuation of favourable farm sentiments supported by various Government support programmes have supported a robust volume growth in the agri-machinery division (~22% in 11m FY2019), the construction equipment division volumes have also continued to benefit from a healthy end user demand. Buoyed by the increased scale of operations and the consequent benefits from scale, Escorts has been able to achieve a healthy improvement in operating profit margins (expansion of ~70 basis points in 9m FY2019). The various cost efficiency measures undertaken by the company over the past 2-3 years have also contributed to the margin expansion and underpin ICRA’s belief that the company will sustain strong profitability metrics, going forward.

The ratings also favourably factor in the company’s strong financial risk profile. The strong cash accruals on the back of an improved operating performance have helped Escorts maintain low debt levels and substantial cash and liquid investments (negative net debt of ~Rs. 281.5 crore as of March 20, 2019), which provide comfort. Despite capital expenditure (towards new product development and capacity expansion) and investment plans (equity infusion of ~Rs. 120 crore in a Joint Venture (JV) with Kubota Group over FY2019-FY2020), the company’s expected healthy cash accruals and available cash balances are expected to help keep its dependence on external borrowings to a minimum.

ICRA notes the inherent cyclicality in both the tractor and construction equipment sectors, which remain the company’s key business segments. However, the ratings assigned continue to take comfort from the company’s established market presence and strong brand franchise. Escorts continues to be a leading tractor manufacturer in the country, aided by an 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 continues to remain weak (~4.0% and ~6.9% in 11m FY2019, respectively), the company’s efforts to further expand its dealership network in these regions, are likely to support volume growth in these regions over the medium term. Although the division derives modest volumes from exports, expansion in international markets has been a focus area identified by the management and provides opportunities for growth over the medium term; as part of its collaboration with Kubota, Escorts tractors (jointly branded) would be sold through Kubota global distribution network in specific markets going forward. Escort’s ability to strengthen its market position in the domestic market, especially in southern and western India, and expand its presence in the exports market, remains to be seen and would remain a key rating sensitivity, going forward.

The impact of any inorganic growth steps undertaken by the company, on the credit profile of the company, would continue to be monitored. Further, ICRA notes that the proceeds from the rated commercial paper programme are intended to be utilised for funding the working capital requirements, as per the objects of the issue. Any deviation from the above, which has the effect of exerting pressure on the asset-liability position of the company, would be a rating sensitivity.

Outlook: Stable

The stable outlook on the long-term rating reflects ICRA's expectation that Escorts would be able to report a healthy revenue and earnings growth over the medium term, benefitting from the Government's plans to increase farm income and promote infrastructure investment. The outlook may be revised to Positive if the company's efforts to expand its dealership network in India's southern and western regions aid it in gaining healthy market share in the domestic market, or the company records a healthier than expected improvement in its operating performance. The outlook may be revised to Negative if the company is not able to sustain the improvement in operating profitability demonstrated over the past two years, leading to deterioration in the company's return indicators. Furthermore, an adverse impact of any acquisitions undertaken by the company on its financial risk profile, could also trigger a revision in outlook.

Key rating drivers

Credit strengths

Strong brand franchise, vast dealer network and established track record of the company in the agri-machinery business – Escorts is one of the leading tractor manufacturers in the country, aided by an established dealer network, healthy financing tie-ups, regular product launches/refreshes and targeted marketing efforts. The company has an installed capacity of 100,000 tractors/year. The agri-machinery division offers a wide range of tractors, primarily under the two brands, Farmtrac and Powertrac. Escorts also sells a low HP tractor (10-15 HP) through a joint venture (JV) with the Rajkot-based Adico Group (under the Steeltrac brand). Over the past three fiscals, the company's agri-machinery division has recorded a healthy growth in revenues and profits, largely benefitting from an improved industry demand driven by favourable farm sentiments. Buoyed by the growth, the company has plans to increase its manufacturing capacity in a phased manner over the next two fiscals (capacity to expand to 150,000 tractors/year).

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

Sustainable improvement in cost structure driven by cost rationalisation initiatives across various divisions – Escorts has been focused on improving profitability and has implemented various cost rationalisation 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 (Value Analysis/Value Engineering) efforts. The company's operating profit margins have improved significantly over the past two years, benefitting from economies of scale and savings on account of various cost reduction measures.

Strong financial risk profile characterised by negligible debt, healthy cash balances and strong liquidity profile – The capital structure of the company remains healthy, characterised by low debt, healthy debt coverage indicators and significant cash and bank balances (~Rs. 618.0 crore as on March 20, 2019). Going forward, while Escorts has capex plans towards new product development and capacity expansion, the same are likely to be largely funded through existing cash balances and future cash accruals, keeping the credit profile strong.

Credit challenges

Agri-machinery and construction equipment divisions remain exposed to cyclicality – The company's leading business divisions—agri-machinery and construction equipment, remain inherently cyclical in nature. While the agri-machinery division remains exposed to fluctuations in demand scenario with sensitivity to monsoons and farmer sentiments, the construction equipment business growth remains strongly correlated to the level of economic activity in the country. The Government of India (GoI), however, remains committed towards rural development and agri-mechanisation, while also focusing on improving the infrastructure in the country with enhanced budgetary allocations. Continued Government focus is likely to aid growth in industry volumes across both sectors over the medium to long-term.

Market presence of the agri-machinery division in southern and western India continues to remain weak – The agri-machinery division's presence in the western and southern regions continues to remain weak, which has limited the company's market share gain prospects over the past few years. The division has identified various markets in the country's western and southern regions, where the division would be ramping up its management interaction efforts as well as dealership penetration to gain market share. Its ability to gain market share in these markets remains critical, given their high growth potential.

Limited market share in the highly competitive construction equipment sector – The company's product range in the construction equipment segment (slew cranes, compactors and backhoe loaders) remains limited, constraining the company's growth prospects in the construction equipment sector. While a healthy growth in volumes over the past two fiscals has helped the division report a profit at the PBIT level, the division's 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 August 2018, Escorts and Tadano Group, Japan's biggest and world's leading mobile crane manufacturer, announced their joint venture to manufacture rough terrain cranes and truck mounted cranes. The joint venture is likely to help strengthen Escorts market presence in the material handling equipment space over the medium to long term.

Liquidity position

Escorts' cash flows from operations have improved considerably over the past three fiscals, aided by an improvement in scale and operating profitability, even as the blockage of funds in working capital requirements continues to remain low. The company has also been able to report positive free cash flows over the past few fiscals, with capex outgo remaining limited. Although the company has substantial capex plans towards capacity expansion and new product developments, it is likely to largely remain self-sufficient for its fund requirement, given its strong liquidity (non-encumbered cash balances and liquid investments of ~Rs. 618 crore on its books as of March 20, 2019).

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, 2018, the Company had 11 subsidiaries, 1 associate company and 1 JV, that are enlisted in Annexure-2.

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 as 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 manufacturing of 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 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 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.

At present, Escorts is engaged in three major segments - its agri-machinery division (EAM) engaged in manufacturing tractors; the construction equipment division (ECE) engaged in manufacturing and trading in construction equipment products; and its railway equipment division (RED) comprising shock absorbers for railway coaches, centre buffer couplers and brake systems. The company has six manufacturing facilities in Faridabad (Haryana) and one manufacturing facility each in Rudrapur (Uttarakhand) and Poland.

Key financial indicators– Consolidated

	FY2017 (Audited)	FY2018 (Audited)
Operating Income (Rs. crore)	4,145.3	5,059.3
PAT (Rs. crore)	130.8	347.0
OPBDIT/OI (%)	7.5%	10.9%
RoCE (%)	13.1%	26.3%
Total Debt/TNW (times)	0.2	0.0
Total Debt/OPBDIT (times)	0.9	0.1
Interest Coverage (times)	9.6	18.8

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Current Rating (FY2019) Date & Rating March 2019	October 2018	July 2018	Chronology of Rating History for the past 3 years Date & Rating in FY2018 November 2017	Date & Rating in FY2017 March 2017	October 2016	Date & Rating in FY2016 March 2016
1	Term Loans	Long Term	25.9	**13.5**	**[ICRA]AA- (stable)**	**[ICRA]AA- (stable)**	**[ICRA]AA- (stable)**	**[ICRA]A+ (positive)**	**[ICRA]A (positive)**	**[ICRA]A- (stable)**	**[ICRA]A- (stable)**
2	Fund-based-Working Capital Facilities	Long Term/ Short Term	425.0	-	**[ICRA]AA- (stable)/ [ICRA]A1+**	**[ICRA]AA- (stable)/ [ICRA]A1+**	**[ICRA]AA- (stable)/ [ICRA]A1+**	**[ICRA]A+ (positive) / [ICRA]A1+**	**[ICRA]A (positive)/ [ICRA]A1**	**[ICRA]A- (stable)/ [ICRA]A1**	**[ICRA]A- (stable)/ [ICRA]A1**
3	Non-fund based-Working Capital Facilities	Short Term	400.0	-	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1**	**[ICRA]A1**	**[ICRA]A1**
4	Unallocated Limits	Long Term/ Short Term	15.1	-	**[ICRA]AA- (stable)/ [ICRA]A1+**	**[ICRA]AA- (stable)/ [ICRA]A1+**	-	**[ICRA]A+ (positive) / [ICRA]A1+**	**[ICRA]A (positive)/ [ICRA]A1**	**[ICRA]A- (stable)/ [ICRA]A1**	**[ICRA]A- (stable)/ [ICRA]A1**
5	Commercial Paper	Short Term	200.0	**50.0**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[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: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan	August 2015	-	June 2019	25.9	[ICRA]AA- (stable)
NA	Fund-based- Working Capital Facilities	-	-	-	425.0	[ICRA]AA- (stable)/ [ICRA]A1+
NA	Non-fund based- Working Capital Facilities	-	-	-	400.0	[ICRA]A1+
NA	Unallocated Limits	-	-	-	15.1	[ICRA]AA- (stable)/ [ICRA]A1+
INE042A14835	Commercial Paper	March 2019	-	May 2019	50.0	[ICRA]A1+
NA	Commercial Paper	Yet to be placed			150.0	[ICRA]A1+

Source: Escorts Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Escorts Finance Limited	69.42%	Full Consolidation
Escorts Securities Limited	98.86%	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
Haritha Raithu Mithra Agri Services LLP (LLP)	100.00%	Full Consolidation
Revanpalli Raytu Sangam Agri Services LLP (LLP)	100.00%	Full Consolidation
Baba Chadaneswar Agri Services LLP, Balasore (LLP)	100.00%	Full Consolidation
Pancha Sakha Agri Services LLP, Balasore (LLP)	100.00%	Full Consolidation
Jay Jagannath Agri Services LLP, Balipal (LLP)	100.00%	Full Consolidation
Adico Escorts Agri Equipment Private Limited	40.00%	Equity Method
Escorts Consumer Credit Limited	29.40%	Equity Method

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About ICRA Limited:

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Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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