July 19, 2019

Escorts Limited: Ratings reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	25.9	0.0	-
Fund-based - Working Capital Facilities	425.0	339.0	[ICRA]AA-(Stable)/[ICRA]A1+; Reaffirmed
Non-fund Based - Working Capital Facilities	400.0	341.0	[ICRA]A1+; Reaffirmed
Unallocated	15.1	270.0	[ICRA]AA-(Stable)/[ICRA]A1+; Reaffirmed
Total	**866.0**	**950.0**	
Commercial Paper	200.0	200.0	[ICRA]A1+; Reaffirmed

**Instrument details are provided in Annexure-1*

Rationale

The ratings reaffirmation takes into account the steady operational performance of Escorts Limited (Escorts), reflected in healthy volume and profitability expansion in its key business divisions of agri-machinery and construction equipment. While a continuation of favourable farm sentiments (given various Government support programmes) led to a robust volume growth in the agri-machinery division in FY2019, the construction equipment division volumes also continued to benefit from a healthy end-user demand. Benefitting from an improved scale of operations, Escorts achieved a healthy improvement in operating profit margins (expansion of ~70 basis points in FY2019). There has been a moderation in demand in the agri-machinery industry over the last few months, led by suppressed farm cash flows and a delayed monsoon; however, the company's various cost efficiency measures are likely to help it sustain healthy profitability metrics going forward and limit the impact of any downturn in demand.

The ratings continue to favourably factor in the company's strong financial risk profile, characterised by a conservative capital structure and strong debt coverage indicators. Additionally, Escorts continues to maintain healthy cash and bank balances (unencumbered cash and bank balances of Rs. 502.7 crore as on March 31, 2019), resulting in a strong liquidity profile and providing comfort. Going forward, while Escorts has capex plans towards new product development and capacity expansion as well as investment plans in joint ventures (JVs; equity infusion of ~Rs. 60-crore in a JV with the Kubota Group in FY2020), the same are likely to be primarily funded through existing cash balances and future cash accruals, helping it maintain a strong credit profile.

ICRA notes the inherent cyclicality in both tractor and construction equipment sectors, the company's key business segments. However, the ratings continue to take comfort from the company's established market presence and strong brand franchise. Escorts remains 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 share in the southern and western markets in India remains weak (~4.0% and ~7.2% in FY2019, respectively), efforts to further expand its dealership network in these regions are likely to support volume growth over the medium term. While the company's agri-machinery derives modest volumes from exports, the management's focus has been on expansion in the international markets, which is likely to provide growth opportunities over the medium term. As part of its collaboration with Kubota, Escorts tractors (jointly branded) would be sold through Kubota's global distribution network in specific markets, going forward. The company's ability to strengthen its 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.

Over the recent past, the company has been on the lookout for acquisitions to enhance its product profile in the railway equipment division. The impact of any inorganic growth steps undertaken by the company on its credit profile would continue to be monitored. Further, ICRA notes that proceeds from the rated commercial paper programme are intended to be utilised for funding working capital requirements, as per the objects of the issue. Any deviation from the above, which has the effect of exerting pressure on the company's asset-liability position, would be a rating sensitivity.

Outlook: Stable

The Stable outlook on the long-term rating reflects ICRA's expectation that Escorts would report a moderate-to-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 southern and western India aid it in gaining a healthy share in the domestic market, or if it records a healthier-than-expected improvement in 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 last two years, leading to deterioration in its return indicators. 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 in agri-machinery business - Escorts is a leading tractor manufacturer 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 1,00,000 tractors/year and is the midst of expanding its capacity. The agri-machinery division offers a wide range of tractors, primarily under two brands - Farmtrac and Powertrac. Escorts also sells low-horsepower (HP) tractors (10-15 HP) through a JV with the Rajkot-based Adico Group (under the Steeltrac brand). Over the past three fiscals, the company's agri-machinery division recorded a healthy growth in revenues and profits, mainly benefitting from an improved industry demand driven by favourable farm sentiments.

Presence in multiple product segments - Escorts is present in various products, including tractors and agri-machinery manufactured and marketed by its agri-machinery division (EAM), construction equipment such as cranes, compactors and backhoe 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. Though the EAM division drives its revenues and profits, the other businesses provide growth avenues. Additionally, the presence across multiple product segments is likely to limit the impact of any downturn in demand in the agri-machinery industry (as witnessed over the last few months) on Escorts.

Sustainable improvement in cost structure driven by cost rationalisation initiatives across divisions - Escorts is focussed on improving its profitability and has implemented various cost rationalisation exercises over the last few years. Raw material costs have been reduced across divisions through vendor consolidation, price renegotiation, product re-designing and other value analysis/value engineering (VAVE) efforts. The company's operating profit margins improved significantly over the three 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 company has a conservative capital structure and strong debt coverage indicators. Additionally, the company continues to maintain healthy cash and bank balances (unencumbered cash and bank balances of Rs. 502.7 crore as on March 31, 2019), resulting in a strong liquidity profile. Going forward, while Escorts has capex plans towards new product development and capacity expansion, the same are likely to be primarily 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 the demand scenario with sensitivity to monsoon 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 focussing on improving infrastructure in the country with enhanced budgetary allocations. Though the continued Government focus is likely to aid growth in industry volumes across both sectors over the medium to long term, the company is likely to remain exposed to periods of downturn in demand in the key industries catered.

Market presence of agri-machinery division in southern and western India remains weak - Though the company has strengthened its business position over the last three years, its market share in the western and southern regions remains weak, limiting its market share gain prospects at a pan-India level. The agri-machinery division has identified various markets in these regions, where management interaction efforts as well as dealership penetration would be ramped up to gain market share. Its ability to gain share in these markets remains critical, given their high growth potential.

Limited market share in highly competitive construction equipment sector - The company's product range in the construction equipment segment (cranes, compactors and backhoe loaders) remains limited, constraining its growth prospects in the sector. While a healthy volume growth over the last two fiscals helped the division report a profit at the PBIT level, the division's ability to increase scale of operations for contributing in a meaningful manner to the company's profitability remains to be seen. In August 2018, Escorts and the Tadano Group (Japan's largest and the world's leading mobile crane manufacturer) announced their JV to manufacture rough terrain cranes and truck-mounted cranes. The JV is likely to help Escorts strengthen its market presence in the material handling equipment space over the medium to long term.

Liquidity position

The company's cash flows from operations remained healthy over the last few fiscals, aided by an improvement in scale and operating profitability, while blockage of funds in working capital requirements remained low. In FY2019, however, an increase in working capital intensity (at the fiscal end) led to increased blockage of funds in working capital requirements. This was primarily attributable to higher inventory and debtors on the company's books as on March 31, 2019, resulting from a weakness in demand in Q4 FY2019; however, the company had ramped up its production levels in anticipation of better demand during the festive season and the post rabi harvest period. With the company undertaking production cuts over the last few months, there is likely to be a release of funds from working capital over the next few months. As such, Escorts is expected to report positive free cash flows from FY2020, though capex outgo is expected to remain at sizeable levels. The company is also likely to primarily remain self-sufficient for its funding requirements, aided by sufficient healthy cash and bank balances (unencumbered cash and bank balances of Rs. 502.7 crore as on March 31, 2019) and an expectation of healthy cash accruals.

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, 2019, the company had six subsidiaries, one associate company, and three JVs, which are enlisted in Annexure-2.

About the company

Escorts Limited 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 in January 1960. The company started with manufacturing tractors under the Escorts brand name in the 25-40 HP range. In 1969, the company promoted Escorts Tractors Limited (ETL) as a JV with Ford Motor Company (FMC), USA, to manufacture the Ford series of tractors in the 40-50 HP range. Escorts acquired the entire equity stake in ETL in August 1995, making ETL its subsidiary (subsequently merged with its 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 and software) and its JV stake in Carraro were divested during the mid-2000s.

At present, Escorts is involved in three major segments - its agri-machinery division (EAM) manufacturing tractors, construction equipment division (ECE) manufacturing and trading in construction equipment products, and railway equipment division (RED) comprising shock absorbers for railway coaches, centre buffer couplers and brake systems. In December 2016, the company sold off its auto product assets, leading to the closure of the division. The company has manufacturing facilities in Faridabad (Haryana), Rudrapur (Uttarakhand) and Poland.

Key financial indicators - Consolidated

	FY2018 (Audited)	FY2019 (Audited)
Operating Income (Rs. crore)	5,059.3	6,262.0
PAT (Rs. crore)	347.0	478.6
OPBDIT/OI (%)	10.9%	11.6%
RoCE (%)	26.3%	28.4%
Total Debt/TNW (times)	0.0	0.1
Total Debt/OPBDIT (times)	0.1	0.4
Interest Coverage (times)	18.8	37.2

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2020) Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating July 2019	Chronology of Rating History for the past 3 years: Date & Rating in FY2019 March 2019	October 2018	July 2018	Date & Rating in FY2018 November 2017	Date & Rating in FY2017 March 2017	October 2016
1	Fund-based - Working Capital Facilities	Long Term/ Short Term	339.0	-	[ICRA]AA- (Stable)/ [ICRA]A1+	[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
2	Non-fund Based - Working Capital Facilities	Short Term	341.0	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1	[ICRA]A1
3	Unallocated Limits	Long Term/ Short Term	270.0	-	[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
4	Term Loans	Long Term	0.0	-	-	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A (Positive)	[ICRA]A- (Stable)
5	Commercial Paper	Short Term	200.0	-	[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	Fund-based - Working Capital Facilities	-	-	-	339.0	[ICRA]AA- (Stable)/ [ICRA]A1+
NA	Non-fund Based - Working Capital Facilities	-	-	-	341.0	[ICRA]A1+
NA	Unallocated Limits	-	-	-	270.0	[ICRA]AA- (Stable)/ [ICRA]A1+
NA	Commercial Paper	Yet to be placed			200.0	[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	51.26%	Full Consolidation
Escorts Benefit & Welfare Trust	100.00%	Full Consolidation
Escorts Benefit Trust	100.00%	Full Consolidation
Farmtrac Tractors Europe Spolkaz.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
Escorts Consumer Credit Limited	29.40%	Equity Method

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About ICRA Limited:

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