September 22, 2023

Escorts Kubota Limited: Ratings reaffirmed and withdrawn

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term/ Short-term – Fund-based – Working Capital	636.00	636.00	[ICRA]AA+ (Stable)/[ICRA]A1+; reaffirmed and withdrawn
Short-term – Non-fund Based – Working Capital	281.00	281.00	[ICRA]A1+; reaffirmed and withdrawn
Long-term / Short-term – Unallocated	33.00	33.00	[ICRA]AA+(Stable)/[ICRA]A1+; reaffirmed and withdrawn
Total	**950.00**	**950.00**	

**Instrument details are provided in Annexure I*

Rationale

ICRA has reaffirmed the ratings on the bank facilities of Escorts Kubota Limited (EKL) and subsequently withdrawn the ratings at the request of the company and based on the No Objection Certificate received from the banker, and in accordance with ICRA's policy on withdrawal of credit ratings.

The rating reaffirmation of EKL factors in its sustained operational performance and market position across diversified business divisions, which is likely to help it continue to generate healthy cash flows. The ratings also reflect the strong financial profile of the company, characterised by healthy free cash flows and superior liquidity with sizeable cash/bank balances and liquid investments.

The company reported healthy growth in its top line in FY2023; revenues from its agri-machinery (AGM) business division and construction equipment (CE) business division grew by 13.5% and 19.5%, respectively, while its railway equipment (RE) business division reported a YoY improvement by 32.3%. Its revenues grew by 15.9% YoY in Q1 FY2024 supported by 5% growth in the AGM division, 46% growth in the CE division and 72% growth in the RE division. Despite an improvement in EKL's scale of operations, there was a dip in the operating margins by 440 bps in FY2023 over FY2022. The margins remained impacted mainly in its agri-division owing to the inflationary pressures, an unfavourable product mix, and impact of price rationalisation across certain products and geographies. However, aided by price hikes, costs corrective measures and a softening in commodity prices, its margins improved to 14.1% in Q1 FY2024 (10.0% in Q1-FY2023) and are expected to sustain at healthy level in FY2024 with some improvement on a YoY basis. Further, the domestic market share of the company in the tractor segment declined marginally to 10.1% in FY2023 against 10.3% in FY2022. Following a dip in market share in Q1 FY2023, EKL took some corrective actions, which led to a QoQ improvement in the same through the course of the fiscal.

ICRA notes that the shareholding of Kubota Corporation (Kubota) in EKL reached 53.50% as of May 31, 2023, after cancellation of the entire stake of Escorts Benefit and Welfare Trust in the company. Kubota is a well-established global player in the farm equipment, mechanisation and CE segments. The enhanced ownership of Kubota is likely to help the company in strengthening its product development capabilities. EKL is also expected to benefit from the global supply chain of Kubota, leading to a ramp up in its exports over the medium term. The ratings further take into account the healthy financial risk profile of the company, characterised by robust capitalisation and coverage metrics (Debt[1]/OPBDITA at 0.1 time and interest coverage at 58.9 times in FY2023). The strong cash and liquid investments of ~Rs. 4,800 crore and significant working capital buffer as on March 31, 2023, provide additional comfort.

[1] *Debt represents only lease liabilities, and the bank borrowing stands nil as of March 31, 2023.*

The company has plans to increase its manufacturing capacity to three lakh tractors per annum by FY2028 with capex plans of Rs. 350-400 crore per annum. The capex is likely to be funded through existing cash balances and internal accruals. Furthermore, the merger of the joint ventures (JVs), Kubota Agricultural Machinery India Pvt. Ltd. (KAI) and Escorts Kubota India Pvt. Ltd. (EKI) into EKL is likely to be completed by March 2024. The management expects the consolidated margins to decline by ~1.5–2.0% after the merger; nevertheless, the same is expected to improve as the cost synergies play out, going forward.

The ratings remain constrained to an extent, by the inherent cyclicality in both the AGM and CE business divisions. ICRA, however, continues to take comfort from the company's established market share and strong brand franchise in the AGM division, especially in the northern and central markets. Though its 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 over the medium term.

The Stable outlook on the long-term rating reflects ICRA's expectation that EKL would be able to report a moderate-to-healthy earnings growth over the medium term, benefitting from its established market position, collaboration with Kubota and Government plans to promote infrastructure investment. The same is likely to help the company 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 – EKL is one of the leading tractor manufacturers in the country, aided by regular product launches, an established dealership network, healthy financing tie-ups, and targeted marketing efforts. The company has an installed production capacity of 1,70,000 tractors/year (including 50,000 in JV with Kubota) and is in the middle of expanding its capacity. The AGM division offers a wide range of tractors, primarily under two brands, Farmtrac and Powertrac. EKL 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 AGM division has recorded healthy revenues and profits, benefitting from a healthy industry demand driven by favourable farm sentiments. The division recorded a YoY volume growth of 9.6% in FY2023 against industry volume growth of 10.6%, on the back of healthy crop production, a good monsoon, and sound availability of retail finance. The division's growth prospects, however, are expected to moderate in FY2024 on a high base. Any monsoon disruption on account of an El Nino occurrence, unseasonal rainfall or deficient monsoon, which could further dampen farm sentiments, remains a monitorable.

Collaboration with Kubota to deepen technological capabilities and aid exports ramp up – Kubota picked up a stake in EKL (formerly Escorts Limited) through a preferential share issue in 2020. It further enhanced its stake through a preferential issue (February 2022) and an open offer (April 2022) and its shareholding in EKL stands at 53.50% as on date. Given EKL's limited presence in the exports market (exports market share of ~6% and revenue share of ~8% in FY2023), its collaboration with Kubota is likely to help ramp up exports. The collaboration is also likely to strengthen EKL's product development capabilities and help it improve its product portfolio over the medium term. Kubota and EKL's joint ventures in India are also likely to merge into EKL in FY2024, following the requisite approvals, leading to a simplified holding structure.

Presence in multiple product segments – EKL is present across various product segments. These include agri-machinery equipment manufactured and marketed by its AGM division; construction equipment, such as cranes, compactors and back-hoe loaders from its CE division; and railway equipment (shock absorbers for railway coaches, centre buffer couplers and brake systems among others) by its RE division. The company's healthy order book of Rs 1,050 crore in its railway segment as of March 31, 2023, provides stable revenue visibility. Although the AGM division drives its revenues and profits, the company's presence in other businesses provides avenues for growth supported by the GoI's continued thrust on infrastructure activities and a focus on augmenting the country's railway infrastructure.

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 58.9 times as on March 31, 2023). Additionally, the company continues to maintain healthy cash and bank balances (unencumbered cash and liquid investments of ~Rs. 4,800 crore as on March 31, 2023), resulting in a superior liquidity profile. EKL has been able to maintain healthy profitability and return indicators over the past few years. While the operating margins moderated to ~9.3% in FY2023, the same are expected to improve benefitting from the economies of scale, easing of input costs as well as a high localisation in its RE division. The company does not have any bank debt on its books as of March 31, 2023. Going forward, its capex plans are likely to be largely funded through existing cash balances and cash accruals, keeping the credit profile robust.

Credit challenges

AGM and CE business divisions exposed to cyclicality – The company's leading business divisions, AGM and CE, are inherently cyclical in nature. While the AGM division remains exposed to the fluctuations in demand with sensitivity to monsoons and farmer sentiments, growth in the CE business 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 GoI 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 its key end-user industries.

Market presence of AGM 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 focused on launching new application targeted products to plug any gaps in its product portfolio. EKL's 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 CE 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 its profitability remains to be seen. In FY2023, while the division's profitability improved on YoY basis, it remained adversely impacted by inflationary pressures particularly during H1 FY2023. Going forward, the segment margins are likely to improve with an easing of commodity prices and increasing contribution from safe cranes, which is a relatively higher margin product.

Liquidity position: Superior

EKL's liquidity is superior, characterised by expectation of strong cash accruals, cash and liquid investments of ~Rs. 4,800 crore (funds infused through preferential issue from Kubota to be used primarily for capacity expansion and product development under the tractor/CE segments) and significant working capital buffer as on March 31, 2023. The company is expected to incur capex of Rs. 350–400 crore per year and does not have any long-term debt on its books. Going forward, EKL 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.

Environmental and Social Risks

Environmental considerations: Tractor OEMs are exposed to adverse weather conditions such as droughts, floods, change in monsoon patterns, and other agro-climatic factors as they derive most of their demand from the rural sector. Construction/ agricultural equipment OEMs also remain exposed to climate transition risks emanating from a likelihood of tightening emission control requirements, with the GoI focused on reducing the adverse impact of automobile emissions. Companies like EKL may also need to invest materially to develop products to meet regulatory thresholds, which may have a moderating impact on their credit metrics.

Social considerations: OEMs like EKL are exposed to risk arising from labour unrest like strikes and lockouts. The company regularly conducts welfare activities for its employees to mitigate the risk. Another social risk that EKL faces pertains to product safety and quality, wherein instances of product recalls and high warranty costs may not only lead to a financial implication but could also harm their reputation and create a more long-lasting adverse impact on demand. In this regard, EKL's strong brand reputation along with its healthy market share over the years underscore its ability to mitigate these risks to an extent. Further, with Kubota becoming a co-promoter, EKL's focus on improving its product quality, manufacturing processes, and technology adoption has been enhanced.

Rating sensitivities

Positive factors – Not applicable

Negative factors – Not applicable

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Policy on Withdrawal of Credit Ratings Rating Methodology for Tractor Manufacturers
Parent/Group support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of EKL, details of which are enlisted in Annexure II.

About the company

Incorporated in 1944, Escorts Kubota Limited (formerly Escorts Limited) is a leading tractor and farm equipment OEM in India with ~10.1% market share in the domestic market (FY2023). The company generates business from its three key divisions— AGM, involved in manufacturing tractors (~76% of revenues in FY2023); the CE division, involved in manufacturing and trading construction equipment products (~14%); and the RE division, which manufactures shock absorbers for railway coaches, centre buffer couplers and brake systems, etc (~10%). The company has manufacturing facilities in Faridabad (Haryana) and Poland.

The AGM 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. EKL entered into a collaboration with Kubota Corporation, Japan, wherein after establishing two JVs, the latter acquired an equity stake in the company through a preferential issue in 2020. Thereafter, in February 2022, and a mandatory open offer in April 2022, Kubota's shareholding in EKL rose to ~53.50%. The company's board comprises 18 members, of whom nine are independent directors.

EKL was incorporated as Escorts (Agents) Private Limited (EAPL) in Lahore in 1944. EAPL was subsequently converted into a public limited company and renamed as Escorts Limited 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, USA, for manufacturing the Ford Series of tractors in the 40–50 HP range. Escorts Limited acquired the entire equity stake of ETL in August 1995, making ETL its subsidiary (to be subsequently merged with the AGM division).

Key financial indicators (audited)

EKL (consolidated)	FY2022	FY2023	Q1-FY2024
Operating income	7,282.7	8,428.7	2,355.2
PAT	765.0	644.1	285.2
OPBDIT/OI	13.7%	9.3%	14.1%
PAT/OI	10.5%	7.6%	12.1%
Total outside liabilities/Tangible net worth (times)	0.2	0.2	-
Total debt/OPBDIT (times)	0.1	0.1	-
Interest coverage (times)	66.6	58.9	96.5

Rs crore; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; Total debt represents only lease liabilities and the bank borrowing stands nil; balance sheet figures not available for Q1; Source: Company, ICRA Research. All ratios as per ICRA calculations.

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2024)					Chronology of Rating History for the past 3 years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding as on March 31, 2023 (Rs. crore)	Date & Rating in		Date & Rating in FY2023	Date & Rating in FY2022		Date & Rating in FY2021	
					Sep 22, 2023	Jun 30, 2023	Apr 20, 2022	Nov 29, 2021	Oct 25, 2021	Mar 31, 2021	Sep 17, 2020
1	**Fund-based- Working Capital Facilities**	Long Term/ Short Term	636.00	-	[ICRA]AA+(Stable)/ [ICRA]A1+; Withdrawn	[ICRA]AA+ (Stable)/ [ICRA]A1+	[ICRA]AA+ (Stable)/ [ICRA]A1+	[ICRA]AA&/ [ICRA]A1+	[ICRA]AA (stable)/ [ICRA]A1+	[ICRA]AA (stable)/ [ICRA]A1+	[ICRA]AA (stable)/ [ICRA]A1+
2	**Non-fund based- Working Capital Facilities**	Short Term	281.00	-	[ICRA]A1+; Withdrawn	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3	**Unallocated Limits**	Long Term/ Short Term	33.00	-	[ICRA]AA+(Stable)/ [ICRA]A1+; Withdrawn	[ICRA]AA+ (Stable)/ [ICRA]A1+	[ICRA]AA+ (Stable)/ [ICRA]A1+	[ICRA]AA&/ [ICRA]A1+	[ICRA]AA (stable)/ [ICRA]A1+	[ICRA]AA (stable)/ [ICRA]A1+	[ICRA]AA (stable)/ [ICRA]A1+
4	**Commercial Paper**	Short Term	-	-	-	-	-	-	-	[ICRA]A1+ Withdrawn	[ICRA]A1+

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 analysing 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 are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Fund-based- Working Capital Facilities**	NA	NA	NA	**636.00**	[ICRA]AA+(Stable)/[ICRA]A1+; Reaffirmed and withdrawn
NA	**Non-fund based- Working Capital Facilities**	NA	NA	NA	**281.00**	[ICRA]A1+; Reaffirmed and withdrawn
NA	**Unallocated Limits**	NA	NA	NA	**33.00**	[ICRA]AA+(Stable)/[ICRA]A1+; Reaffirmed and withdrawn

Source: Company

Annexure II: List of entities considered for consolidated analysis:

Company Name	EKL Ownership	Consolidation Approach
Escorts Kubota Limited	100.00% (rated entity)	Full Consolidation
Invigorated Business Consulting Ltd (Formerly Escorts Finance Ltd)	67.87%	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	29.41%	Equity Method

*Source: Annual report FY2023; *relationship ceased w.e.f. November 09, 2022*

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