

June 30, 2023

Escorts Kubota Limited: Ratings reaffirmed

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	646.0	636.0	[ICRA]AA+ (Stable)/[ICRA]A1+; Reaffirmed
Short-term – Non-fund based working capital	281.0	281.0	[ICRA]A1+; Reaffirmed
Unallocated	23.0	33.0	[ICRA]AA+ (Stable)/[ICRA]A1+; Reaffirmed
Total	950.00	950.00	

*Instrument details are provided in Annexure-1

Rationale

The rating reaffirmation of Escorts Kubota Limited's (EKL) factors in its sustained operational performance and market position across diversified business divisions, which is likely to help it continue to generate healthy flows, going forward. 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 business division (AGM) and construction equipment business division (CE) grew by 13.5% and 19.5%, respectively, while its railway equipment business division (RE) reported a YoY improvement by 32.3%. 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 on input costs, an unfavourable product mix, and impact of price rationalisation across certain products and geographies. Aided by various corrective measures and a softening in commodity prices, the margins are likely to improve in FY2024. 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 fiscal.

ICRA notes that the shareholding of Kubota Corporation (Kubota) in EKL has reached 53.50% as on date, after cancellation of entire stake of Escorts Benefit and Welfare Trust in the company. Kubota is a well-established global player in the farm equipment, mechanisation and construction equipment 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 (Debt¹/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.

The company has plans to increase its manufacturing capacity to three lakh tractors per annum by FY2028. While the capex is likely to be funded only through existing cash balances and internal accruals; ICRA would continue to monitor impact of any major capex on its credit profile. 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 Q4 FY2024. The management expects the consolidated margins to decline by ~1.5–2.0% after the merger; nevertheless, the margins are expected to improve as the cost synergies play out, going forward.

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

The ratings remain constrained to an extent, by the inherent cyclicity 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 increase agricultural income and 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/ refreshes, 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 to an extent in FY2024 on a high base. Further, any monsoon disruption on account of an El Nino occurrence, unseasonal rainfall or deficient monsoon precipitation, which could 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 Government'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 cyclicity – 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 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 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 focussed 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 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 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 tractor/ construction equipment 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, etc, as they derive most of their demand from the rural sector, which may be impacted by such environmental factors. Construction/agricultural equipment OEMs also remain exposed to climate transition risks emanating from a likelihood of tightening emission control requirements, with the Government 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. It 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 – 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 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); CE division, involved in manufacturing and trading construction equipment products (~14%); and 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 and thereafter increased the same through a further preferential issue and mandatory open offer, taking Kubota’s shareholding to ~53.50% as on date. 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 (subsequently merged with the AGM division).

Key financial indicators (audited)

EKL (consolidated)	FY2022	FY2023
Operating income	7,282.7	8,428.7
PAT	765.0	644.1
OPBDIT/OI	13.7%	9.3%
PAT/OI	10.5%	7.6%
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

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; 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	Type	Current Rating (FY2024)		Chronology of Rating History for the past 3 years					
		Amount Rated (Rs. crore)	Amount Outstanding as of Mar 31, 2023 (Rs. crore)	Date & Rating in Jun 30, 2023	Date & Rating in FY2023	Date & Rating in FY2022		Date & Rating in FY2021	
						Apr 20, 2022	Nov 29, 2021	Oct 25, 2021	Mar 31, 2021
1 Fund-based-Working Capital Facilities	Long Term/Short Term	636.0	-	[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	281.0	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3 Unallocated Limits	Long Term/Short Term	33.0	-	[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+

&= 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: [Click Here](#)

Annexure I: 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	NA	NA	NA	636.0	[ICRA]AA+(stable)/[ICRA]A1+
NA	Non-fund based-Working Capital Facilities	NA	NA	NA	281.0	[ICRA]A1+
NA	Unallocated Limits	NA	NA	NA	33.0	[ICRA]AA+(stable)/[ICRA]A1+

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
Escorts Finance Limited	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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