

September 17, 2020

Escorts Limited: Long-term rating upgraded to [ICRA]AA; short-term rating of [ICRA]A1+ reaffirmed

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based – Working Capital Facilities	339.0	339.0	[ICRA]AA (Stable); Upgraded from [ICRA]AA- &, removed from rating watch with developing implications; [ICRA]A1+ Reaffirmed
Non-fund Based – Working Capital Facilities	341.0	356.0	[ICRA]A1+ reaffirmed
Unallocated	270.0	255.0	[ICRA]AA (Stable); Upgraded from [ICRA]AA- &, removed from rating watch with developing implications; [ICRA]A1+ Reaffirmed
Total	950.0	950.0	
Commercial Paper	200.0	200.0	[ICRA]A1+ reaffirmed

*Instrument details are provided in Annexure-1

Rationale

ICRA had placed the long-term ratings of Escorts Limited (Escorts) on rating watch with developing implications in March 2020, following the in-principle approval by the company's board to issue 10% equity stake on a preferential basis to Kubota Corporation, for a consideration of Rs. 1,041.9 crore. Furthermore, as part of the collaboration, Escorts agreed to acquire a 40% stake in Kubota Agricultural Machinery Private Limited (marketing and sales company of Kubota Corporation in India) at a consideration of Rs. 90 crore.

In July 2020, the company notified the completion of the preferential issue to Kubota Corporation; the transaction to acquire a 40% stake in Kubota Agricultural Machinery Private Limited is expected to be completed by the end of Q3 FY2021. Given these developments, ICRA has removed the long-term ratings from watch with developing implications and upgraded the rating, while also assigning a Stable outlook to the same. The rating upgrade takes into account a further improvement in the company's financial risk profile, post the completion of the preferential issue. Over the past few years, Escorts has been able to report a sustained healthy operational performance across business divisions. This has aided the company in recording strong cash accruals and had helped Escorts become nearly debt free (debt of Rs. 19.9 crore excluding lease liabilities as of March 31, 2020) while also having substantial unencumbered cash and liquid investments. A continuation of steady operational performance in Q1 FY2021, despite the adverse impact of the lockdowns following the spread of novel coronavirus (Covid-19), coupled with the receipt of funds post the completion of the preferential issue, has led to a further enhancement in the unencumbered cash and liquid investments to levels of Rs. 2,219 crore as of July 31, 2020; the same is expected to aid Escorts in strengthening its business profile by supporting its capacity and network expansion plans over the medium term.

Escorts entered into a collaboration with Kubota Corporation in December 2018, under which initially the two OEMs decided to set up a joint venture engaged in manufacturing of tractors. As a part of the collaboration, the companies also decided to jointly develop new products to cater to domestic and overseas markets. The rating upgrade also factors in

favourably an expectation of a further strengthening in Escorts's product development capabilities post the strengthening of the collaboration, which is likely to help Escorts enrich its product profile and improve its competitive positioning over the medium term.

The ratings continue to favourably factor in the steady operational performance of Escorts. Despite the adverse impact of the lockdowns following the spread of Covid-19 on the company's revenue growth prospects over the short term, ICRA takes comfort from the strong recovery in farm sentiments post the relaxation of lockdown measures, which has led to robust growth in volumes for the agri-machinery division (drove 77% of revenues in FY2020) over the past few months. Aided by an expectation of continuation of healthy farm sentiments led by healthy monsoon precipitation and kharif crop outlook, the agri-machinery division is likely to record a growth in revenues in the current fiscal. The strong performance of the agri-machinery division will, thus, help Escorts offset an expectation of relatively weak performance of the construction equipment division (fortunes of construction equipment division significantly impacted by the lockdown measures) and help curtail the revenue decline for the company in FY2021, while also helping it maintain healthy profitability and return indicators.

ICRA notes the inherent cyclicity 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 (11.6% market share in FY2020) and strong brand franchise, especially in the northern and Central markets. Escorts continues to be 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 market share in the southern and western markets in India continues to remain limited, its efforts to further expand its dealership network in these regions are likely to support volume growth in the regions over the medium term.

Over the recent past, the company has been on the lookout for acquisitions to enhance its product profile in the railway equipment division. As a part of its collaboration with Kubota Corporation, the company could also undertake significant investments in the agri-machinery/construction equipment segments for enhancing its product profile; more clarity on the same is expected to emerge towards the end of this fiscal. The impact of any major investments/inorganic growth steps undertaken by the company, on its credit profile, would continue to be monitored.

The Stable outlook on the long-term rating reflects ICRA's expectation that Escorts would be able to 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 same is likely to help the company maintain a strong credit profile.

Key rating drivers and their description

Credit strengths

Leading tractor OEM in India with strong brand franchise, vast dealer network and established track record; collaboration with Kubota Corporation to aid exports ramp up – Escorts is one of the leading tractor manufacturers in the country (domestic market share of 11.6% in FY2020), aided by regular product launches/refreshes, an established dealer network, healthy financing tie-ups, and targeted marketing efforts. The company has an installed capacity of 1,00,000 tractors/year and is in the midst of expanding its capacity. The agri-machinery division offers a wide range of tractors, primarily under the two brands, Farmtrac and Powertrac. Escorts also sells a low horsepower (HP) tractor (10-15 HP category) 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 healthy revenues and profits, largely benefitting from steady industry demand, driven by favourable farm sentiments.

Escorts entered into a collaboration with Kubota Corporation in December 2018, under which initially the two OEMs decided to set up a joint venture engaged in manufacturing of tractors. As a part of the collaboration, Escorts also gained access to Kubota Corporation's distribution network in various export markets; these included the developed US and European markets, for hobby/garden farming applications. The collaboration between Escorts and Kubota Corporation has been enhanced in 2020, wherein the latter has now acquired a 9.09%¹ stake in Escorts through a preferential share issue; additionally, Escorts will also acquire a 40% stake in Kubota Corporation's marketing arm in the Indian market. Given Escorts limited presence in the exports market till date, its collaboration with Kubota Corporation (a well-established player in global markets) is likely to ramp up the company's exports, going forward. The collaboration is also likely to strengthen Escorts's product development capabilities, and help it further improve its product portfolio through various application targeted launches.

Presence in multiple product segments like agri-machinery, construction equipment and railway equipment – Escorts has a presence across various product segments. These include 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.

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 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. 2,219 crore as of July 31, 2020), resulting in a strong liquidity profile. Escorts has been able to maintain healthy profitability and return indicators over the past few years, benefitting from economies of scale and various cost efficiency measures. Even as an expected decline in scale of operations of the construction equipment division is likely to exert pressure on the profitability margins in FY2021, an expected healthy performance of the agri-machinery division is likely to lend support to profitability. 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 cyclical – 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 with sensitivity to monsoons and farmer sentiments, growth in the construction equipment business 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 focusing on improving the infrastructure in the country with enhanced budgetary allocations. Even as continued Government focus is likely to aid a 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 end-user industries. In the current fiscal, while there has been a strong recovery in demand for the agri-machinery segment following the disruption in operations on account of the pandemic induced lockdowns, the performance of the construction equipment segment is expected to remain impacted.

¹ Simultaneously with the approval for the preferential issue, the board also gave an in-principle approval to cancel an equivalent amount of shares held by Escorts Benefit and Welfare Trust (treasury shares with Escorts Limited being the ultimate beneficiary), subject to necessary approvals and completion of the preferential allotment to Kubota Corporation. Post the cancellation of shares (expected by fiscal end), shareholding of Kubota Corporation would increase to 10%.

Market presence of the agri-machinery division in southern and western India remains limited – Even as the company has strengthened its business position over the past three years, its market share in the western and southern regions remains limited, which has restricted the company's market share gain prospects at a pan India level. The agri-machinery 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. Additionally, the management remains focussed on launching new application targeted products such as haulage tractors and lightweight paddy tractors to plug any gaps in its product portfolio. Its ability to gain market share in these domains 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 (cranes, compactors and backhoe loaders) remains limited, constraining the company's growth prospects in the sector. While an improvement in the scale of operations of the division over the past few fiscals has helped the division report a profit at the PBIT level, its 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 the current fiscal, led by disruptions caused by the enforced lockdowns, the division's performance is expected to remain impacted. In August 2018, Escorts and Tadano Group, Japan's biggest 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 strengthen Escorts's market presence in the material handling equipment space over the medium to long-term.

Liquidity position: Strong

The liquidity position of the entity remains strong, supported by sizeable cash and bank balances (~Rs. 2,219 crore unencumbered cash and bank balances as of July 31, 2020) and marginal utilisation of revolving credit and working capital facilities (buffer of ~Rs. 330 crore as of July 31, 2020). The strong liquidity profile is likely to remain more than adequate to help the company meet its debt obligations (repayments of ~Rs. 3.4 crore in FY2021) and capital expenditure plans (~Rs. 200-250 crore in FY2021), while continuing to provide comfort.

Rating sensitivities

Positive triggers – The rating may be revised upwards if the company further strengthens its market share meaningfully in the domestic tractor and farm equipment segment, aided by new product launches, market share traction in geographies where it has relatively limited presence and technological support by virtue of its business tie-up with Kubota Corporation. The company's ability to maintain comfortable profitability and credit metrics on a sustained basis will also be considered favourably for a rating revision.

Negative triggers – The rating may be revised downwards if the company is not able to sustain the improvement in operating profitability demonstrated over the last two years, leading to a significant deterioration in its return indicators and credit metrics. The adverse impact of any acquisitions undertaken 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 Escorts Limited. As on March 31, 2020, the company had six subsidiaries, an associate company and three JVs, which are enlisted in Annexure-2.

About the company

Incorporated in 1944, Escorts Limited is a leading tractor and farm equipment OEM in India with ~11.6% market share in the domestic market. The company generates business from its three key divisions—agri-machinery (EAM) engaged in manufacturing tractors (~77% of revenues), construction equipment (ECE) engaged in manufacturing and trading in construction equipment products (~15%), and the railway equipment division (RED), which manufactures shock absorbers for railway coaches, centre buffer couplers and brake systems (~8%). The company has manufacturing facilities in Faridabad (Haryana), Rudrapur (Uttarakhand) and Poland.

EAM manufactures and markets its tractors under the 'Farmtrac', 'Powertrac' and 'Steeltrac' brands and commands a strong presence in the northern and Central regions 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. Escorts has entered into a collaboration with Kubota Corporation, wherein after establishing a manufacturing JV, the latter has acquired an equity stake in Escorts through a preferential issue. ECE manufactures as well as trades construction, material handling and earth moving equipment. The division's manufactured product range includes pick-and-carry cranes (PNC), vibratory compactors, slew cranes and back-hoe loaders etc..

The company was promoted by the Delhi NCR-based Nanda family. Mr. Nikhil Nanda is the current chairman and managing director of the company. The company's board comprises 12 members, of whom six are independent. 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 in January 1960. The company started off by 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, for manufacturing 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 the 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, 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. In December 2016, the company sold off its auto product assets, leading to the closure of the division.

Key financial indicators– Consolidated

	FY2019	FY2020
Operating Income (Rs. crore)	6,262.0	5,810.1
PAT (Rs. crore)	478.6	472.8
OPBDIT/OI (%)	11.6%	11.4%
RoCE (%)	28.4%	21.4%
Total Outside Liabilities/Tangible Net Worth (times)	0.8	0.6
Total Debt/OPBDIT (times)	0.4	0.1
Interest Coverage (times)	37.2	38.5
DSCR	11.2	22.7

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Rating history for last three years:											
		Current Rating (FY2021)			Chronology of Rating History for the past 3 years						
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2020		Date & Rating in FY2019		Date & Rating in FY2018	
						30-Mar-20	19-Jul-19	28-Mar-19	4-Oct-18	19-Jul-18	21-Nov-17
1	Fund-based-Working Capital Facilities	Long Term/Short Term	339.0	-	[ICRA]AA (stable)/[ICRA]A1+	[ICRA]AA- &/[ICRA]A1+	[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+
2	Non-fund based-Working Capital Facilities	Short Term	356.0	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3	Unallocated Limits	Long Term/Short Term	255.0	-	[ICRA]AA (stable)/[ICRA]A1+	[ICRA]AA- &/[ICRA]A1+	[ICRA]AA-(stable)/[ICRA]A1+	[ICRA]AA-(stable)/[ICRA]A1+	[ICRA]AA-(stable)/[ICRA]A1+	-	[ICRA]A+ (positive)/[ICRA]A1+
4	Term Loans	Long Term	0.0	-	-	-	-	[ICRA]AA-(stable)	[ICRA]AA-(stable)	[ICRA]AA-(stable)	[ICRA]A+ (positive)
5	Commercial Paper	Short Term	200.0	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

& Rating on watch with developing implications

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	-	-	-	356.0	[ICRA]A1+
NA	Unallocated Limits	-	-	-	255.0	[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 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
Escorts Consumer Credit Limited	29.40%	Equity Method

ANALYST CONTACTS

Subrata Ray

+91 22 6114 3408

subrata@icraindia.com

Shamsher Dewan

+91 1244545328

shamsherd@icraindia.com

Rohan Kanwar Gupta

+91 1244545808

rohan.kanwar@icraindia.com

RELATIONSHIP CONTACT

L Shivakumar

+91 22 2433 1046

shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani

Tel: +91 124 4545 860

communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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For more information, visit www.icra.in

ICRA Limited

Corporate Office

Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002

Tel: +91 124 4545300

Email: info@icraindia.com

Website: www.icra.in

Registered Office

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001

Tel: +91 11 23357940-50

Branches

Mumbai + (91 22) 24331046/53/62/74/86/87

Chennai + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,

Kolkata + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,

Bangalore + (91 80) 2559 7401/4049

Ahmedabad+ (91 79) 2658 4924/5049/2008

Hyderabad + (91 40) 2373 5061/7251

Pune + (91 20) 2556 0194/ 6606 9999

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