WEATHER'S GOOD Monsoon, pick-up in construction biz to help turnaround

Escorts to Thrive with Good Rains, New Products

Escorts: EBITDA Margin Trajectory

FY	2011	2012	2014*	2015	2016	2017
Raw Material (%)	72.8	72.9	71.6	71.2	69.1	68.7
Employee Cost (%)	9.4	10.4	10.6	10.9	12.3	10.7
EBITDA	167.5	189.6	387	162.7	146.4	255.2
EBITDA Margin (%)	4.1	4.7	6	4	4.1	6.1

*(18 months) Source: MOST

MIDCAP MANTRA

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ET Intelligence Group: Amidst lower farm income due to two years of drought, tractor-maker Escorts took efforts to plug gaps in its product portfolio. This makes the company ready to take advantage of a turnaround in demand as this year's monsoon advances. In addition, its construction division is set to gain due to the government's initiatives to revive demand.

Escorts has installed a capacity of 1 lakh tractors per annum. It earns 80% revenue by selling tractors. Around one-third of the income of a tractor owner depends on non-agricultural activities. To address this requirement, the company launched multi-purpose anti-lift tractors (ALTs). These tractors now contribute 10% to total sales volume. To help customers identify tractors that suit their requirements, the company has started selling tractors that deliver higher power and those which deliver better mileage, separately.

Due to these initiatives, the company's market share in FY16 inched up 1.2% year-on-year to 10.9% in the 30-45 HP segment, where growth rate is higher than the industry average. Analysts expect these steps will help the company to grow its volume with a compounded average of 14% between FY16 and FY18.

Escorts' operating margins of 5-8% are way lower than its peer Mahindra & Mahindra (M&M), at 13-15%. To improve profitability, Escorts plans to bring down the proportion of raw materials in sales from 72% in FY15. In addition, it has started offering voluntary retirement to employees to reduce the long-term employee costs. It has targeted an operating margin of 13-14% by FY18-19.

After five consecutive years of decline, the construction business is gradually picking up, thanks to the government's efforts to increase road construction to 30 km per day. The Construction equipment industry witnessed a growth of 15.8% in FY16 and Escorts' served markets grew by 5.5%. The volume growth in equipment used in road construction such as compactors, backhoe loader has increased more 50% in the first two months of FY17. This sparks confidence among investors that the company's construction division will break even this fiscal.

VALUATION GAME

At CMP of ₹209.4, the stock is valued at 10 times its projected FY17 earnings

At the Friday's closing of ₹209.4, the stock is valued at 10 times its projected FY17 earnings — a 30% discount to M&M. The company will be among the direct beneficiaries of an above average monsoon.