Sharekhan by BNP PARIBAS

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Viewpoint

Result Update

VST Tillers and Tractors Ltd

Margins plunge in Q1; Outlook stays positive

Automobiles	Sharekhan code: VSTTILLERS		
Reco/View: Positive ↔	CMP: Rs. 2,376	Upside potential: 17% ↓	

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

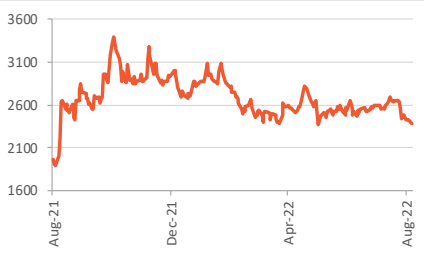
Company details

Market cap:	Rs. 2,053 cr
52-week high/low:	Rs. 3,458 / 1,890
NSE volume: (No of shares)	38.5 lakh
BSE code:	531266
NSE code:	VSTTILLERS
Free float: (No of shares)	0.4 cr

Shareholding (%)

Promoters	54.8
FII	5.4
DII	16.4
Others	23.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-8.4	-4.6	-16.7	20.9
Relative to Sensex	-20.3	-17.6	-18.8	11.2

Sharekhan Research, Bloomberg

Summary

- We maintain a positive view on VST Tillers & Tractors Limited (VST Tillers) and expect an upside of 17%, led by improving rural sentiments, positive business outlook and comfortable valuations.
- Q1FY23 performance was weak, driven by a sharp fall in EBITDA margin led by raw material inflation and increase in other operating expenses.
- The company is well-placed to benefit from a strong rural economy and increase in farm mechanisation; earnings to grow robust at 23.1% CAGR during FY22-FY24E.
- The stock trades at attractive valuations of P/E multiple of 13.7x and EV/EBITDA multiple of 11.1x its FY24E estimates.

VST Tillers & Tractors Ltd's (VST Tillers') Q1FY23 performance was weak, driven by a sharp fall in EBITDA margin led by raw material price inflation and an increase in other operating expenses. Despite the revenues grew by 21.9% y-o-y in Q1FY23, the EBITDA and PAT declined 33% y-o-y and 58.1% y-o-y respectively. The management has given a positive outlook across its business, driven by strong rural sentiments and its focus on increasing addressable markets through technological partnerships, niche product launches, wider distribution networks and increasing brand building exercises. The company aspires to be a Rs. 3,000 crore global brand in the diversified farm mechanization products and solutions sector by FY2025E, growing at 52% revenue CAGR over the period FY22-FY25E. We remain positive on the rural economy and expect VST Tillers to be a key beneficiary. In addition, we expect EBITDA margin to normalize from Q3FY22 onwards. We reiterate our positive viewpoint rating on the stock with an upside potential of 17%.

Key positives

- Power tillers continue to be the key growth driver for the company, growing 36.1% y-o-y in Q1.

Key negatives

- EBITDA margin witnessed sharp contraction of 660bps q-o-q to 7.2% in Q1FY23, led by commodity price inflation and unfavourable product mix. Gross margin declined 430 bps q-o-q to 37.4%.

Management Commentary

- The management stays positive on outlook across business, driven by strong rural sentiments and its focus on increasing addressable markets through technological partnerships, launching niche products, enhancing distribution networks and increasing brand building exercises//.
- The company maintained its capex spending at Rs. 60 crore in FY23E, for new launches and product developments.
- The company undertook a 1-2% price hike in July.

Our Call

Valuation – Maintain a Positive viewpoint rating with an upside potential of 17%: VST Tillers is well-positioned to maintain its dominant market share in the power tiller market. Market share gains driven by new product launches across brands would increase the company's addressable market. In addition, the company is strengthening its distribution network across the country. The company has technological tie-ups with Pubert (France) and Zetor (Czech Republic) for product development. VST Tillers has invested in California, US-based Zimeno Inc, a manufacturer of driver optional born electric tractors under the Monarch brand. The stock is trading below its historical average, at P/E multiple of 13.7x and EV/EBITDA of 11.1x on its FY24E estimates. We remain positive on the company, given a strong brand recall, extensive network, strong balance sheet and superior return ratio profile. Thus, reiterate our positive viewpoint rating on the stock with an upside potential of 17%.

Key Risks

Rising commodity prices and pricing pressures from automotive OEM customers can impact its profitability. Uneven distribution of monsoon could potentially impact our future estimates.

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Net sales	764	854	1,039	1,253
Growth (%)	40.6	11.7	21.7	20.6
EBIDTA	105	124	131	182
OPM (%)	13.8	14.5	12.7	14.5
Adj PAT	104	99	110	150
Growth (%)	479.2	(4.7)	10.3	37.2
FD EPS	120.7	114.9	126.8	174.0
P/E (x)	19.7	20.7	18.7	13.7
P/BV (x)	3.1	2.8	2.6	2.9
EV/EBITDA (x)	19.3	16.3	15.4	11.1
RoE (%)	16.8	14.3	14.5	20.0
RoCE (%)	16.9	14.4	14.6	20.2

Source: Company; Sharekhan estimates

Weak operational performance in Q1FY23:

VST Tillers & Tractors Ltd's (VST Tillers') Q1FY23 performance was weak, driven by sharp fall in EBITDA margin led by raw material inflation and increase in other operating expenses. Despite the revenues grew by 21.9% y-o-y in Q1FY23, the EBITDA and PAT declined 33% y-o-y and 58.1% y-o-y respectively. Net revenue increased 21.9% y-o-y to Rs236 crore, led by 23.6% growth in volumes, partially offset by 1.4% decline in average sales realisation. The q-o-q improvement in revenues was aided by 8.2% improvement in average sales realisation. EBITDA margin witnessed sharp contraction of 660bps q-o-q to 7.2% in Q1FY23, led by commodity price inflation and unfavourable product mix. The gross margin declined 430 bps q-o-q to 37.4%. As a result, EBITDA and PAT declined 43.5% q-o-q and 54.5% q-o-q to Rs17 crore and Rs 10.1 crore respectively.

Positive outlook:

The management has given a positive outlook across its business, with the expectations of a normal monsoon this year and its focus on increasing addressable markets through technological partnerships, launching niche products, enhancing distribution networks and increasing brand building exercises. The company has maintained its capex spending at Rs. 60 crore for FY23E, for new launches and product developments. The company undertook a 1-2% price hike in July. The company continues its efforts for increasing market share across product ranges. Power tillers and power weeders remain the focus area for the company.

Eyeing revenues of Rs. 3,000 crore by FY2025E:

VST Tillers eyes annual revenues of Rs. 3,000 crore by FY2025, from Rs. 854 crore in FY2022, at an implied revenue CAGR of 52%. The company has laid down four key strategies to achieve the target. As a company, VST targets to evolve from a power tillers company to an established small farm mechanisation company. The second strategy is to strengthen its leadership in the compact tractor category with greater coverage and a broader range of products. Thirdly, the company focuses on the higher HP segment through its partnership with Zetor. Lastly, the company is developing a precision component business for its Mysore plant, to promote precision in farm mechanization products. The company has introduced new products in FY2021, including the 27-HP high torque compact tractor and a 16 HP power tiller. The 30 HP VST 932 compact tractor has also been launched this year.

Exports remain a key focus area:

In the overseas market, the company has an offering of its complete range of VST Tractors and VST FIELDTRAC. VST's focus has been on Europe, Africa & Asia. The company has established a significant presence in Europe with distribution in France, Germany, Netherland, Spain, Portugal, Poland, Romania, Bulgaria etc. The company has over 10% market share in France in greater than 30 HP segment. In the export market, the company has collaborated with eminent global partners such as Monarch, Pubert France and Zetor. The company has strengthened its distributor network across various countries.

Strong earnings growth and robust balance sheet

VST is virtually debt-free and is expected to generate free cash flows (FCF) of Rs. 100-150 crore annually going forward. In FY23E, the company would have Capex requirement of Rs. 60 crores. The company is expected to grow business with internal accruals. Earnings are expected to grow strongly at 23.1% CAGR over FY22-24E, led by a 21.1% revenue CAGR and a 10bps improvement in EBITDA margin. We expect VST's return ratios to revert to peak levels. The company's return ratios are reflective of the cyclical nature of business due to the cyclical nature of farm business and its high dependency on monsoon and government intervention. We expect the company's ROCE to revert to 18-20% over the next few years. Going forward, VST will be more focused on increasing market share through niche product development, a wider distribution network, and brand-building exercises. We remain positive on the rural economy and expect VST Tillers to be a key beneficiary.

Results (Standalone) Rs cr

Particulars	Q1FY23	Q1FY22	Y-o-Y %	Q4FY22	Q-o-Q %
Revenue	236.0	193.6	21.9	218.4	8.1
Total operating expenes	219.0	168.2	30.2	188.2	16.3
EBIDTA	17.0	25.4	-33.0	30.2	(43.5)
Depreciation	6.4	5.8	10.2	7.2	(10.7)
Interest	0.2	0.2	15.8	0.3	(12.0)
Other Income	2.3	11.8	-80.7	6.4	(64.5)
PBT	12.7	31.2	-59.4	29.2	(56.5)
Tax	2.6	7.2	-63.4	7.1	(62.7)
Reported PAT	10.1	24.0	-58.1	22.1	(54.5)
Adjusted PAT	10.1	24.0	-58.1	22.1	(54.5)
EPS	11.6	27.8	-58.1	25.6	(54.5)

Source: Company; Sharekhan Research

Key ratios (Standalone)

Particulars	Q1FY23	Q1FY22	Y-o-Y (bps)	Q4FY22	Q-o-Q (bps)
Gross margin (%)	27.4	30.8	(340)	31.6	(430)
EBIDTA margin (%)	7.2	13.1	(590)	13.8	(660)
EBIT margin (%)	4.5	10.1	(560)	10.5	(600)
Net profit margin (%)	4.3	12.4	(810)	10.1	(590)
Effective tax rate (%)	20.7	23.0	(230)	24.2	(350)

Source: Company; Sharekhan Research

Volume Analysis Rs./ Vehicle

Particulars	Q1FY23	Q1FY22	Y-o-Y %	Q4FY22	Q-o-Q %
Volume	10,848	8,777	23.6	10,858	(0.1)
Average sales realisation	2,17,533	2,20,577	(1.4)	2,01,105	8.2
RMC/Vehicle	1,57,965	1,52,683	3.5	1,37,456	14.9
EBITDA/Vehicle	15,690	28,928	(45.8)	27,768	(43.5)
PAT/Vehicle	9,264	27,356	(66.1)	20,354	(54.5)

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector Outlook – Demand for agri-machinery to remain healthy on strong rural economy

We expect the farm machinery industry to remain healthy over the next couple of years, aided by healthy rural cash flows. Though COVID-19 has hit the rural economy over the last 2 years, we expect it to recover strongly, led by the government's grounded initiatives for the agriculture and farming sector, strong Kharif crop in the previous year, higher reservoir levels, a forecast for normal rains this year and pent up demand. The government has hiked minimum support prices (MSPs) of Kharif crops for marketing season FY22 to support farmers for their produce. Rural cash flows have further been supported by the government's increased outlay for the MSP procurement (targeting farmers) and MGNREGS (targeting migrant labours).

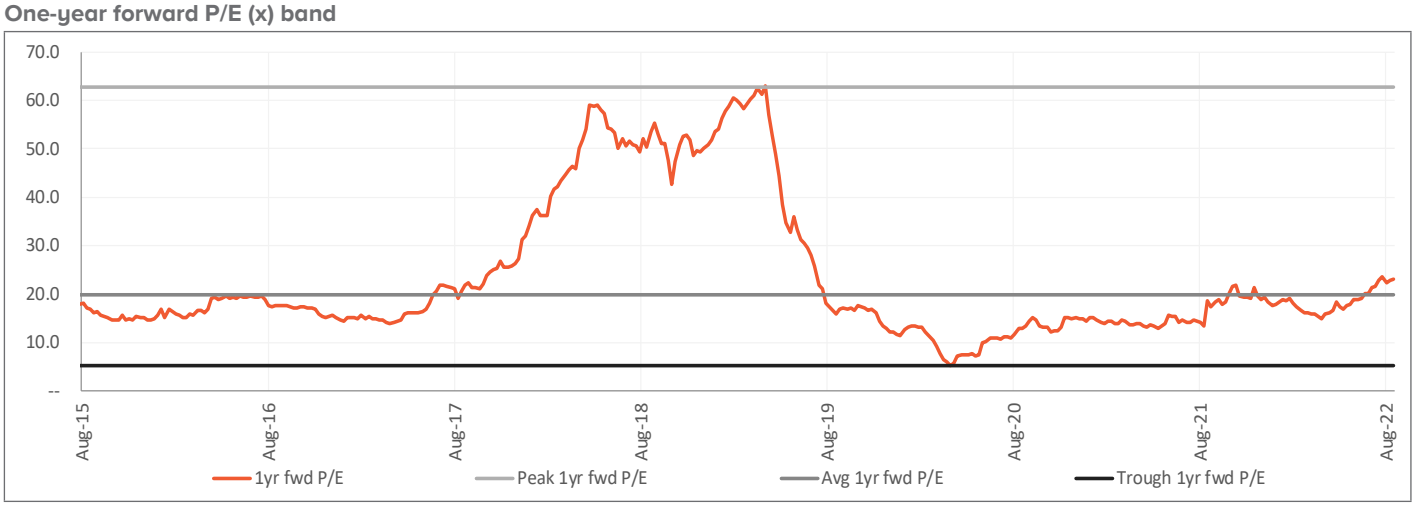
■ Company Outlook – Strong earnings growth and robust balance sheet

VST is virtually debt-free and is expected to generate free cash flows (FCF) of Rs. 100-150 crore annually going forward. In FY23E, the company would have a capex requirement of Rs. 60 crore. The company is expected to grow business with internal accruals. Earnings are expected to grow strongly at 23.5% CAGR over FY22-24E, led by a 21.1% revenue CAGR and a 10bps improvement in EBITDA margin. We expect VST's return ratios to revert to peak levels. Going forward, VST will be greatly focusing on increasing its market share through product development in a niche area, increasing its distribution network, and brand-building exercises. We remain positive on the rural economy and expect VST Tillers to be a key beneficiary.

■ Valuation – Maintain a Positive viewpoint rating with an upside potential of 17%

VST Tillers is well-positioned to maintain its dominant market share in the power tiller market. Market share gains driven by new product launches across brands would increase the company's addressable market. In addition, the company is strengthening its distribution network across the country. The company has technological tie-ups with Pubert (France) and Zetor (Czech Republic) for product development. VST Tillers has invested in California, US-based Zimeno Inc, a manufacturer of driver optional born electric tractors under the Monarch brand. The stock is trading below its historical average, at P/E multiple of 13.7x and EV/EBITDA of 11.1x on its FY24E estimates. We remain positive on the company, given a strong brand recall, extensive network, strong balance sheet and superior return ratio profile. Thus, reiterate our positive viewpoint rating on the stock with an upside potential of 17%.

One-year forward P/E (x) band



Source: Company, Sharekhan Research

Peer Comparison

Particulars	CMP	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	Rs/ Share	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
VST Tillers and Tractors	2,376	20.7	18.7	13.7	16.3	15.4	11.1	14.4	14.6	20.2
Escorts	1,843	22.8	19.7	17.6	21.0	17.7	15.2	17.7	18.2	18.0
M&M	1,288	30.0	24.5	18.9	21.6	15.8	12.1	14.6	17.1	19.8

Source: Company, Sharekhan estimates

About company

VST Tillers and Tractors Limited was established in the year 1967 by the VST Group of companies. The company is the largest Indian manufacturer of power tillers, four-wheel drive compact tractors and among the leading manufacturer of the other category such as tractors, engines, transmission, power reapers and precision components. VST also exports products to European, Asian, and African markets.

Investment theme

VST would gain from the revival of the rural economy. Higher rabi sowing and water reservoir levels and expectations of a normal monsoon is likely to result in strong growth in the agriculture machinery industry. The company is expected to increase its market share in power tillers and tractors segments, led by stronger rural sentiments, new launches and strong brand recall among small and marginal farmers. The company is targeting to increase in addressable markets through technological partnerships and focus on niche segments. VST aims to achieve revenue of Rs. 3,000 crore by FY2025 from revenue of Rs. 764 crore in FY21. VST is well positioned to gain from its strategy of product development, brand building exercise and increase in the distribution network.

Key Risks

- Erratic monsoons can have an adverse impact on the growth in the tractor segment.
- Prolonged COVID infection in India would impact economic growth and consequently impact the rural economy.

Additional Data

Key management personnel

V K Surendra	Chairman
V P Mahendra	Vice Chairman
V T Ravindra	Managing Director
Antony Cherukara	Chief Executive Officer
Pankaj Khemka	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	V K Surendra	21.6
2	V P Mahendra	7.3
3	Kotak Small Cap Fund	5.0
4	Vst Motors Private Limited	4.1
5	Nippon Life India Trustee	4.0
6	First Sentier Investments Icvc	3.9
7	L&t Mutual Fund Trustee	3.3
8	Mitsubishi Heavy Industries Engine	2.9
9	V V Pravindra	2.6
10	V S Arun	2.5

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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