BUY
TP: Rs 523 | 15%

ITC | Consumer Staples | 14 December 2023

Analyst meet takeaways: Multiple levers for growth

- **Management is guiding for 80-100bps EBITDA margin expansion every year from cost cuts, scale and premiumisation**
- **Cigarette volumes recovered last year but illicit trade still a worry; in F&B, conversion to branded products holds large opportunity**
- **We see multiple levers for growth and margin expansion; maintain BUY with unchanged TP of Rs 523**

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Urban markets continue to drive growth; rural lags: ITC indicated that urban markets continue to grow ahead of rural markets on the back of premiumisation. Rural demand is witnessing green shoots and management expects a better crop, higher farm and non-farm income, real estate activities and increased government spending to rejuvenate demand.

Illicit cigarettes remain key concern: Illicit cigarettes are still a key concern for the company despite a stable tax regime over the last couple of years. India's cigarette industry had witnessed a sharp increase in tax from 2013 to 2020 which resulted in a ~20% volume drop. However, since FY22, taxes have been relatively stable, leading to a claw back of sales from illicit trade channels. This coupled with product launches and agile execution aided volume recovery for ITC in FY22 and FY23.

Large opportunities seen in FMCG business: Branded products contribute merely 18% of India's food & beverages (F&B) market, which presents significant room for ITC to grow. Apart from customer conversion from non-branded products, the company sees factors such as premiumisation, product introductions, portfolio expansion in adjacent categories and new vectors of growth, including beverages, home care, premium skin care, chocolates and frozen snacks, as large business opportunities.

Expanding in hotels, agri, paper and packaging: ITC intends to continue with its asset-right strategy in the hotels business where it has 35 hotels and 3,200 keys in the pipeline. Over the next five years, it is aiming for 200 hotels and 18,000 keys. In the agri and paper & packaging segments, the company remains focused on expanding the value-added portfolio and has planned capital allocation for growth.

Maintain BUY: ITC's focus on driving innovation, strengthening the core while growing adjacent categories, launching value-added products, harnessing emerging markets, tapping inorganic growth opportunities and lifting margins bodes well. Management has guided for 80-100bps EBITDA margin expansion every year and annual capex of Rs 30bn largely toward the FMCG and paper businesses. Given strong earnings visibility, we maintain BUY with an unchanged SOTP-based TP of Rs 523.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	ITC IN/Rs 456
Market cap	US$ 68.9bn
Free float	71%
3M ADV	US$ 50.4mn
52wk high/low	Rs 500/Rs 325
Promoter/FPI/DII	0%/43%/57%

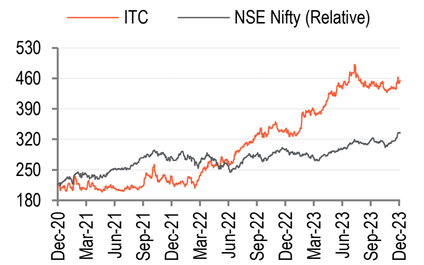
Source: NSE | Price as of 13 Dec 2023

Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	709,369	741,223	882,161
EBITDA (Rs mn)	256,649	271,482	319,342
Adj. net profit (Rs mn)	194,039	207,846	237,968
Adj. EPS (Rs)	15.4	16.5	18.9
Consensus EPS (Rs)	15.4	15.8	17.8
Adj. ROAE (%)	27.9	28.5	31.0
Adj. P/E (x)	29.5	27.6	24.1
EV/EBITDA (x)	22.1	20.9	17.7
Adj. EPS growth (%)	22.4	7.0	14.5

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

Analyst meet takeaways

Capex and margin guidance

- ITC has laid down a capital allocation strategy to spur growth across segments and to enable investment in new growth areas as well as in M&A opportunities. Management has guided for annual capex of ~Rs 30bn, of which 40-45% would be allocated towards the FMCG businesses, 30-35% towards paper and packaging and the balance towards other segments.
- The company expects annual EBITDA margin expansion of 80-100bps each year, with 30-40bps guided to come from premiumisation & adjacencies, ~20bps from scale and 30-40bps from cost optimisation.
- Urban markets continue to grow riding on premiumisation. According to management, rural demand is witnessing green shoots and should recover further on the back of a better harvest, higher farm and non-farm income, real estate activities and increased government spending.

Cigarettes business – Illicit trade remains a key concern

- In India, legal cigarette sales account for only 9% of tobacco consumption but contribute ~80% of tobacco tax revenue. The legal tobacco industry was severely affected by a series of tax hikes from 2013 to 2020.
- India is the third largest market for illicit cigarettes globally and these account for a third of legal cigarette sales.
- New cigarette launches have increased 5x over the last five years and account for ~17% of industry volumes.
- ITC's brands are available across ~7mn+ outlets in ~120 SKUs. The company has a strong portfolio of leading brands in every geography, which includes *Navy Cut, Bristol, Capstan, Flake, American Club, Silk Cut, Scissors* and *Players.*
- The company has strong R&D capabilities with 80+ scientists and 24 patents besides ~60 more in the pipeline.
- In the *Classic* portfolio, ITC has launched four new variants in the last five years which contribute ~25% of its portfolio. Per management, recent launches such as *Classic Connect* and *Alphatec* have leveraged the company's capabilities in advanced filter technology and its agile manufacturing.
- ITC's *Gold Flake* brand has over 100 years of legacy and launches during the last five years across subsegments account for ~19% of its portfolio.

FMCG-Others – Focus on growing adjacencies

- ITC's other FMCG business has grown five-fold over FY10-FY23 backed by brands developed in-house. The company continues to strengthen its core business and simultaneously address adjacencies and build new vectors of growth.
- Management is targeting value-added adjacencies and premiumisation across key brands such as *Fiama*, *Engage*, *Classmate*, *Savlon*, and *Sunfeast Dark Fantasy*.
- The company is fortifying its *Aashirvaad* portfolio by launching products in adjacent categories, such as spices, salt, ghee, milk, yoghurt, *paneer* (Indian cottage cheese), organic *dals* (lentils), vermicelli, *besan* (gram flour), *rava* (semolina) and millets.
- ITC has identified beverages, homecare, premium skin care, chocolates, and frozen snacks as new growth opportunities.
- Over the last five years, the company has increased its market coverage by 3x and stockist network by 8x while continuing to enhance its offerings on new-age platforms by leveraging in-house digital capabilities.
- In the last three years, ITC has rapidly scaled up its presence on modern trade and e-commerce platforms, raising the share of revenue from alternate channels to 25% in FY23 from 17% in FY20.
- Segmental EBITDA margin has expanded 770bps over six years to 10.2% in FY23 from 2.5% in FY17 driven by innovation, digitisation, operating leverage, strong brands and an efficient supply chain.
- In *atta* (wheat flour), *Aashirvaad* has gained ~190bps market share over the last three years. In cream biscuits, it has ~24% share which is largely range bound, in premium biscuits 60%+, and in the *Sunrise* brand +110bps YoY increase in West Bengal. In noodles, market share of ~20% is largely unchanged.

Hotels – Asset-right strategy to boost growth

- ITC has a portfolio of 131 hotels and 12,000 rooms across 80 destinations and aims to reach 200 hotels and 18,000 keys in the next five years.
- India's hospitality industry has witnessed a strong upcycle as demand has outstripped supply over FY16-FY23 at 6.2% vs. 5.5% (CAGR). Management expects demand to accelerate to ~10.5% CAGR over FY24-FY27 and supply to grow at ~7.1%, resulting in improved occupancy.
- India had only 6.2mn foreign tourist arrivals in CY22, the lowest among developed as well as key emerging economies. ITC expects arrivals in CY23 to remain muted, at 85% of pre-pandemic levels.
- Management believes its asset-right strategy offers immense opportunity for growth as ~20% of the inventory is still gestating and is less than five years old, where occupancy is 56% compared to 72% in the case of gestated hotels.
- The company expects to launch two properties in early CY24 – Welcomhotel Chennai (renovated, 90 keys) and ITC Ratnadipa, Colombo (352 keys).
- The F&B business added two restaurants in FY23 with three in the pipeline for FY24.

Paper and paperboard – Recovery expected in near future

- ITC is a clear market leader in the paper and paperboard business with best-in-class operating metrics. The company continues to focus on the value-added segment to drive growth.
- Last year's performance was impacted by cheap Chinese supply in global markets, a drop in China and EU demand, a sharp reduction in global pulp prices, and near-term headwinds in domestic wood prices.
- Per management, global pulp prices are likely to have bottomed out and the company is seeing green shoots of demand revival, with growth and margins expected to bounce back after a lag of a couple of quarters.
- ITC's competitive strength stems from its renewable and fibre value chain which is strategically located in proximity to its manufacturing plants.
- In the paper segment, the current facility is saturated and the company is planning greenfield expansion. In packaging, capacity to cater to the western region has already been set up at Nadiad in Gujarat.

Agri business – Focus on value-added products

- ITC is a leading player in agri with crop throughput of more than 4.5mtpa. The company has a presence in 20+ crops across 22 states, besides being the largest buyer, processor, consumer and exporter of cigarette tobacco (40% of India's exports).
- ITC's agri business services 100+ customers (including Nestle, McCormick, Haldiram's, Jubilant Foodworks) across the food service, industrial, ingredient and retail segments in 35+ countries.
- The company has identified the value-added products of nicotine and derivatives in tobacco, spices and other products to boost growth and margins.
- Its smart farming app, ITCMaars, helps address the problems faced by farmers. The platform is a phygital ecosystem that provides farmers with artificial intelligence/machine learning-led personalised advisories to raise productivity, reduce cost and enable efficient price discovery.

Valuation methodology

We expect ITC to maintain growth momentum given its initiatives to fortify the core business, introduce value-added products, deepen its presence in emerging markets, build adjacencies in FMCG and tap new distribution channels. The cigarettes business continues to deliver strong volume growth and derive market share gains from illicit trade. The FMCG-others and hotels segments are also seeing a healthy performance across markets and portfolios.

ITC continues to invest toward expanding its distribution footprint and capacity in the FMCG, paper and agriculture segments. We also expect the hotels business to fare well, backed by growth in average room rate, a strong wedding calendar and a large pipeline of management contracts. Overall, we model for a revenue/PAT CAGR of 13.3%/15.5% for ITC over FY22-FY25, with operating margin expanding 215bps over this period to 36.2% on the strength of premiumisation, easing input costs, operating leverage and cost rationalisation.

We maintain our target multiples across businesses, leading to an unchanged SOTP-based TP of Rs 523. Barring FMCG, we have valued ITC's businesses based on FY25E EV/EBITDA as follows: (i) cigarettes at 17.2x, (ii) hotels at 18.9x, (iii) agriculture at 6.2x, and (iv) paper at 6.5x. We assign the FMCG-others segment an EV/Revenue multiple of 7.1x on FY25E revenue. Considering the strong volume growth in cigarettes and earnings visibility in the FMCG and hotels businesses, we maintain BUY.

Fig 1 – SOTP valuation summary

EV/EBITDA	FY25E EBITDA	Multiple (x)	EV
Cigarettes	2,39,444	17.2x	41,18,431
Hotel	12,023	18.9x	2,27,228
Agri	22,377	6.2x	1,38,737
Paper	28,603	6.5x	1,85,917
EV/Revenue	**FY25E Revenue**	**Multiple (x)**	**EV**
FMCG	2,50,029	7.1x	17,75,206
Enterprise Value	-	-	64,45,519
Less: Net debt	-	-	(58,439)
Market Value (Rs mn)	-	-	65,03,959
No of shares (mn)	-	-	12,439
Target Price (Rs)	-	-	523

Source: BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- delayed rural recovery,
- further increases in duty on cigarettes, and
- input cost inflation.

Sector recommendation snapshot

Company	Ticker	Market Cap (US$ bn)	Price (Rs)	Target (Rs)	Rating
Britannia Industries	BRIT IN	14.4	4,919	5,844	BUY
Dabur India	DABUR IN	11.8	548	669	BUY
Godrej Consumer Products	GCPL IN	13.0	1,046	1,159	BUY
Hindustan Unilever	HUVR IN	71.8	2,512	3,069	BUY
ITC	ITC IN	68.9	456	523	BUY
Marico	MRCO IN	8.5	540	646	BUY
Nestle India	NEST IN	29.4	25,044	28,260	BUY
Tata Consumer Products	TATACONS IN	10.8	957	1,038	BUY
Zydus Wellness	ZYWL IN	1.2	1,530	1,556	HOLD

Source: BOBCAPS Research, NSE | Price as of 13 Dec 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Total revenue	**492,728**	**606,681**	**709,369**	**741,223**	**882,161**
EBITDA	170,027	206,584	256,649	271,482	319,342
Depreciation	16,456	17,324	18,090	19,174	22,078
EBIT	153,571	189,260	238,559	252,308	297,264
Net interest inc./(exp.)	(446)	(394)	(432)	(435)	(523)
Other inc./(exp.)	26,326	18,364	19,805	25,822	20,628
Exceptional items	0	0	(729)	0	0
EBT	179,451	207,230	258,661	277,695	317,369
Income taxes	45,553	52,373	64,384	70,319	79,977
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	(69)	175	490	470	576
Reported net profit	**133,829**	**155,031**	**194,767**	**207,846**	**237,968**
Adjustments	0	0	(729)	0	0
Adjusted net profit	**133,829**	**155,031**	**194,039**	**207,846**	**237,968**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Accounts payables	43,187	44,173	46,590	34,876	40,667
Other current liabilities	42,944	51,160	55,714	55,714	55,714
Provisions	3,815	3,006	3,598	3,598	3,598
Debt funds	95	56	388	388	388
Other liabilities	41,211	45,982	57,153	57,153	57,153
Equity capital	12,309	12,323	12,428	12,428	12,428
Reserves & surplus	594,633	615,895	682,960	716,686	755,214
Shareholders' fund	606,942	628,219	695,388	729,114	767,642
Total liab. and equities	**738,193**	**772,596**	**858,830**	**880,843**	**925,160**
Cash and cash eq.	2,904	2,714	4,634	33,473	14,084
Accounts receivables	25,017	24,619	29,562	30,889	36,763
Inventories	103,972	108,642	117,712	119,682	143,558
Other current assets	10,952	13,061	15,618	15,618	15,618
Investments	249,809	249,505	295,580	280,335	309,023
Net fixed assets	191,539	202,074	211,171	214,453	219,722
CWIP	40,045	31,985	29,847	29,847	29,847
Intangible assets	20,179	20,402	27,459	27,459	27,459
Deferred tax assets, net	585	635	520	520	520
Other assets	93,190	118,960	126,728	128,567	128,567
Total assets	**738,193**	**772,596**	**858,830**	**880,843**	**925,160**

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Cash flow from operations	**125,270**	**157,755**	**188,776**	**212,008**	**236,088**
Capital expenditures	(18,366)	(21,416)	(27,430)	(23,719)	(27,347)
Change in investments	52,592	(18,536)	(94,376)	15,245	(28,688)
Other investing cash flows	22,604	17,567	64,482	0	0
Cash flow from investing	**56,829**	**(22,385)**	**(57,323)**	**(8,474)**	**(56,035)**
Equities issued/Others	2,907	2,918	24,774	0	0
Debt raised/repaid	(570)	(597)	(598)	0	0
Interest expenses	(412)	(396)	(414)	0	0
Dividends paid	(188,674)	(137,883)	(153,971)	(174,120)	(199,441)
Other financing cash flows	412	153	149	0	0
Cash flow from financing	**(186,338)**	**(135,805)**	**(130,060)**	**(174,120)**	**(199,441)**
Chg in cash & cash eq.	**(4,239)**	**(435)**	**1,392**	**29,414**	**(19,389)**
Closing cash & cash eq.	**2,904**	**2,714**	**4,633**	**33,473**	**14,084**

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23A	FY24E	FY25E
Reported EPS	10.7	12.4	15.5	16.5	18.9
Adjusted EPS	10.9	12.6	15.4	16.5	18.9
Dividend per share	15.3	11.2	12.4	14.0	16.1
Book value per share	49.0	50.7	56.1	58.8	61.9

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23A	FY24E	FY25E
EV/Sales	11.5	9.3	8.0	7.6	6.4
EV/EBITDA	33.3	27.4	22.1	20.9	17.7
Adjusted P/E	41.9	36.1	29.5	27.6	24.1
P/BV	9.3	9.0	8.1	7.7	7.4

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23A	FY24E	FY25E
Tax burden (Net profit/PBT)	74.6	74.8	75.0	74.8	75.0
Interest burden (PBT/EBIT)	116.9	109.5	108.4	110.1	106.8
EBIT margin (EBIT/Revenue)	31.2	31.2	33.6	34.0	33.7
Asset turnover (Rev./Avg TA)	66.7	78.5	82.6	84.1	95.4
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.2	1.2	1.2
Adjusted ROAE	22.0	24.7	27.9	28.5	31.0

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23A	FY24E	FY25E
YoY growth (%)					
Revenue	(0.3)	23.1	16.9	4.5	19.0
EBITDA	(11.7)	21.5	24.2	5.8	17.6
Adjusted EPS	(13.4)	15.8	22.4	7.0	14.5
Profitability & Return ratios (%)					
EBITDA margin	34.5	34.1	36.2	36.6	36.2
EBIT margin	31.2	31.2	33.6	34.0	33.7
Adjusted profit margin	27.2	25.6	27.4	28.0	27.0
Adjusted ROAE	22.0	24.7	27.9	28.5	31.0
ROCE	25.3	30.1	34.3	34.6	38.7
Working capital days (days)					
Receivables	19	15	15	15	15
Inventory	189	150	148	148	148
Payables	78	61	59	59	59
Ratios (x)					
Gross asset turnover	1.9	2.1	2.2	2.2	2.4
Current ratio	3.3	2.8	2.9	3.3	3.5
Net interest coverage ratio	344.5	480.8	552.2	579.6	568.7
Adjusted debt/equity	0.0	0.0	0.0	0.0	0.0

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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Note: Recommendation structure changed with effect from 21 June 2021

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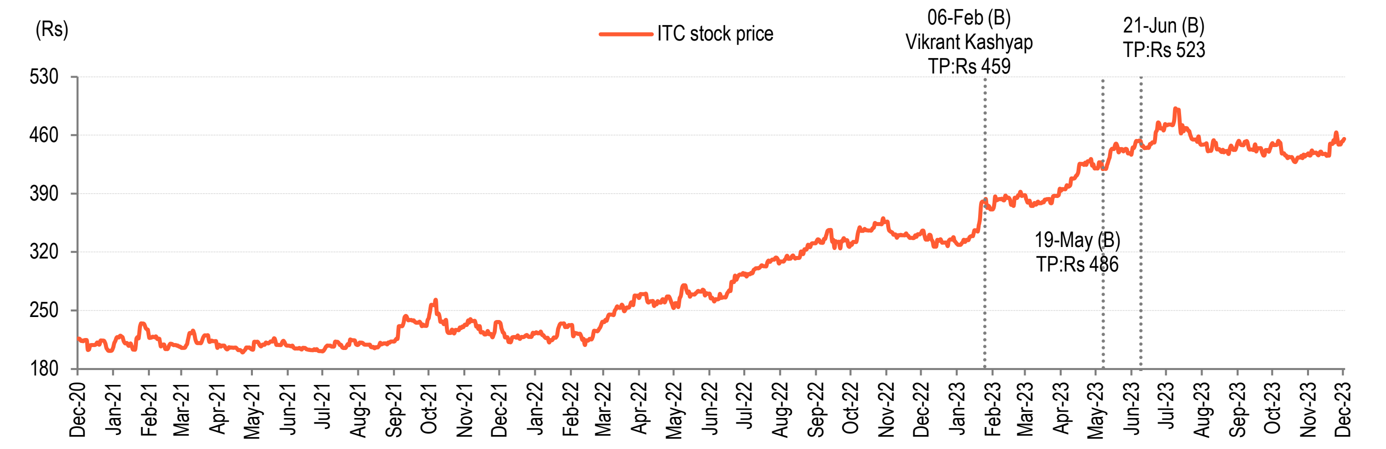
Ratings and Target Price (3-year history): ITC (ITC IN)



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