

**BUY**

TP: Rs 523 | ▲ 16%

ITC

Consumer Staples

16 August 2023

## Robust growth and margins

- Cigarettes business delivered sustained volume growth in Q1 at ~10% YoY; innovation remains in focus
- FMCG-others segment registered double-digit growth with further margin expansion
- Hotels business expected to list in ~15 months; maintain BUY with an unchanged SOTP-based TP of Rs 523

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**Strong performance in cigarettes and FMCG-others:** ITC's Q1FY24 revenue declined 7% YoY (up 11% excluding agricultural business) to Rs 171.6bn, largely due to (i) a slowdown in agricultural business (-24% YoY) on account of the ban on wheat exports, and (ii) a subdued performance in the paper and paperboard segment (-6% YoY) owing to poor demand in domestic and global markets and cheap Chinese supply. The cigarettes business continued to do well, growing 12% YoY for the quarter, FMCG-others revenue was up 16% YoY and the hotels segment grew 8% despite a high base of last year.

**Margin expansion continues:** Consolidated gross margin swelled 810bps YoY (20bps QoQ) as input costs moderated. EBITDA margin expanded 800bps YoY (370bps QoQ) to 38.9%, and adj. PAT grew 16% YoY to Rs 51bn with 600bps margin gains. Business-wise, FMCG-others saw the strongest EBITDA margin increase of 325bps YoY (510bps over Q1FY20) to 11%, and hotels posted 140bps YoY expansion to 33.9%. However, profitability in the paper and paperboard segment was dented by lower realisations and a spike in input costs.

**Proposed demerger of hotels business:** ITC has announced the demerger of its hotels business by creating a wholly-owned subsidiary 'ITC Hotels Ltd' that it expects to list on the bourses in ~15 months. ITC shareholders will get 1 share of ITC Hotels for every 10 shares held based on the share entitlement ratio, which is a function of the share capital of the two companies and has no bearing on the market capitalisation of ITC Hotels.

**Maintain BUY:** We expect ITC to sustain its strong growth momentum and retain estimates of a revenue/EBITDA/PAT CAGR of 14%/16%/16% over FY22-FY25. The cigarettes business continues to deliver double-digit volume growth and market share gains in the absence of competition from illicit trade. In addition, the FMCG-others segment has registered a healthy performance across markets and portfolios. Given strong volume growth in cigarettes and earnings visibility in the FMCG and hotels businesses, we maintain BUY for an SOTP-based TP of Rs 523 (unchanged).

## Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	ITC IN/Rs 449
Market cap	US\$ 67.9bn
Free float	71%
3M ADV	US\$ 62.6mn
52wk high/low	Rs 500/Rs 305
Promoter/FPI/DII	0%/43%/57%

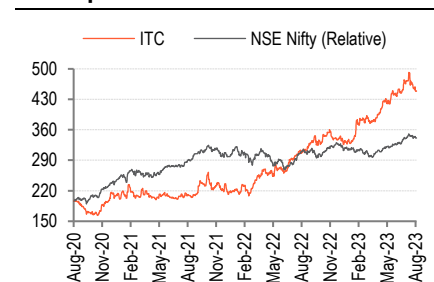
Source: NSE | Price as of 14 Aug 2023

## Key financials

Y/E 31 Mar	FY23P	FY24E	FY25E
Total revenue (Rs mn)	7,09,369	7,94,958	8,97,358
EBITDA (Rs mn)	2,56,649	2,84,518	3,24,844
Adj. net profit (Rs mn)	1,94,039	2,12,995	2,42,377
Adj. EPS (Rs)	15.4	16.9	19.3
Consensus EPS (Rs)	15.4	15.8	17.8
Adj. ROAE (%)	27.9	29.2	31.5
Adj. P/E (x)	29.1	26.5	23.3
EV/EBITDA (x)	21.8	19.6	17.2
Adj. EPS growth (%)	22.4	9.7	13.8

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

## Stock performance



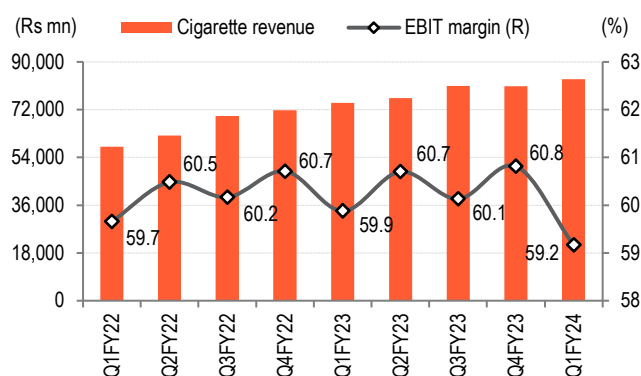
Source: NSE



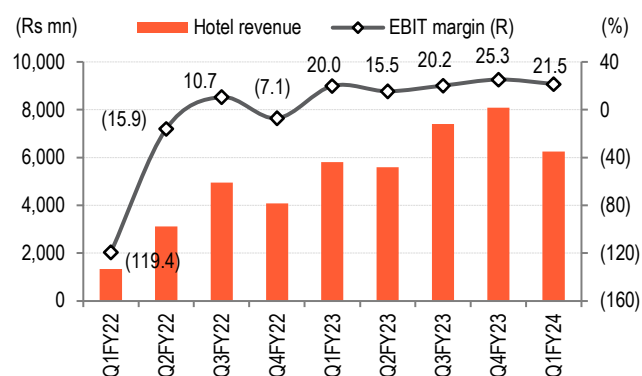
**Fig 1 – Quarterly performance**

(Rs mn)	Q1FY24	Q4FY23	Q1FY23	QoQ (%)	YoY (%)	Estimates	Variance (%)
Revenue	171,645	176,349	184,895	(2.7)	(7.2)	187,608	(8.5)
EBITDA	66,701	66,240	60,771	0.7	9.8	69,907	(4.6)
Adj. PAT	51,049	51,026	43,898	0.0	16.3	51,585	(1.0)
Gross Margin (%)	61.8	61.6	53.7	20bps	810bps	61.0	80bps
EBITDA Margin (%)	38.9	35.2	30.9	370bps	800bps	37.3	160bps
Adj. PAT Margin (%)	29.7	28.9	23.7	80bps	600bps	27.5	220bps

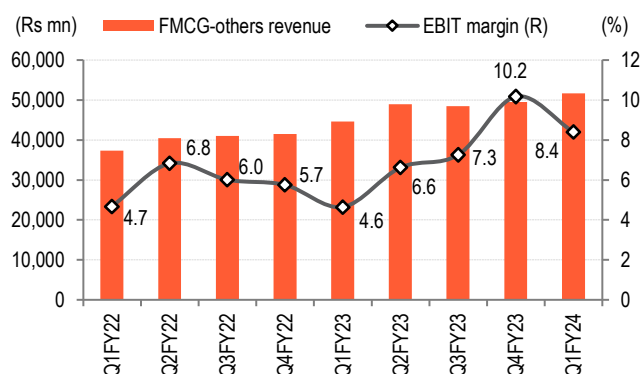
Source: Company, BOBCAPS Research

**Fig 2 – Cigarettes revenue & EBIT margin**

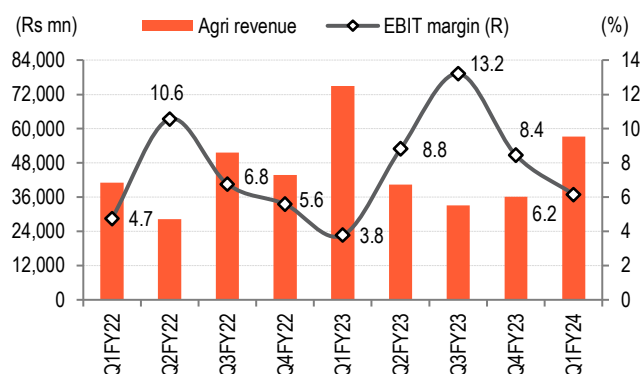
Source: Company, BOBCAPS Research

**Fig 3 – Hotels revenue & EBIT margin**

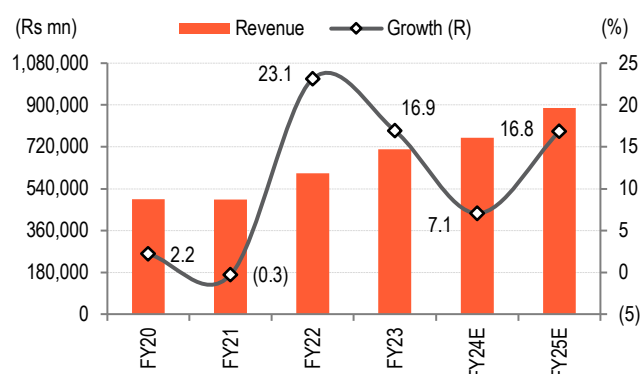
Source: Company, BOBCAPS Research

**Fig 4 – FMCG-Others revenue & EBIT margin**

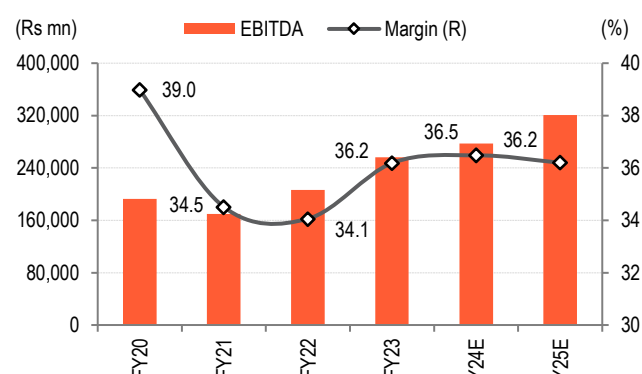
Source: Company, BOBCAPS Research

**Fig 5 – Agri revenue & EBIT margin**

Source: Company, BOBCAPS Research

**Fig 6 – Consolidated revenue & growth forecast**

Source: Company, BOBCAPS Research

**Fig 7 – EBITDA and margin forecast**

Source: Company, BOBCAPS Research

## Earnings call highlights

### Cigarettes: Growth momentum continues

- ITC's cigarettes business revenue grew 11.9% YoY in Q1FY24 led by sustained volume clawback from illicit trade on the back of deterrent action by enforcement agencies, and stability in taxes.
- The company recently launched new brands: Classic Alphatec, Classic Verve Balanced Taste, American Club NY Cool & LA Twist, Players Klov, American Club Smash, Players Rush, and Gold Flake Glostar.

### FMCG-others: Robust showing in both urban and rural markets

- FMCG-others revenue grew 16% YoY driven by staples, biscuits, noodles, beverages, dairy, incense sticks (*agarbatti*), and premium soaps. The education and stationary business continued to witness traction.
- Segmental EBITDA margin expanded by 325bps YoY (510bps over Q1FY20) to 11%, with EBITDA up 64% YoY (3.2x of Q1FY20) to Rs 5.7bn. Margin expansion was supported by premiumisation, supply chain optimisation, judicious pricing action, fiscal incentives, strategic cost management, and digital initiatives.
- The segment witnessed robust growth in both urban and rural markets, showing traction in traditional as well as modern trade, e-commerce, and quick commerce.
- ITC continued to scale up its stockist network in rural markets which is currently 3x compared to pre-pandemic levels. Market coverage has increased by 1.9x, direct outlets by 1.2x and total outlets by 1.1x compared to pre-pandemic levels.
- Aashirvad atta* (wheat flour) delivered a strong performance and the value-added atta range was bolstered by emerging channels. During the quarter, the company expanded the Aashirvad portfolio by launching *rava* (semolina), organic *dals* (lentils), *besan* (gramflour), and vermicelli under the mother brand.
- Sunfeast* biscuits and cakes posted high growth in the core portfolio as new variants scaled up. The portfolio added new products such as Sunfeast All Rounder Sweet & Salty, Sunfeast Supermilk and Sunfeast Farmlite Super Millets.
- YiPPee!* noodles had a robust quarter on the back of increased penetration and brand outreach. Dairy & beverages saw strong growth and strengthened the Sunfeast milkshake portfolio with the launch of new flavours: Badam Milk and Rose Milk.
- In the personal care products business, the *Fiama* range of personal wash products fared well driven by investments in brand building, wider distribution, and growth across channels. The business also launched *Engage L'amante* luxury perfume sprays.
- In education and stationery products, *Classmate Notebooks* delivered a strong Q1 led by portfolio premiumisation, judicious pricing actions, and exports.
- Mangaldeep* agarbattis and *dhoop* (incense) recorded robust growth and launched Anushri Aqua – refreshing fragrances – and Anushri Woody – exotic fragrances.

### Hotels: High ARR across properties

- ITC's hotels business registered a strong quarter on a high base of last year, posting 8% YoY growth as the average room rate (ARR) moved up. Occupancy, however, moderated due to relatively fewer wedding dates during Q1 and pre-planned renovations.
- Segment EBITDA margin expanded by 140bps YoY to 33.9% driven by higher revenue per available room (RevPAR), structural cost interventions and operating leverage.
- The hotels business is witnessing rising interest amongst property owners to partner with ITC's iconic brands, resulting in healthy generation of leads and a pipeline of management contracts under the Mementos, Welcomhotel, Storii, Fortune, and Welcomheritage brands.
- During the quarter, six hotels were added to the group portfolio, including Welcomhotel Hamsa Manali and Storii Moira Riviera, a boutique resort in North Goa.

### Paperboards, Paper & Packaging: Weak quarter

- Paper and paperboard revenue declined 6% YoY and segment profits fell 23% in Q1. Growth was impacted by subdued demand in domestic as well as exports markets, low priced Chinese supply, and a steep decline in global pulp prices on a high base.
- Décor & Fine paper grades witnessed a resilient performance. New business development is being accelerated in both domestic and export markets with a special focus on consumer electronics and sustainable paperboards and packaging.
- Capacity utilisation at the recently commissioned Nadiad unit in Gujarat continues to be ramped up progressively to efficiently service customers in proximal markets.
- The sustainable packaging solutions portfolio continues to forge ahead, posting a two-year CAGR of 53%. Subsidiary ITC Fibre Innovations is in the process of setting up a state-of-the-art premium moulded fibre product manufacturing facility in Badiyakhedi, Madhya Pradesh. The project is progressing as per schedule.

### Agri: Ban on wheat exports remains an overhang

- ITC's agriculture business, excluding wheat exports, grew 31% YoY buoyed by value-added agri products and leaf tobacco. Restrictions imposed on wheat and rice exports by the government weighed on segment revenue for the quarter.
- During Q1, subsidiary ITC IndiVision (IIVL) successfully completed necessary trials and obtained statutory clearances for its pilot plant at Mysuru for the manufacture and export of nicotine and nicotine derivative products conforming to US and EU pharmacopoeia standards.
- The recently commissioned value-added spices processing facility in Guntur continues to scale up.

### ITC Infotech: Soft quarter

- ITC Infotech's revenue grew 12% YoY in Q1 to Rs 8.4bn, with EBITDA margin at the upper end of the band for mid-tier IT companies. EBITDA was flat at Rs 1.1bn.
- During the year, investments toward capability building continued in strategic focus areas and infrastructure.

### Hotels: Demerger on the cards

- ITC has announced the demerger of its hotels business through a scheme of arrangement to be approved by the National Company Law Tribunal (NCLT). The company proposes to list the business in ~15 months by creating a subsidiary christened ITC Hotels.
- ITC's existing shareholders will hold 100% of ITC Hotels (~60% directly and ~40% through their shareholding in ITC). ITC shareholders will get 1 share of ITC Hotels for every 10 shares held based on the share entitlement ratio, which is a function of the share capital of the two companies and has no bearing on the market capitalisation of ITC Hotels.
- The company expects the hotels business to deliver accelerated growth following an asset-right strategy, while continuing to leverage ITC's institutional strength and brand equity.
- Management expects ITC Hotels to operate on an optimal capital structure and have the ability to access equity and/or debt markets to fund future growth.
- The proposed subsidiary will be given a license to use the 'ITC' name as part of its corporate name and some of its property/brand names for a suitable fee.

**Fig 8 – Share entitlement ratio**

Particulars	Value
Total no. of equity shares of ITC Hotels (pre-demerger)	830mn
Equity stake of ITC in ITC Hotels (post-demerger)	40%
Total no. of equity shares of ITC Hotels (post-demerger)	2,080mn
No. of equity shares of ITC Hotels to be issued to ITC's shareholders	1,250mn
Total no. of equity shares of ITC	12,465mn
Number of ITC shares against which 1 share of ITC Hotels will be issued	10

Source: Company, BOBCAPS Research

## Valuation methodology

We expect ITC to sustain its strong growth momentum and retain our estimates of a revenue/EBITDA/PAT CAGR of 14%/16%/16% over FY22-FY25. The cigarettes business continues to deliver double-digit volume growth and market share gains in the absence of competition from illicit trade. In addition, the FMCG-others segment has been registering a healthy performance across markets and portfolios, and we expect margins to improve driven by premiumisation, moderating input costs, operating leverage, increasing market penetration, and innovation.

ITC continues to invest in digital channels and capacity expansion in the FMCG, paper and agriculture segments to boost growth. In the hotels segment, we like the company's policy of adding new properties under management contracts. We expect this business to perform well, backed by growth in ARR, improvement in occupancy rate and a strong pipeline of management contracts.

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 9 – SOTP valuation summary**

EV/EBITDA	FY25E EBITDA	Multiple (x)	EV
Cigarettes	2,38,179	17.2x	40,96,675
Hotels	11,916	18.9x	2,25,220
Agri	21,459	6.2x	1,33,047
Paper	31,485	6.5x	2,04,654
EV/Revenue	FY25E Revenue	Multiple (x)	EV
FMCG	2,51,575	7.1x	17,86,183
Enterprise Value			64,45,778
Less: Net debt			(56,960)
Market Value (Rs mn)			65,02,738
No of share (mn)			12,439
Target Price (Rs)			523

Source: BOBCAPS Research

## Key risks

Key downside risks to our estimates are:

- delayed rural recovery,
- a further increase 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	13.2	4,500	5,844	BUY
Dabur India	DABUR IN	12.2	565	669	BUY
Godrej Consumer Products	GCPL IN	12.9	1,036	1,159	BUY
Hindustan Unilever	HUVR IN	72.4	2,533	3,069	BUY
ITC	ITC IN	67.9	449	523	BUY
Marico	MRCO IN	8.9	568	646	BUY
Nestle India	NEST IN	25.7	21,900	26,430	BUY
Tata Consumer Products	TATACONS IN	9.6	845	994	BUY
Zydus Wellness	ZYWL IN	1.2	1,522	1,556	HOLD

Source: BOBCAPS Research, NSE | Price as of 14 Aug 2023

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
<b>Total revenue</b>	<b>4,92,728</b>	<b>6,06,681</b>	<b>7,09,369</b>	<b>7,94,958</b>	<b>8,97,358</b>
EBITDA	1,70,027	2,06,584	2,56,649	2,84,518	3,24,844
Depreciation	16,456	17,324	18,090	20,540	22,209
EBIT	1,53,571	1,89,260	2,38,559	2,63,977	3,02,634
Net interest inc./(exp.)	(446)	(394)	(432)	(475)	(523)
Other inc./(exp.)	26,326	18,364	19,805	20,562	21,145
Exceptional items	0	0	(729)	0	0
EBT	1,79,451	2,07,230	2,58,661	2,84,064	3,23,257
Income taxes	45,553	52,373	64,384	71,584	81,461
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	(69)	175	490	515	582
<b>Reported net profit</b>	<b>1,33,829</b>	<b>1,55,031</b>	<b>1,94,767</b>	<b>2,12,995</b>	<b>2,42,377</b>
Adjustments	0	0	(729)	0	0
<b>Adjusted net profit</b>	<b>1,33,829</b>	<b>1,55,031</b>	<b>1,94,039</b>	<b>2,12,995</b>	<b>2,42,377</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Accounts payables	43,187	44,173	46,590	36,519	41,367
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	5,94,633	6,15,895	6,82,960	7,17,444	7,56,685
Shareholders' fund	6,06,942	6,28,219	6,95,388	7,29,872	7,69,113
<b>Total liab. and equities</b>	<b>7,38,193</b>	<b>7,72,596</b>	<b>8,58,830</b>	<b>8,83,243</b>	<b>9,27,332</b>
Cash and cash eq.	2,904	2,714	4,634	10,710	9,232
Accounts receivables	25,017	24,619	29,562	33,128	37,396
Inventories	1,03,972	1,08,642	1,17,712	1,30,689	1,46,031
Other current assets	10,952	13,061	15,618	15,618	15,618
Investments	2,49,809	2,49,505	2,95,580	2,91,900	3,12,248
Net fixed assets	1,91,539	2,02,074	2,11,171	2,16,069	2,21,678
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	1,18,960	1,26,728	1,27,303	1,27,303
<b>Total assets</b>	<b>7,38,193</b>	<b>7,72,596</b>	<b>8,58,830</b>	<b>8,83,243</b>	<b>9,27,332</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
<b>Cash flow from operations</b>	<b>1,25,270</b>	<b>1,57,755</b>	<b>1,88,776</b>	<b>2,06,921</b>	<b>2,49,825</b>
Capital expenditures	(18,366)	(21,416)	(27,430)	(25,439)	(27,818)
Change in investments	52,592	(18,536)	(94,376)	3,680	(20,348)
Other investing cash flows	22,604	17,567	64,482	0	0
<b>Cash flow from investing</b>	<b>56,829</b>	<b>(22,385)</b>	<b>(57,323)</b>	<b>(21,759)</b>	<b>(48,166)</b>
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	(1,88,674)	(1,37,883)	(1,53,971)	(1,78,511)	(2,03,137)
Other financing cash flows	412	153	149	0	0
<b>Cash flow from financing</b>	<b>(1,86,338)</b>	<b>(1,35,805)</b>	<b>(1,30,060)</b>	<b>(1,78,511)</b>	<b>(2,03,137)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>(4,239)</b>	<b>(435)</b>	<b>1,392</b>	<b>6,651</b>	<b>(1,477)</b>
<b>Closing cash &amp; cash eq.</b>	<b>2,904</b>	<b>2,714</b>	<b>4,633</b>	<b>10,710</b>	<b>9,232</b>

### Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23P	FY24E	FY25E
Reported EPS	10.7	12.4	15.5	16.9	19.3
Adjusted EPS	10.9	12.6	15.4	16.9	19.3
Dividend per share	15.3	11.2	11.3	14.4	16.4
Book value per share	49.0	50.7	56.1	58.9	62.0

### Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23P	FY24E	FY25E
EV/Sales	11.3	9.2	7.9	7.0	6.2
EV/EBITDA	32.8	27.0	21.8	19.6	17.2
Adjusted P/E	41.3	35.6	29.1	26.5	23.3
P/BV	9.2	8.9	8.0	7.6	7.2

### DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23P	FY24E	FY25E
Tax burden (Net profit/PBT)	74.6	74.8	75.0	75.0	75.0
Interest burden (PBT/EBIT)	116.9	109.5	108.4	107.6	106.8
EBIT margin (EBIT/Revenue)	31.2	31.2	33.6	33.2	33.7
Asset turnover (Rev./Avg TA)	66.7	78.5	82.6	90.0	96.8
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.2	1.2	1.2
<b>Adjusted ROAE</b>	<b>22.0</b>	<b>24.7</b>	<b>27.9</b>	<b>29.2</b>	<b>31.5</b>

### Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23P	FY24E	FY25E
<b>YoY growth (%)</b>					
Revenue	(0.3)	23.1	16.9	12.1	12.9
EBITDA	(11.7)	21.5	24.2	10.9	14.2
Adjusted EPS	(13.4)	15.8	22.4	9.7	13.8

### Profitability & Return ratios (%)

EBITDA margin	34.5	34.1	36.2	35.8	36.2
EBIT margin	31.2	31.2	33.6	33.2	33.7
Adjusted profit margin	27.2	25.6	27.4	26.8	27.0
Adjusted ROAE	22.0	24.7	27.9	29.2	31.5
ROCE	25.3	30.1	34.3	36.1	39.3

### 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	2.3	2.4
Current ratio	3.3	2.8	2.9	3.3	3.4
Net interest coverage ratio	344.5	480.8	552.2	555.5	579.0
<b>Adjusted debt/equity</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

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



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### Recommendation scale: Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

**HOLD** – Expected return from -6% to +15%

**SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

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



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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