

BUY**TP: Rs 459 | ▲ 20%****ITC**

Consumer Staples

06 February 2023

Stellar show continues; outlook bright

- Q3 revenue grew 3.5% YoY and gross margin expanded 700bps driven by a strong performance across categories
- FMCG business delivered strong, sustained growth with double-digit segmental EBITDA margin
- We assume coverage with BUY and a TP of Rs 459, offering 20% upside

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Strong all-round performance: ITC witnessed 3.5% YoY revenue growth to Rs 177bn in Q3FY23 led by an uptick in cigarettes, FMCG – others, hotels, and paper and paperboards, while the agriculture business was adversely affected by the ban on wheat and rice exports. In the FMCG – others segment, revenue and EBITDA grew 1.5x and 1.9x respectively over Q3FY20. Consolidated EBITDA margin expanded 480bps YoY (150bps QoQ) to 35.5% amidst elevated commodity prices. Adj. PAT grew 23% YoY to Rs 50bn with margin expansion of 460bps. The company announced interim dividend of Rs 6/sh.

Momentum continues in cigarettes: Cigarette volumes increased 14-15% YoY. Per management, stability in cigarette taxation, backed by the deterrent actions of enforcement agencies, continues to enable recovery of volumes from illicit trade, resulting in higher demand. Recent launches continued to gain traction along with robust growth across regions and markets.

FMCG margin in double-digits for the first time: The FMCG business is seeing sustained traction, with segment revenue growing 18% YoY led by higher sales across staples, biscuits, noodles, snacks, dairy, beverages, and frozen foods. FMCG segment margin improved by 90bps YoY to 10% despite elevated input costs even as some commodities witnessed sequential moderation in prices. The margin expansion was backed by cost rationalisation initiatives, premiumisation, supply chain agility, judicious pricing actions, fiscal incentives, and digital investments.

BUY, TP Rs 459: We expect ITC to sustain its strong growth momentum across categories and model for a revenue/EBITDA/PAT CAGR of 12%/14%/14% over FY22-FY25. The cigarettes business continues to deliver volume growth and market share gains in the absence of competition from illicit trade, with the recent tax hike unlikely to dent sales. The FMCG segment too has outperformed some peers, and we expect margins to improve as input costs soften. We assume coverage on ITC with BUY and value the stock on SOTP basis at a TP of Rs 459.

Ticker/Price	ITC IN/Rs 383
Market cap	US\$ 57.5bn
Free float	71%
3M ADV	US\$ 51.4mn
52wk high/low	Rs 388/Rs 207
Promoter/FPI/DII	0%/43%/57%

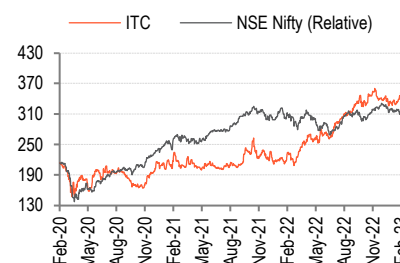
Source: NSE | Price as of 6 Feb 2023

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	6,06,681	7,03,269	7,61,674
EBITDA (Rs mn)	2,06,584	2,55,615	2,72,606
Adj. net profit (Rs mn)	1,55,031	1,90,557	2,03,519
Adj. EPS (Rs)	12.6	15.2	16.2
Consensus EPS (Rs)	12.6	14.6	15.8
Adj. ROAE (%)	24.3	27.5	28.1
Adj. P/E (x)	30.4	25.3	23.7
EV/EBITDA (x)	23.0	18.6	17.5
Adj. EPS growth (%)	15.8	20.2	6.8

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Result highlights

Cigarette revenue grew 16% YoY

- ITC's net cigarette revenue grew 16% YoY to Rs 80.8bn in Q3FY23, with strong volume growth of 14-15%, aided by innovation, enhanced product availability and a focus on premiumisation across categories.
- The company plans to continue rolling out several differentiated variants to further strengthen its offerings and ensure that its product portfolio is future-ready.
- Per management, stability in taxes on cigarettes, backed by deterrent actions by enforcement agencies, continues to enable recovery of volumes from illicit trade, resulting in higher demand.
- Recent launches such as 'Classic Connect', 'Gold Flake Mixpod', 'Gold Flake SLK', and 'American Club Clove Mint' continue to gain traction.

FMCG – Others: Strong growth across channels and markets

- Sales in the FMCG – Others segment grew 18% YoY to Rs 48.4bn in Q3 driven by strong growth in staples, biscuits, noodles, snacks, dairy, beverages, and frozen foods.
- Per management, the FMCG businesses witnessed robust growth across channels and markets (both urban and rural) spurred by ramp-up in outlet coverage, enhanced penetration and superior last-mile execution.
- Personal wash products including 'Fiama' and 'Vivel' performed well. The hygiene segment continued to witness demand moderation, though revenue is ahead of pre-pandemic levels. Stationery also saw strong growth during the quarter.
- The segment's EBITDA margin stood at 10%, up 90bps YoY and 50bps QoQ in Q3. Management attributed this to cost rationalisation initiatives, premiumisation, supply chain agility, judicious pricing actions, fiscal incentives, leveraging digital media, and optimising channel assortment.
- Digital technologies are being increasingly leveraged to sharpen focus and fuel growth in rural markets and tier-2 cities.
- E-commerce sales witnessed rapid growth led by account-specific strategies, product launches, and customised supply chain solutions.
- ITC continued to scale up its direct-to-consumer (D2C) interventions such as Aashirvaad 'Meri Chakki Atta' in the branded packaged foods business, 'Dermafique' in premium skin care, and 'classmateshop.com' in the education and stationery products business.

Hotels – RevPAR ahead of pre-pandemic levels

- Revenue in the hotels business grew 50% YoY to Rs 7.4bn in Q3 with strong margin expansion from higher RevPAR (revenue per available room), operating leverage, and cost rationalisation initiatives.
- RevPAR moved ahead of pre-pandemic levels backed by retail, leisure, weddings, and the MICE (meetings, incentives, conferences and exhibitions) segments. Normalisation in domestic business travel along with pickup in inbound foreign travel augurs well for growth.
- During the quarter, ITC launched 'Welcomhotel Jim Corbett' at Jim Corbett National Park, Uttarakhand, which is in line with its 'asset-right' strategy. So far, the company has added eight properties in the current financial year through management contracts.
- In Aug'22, the company launched 'ITC Narmada' – a luxury 291-key hotel in Ahmedabad.

Paperboards, Paper & Packaging

- Paper and Paperboard revenue grew 13% YoY to Rs 23bn driven by higher realisations in domestic and export markets.
- Growth in value-added products rebounded aided by higher realisations. The fine paper segment performed well during the quarter owing to a pick up in the publication and notebooks segment.
- Global pulp prices moderated sequentially toward the end of the quarter even as other input costs remained elevated.
- The segment is scaling up its recently commissioned unit in Nadiad, Gujarat.
- ITC witnessed strong growth in its sustainable product portfolio.

Agri – Ban on export of wheat and rice impacted growth

- Agri segment revenue declined 36% YoY in Q3 due to a ban on the export of wheat and rice. However, the segment grew 33% YoY led by growth in leaf tobacco exports and value-added agricultural products.
- During the quarter, the segment commissioned its new value-added spices processing facility in Guntur.

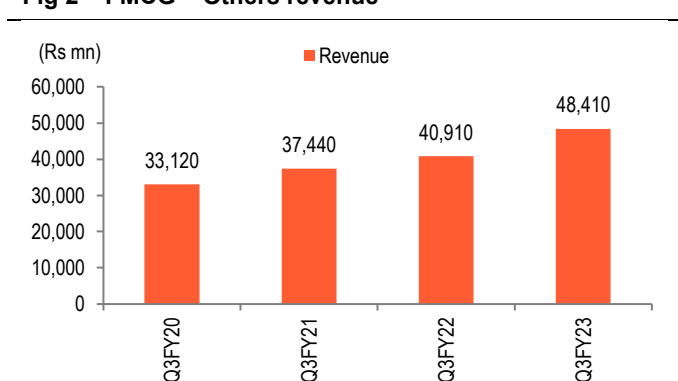
ITC Infotech

- ITC Infotech registered revenue growth of 6% QoQ to Rs 8.7bn with an EBITDA margin of 19%.
- The company continues to invest in capability building in strategic focus areas and infrastructure.

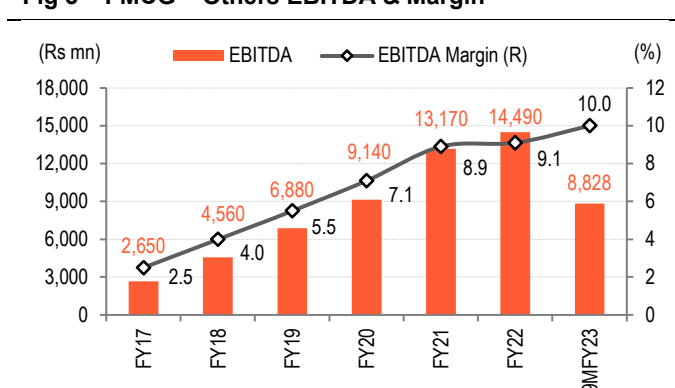
Fig 1 – Quarterly performance

(Rs mn)	Q3FY23	Q2FY23	Q3FY22	QoQ (%)	YoY (%)	Estimates	Variance (%)
Revenue	1,77,045	1,71,080	1,71,082	3.5	3.5	1,75,749	0.7
EBITDA	67,047	62,591	55,977	7.1	19.8	61,074	9.8
Adj. PAT	50,067	46,198	40,567	8.4	23.4	45,408	10.3
Gross Margin (%)	61.1	60.3	54.1	80bps	700bps	57.1	400bps
EBIDTA Margin (%)	35.5	34	30.7	150bps	480bps	32.3	320bps
Adj. PAT Margin (%)	28.3	27	23.7	130bps	460bps	25.8	250bps

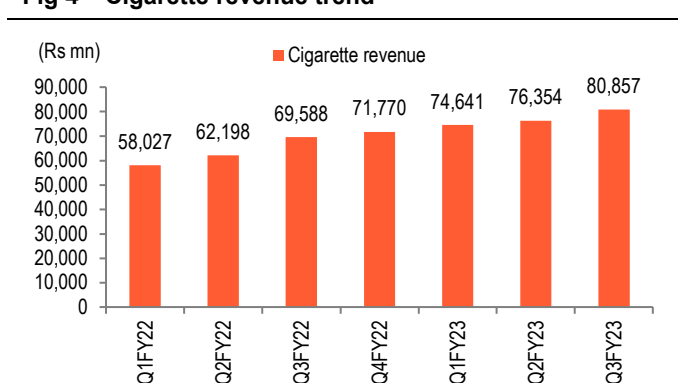
Source: Company, BOBCAPS Research

Fig 2 – FMCG – Others revenue

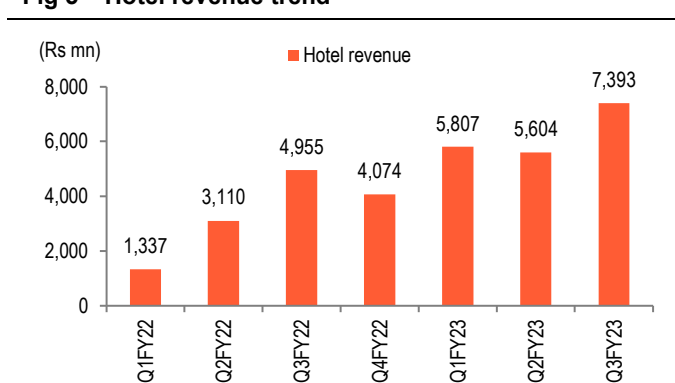
Source: Company, BOBCAPS Research

Fig 3 – FMCG – Others EBITDA & Margin

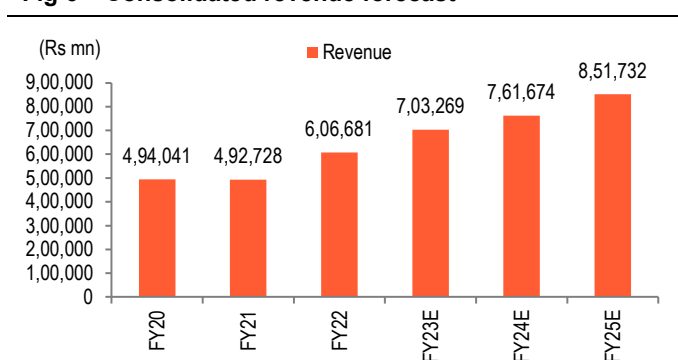
Source: Company, BOBCAPS Research

Fig 4 – Cigarette revenue trend

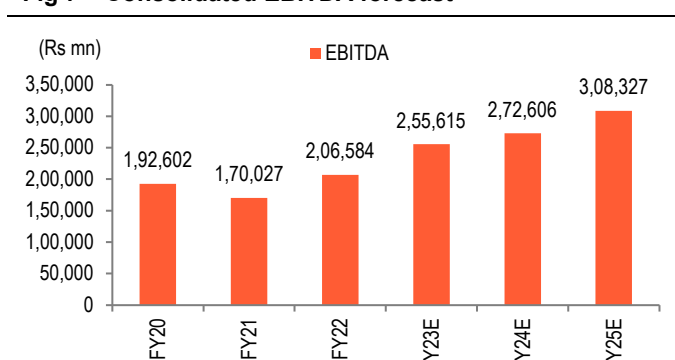
Source: Company, BOBCAPS Research

Fig 5 – Hotel revenue trend

Source: Company, BOBCAPS Research

Fig 6 – Consolidated revenue forecast

Source: Company, BOBCAPS Research

Fig 7 – Consolidated EBITDA forecast

Source: Company, BOBCAPS Research

Valuation methodology

We expect ITC to sustain its strong growth momentum across categories and model for a revenue/EBITDA/PAT CAGR of 12%/14%/14% over FY22-FY25. The cigarettes business continues to deliver volume growth and market share gains in the absence of competition from illicit trade, with the recent tax hike unlikely to dent sales. The FMCG segment too has outperformed some peers, and we expect margins to improve as input costs soften.

We assume coverage on ITC with a BUY rating and value the stock on SOTP basis at a TP of Rs 459. Barring the FMCG business, we have valued the other segments based on FY25E EV/EBITDA as follows: (i) cigarettes at 14.6x, (ii) hotels at 17.4x, (iii) agriculture at 7.7x, and (iv) paper at 6.2x. We assign the FMCG – others segment an EV/Revenue multiple of 6.6x on FY25E revenue.

Fig 8 – SOTP valuation

Business	EV/EBITDA (Rs mn)	Multiple (x)	EV (Rs mn)
EV/EBITDA	FY25E EBITDA		
Cigarettes	2,32,977	14.6x	34,03,228
Hotels	11,493	17.4x	2,00,463
Agri	24,464	7.7x	1,87,385
Paper	32,695	6.2x	2,01,259
EV/Revenue	FY25E Revenue		
FMCG	2,48,734	6.6x	16,30,202
Enterprise Value (Rs mn)			56,22,537
Less: Net debt (Rs mn)			(68,621)
Market Value (Rs mn)			56,91,158
No of share (mn)			12,399
Target Price (Rs)			459

Source: BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- further increase in duty on cigarettes, and
- elevated input costs.

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Total revenue	4,92,728	6,06,681	7,03,269	7,61,674	8,51,732
EBITDA	1,70,027	2,06,584	2,55,615	2,72,606	3,08,327
Depreciation	16,456	17,324	18,845	20,308	21,892
EBIT	1,53,571	1,89,260	2,36,770	2,52,298	2,86,435
Net interest inc./(exp.)	(446)	(394)	(433)	(476)	(524)
Other inc./(exp.)	26,326	18,364	18,331	19,704	20,833
Exceptional items	0	0	0	0	0
EBT	1,79,451	2,07,230	2,54,668	2,71,526	3,06,745
Income taxes	45,553	52,373	64,517	68,424	77,300
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	(69)	175	406	418	467
Reported net profit	1,33,829	1,55,031	1,90,557	2,03,519	2,29,912
Adjustments	0	0	0	0	0
Adjusted net profit	1,33,829	1,55,031	1,90,557	2,03,519	2,29,912

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Accounts payables	43,187	44,173	32,719	35,809	40,183
Other current liabilities	42,944	51,160	51,160	51,160	51,160
Provisions	3,815	3,006	3,006	3,006	3,006
Debt funds	95	56	56	56	56
Other liabilities	41,211	45,982	45,982	45,982	45,982
Equity capital	12,309	12,323	12,323	12,323	12,323
Reserves & surplus	5,94,633	6,15,895	6,69,394	7,02,344	7,39,567
Shareholders' fund	6,06,942	6,28,219	6,81,718	7,14,667	7,51,890
Total liab. and equities	7,38,193	7,72,596	8,14,641	8,50,681	8,92,277
Cash and cash eq.	2,904	2,714	13,581	21,271	24,846
Accounts receivables	25,017	24,619	28,901	31,302	35,003
Inventories	1,03,972	1,08,642	1,05,030	1,12,431	1,24,453
Other current assets	10,952	13,061	13,061	13,061	13,061
Investments	2,49,809	2,49,505	2,74,243	2,88,725	3,06,511
Net fixed assets	1,91,539	2,02,074	2,07,844	2,11,910	2,16,421
CWIP	40,045	31,985	31,985	31,985	31,985
Intangible assets	20,179	20,402	20,402	20,402	20,402
Deferred tax assets, net	585	635	635	635	635
Other assets	93,190	1,18,960	1,18,960	1,18,960	1,18,960
Total assets	7,38,193	7,72,596	8,14,641	8,50,681	8,92,277

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Cash flow from operations	1,25,270	1,57,755	1,97,325	2,17,115	2,40,455
Capital expenditures	(18,366)	(21,416)	(24,614)	(24,374)	(26,404)
Change in investments	52,592	(18,536)	(24,738)	(14,482)	(17,787)
Other investing cash flows	22,604	17,567	0	0	0
Cash flow from investing	56,829	(22,385)	(49,353)	(38,855)	(44,190)
Equities issued/Others	2,907	2,918	0	0	0
Debt raised/repaid	(570)	(597)	0	0	0
Interest expenses	(412)	(396)	0	0	0
Dividends paid	(1,88,674)	(1,37,883)	(1,37,058)	(1,70,569)	(1,92,690)
Other financing cash flows	412	153	0	0	0
Cash flow from financing	(1,86,338)	(1,35,805)	(1,37,058)	(1,70,569)	(1,92,690)
Chg in cash & cash eq.	(4,239)	(435)	10,914	7,690	3,575
Closing cash & cash eq.	2,904	2,714	13,581	21,271	24,846

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23E	FY24E	FY25E
Reported EPS	10.7	12.4	15.2	16.2	18.3
Adjusted EPS	10.9	12.6	15.2	16.2	18.3
Dividend per share	15.3	11.2	11.1	13.8	15.5
Book value per share	49.0	50.7	55.0	57.6	60.6

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23E	FY24E	FY25E
EV/Sales	9.7	7.8	6.8	6.2	5.6
EV/EBITDA	28.0	23.0	18.6	17.5	15.4
Adjusted P/E	35.2	30.4	25.3	23.7	21.0
P/BV	7.8	7.6	7.0	6.7	6.3

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23E	FY24E	FY25E
Tax burden (Net profit/PBT)	74.6	74.8	74.8	75.0	75.0
Interest burden (PBT/EBIT)	116.9	109.5	107.6	107.6	107.1
EBIT margin (EBIT/Revenue)	31.2	31.2	33.7	33.1	33.6
Asset turnover (Rev./Avg TA)	66.7	78.5	86.3	89.5	95.5
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.2	1.2	1.2
Adjusted ROAE	22.0	24.7	28.0	28.5	30.6

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
YoY growth (%)					
Revenue	(0.3)	23.1	15.9	8.3	11.8
EBITDA	21.5	23.7	6.6	13.1	0.0
Adjusted EPS	(13.4)	15.8	20.2	6.8	13.0
Profitability & Return ratios (%)					
EBITDA margin	34.5	34.1	36.3	35.8	36.2
EBIT margin	31.2	31.2	33.7	33.1	33.6
Adjusted profit margin	27.2	25.6	27.1	26.7	27.0
Adjusted ROAE	21.7	24.3	27.5	28.1	30.1
ROCE	25.3	30.1	34.7	35.3	38.1
Working capital days (days)					
Receivables	19	15	15	15	15
Inventory	189	150	133	133	133
Payables	78	61	60	60	60
Ratios (x)					
Gross asset turnover	1.9	2.1	2.2	2.3	2.3
Current ratio	3.3	2.8	3.4	3.6	3.8
Net interest coverage ratio	344.5	480.8	546.9	529.8	546.8
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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BUY – Expected return >+15%

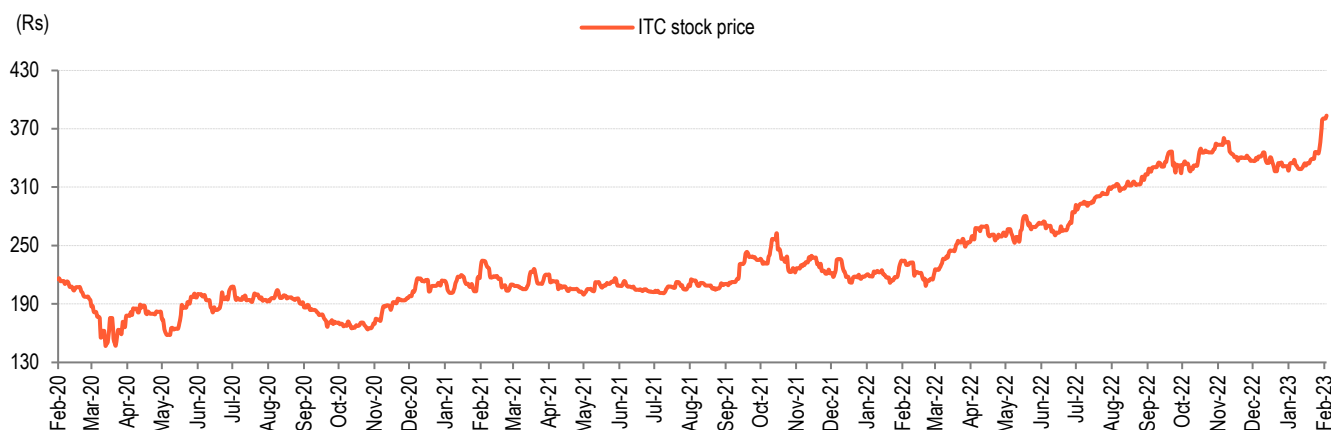
HOLD – Expected return from -6% to +15%

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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