RESULT REVIEW

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

BUY
TP: Rs 532 | ⮝ 21%

ITC | Consumer Staples | 30 January 2024

Cigarette and paperboard businesses disappoint

- **Cigarette business had a soft quarter while FMCG-others remained resilient, and hotels posted its best quarter on a high base**
- **Paperboard and agri businesses remained under pressure owing to challenges in their respective categories**
- **Expect gradual recovery in key segments as consumption improves; maintain BUY with new TP of Rs 532 (vs. Rs 523) on rollover**

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Soft performance in cigarette, agri and paperboard segments: Amidst a challenging operating environment, ITC posted muted 1.8% YoY revenue growth to Rs 180.2bn in Q3FY24. The quarterly performance was affected by a slowdown in cigarette volumes on a high base, continued stress in the agricultural business on account of the ban on wheat & rice exports, and a subdued performance in the paper and paperboard segment owing to poor demand in domestic and global markets and cheap Chinese supply. FMCG-others revenue was up 7.6% YoY and the hotels segment climbed 18% despite a high base.

Steady margins across key segments (ex-agri & paperboard): ITC reported steady margins across segments, barring the paperboard and agri businesses where segment EBIT declined by 51% and 13% YoY respectively. Cigarettes posted 2.3% YoY EBIT growth in a challenging quarter on a high base. FMCG-others clocked 100bps YoY expansion in EBITDA margin to 11% and the hotels business saw 470bps expansion to 36.2%, driven mainly by higher RevPARs, operating leverage and strategic cost initiatives taken by the company. ITC's consolidated EBITDA declined 3% YoY while adj. PAT grew 6.7%.

Operating environment challenging: Management stated that consumption demand was subdued during the quarter, as also seen in Q2FY24, especially in the value segment and in rural markets. However, the company believes that improving farm terms of trade, good recovery in winter crop sowing, and higher government spending augur well for a pickup in rural demand going forward.

Maintain BUY: We trim our FY24/FY25 earnings estimates by 1%/7% post results and introduce FY26 forecasts. In our view, ITC's growth will gather pace as the demand environment improves and strategic initiatives taken by the company yield results. The cigarettes business had a soft quarter on a high base while the FMCG-others and hotels segments have both registered a healthy performance across markets and portfolios. Given strong earnings visibility in the cigarette, FMCG and hotels businesses, we maintain BUY on ITC. Our SOTP-based TP stands revised to Rs 532 (earlier Rs 523) as we roll valuations over to FY26E.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	ITC IN/Rs 438
Market cap	US$ 66.5bn
Free float	71%
3M ADV	US$ 60.2mn
52wk high/low	Rs 500/Rs 329
Promoter/FPI/DII	0%/43%/57%

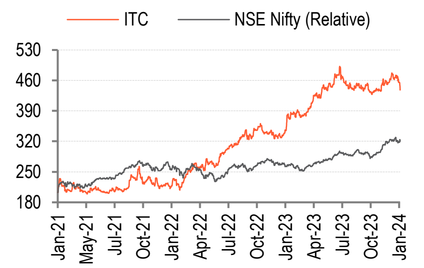
Source: NSE | Price as of 30 Jan 2024

Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	709,369	710,387	821,510
EBITDA (Rs mn)	256,649	260,978	297,387
Adj. net profit (Rs mn)	194,039	205,304	221,120
Adj. EPS (Rs)	15.4	16.3	17.5
Consensus EPS (Rs)	15.4	15.8	17.8
Adj. ROAE (%)	27.9	28.2	28.9
Adj. P/E (x)	28.4	26.9	25.1
EV/EBITDA (x)	21.3	20.9	18.4
Adj. EPS growth (%)	22.4	5.4	7.4

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



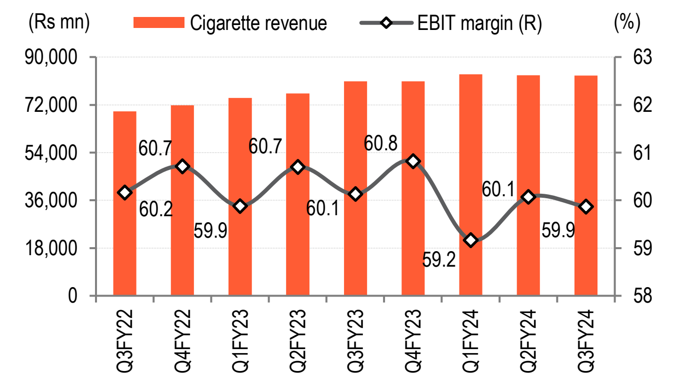
Source: NSE

Fig 1 – Financial performance

(Rs mn)	Q3FY24	Q2FY24	Q3FY23	QoQ (%)	YoY (%)	Estimates	Variance (%)
Revenue	180,194	177,745	177,045	1.4	1.8	183,995	(2.1)
EBITDA	65,038	64,542	67,047	0.8	(3.0)	66,460	(2.1)
Adj. PAT	53,407	48,981	50,067	9.0	6.7	50,198	6.4
Gross Margin (%)	60.9	60.2	61.1	70bps	(20bps)	59.8	110bps
EBITDA Margin (%)	36.1	36.3	35.5	(20bps)	60bps	36.1	0bps
Adj. PAT Margin (%)	29.6	27.6	28.3	200bps	130bps	27.3	230bps

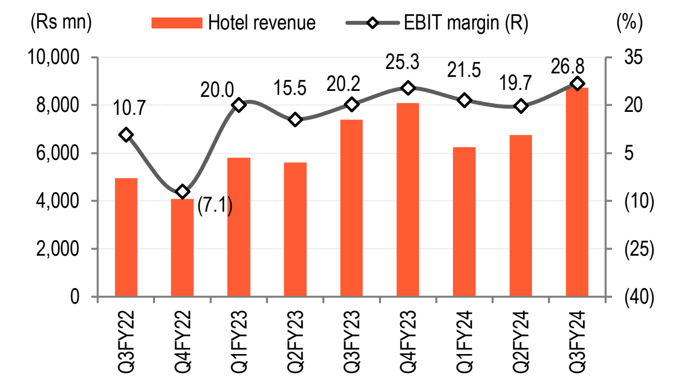
Source: Company, BOBCAPS Research

Fig 2 – Cigarettes revenue & EBIT margin



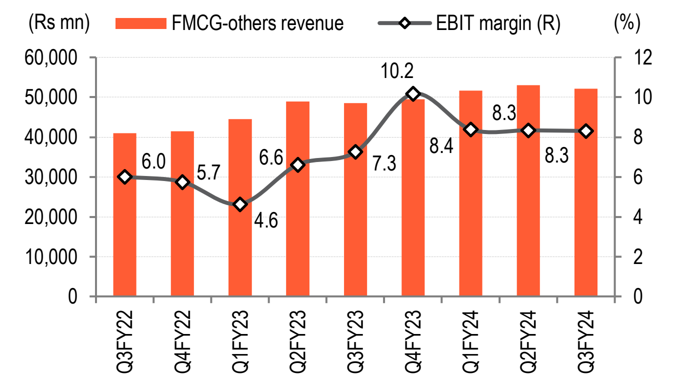
Source: Company, BOBCAPS Research

Fig 3 – Hotels revenue & EBIT margin



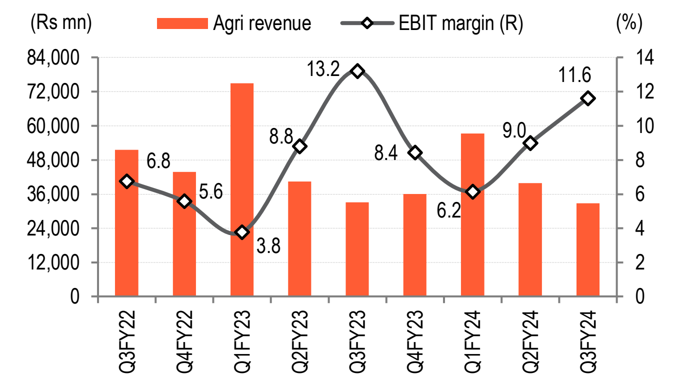
Source: Company, BOBCAPS Research

Fig 4 – FMCG-others revenue & EBIT margin



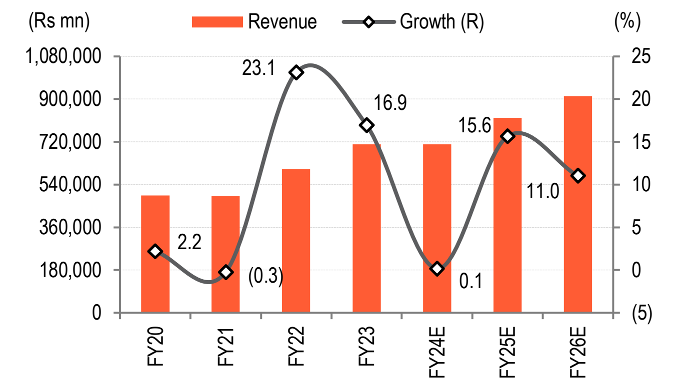
Source: Company, BOBCAPS Research

Fig 5 – Agri revenue & EBIT margin



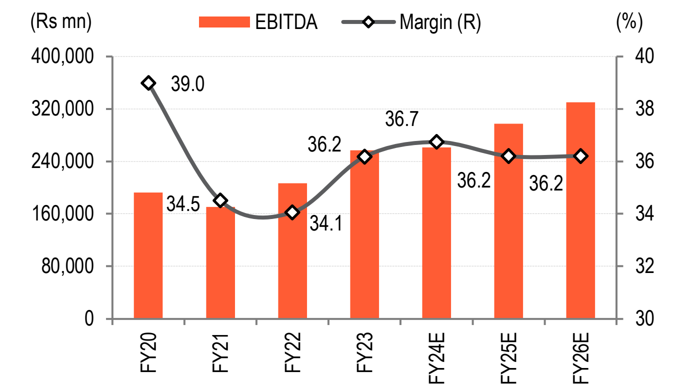
Source: Company, BOBCAPS Research

Fig 6 – Consolidated revenue & growth forecast



Source: Company, BOBCAPS Research

Fig 7 – EBITDA and margin forecast



Source: Company, BOBCAPS Research

Result highlights

Cigarettes: Subdued growth on a high base

- ITC's cigarettes business grew 2.6% YoY in Q3FY24 on a high base in the year-ago quarter. On a two-year CAGR basis, revenue grew 9.3% and EBIT 9.4%.
- The company continues to counter illicit trade and reinforce market standing by fortifying the product portfolio through innovation, premiumisation and enhancing product availability.
- Differentiated and premium offerings continue to do well for the company.
- A sharp rise in costs of leaf tobacco and certain other inputs, along with an increase in taxes, was largely mitigated by an improved mix, strategic cost management and calibrated pricing.

FMCG-Others: Resilient performance amidst demand slowdown

- The FMCG-others segment grew 7.6% YoY amidst a subdued demand environment. Segment EBITDA margin expanded 100bps YoY to 11% in Q3FY24.
- Staples, dairy, beverages, fragrances, personal wash, homecare, *agarbatti* (incense sticks) and notebooks supported growth.
- Growth in both traditional and emerging channels continued during Q3, driven by efficient execution, collaborations, format-based assortments and category-specific marketing strategies.
- Competitive intensity remained high in certain categories, such as biscuits, snacks, noodles and soaps, with regional players also in the fray.
- The segment continues to target improvement in profitability by way of premiumisation, supply chain optimisation, digital initiatives across the value chain, strategic cost management and judicious pricing actions.
- *Aashirvaad Atta* posted strong growth, reinforcing its leadership position in the branded wheat flour industry. *Sunfeast* biscuits and cakes did well during Q3 with the scale-up of recent launches, such as *Sunfeast Supermilk* in Tamil Nadu and strong growth in the *Mom's Magic* cookies range.
- *YiPPee* noodles sustained its position as a strong number two brand amidst increasing competitive intensity in the segment.
- The *Aashirvaad Svasti* fresh dairy portfolio, which includes pouch milk, curd, lassi and paneer, recorded strong growth on the back of best-in-class quality standards, differentiated products and superior taste.

Hotels: Best-ever performance during Q3

- The hotels segment continues to deliver a strong performance, with segment revenue and EBIT up 18% and 57% YoY respectively in Q3. Segment EBITDA margin expanded 470bps YoY to 36.2% driven by higher RevPAR, structural cost interventions and operating leverage.
- During the quarter, the hotels business posted strong growth in annual recurring revenue (ARR) and occupancies across properties driven by the retail and MICE (meetings, incentives, conferences and exhibitions) segments, as well as marquee events like the ICC Cricket World Cup.
- Welcomhotel Chennai reopened in January after renovation.
- The segment continues to follow the 'asset-right' strategy and added three new properties during Q3, including Fortune Park, Aligarh; Fortune Park, Tiruppur; and Fortune Park East Delhi, Vivek Vihar.
- Including new launches, ITC has added a total of 22 properties to its portfolio in the last 24 months. The pipeline of managed properties continues to be strengthened across the Welcomhotel, Mementos, Storii, Fortune and WelcomHeritage brands.

Paper, paperboard & packaging: Global and domestic headwinds

- ITC's paper, paperboard & packaging segment continues to face headwinds from low priced Chinese supplies in global markets, muted domestic demand, a surge in wood costs and a high base effect.
- Global demand remained subdued during Q3FY24 and domestic demand recovery slowed post-festive season.
- Subdued realisations and surging domestic wood prices continued to hurt margins. Strategic investments in a high-pressure recovery boiler and proactive capacity augmentation in value-added paperboards helped to partly mitigate margin stress.
- Demand for fine paper remained relatively firm and décor paper fared well in Q3.
- The company reported record-high production of in-house chemical pulp, leveraging recent capacity expansion. Also, capacity utilisation of the Nadiad packaging and printing unit in Gujarat has been progressively ramped up.
- Wholly owned subsidiary, ITC Fibre Innovations, is in the process of setting up a state-of-the-art premium moulded fibre products manufacturing facility in Badiyakhedi, Madhya Pradesh. The project is progressing on schedule and is expected to be commissioned by the end of FY24.
- ITC's packaging and printing business continues to focus on accelerating new business development in domestic and export markets by offering innovative and customised solutions, with a special focus on consumer electronics, QSR and personal care products.
- The company's sustainable paperboards/packaging solutions portfolio continues to witness strong growth, leveraging cutting-edge innovation platforms.

Agri business: Wheat & rice export ban remains an overhang

- Agri business declined 2.2% YoY in Q3 due to trade restrictions on agri commodities; revenue excluding the wheat & rice segment grew 14.2% YoY.
- Strong customer relationships and agile execution in leaf tobacco and value-added agri products continue to drive growth in these categories.
- The state-of-the-art facility to manufacture and export nicotine and nicotine derivative products has been commissioned, with export shipments expected to commence from Q4FY24. Regulatory approvals to commence shipments to the EU are in place.
- Capacity utilisation of the recently commissioned state-of-the-art value-added spices processing facility in Guntur has ramped up.

Valuation methodology

We expect ITC's growth to pick up as the demand climate improves and its margins to remain steady on the strength of premiumisation, easing input costs, operating leverage, increasing market penetration and innovation. The company continues to invest in expanding its distribution footprint, building out digital channels and raising capacity in the FMCG, paper and agriculture segments. We see strong earnings visibility in its cigarette and FMCG businesses, with the hotels segment also expected to perform well backed by growth in ARR, higher occupancy, and a strong pipeline of management contracts.

We revise our FY24/FY25 earnings estimates down 1%/7% post results and introduce FY26 estimates for ITC. On rolling our target multiples forward across businesses, we arrive at a revised SOTP-based TP of Rs 532 (vs. Rs 523). Barring FMCG, we have valued ITC's businesses based on FY26E EV/EBITDA using unchanged target multiples 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 (unchanged) on FY26E revenue. Maintain BUY.

Fig 8 – SOTP valuation

EV/EBITDA	FY26E EBITDA	Multiple (x)	EV
Cigarettes	235,947	17.2x	4,058,290
Hotels	13,316	18.9x	251,681
Agri	22,930	6.2x	142,164
Paper	30,379	6.5x	197,464
EV/Revenue	**FY26E Revenue**	**Multiple (x)**	**EV**
FMCG	265,558	7.1x	1,885,458
Enterprise Value			6.535,057
Less: Net debt			(80,623)
Market Value (Rs mn)			6,615,680
No of share (mn)			12,439
Target Price (Rs)			**532**

Source: Company, BOBCAPS Research

Fig 9 – Revised estimates

(Rs mn)	New			Old		Change (%)	
	FY24E	FY25E	FY26E	FY24E	FY25E	FY24E	FY25E
Revenue	710,387	821,510	912,018	741,223	882,161	(4.2)	(6.9)
EBITDA	260,987	297,387	330,150	271,482	319,342	(3.9)	(6.9)
PAT	205,304	221,120	245,686	207,846	237,968	(1.2)	(7.1)
EBITDA margin (%)	36.7	36.2	36.2	36.6	36.2	10bps	0bps

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	14.9	5,092	5,844	BUY
Dabur India	DABUR IN	11.6	536	669	BUY
Hindustan Unilever	HUVR IN	70.3	2,459	2,895	BUY
ITC	ITC IN	66.5	438	532	BUY
Marico	MRCO IN	8.2	523	646	BUY
Nestle India	NEST IN	2.9	2,492	2,826	BUY
Zydus Wellness	ZYWL IN	1.2	1,602	1,556	HOLD

Source: BOBCAPS Research, NSE | Price as of 30 Jan 2024

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Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Total revenue	**492,728**	**606,681**	**709,369**	**710,387**	**821,510**
EBITDA	170,027	206,584	256,649	260,978	297,387
Depreciation	16,456	17,324	18,090	18,389	21,906
EBIT	153,571	189,260	238,559	242,589	275,481
Net interest inc./(exp.)	(446)	(394)	(432)	(453)	(523)
Other inc./(exp.)	26,326	18,364	19,805	26,843	19,941
Exceptional items	0	0	(729)	(55)	0
EBT	179,451	207,230	258,661	269,035	294,899
Income taxes	45,553	52,373	64,384	64,085	74,315
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	(69)	175	490	410	535
Reported net profit	**133,829**	**155,031**	**194,767**	**205,360**	**221,120**
Adjustments	0	0	(729)	(55)	0
Adjusted net profit	**133,829**	**155,031**	**194,039**	**205,304**	**221,120**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Accounts payables	43,187	44,173	46,590	34,362	37,871
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	12,476	12,476
Reserves & surplus	594,633	615,895	682,960	716,245	752,044
Shareholders' fund	606,942	628,219	695,388	728,721	764,520
Total liab. and equities	**738,193**	**772,596**	**858,830**	**879,936**	**919,243**
Cash and cash eq.	2,904	2,714	4,634	46,600	35,052
Accounts receivables	25,017	24,619	29,562	29,604	34,235
Inventories	103,972	108,642	117,712	113,573	133,688
Other current assets	10,952	13,061	15,618	15,618	15,618
Investments	249,809	249,505	295,580	273,603	296,152
Net fixed assets	191,539	202,074	211,171	214,544	218,105
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**	**879,936**	**919,243**

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Cash flow from operations	**125,270**	**157,755**	**188,776**	**215,372**	**221,788**
Capital expenditures	(18,366)	(21,416)	(27,430)	(22,732)	(25,467)
Change in investments	52,592	(18,536)	(94,376)	21,976	(22,549)
Other investing cash flows	22,604	17,567	64,482	0	0
Cash flow from investing	**56,829**	**(22,385)**	**(57,323)**	**(756)**	**(48,015)**
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)	(172,074)	(185,320)
Other financing cash flows	412	153	149	0	0
Cash flow from financing	**(186,338)**	**(135,805)**	**(130,060)**	**(172,074)**	**(185,320)**
Chg in cash & cash eq.	**(4,239)**	**(435)**	**1,392**	**42,542**	**(11,548)**
Closing cash & cash eq.	**2,904**	**2,714**	**4,633**	**46,600**	**35,052**

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23A	FY24E	FY25E
Reported EPS	10.7	12.4	15.5	16.3	17.5
Adjusted EPS	10.9	12.6	15.4	16.3	17.5
Dividend per share	15.3	11.2	12.4	13.8	14.9
Book value per share	49.0	50.7	56.1	58.8	61.7

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23A	FY24E	FY25E
EV/Sales	11.1	9.0	7.7	7.7	6.7
EV/EBITDA	32.1	26.5	21.3	20.9	18.4
Adjusted P/E	40.2	34.7	28.4	26.9	25.1
P/BV	8.9	8.6	7.8	7.5	7.1

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23A	FY24E	FY25E
Tax burden (Net profit/PBT)	74.6	74.8	75.0	76.3	75.0
Interest burden (PBT/EBIT)	116.9	109.5	108.4	110.9	107.0
EBIT margin (EBIT/Revenue)	31.2	31.2	33.6	34.1	33.5
Asset turnover (Rev./Avg TA)	66.7	78.5	82.6	80.7	89.4
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.2	1.2	1.2
Adjusted ROAE	22.0	24.7	27.9	28.2	28.9

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23A	FY24E	FY25E
YoY growth (%)					
Revenue	(0.3)	23.1	16.9	0.1	15.6
EBITDA	(11.7)	21.5	24.2	1.7	14.0
Adjusted EPS	(13.4)	15.8	22.4	5.4	7.4
Profitability & Return ratios (%)					
EBITDA margin	34.5	34.1	36.2	36.7	36.2
EBIT margin	31.2	31.2	33.6	34.1	33.5
Adjusted profit margin	27.2	25.6	27.4	28.9	26.9
Adjusted ROAE	22.0	24.7	27.9	28.2	28.9
ROCE	25.3	30.1	34.3	33.3	36.0
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	2.1	2.3
Current ratio	3.3	2.8	2.9	3.3	3.5
Net interest coverage ratio	344.5	480.8	552.2	536.1	527.0
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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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

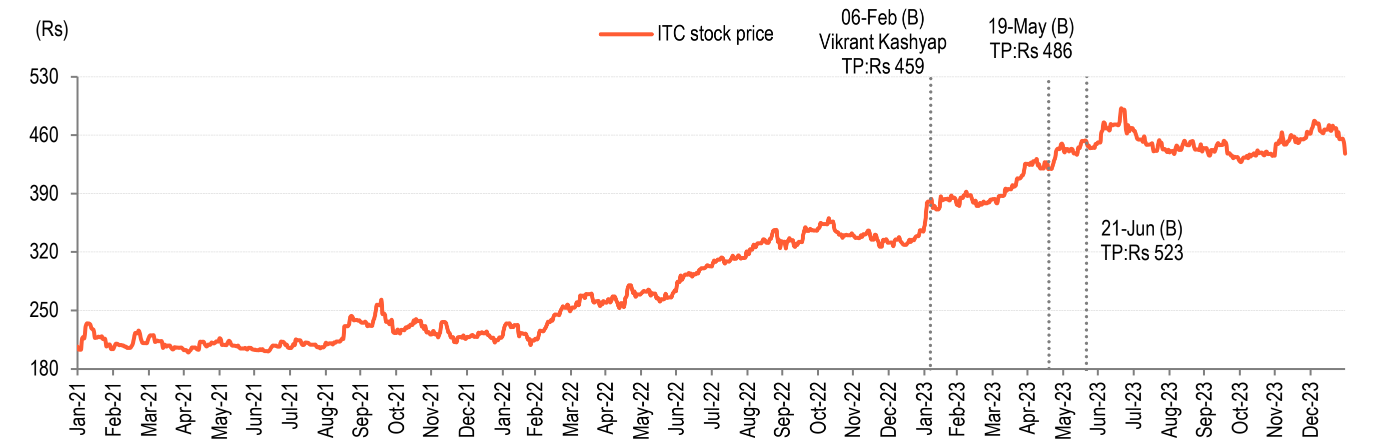
HOLD – Expected return from -6% to +15%

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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