Systematix

Institutional Equities

ITC

19 October 2023

Topline beat offset by soft margin performance

RESULT UPDATE

Sector: FMCG	**Rating: BUY**
CMP: Rs 450	**Target Price: Rs 515**

Stock Info

Sensex/Nifty	65,629/ 19,624
Bloomberg	ITC IN
Equity shares (mn)	12439
52-wk High/Low	Rs 499/ 304
Face value	Rs 1
M-Cap	Rs 5615bn/US$ 69bn
3-m Avg volume	US$ 59mn

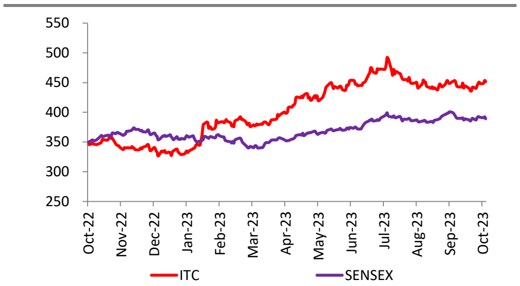
Financial Snapshot (Rs mn)

Y/E Mar	FY23	FY24E	FY25E
Sales	709,369	744,240	833,312
PAT	193,549	208,405	236,882
EPS (Rs)	15.6	16.8	19.1
PE (x)	28.8	26.8	23.6
EV/EBITDA (x)	21.6	20.5	18.1
P/BV (x)	8.0	7.8	7.5
EV/Sales	7.8	7.5	6.7
RoE (%)	29.4	29.7	32.7
RoCE (%)	39.0	39.3	43.3
NWC (days)	52	60	61
Net gearing (x)	0.0	0.0	0.0

Shareholding pattern (%)

	Sep 23	Jun 23	Mar 23
Promoter	-	-	-
–Pledged	-	-	-
FII	43.3	43.6	43.4
DII	41.9	41.9	42.1
Others	14.7	14.5	14.6

Stock Performance (1-year)



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Revenues came in above expectations at 2.6% with better-than-expected cigarette volumes, hotel and agribusiness revenue. EBITDA margins were lower than our expectations at 36.5%, up 15bps YoY due to inferior segment mix, lower margins in cigarettes and severe margin pressure in the paper business.

Key highlights: 1) Cigarette volume/revenue/EBIT growth of ~6%/10%/8% (5% 4-yr volume CAGR) led by sustained volume claw back from illicit trade on the back of deterrent actions by enforcement agencies and relative stability in taxes, 2) FMCG grew 8.3% to Rs 52.9bn (2-yr CAGR of 14.5%) led by growth in Atta, Spices, Personal Wash and Agarbatti categories, with continued margin expansion of 150bps, 3) Hotel business continued a strong rebound despite high base, grew 21.2% YoY and EBIT grew 50% YoY (margin up 370bps YoY) driven by higher RevPAR and strategic cost management initiatives, 4) Agri business declined only 1.7% and grew 26.4% ex-wheat/rice driven by leaf tobacco and value added products, 5) paper segment revenue declined 9.5% due to low priced Chinese supplies, subdued demand and fall in pulp prices and 6) ITC Infotech posted revenue growth of 13.3% with EBITDA margins of 18% (up 150bps YoY).

We expect the volume trajectory on cigarettes to sustain with stable margins, while FMCG traction should continue given the distribution ramp-up alongside a continued improvement in margins. Hotels and agribusiness should continue strong momentum while paper business seems to be bottoming out. Strong cash generation and a solid dividend yield should continue to provide downside support. The hotels business demerger is a positive and we expect an accelerated re-rating if it is followed with similar actions in FMCG/IT businesses as well. We build in 8%/9%/11% revenue/EBITDA/PAT CAGR over FY23-25E. We maintain our BUY rating with a revised target price of Rs 515 (Rs 510 earlier), based on 27x FY25E earnings, a 10% premium to LPA multiple given visibility of a double-digit earnings CAGR and possible restructuring triggers.

Cigarette growth picking up given favorable government action: Cigarette revenue was up 10% (up 8.5% net of excise and NCCD) with volumes growing around 6%, better than our expectations of 4%, pushing up the 4-yr CAGR to 5%, indicating continued share gains from illicit trade. Growth was broad-based across regions and markets with innovation and premiumization helping profitability as well. Cigarette EBIT grew 8% YoY, led by a slightly inferior mix and high base. The numbers indicate superior execution, focused portfolio/market interventions and traction in new innovative launches like *Classic Connect, Gold Flake Indie Mint, Gold Flake SLK, Classic Alphatec, American club clove mint, American club mash* and *GF Glostar.* Taxation stability and enforcement action are countering illicit trade and driving volume recovery for the legal cigarettes industry.

FMCG business tracking well on both growth and margins: FMCG revenue grew 8.3% YoY (solid 2-yr CAGR of 14.5%). EBITDA margins continue to expand reaching new highs of 11% with EBIT margin expanding to 8.3% due to a combination of commodity price deflation in agri commodities, premiumization, pricing actions and strategic cost management. Atta, Spices, Personal Wash and Agarbatti derived growth amidst relatively subdued consumer demand environment, while Stationery Products Business continued to witness strong traction. Other notable trends were a rapid scale up in alternate channels, increased competitive intensity from local/regional players and step up in marketing spends.

Investors are advised to refer disclosures made at the end of the research report.

Hotel business grew led by strong growth in ARR: Hotel business revenue grew 21.2% YoY despite high base led by strong growth in ARRs across properties. Occupancy remained flattish mainly due to relatively fewer wedding dates during the quarter and pre-planned renovations. Hotel EBITDA margin expanded by 170 bps YoY to 30.7%; margin expansion driven by higher RevPAR, curated packages, strong F&B offerings and strategic cost management initiatives. EBIT margin stood at 19.4%, expanded 370bps YoY. Scheme of Demerger approved by Board in August 2023; demerger is progressing as per scheduled timelines.

Paperboards, Paper & Packaging performance was subdued: Paperboard revenue declined 9.5% YoY (on a base of 25% YoY) due to subdued demand conditions, low priced Chinese supplies in global markets and steep decline in global pulp prices on a high base. EBIT margin contracted 1230bps YoY to 15.3%. Sustainable products portfolio continues to witness strong growth. Integrated business model, interventions in import pulp substitution and high pressure recovery boiler partially mitigated inflationary impact. Company's In-house chemical pulp capacity expansion project adding 20% capacity was completed during the quarter; this initiative will further enhance substitution of imported pulp and enable reduction in operating costs.

Export restrictions on wheat/rice impacted an otherwise strong agri-business: Agri business revenue declined 1.7% YoY (on a base of 44% YoY), while EBIT margin expanded 44bps YoY to 9.1% (seen sequential improvement of 280bps). Ex-wheat exports, revenue was up 26.4% yoy. Leaf tobacco exports and value-added agri products witnessed strong growth, however restrictions on exports of wheat and rice by the Government impacted business. The business continues to provide strategic sourcing support to the branded packaged foods business leveraging the e-Choupal network. The company remained focused on its strategy of rapidly scaling up its VAP portfolio to accelerate growth and enhance value capture in segments like spices, coffee, marine products and processed fruits. During the quarter, ITC commissioned Mysuru facility for export of Nicotine & Nicotine Derivative products conforming to US & EU pharmacopoeia standards.

Risks: 1) Sharp increase in cigarette taxes, 2) regulatory norms such as implementation of plain packaging or other stricter norms to curb tobacco consumption, and 3) slowdown in consumer spending, impacting growth rate in the FMCG business.

Exhibit 1: Quarterly performance

YE March (Rs mn)	Q2FY24	Q2FY23	Q1FY24	y-y (%)	q-q (%)
Net sales	175,488	169,712	168,429		
Excise duty	11,550	10,297	11,673		
Other operating income	1,563	1,884	1,526		
Net Revenues	**165,501**	**161,299**	**158,282**	**2.6**	**4.6**
Cost of materials	57,792	59,175	45,800	(2.3)	26.2
(% of sales)	32.9	34.9	27.2		
Purchase of stock in trade	12,851	10,205	18,355	25.9	(30.0)
(% of sales)	7.8	6.3	11.6		
Gross profit	**94,858**	**91,919**	**94,127**	**3.2**	**0.8**
Gross margin (%)	**57.3**	**57.0**	**59.5**		
Employee cost	9,092	9,364	9,038	(2.9)	0.6
(% of sales)	5.5	5.8	5.7		
Others	25,350	23,912	22,588	6.0	12.2
(% of sales)	15.3	14.8	14.3		
EBITDA	**60,416**	**58,643**	**62,501**	**3.0**	**(3.3)**
EBITDA margin (%)	**36.5**	**36.4**	**39.5**		
Other income	8,956	5,069	7,087	76.7	26.4
PBIDT	**69,372**	**63,712**	**69,588**	**8.9**	**(0.3)**
Depreciation	4,132	4,220	4,025	(2.1)	2.7
Interest	105	107	107	(1.5)	(1.8)
PBT	**65,135**	**59,385**	**65,456**	**9.7**	**(0.5)**
Tax	15,865	14,712	16,429	7.8	(3.4)
ETR (%)	24.4	24.8	25.1		
Deferred tax	-	13	-		
P/L of associate and JV	-	-	-		
Adjusted PAT	**49,270**	**44,661**	**49,028**	**10.3**	**0.5**
PATAMI margin	29.8	27.7	31.0		
Exceptional item	-		-		
Reported PAT	**49,270**	**44,661**	**49,028**	**10.3**	**0.5**
No. of shares (mn)	12,428.0	12,323.3	12,428.0		
Adj EPS (Rs)	**4.0**	**3.6**	**3.9**		

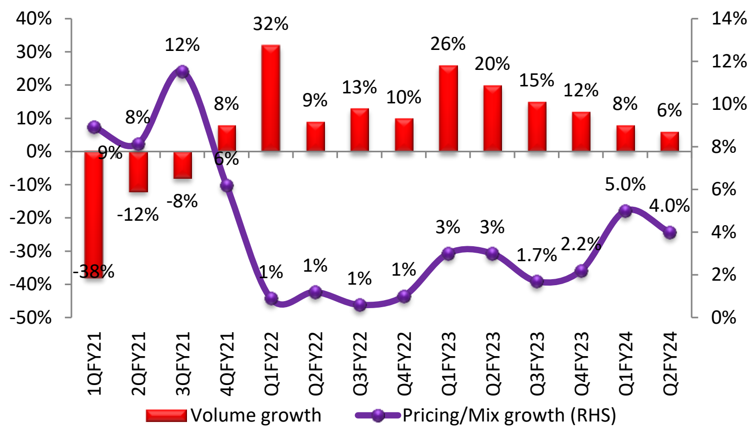
Source: Company, Systematix Institutional Research

Exhibit 2: Change in estimates (Rs mn)

	Old estimates		Revised estimates		Variation (%)	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Net sales	728,935	815,919	744,240	833,312	2%	2%
EBITDA	278,990	313,913	269,962	306,689	-3%	-2%
EBITDA margin	38.3%	38.5%	36.3%	36.8%		
Adj. PAT	208,744	234,774	208,405	236,882	0%	1%

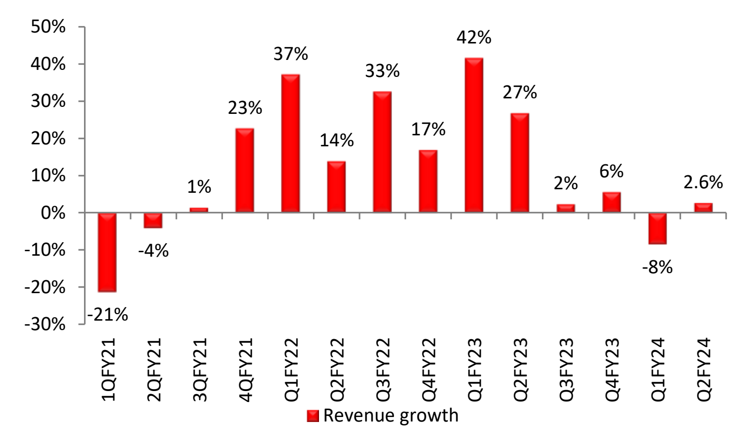
Source: Company, Systematix Institutional Research

Exhibit 3: Cigarette volume growth at 6%



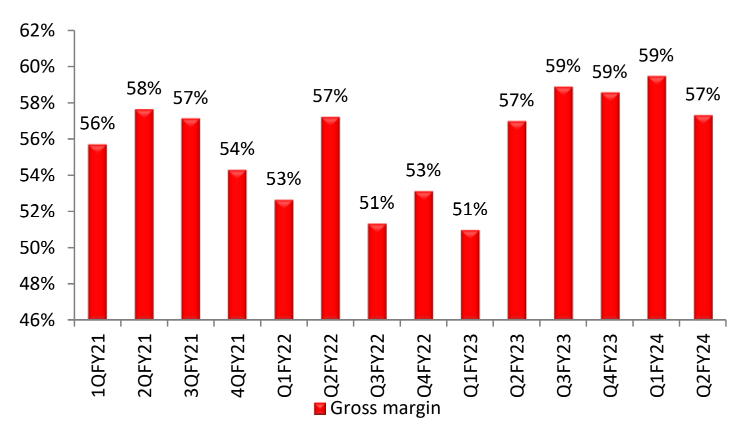
Source: Company, Systematix Institutional Research

Exhibit 4: Revenue up 2.6% YoY given decline in agri/paper biz



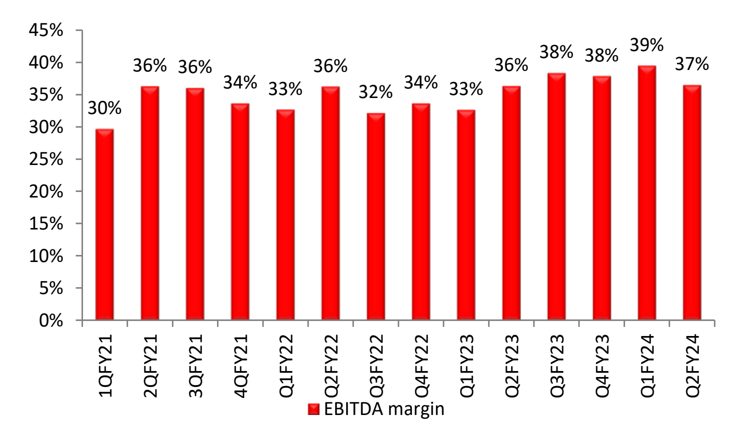
Source: Company, Systematix Institutional Research

Exhibit 5: Gross margin expands 33bps YoY



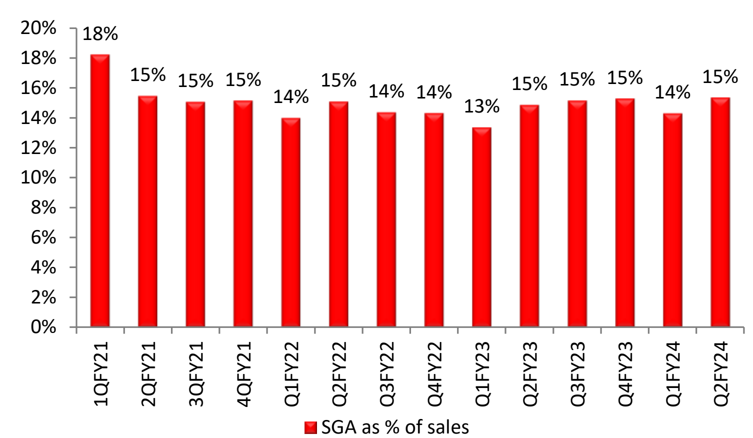
Source: Company, Systematix Institutional Research

Exhibit 6: EBITDA margin up 15bps YoY



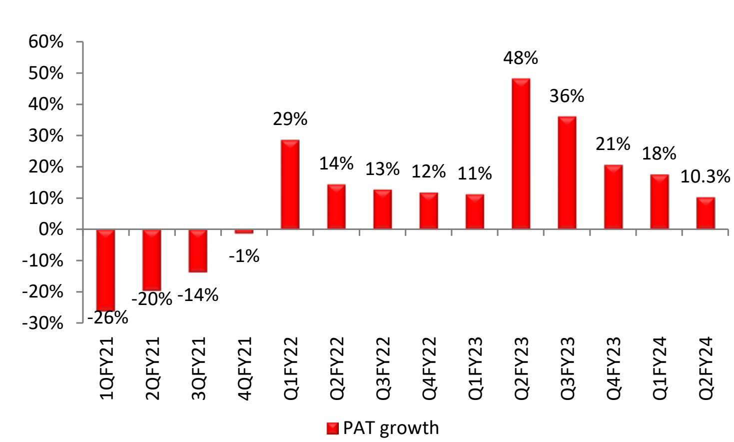
Source: Company, Systematix Institutional Research

Exhibit 7: SGA expenses increased 50 bps YoY



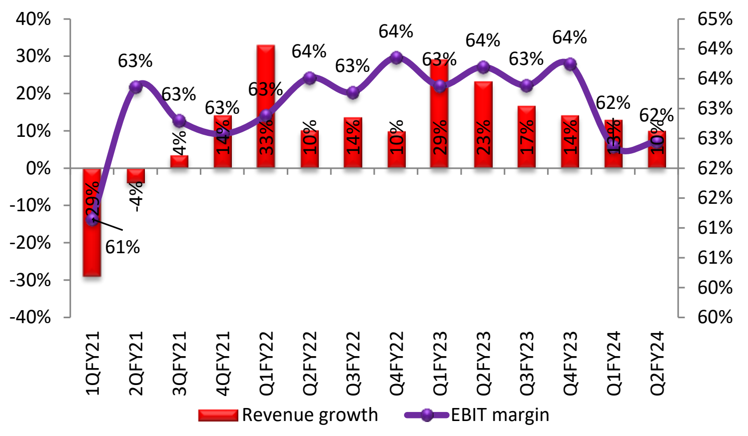
Source: Company, Systematix Institutional Research

Exhibit 8: PAT grew 10.3% YoY



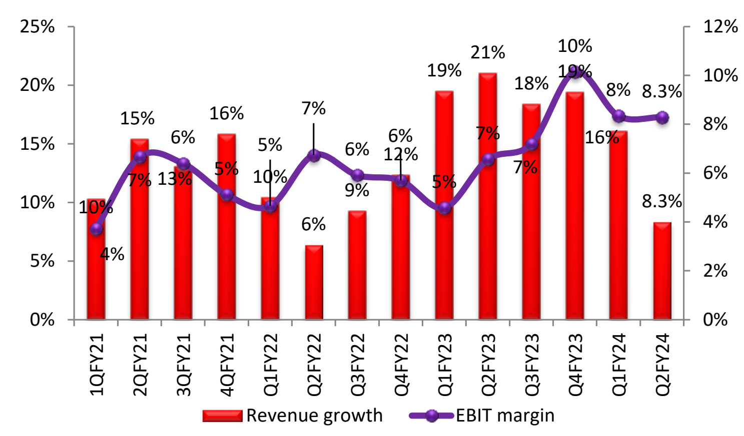
Source: Company, Systematix Institutional Research

Exhibit 9: Cigarette revenue grew 10% YoY



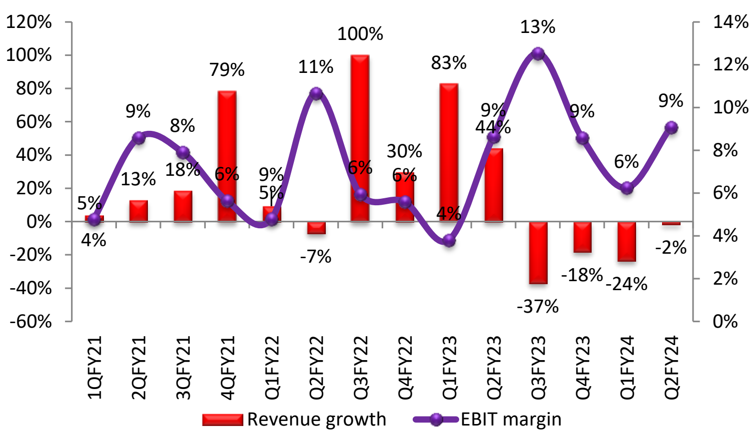
Source: Company, Systematix Institutional Research

Exhibit 10: FMCG revenue grew 8.3% YoY



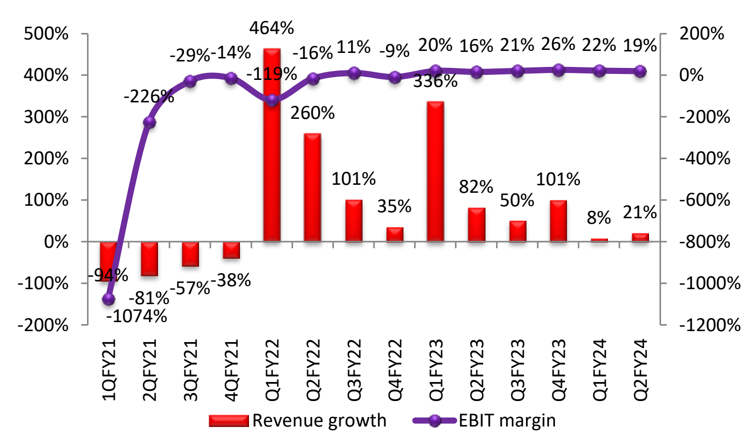
Source: Company, Systematix Institutional Research

Exhibit 11: Agri business declines 1.7% YoY



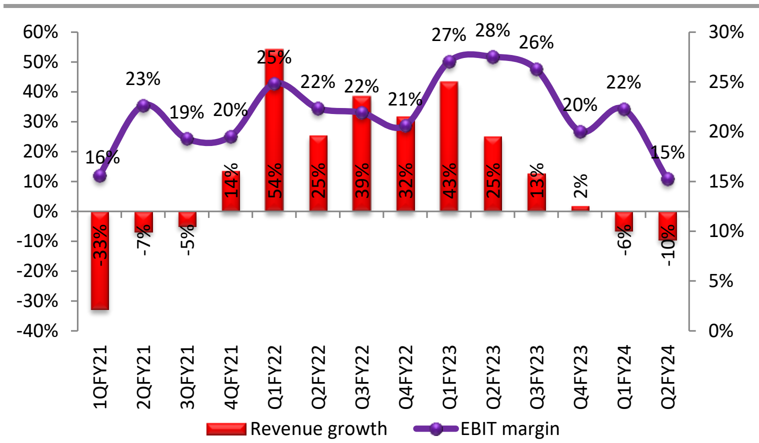
Source: Company, Systematix Institutional Research

Exhibit 12: Hotel business grew 21.2% YoY



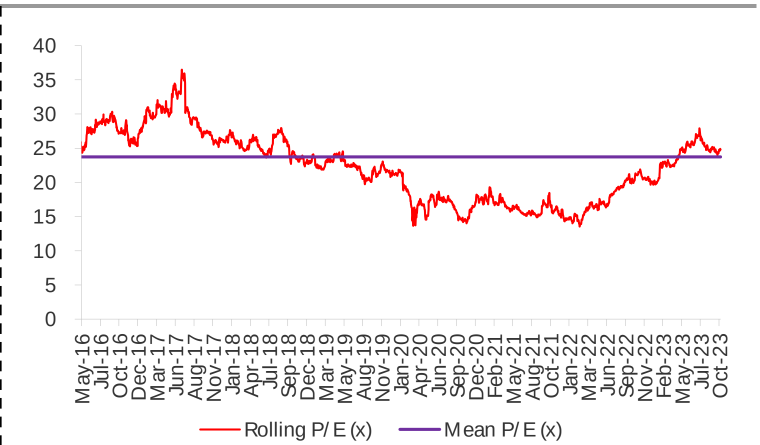
Source: Company, Systematix Institutional Research

Exhibit 13: Paper business declines 9.5% YoY



Source: Company, Systematix Institutional Research

Exhibit 14: Currently trades at 24.8x one year forward P/E



Source: Company, Systematix Institutional Research

FINANCIALS

Profit & Loss Statement

YE: Mar (Rs mn)	FY21	FY22	FY23	FY24E	FY25E
Revenue	**4,92,728**	**6,06,681**	**7,09,369**	**7,44,240**	**8,33,312**
Gross profit	2,91,413	3,42,830	4,19,311	4,48,777	5,06,904
GP margin (%)	59.1%	56.5%	59.1%	60.3%	60.8%
Operating profit	**1,70,027**	**2,06,584**	**2,56,649**	**2,69,962**	**3,06,689**
OP margin (%)	34.5%	34.1%	36.2%	36.3%	36.8%
Depreciation	16,456	17,324	18,090	18,715	20,185
Interest expense	446	394	432	454	476
Other income	26,326	18,364	19,805	26,341	28,975
Profit before tax	1,79,451	2,07,230	2,57,932	2,77,135	3,15,002
Taxes	45,553	52,373	64,384	68,729	78,121
Tax rate (%)	25.4%	25.3%	25.0%	24.8%	24.8%
Adj. PAT	**1,31,612**	**1,52,427**	**1,93,549**	**2,08,405**	**2,36,882**
Exceptional loss	69	-	(729)	-	-
Net profit	1,31,543	1,52,427	1,94,277	2,08,405	2,36,882
EPS	**10.7**	**12.4**	**15.6**	**16.77**	**19.06**

Source: Company, Systematix Institutional Research

Balance Sheet

YE: Mar (Rs mn)	FY21	FY22	FY23	FY24E	FY25E
Equity capital	12,309	12,323	12,428	12,428	12,428
Reserves	5,91,165	6,12,232	6,79,125	6,99,965	7,23,653
Debt	95	56	388	388	388
Minority Int	3,468	3,663	3,835	3,835	3,835
Deffered tax Liab	16,779	16,099	15,770	15,770	15,770
Other non current liabilities	6,935	5,957	9,723	10,209	10,719
Total liabilities	**6,30,750**	**6,50,331**	**7,21,269**	**7,42,595**	**7,66,794**
Fixed Asset	2,59,560	2,62,258	2,76,274	2,87,560	2,97,376
Investments	2,52,474	2,52,052	2,97,673	2,97,673	2,97,673
Other Non-current Assets	24,117	37,968	59,982	62,981	66,130
Inventories	**1,03,972**	**1,08,642**	**1,17,712**	**1,32,536**	**1,50,681**
Sundry debtors	25,017	24,619	29,562	40,780	47,944
Cash & equivalents	**46,590**	**46,544**	**48,802**	**35,003**	**38,837**
Loans and Advances	25,878	39,877	28,305	29,849	33,639
Sundry creditors	43,187	44,173	46,590	50,975	59,359
Other current liabilities	63,671	77,457	90,451	92,811	1,06,129
Total Assets	**6,30,750**	**6,50,331**	**7,21,269**	**7,42,595**	**7,66,793**

Source: Company, Systematix Institutional Research

Cash Flow

YE: Mar (Rs mn)	FY21	FY22	FY23	FY24E	FY25E
PBIT	1,79,897	2,07,624	2,58,364	2,77,588	3,15,479
Depreciation	16,456	17,324	18,090	18,715	20,185
Tax paid	(45,553)	(52,373)	(64,384)	(68,729)	(78,121)
Working capital Δ	30,225	22,321	(36,716)	(20,841)	(7,397)
Other operating items	-	-	-	-	-
Operating cashflow	**1,81,025**	**1,94,895**	**1,75,355**	**2,06,732**	**2,50,145**
Capital expenditure	(39,843)	(20,022)	(32,106)	(30,000)	(30,001)
Free cash flow	**1,41,181**	**1,74,873**	**1,43,249**	**1,76,732**	**2,20,144**
Equity raised	(48,482)	10,374	65,354	(0)	0
Investments	6,993	(25,398)	4,065	-	-
Debt financing/disposal	21	(39)	332	-	-
Interest Paid	(446)	(394)	(432)	(454)	(476)
Dividends paid	(1,32,320)	(1,41,718)	(1,92,634)	(1,87,565)	(2,13,194)
Other items	6,869	(17,745)	(17,676)	(2,513)	(2,639)
Net Δ in cash	**(26,183)**	**(46)**	**2,258**	**(13,799)**	**3,836**

Source: Company, Systematix Institutional Research

Ratios

YE: Mar	FY21	FY22	FY23	FY24E	FY25E
Revenue growth (%)	-0.3	23.1	16.9	4.9	12.0
Op profit growth (%)	-11.7	21.5	24.2	5.2	13.6
Net profit growth (%)	-16.3	15.8	27.0	7.7	13.7
OPM (%)	34.5	34.1	36.2	36.3	36.8
Net profit margin (%)	26.7	25.1	27.3	28.0	28.4
RoCE (%)	28.5	33.6	39.0	39.3	43.3
RoNW (%)	21.0	24.8	29.4	29.7	32.7
EPS (Rs)	10.7	12.4	15.6	16.8	19.1
DPS (Rs)	10.8	11.5	15.5	15.1	17.2
BVPS (Rs)	49.3	51.0	56.0	57.6	59.5
Debtor days	19	15	15	20	21
Inventory days	77	65	61	65	66
Creditor days	32	27	24	25	26
P/E (x)	42.0	36.3	28.8	26.8	23.6
P/B (x)	9.1	8.8	8.0	7.8	7.5
EV/EBITDA (x)	32.2	26.6	21.6	20.5	18.1

Source: Company, Systematix Institutional Research

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