BOBCAPS
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BUY
TP: Rs 523 | ⮝ 19%

ITC | Consumer Staples | 20 October 2023

FMCG and hotels continue to shine

- **FMCG business delivered strong topline (+8% YoY) growth in Q2 led by steady portfolio expansion**
- **Hotels segment grew 21% YoY on the back of strong growth in ARR; EBIT swelled 50% led by retail and MICE**
- **Expect deepening rural recovery to aid growth; maintain BUY with an unchanged SOTP-based TP of Rs 523**

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FMCG and hotels lead growth: ITC posted 3.9% YoY revenue growth to Rs 177.7bn in Q2FY24 despite (i) a slowdown in agricultural business on account of the ban on wheat exports, and (ii) a subdued performance in the paper and paperboard segment owing to poor demand in domestic and global markets and cheap Chinese supply. The cigarettes business continued to perform well, growing 9.1% YoY for the quarter, FMCG-others revenue was up 8.3%, and the hotels segment climbed 21.2% YoY (1.5x Q2FY20) despite a high base.

Margin expands despite stress in paper business: ITC's EBITDA margin increased 230bps YoY (-260bps QoQ) to 36.3% as the hotels business saw 170bps expansion to 30.7%, followed by FMCG-others (+150bps to 11%). Profitability in the paper and paperboard segment was dented by lower realisations and a spike in input costs. Adj. PAT grew 6% YoY to Rs 48.9bn with margin gains of 60bps.

Operating environment remains challenging: ITC mentioned that consumption demand has been relatively subdued, especially in the value segment and in rural markets due to subpar monsoons and a spike in food inflation during the quarter. However, management indicated that it is seeing green shoots of recovery as the prospects of improved agricultural output, onset of the festive season, higher rural wages, and government spending on infrastructure augur well for a recovery in rural markets.

Maintain BUY: We expect ITC's growth to pick up as the ongoing demand recovery deepens. The cigarettes business continues to deliver strong volume growth and market share gains in the absence of competition from illicit trade. Further, the FMCG-others and hotels segment have both registered a healthy performance across markets and portfolios. Given robust cigarette sales and earnings visibility in the FMCG and hotels businesses, we maintain BUY on ITC with an unchanged SOTP-based TP of Rs 523.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	ITC IN/Rs 438
Market cap	US$ 66.3bn
Free float	71%
3M ADV	US$ 61.1mn
52wk high/low	Rs 500/Rs 325
Promoter/FPI/DII	0%/43%/57%

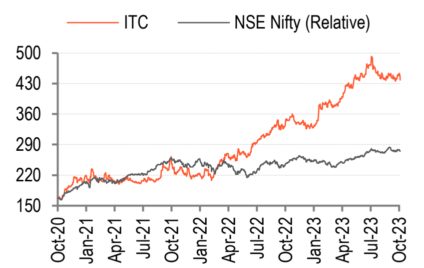
Source: NSE | Price as of 20 Oct 2023

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)	28.4	26.5	23.2
EV/EBITDA (x)	21.2	20.1	17.1
Adj. EPS growth (%)	22.4	7.0	14.5

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



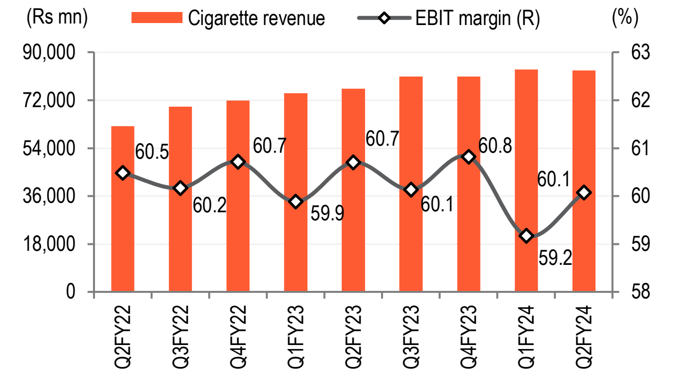
Source: NSE

Fig 1 – Financial performance

(Rs mn)	Q2FY24	Q1FY24	Q2FY23	QoQ (%)	YoY (%)	Estimates	Variance (%)
Revenue	177,745	171,645	171,080	3.6	3.9	177,716	0.0
EBITDA	64,542	66,701	62,591	(3.2)	3.1	68,763	(6.1)
Adj. PAT	48,981	51,049	46,198	(4.1)	6.0	51,384	(4.7)
Gross Margin (%)	60.2	61.8	60.3	(160bps)	(10bps)	61.5	(130bps)
EBITDA Margin (%)	36.3	38.9	34.0	(260bps)	230bps	38.7	(240bps)
Adj. PAT Margin (%)	27.6	29.7	27.0	(210bps)	60bps	28.9	(130bps)

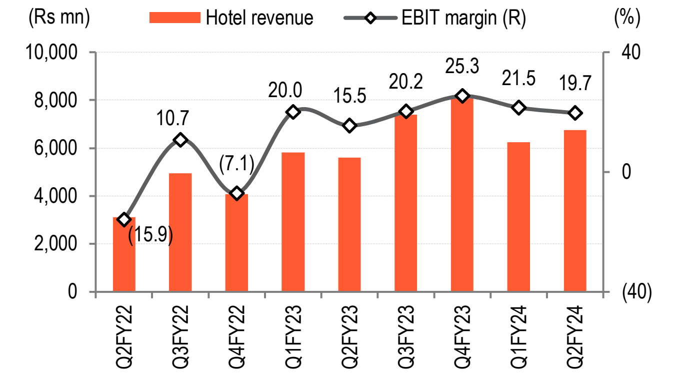
Source: Company, BOBCAPS Research

Fig 2 – Cigarettes revenue & EBIT margin



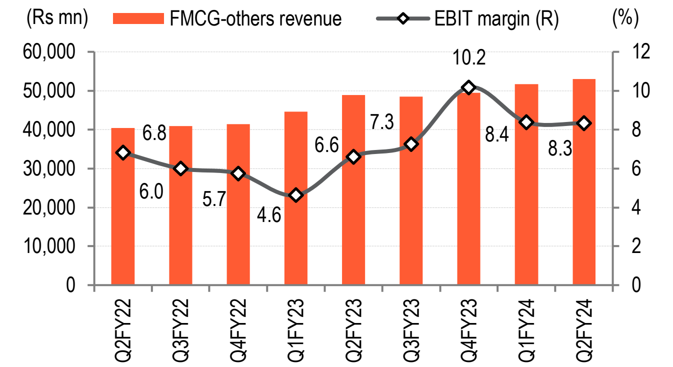
Source: Company, BOBCAPS Research

Fig 3 – Hotels revenue & EBIT margin



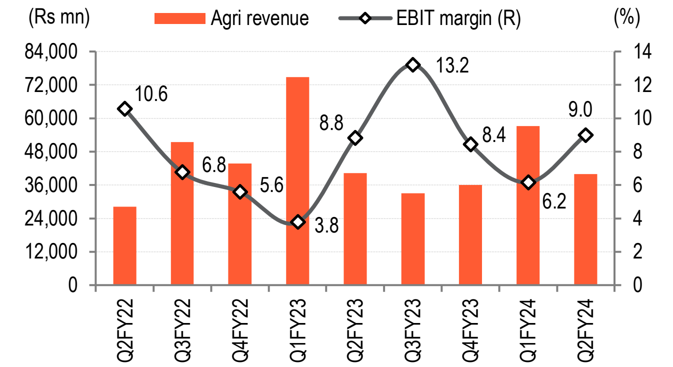
Source: Company, BOBCAPS Research

Fig 4 – FMCG-Others revenue & EBIT margin



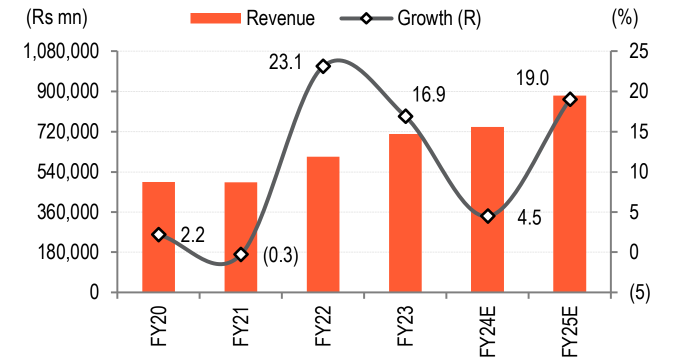
Source: Company, BOBCAPS Research

Fig 5 – Agri revenue & EBIT margin



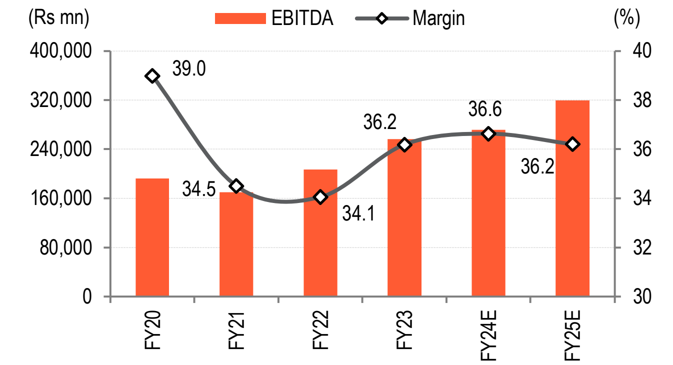
Source: Company, BOBCAPS Research

Fig 6 – Consolidated revenue & growth forecast



Source: Company, BOBCAPS Research

Fig 7 – EBITDA and margin forecast



Source: Company, BOBCAPS Research

Result highlights

Cigarettes: Strong performance on a high base

- ITC's cigarettes business posted gross revenue growth of 9.1% YoY (2Y CAGR of 15.7%) in Q2FY24 led by sustained volume clawback from illicit trade on the back of deterrent action by enforcement agencies, innovation, premiumisation, enhanced product availability and stability in taxes.
- Higher costs of leaf tobacco and certain other inputs, along with higher taxes, were largely mitigated by calibrated pricing, an improved mix and strategic cost management.
- The company recently launched seven new cigarette brands: Classic Alphatec, Classic Verve Balanced Taste, American Club Clove Magik, Players Rush, American Club Smash, Capstan Victory, and GF Glostar.

FMCG-Others: Robust growth across the portfolio

- Revenue in the FMCG-others segment grew 8.3% YoY (2Y CAGR of 14.5%) in Q2 on a high base. Growth was backed by a strong YoY increase in sales of *atta* (wheat flour), spices, personal wash products and *agarbatti* (incense sticks). *Classmate* notebooks and pens continued to witness strong traction as well.
- Segment EBITDA margins expanded 150bps YoY to 11% in Q2, supported by multi-pronged interventions such as premiumisation, supply chain agility, judicious pricing actions, digital initiatives and strategic cost management.
- The FMCG-others businesses continued to do well in both urban and rural markets as it expanded its distribution footprint and ramped up last-mile execution.
- Traditional as well as emerging channels (modern trade, ecommerce, and quick commerce) witnessed high traction.
- Certain categories such as biscuits, snacks, noodles and popular soaps witnessed increasing competitive intensity, including from regional players, against the backdrop of commodity price deflation.
- *Aashirvaad Atta* posted robust growth in Q2 with the value-added range sustaining its strong growth momentum due to an increased thrust on the modern trade and e-commerce channels.
- ITC continues to enhance its product portfolio under *Aashirvaad* with the launch of several differentiated variants, such as gluten-free flour, ragi flour, multi-millet mix, *rava*, roasted suji rava, organic pulses, besan and vermicelli.
- *Yippee* noodles sustained its position as a strong No. 2 brand amidst increasing competition.
- *Sunrise* spices posted robust growth during Q2 and ITC launched the *Swaad Bihar Ka* range of spices customised to regional tastes during the quarter.
- In personal care, the *Fiama* range of personal wash products fared well and *Savlon Cool* soap continued to garner an encouraging consumer response. In homecare, *Nimyle* floor cleaning registered strong sales.

- ITC's *Classmate* brand of notebooks strengthened its leadership position and the company saw sustained traction in the premium portfolio, comprising *Paperkraft*, *Classmate Pulse* and *Classmate Interaktiv* continued to gain traction.

Hotels: Robust showing led by retail and MICE

- ITC's hotels business continued its growth trajectory, with revenues increasing 21.2% YoY in Q2 (1.5x of Q2FY20) despite a high base. Segment EBIT swelled 50% YoY (7x of Q2FY20) led by the retail and MICE (meetings, incentives, conferences and exhibitions) segments.
- ITC witnessed strong growth in annual recurring revenue (ARR) across properties. Occupancy was flattish YoY mainly due to renovations and relatively fewer wedding dates during the quarter.
- The business continued with its strategy of offering a host of curated propositions across accommodations and iconic cuisine brands to augment revenues across properties.
- Segment EBITDA margin expanded 170bps YoY to 30.7% driven by higher RevPAR, curated packages, premium F&B offerings and strategic cost management initiatives.

Paper, paperboard & packaging: Still subdued

- ITC's paper, paperboard & packaging segment posted a 9.5% YoY decline in Q2 revenue (2Y CAGR of +6.4%) owing to a sharp drop in realisations. Margins were further drained by high input costs, primarily of wood and coal.
- The Q2 performance was affected by low-priced Chinese supplies and muted demand in export markets, a sharp reduction in global pulp prices, relatively subdued domestic demand and a high base effect.
- Management believes realisations and global pulp prices are likely to have bottomed out and highlighted early signs of demand revival in value-added products and recycled boards towards the end of the quarter.

Agri business: Ban on wheat & rice exports continues to impact growth

- Agri business revenue (excluding wheat & rice exports) grew 26.4% YoY on the back of sales of value-added agricultural products and leaf tobacco.
- During the quarter, stock limits on wheat, the ban on non-basmati rice exports and export duty on parboiled rice limited business opportunities.
- Capacity utilisation of the recently commissioned state-of-the-art value-added spice processing facility in Guntur has ramped up.

Valuation methodology

We expect ITC's growth to pick up as the demand climate improves. The cigarettes business continues to deliver strong volume growth and market share gains in the absence of competition from illicit trade. In addition, the FMCG-others and hotels segments have registered a healthy performance across markets and portfolios during Q2FY24. We expect margins to improve on the strength of premiumisation, easing input costs, operating leverage, increasing market penetration and innovation.

ITC continues to invest in expanding its distribution footprint, digital channels and also capacity in the FMCG, paper and agriculture segments. We expect the hotels business to perform well, backed by growth in ARR, a strong wedding calendar, demand during the Cricket World Cup 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 8 – SOTP valuation summary

EV/EBITDA	FY25E EBITDA	Multiple (x)	EV
Cigarettes	2,39,444	17.2x	41,18,431
Hotels	12,023	18.9x	2,27,228
Agri	22,377	6.2x	1,37,737
Paper	28,603	6.5x	1,85,917
EV/Revenue	**FY25E Revenue**	**Multiple (x)**	**EV**
FMCG	2,50,029	7.1x	17756,206
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,
- 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	13.4	4,580	5,844	BUY
Dabur India	DABUR IN	11.3	525	669	BUY
Godrej Consumer Products	GCPL IN	12.3	988	1,159	BUY
Hindustan Unilever	HUVR IN	71.4	2,495	3,069	BUY
ITC	ITC IN	66.3	438	523	BUY
Marico	MRCO IN	8.5	542	646	BUY
Nestle India	NEST IN	28.5	24,280	28,260	BUY
Tata Consumer Products	TATACONS IN	10.2	899	994	BUY
Zydus Wellness	ZYWL IN	1.2	1,568	1,556	HOLD

Source: BOBCAPS Research, NSE | Price as of 20 Oct 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	11.1	9.0	7.7	7.3	6.2
EV/EBITDA	32.0	26.4	21.2	20.1	17.1
Adjusted P/E	40.3	34.8	28.4	26.5	23.2
P/BV	9.0	8.7	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	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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BUY – Expected return >+15%

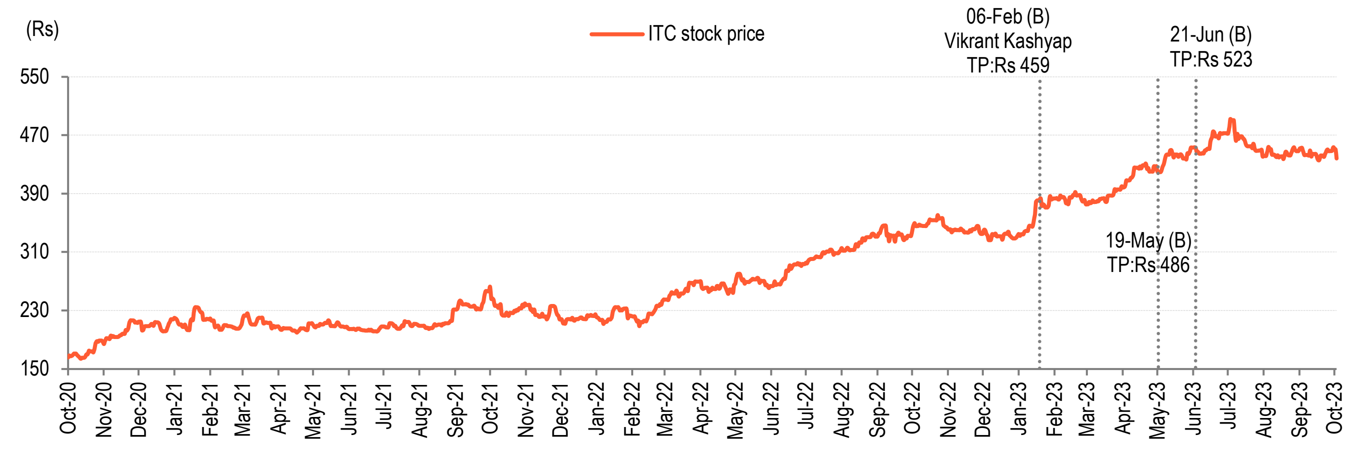
HOLD – Expected return from -6% to +15%

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)



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