RETAIL EQUITY RESEARCH

ITC Ltd.

Consumer

BSE CODE: 500875 NSE CODE: ITC
Bloomberg CODE: ITC:IN SENSEX: 31,262

BUY

Rating as per Largecap 12months investment period

CMP Rs306 TARGET Rs336 RETURN 10%

12th June, 2017

In line quarter…

ITC is a diversified conglomerate, present across categories– Cigarettes, Other FMCG, Hotels, Paper& Agri-business. ITC is a market leader in the cigarettes category with volume market share of ~75%.

- **During Q4FY17, net sales & Adj PAT increased by 14% and 12% respectively on a YoY basis.**
- **ITC surprised positively by posting flattish volume growth in cigarette category in Q4FY17.**
- **EBITDA margin was down 212bps YoY to 34.8% owing to tepid performance of other FMCG & Agri businesses at EBIT level.**
- **We increase our revenue estimates by 6.3%/6.5% for FY18E/FY19E to factor in cigarette volumes recovery and no negative surprise in GST rate.**
- **Sales/PAT to grow at a CAGR of 13.6%/15.4% over FY17-19E owing to the healthy revenue CAGR of 8.7%/16% in cigarettes/FMCG.**
- **The neutral GST rate augurs well for cigarette volumes & hence, we upgrade our rating from 'HOLD' to 'BUY' with a revised TP of Rs336 based on 30x FY19E P/E.**

Cigarette volumes were ahead of estimates

While ITC's gross sales grew by mere 6% YoY in Q4FY17, net sales grew by healthy 14% YoY driven by 11% drop in excise duty outgo this quarter. Notably, the base quarter witnessed higher excise as inventory rose in the system ahead of pictorial warning implementation. Cigarettes business (contributes ~50% to revenues) registered a growth of 4.8% YoY led by realisation growth on account of price hikes undertaken by ITC post excise hike. Notably, the neutral GST rate for this category augurs well for volume growth & hence, we expect this segment to grow at revenue CAGR of ~8.7% over FY17-19E.

Other FMCG- Stable revenue growth

Despite the challenging environment, non-cigarette FMCG business grew by 6.5% YoY. Although this was broadly on expected lines yet the rising input costs coupled with gestation costs on new categories (juices & dairy) & heavy discounting in Apparel negatively impacted its profitability. Hence, segment EBIT declined by 29% YoY to Rs55.6cr (EBIT loss in Q3FY17: Rs19.7cr). Going ahead, we expect this segment to report a CAGR of 16% over FY17-19E led by upturn in consumer demand.

Other businesses

While the hotel business reported revenue growth of ~7% YoY led by improvement in average room rates, Agri business grew by just ~6% YoY owing to fall in wheat exports. Likewise, ITC's paper business posted growth of only 4.4% YoY on account of sluggish demand conditions prevailing in the FMCG & legal cigarette industry.

Tepid operating performance

EBITDA margin witnessed a decline of 212bps YoY to 34.8% in Q4FY17 due to sluggish performance of other FMCG (EBIT Margin at 1.9% vs 2.9% in Q4FY16) & Agri businesses (margin down 239bps YoY). Although EBITDA grew 7.5% YoY yet PAT rose 12.1% YoY largely driven by higher other income (up 8% YoY) & lower tax outgo (effective tax rate at 36% vs. 34% in Q4FY16). Further, we are estimating overall EBITDA margin to expand from 36.4% in FY17 to 37.5% in FY19E led by better profitability in cigarette segment.

Outlook & Valuation

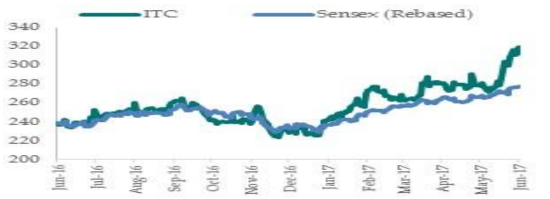
We have increased our EPS estimates by 4.3%/3.7% for FY18E/FY19E to factor in higher revenue estimates. Given its leadership position in cigarette category, continuous investment behind brand building & innovations in Other FMCG business, we maintain positive stance on the stock. Further, revenue/PAT is expected to witness a CAGR of 13.6%/15.4% over FY17-19E. The neutral GST rate for cigarette augurs well for volume growth of the category & hence, we upgrade our rating from 'HOLD' to 'BUY' with a revised TP of Rs336 (earlier Rs291) based on 30x FY19E P/E.

Company Data	
Market Cap (Rs cr)	3,71,953
Enterprise Value (Rs cr)	3,58,777
Outstanding Shares (cr)	1214.7
Free Float	100%
Dividend Yield	1.5%
52 week high	Rs320
52 week low	Rs222
6m average volume (cr)	1.2
Beta	1.4
Face value	Rs1

Shareholding %	Q2FY16	Q3FY16	Q4FY17
Promoters	0.0	0.0	0.0
FII's	20.9	20.3	20.1
MFs/Insti	35.0	35.4	35.8
Public & Others	44.1	44.3	44.1
Total	100.0	100.0	100.0

Price Performance	3mth	6mth	1 Year
Absolute Return	16%	31%	30%
Absolute Sensex	8%	17%	16%
Relative Return*	8%	14%	14%

*over or under performance to benchmark index



Standalone (Rs.cr)	FY17	FY18E	FY19E
Sales	40,089	45,637	51,744
Growth (%)	9.6	13.8	13.4
EBITDA	14,578	16,831	19,394
Margin(%)	36.4	36.9	37.5
PAT Adj	10,201	11,861	13,589
Growth (%)	9.4	16.3	14.6
Adj.EPS	8.4	9.8	11.2
Growth (%)	9.4	16.3	14.6
P/E	36.5	31.4	27.4
P/B	8.2	7.6	6.9
EV/EBITDA	25.3	21.9	19.0
RoE (%)	23.5	25.1	26.5
D/E	0.0	0.0	0.0

Quarterly Financials (Standalone)

Profit & Loss Account

(Rs cr)	Q4FY17	Q4FY16	YoY Growth %	Q3FY17	QoQ Growth %
Sales	**11,126**	**9,757**	*14.0*	**9,248**	*20.3*
EBITDA	**3,875**	**3,605**	*7.5*	**3,546**	*9.3*
Margin (%)	34.8	36.9	*(212)bps*	38.3	(351)*bps*
Depreciation	242	246	*(1.9)*	267	*(9.3)*
EBIT	**3,634**	**3,359**	*8.2*	**3,280**	*10.8*
Interest	(11)	12	-	14	-
Other Income	402	371	*8.3*	688	*(41.6)*
Exceptional Items	-	-	-	-	-
PBT	**4,047**	**3,718**	*8.9*	**3,954**	*2.4*
Tax	1,378	1,337	*3.1*	1,307	*5.4*
Reported PAT	**2,669**	**2,381**	*12.1*	**2,647**	*0.9*
Adjustment	-	-	-	-	-
Adj PAT	**2,669**	**2,381**	*12.1*	**2,647**	*0.9*
No. of shares (cr)*	1214.7	1214.7		1214.7	
EPS (Rs)	**2.2**	**2.0**	*12.1*	**2.2**	*0.9*

**Adjusted for bonus shares*

Change in Estimates

	Old estimates		New estimates		Change %	
Year / Rscr	**FY18E**	**FY19E**	**FY18E**	**FY19E**	**FY18E**	**FY19E**
Revenue	42,913	48,572	45,637	51,744	*6.3*	*6.5*
EBITDA	16,489	18,858	16,831	19,394	*2.1*	*2.8*
Margins (%)	38.0	38.4	36.9	37.5	*(110)bps*	*(90)bps*
PAT	11,446	13,054	11,861	13,589	*3.6*	*4.1*
EPS	9.4	10.8	9.8	11.2	*4.3*	*3.7*

Standalone Financials

Profit & Loss Account

Y.E March (Rs cr)	FY15	FY16	FY17	FY18E	FY19E
Sales	**36,083**	**36,583**	**40,089**	**45,637**	**51,744**
% change	9.7%	1.4%	9.6%	13.8%	13.4%
EBITDA	**13,474**	**13,715**	**14,578**	**16,831**	**19,394**
% change	8.2%	1.8%	6.3%	15.5%	15.2%
Depreciation	962	1,001	1,038	1,110	1,245
EBIT	**12,512**	**12,714**	**13,540**	**15,721**	**18,149**
Interest	57	49	23	23	23
Other Income	1,543	1,769	1,986	2,273	2,463
PBT	**13,998**	**14,434**	**15,503**	**17,971**	**20,589**
% change	10.6%	3.1%	7.4%	15.9%	14.6%
Tax	4,390	5,106	5,302	6,110	7,000
Tax Rate (%)	31.4%	35.4%	34.2%	34.0%	34.0%
Reported PAT	**9,608**	**9,328**	**10,201**	**11,861**	**13,589**
Adj*	-	-	-	-	-
Adj PAT	**9,608**	**9,328**	**10,201**	**11,861**	**13,589**
% change	9.4%	-2.9%	9.4%	16.3%	14.6%
No. of shares (cr)*	1,214.7	1,214.7	1,214.7	1,214.7	1,214.7
Adj EPS (Rs)	**7.9**	**7.7**	**8.4**	**9.8**	**11.2**
% change	9.4%	-2.9%	9.4%	16.3%	14.6%
DPS (Rs)	4.1	5.6	4.8	5.6	6.2

**Adjusted for bonus shares*

Balance Sheet

Y.E March (Rs cr)	FY15	FY16	FY17	FY18E	FY19E
Cash	7,589	5,639	2,747	2,967	4,137
Accounts Receivable	1,722	1,686	2,208	2,513	2,849
Inventories	7,837	8,520	7,864	8,924	10,062
Other Cur. Assets	843	917	1,619	1,700	1,785
Investments	8,405	13,325	18,585	20,585	22,585
Gross Fixed Assets	21,727	22,560	24,467	29,004	31,004
Net Fixed Assets	14,178	14,011	14,880	18,308	19,063
CWIP	2,114	2,419	3,537	1,000	1,000
Intangible Assets	-	-	-	-	-
Def. Tax (Net)	(1,632)	(1,867)	(1,872)	(1,872)	(1,872)
Other Assets	1,506	3,514	2,776	2,776	2,776
Total Assets	**42,564**	**48,164**	**52,344**	**56,901**	**62,385**
Current Liabilities	11,668	6,351	6,830	7,689	8,622
Provisions	-	-	-	-	-
Debt Funds	53	29	18	18	18
Other Liabilities	108	127	155	155	155
Equity Capital	802	805	1,215	1,215	1,215
Reserves & Surplus	29,934	40,852	44,126	47,824	52,375
Shareholder's Fund	30,736	41,656	45,341	49,039	53,590
Total Liabilities	**42,564**	**48,164**	**52,344**	**56,901**	**62,385**
BVPS (Rs)	25.3	34.3	37.3	40.4	44.1

Cash flow

Y.E March (Rs cr)	FY15	FY16	FY17	FY18E	FY19E
Pre-tax profit	**13,998**	**14,958**	**15,503**	**17,971**	**20,589**
Depreciation	962	1,034	1,038	1,110	1,245
Changes in W.C	30	(162)	683	(588)	(626)
Others	(1,455)	(1,752)	(1,963)	(2,250)	(2,440)
Tax paid	(4,226)	(4,828)	(5,302)	(6,110)	(7,000)
C.F.O	**9,309**	**9,251**	**9,959**	**10,133**	**11,768**
Capital exp.	(3,140)	(2,592)	(3,025)	(2,000)	(2,000)
Change in inv.	734	(3,387)	(5,261)	(2,000)	(2,000)
Other invest.CF	(2,416)	2,228	1,986	2,273	2,463
C.F - investing	**(4,823)**	**(3,750)**	**(6,300)**	**(1,727)**	**(1,537)**
Issue of equity	979	532	410	-	-
Issue/repay debt	(15)	(14)	(11)	-	-
Dividends paid	(4,772)	(5,010)	(6,924)	(8,163)	(9,038)
Other finance.CF	(765)	(969)	(364)	(23)	(23)
C.F - Financing	**(4,574)**	**(5,462)**	**(6,889)**	**(8,186)**	**(9,061)**
Chg. in cash	(87)	39	(3,230)	220	1,170
Closing cash	7,589	5,639	2,747	2,967	4,137

Ratios

Y.E March	FY15	FY16	FY17	FY18E	FY19E
Profitab. & Return					
EBITDA margin (%)	36.9	37.5	36.4	36.9	37.5
EBIT margin (%)	34.3	34.8	33.8	34.4	35.1
Net profit mgn.(%)	26.3	25.5	25.4	26.0	26.3
ROE (%)	33.7	25.8	23.5	25.1	26.5
ROCE (%)	49.2	40.0	35.7	38.1	40.2
W.C & Liquidity					
Receivables (days)	12.6	11.8	14.5	14.5	14.5
Inventory (days)	144.7	162.2	129.5	129.5	130.0
Payables (days)	30.2	35.6	36.5	36.7	36.7
Current ratio (x)	1.5	2.6	2.1	2.1	2.2
Quick ratio (x)	0.9	1.3	1.0	0.9	1.0
Turnover &Levg.					
Gross asset T.O (x)	1.8	1.7	1.7	1.7	1.7
Total asset T.O (x)	0.9	0.8	0.8	0.8	0.8
Adj. D/E ratio (x)	0.0	0.0	0.0	0.0	0.0
Valuation ratios					
EV/Sales (x)	10.1	10.0	9.2	8.1	7.1
EV/EBITDA (x)	27.0	26.7	25.3	21.9	19.0
P/E (x)	38.7	39.9	36.5	31.4	27.4
P/BV (x)	12.1	8.9	8.2	7.6	6.9

Recommendation Summary (last 3 years)

Dates	Rating	Target
31-Jul-14	BUY	257
04-Nov-14	BUY	267
01-Mar-16	BUY	257
04-Nov-16	HOLD	272
07-Feb-17	HOLD	291
12-Jun-17	BUY	336

Source: Bloomberg, Geojit Research

Investment Rating Criteria

Large Cap Stocks;

Buy	**-**	**Upside is 10% or more.**
Hold	**-**	**Upside or downside is less than 10%.**
Reduce	**-**	**Downside is 10% or more.**

Mid Cap and Small Cap;

Buy	**-**	**Upside is 15% or more.**
Accumulate*	**-**	**Upside between 10% - 15%.**
Hold	**-**	**Absolute returns between 0% - 10%.**
Reduce/Sell	**-**	**Absolute returns less than 0%.**

To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

The recommendations are based on 12 month horizon, unless otherwise specified. The investment ratings are on absolute positive/negative return basis. It is possible that due to volatile price fluctuation in the near to medium term, there could be a temporary mismatch to rating.
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