

October 26, 2018

Q2FY19 Result Update

■ Change in Estimates | ☒ Target | ■ Reco

Change in Estimates

	Current		Previous	
	FY19E	FY20E	FY19E	FY20E
Rating	BUY		BUY	
Target Price	364		346	
Sales (Rs. m)	471,122	512,342	471,122	512,342
% Chng.	-	-	-	-
EBITDA (Rs. m)	181,182	204,852	181,182	204,852
% Chng.	-	-	-	-
EPS (Rs.)	10.5	11.9	10.5	11.9
% Chng.	-	-	-	-

Key Financials

	FY18	FY19E	FY20E	FY21E
Sales (Rs. bn)	406	471	512	559
EBITDA (Rs. bn)	155	181	205	224
Margin (%)	38.3	38.5	40.0	40.0
PAT (Rs. bn)	112	128	147	162
EPS (Rs.)	9.2	10.5	11.9	13.1
Gr. (%)	9.5	13.7	13.7	9.9
DPS (Rs.)	5.2	6.2	6.8	7.5
Yield (%)	1.8	2.2	2.4	2.7
RoE (%)	23.2	23.8	24.7	24.4
RoCE (%)	29.8	31.4	32.3	31.7
EV/Sales (x)	8.1	7.0	6.4	5.8
EV/EBITDA (x)	21.3	18.2	15.9	14.4
PE (x)	30.5	26.9	23.6	21.5
P/BV (x)	6.7	6.1	5.5	5.0

Key Data

ITC.BO | ITC IN

52-W High / Low	Rs.323 / Rs.250	
Sensex / Nifty	33,349 / 10,030	
Market Cap	Rs.3,439bn/ \$ 46,874m	
Shares Outstanding	12,241m	
3M Avg. Daily Value	Rs.8477.12m	

Shareholding Pattern (%)

Promoter's	-
Foreign	17.31
Domestic Institution	37.75
Public & Others	44.94
Promoter Pledge (Rs bn)	-

Stock Performance (%)

	1M	6M	12M
Absolute	(4.2)	1.0	4.7
Relative	5.0	5.1	4.0

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Recovery on course, Compelling Valuations

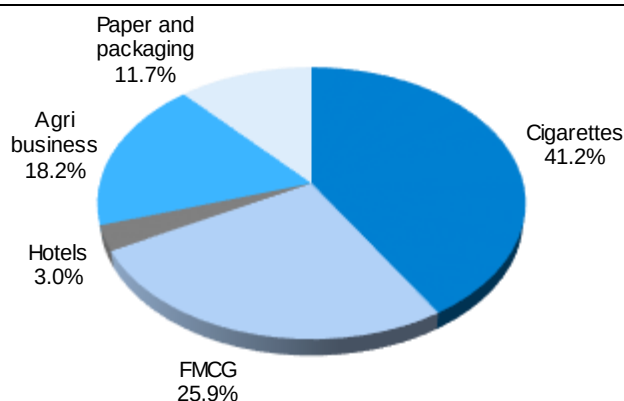
ITC reported healthy 6% cigarette volume growth and 8.7% EBIT growth on QoQ improvement in cigarette demand. This has been the highest volume growth since 4QFY12 (6%). Recovery in demand, stabilization of sales mix and cigarette prices and stable taxation regime can result in gradual recovery post 17% decline in volumes in past 5 years. We expect FMCG business led by processed foods to show steady increase in profitability given that some of the businesses like Biscuits and Atta have achieved economies of scale and personal care is stabilizing, however Lifestyle retailing would remain a drag. Paperboard margins are expected to improve given benign input costs and revamp of the 1.5 lakh TPA value added paperboard machine. We expect higher ARR, occupancy rates and growth in F&B sales to improve profitability in Hotels. However, Agri business led by leaf tobacco would take time to recover, despite some relief from INR depreciation. ITC trades at 22.5xSept EPS, 35-40% discount to our coverage universe, which limits downside in the stock. Retain "Buy" with SOTP based target price of Rs364 (Rs364 earlier). Steep increase in cigarette taxes are a key risk to our call.

- **Cigarettes volumes up 6%, EBIT up 8.7%:** Cigarette business reported 6% volume growth, highest growth post 4QFY12. Mix remains stable has stabilized with 64mm segment at 37-38% of volumes. Stability in GST rates remains key for sustained recovery in cigarette volumes; our estimates factor in 3% cigarette volume growth for FY18-20. Margins have seen a hit of 100bps on account of damaged stock due to floods in Kerala and expenses on implementation of new pictorial warnings. ITC has also increased prices of Flake filter in the RSFT segment, first one after several quarters.
- **FMCG EBITDA margin at 5%:** Adj. Sales grew 12.7%. EBITDA grew 76.9% to Rs1.59bn. EBIT at Rs584.5mn increased 185.3% with market share enhancement in most of the categories. Foods, personal care and stationary have reported improved performance while Lifestyle retailing remains a drag.
- **Hotels margin up on higher ARR and Occupancy levels:** EBIT increased 267% on 20.8% increase in sales and 290bps margin expansion led by improvement in ARR, higher occupancy levels and strong growth in F&B sales. Hotels business is expected to report steady improvement in coming quarters.
- **Paperboard and Paper sales grew 8.8% as EBIT increased 13.4% on 90bps margin expansion led by lower input costs, higher in-house pulp and recovery in cigarette volumes.** ITC completed rebuild of 1.5lakh ton machine for value added paperboards which will increase profitability in coming periods.
- **Agri Business sales increased 12.8% however, EBIT declined 7.9% on 240bps margin decline.** Although ITC had higher commodity exports, pressures on legal cigarette industry, firm leaf tobacco prices, damaged AP crop and lower export incentives impacted margins and profits. INR depreciation has restored some competitiveness in leaf tobacco exports.

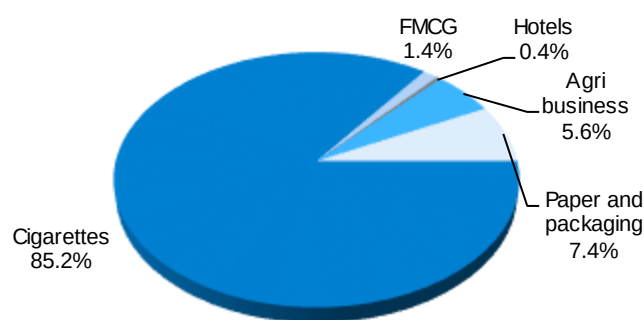
Exhibit 1: Q2FY19 Result Overview: Net Sales up 7.3% on growth across segments, Adj. PAT up 11.9%

Y/e March (Rs mn)	Q2FY19	Q2FY18	YoY gr. (%)	Q1FY19	FY19E	FY18	YoY gr. (%)
Net Sales	1,10,689	1,03,141	7.3	1,07,070	4,71,122	4,06,275	16.0
EBITDA	42,060	37,615	11.8	42,021	1,81,182	1,55,564	16.5
<i>Margins (%)</i>	38.0	36.5	1.5	39.2	38.5	38.3	0.2
Depreciation	3,275	2,824		2,987	12,167	11,454	
Interest	135.0	290.1		73	674	867	
Other Income	5,041	4,942		4,039	25,102	21,144	
PBT	43,691	39,443	10.8	42,999	1,93,443	1,64,388	17.7
Tax	14,145	13,045		14,813	65,190	54,856	
<i>Rate (%)</i>	32.4	33.1	(0.7)	34.4	33.7	33.4	0.3
Adj. PAT	29,547	26,398	11.9	28,187	1,28,253	1,09,533	17.1

Source: Company, PL

Exhibit 2: Cigarettes are 41.2% of Sales, FMCG 25.9%


Source: Company, PL

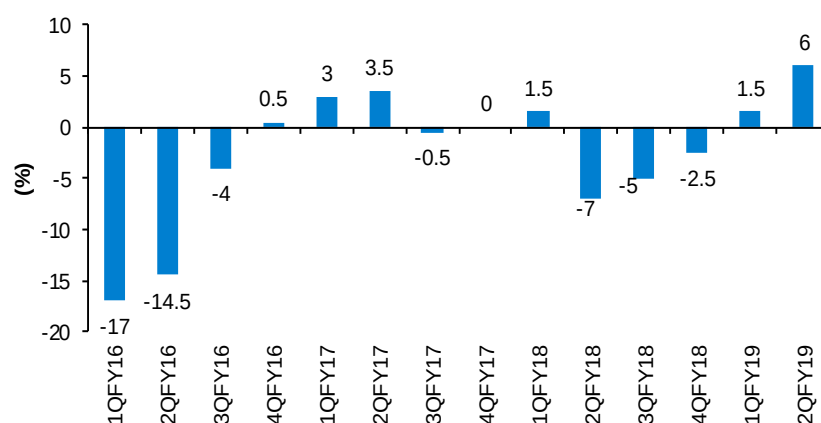
Exhibit 3: Cigarettes are 85.2% of EBIT


Source: Company, PL

Cigarette Volumes increased ~6% which has been the highest since 4QFY12 (6%).

EBIT growth impacted by 1% due to loss of stock in Kerala and expenses on change in pictorial health warnings on packs from Sept'2018

Prices of Flake filter cigarette in RSFT segment increased by Rs.1/- per stick from Rs.7/- to Rs.8/-

Exhibit 4: Cigarettes: Volumes up ~6%, highest since 4QFY12


Source: Company, PL

Signs of recovery seen in rural markets.

FMCG comparable sales up 14.3% led by Staples, Packaged foods, Personal care and Stationery ; Lifestyle retailing remained sluggish.

Packagd food business growth led by Bingo snacks, Yippee noodles and consolidation of leadership in Aashirvaad Atta

Cake segment entered recently with Dark Fantasy Choco Jellifills and Bounce brands. ITC launched truffles range with Dessert collection under Fabelle

Personal care growth was led by Deo's, handwash and Body wash. ITC launched 4 essential oil variants under Fiama brand, Braille enabled packs in Savlon and reintroduced Charmis cream.

Hotels business performed well on higher ARR, operating leverage and recovery in F&B revenues

ITC Grand Goa, Resort & Spa with 252 rooms commenced operations from 15th Oct 2018

Agri business remains impacted on shortage of Leaf Tobacco in AP and adverse crop quality. Recovery will take time despite INR depreciation

In Frozen snacks category, ITC has launched 10 variants of snacks under the ITC Mster chef brand in 3 cities

In the paperboard segment, operations of Bleached Chemical Thermo Mechanical Pulp mill were scaled to reduce import dependency.

Rebuild of Value added paperboard machine of 1.5lakhs TPA was completed in 2Q

Exhibit 5: FMCG EBITDA grw 76.9%; Paper business on steady recovery path

	2QFY18	3QFY18	4Q18	1QFY19	2QFY19
Cigarette Volume Growth %	-7.0	-5.0	-2.5	1.5	6.0
Sales (INR m)	1,09,359	1,07,159	1,15,054	1,28,460	1,21,932
Cigarettes	45,542	46,292	49,365	51,276	50,261
FMCG	28,041	28,718	30,518	28,700	31,604
Hotels	3,002	4,044	4,080	3,413	3,626
Agri business	19,680	15,309	18,083	31,513	22,197
Paper and packaging	13,094	12,796	13,008	13,558	14,245
Sales growth (YoY)					
Cigarettes	(2.1)	14.2	(4.1)	4.0	10.4
FMCG	5.0	11.8	5.8	10.3	12.7
Hotels	1.0	9.2	5.6	11.9	20.8
Agri business	4.7	(8.4)	(5.7)	14.2	12.8
Paper and packaging	4.6	(4.2)	(5.2)	(0.3)	8.8
EBIT (INR m)	38,468	38,726	40,388	41,119	42,001
Cigarettes	32,917	32,693	35,058	35,584	35,791
FMCG	205	470	912	501	585
Hotels	42	548	755	132	156
Agri business	2,562	2,333	1,240	1,945	2,361
Paper and packaging	2,742	2,683	2,424	2,957	3,109
EBIT growth (YoY)	2.8	9.4	7.5	8.9	9.2
Cigarettes	2.3	7.8	7.6	8.7	8.7
FMCG	728.5	339.0	64.2	823.0	185.3
Hotels	552.3	29.9	12.8	149.0	267.0
Agri business	(13.7)	(1.4)	(8.1)	(17.3)	(7.9)
Paper and packaging	18.2	9.0	0.9	14.9	13.4
EBIT Margin (%)					
Cigarettes	72.3	70.6	71.0	69.4	71.2
FMCG	0.7	1.6	3.0	1.7	1.8
Hotels	1.4	13.5	18.5	3.9	4.3
Agri business	13.0	15.2	6.9	6.2	10.6
Paper and packaging	20.9	21.0	18.6	21.8	21.8

Source: Company, PL

Financials

Income Statement (Rs m)

Y/e Mar	FY18	FY19E	FY20E	FY21E
Net Revenues	406,275	471,122	512,342	559,057
YoY gr. (%)	1.3	16.0	8.7	9.1
Cost of Goods Sold	157,991	176,636	194,907	215,572
Gross Profit	248,285	294,486	317,435	343,485
Margin (%)	61.1	62.5	62.0	61.4
Employee Cost	24,865	27,573	28,486	31,091
Other Expenses	35,491	46,069	44,584	46,790
EBITDA	155,409	181,182	204,852	223,718
YoY gr. (%)	6.6	16.6	13.1	9.2
Margin (%)	38.3	38.5	40.0	40.0
Depreciation and Amortization	11,454	12,167	13,033	13,900
EBIT	143,956	169,015	191,819	209,818
Margin (%)	35.4	35.9	37.4	37.5
Net Interest	867	674	674	674
Other Income	21,298	25,102	29,904	35,016
Profit Before Tax	164,388	193,443	221,049	244,160
Margin (%)	40.5	41.1	43.1	43.7
Total Tax	52,156	65,190	74,493	82,282
Effective tax rate (%)	31.7	33.7	33.7	33.7
Profit after tax	112,232	128,253	146,555	161,878
Minority interest	-	-	-	-
Share Profit from Associate	-	-	-	-
Adjusted PAT	112,232	128,253	146,555	161,878
YoY gr. (%)	10.0	14.3	14.3	10.5
Margin (%)	27.6	27.2	28.6	29.0
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	112,232	128,253	146,555	161,878
YoY gr. (%)	10.0	14.3	14.3	10.5
Margin (%)	27.6	27.2	28.6	29.0
Other Comprehensive Income	3,823	-	-	-
Total Comprehensive Income	116,056	128,253	146,555	161,878
Equity Shares O/s (m)	12,204	12,264	12,324	12,384
EPS (Rs)	9.2	10.5	11.9	13.1

Source: Company Data, PL Research

Balance Sheet Abstract (Rs m)

Y/e Mar	FY18	FY19E	FY20E	FY21E
Non-Current Assets				
Gross Block	264,880	284,993	305,193	325,393
Tangibles	256,266	276,179	296,179	316,179
Intangibles	8,614	8,814	9,014	9,214
Acc: Dep / Amortization	109,133	121,299	134,332	148,232
Tangibles	104,979	116,855	129,590	143,186
Intangibles	4,154	4,445	4,742	5,046
Net fixed assets	155,748	163,694	170,861	177,161
Tangibles	151,287	159,324	166,589	172,993
Intangibles	4,460	4,369	4,272	4,168
Capital Work In Progress	50,169	30,000	30,000	30,000
Goodwill	-	-	-	-
Non-Current Investments	135,012	140,710	146,978	153,873
Net Deferred tax assets	(19,179)	(20,138)	(21,145)	(22,203)
Other Non-Current Assets	37,669	30,623	33,302	36,339
Current Assets				
Investments	99,035	128,435	171,152	222,867
Inventories	72,372	94,721	103,039	112,468
Trade receivables	23,570	26,240	27,848	29,637
Cash & Bank Balance	25,949	27,999	30,175	29,503
Other Current Assets	12,584	7,067	7,685	8,386
Total Assets	623,627	662,160	734,976	815,560
Equity				
Equity Share Capital	12,204	12,264	12,324	12,384
Other Equity	501,796	549,667	614,731	686,035
Total Network	514,001	561,932	627,055	698,419
Non-Current Liabilities				
Long Term borrowings	111	53	-	-
Provisions	1,219	1,471	1,550	1,692
Other non current liabilities	383	421	463	510
Current Liabilities				
ST Debt / Current of LT Debt	0	0	0	0
Trade payables	33,823	28,191	30,431	33,429
Other current liabilities	54,557	49,566	53,903	58,836
Total Equity & Liabilities	623,627	662,160	734,976	815,560

Source: Company Data, PL Research

Cash Flow (Rs m)

Y/e Mar	FY18	FY19E	FY20E	FY21E
PBT	164,388	193,443	221,049	244,160
Add. Depreciation	11,454	12,167	13,033	13,900
Add. Interest	867	674	674	674
Less Financial Other Income	21,298	25,102	29,904	35,016
Add. Other	(12,903)	(7,097)	(10,000)	(10,000)
Op. profit before WC changes	163,805	199,186	224,756	248,734
Net Changes-WC	19,095	(59,394)	(46,783)	(55,808)
Direct tax	(52,156)	(65,190)	(74,493)	(82,282)
Net cash from Op. activities	130,744	74,602	103,480	110,644
Capital expenditures	(33,197)	55	(20,200)	(20,200)
Interest / Dividend Income	-	-	-	-
Others	(42,639)	(16,063)	(8,945)	(9,929)
Net Cash from Invst. activities	(75,836)	(16,007)	(29,145)	(30,129)
Issue of share cap. / premium	13,295	19,925	20,195	20,471
Debt changes	(69)	(59)	(53)	-
Dividend paid	(69,447)	(75,737)	(91,627)	(100,985)
Interest paid	(867)	(674)	(674)	(674)
Others	-	-	-	-
Net cash from Fin. activities	(57,087)	(56,544)	(72,159)	(81,188)
Net change in cash	(2,178)	2,051	2,176	(673)
Free Cash Flow	97,547	74,658	83,280	90,444

Source: Company Data, PL Research

Key Financial Metrics

Y/e Mar	FY18	FY19E	FY20E	FY21E
Per Share(Rs)				
EPS	9.2	10.5	11.9	13.1
CEPS	10.1	11.4	12.9	14.2
BVPS	42.1	45.8	50.9	56.4
FCF	8.0	6.1	6.8	7.3
DPS	5.2	6.2	6.8	7.5
Return Ratio(%)				
RoCE	29.8	31.4	32.3	31.7
ROIC	28.9	33.4	35.9	37.3
RoE	23.2	23.8	24.7	24.4
Balance Sheet				
Net Debt : Equity (x)	(0.2)	(0.3)	(0.3)	(0.4)
Net Working Capital (Days)	56	72	72	71
Valuation(x)				
PER	30.5	26.9	23.6	21.5
P/B	6.7	6.1	5.5	5.0
P/CEPS	10.1	11.4	12.9	14.2
EV/EBITDA	21.3	18.2	15.9	14.4
EV/Sales	8.1	7.0	6.4	5.8
Dividend Yield (%)	1.8	2.2	2.4	2.7

Source: Company Data, PL Research

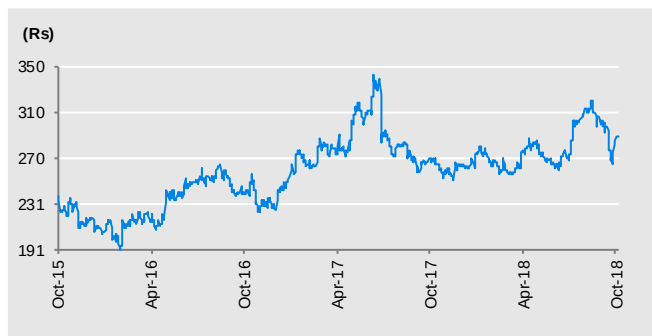
Quarterly Financials (Rs m)

Y/e Mar	Q3FY18	Q4FY18	Q1FY19	Q2FY19
Net Revenue	97,720	105,867	107,070	110,689
YoY gr. (%)	5.7	(4.8)	7.6	7.3
Raw Material Expenses	35,810	40,012	41,094	42,797
Gross Profit	61,910	65,855	65,977	67,892
Margin (%)	63.4	62.2	61.6	61.3
EBITDA	39,045	41,440	42,021	42,060
YoY gr. (%)	3.8	6.1	1.4	0.1
Margin (%)	40.0	39.1	39.2	38.0
Depreciation / Depletion	2,908	3,040	2,987	3,275
EBIT	36,138	38,400	39,034	38,785
Margin (%)	37.0	36.3	36.5	35.0
Net Interest	240	232	73	135
Other Income	6,269	5,165	4,039	5,041
Profit before Tax	42,167	43,333	42,999	43,691
Margin (%)	43.2	40.9	40.2	39.5
Total Tax	13,965	14,006	14,813	14,145
Effective tax rate (%)	33.1	32.3	34.4	32.4
Profit after Tax	28,202	29,327	28,187	29,547
Minority interest	-	-	-	-
Share Profit from Associates	-	-	-	-
Adjusted PAT	28,202	29,327	28,187	29,547
YoY gr. (%)	6.6	9.9	10.1	11.9
Margin (%)	28.9	27.7	26.3	26.7
Extra Ord. Income / (Exp)	2,700	-	-	-
Reported PAT	30,902	29,327	28,187	29,547
YoY gr. (%)	16.8	9.9	10.1	11.9
Margin (%)	31.6	27.7	26.3	26.7
Other Comprehensive Income	869	1,677	784	(2,001)
Total Comprehensive Income	31,771	31,004	28,971	27,546
Avg. Shares O/s (m)	1	1	2	2
EPS (Rs)	28,202.0	29,327.1	14,093.4	14,773.4

Source: Company Data, PL Research

Price Chart

Recommendation History



No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	27-Oct-17	BUY	333	269
2	10-Jan-18	BUY	333	271
3	20-Jan-18	BUY	333	274
4	12-Feb-18	BUY	333	271
5	15-Mar-18	BUY	333	266
6	13-Apr-18	BUY	333	261
7	16-May-18	BUY	346	286
8	23-May-18	BUY	346	279
9	19-Jun-18	BUY	366	266
10	21-Jun-18	BUY	346	261

Analyst Coverage Universe

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Asian Paints	Accumulate	1,300	1,138
2	Avenue Supermarts	Reduce	1,286	1,412
3	Britannia Industries	Accumulate	6,588	5,625
4	Colgate Palmolive	Reduce	1,084	1,069
5	Dabur India	Hold	440	415
6	Emami	Accumulate	603	474
7	Future Retail	BUY	613	443
8	GlaxoSmithKline Consumer Healthcare	Hold	7,382	6,552
9	Hindustan Unilever	Hold	1,703	1,570
10	ITC	BUY	346	287
11	Jubilant FoodWorks	Accumulate	1,395	1,193
12	Kansai Nerolac Paints	Accumulate	474	387
13	Marico	Hold	366	314
14	Nestle India	Accumulate	10,996	9,609
15	Pidilite Industries	Accumulate	1,175	968
16	Titan Company	BUY	1,115	777
17	Tribhovandas Bhimji Zaveri	Accumulate	78	71

PL's Recommendation Nomenclature (Absolute Performance)

Buy	: > 15%
Accumulate	: 5% to 15%
Hold	: +5% to -5%
Reduce	: -5% to -15%
Sell	: < -15%
Not Rated (NR)	: No specific call on the stock
Under Review (UR)	: Rating likely to change shortly

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