Result Update

ITC

Buy

DART
DOLAT ANALYSIS & RESEARCH THEMES
IN-DEPTH• PRECISE• ACTIONABLE

View: Volume growth improvement continues; Upgrade to BUY

ITC's Q3FY19 results were marginally ahead of our estimates. The cigarette business posted 8% volume growth, which was marginally more than our estimate of 7%. The company's FMCG business reported a strong 11.5% jump. In addition, a 25.7% revenue growth in the Agri businesses was encouraging, as this was the third consecutive quarter of strong growth. Continuous volume increases in cigarette business is a key positive. However, decline in margins in the cigarette business is a cause for concern. Nevertheless, we believe that ITC benefits from a strong leadership in the category and it is likely to increase prices to improve margins, post volume growth stabilization. Going ahead, we believe volume growth will continue to improve, given the delay in duty hike. Considering the constant increase in smuggled cigarettes, the increase in duty is likely to be modest, whenever it happens. Further, ITC's entry in new FMCG categories, such as dairy, juices and impetus to accelerate growth in existing categories will potentially increase profitability. We have upward revised our FY19E and FY20E EPS estimates to ₹ 10.1 and ₹ 11.2, respectively. We introduce FY21E EPS at ₹ 12.2. In our view, the stock is trading at a steep discount to peers and is an attractive bet. We value the stock at 26x PE, to arrive at a TP of ₹ 320. Upgrade to BUY.

Profitability was marginally better than estimate

Net sales jumped 14.9% to ₹ 112bn, with a 8% volume growth in the cigarette business. The EBITDA grew 11.2% YoY, to ₹ 43.3bn, in line with our estimate. The EBITDA margins fell 130bps YoY to 38.5%, as a 150/30bps increase in RM/other expenses was partially offset by a 50bps decline in employee expenses. The APAT grew 19.9% YoY, to ₹ 32.1bn, marginally ahead of our expectation.

Signs of volume recovery

Since FY14, ITC's volumes have declined ~17%, due to a continuous increase in duties and the rise in the contribution of smuggled cigarettes in the market. After FY14, the frequency of duty hikes (at least once in a year) has fallen, compared to earlier period (once in two years). We believe that the pace of duty increase will moderate, which should help volume growth to improve further. (6% volume growth estimate for FY19E).

Q3FY19 Result (₹ Mn)

Particulars	Q3FY19	Q3FY18	YoY (%)	Q2FY19	QoQ (%)
Revenue	112,277	97,720	14.9	110,689	1.4
Total Expense	69,019	58,830	17.3	68,629	0.6
EBITDA	43,258	38,891	11.2	42,060	2.8
Depreciation	3,354	2,908	15.3	3,275	2.4
EBIT	39,904	35,983	10.9	38,785	2.9
Other Income	8,364	6,424	30.2	5,041	65.9
Interest	56	240	(76.6)	135	(58.4)
EBT	52,491	47,164	10.9	41,690	25.9
Tax	16,121	15,394	4.7	14,145	14.0
RPAT	36,370	31,771	14.5	27,546	32.0
APAT	32,091	26,773	19.9	29,547	8.6
			(bps)		(bps)
Gross Margin (%)	61.7	63.2	(150)	61.3	36
EBITDA Margin (%)	38.5	39.8	(127)	38.0	53
NPM (%)	32.4	32.5	(12)	24.9	751
Tax Rate (%)	30.7	32.6	(193)	33.9	(322)
EBIT Margin (%)	35.5	36.8	(128)	35.0	50

CMP	₹ 277
Target / Upside	₹ 320 / 15%
BSE Sensex	36,109
NSE Nifty	10,832

Scrip Details

Equity / FV	₹ 12,249mn / ₹ 1
Market Cap	₹ 3,397bn
	US$ 48bn
52-week High/Low	₹ 323/₹ 253
Avg. Volume (no)	9,970,470
NSE Symbol	ITC
Bloomberg Code	ITC IN

Shareholding Pattern Dec'18(%)

Promoters	0.0
MF/Banks/FIs	37.7
FIIs	47.6
Public / Others	14.7

Valuation (x)

	FY19E	FY20E	FY21E
P/E	27.5	24.7	22.8
EV/EBITDA	18.6	16.5	15.1
ROE (%)	23.0	23.3	22.7
RoACE (%)	22.1	22.4	21.9

Estimates (₹ mn)

	FY19E	FY20E	FY21E
Revenue	446,591	490,281	531,605
EBITDA	172,854	194,554	212,395
PAT	123,493	137,500	149,183
EPS (₹)	10.1	11.2	12.2

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Segmental Performance

FMCG business reported 11.5% YoY sales growth, and EBIT of ₹ 767mn compared to a profit of ₹ 470mn in Q3FY18. Hotel business posted 11.7% sales growth and EBIT of ₹ 603mn v/s ₹ 548mn in Q3FY18. Agri Business reported 25.7% YoY revenue growth to ₹ 19.2bn but 14.8% drop in EBIT. Paper & packaging (PPP) revenue was up by 20.5% at ₹ 15.4bn with 23.8% EBIT growth.

Exhibit 1: Segmental Performance

Particulars (₹ Mn)	Q3FY19	Q3FY18	YoY (%)	Q2FY19	QoQ (%)	Remarks
Cigarettes						▪ Volume growth improved to 8.0%. Steep escalation of 13% in tax incidence under GST regime continues to weigh on FMCG Cigarettes performance. ▪ Margin contraction due to escalation in input costs largely on account of consumption of higher cost leaf tobacco crop and increased salience of capsule cigarettes in the sales mix.
Revenue	50,734	46,292	9.6	50,261	0.9	
EBIT	35,577	32,693	8.8	35,791	(0.6)	
EBIT Margin (%)	70.1	70.6		71.2		
FMCG Others						▪ Robust growth in Branded Packaged Foods. Aashirvaad atta consolidated its leadership position across markets. Increased consumer traction in Bingo and Tedhe Medhe. Dark Fantasy Choco Fills continue to witness impressive growth. Personal Care growth led by fragrancing products, liquids (handwash and bodywash) and `Nimyle' range of herbal floor cleaners. ▪ Margin expansion due to enhanced scale, product mix enrichment and cost management initiatives.
Revenue	32,010	28,718	11.5	31,604	1.3	
EBIT	767	470	63.1	585	31.2	
EBIT Margin (%)	2.4	1.6		1.8		
Hotels						▪ Growth was driven by improvement in room rates. Operations at the recently commissioned hotels - ITC Kohenur (commissioned in Q1 FY19) and ITC Grand Goa, Resort & Spa (commissioned in October'18) were scaled up and received excellent guest response. ▪ Steady progress in the construction of ITC Hotels at Kolkata & Ahmedabad and WelcomHotels in Amritsar, Guntur & Bhubaneswar during Q3.
Revenue	4,519	4,044	11.7	3,626	24.6	
EBIT	603	548	10.1	156	287.5	
EBIT Margin (%)	13.3	13.5		4.3		
Agri Business						▪ Robust growth due to trading opportunities in Wheat and Oilseeds along with enhanced focus on value added portfolio, especially Coffee, Spices and Aqua. ▪ Margin contraction due to subdued demand for leaf tobacco in international markets, relatively steeper depreciation in currencies of competing origins along with leaf cost escalation of Andhra 2017 crop.
Revenue	19,246	15,309	25.7	22,197	(13.3)	
EBIT	1,988	2,333	(14.8)	2,361	(15.8)	
EBIT Margin (%)	10.3	15.2		10.6		
Paper & Packaging						▪ Growth driven by strong demand and capacity augmentation in Value Added Paperboard and Decor segments. ▪ Margin expansion due to strategic investments in imported pulp substitution, cost competitive fibre chain, product mix enrichment and higher realization.
Revenue	15,425	12,796	20.5	14,245	8.3	
EBIT	3,321	2,683	23.8	3,109	6.8	
EBIT Margin (%)	21.5	21.0		21.8		
Total						
Revenue	121,933	107,159	13.8	121,932	0.0	
EBIT	42,256	38,726	9.1	42,001	0.6	
EBIT Margin (%)	34.7	36.1		34.4		

Source: DART, Company

Exhibit 2: Change in estimate

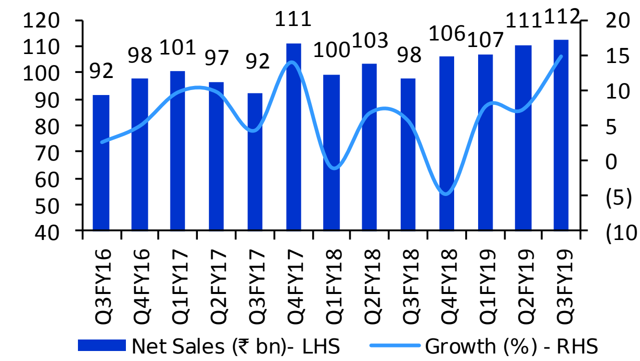
	FY19E			FY20E		
(₹ mn)	New	Old	Chg (%)	New	Old	Chg (%)
Revenue	446,591	438,104	1.9	490,281	477,124	2.8
EBITDA	172,854	173,343	(0.3)	194,554	188,183	3.4
Margin (%)	38.7	39.6	-90 bps	39.7	39.4	20 bps
PAT	123,493	120,488	2.5	137,500	131,201	4.8
EPS (₹)	10.1	9.8	2.4	11.2	10.7	4.7

Source: DART, Company

Change in estimates

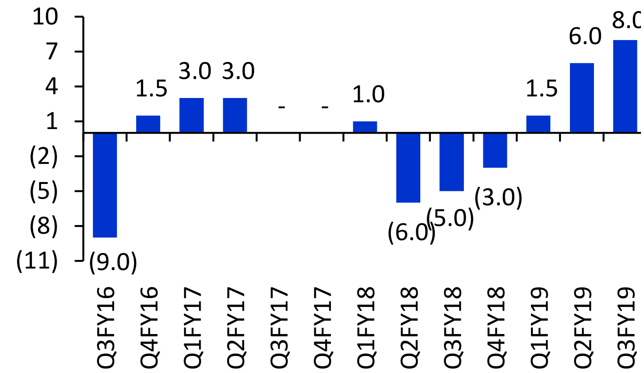
Considering the strong cigarette volume performance in Q3FY19, we have revised our FY19E revenue estimates and cigarette volume estimates upwards (up to 6% from 5% earlier). For FY20E, we have assumed 6.5% cigarette volume growth and 6% for FY21E. Without considering duty hike we believe that the company would implement 4% price hike annually to mitigate increase in costs. Consequently, we have revised our EPS estimates for FY20E by 4.7%.

Exhibit 3: Trend in Net Sales & YoY Growth (%)



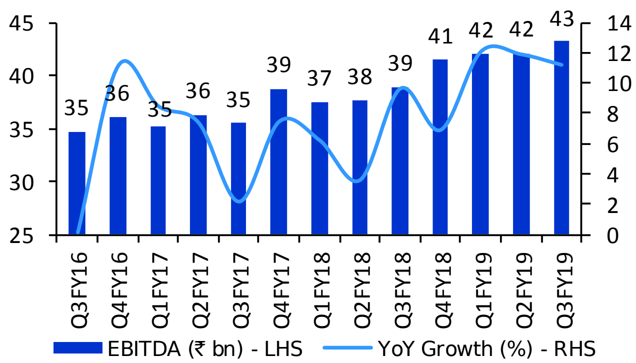
Source: DART, Company

Exhibit 4: Trend in Cigarette Volume Growth (%)



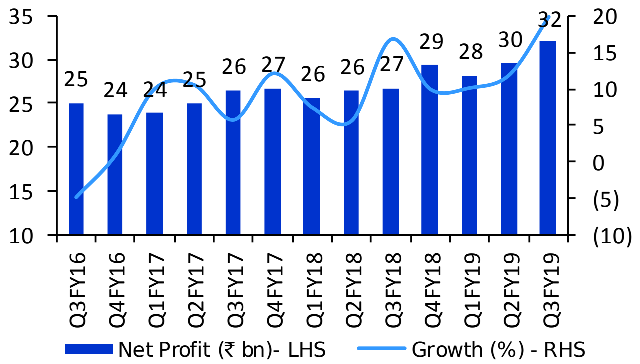
Source: DART, Company

Exhibit 5: Trend in EBITDA & YoY EBITDA growth (%)



Source: DART, Company

Exhibit 6: Trend in Net Profit & YoY Net Profit Growth (%)



Source: DART, Company

Profit and Loss Account

(₹ Mn)	FY18A	FY19E	FY20E	FY21E
Revenue	**406,275**	**446,591**	**490,281**	**531,605**
Total Expense	**250,866**	**273,736**	**295,727**	**319,210**
COGS	157,900	172,771	188,425	206,089
Employees Cost	24,875	26,091	27,152	27,814
Other expenses	68,091	74,874	80,151	85,307
EBIDTA	**155,410**	**172,854**	**194,554**	**212,395**
Depreciation	11,454	12,996	14,286	15,576
EBIT	**143,956**	**159,858**	**180,268**	**196,819**
Interest	867	347	364	382
Other Income	21,298	25,815	26,444	27,443
Exc. / E.O. items	4,129	0	0	0
EBT	**168,517**	**185,326**	**206,347**	**223,880**
Tax	56,285	61,834	68,847	74,697
RPAT	112,233	123,493	137,500	149,183
Minority Interest	0	0	0	0
Profit/Loss share of associates	**0**	**0**	**0**	**0**
APAT	**108,104**	**123,493**	**137,500**	**149,183**

Balance Sheet

(₹ Mn)	FY18A	FY19E	FY20E	FY21E
Sources of Funds				
Equity Capital	12,204	12,249	12,249	12,249
Minority Interest	0	0	0	0
Reserves & Surplus	501,796	548,182	608,575	680,651
Net Worth	**514,000**	**560,431**	**620,824**	**692,901**
Total Debt	111	4,111	4,111	4,111
Net Deferred Tax Liability	19,179	21,200	21,200	21,200
Total Capital Employed	**533,290**	**585,742**	**646,135**	**718,212**
Applications of Funds				
Net Block	**151,200**	**158,204**	**163,918**	**168,342**
CWIP	50,168	50,168	50,168	50,168
Investments	134,938	138,986	180,682	234,886
Current Assets, Loans & Advances	**265,340**	**338,692**	**360,031**	**382,809**
Inventories	72,372	83,399	90,605	98,686
Receivables	23,570	25,886	28,444	30,863
Cash and Bank Balances	25,948	51,109	62,161	73,576
Loans and Advances	38,207	41,437	40,611	40,611
Other Current Assets	6,209	6,861	8,210	9,073
Less: Current Liabilities & Provisions	**68,355**	**100,307**	**108,663**	**117,993**
Payables	33,822	29,244	31,818	34,763
Other Current Liabilities	34,533	71,064	76,845	83,230
Net Current Assets	196,985	238,384	251,368	264,816
Total Assets	**533,290**	**585,742**	**646,135**	**718,212**

E – Estimates

Important Ratios

Particulars	FY18A	FY19E	FY20E	FY21E
(A) Margins (%)				
Gross Profit Margin	61.1	61.3	61.6	61.2
EBIDTA Margin	38.3	38.7	39.7	40.0
EBIT Margin	35.4	35.8	36.8	37.0
Tax rate	33.4	33.4	33.4	33.4
Net Profit Margin	27.6	27.7	28.0	28.1
(B) As Percentage of Net Sales (%)				
COGS	38.9	38.7	38.4	38.8
Employee	6.1	5.8	5.5	5.2
Other	16.8	16.8	16.3	16.0
(C) Measure of Financial Status				
Gross Debt / Equity	0.0	0.0	0.0	0.0
Interest Coverage	166.1	461.2	495.3	515.0
Inventory days	65	68	67	68
Debtors days	21	21	21	21
Average Cost of Debt	469.1	16.4	8.9	9.3
Payable days	30	24	24	24
Working Capital days	177	195	187	182
FA T/O	2.7	2.8	3.0	3.2
(D) Measures of Investment				
AEPS (₹)	8.8	10.1	11.2	12.2
CEPS (₹)	9.8	11.1	12.4	13.5
DPS (₹)	5.6	6.3	6.3	6.3
Dividend Payout (%)	63.6	62.4	56.1	51.7
BVPS (₹)	42.0	45.8	50.7	56.6
RoANW (%)	23.2	23.0	23.3	22.7
RoACE (%)	21.7	22.1	22.4	21.9
RoAIC (%)	30.2	30.7	32.2	32.0
(E) Valuation Ratios				
CMP (₹)	277	277	277	277
P/E	31.4	27.5	24.7	22.8
Mcap (₹ Mn)	3,396,777	3,396,777	3,396,777	3,396,777
MCap/ Sales	8.4	7.6	6.9	6.4
EV	3,271,905	3,219,778	3,208,727	3,197,312
EV/Sales	8.1	7.2	6.5	6.0
EV/EBITDA	21.1	18.6	16.5	15.1
P/BV	6.6	6.1	5.5	4.9
Dividend Yield (%)	2.0	2.3	2.3	2.3
(F) Growth Rate (%)				
Revenue	1.3	9.9	9.8	8.4
EBITDA	6.6	11.2	12.6	9.2
EBIT	6.3	11.0	12.8	9.2
PBT	8.7	10.0	11.3	8.5
APAT	6.0	14.2	11.3	8.5
EPS	6.0	14.2	11.3	8.5

Cash Flow

(₹ Mn)	FY18A	FY19E	FY20E	FY21E
CFO	123,308	151,563	150,218	163,108
CFI	(75,451)	(55,014)	(61,696)	(74,204)
CFF	(49,382)	(71,388)	(77,471)	(77,489)
FCFF	95,976	131,563	130,218	143,108
Opening Cash	27,473	25,948	51,109	62,161
Closing Cash	25,948	51,109	62,161	73,576

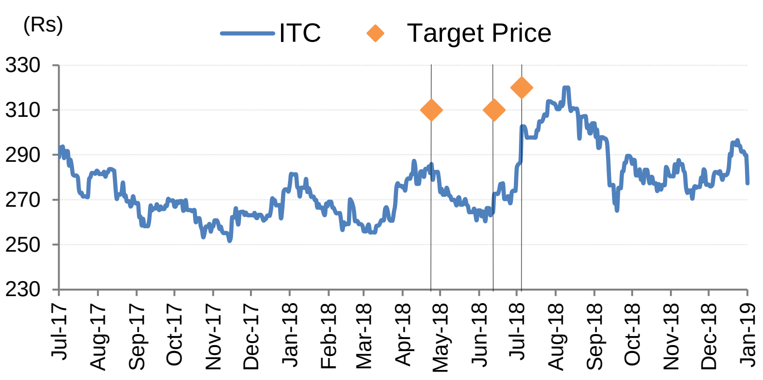
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	**> 20%**
Accumulate	**10 to 20%**
Reduce	**0 to 10%**
Sell	**< 0%**

Rating and Target Price History



Month	Rating	TP (₹)	Price (₹)
May-18	Accumulate	310	286
Jul-18	Accumulate	310	273
Jul-18	Accumulate	320	303
Oct-18	Accumulate	320	288

*Price as on recommendation date

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