

Stock Update

Cigarette price hikes; Minimal impact on earnings

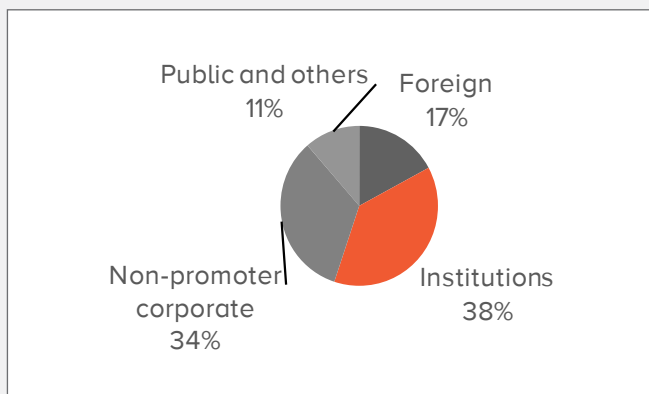
ITC

Reco: Buy | CMP: Rs285

Company details

Price target:	Rs347
Market cap:	Rs349,588 cr
52-week high/low:	Rs323/251
NSE volume: (No of shares)	119 lakh
BSE code:	500875
NSE code:	ITC
Sharekhan code:	ITC
Free float: (No of shares)	1,224.7 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.1	2.6	-8.9	10.6
Relative to Sensex	3.5	0.9	-5.4	1.2

Key points

- ♦ **ITC hikes prices of lower-end cigarette brands:** ITC has taken price hike in 20% of its cigarette portfolio by increasing the prices of Flake Excel by 11% to Rs. 60 (pack of 10 sticks), Bristol by 6.7% to Rs. 64 (pack of 10 sticks) and Capstan by 14.5% to Rs. 55 (pack of 10 sticks). Our calculation suggests that this selective price hike would result in average price hike of 2%. Further, year-to-date, the weighted average price increase stands at ~4%.
- ♦ **Price hikes would have initial impact on sales volumes; Earnings impact would be minimal:** The recent price hikes are undertaken in the lower end of the portfolio and will have an immediate negative impact on sales volume. Brands such as Capstan, Bristol and Flake Excel have very limited preference in urban markets but are largely sold in tier-II and tier-III towns. However, price hikes in these brands were taken after a long gap as there was no significant tax increase on cigarettes in recent times. Hence, we expect price hikes to get absorbed in the market over the next two quarters. Though the price hike would result in moderation in sales volume in the immediate term, it will have limited impact on FY2020 earnings (factored in a 1% decline in FY2020 and FY2021 earnings estimates). We expect price hikes to provide some cushioning to EBIT margins of the cigarette business in the backdrop of revenue mix shifting towards low-price cigarettes (largely below 69mm).
- ♦ **Retain Buy due to discounted valuations:** Sales volumes of ITC's cigarette business are expected to grow in mid-single digit in FY2019 in absence of any significant increase in its cigarette portfolio. However, sustenance of the same would depend upon the government's action in terms of tax hike on cigarette (especially after the elections). On the other hand, the non-cigarette FMCG business is expected to post double-digit revenue growth with strong growth in categories such as biscuits, snacks and personal care products. Moreover, profitability of the business is expected to improve with the increase in the scale of business. The hotel business will continue to post better performance because of strong room demand, while the paperboard, paper and packaging business would see margin improvement due to product mix enrichment and higher realisation. ITC's

revenue and earnings are expected to report a CAGR of 12-14% over FY2018-FY2021. The stock continues to trade at a discounted valuation of 25x its FY2020E earnings, which is at 50%

discount to some of the large-cap stocks such as HUL. We maintain our Buy recommendation on the stock with an unchanged price target (PT) of Rs. 347.

Valuations (Standalone)

					Rs cr
Particulars	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Revenue	40,088.7	40,627.5	45,363.0	51,013.1	57,475.9
Net profit	10,200.9	10,397.5	12,062.7	13,707.9	15,402.8
OPM (%)	36.4	38.3	38.1	38.6	38.9
EPS (Rs.)	8.4	8.5	9.9	11.2	12.6
PE(x)	34.1	33.5	28.8	25.4	22.6
EV/EBITDA (x)	22.5	20.9	18.7	16.3	14.4
RoCE (%)	29.8	28.4	28.9	31.0	32.5
RoNW (%)	23.5	21.5	22.9	24.5	25.2

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