Prabhudas Lilladher
POWERING YOUR FINANCIAL GROWTH

ITC (ITC IN)

Rating: BUY | CMP: Rs265 | TP: Rs367

August 2, 2019

Q1FY20 Result Update

☑ Change in Estimates | ☑ Target | ■ Reco

Change in Estimates

	Current		Previous	
	FY20E	FY21E	FY20E	FY21E
Rating	**BUY**		**BUY**	
Target Price	**367**		**369**	
Sales (Rs. m)	492,621	536,842	495,813	541,909
% Chng.	*(0.6)*	*(0.9)*		
EBITDA (Rs. m)	191,069	211,677	201,708	225,023
% Chng.	*(5.3)*	*(5.9)*		
EPS (Rs.)	11.2	12.3	11.4	12.8
% Chng.	*(2.1)*	*(3.7)*		

Key Financials - Standalone

Y/e Mar	FY18	FY19	FY20E	FY21E
Sales (Rs. bn)	406	450	493	537
EBITDA (Rs. bn)	155	173	191	212
Margin (%)	*38.3*	*38.5*	*38.8*	*39.4*
PAT (Rs. bn)	112	125	138	152
EPS (Rs.)	9.2	10.2	11.2	12.3
Gr. (%)	*9.5*	*10.6*	*9.8*	*10.2*
DPS (Rs.)	5.2	5.8	7.0	7.4
Yield (%)	*1.9*	*2.2*	*2.6*	*2.8*
RoE (%)	*23.2*	*22.8*	*22.6*	*22.9*
RoCE (%)	*29.8*	*29.2*	*29.1*	*29.5*
EV/Sales (x)	7.6	6.8	6.3	5.8
EV/EBITDA (x)	20.0	17.8	16.2	14.7
PE (x)	28.8	26.0	23.7	21.5
P/BV (x)	6.3	5.6	5.1	4.7

Key Data

Key Data	ITC.BO | ITC IN
52-W High / Low	Rs.323 / Rs.263
Sensex / Nifty	37,118 / 10,997
Market Cap	Rs.3,246bn/ $ 46,649m
Shares Outstanding	12,272m
3M Avg. Daily Value	Rs.6893.81m

Shareholding Pattern (%)

Promoter's	-
Foreign	17.49
Domestic Institution	37.63
Public & Others	45.90
Promoter Pledge (Rs bn)	-

Stock Performance (%)

	1M	6M	12M
Absolute	(3.4)	(5.8)	(11.6)
Relative	3.6	(7.5)	(11.5)

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Challenging environment; Risk reward favourable

Quick Pointers:

- Cigarette volume growth disappoint at ~2.5%
- FMCG EBITDA up 41.4% with 5.9% margins

We are cutting FY20 and FY21 EPS estimates of ITC by 2.1% and 3.7% following disappointing cigarette volume growth of 2.5%. We believe that coming quarters in FY20 will show low single digit volume growth given 6.5-7.5% volume growth in base quarters, and challenging consumer environment. FMCG business has reported 5.9% (up 150bps YoY) which reinforces our confidence of double digit EBIDTA margins over next 3-5 years. Although ITC is likely to face near term headwinds in demand, long term outlook looks promising given sustained innovations new launches in snacking and dairy. Paperboard business is in fine fettle given gains from steady prices and benign input costs. Hotels ARR and occupancy indicates steady improvement in profits, however we are far off from pre 2009 profitability. ITC trades at 21.5xFY21 EPS, ~40% discount to our coverage universe with 2.2% dividend yield. Risk reward remains favorable, although returns might be back ended due to poor visibility on cigarette volume growth. Retain "Buy" with SOTP based target price of Rs367 (Rs369 earlier).

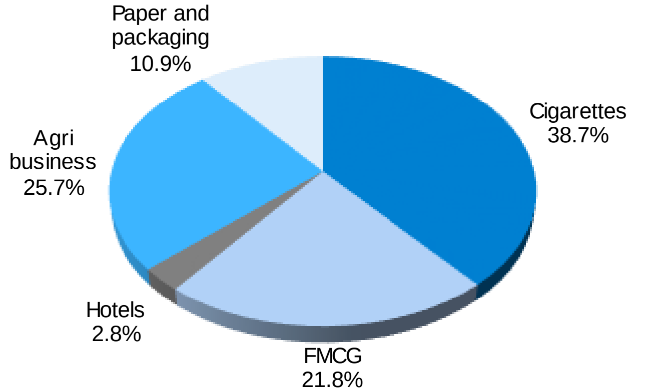
- **Cigarettes volumes up ~2.5%; EBIT up 8.2%:** 1Q20 Cigarette Volumes increased only ~2.5% despite a favourable base due to increase in prices in few brands and subdued economic environment. Margins remained healthy at 70.8% with 140bps expansion led by price increases taken in the quarter.
- **FY19 FMCG EBIDTA margin at 5.5%:** 1Q FMCG Sales grew 6.6%. Comparable sales excluding lifestyle restructuring it grew by 8%. EBITDA grew by 41.4% to Rs1.8bn. EBIT at Rs780mn increased 55.7%.
- **Hotels perform led by recently commissioned hotels:** Sales increased 15% while EBIT Hotels business grew 15% led by the recently commissioned hotels (ITC Kohenur in Hyderabad and ITC Grand Goa in Goa). Segment EBITDA grew 18% while EBIT declined due to additional depreciation on the new properties. ARR and occupancies remained healthy.
- **Paperboard and Paper** increased 12.7% backed by volumes from VA paperboard and favourable sales mix. EBIT increased 21.6%, however margins declined 20bps due to sluggish exports and FMCG demand conditions
- **Agri Business** sales increased 14.6% however, EBIT increased by only 4.3% with 60bps margin decline due to lack of trading opportunities in Oilseeds and Pulses, subdued demand for leaf tobacco in international markets, relatively steeper depreciation in currencies and adverse business mix.

Exhibit 1: Q1FY20 Result Overview: Net Sales up 7.4% led by Agri and paper, Adj. PAT up 12.6%

Y/e March	Q1FY20	Q1FY19	*YoY gr. (%)*	Q4FY19	FY20E	FY19	*YoY gr. (%)*
Net Sales	**1,15,028**	**1,07,070**	***7.4***	**1,19,921**	**4,92,621**	**4,49,957**	***9.5***
EBITDA	**45,657**	**42,021**	***8.7***	**45,717**	**1,91,069**	**1,73,055**	***10.4***
Margins (%)	*39.7*	*39.2*	*0.4*	*38.1*	*38.8*	*38.5*	*0.3*
Depreciation	3,589	2,987	*20.2*	3,502	14,023	13,117	*6.9*
Interest	152.2	73.4	*107.4*	77	424	342	*24.1*
Other Income	6,202	4,039	*53.6*	7,402	28,998	24,845	*16.7*
PBT	**48,117**	**42,999**	***11.9***	**49,539**	**2,05,620**	**1,84,442**	***11.5***
Tax	16,378	14,813	*10.6*	14,720	68,060	59,798	*13.8*
Rate (%)	*34.0*	*34.4*	*(0.4)*	*29.7*	*33.1*	*32.4*	*0.7*
Adjusted PAT	**31,739**	**28,187**	***12.6***	**34,819**	**1,37,560**	**1,24,643**	***10.4***

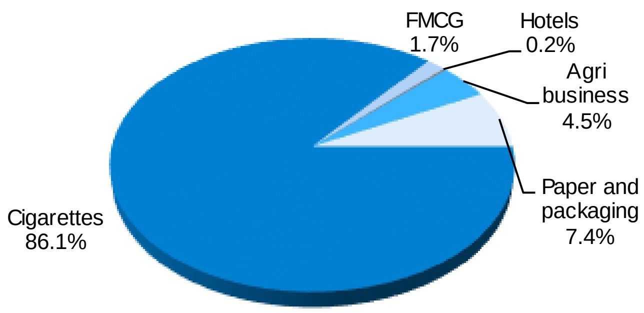
Source: Company, PL

Exhibit 2: Cigarettes are 38.7% of Sales, FMCG 28.1%



Source: Company, PL

Exhibit 3: Cigarettes are 86.1% of EBIT

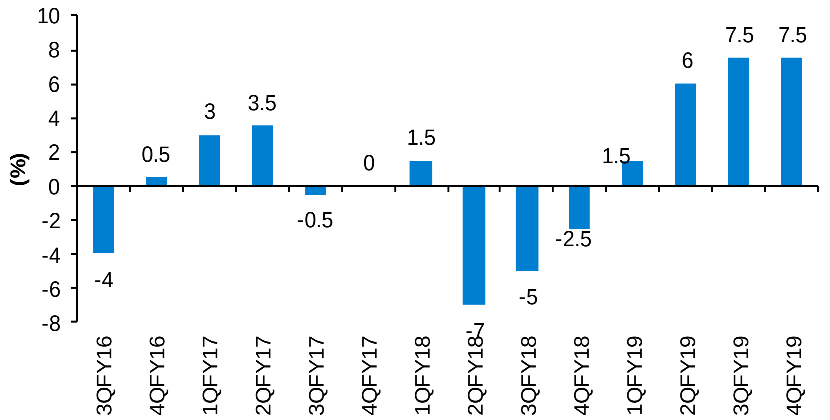


Source: Company, PL

Cigarette Volumes increased only ~2.5% on a favourable base due to increase in prices in few brands and subdued economic environment.

Margins remained healthy with 140bps expansion led by price increases taken.

Exhibit 4: Cigarettes: Volumes up ~7.5% as growth momentum sustains



Source: Company, PL

FMCG sales up 6.6% on sluggish demand conditions. Comparable FMCG sales (excl. lifestylw retailing) increased 8% led by Atta, Potato Chips, Premium Cream Biscuits, Noodles, Handwash and Bodywash.

It launched Aashirvaad Nature's Super Foods

In Snacks, ITC launched 'Bingo! Starters', in four variants

ITC launched 'YiPPee! Quik Mealz– Asian Surprise', a first-of-its-kind delicious bowl of noodles for on-the-go consumption.

ITC launched Fiama Handwash in the premium segment in three variants and 'Engage' L'amante, a premium perfume for men and women.

The dedicated manufacturing facility for notebooks being set up in Andhra Pradesh is nearing completion.

Hotels business grew 15% led by the recently commissioned hotels - ITC Kohenur, Hyderabad and ITC Grand Goa, Resort & Spa, Goa. Segment EBITDA grew 18% while EBIT declined due to additional depreciation on the new properties

Agri EBIT growth remained muted due to lack of trading opportunities in Oilseeds and Pulses, subdued demand for leaf tobacco in international markets, relatively steeper depreciation in currencies and adverse business mix

Paperboards Business sales grew driven by strong volume growth in the Value Added Paperboard segment and better product mix. However, growth in Packaging & Printing was impacted due to sluggish demand conditions in the FMCG industry and exports.

Exhibit 5: FMCG EBITDA up 41.4% with 150bps EBITDA mrgin expansion

	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20
Cigarette Volume gr %	**-3**	**2**	**6.0**	**7.5**	**7.5**	**2.5**
Sales (INR m)	**1,15,054**	**1,28,460**	**1,21,932**	**1,21,933**	**1,29,079**	**1,40,248**
Cigarettes	49,365	51,276	50,261	50,734	54,859	54,334
FMCG	30,518	28,700	31,604	32,010	32,739	30,601
Hotels	4,080	3,413	3,626	4,519	5,098	3,926
Agri business	18,083	31,513	22,197	19,246	21,009	36,112
Paper and packaging	13,008	13,558	14,245	15,425	15,374	15,275
Sales growth (YoY)						
Cigarettes	(4.1)	4.0	10.4	9.6	11.1	6.0
FMCG	5.8	10.3	12.7	11.5	7.3	6.6
Hotels	5.6	11.9	20.8	11.7	24.9	15.0
Agri business	(5.7)	14.2	12.8	25.7	16.2	14.6
Paper and packaging	(5.2)	(0.3)	8.8	20.5	18.2	12.7
EBIT (INR m)	**40,388**	**41,119**	**42,001**	**42,256**	**45,229**	**44,703**
Cigarettes	35,058	35,584	35,791	35,577	38,560	38,491
FMCG	912	501	585	767	1,305	780
Hotels	755	132	156	603	887	104
Agri business	1,240	1,945	2,361	1,988	1,472	2,030
Paper and packaging	2,424	2,957	3,109	3,321	3,005	3,298
EBIT growth (YoY)	**7.5**	**8.9**	**9.2**	**9.1**	**12.0**	**8.7**
Cigarettes	7.6	8.7	8.7	8.8	10.0	8.2
FMCG	64.2	823.0	185.3	63.1	43.1	55.7
Hotels	12.8	149.0	267.0	10.1	17.5	(21.4)
Agri business	(8.1)	(17.3)	(7.9)	(14.8)	18.8	4.3
Paper and packaging	0.9	14.9	13.4	23.8	24.0	11.5
EBIT Margin (%)						
Cigarettes	71.0	69.4	71.2	70.1	70.3	70.8
FMCG	3.0	1.7	1.8	2.4	4.0	2.5
Hotels	18.5	3.9	4.3	13.3	17.4	2.6
Agri business	6.9	6.2	10.6	10.3	7.0	5.6
Paper and packaging	18.6	21.8	21.8	21.5	19.5	21.6

Source: Company, PL

Financials

Income Statement (Rs m)

Y/e Mar	FY18	FY19	FY20E	FY21E
Net Revenues	**406,275**	**449,957**	**492,621**	**536,842**
YoY gr. (%)	*1.3*	*10.8*	*9.5*	*9.0*
Cost of Goods Sold	157,901	173,052	190,434	209,278
Gross Profit	248,375	276,905	302,186	327,564
Margin (%)	*61.1*	*61.5*	*61.3*	*61.0*
Employee Cost	24,875	27,284	29,984	31,694
Other Expenses	32,353	76,566	39,827	41,022
EBITDA	**155,409**	**173,055**	**191,069**	**211,677**
YoY gr. (%)	*6.6*	*11.4*	*10.4*	*10.8*
Margin (%)	*38.3*	*38.5*	*38.8*	*39.4*
Depreciation and Amortization	11,454	13,117	14,023	15,322
EBIT	**143,956**	**159,938**	**177,046**	**196,355**
Margin (%)	*35.4*	*35.5*	*35.9*	*36.6*
Net Interest	867	342	424	424
Other Income	21,298	24,845	28,998	31,665
Profit Before Tax	**164,388**	**184,442**	**205,620**	**227,595**
Margin (%)	*40.5*	*41.0*	*41.7*	*42.4*
Total Tax	52,156	59,798	68,060	75,334
Effective tax rate (%)	*31.7*	*32.4*	*33.1*	*33.1*
Profit after tax	**112,232**	**124,643**	**137,560**	**152,261**
Minority interest	-	-	-	-
Share Profit from Associate	-	-	-	-
Adjusted PAT	**112,232**	**124,643**	**137,560**	**152,261**
YoY gr. (%)	*10.0*	*11.1*	*10.4*	*10.7*
Margin (%)	*27.6*	*27.7*	*27.9*	*28.4*
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	**112,232**	**124,643**	**137,560**	**152,261**
YoY gr. (%)	*10.0*	*11.1*	*10.4*	*10.7*
Margin (%)	*27.6*	*27.7*	*27.9*	*28.4*
Other Comprehensive Income	3,823	3,626	-	-
Total Comprehensive Income	116,056	128,269	137,560	152,261
Equity Shares O/s (m)	**12,204**	**12,259**	**12,319**	**12,379**
EPS (Rs)	**9.2**	**10.2**	**11.2**	**12.3**

Source: Company Data, PL Research

Balance Sheet Abstract (Rs m)

Y/e Mar	FY18	FY19	FY20E	FY21E
Non-Current Assets				
Gross Block	**264,514**	**294,726**	**324,827**	**355,027**
Tangibles	255,755	285,767	315,668	345,668
Intangibles	8,759	8,959	9,159	9,359
Acc: Dep / Amortization	**108,767**	**121,785**	**135,807**	**151,129**
Tangibles	104,468	117,037	130,611	145,475
Intangibles	4,299	4,747	5,196	5,655
Net fixed assets	**155,747**	**184,963**	**189,020**	**203,898**
Tangibles	151,287	179,457	185,057	200,193
Intangibles	4,460	5,506	3,963	3,705
Capital Work In Progress	50,169	33,915	44,000	44,000
Goodwill	-	-	-	-
Non-Current Investments	142,266	140,777	159,977	172,546
Net Deferred tax assets	(19,179)	(20,441)	(20,646)	(19,614)
Other Non-Current Assets	30,415	42,635	42,179	45,590
Current Assets				
Investments	99,035	125,066	117,699	135,354
Inventories	72,372	75,872	96,008	107,581
Trade receivables	23,570	36,462	28,002	31,257
Cash & Bank Balance	25,949	37,687	37,811	34,823
Other Current Assets	12,584	6,949	12,316	14,495
Total Assets	**623,627**	**697,979**	**742,029**	**806,058**
Equity				
Equity Share Capital	12,204	12,259	12,319	12,379
Other Equity	501,796	567,239	623,525	682,397
Total Networth	**514,000**	**579,498**	**635,843**	**694,776**
Non-Current Liabilities				
Long Term borrowings	111	79	-	-
Provisions	1,219	1,326	1,544	1,651
Other non current liabilities	383	-	-	-
Current Liabilities				
ST Debt / Current of LT Debt	-	0	0	0
Trade payables	33,823	33,683	29,556	31,429
Other current liabilities	54,557	62,532	53,979	58,082
Total Equity & Liabilities	**623,626**	**697,979**	**742,029**	**806,058**

Source: Company Data, PL Research

Cash Flow (Rs m)

Y/e Mar	FY18	FY19	FY20E	FY21E
PBT	164,388	184,442	205,620	227,595
Add. Depreciation	11,454	13,117	14,023	15,322
Add. Interest	867	342	424	424
Less Financial Other Income	21,298	24,845	28,998	31,665
Add. Other	(2,864)	(11,157)	918	(4,292)
Op. profit before WC changes	173,844	186,744	220,985	239,050
Net Changes-WC	19,829	(43,741)	(13,403)	(32,759)
Direct tax	(52,156)	(59,798)	(68,060)	(75,334)
Net cash from Op. activities	**141,518**	**83,204**	**139,521**	**130,957**
Capital expenditures	(33,197)	(26,079)	(28,165)	(30,200)
Interest / Dividend Income	-	-	-	-
Others	(56,338)	1,477	(19,199)	(12,566)
Net Cash from Invt. activities	**(89,535)**	**(24,602)**	**(47,364)**	**(42,766)**
Issue of share cap. / premium	17,161	16,591	3,722	10,579
Debt changes	(69)	(32)	(79)	-
Dividend paid	(68,803)	(75,737)	(84,937)	(103,907)
Interest paid	(867)	(342)	(424)	(424)
Others	-	-	-	-
Net cash from Fin. activities	**(52,577)**	**(59,520)**	**(81,718)**	**(93,753)**
Net change in cash	**(594)**	**(917)**	**10,440**	**(5,563)**
Free Cash Flow	108,321	57,125	111,356	100,757

Source: Company Data, PL Research

Key Financial Metrics

Y/e Mar	FY18	FY19	FY20E	FY21E
Per Share(Rs)				
EPS	9.2	10.2	11.2	12.3
CEPS	10.1	11.2	12.3	13.5
BVPS	42.1	47.3	51.6	56.1
FCF	8.9	4.7	9.0	8.1
DPS	5.2	5.8	7.0	7.4
Return Ratio(%)				
RoCE	29.8	29.2	29.1	29.5
ROIC	28.9	29.9	30.2	30.9
RoE	23.2	22.8	22.6	22.9
Balance Sheet				
Net Debt : Equity (x)	(0.2)	(0.3)	(0.2)	(0.2)
Net Working Capital (Days)	56	64	70	73
Valuation(x)				
PER	28.8	26.0	23.7	21.5
P/B	6.3	5.6	5.1	4.7
P/CEPS	10.1	11.2	12.3	13.5
EV/EBITDA	20.0	17.8	16.2	14.7
EV/Sales	7.6	6.8	6.3	5.8
Dividend Yield (%)	1.9	2.2	2.6	2.8

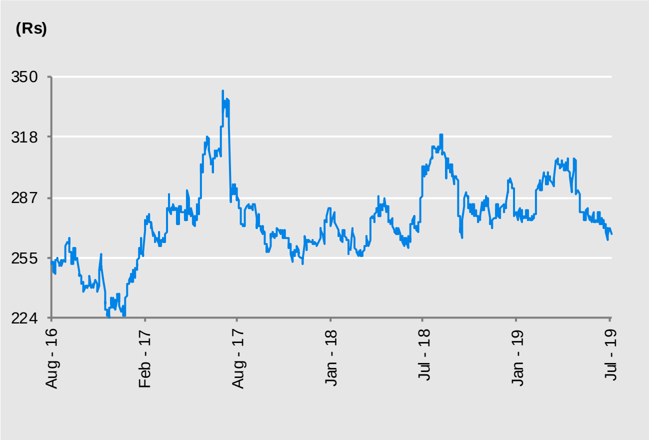
Source: Company Data, PL Research

Quarterly Financials (Rs m)

Y/e Mar	Q2FY19	Q3FY19	Q4FY19	Q1FY20
Net Revenue	**110,689**	**112,277**	**119,921**	**115,028**
YoY gr. (%)	*7.3*	*14.9*	*13.3*	*7.4*
Raw Material Expenses	42,797	43,005	46,156	41,399
Gross Profit	67,892	69,272	73,765	73,630
Margin (%)	*61.3*	*61.7*	*61.5*	*64.0*
EBITDA	**42,060**	**43,258**	**45,717**	**45,657**
YoY gr. (%)	*11.8*	*10.8*	*10.3*	*8.7*
Margin (%)	*38.0*	*38.5*	*38.1*	*39.7*
Depreciation / Depletion	3,275	3,354	3,502	3,589
EBIT	**38,785**	**39,904**	**42,215**	**42,068**
Margin (%)	*35.0*	*35.5*	*35.2*	*36.6*
Net Interest	135	56	77	152
Other Income	5,041	8,364	7,402	6,202
Profit before Tax	**43,691**	**48,212**	**49,539**	**48,117**
Margin (%)	*39.5*	*42.9*	*41.3*	*41.8*
Total Tax	14,145	16,121	14,720	16,378
Effective tax rate (%)	*32.4*	*33.4*	*29.7*	*34.0*
Profit after Tax	**29,547**	**32,091**	**34,819**	**31,739**
Minority interest	-	-	-	-
Share Profit from Associates	-	-	-	-
Adjusted PAT	**29,547**	**32,091**	**34,819**	**31,739**
YoY gr. (%)	*11.9*	*13.8*	*18.7*	*12.6*
Margin (%)	*26.7*	*28.6*	*29.0*	*27.6*
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	**29,547**	**32,091**	**34,819**	**31,739**
YoY gr. (%)	*11.9*	*3.8*	*18.7*	*12.6*
Margin (%)	*26.7*	*28.6*	*29.0*	*27.6*
Other Comprehensive Income	(2,001)	4,279	563	(2,130)
Total Comprehensive Income	**27,546**	**36,370**	**35,382**	**29,609**
Avg. Shares O/s (m)	12,242	12,247	12,259	12,242
EPS (Rs)	**2.4**	**2.6**	**2.8**	**2.6**

Source: Company Data, PL Research

Price Chart



Recommendation History

No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	4-Jul-19	BUY	369	278
2	13-May-19	BUY	369	289
3	5-Apr-19	BUY	362	295
4	23-Jan-19	BUY	364	277
5	7-Jan-19	BUY	364	282
6	26-Oct-18	BUY	364	281
7	5-Oct-18	BUY	346	287

Analyst Coverage Universe

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Asian Paints	Accumulate	1,522	1,479
2	Avenue Supermarts	Hold	1,338	1,359
3	Britannia Industries	Accumulate	3,145	2,841
4	Colgate Palmolive	Hold	1,208	1,204
5	Crompton Greaves Consumer Electricals	BUY	297	225
6	Dabur India	Hold	437	420
7	Emami	Accumulate	382	301
8	Future Retail	BUY	512	412
9	GlaxoSmithKline Consumer Healthcare	Hold	7,744	7,805
10	Hindustan Unilever	Accumulate	1,816	1,690
11	ITC	BUY	369	278
12	Jubilant FoodWorks	BUY	1,459	1,153
13	Kansai Nerolac Paints	Accumulate	479	434
14	Marico	Hold	357	363
15	Nestle India	Accumulate	10,656	11,884
16	Pidilite Industries	Accumulate	1,184	1,227
17	Titan Company	BUY	1,267	1,290
18	Voltas	Accumulate	584	635

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

ANALYST CERTIFICATION

(Indian Clients)

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