

View: EBIT margin improvement in cigarette business; Maintain Buy.

ITC's Q1FY20 results were broadly in line with our estimates. The cigarette business posted +3% YoY volume growth, below our estimate of 5%. However, increase in margins in the cigarette business was encouraging. Despite sluggish demand in Q1, ITC's FMCG business reported a 6.6% increase in topline and 80bps expansion in margin. We have maintained our FY20E and FY21E EPS estimates at ₹ 11.4 and ₹ 12.2, respectively. In our view, the stock is trading at a steep discount to peers and is an attractive stock. We value the stock at 26x PE, with a TP of ₹ 320. Maintain Buy. In volatile market conditions, we believe that there may be some pressure on ITC. Nevertheless, in the long run we maintain a positive view.

Continuous volume rise in the cigarette business is a key positive. We believe that ITC benefits from a strong leadership in the category and volumes should increase with price stabilization. Considering the constant rise 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.

Profitability was in line with the estimate

Net sales jumped 5.8% to ₹ 115bn, with a +3% volume growth in the cigarette business. EBITDA grew by 12.6% YoY to ₹ 45.7bn – came in line with our estimate. EBITDA margins expanded by 50bps YoY to 39.7%, as 180/80bps decrease in RM/employee costs was partially offset by 160bps increase in other expenses. APAT grew 12.6% YoY to ₹ 31.7bn – in line with our expectation.

Volume growth would improve going ahead

Since FY14, ITC's cigarette volumes have declined 13% overall, due to a continuous increase in duties and 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). In the last budget, the duty remained unchanged. We believe that the pace of duty increase has moderated, which should help volume growth to improve further (5% volume growth estimate for FY20E). We do not see FY19 base as a hurdle for growth as the long-term base remains favorable.

Q1FY20 Result (₹ Mn)

Particulars	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Revenue	115,028	108,746	5.8	122,060	(5.8)
Total Expense	69,371	66,725	4.0	76,344	(9.1)
EBITDA	45,657	42,021	8.7	45,717	(0.1)
Depreciation	3,589	2,987	20.2	3,502	2.5
EBIT	42,068	39,034	7.8	42,215	(0.3)
Other Income	6,202	4,039	53.6	7,402	(16.2)
Interest	152	73	107.4	77	96.6
EBT	45,987	43,784	7.8	50,102	(8.2)
Tax	16,378	14,813	10.6	14,720	11.3
RPAT	29,609	28,971	2.2	35,382	(16.3)
APAT	31,739	28,187	12.6	34,819	(8.8)
			(bps)		(bps)
Gross Margin (%)	64.0	62.2	180	62.2	182
EBITDA Margin (%)	39.7	38.6	105	37.5	224
NPM (%)	25.7	26.6	(90)	29.0	(325)
Tax Rate (%)	35.6	33.8	178	29.4	623
EBIT Margin (%)	36.6	35.9	68	34.6	199

CMP	₹ 265
Target / Upside	₹ 320 / 21%
BSE Sensex	37,146
NSE Nifty	10,997

Scrip Details

Equity / FV	₹ 12,259mn / ₹ 1
Market Cap	₹ 3,242bn
	US\$ 47bn
52-week High/Low	₹ 323/₹ 263
Avg. Volume (no)	11,901,700
NSE Symbol	ITC
Bloomberg Code	ITC IN

Shareholding Pattern Jun'19(%)

Promoters	0.0
MF/Banks/FIs	38.1
FIIIs	17.8
Public / Others	44.1

Valuation (x)

	FY19A	FY20E	FY21E
P/E	26.0	23.3	21.6
EV/EBITDA	17.8	15.8	14.2
ROE (%)	22.8	22.9	22.4
RoACE (%)	22.1	22.2	21.7

Estimates (₹ mn)

	FY19A	FY20E	FY21E
Revenue	449,957	490,281	531,605
EBITDA	173,055	192,604	213,407
PAT	124,643	139,343	150,161
EPS (₹)	10.2	11.4	12.2

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Exhibit 1: Segmental Performance

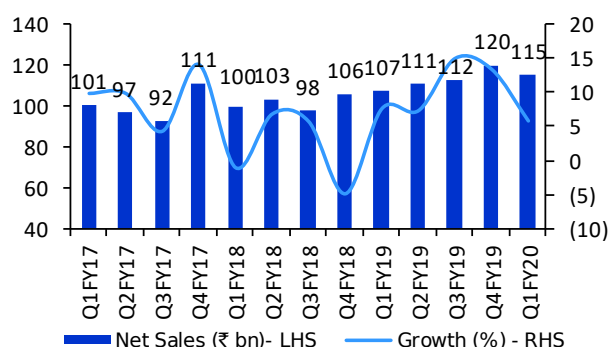
Particulars (₹ Mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)	Remarks
Cigarettes						<ul style="list-style-type: none">Volume growth stood at 3.0%. Steep escalation of 13% in tax incidence under GST regime continues to weigh on FMCG Cigarettes performance.
Revenue	54,334	51,276	6.0	54,859	(1.0)	
EBIT	38,491	35,584	8.2	38,560	(0.2)	
EBIT Margin (%)	70.8	69.4		70.3		
FMCG Others						<ul style="list-style-type: none">Amidst a slowdown, revenue grew 8% (comparable basis) led by atta, potato chips, premium cream biscuits and noodles in the branded packaged foods business, liquids (hand wash & body wash) in the personal care products businesses. Focus on innovative product launches and impactful media campaigns also boost performance.Margin expansion despite increased investments in brand building, gestation and start-up costs of new categories / new facilities.
Revenue	30,601	28,700	6.6	32,739	(6.5)	
EBIT	780	501	55.7	1,305	(40.2)	
EBIT Margin (%)	2.5	1.7		4.0		
Hotels						<ul style="list-style-type: none">Revenue growth driven by robust performance of new properties, amidst relatively soft demand conditions.Additional depreciation pertaining to new properties weighed on margins. ITC Royal Bengal, Kolkata commissioned on 1st June 2019, has received excellent initial response.
Revenue	3,926	3,413	15.0	5,098	(23.0)	
EBIT	104	132	(21.4)	887	(88.3)	
EBIT Margin (%)	2.6	3.9		17.4		
Agri Business						<ul style="list-style-type: none">ITC focused on strengthening value added products portfolio. The recent foray into the Frozen Snacks segment under the 'ITC Master Chef' brand, received encouraging consumer response and continued to scale up.Lack of trading opportunities in Oilseeds and Pulses, subdued demand for leaf tobacco in international markets, relatively steeper currency depreciation and adverse business mix impacted margins
Revenue	36,112	31,513	14.6	21,009	71.9	
EBIT	2,030	1,945	4.3	1,472	37.8	
EBIT Margin (%)	5.6	6.2		7.0		
Paper & Packaging						<ul style="list-style-type: none">Revenue growth driven by strong growth in Value Added Paperboards segment and product mix enrichment. Packaging & Printing Business, however, was impacted by slowdown in the FMCG industry and exports.Healthy margins due to product mix enrichment, higher realization, strategic investments in imported pulp substitution, and a cost-competitive fiber chain.
Revenue	15,275	13,558	12.7	15,374	(0.6)	
EBIT	3,298	2,957	11.5	3,005	9.7	
EBIT Margin (%)	21.6	21.8		19.5		
Total						
Revenue	140,248	128,460	9.2	129,079	8.7	
EBIT	44,703	41,119	8.7	45,229	(1.2)	
EBIT Margin (%)	31.9	32.0		35.0		

Source: DART, Company

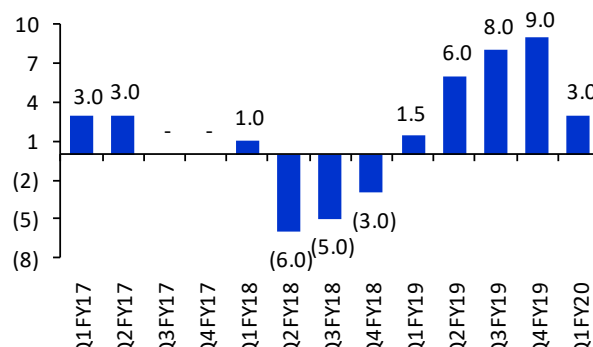
Exhibit 2: Change in estimate

(₹ mn)	FY20E			FY21E		
	New	Old	Chg (%)	New	Old	Chg (%)
Revenue	490,281	490,281	0.0	531,605	531,605	0.0
EBITDA	192,604	194,547	(1.0)	213,407	212,450	0.5
Margin (%)	39.3	39.7	-40 bps	40.1	40.0	20 bps
PAT	139,343	137,748	1.2	150,161	149,611	0.4
EPS (₹)	11.4	11.2	1.2	12.2	12.2	0.4

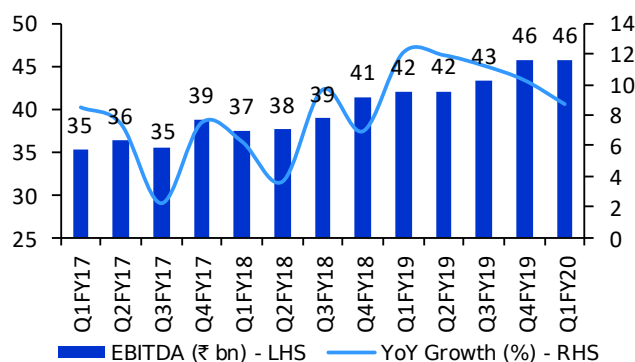
Source: DART, Company

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


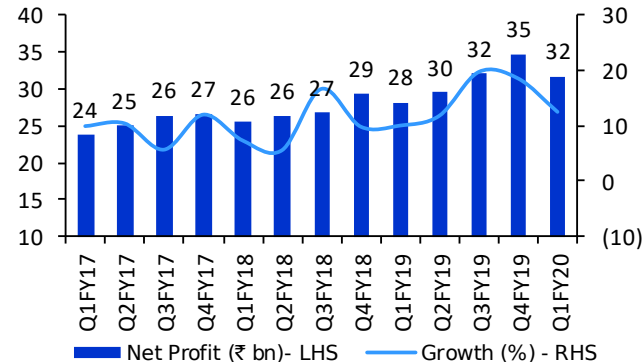
Source: DART, Company

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	FY19A	FY20E	FY21E
Revenue	406,275	449,957	490,281	531,605
Total Expense	250,866	276,901	297,677	318,198
COGS	157,900	173,052	177,897	191,011
Employees Cost	24,875	27,284	27,152	27,814
Other expenses	68,091	76,566	92,628	99,373
EBIDTA	155,410	173,055	192,604	213,407
Depreciation	11,454	13,117	13,703	14,993
EBIT	143,956	159,938	178,901	198,414
Interest	867	342	486	510
Other Income	21,298	24,845	30,698	27,443
Exc. / E.O. items	4,129	0	0	0
EBT	168,517	184,442	209,113	225,347
Tax	56,285	59,798	69,770	75,186
RPAT	112,233	124,643	139,343	150,161
Minority Interest	0	0	0	0
Profit/Loss share of associates	0	0	0	0
APAT	108,104	124,643	139,343	150,161

Balance Sheet

(₹ Mn)	FY18A	FY19A	FY20E	FY21E
Sources of Funds				
Equity Capital	12,204	12,259	12,259	12,259
Minority Interest	0	0	0	0
Reserves & Surplus	501,796	567,239	624,478	691,820
Net Worth	514,000	579,498	636,736	704,078
Total Debt	111	79	4,079	4,079
Net Deferred Tax Liability	19,179	20,441	21,200	21,200
Total Capital Employed	533,290	600,018	662,015	729,357

Applications of Funds

Net Block	156,697	185,864	192,161	197,168
CWIP	50,168	33,915	33,915	33,915
Investments	134,938	140,715	182,929	237,808
Current Assets, Loans & Advances	265,340	323,385	352,018	367,133
Inventories	72,372	75,872	77,276	83,119
Receivables	23,570	36,462	28,444	30,863
Cash and Bank Balances	25,948	37,687	65,677	78,606
Loans and Advances	38,207	41,437	40,611	40,611
Other Current Assets	6,209	6,861	10,010	3,934
Less: Current Liabilities & Provisions	73,852	83,860	99,007	106,666
Payables	33,822	33,682	32,130	34,531
Other Current Liabilities	40,030	50,178	66,877	72,135
sub total				
Net Current Assets	191,488	239,525	253,011	260,467
Total Assets	533,290	600,018	662,015	729,357

E – Estimates

Important Ratios

Particulars	FY18A	FY19A	FY20E	FY21E
(A) Margins (%)				
Gross Profit Margin	61.1	61.5	63.7	64.1
EBIDTA Margin	38.3	38.5	39.3	40.1
EBIT Margin	35.4	35.5	36.5	37.3
Tax rate	33.4	32.4	33.4	33.4
Net Profit Margin	27.6	27.7	28.4	28.2
(B) As Percentage of Net Sales (%)				
COGS	38.9	38.5	36.3	35.9
Employee	6.1	6.1	5.5	5.2
Other	16.8	17.0	18.9	18.7
(C) Measure of Financial Status				
Gross Debt / Equity	0.0	0.0	0.0	0.0
Interest Coverage	166.1	467.8	368.3	389.0
Inventory days	65	62	58	57
Debtors days	21	30	21	21
Average Cost of Debt	469.1	360.1	23.4	12.5
Payable days	30	27	24	24
Working Capital days	172	194	188	179
FA T/O	2.6	2.4	2.6	2.7
(D) Measures of Investment				
AEPS (₹)	8.8	10.2	11.4	12.2
CEPS (₹)	9.8	11.2	12.5	13.5
DPS (₹)	5.6	6.1	6.7	6.8
Dividend Payout (%)	63.6	60.1	58.9	55.2
BVPS (₹)	41.9	47.3	51.9	57.4
RoANW (%)	23.2	22.8	22.9	22.4
RoACE (%)	21.7	22.1	22.2	21.7
RoAIC (%)	30.2	29.9	30.9	31.8
(E) Valuation Ratios				
CMP (₹)	265	265	265	265
P/E	30.0	26.0	23.3	21.6
Mcap (₹ Mn)	3,242,400	3,242,400	3,242,400	3,242,400
MCap/ Sales	8.0	7.2	6.6	6.1
EV	3,117,528	3,079,726	3,050,802	3,037,872
EV/Sales	7.7	6.8	6.2	5.7
EV/EBITDA	20.1	17.8	15.8	14.2
P/BV	6.3	5.6	5.1	4.6
Dividend Yield (%)	2.1	2.3	2.5	2.6
(F) Growth Rate (%)				
Revenue	1.3	10.8	9.0	8.4
EBITDA	6.6	11.4	11.3	10.8
EBIT	6.3	11.1	11.9	10.9
PBT	8.7	9.4	13.4	7.8
APAT	6.0	15.3	11.8	7.8
EPS	6.0	15.3	11.8	7.8

Cash Flow

(₹ Mn)	FY18A	FY19A	FY20E	FY21E
CFO	128,805	127,835	172,970	171,137
CFI	(80,948)	(56,740)	(67,149)	(74,879)
CFF	(49,382)	(59,356)	(77,832)	(83,328)
FCFF	95,976	102,903	152,970	151,137
Opening Cash	27,473	25,948	37,687	65,677
Closing Cash	25,948	37,687	65,677	78,606

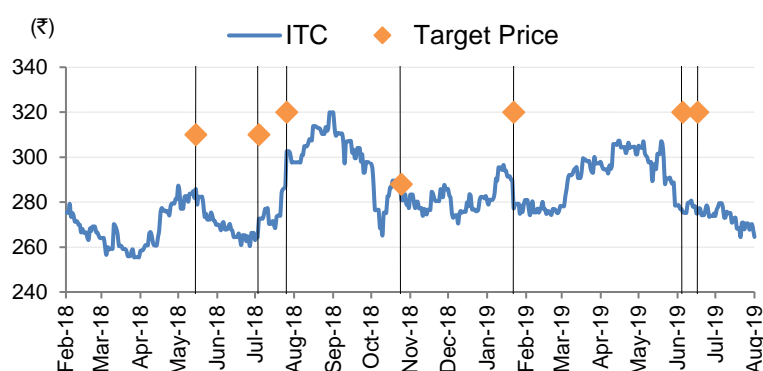
E – Estimates

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	288	281
Jan-19	Accumulate	320	277
Jun-19	Buy	320	276
Jun-19	Buy	320	275

*Price as on recommendation date

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