Sharekhan
by BNP PARIBAS

ITC

On road to recovery

Sector: Consumer Goods

Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 195**	
Price Target: **Rs. 240**	↑

↑ Upgrade ↔ No change ↓ Downgrade

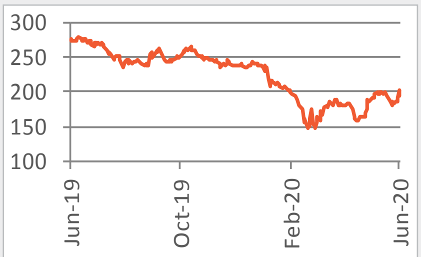
Company details

Market cap:	Rs. 2,39,699 cr
52-week high/low:	Rs. 283/135
NSE volume: (No of shares)	165.7 lakh
BSE code:	500875
NSE code:	ITC
Sharekhan code:	ITC
Free float: (No of shares)	1229.2 cr

Shareholding (%)

Promoters	0.0
FII	14.7
DII	42.5
Others	42.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.9	24.1	-17.6	-28.7
Relative to Sensex	-13.0	6.7	-3.1	-17.5

Sharekhan Research, Bloomberg

ITC's Q4FY2020 performance was affected by lockdown with revenues declining by 6.4% and adjusted PAT stood flat. Cigarette business revenue declined by ~6.5%, largely due to a 10-11% dip in cigarette sales volumes. The sales volumes stood almost flat in January-February. Non-cigarette FMCG business declined by ~3% (comparable revenue growth excluding stationary business and hived-off the retail business stood at 5%). Revenue and PAT grew by 2.2% and 23% (aided cut in the corporate tax rate) in FY2020. Manufacturing of essentials such as personal wash, hygiene products, atta, biscuits and noodles was quickly resume after acquiring necessary approvals in the month of April. Most of these categories are growing in the high teens. Cigarette business was non-operational for 45 days and resume partially in mid-May. It is currently operating at a 100% capacity and almost selling whatever it has manufactured. The agri & paperboard, paper & packaging (PPP) is gaining momentum. Hotel business will remain an underperformer in FY2021 (likely to see a strong recovery in FY2022). The company is stringently managing cost by cutting on discretionary expenses (including travel and irrelevant media activities). There might be some margin deceleration in FY2021 but it is expected to recover in FY2022. Under the new dividend policy the company declared dividend per share of Rs10.15 for FY2020 better than Rs5.8 per share of dividend paid in FY2019.

Key positives

- Key businesses (including cigarettes and non-cigarette FMCG) are recovering back to pre-COVID-19 levels.
- Free cash flows increased by 30% to Rs. 11,693; cash on books stood ~Rs. 7,000 crore in FY2020.
- The company declared dividend of Rs10.15 per share (dividend payout of 85%).

Key negatives

- Cigarette sales volumes decline by 10-11% in Q4
- Recovery of hotel business will take time than anticipated earlier.

Our Call

View: Retain Buy with revised price target of Rs. 240: We have lowered our earnings estimates by 11% and 8%, respectively for FY2021 and FY2022 to factor the impact of supply disruption caused by lockdown in Q1FY2021. ITC's key businesses have recovery close to pre-COVID-19 levels. Strong cash flows and extensive distribution reach (pan-India) will help ITC to gain market share from small players in coming quarters. The stock is currently trading at a stark discount of 15x its FY2022E earnings, which is at stark discount to its historical average multiple. This along with a dividend yield of 5.2% makes it a good bet in the FMCG space. We maintain our Buy recommendation on the stock with a revised price target of Rs. 240 (valuing it at 19x its FY2022E earnings).

Key Risks

Any increase in tax on cigarettes in the upcoming GST meets or sustain slowdown in the consumer demand would act as a key risk to our earnings estimates.

Valuations (Standalone) Rs cr

Particulars	FY18	FY19	FY20	FY21E	FY22E
Revenues	40,628	45,784	46,807	44,886	51,348
OPM (%)	38.3	37.8	38.3	37.3	38.2
Adjusted PAT	10,810	12,387	15,170	13,631	15,749
Adjusted EPS (Rs.)	8.5	10.1	12.4	11.2	12.9
P/E (x)	23.0	19.3	15.7	17.5	15.1
P/B (x)	4.6	4.1	3.7	3.7	3.6
EV/EBIDTA (x)	13.9	12.3	11.8	12.5	10.6
RoNW (%)	21.5	22.5	24.8	21.3	24.1
RoCE (%)	28.4	27.8	25.5	22.4	26.1

Source: Company; Sharekhan estimates

Revenue declined by ~6.4%; margins fell by 100 bps: Net revenue fell by 6.4% y-o-y in Q4FY2020 to Rs. 11,420 crore, due to a 6% decline in core cigarette business and 3% decline in the non-cigarette FMCG business affected by disruptions due to lockdown in the last few days of March 2020. Hotel business posted sharp decline of 9% and 52% in revenues and PBIT. Gross margins declined by 111 bps to 59.3% due to higher input costs and change in revenue mix. OPM fell by 100 bps to 36.5% mainly on account of lower operating leverage. Operating profit declined by 8.9% y-o-y to Rs. 4,163.5 crore. A rise in depreciation & interest costs led to 8.9% decline in profit before tax (PBT) which stood at Rs. 4,511.8 crore. Despite a decline in PBT, lower incidence of tax due to reduction in corporate tax rate resulted in adjusted PAT to remain flat at Rs. 3,457.1 crore. There was an exceptional item of Rs. 340 crore pertaining to re-measurement of tax expenses for the year. This caused PAT to grow by 9.1% y-o-y to Rs. 3,797 crore in Q4FY2020 from Rs. 3,482 crore in Q4FY2019.

Cigarette business volumes fell by 11%, margins declined: Cigarette business sales volume declined by 11% in Q4FY2020 affected by lockdown impacting sales in the fag-end of the quarter. Cigarette sales volume grew by low single digits in January. However, it declined in February post the declaration of Union Budget as dealers/distributors didn't bought adequate inventpry in anticipation of price increase. Cigarette business revenues fell by 6.5% y-o-y to Rs. 5,130.5 crore whereas margins dipped by 396 bps. Cigarette factories saw no operations for 45 days from April 1 till mid-May. However, post the gaining the regulatory approval, operations gradually started with a 50% capacity utilisation and reach 100% by the end of June 2020. The company is managing to sell whatever is manufactured. It took a price hike of 8-9% in 70% of its cigarette portfolio post the Union Budget. The impact of the price hike could be seen in Q4 results were realisation growth stood at 5%. With business is coming back to normalcy and cigarette sales like to improve in the coming quarters, we expect cigarette sales volumes to decline by 6-7% affected by disruption in Q1FY2021.

Non-cigarette FMCG business less affected by pandemic; profitability sustained: ITC's non-cigarette FMCG business revenues fell by 2.8% y-o-y to Rs. 3,183.6 crore affected by lockdown amid the pandemic which impacted rural markets. Revenue grew by 5% y-o-y on a comparable basis (excluding the discontinued retail business and stationary products business). Prior to the COVID-19 outbreak, the segment was on track to register double-digit revenue growth for Q4FY2020, on a comparable basis. An enhanced scale, product mix enrichment, reduced distance-to-market and other strategic cost management initiatives led margins to expand by 63 bps in Q4FY2020. Segment PBIT rose by 12.6% y-o-y. EBITDA grew by 12.4% y-o-y to Rs. 256.5 crore despite a step-up in investments in brand building, gestation and start-up costs of new categories/new facilities. Essential consumer goods such as staples, noodles, biscuits, dairy etc. witnessed robust demand. Post acquiring necessary approvals the manufacturing of these categories scale-up to 100% (it was high for hygiene products). Most of these categories are growing in high teens. This along with good traction for hygiene products and new launches would help ITC to achieve good growth in the coming years. However stationery business (~7-8% of non-cigarette FMCG revenues) is expected to remain muted as there is no demand due non-operational of educational institutes. Margins of non-cigarette FMCG is expected to increase in the coming years helped by increase in scale of new launches and a better revenue mix.

Leveraged heightened need for health & hygiene products: A heightened awareness for personal hygiene led to a surge in demand for products such as hand sanitisers, hand wash, antiseptic liquids and floor cleaners. The company expanded manufacturing capacity and enhanced availability of the Savlon antiseptic liquid, soap, hand wash, hand sanitisers and Fiama handwash products in the market. A newly set-up perfume factory was redirected swiftly to manufacture hand sanitisers. In view of the market requirement, the company launched two innovative products in record time, Savlon Surface Disinfectant Spray and Savlon Hexa hand sanitising liquid during the quarter. Moreover, the company also launched Savlon germ protection wipes, Savlon disinfectant spray, Savlon Hexa soaps and vegetable, fruit wash and immunity boosting juices under B-Natural in the past two months. All the new launches are gaining good traction. It spiced its FMCG business by acquired Sunrise Foods (strong spice brand in eastern India)/ The brand has turnover of ~Rs700crore. ITC wants to expand the brand Pan India on back of its strong distribution system. The company adopted new delivery models such as bulk delivery to housing complexes and partnering with last-mile delivery partners to ensure smooth delivery to consumers. The company continued to mitigate the impact of slowdown by enhancing its direct reach, introducing offers, investing in modern trade/e-commerce channels and extending credit to certain trade partners.

Hotel business expected to remain under performer in FY2021: Revenue declined by 8.6% y-o-y, driven severe disruptions in operations since February 2020 with the onset of COVID-19 pandemic. Growth momentum was sustained in January and February. However, with severe restrictions in travel for business as well as leisure, and heightened sensitivity around hygiene and social distancing, revenue streams across all segments of operations have been significantly impacted. New properties such as ITC Kohenur and ITC Grand Goa continued to scale up operations. EBIT of the hotel business fell by 52% y-o-y, with margins declining significantly. We expect the hotel business to underperform in FY2021 owing to disruption in tourism and business due to the pandemic. If the vaccine is discovered by end of the year, we can see faster recovery in the travel & tourism sector.

Agri and PPP are on a recovery mode: Revenue of the agri business declined by 16.4% y-o-y, whereas PBIT margins fell by 49 bps, mainly affected due to supply chain disruptions, which led to lower exports and domestic sales towards the end of the year. To ensure steady support to the branded packaged foods business as also to support the agri sector during this critical time, the Business was able to secure necessary permissions expeditiously to ramp up agri operations including direct buying from farmers, leveraging its e-Choupal network to expand buying locations at the village level to overcome labour and transport challenges from the market yards, which were non-operational during March and April. The agri-business remains focused on enhancing its presence in identified high value-added segments such as spices for 'food-safe' markets, processed fruits, frozen marine products, etc. This includes the 'ITC Master Chef' range of 'Super Safe' frozen prawns, which adhere to stringent standards prevalent in USA, Europe, and Japan. During the year, the 'ITC Master Chef' range of frozen snacks was augmented with the launch of a unique range of kebabs for the retail segment. The frozen snacks range, currently comprising 11 vegetarian and six non-vegetarian delicacies, is available in over 50 cities and is gaining good consumer traction. Exports continued during the lockdown period and business is well-poised to support is branded packaged food business. We expect agri-business to deliver steady performance in FY2021.

Revenue of the PPP business declined by 5% y-o-y affected by a fall in rural demand and a slowdown in demand especially in the FMCG and liquor industries. The PPP' business' PBIT margin stood flat at 19.6%. Business provides strong support to cigarette and non-cigarette FMCG business along with providing superior packaging services externally. The business is expected to recover gradually in line with recovery in the key businesses.

Results (Standalone) Rs cr

Particulars	Q4FY20	Q4FY19	y-o-y (%)	Q3FY20	q-o-q (%)
Net revenue	11420.0	12206.0	-6.4	12013.0	-4.9
Total expenditure	7256.5	7634.4	-4.9	7400.3	-1.9
Operating Profit	4163.5	4571.7	-8.9	4612.7	-9.7
Other income	755.5	740.2	2.1	983.6	-23.2
Interest	14.7	7.7	90.3	12.4	18.4
Depreciation	392.5	350.2	12.1	416.2	-5.7
Profit before tax	4511.8	4953.9	-8.9	5167.6	-12.7
Tax	1054.8	1472.0	-28.3	1269.3	-16.9
Adjusted PAT	3457.1	3481.9	-0.7	3898.4	-11.3
Exceptional item	340.0	0.0	-	243.6	-
Reported PAT	3797.1	3481.9	9.1	4141.9	-8.3
EPS (Rs.)	2.8	2.8	-0.7	3.2	-11.3
			bps		**bps**
GPM (%)	59.3	60.4	-111	60.4	-110
OPM (%)	36.5	37.5	-100	38.4	-194

Source: Company, Sharekhan Research

Segmental revenue (Standalone) Rs cr

Particulars	Q4FY20	Q4FY19	YoY%	Q3FY20	QoQ%
FMCG - cigarettes	5130.5	5485.9	-6.5	5311.0	-3.4
FMCG - others	3183.6	3273.9	-2.8	3312.3	-3.9
Hotels	465.8	509.8	-8.6	552.3	-15.7
Agri	1887.3	2100.9	-10.2	2094.7	-9.9
Paperboard, Paper and Packaging	1458.9	1537.4	-5.1	1555.4	-6.2
Total	**12126.0**	**12907.9**	**-6.1**	**12825.7**	**-5.5**
Less: inter segment sales	825.9	843.7	-2.1	913.5	-9.6
Gross Sales	**11300.1**	**12064.2**	**-6.3**	**11912.2**	**-5.1**

Source: Company, Sharekhan Research

Segmental PBIT (Standalone) Rs cr

Business	PBIT (Rs crore)			Margins (%)		
	Q4FY20	Q4FY19	YoY %	Q4FY20	Q4FY19	Chg in BPS
FMCG - cigarettes	3403.0	3856.0	-11.7	66.3	70.3	-396
FMCG - others	147.0	130.5	12.6	4.6	4.0	63
Hotels	42.6	88.7	-52.0	9.1	17.4	-825
Agri	123.1	147.2	-16.4	6.5	7.0	-49
Paperboard, Paper and Packaging	285.7	300.5	-4.9	19.6	19.5	4
Total	**4001.4**	**4522.9**	**-11.5**	**33.0**	**35.0**	**-204**

Source: Company, Sharekhan Research

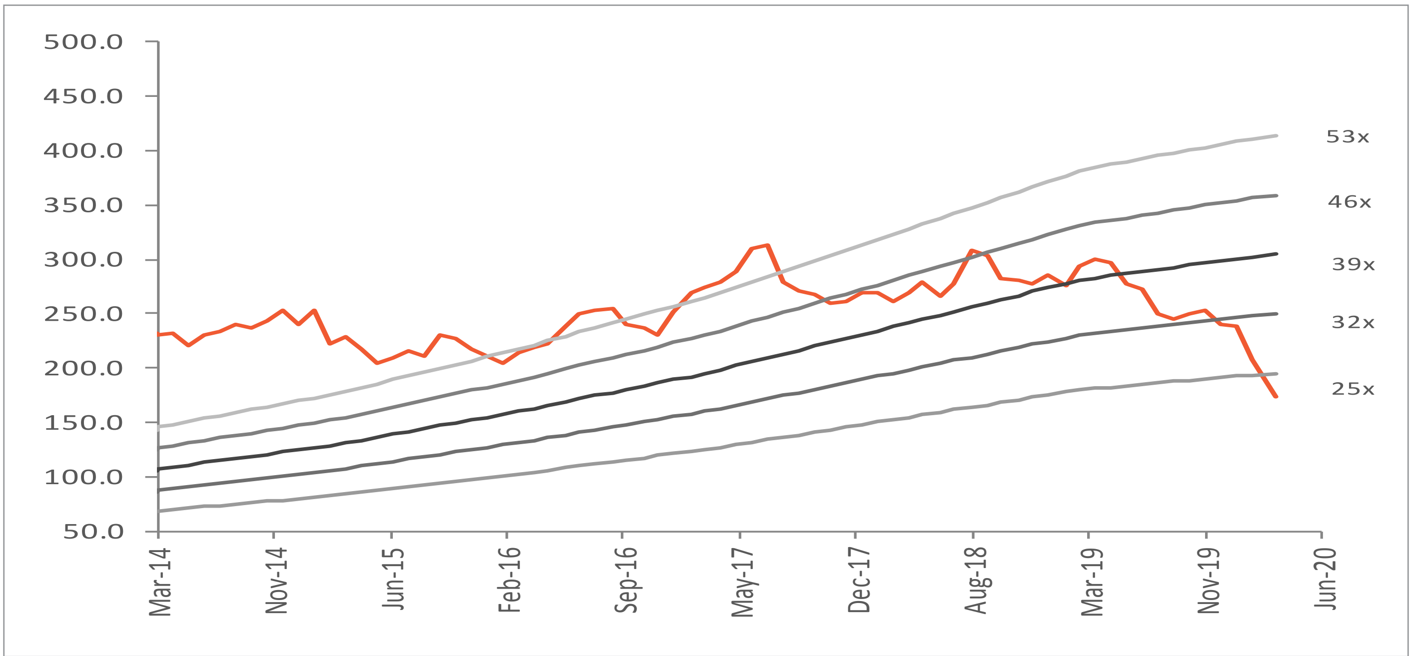
Outlook

Revenues to decline by 4-5% in FY2021; likely to post double digit growth in FY2022: Revenues grew by ~5% on comparable basis and PAT grew by 23% in FY2020. Post the easing of the lockdown norms key businesses (including cigarette and non-cigarette FMCG) operations have recovered close to pre-COVID levels. We expect FY2021 revenue to decline by 4-5% with cigarette volume to decline by 6-7%, while growth in the non-cigarette FMCG business is expected to be in low double digits. Hotel business will be underperformer in FY2021. However, a strong recovery is anticipated in all businesses in FY2022, which will help in driving double-digit revenue growth. The company is stringently managing costs by cutting discretionary expenses (including travel & irrelevant media activities). There might be some margin deceleration in FY2021 but it is expected to recover in FY2022.

Valuation

We have lowered our earnings estimates by 11% and 8%, respectively for FY2021 and FY2022 to factor the impact of supply disruption caused by lockdown in Q1FY2021. ITC's key businesses have recovery close to pre-COVID-19 levels. Strong cash flows and extensive distribution reach (pan-India) will help ITC to gain market share from small players in coming quarters. The stock is currently trading at a stark discount of 15x its FY2022E earnings, which is at stark discount to its historical average multiple. This along with a dividend yield of 5.2% makes it a good bet in the FMCG space. We maintain our Buy recommendation on the stock with a revised price target of Rs. 240 (valuing it at 19x its FY2022E earnings).

One-year forward P/E band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Hindustan Unilever	65.5	64.3	48.1	46.4	51.4	40.8	105.2	35.9	27.9
ITC	15.7	17.5	15.1	11.8	12.5	10.6	25.5	22.4	26.1

Source: Company, Sharekhan estimates

About company

ITC is one of the largest diversified players in India present in businesses such as cigarettes, FMCG, hotels and paper. The company is the market leader in the domestic cigarette and PPP segments. The company is also the second-largest hotel chain by revenue and profitability, with a strong room inventory. The company has a strong distribution reach of more than 2 million, which it is utilising to scale-up its consumer goods business and de-risk its business model. ITC's revenue and PAT grew by 3.0x and 3.8x over FY2009-FY2020.

Investment theme

ITC is focusing on de-risking its business model by reducing dependence on its core cigarette business (affected by regulatory and tax hurdles for past few years) by scaling up the fast-growing consumer goods and hotel businesses. The company has quickly rebound from the disruption caused by lockdown and key businesses are operating at normal levels. Though FY2021 is expected to be impacted by supply disruption, the strong recovery is anticipated in FY2022. Further scale up in the performance of non-cigarette FMCG business and improvement in the margins would be trigger for the stock going in the medium to long term. Also strong cash flows and cheery dividend payout makes it good bet in the current uncertain environment.

Key Risks

- Significant rise in taxes on cigarettes or government actions to curb tobacco and tobacco consumption would act as a key risk to the cigarette business.
- Sustained consumption slowdown would affect the growth rate of categories such as consumer goods and hotels in the near term.

Additional Data

Key management personnel

Sanjiv Puri	Chairman and Managing Director
Rajiv Tandon	Executive Director and Chief Financial Officer
Sandeep Kaul	Divisional Chief Executive
Rajendra Kumar Singhi	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	British American Tobacco PLC	29.4
2	Life Insurance Corp of India	16.3
3	Oriental Insurance Co Ltd	11.1
4	Unit Trust of India	7.9
5	HDFC Asset Management Co Ltd	2.2
6	ICICI Prudential Asset Management	2
7	SBI Funds Management Pvt Ltd	2
8	General Insurance Corp of India	1.8
9	New India Assurance Co Ltd	1.5
10	Republic of Singapore	1.5

Source: Bloomberg

Sharekhan

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