

ITC

Refer to important disclosures at the end of this report

FMCG margins can surprise; cigarette recovery holds key

CMP: Rs 201
as of (July 23, 2020)TP: Rs 255 (▲)
12 months

Rating: BUY (■)

Upside: 19.6 %

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- We believe ITC can surprise on FMCG margins which may reach close to double-digits in FY21, with EBIT almost doubling. We increase ITC's FY21-23E earnings by ~3%, driven by increase in FMCG margin assumptions to 10-11% from a conservative 7-7.5% earlier.
- The performance of foods businesses of BRIT and HUL and our channel checks indicate strong traction for ITC's foods division (85% of FMCG), which can offset the weakness in the non-essential portfolio and drive healthy growth. Low ad spends, benign input prices and scale efficiencies can potentially drive a jump in margins, similar to BRIT.
- Cigarettes remain the key earnings driver, and higher pace of recovery in cigarettes should improve growth visibility. The recovery in ITC's cigarette business seems to be faster than peers, indicating market share gains, which can be a key positive.
- Excluding the value of other segments, the cigarette division is trading at 11x earnings (see Exhibit 11), in line with global peers despite the higher growth potential. We value ITC at 18x Sept-22E EPS and increase TP to Rs255 from Rs240. Faster recovery in cigarettes and strong profitability in FMCG can drive re-rating. Maintain Buy/OW in EAP.

Strong trends in foods can double FMCG EBIT and margins: ITC's FMCG segment seems well-poised to gain from the current strong demand trend led by higher in-home consumption. Our channel checks and BRIT/HUVR results suggest ITC's food business (85% of FMCG) can deliver healthy growth and can more than offset the weakness in the non-essential portfolio (~15% of sales). Strong growth, along with benign inputs and low ad spends and efficiencies, can drive a significant improvement in the segment margins. FMCG segment was already recording higher-than-expected margin gains (+300bps in 2 years), which may increase further. We now forecast FY21/22 FMCG EBITDA margins of 9.2%/10.8% (7-7.5% earlier) vs. 7.1% in FY20, which can result in EBIT doubling in FY21.

Cigarettes recovery and outperformance vs. peers can be key positives: Cigarette business had recovered to 80-85% of last year at the time of Q4FY20 results in June. Like FMCG, cigarettes also witnessed a further improvement, with the recovery faster than that of peers, as per our channel checks. Although Q1 will be affected by the lockdown, sequential improvement can improve earnings visibility and drive upsides to EBIT, in our view. We estimate cigarette sales/EBIT decline of 47%/55% for Q1 and 7%/14% for FY21.

Valuations similar to global peers despite higher growth potential; Buy: After significant underperformance, valuations at 16x FY22E EPS provide comfort, as the cigarette business' valuation at ~11x is similar to global peers (see Exhibit 11) despite the higher growth outlook. The increase in FMCG forecasts lead to ~3% rise in our earnings estimates for ITC. We increase ITC's TP to Rs255, valuing it at 18x Sept-22E EPS. Faster recovery in cigarettes, along with market share gains and strong improvement in FMCG profitability, can provide room for further re-rating.

Please see our sector model portfolio (Emkay Alpha Portfolio): [Consumer Goods & Retail \(page 6\)](#)

Financial Snapshot (Standalone)

(Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Revenue	4,49,957	4,56,197	4,45,344	5,19,589	5,66,964
EBITDA	1,73,055	1,79,043	1,59,888	2,00,614	2,20,676
EBITDA Margin (%)	38.5	39.2	35.9	38.6	38.9
APAT	1,24,643	1,52,682	1,29,781	1,61,814	1,79,442
EPS (Rs)	10.2	12.4	10.6	13.2	14.6
EPS (% chg)	13.3	22.2	(15.0)	24.7	10.9
ROE (%)	22.8	25.8	21.1	25.2	26.5
P/E (x)	19.7	16.2	19.0	15.2	13.7
EV/EBITDA (x)	13.3	12.7	14.1	11.2	10.0
P/BV (x)	4.2	4.1	3.9	3.7	3.5

Source: Company, Emkay Research



Change in Estimates

EPS Chg FY21E/FY22E (%)	1.5/2.8
Target Price change (%)	6.3
Target Period (Months)	12
Previous Reco	BUY

Emkay vs Consensus

EPS Estimates		
	FY21E	FY22E
Emkay	10.6	13.2
Consensus	11.6	13.3
Mean Consensus TP (12M)	Rs 234	

Stock Details

Bloomberg Code	ITC IN
Face Value (Rs)	1
Shares outstanding (mn)	12,293
52 Week H/L	273 / 135
M Cap (Rs bn/USD bn)	2,467 / 33.00
Daily Avg Volume (nos.)	3,09,34,740
Daily Avg Turnover (US\$ mn)	78.2

Shareholding Pattern Jun '20

Promoters	-%
FII	14.6%
DII	42.0%
Public and Others	43.4%

Price Performance

(%)	1M	3M	6M	12M
Absolute	8	11	(16)	(26)
Rel. to Nifty	1	(8)	(8)	(25)

Relative price chart



Source: Bloomberg

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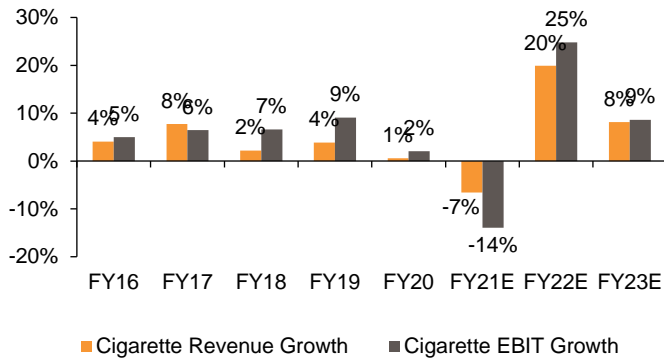
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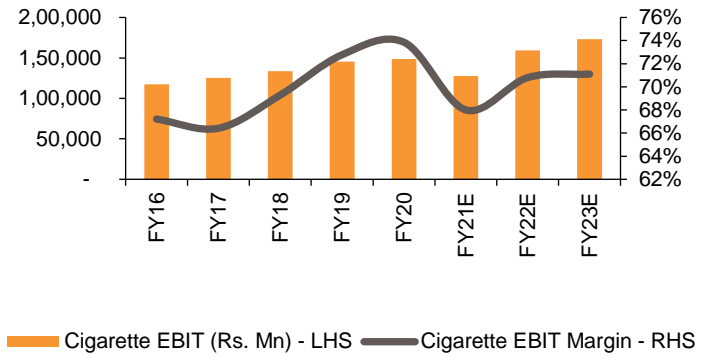
Story in charts

Exhibit 1: Cigarettes should bounce back after a weak FY21, impacted by lockdown in Q1



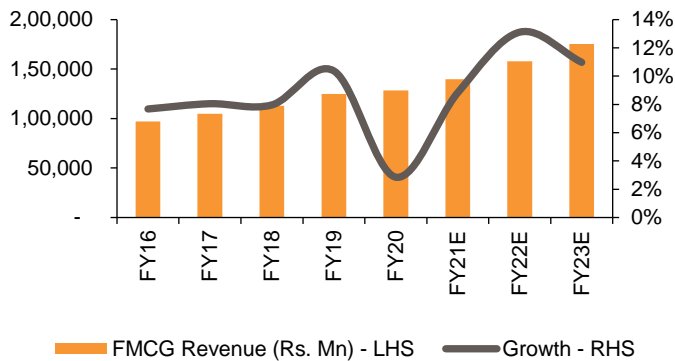
Source: Company, Emkay Research

Exhibit 2: Cigarette EBIT margins to recover in FY22 with sales and volumes



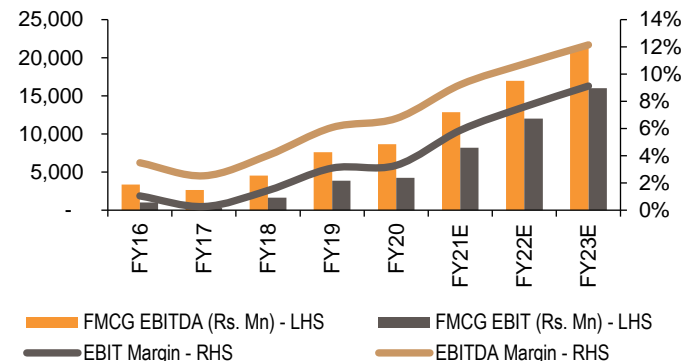
Source: Company, Emkay Research

Exhibit 3: FMCG revenue growth has been steady; may see upsides from stronger traction in foods



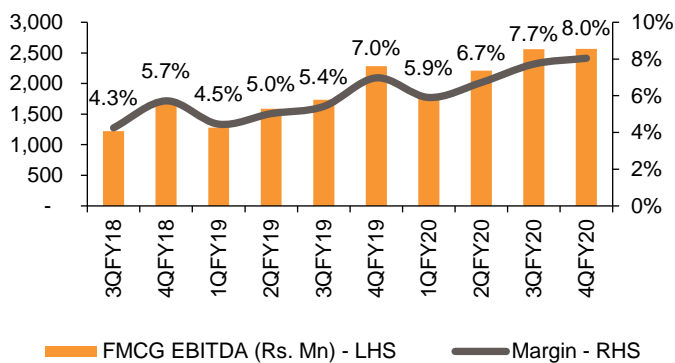
Source: Company, Emkay Research

Exhibit 4: Margin expansion had accelerated; may see further step-up



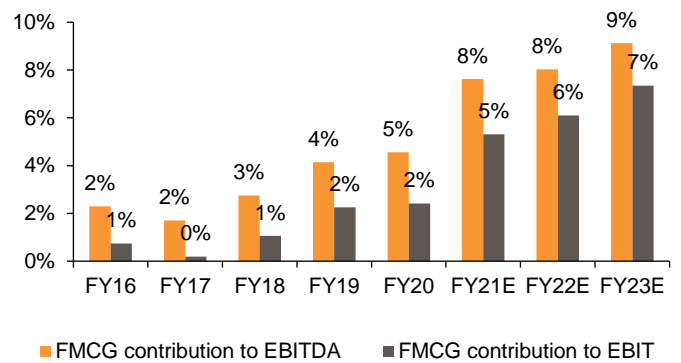
Source: Company, Emkay Research

Exhibit 5: Margins were already witnessing strong improvement

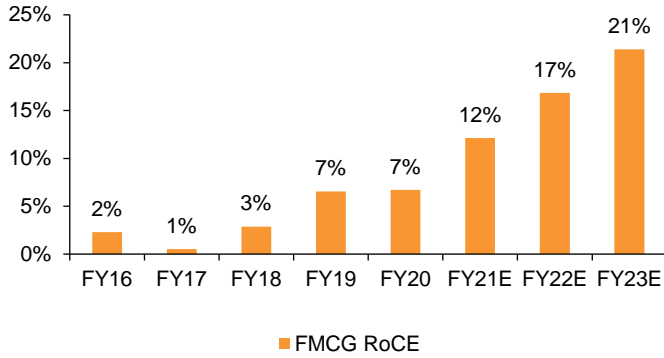


Source: Company, Emkay Research

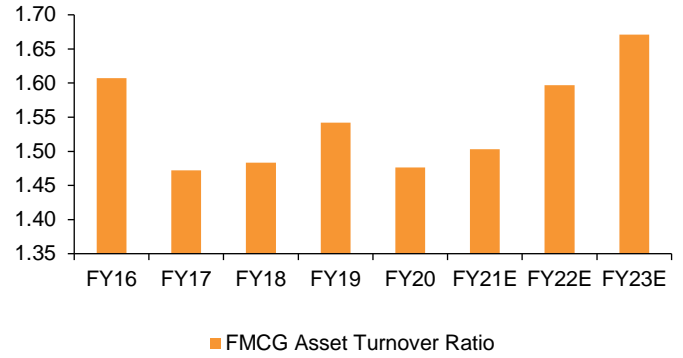
Exhibit 6: FMCG earnings contribution can improve meaningfully



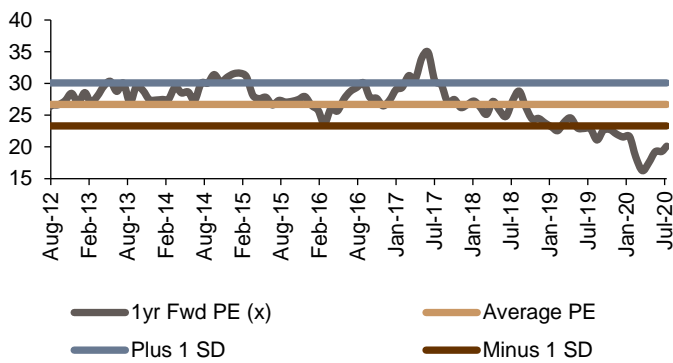
Source: Company, Emkay Research

Exhibit 7: Strong margins expansion and lower capex can drive FMCG ROCEs above 20%

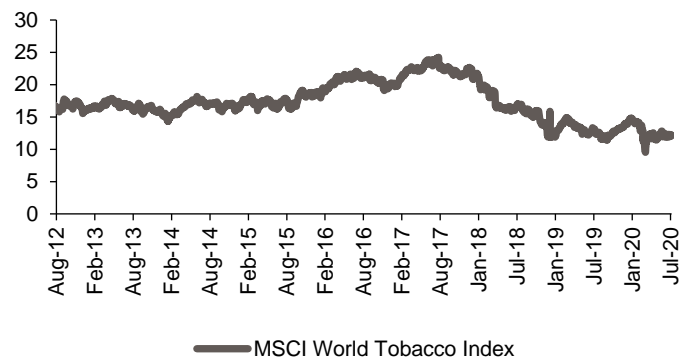
Source: Company, Emkay Research

Exhibit 8: Asset turnover far lower than peers and should improve with growth

Source: Company, Emkay Research

Exhibit 9: Sharp de-rating more than factors in the risks

Source: Company, Emkay Research

Exhibit 10: Global tobacco companies trading at 12x; similar to ITC's derived cigarette business valuation

Source: Company, Emkay Research

Exhibit 11: ITC's cigarette division trading at just 11x

Segment	Value Rs/ share	Value Rs mn	Multiples
FMCG	47	574,355	30x Sept-22 EBITDA
Hotels	3	36,212	12x EV / EBITDA
Agri business	4	52,969	5x EV/EBITDA
Paper & Paperboards	13	164,481	8x EV/EBITDA
Cash and current investments	20	184,380	
Total of the non-cigarettes business divisions (A)	87	1,012,396	
Current Mcap of ITC (B)	200	2,458,400	
Derived value of cigarettes division (B-A) - (C)	113	1,384,544	
	EPS	PAT	
Cigarette earnings (D)	10.1	124,450	Cigarettes Sept 22 EBIT x (1-ETR)
Cigarette division PE (C/D)	11		

Source: Company, Emkay Research

Exhibit 12: Revision in estimates

Y/E, Mar (Rs. mn)	FY21E			FY22E			FY23E		
	Earlier	Revised	% Change	Earlier	Revised	% Change	Earlier	Revised	% Change
Revenues	441,047	445,344	1.0	517,091	519,589	0.5	564,217	566,964	0.5
EBITDA	156,925	159,888	1.9	194,230	200,614	3.3	214,329	220,676	3.0
EBITDA Margin (%)	35.6	35.9	30 bps	37.6	38.6	100 bps	38	38.9	90 bps
APAT	127,713	129,781	1.6	157,316	161,814	2.9	174,722	179,442	2.7
EPS	10.4	10.6	1.5	12.8	13.2	2.8	14.2	14.6	2.8

Source: Company, Emkay Research

Key Financials (Standalone)**Income Statement**

Y/E Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Revenue	4,49,957	4,56,197	4,45,344	5,19,589	5,66,964
Expenditure	2,76,901	2,77,155	2,85,456	3,18,974	3,46,289
EBITDA	1,73,055	1,79,043	1,59,888	2,00,614	2,20,676
Depreciation	13,117	15,633	15,983	16,788	17,519
EBIT	1,59,938	1,63,410	1,43,905	1,83,827	2,03,157
Other Income	24,845	30,137	30,156	33,059	37,296
Interest expenses	342	557	557	557	557
PBT	1,84,442	1,92,989	1,73,504	2,16,329	2,39,895
Tax	59,798	40,308	43,723	54,515	60,454
Extraordinary Items	0	(1,321)	0	0	0
Minority Int./Income from Assoc.	0	0	0	0	0
Reported Net Income	1,24,643	1,51,361	1,29,781	1,61,814	1,79,442
Adjusted PAT	1,24,643	1,52,682	1,29,781	1,61,814	1,79,442

Balance Sheet

Y/E Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Equity share capital	12,259	12,292	12,292	12,292	12,292
Reserves & surplus	5,67,239	5,93,834	6,12,985	6,45,731	6,83,812
Net worth	5,79,498	6,06,126	6,25,277	6,58,023	6,96,104
Minority Interest	0	0	0	0	0
Loan Funds	79	0	0	0	0
Net deferred tax liability	23,888	23,888	23,888	23,888	23,888
Total Liabilities	6,03,465	6,30,014	6,49,165	6,81,911	7,19,993
Net block	1,84,864	1,90,731	1,87,248	1,88,860	1,89,741
Investment	2,65,780	2,65,780	2,65,780	2,65,780	2,65,780
Current Assets	2,13,322	2,29,155	2,49,894	2,95,519	3,42,064
Cash & bank balance	37,687	61,406	80,321	1,01,123	1,29,441
Other Current Assets	25,780	27,759	29,663	33,088	36,326
Current liabilities & Provision	94,514	89,666	87,770	1,02,262	1,11,606
Net current assets	1,18,808	1,39,489	1,62,124	1,93,257	2,30,457
Misc. exp	0	0	0	0	0
Total Assets	6,03,465	6,30,014	6,49,165	6,81,911	7,19,993

Cash Flow

Y/E Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
PBT (Ex-Other income) (NI+Dep)	1,59,596	1,62,853	1,43,347	1,83,269	2,02,600
Other Non-Cash items	0	0	0	0	0
Chg in working cap	(8,957)	3,036	(3,719)	(10,332)	(8,882)
Operating Cashflow	1,29,146	1,70,587	1,42,603	1,68,827	1,88,636
Capital expenditure	(26,079)	(21,500)	(12,500)	(18,400)	(18,400)
Free Cash Flow	1,03,067	1,49,087	1,30,103	1,50,427	1,70,236
Investments	(31,808)	0	0	0	0
Other Investing Cash Flow	(24,845)	(30,137)	(30,156)	(33,059)	(37,296)
Investing Cashflow	(57,887)	(21,500)	(12,500)	(18,400)	(18,400)
Equity Capital Raised	54	33	0	0	0
Loans Taken / (Repaid)	(32)	(79)	0	0	0
Dividend paid (incl tax)	(78,911)	(1,24,766)	(1,10,630)	(1,29,068)	(1,41,360)
Other Financing Cash Flow	19,711	0	0	0	0
Financing Cashflow	(59,520)	(1,25,369)	(1,11,187)	(1,29,625)	(1,41,918)
Net chg in cash	11,739	23,718	18,916	20,801	28,319
Opening cash position	25,949	37,687	61,406	80,321	1,01,123
Closing cash position	37,687	61,406	80,321	1,01,123	1,29,441

Source: Company, Emkay Research

Key Ratios

Profitability (%)	FY19	FY20	FY21E	FY22E	FY23E
EBITDA Margin	38.5	39.2	35.9	38.6	38.9
EBIT Margin	35.5	35.8	32.3	35.4	35.8
Effective Tax Rate	32.4	20.9	25.2	25.2	25.2
Net Margin	27.7	33.5	29.1	31.1	31.6
ROCE	32.5	31.4	27.2	32.6	34.3
ROE	22.8	25.8	21.1	25.2	26.5
RoIC	65.4	61.1	53.5	66.8	71.1

Per Share Data (Rs)	FY19	FY20	FY21E	FY22E	FY23E
EPS	10.2	12.4	10.6	13.2	14.6
CEPS	11.2	13.7	11.9	14.5	16.0
BVPS	47.3	49.3	50.9	53.5	56.6
DPS	5.8	10.2	9.0	10.5	11.5

Valuations (x)	FY19	FY20	FY21E	FY22E	FY23E
PER	19.7	16.2	19.0	15.2	13.7
P/CEPS	24.9	20.5	23.6	19.3	17.5
P/BV	4.2	4.1	3.9	3.7	3.5
EV / Sales	5.2	5.1	5.1	4.4	3.9
EV / EBITDA	13.3	12.7	14.1	11.2	10.0
Dividend Yield (%)	2.9	5.1	4.5	5.2	5.7

Gearing Ratio (x)	FY19	FY20	FY21E	FY22E	FY23E
Net Debt/ Equity	(0.3)	(0.3)	(0.3)	(0.3)	(0.4)
Net Debt/EBITDA	(0.9)	(1.0)	(1.3)	(1.1)	(1.2)
Working Cap Cycle (days)	65.8	62.5	67.0	64.7	65.0

Growth (%)	FY19	FY20	FY21E	FY22E	FY23E
Revenue	10.8	1.4	(2.4)	16.7	9.1
EBITDA	11.4	3.5	(10.7)	25.5	10.0
EBIT	11.1	2.2	(11.9)	27.7	10.5
PAT	11.1	21.4	(14.3)	24.7	10.9

Quarterly (Rs mn)	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20
Revenue	1,19,921	1,15,028	1,18,715	1,18,056	1,08,422
EBITDA	45,717	45,657	45,624	46,127	41,635
EBITDA Margin (%)	38.1	39.7	38.4	39.1	38.4
PAT	34,114	31,739	40,231	41,419	37,970
EPS (Rs)	2.8	2.6	3.3	3.4	3.1

Source: Company, Emkay Research

Shareholding Pattern (%)	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
Promoters	-	-	-	-	-
FII	16.7	15.6	15.2	14.6	14.6
DII	38.3	42.4	42.5	42.4	42.0
Public and Others	44.9	42.0	42.3	43.0	43.4

Source: Capitaline

Emkay Alpha Portfolio – Consumer Goods & Retail



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Sector

Consumer Goods & Retail

Analyst bio

Ashit Desai holds a PGDM and FRM (US GARP) with 12 years of research experience on the sell side. His team currently covers 24 stocks in the Indian Consumer and Retail space.

EAP sector portfolio

Company Name	BSE200 Weight	EAP Weight	OW/UW (%)	OW/UW (bps)	EAP Weight (Normalised)
Consumer Goods & Retail	12.84	12.84	0%	0	100.00
Asian Paints	1.29	0.57	-56%	-72	4.40
Berger Paints	0.21	0.00	-100%	-21	0.00
Britannia Industries	0.75	1.29	72%	54	10.08
Colgate-Palmolive	0.31	0.48	53%	17	3.71
Dabur India	0.46	0.38	-17%	-8	2.94
Emami	0.09	0.00	-100%	-9	0.00
Godrej Consumer Products	0.44	0.00	-100%	-44	0.00
Hindustan Unilever	3.37	2.79	-17%	-58	21.70
ITC	2.81	3.38	20%	57	26.33
Marico	0.30	0.27	-12%	-4	2.08
Nestle India	1.03	0.78	-24%	-25	6.04
Pidilite Industries	0.36	0.00	-100%	-36	0.00
Radico Khaitan	0.00	0.30	NA	30	2.32
United Breweries	0.11	0.48	318%	36	3.72
United Spirits	0.00	0.38	NA	38	2.96
Varun Beverages	0.10	0.35	237%	25	2.73
ABFRL	0.06	0.22	242%	15	1.70
Jubilant FoodWorks	0.21	0.25	16%	4	1.95
Page Industries	0.19	0.00	-100%	-19	0.00
Shoppers Stop	0.00	0.00	NA	0	0.00
Titan Company	0.74	0.94	27%	20	7.35
Cash	12.84	12.84	0%	0	100.00

Source: Emkay Research

* Not under coverage: Equal Weight

■ High Conviction/Strong Over Weight ■ High Conviction/Strong Under Weight

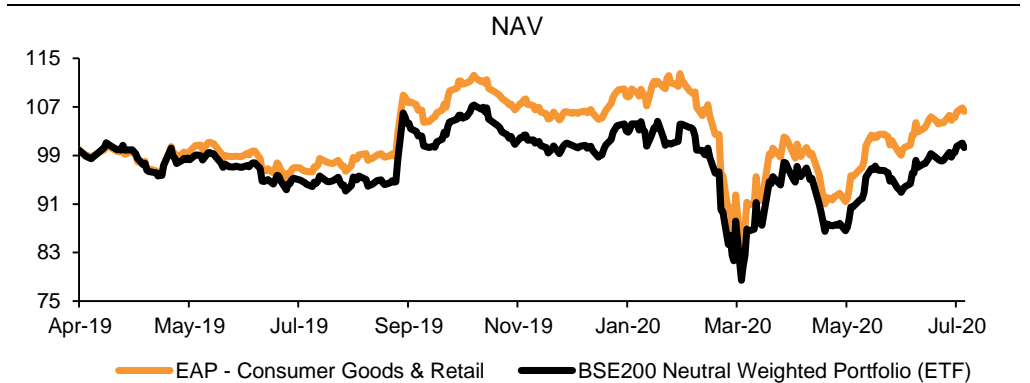
Sector portfolio NAV

	Base					Latest
	1-Apr-19	18-Oct-19	22-Jan-20	22-Apr-20	22-Jun-20	22-Jul-20
EAP - Consumer Goods & Retail	100.0	109.6	108.7	100.9	100.7	106.0
BSE200 Neutral Weighted Portfolio (ETF)	100.0	104.5	102.8	97.2	94.4	99.8

*Performance measurement base date 1st April 2019

Source: Emkay Research

NAV chart



Source: Emkay Research

Please see our model portfolio (Emkay Alpha Portfolio): [SMID](#)

Please see our model portfolio (Emkay Alpha Portfolio): [Nifty](#)

“Emkay Alpha Portfolio – SMID and Nifty are a supporting document to the Emkay Alpha Portfolios Report and is updated on regular intervals”

Emkay Rating Distribution

Ratings	Expected Return within the next 12-18 months.
BUY	Over 15%
HOLD	Between -5% to 15%
SELL	Below -5%

Completed Date: 24 Jul 2020 02:26:48 (SGT)

Dissemination Date: 24 Jul 2020 02:27:48 (SGT)

Sources for all charts and tables are Emkay Research unless otherwise specified.

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