Sharekhan
by BNP PARIBAS

ITC Limited

Essentials did better; cigarette biz recovering

Sector: Consumer Goods
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 200**	
Price Target: **Rs. 250**	↑

↑ Upgrade ↔ No change ↓ Downgrade

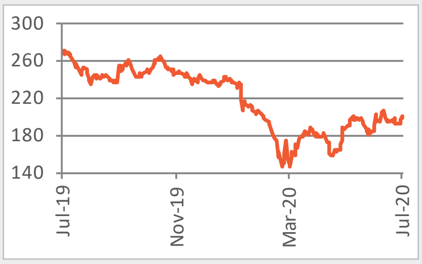
Company details

Market cap:	Rs. 2,45,476 cr
52-week high/low:	Rs. 273/135
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	14.6
DII	42.1
Others	43.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	4.1	10.9	-16.1	-25.5
Relative to Sensex	-5.2	-10.8	-7.8	-26.2

Sharekhan Research, Bloomberg

ITC's Q1FY2021 performance was better than ours as well as the street's expectation mainly on account of a strong growth in essentials segment of the non-cigarette FMCG business and a strong recovery in cigarette sales in June. Revenues and PAT declined by 17% and 26%, respectively, during the quarter. Cigarette sales volume decreased by ~38% y-o-y better than our as well as street expectation of 50-55% decline in sales volume. Non-cigarette FMCG business registered a revenue growth of 12% on comparable basis (excluding education and stationery category, growth was 18%). It was a wash out quarter for the hotel business. Unfavourable revenue mix and increase in excise duty on cigarettes dragged down OPM sharply to 27.9%. Non-cigarette FMCG business will continue to deliver strong performance with essential products gaining strong traction and expanded reach aiding the company for stable supply of products. Cigarette business is recovering and sales volumes are expected to come back on track in the coming quarters. We expect cigarette sales volume to remain flat y-o-y in FY2021 and would see mid-single digit growth in FY2022.

Key positives

- Cigarette sales volume decreased by ~38% as against our and street expectation of a 50-55% decline.
- Essential products' revenue (75% of non-cigarette FMCG business) grew 34% y-o-y.

Key negatives

- Q1 was a wash-out quarter for hotels business due to NIL occupancies
- Paperboard, paper and packaging (PPP) business revenue decreased by ~33% y-o-y.

Our Call

View: Retain Buy with revised price target of Rs. 250: We have raised our earnings estimates by 4-5% by FY2021/FY2022 to factor in better than expected performance in Q1. ITC's key businesses such as cigarettes and non-cigarette FMCG have recovered close to pre-COVID-19 levels. Strong cash flows and extensive distribution reach (pan-India) will help ITC gain market share from small players in coming quarters. The stock is currently trading at a discounted valuation of 15x its FY2022E earnings, which is at significant discount to its historical average multiple. This along with a dividend yield of 5.3% makes it a good bet in the FMCG space. We maintain our Buy recommendation on the stock with a revised price target of Rs. 250 (valuing it at 19x its FY2022E earnings, in line with upward revision in earnings estimates).

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.

Valuation Rs cr

Particulars	FY18	FY19	FY20	FY21E	FY22E
Revenues	40,628	45,784	46,807	46,842	53,339
OPM (%)	38.3	37.8	38.3	37.1	38.4
Adjusted PAT	10,810	12,387	15,170	14,088	16,399
Adjusted EPS (Rs.)	8.5	10.1	12.4	11.5	13.4
P/E (x)	23.5	19.8	16.1	17.3	14.9
P/B (x)	4.7	4.2	3.8	3.8	3.6
EV/EBIDTA (x)	14.2	12.7	12.1	12.4	10.5
RoNW (%)	21.5	22.5	24.8	21.9	24.8
RoCE (%)	28.4	27.8	25.5	23.2	27.0

Source: Company; Sharekhan Research

Revenue declined by 17.4%; margins fell significantly: Net revenue fell by 17.4% y-o-y in Q1FY2021 to Rs. 9,501.8 crore, due to a 29% decline in the core cigarette business affected by disruptions due to a lockdown in the initial part of the quarter. Hotel business posted sharp decline of 94% in revenue. Gross margins declined significantly to 52.2% from 64% in Q1FY2020, due to higher input costs, higher excise duty and change in revenue mix. OPM also plunged to 27.9% in Q1FY2021 from 39.7% in Q1FY2020, mainly on account of higher employee costs and lower operating leverage. Operating profit declined by 42% y-o-y to Rs. 2,646.6 crore. In spite of higher depreciation & interest costs, profit before tax (PBT) declined by 35% y-o-y to Rs. 3,128.4 crore. Lower tax incidence due to a reduction in corporate tax caused reported PAT to decline by 26.2% y-o-y to Rs. 2,342.8 crore.

Cigarette business volumes fell by 38%, margins declined: Cigarette business sales volume declined by 38% in Q1FY2021, better than our as well as the street's estimates of 50-55% volume decline, as the lockdown disrupted manufacturing and selling & distribution operations. Manufacturing resumed in mid-May and rapidly scaled up. Gross cigarette business revenues fell by 29.1% y-o-y to Rs. 3,853.8 crore. Margins declined significantly to 61.1% from 70.8% on a gross level whereas at a net level (excluding the impact of excise duty), margins declined by just 121 bps. All factories are currently operational at pre-COVID levels. Sales and distribution operations have largely normalised. However, localised lockdowns in some parts of the country might affect the cigarette sales in the near term. With business returning to normalcy and cigarette sales likely to improve sequentially and we expect sales volume to remain flat on a y-o-y basis in FY2021.

Non-cigarette FMCG business registered good growth; margins expanded: ITC's non-cigarette FMCG business revenues increased by 10.3% y-o-y to Rs. 3,374.6 crore (12.2% y-o-y on a comparable basis excluding the discontinued retail business) driven by heightened awareness of quality products, focus on health and immunity and rising trend of in-home consumption. Excluding education and stationery products business, which was impacted by the closure of educational institutions, revenue grew by 18.8% y-o-y. Staples, convenience foods and health & hygiene products, representing around 75% of the portfolio, recorded strong growth of 34%, whereas discretionary categories fell by 25%. An enhanced scale, product mix enrichment and other strategic cost management initiatives led margins to expand by 117 bps in Q1FY2021. Segmental PBIT rose by 60.7% y-o-y. EBITDA grew by 42% y-o-y to Rs. 257 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, sanitisers, etc, witnessed robust demand and gained market share. Manufacturing of these categories have scaled up to 100%. Most of these categories are registering robust growth. 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 Savlon antiseptic liquid, soap, hand wash, hand-sanitisers and Fiama handwash products in the market. All formats of Savlon (including newly launched products) grew strongly driven by significant surge in demand, backed by innovative products and rapid scale-up in capacity. The company launched several innovative products under Savlon in record time. All the new launches are gaining good traction. ITC wants to expand the newly-acquired Sunrise brand pan-India on the 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 enhance its direct reach and invest in modern trade/e-commerce channels which are doing exceptionally well.

Hotel business expected to remain an under performer in FY2021: Revenue declined by 94.2% y-o-y, driven by severe disruptions in operations with the onset of COVID-19 pandemic. 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. The hotel business reported a loss before interest and tax of Rs. 242.6 crore. However, the business resumed operations in accordance with prescribed guidelines from the second week of June. We expect the hotel business to underperform in FY2021 owing to disruption in tourism and business due to the pandemic. However, if the vaccine is discovered by the end of the year, we can see faster recovery in the travel and tourism sector. The long-term potential of the sector is intact.

Agri business on recovery: Revenue of the agri-business grew by 3.7% y-o-y driven by trading opportunities mainly in oilseeds and rice. PBIT margins fell by 85 bps, mainly lower exports of leaf tobacco in Q1FY2021 and unfavourable mix. 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 leveraging its e-Choupal network to scale up direct farm purchases. The business was able to ramp up the volume of wheat procurement substantially to cater to the surge in demand for Aashirvaad atta. The business also ramped up the direct milk sourcing network in West Bengal to cater to the increasing requirements on the back of the growing franchise of the Aashirvaad Svasti range of dairy products. 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. The 'ITC Master Chef' range of frozen snacks posted robust growth in the retail channel. The range was augmented with the launch of eight new variants and was extended to 70+ cities during the quarter. The business is well-poised to support its branded packaged food business. We expect agri-business to deliver steady performance in FY2021.

Revenue of the Paperboards, Paper & Packaging (PPP) business declined by 32.8% y-o-y affected by a fall in rural demand and a slowdown in demand especially in the liquor segment and adverse impact in publications. Significant growth in exports partly mitigated weak domestic demand environment. The PPP business' PBIT margin declined by 599 bps to 15.6%. 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 a recovery in the key businesses.

Results (Standalone) — Rs cr

Particulars	Q1FY21	Q1FY20	y-o-y (%)	Q4FY20	q-o-q (%)
Net revenue	9501.8	11502.8	-17.4	11420.0	-16.8
Total expenditure	6855.2	6937.1	-1.2	7256.5	-5.5
Operating Profit	2646.6	4565.7	-42.0	4163.5	-36.4
Other income	896.8	620.2	44.6	755.5	18.7
Interest	16.8	15.2	10.3	14.7	14.0
Depreciation	398.2	358.9	10.9	392.5	1.4
Profit before tax	3128.4	4811.7	-35.0	4511.8	-30.7
Tax	785.7	1637.8	-52.0	1054.8	-25.5
Adjusted PAT	2342.8	3173.9	-26.2	3457.1	-32.2
Exceptional item	0.0	0.0	-	340.0	-
Reported PAT	2342.8	3173.9	-26.2	3797.1	-38.3
EPS (Rs.)	1.9	2.6	-27.3	2.8	-32.2
			bps		**bps**
GPM (%)	52.2	64.0	-	59.3	-708
OPM (%)	27.9	39.7	-	36.5	-860

Source: Company; Sharekhan Research

Segmental revenue (Standalone) — Rs cr

Particulars	Q1FY21	Q1FY20	y-o-y (%)	Q4FY20	q-o-q (%)
FMCG – cigarettes	3853.8	5433.4	-29.1	5130.5	-24.9
FMCG – others	3374.6	3060.1	10.3	3183.6	6.0
Hotels	22.6	392.6	-94.2	465.8	-95.2
Agri	3746.3	3611.2	3.7	1887.3	98.5
Paperboard, Paper and Packaging	1026.4	1527.5	-32.8	1458.9	-29.6
Total	**12023.7**	**14024.8**	**-14.3**	**12126.0**	**-0.8**
Less: inter segment sales	1803.6	2663.5	-32.3	825.9	118.4
Gross Sales	**10220.1**	**11361.4**	**-10.0**	**11300.1**	**-9.6**

Source: Company; Sharekhan Research

Segmental PBIT (Standalone) — Rs cr

Business segments	PBIT (Rs. crore)			Margins (%)		
	Q1FY21	Q1FY21	Q1FY20	y-o-y (%)	Q4FY20	q-o-q (%)
FMCG - cigarettes	2356.4	3849.1	-38.8	61.1	70.8	-
FMCG - others	125.4	78.0	60.7	3.7	2.5	117
Hotels	-242.6	10.4	-	-	2.6	-
Agri	178.7	203.0	-11.9	4.8	5.6	-85
Paperboard, Paper and Packaging	160.1	329.8	-51.4	15.6	21.6	-599
Total	**2578.1**	**4470.3**	**-42.3**	**21.4**	**31.9**	**-**

Source: Company; Sharekhan Research

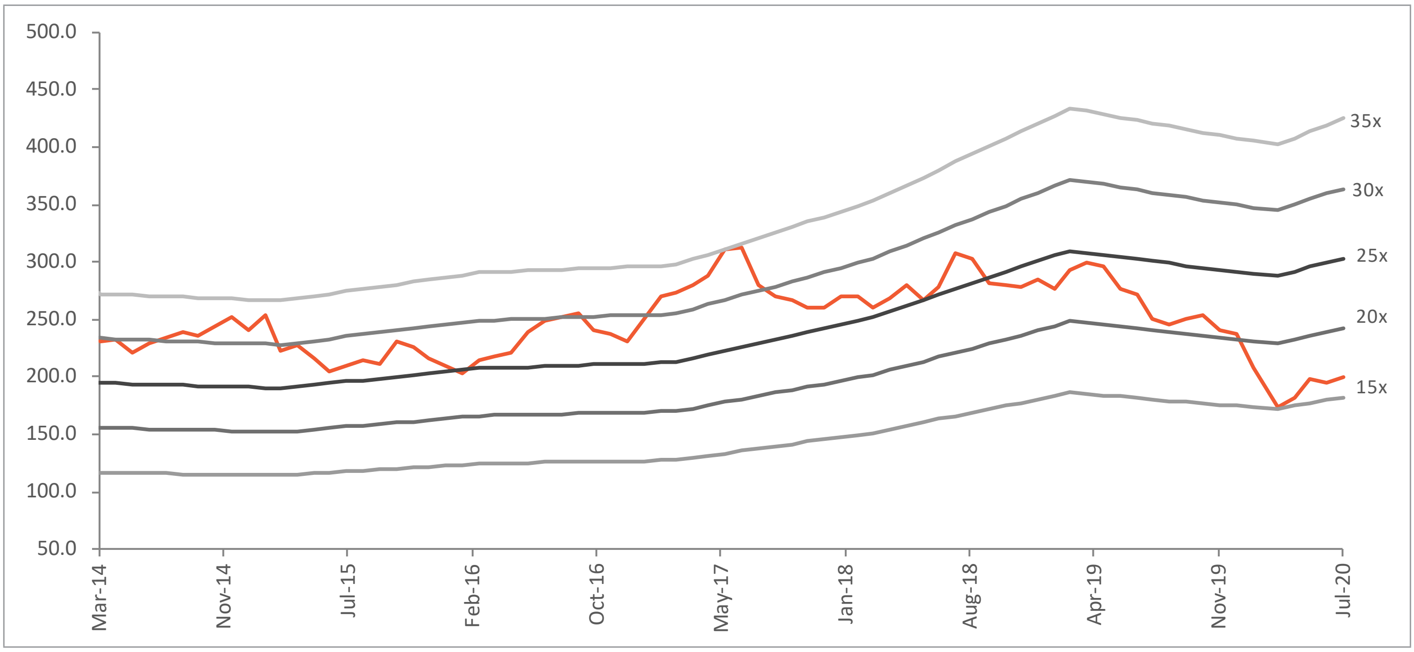
Outlook

Cigarette sales volume to remain flat; FMCG business to double digit growth in FY2021: Q1FY2021 performance was better than expectation with capacity utilisation in key businesses such as cigarette and non-cigarette FMCG returning to pre-COVID levels. We expect sales of cigarettes, non-cigarette FMCG and agri-products to grow y-o-y from Q2FY2021. Hotels business will continue to be affected by fear among travellers and NIL bookings from business tourists. The PPP business will see gradual improvement in the coming quarters with an overall improvement in cigarette business (education and stationery segment will take time to recover). Overall, we expect ITC revenues to remain flat (as against our earlier expectation of 4-5% decline in net revenues) y-o-y with 118 bps decline in OPM to 37.1% (affected by unfavourable revenue mix). We expect FY2022 to be much better than FY2021.

Valuation

We have raised our earnings estimates by 4-5% by FY2021/FY2022 to factor in better than expected performance in Q1. ITC's key businesses such as cigarettes and non-cigarette FMCG have recovered close to pre-COVID-19 levels. Strong cash flows and extensive distribution reach (pan-India) will help ITC gain market share from small players in coming quarters. The stock is currently trading at a discounted valuation of 15x its FY2022E earnings, which is at significant discount to its historical average multiple. This along with a dividend yield of 5.3% makes it a good bet in the FMCG space. We maintain our Buy recommendation on the stock with a revised price target of Rs. 250 (valuing it at 19x its FY2022E earnings, in line with upward revision in earnings estimates).

One-year forward P/E (x) 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	69.3	60.6	48.5	49.2	42.7	36.5	105.2	39.7	28.5
ITC	16.1	17.3	14.9	12.1	12.4	10.5	25.5	23.2	27.0

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	Unit Trust of India	7.9
4	SBI Funds Management Pvt Ltd	2.6
5	HDFC Asset Management Co Ltd	2.3
6	General Insurance Corp of India	1.8
7	ICICI Prudential Asset Management	1.6
8	JPMorgan Chase & Co	1.6
9	New India Assurance Co Ltd	1.5
10	Republic of Singapore	1.2

Source: Bloomberg

Sharekhan

by BNP PARIBAS

Know more about our products and services

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