Sharekhan by BNP PARIBAS

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ITC Limited

FMCG continues the good run; Cigarette volume growth stood at 8%

Consumer Goods	Sharekhan code: ITC	Result Update

Stock Update

3R MATRIX	+	=	-
Right Sector (RS)		✓	
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 215**	
Price Target: **Rs. 265**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

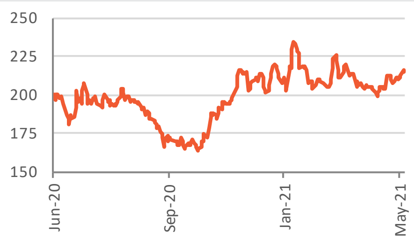
Company details

Market cap:	Rs. 2,64,640 cr
52-week high/low:	Rs. 239 / 163
NSE volume: (No of shares)	344.7 lakh
BSE code:	500875
NSE code:	ITC
Free float: (No of shares)	1230.9 cr

Shareholding (%)

Promoters	0.0
FII	13.7
DII	42.5
Others	43.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	7.0	3.9	10.6	9.0
Relative to Sensex	0.4	-0.3	-5.7	-46.9

Sharekhan Research, Bloomberg

Summary

- ITC's Q4FY2021 cigarettes sales volume growth stood at 8% (net sale grew by 7%), in-line with street expectation of 8%-9% growth; EBIDTA margin up by 70 bps y-o-y. Sales volume recovered to pre-COVID level in Q4.
- Non-cigarette FMCG business revenue grew by ~16% each in Q4FY2021 and FY2021. EBIDTA margin reached ~9% in FY2021 (up by 590 bps over FY2018).
- With no increase in tax rate on cigarettes, we expect cigarette sales volume to gradually pick up (Q1FY2022 might some hiccup due to lockdown restrictions); FMCG is gaining good traction and will maintain its double-digit revenue growth and OPM expansion in the medium term.
- The stock is currently trading at attractive valuation of 15.4x its FY2023E EPS. The company paid dividend of Rs. 10.75 per share (dividend yield of 5%). We maintain Buy with a revised PT of Rs. 265.

ITC registered mixed performance in Q4FY2021 with revenue growing by 24% (boosted by 79% growth in agri-business), while OPM was down by 486 bps to 31.6% due to change in revenue mix and lower profitability in the hotel business. The cigarette business's net revenue (excluding the excise duty) grew by ~6.7% y-o-y with volume growth of 8% (versus volume decline of 7% in Q3 and 12% in Q2). EBIDTA margin of the cigarette business improved by 70 bps. Non-cigarette FMCG business revenue grew by ~16%, driven by 13% growth in staples, convenience foods, and health and hygiene products, while out-of-home categories registered strong recovery with 23% growth. EBIDTA margin of the FMCG business stood flat on a y-o-y basis to 8.3% in Q4, while it improved by 180 bps y-o-y for FY2021. Agri business performance was the highlight of the quarter with revenue growth of 79%, driven by strong export opportunities in low-margin commodities such as wheat, rice, and oilseeds and good recovery in the leaf tobacco business. Hotel business also posted sequential improvement with revenue recovery to 62% of pre-COVID level in Q4 and posted EBIDTA of Rs. 25 crore (fixed cost was cut by 41% in FY2021). Despite disruption in H1FY2021, ITC managed to end the year with revenue growth of ~4%, led by sustained double-digit growth in non-cigarette FMCG business, strong recovery in cigarette business sales in H2FY2021, and agri business posting robust performance in Q4. We expect cigarette sales volume to be affected by limited shops hours in key states in Q1 (but will be higher on a y-o-y basis as cigarettes shops were not allowed to operate during nationwide lockdown in Q1FY2020). With no hike on cigarettes in the Union Budget, we do not expect any price hike in the cigarette portfolio, which will help cigarette sales volume to improve in the subsequent quarters with expected improvement in the mobility with easing of lockdown restrictions. On the other hand, non-cigarette FMCG business would maintain good growth momentum. However, demand for essentials has normalised compared to robust demand during the first wave of COVID-19. Further, the company has worked on supply efficiency to maintain products available on retail shelves. Improving penetration of key categories, higher rural demand, and strong traction to new launches (120+ new products launched in FY2021) would help the non-cigarette FMCG business to report good growth momentum in the near to medium term. Margin expansion of the non-cigarette FMCG business would sustain, with scale up in revenue of products/categories and better revenue mix. With receding virus scare and improving mobility, pent-up demand would help the hotel business to post strong performance in FY2023. Agri business is expected to perform well on account of good export demand for some of the low-margin commodities (Q4FY2021 performance was one-off and growth to normalise in the coming quarters). The company paid final dividend of Rs. 5.75 per share in Q4FY2021. Along with interim dividend of Rs. 5.0 per share, total payout for FY2021 stands at Rs. 10.75 per share (dividend yield of 5%).

Key positives

- Agri business revenue grew by ~79%, driven by export opportunities in wheat, rice, and oilseeds.
- Hotel business recovered to 62% and EBIDTA stood at Rs. 25 crore, led by strong reduction in fixed cost (down by 41% y-o-y).
- Non-cigarette FMCG business margin improved by 180 bps in FY2021 (improved by 490 bps over three years).
- Cigarette business volumes recovered to pre-COVID level in Q4; EBIDTA margin improved by 70 bps y-o-y.

Key negatives

- ITC's OPM was down by 486 bps to 31.6% due to change in revenue mix.

Our Call

View - Retained Buy with an unchanged PT of Rs. 265: We have fine-tuned our earnings estimates to factor in better-than-expected revenue in the agri business, hotels and non-cigarette FMCG businesses and lower margins due to change in mix. With no major increase in taxes on cigarettes in Union Budget, we expect cigarette sales volume to normalise in the coming quarters (Q1FY2022 might see an impact of lesser operating hours of stores). Management's enhanced focus and redefined growth strategies have aided scaling up of the non-cigarette FMCG business margins. Higher focus is on supply agility and reduction in operating cost in the near term. The stock is currently trading at attractive valuations of 15.4x its FY2023E EPS. Any sustained scale-up in the margins of the cigarette business coupled with normalisation in the core cigarette business would be key triggers for valuation uptick. We maintain our Buy recommendation on the stock with an unchanged PT of Rs. 265.

Key Risks

Any increase in tax on cigarettes or government implementing policies to curb tobacco products consumption or any disruption in consumer demand due to frequent lockdowns would act as key risk to our earnings estimates.

Valuation (Consolidated) Rs cr

Particulars	FY18	FY19	FY20	FY21	FY22E	FY23E
Revenues	40,628	45,784	46,807	48,525	52,281	58,188
OPM (%)	38.3	37.8	38.3	32.0	34.3	37.0
Adjusted PAT	10,810	12,387	15,170	13,032	14,377	17,035
Adjusted EPS (Rs.)	8.5	10.1	12.4	10.7	11.8	14.0
P/E (x)	25.3	21.3	17.3	20.1	18.3	15.4
P/B (x)	5.1	4.5	4.1	4.5	4.4	4.2
EV/EBIDTA (x)	15.4	13.8	13.1	15.4	13.2	10.9
RoNW (%)	21.5	22.5	24.8	21.2	24.2	27.7
RoCE (%)	28.4	27.8	25.5	21.5	25.9	30.4

Source: Company; Sharekhan estimates

Revenue grew by 24%; OPM affected by unfavourable mix: ITC's standalone gross revenue grew by 24% y-o-y to Rs. 14,157 crore, driven mainly by 79% robust growth in the agri business. Core cigarette business gross revenue grew by 14% (net revenue grew by 7%) and non-cigarette FMCG business revenue grew by 16% (on a comparable basis). Gross margin declined significantly to 51.0% in Q4FY2021 from 59.3% in Q4FY2020, largely due to change in revenue mix. OPM also plunged to 31.6% in Q4FY2021 from 36.5% in Q4FY2020, major loss mitigated by stringent cost-reduction initiatives. Operating profit grew by 7.4% y-o-y to Rs. 4,473 crore. Adjusted PAT grew by 8.4% to Rs. 3,748.4 crore. Reported PAT stood almost flat.

Cigarette business volumes grew by 8%; Margin improved by 70 bps: Cigarette business gross sales grew by 14% to Rs. 5,859.6 crore. Net revenue excluding excise duty grew by ~7%. Cigarette sales volume grew by 8%, with business recovering to pre-COVID levels in Q4FY2021. Volumes and revenue witnessed sequential recovery, led mainly by metros and large town markets due to progressive easing of restrictions and enhanced mobility. The company has strengthened its direct reach in target markets across all traditional trade channels; stockist network was also augmented to service rural/semi-urban markets more efficiently. Cigarette business EBIT grew by 8% y-o-y. EBIDTA margin as a percentage of net sales improved by 70 bps y-o-y. State-wise restrictions on operations of stores for limited hour are likely to have an impact on the cigarettes sales volume in Q1FY2022. However, sales will be much better on a y-o-y basis, as there was complete restriction on sale of tobacco products during the nationwide lockdown during Q1FY2020n . ITC took a price hike of 5%-8% in its cigarette portfolio prior to the announcement of Union Budget. With no hike on cigarettes in the Union Budget, we do not expect any further price hike in the cigarette portfolio, which will help cigarette sales volume to improve in the coming quarters.

Non-cigarette FMCG business registered good revenue growth and healthy y-o-y margin expansion: ITC's non-cigarette FMCG business reported revenue of Rs. 3,688 crore, an increase of 15.8% in Q4FY2021. Revenue growth was supported by 23% growth in out-of-home categories and 13% growth in staples, convenience foods, and health and hygiene products. Full-year segment's revenue was reported at Rs. 14,728 crore, up by 16% on a comparable basis (+14.7% on a reported basis). Revenue growth was because of surge in demand for staples, convenience foods, and health and hygiene products in H1FY2021 and strong recovery in the out-of-home portfolio in H2FY2021. Segment EBITDA for Q4FY2021/FY2021 was up by 19%/44%, respectively, on a y-o-y basis. EBITDA margin (comparable basis) expanded by 115 bps in Q4FY2021 to 8.3% and expanded by ~180 bps in FY2021 to 8.9%. ITC's robust brand portfolio, supply chain efficiencies, innovative product launches, and higher operating leverage aided margin expansion. ITC launched over 120 new and innovative and first-to-market products, addressing emergent consumer needs and leveraging the company's Life Sciences and Technology Centre (LSTC). New product launches contribute close to mid-single digit of the business of revenue. ITC formed strategic partnerships, deployed innovative delivery models, and enhanced usage of digital technologies for efficient market servicing. The company was also proactively engaged with e-commerce platforms (5% of the business revenue) and aligned the supply chain to deliver the right product assortment and SKUs. The company pioneered an innovative model - ITC Store on Wheels - to directly service consumers across 13 cities. Market and outlet coverage expanded to 1.3x and 1.1x, respectively, compared to pre-COVID levels. Further, the company is focusing on 1) ICML network to reduce distance to the market and responsive supply chain; 2) delayering operations for direct shipments of products and eliminate multiple handlings; 3) smart manufacturing with focus on automation and yield management; and 4) smart buying and value engineering.

Agri business delivered strong performance: ITC's agri business reported revenue of Rs. 3,369 crore in Q4FY2021 and Rs. 12,582 crore in FY2021, 78.5% and 22.9% growth, respectively. Revenue growth was driven by export opportunities in wheat, rice, and oilseeds, strong growth in value-added spices to food safe markets, higher supplies to support enhanced scale in branded packaged foods business, and higher recovery in leaf tobacco business. Q4 performance was one-off with growth expected to normalise in the coming quarters. The company is focusing on moving up the value chain by leveraging geographical spread and competitive sourcing, long-term supply commitments, adding value-added products in the portfolio for end-use specific offerings, and customised supply chain and infrastructure. Moving up the value chain would help to reduce volatility in revenue and improve margin profile of the business in the long run.

Hotel business reported sequential improvement in performance: The hotel business improved on a sequential basis, backed by higher occupancy due to the wedding business, staycations, and accompanied by robust recovery in the F&B segment. Leisure locations continued to witness strong demand and new F&B initiatives continued to gain traction during the quarter. Segment EBITDA was reported at Rs. 25 crore against breakeven level in Q3FY2021. Profitability improved on account of extreme focus on cost reduction and structural interventions to provide sustained benefits. During the year, controllable cash fixed costs were reduced to the extent of 41%. In Q4FY2021, ITC commissioned Welcomhotel Shimla & Welcomhotel Ahmedabad and Welcomhotel Port Blair was relaunched post comprehensive renovation. Construction of three new properties - ITC Narmada, a luxury collection hotel in Ahmedabad, and Welcomhotels at Bhubaneswar and Guntur - with around 500 rooms is nearing completion.

Paperboards, paper, and packaging (PPP) revenue and profitability recovered on a sequential basis: The PPP segment reported revenue of Rs. 1,656 crore in Q4FY2021, up 13.5% y-o-y and Rs. 5,619 crore in FY2021, a decline of 8%. Strong Q4 performance was due to recovery in domestic demand and robust export growth. Barring publications, notebooks, and wedding cards, most other segments reported higher offtake. Strong growth was reported in specialty papers and cartons and flexibles packaging during the quarter. Higher operational efficiencies partially mitigated impact of softer realisations. Paper Machine Rebuild Project at Bhadrachalam was successfully commissioned in March 2021. During the year, the business launched anti-fungal soap packaging paper and also scaled up its sustainable products portfolio comprising recyclable paperboards, 'FiloPack' and 'FiloServe' for the food delivery and food service segments, respectively, and biodegradable paperboards, 'OmegaBev' and 'OmegaBarr', which are alternatives to plastic-coated containers, cups, and other deep freeze applications.

Result Table (Standalone) Rs cr

Particulars	Q4FY21	Q4FY20	Y-o-Y %	Q3FY21	Q-o-Q %
Net revenue	14157.0	11420.0	24.0	12580.4	12.5
Total expenditure	9683.9	7256.5	33.5	8299.1	16.7
Operating Profit	4473.04	4163.5	7.43	4281.4	4.5
Other income	772.0	755.5	2.2	971.0	-20.5
Interest	3.1	14.7	-78.7	13.8	-77.2
Depreciation	388.0	392.5	-1.2	390.9	-0.8
Profit before tax	4853.9	4511.8	7.6	4847.6	0.1
Tax	1105.5	1054.8	4.8	1184.8	-6.7
Adjusted PAT	3748.4	3457.1	8.4	3662.9	2.3
Exceptional item	0.0	340.0	-	0.0	-
Reported PAT	3748.4	3797.1	-1.3	3662.9	2.3
EPS (Rs.)	3.0	2.8	8.4	3.0	2.3
			bps		**bps**
GPM (%)	51.0	59.3	-834	53.8	-286
OPM (%)	31.6	36.5	-486	34.0	-244

Source: Company; Sharekhan Research

Business-wise revenue Rs cr

Particulars	Q4FY21	Q4FY20	Y-o-Y %	Q3FY21	Q-o-Q %
FMCG - cigarettes	5859.6	5130.5	14.2	5498.4	6.6
FMCG - others	3687.5	3183.6	15.8	3561.8	3.5
Hotels	287.8	465.8	-38.2	235.2	22.4
Agri	3368.9	1887.3	78.5	2481.8	35.7
Paperboard, Paper and Packaging	1655.9	1458.9	13.5	1477.5	12.1
Total	**14859.7**	**12126.0**	**22.5**	**13254.8**	**12.1**
Less: inter segment sales	836.3	825.9	1.3	763.1	9.6
Gross Sales	**14023.4**	**11300.1**	**24.1**	**12491.6**	**12.3**

Source: Company; Sharekhan Research

Business-wise revenue Rs cr

Particulars	PBIT (Rs crore)			Margins (%)		
	Q4FY21	Q4FY20	YoY %	Q4FY21	Q4FY20	Chg in BPS
FMCG - cigarettes	3666.5	3403.0	7.7	62.6	66.3	-376
FMCG - others	188.6	147.0	28.4	5.1	4.6	50
Hotels	-40.1	42.6	-194.1	-13.9	9.1	-
Agri	189.9	123.1	54.2	5.6	6.5	-89
Paperboard, Paper and Packaging	323.3	285.7	13.1	19.5	19.6	-6
Total	**4328.1**	**4001.4**	**8.2**	**29.1**	**33.0**	**-387**

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector Outlook - Cigarette sales would remain under regulatory hurdle, FMCG long's-term growth prospects intact

The domestic cigarette industry is affected by sustained increase in taxes and regulatory regime along with a sharp increase in illegal trade in recent years, especially at the premium end, continue to pose significant challenges to the legal cigarette industry in the country. Though cigarette was skipped from the increased taxes in Union Budget, there is sustained risk of regulatory hurdles implemented to curb tobacco products consumption. On the other hand, outlook for the FMCG industry in India is positive as lower capita consumption, emergence of new categories, and improving demographics provide enough scope for FCMG companies to achieve sustainable revenue growth in the medium to long run.

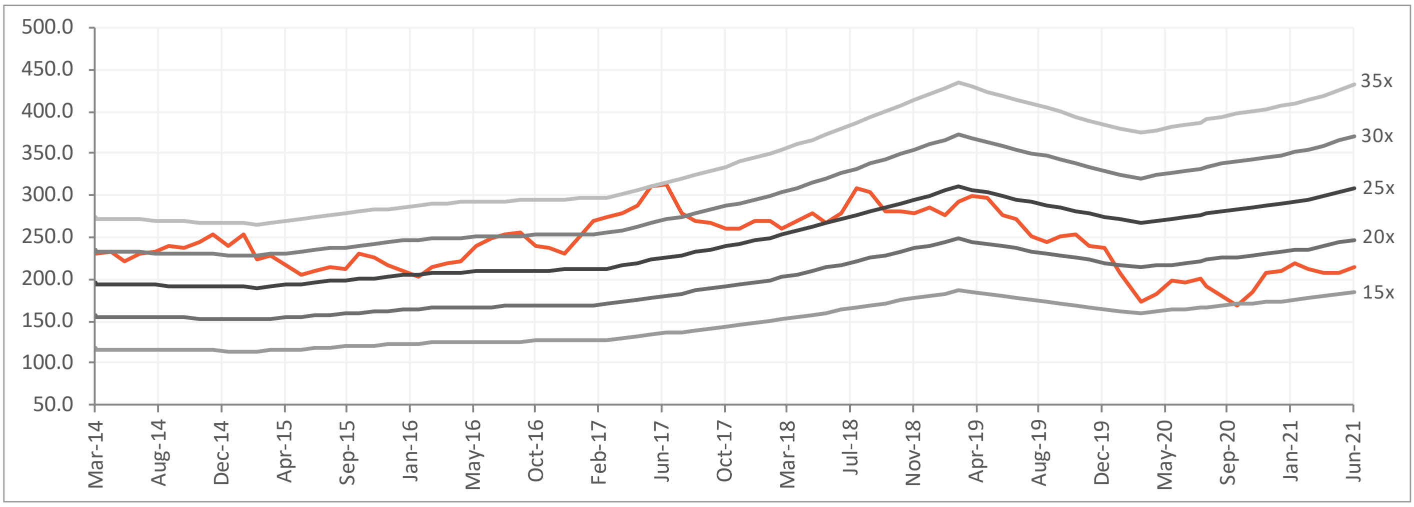
■ Company outlook - Non-cigarette FMCG business remains key growth driver

Despite disruption in H1FY2021, ITC managed to end the year with revenue growth of ~4%, led by sustained double-digit growth in the non-cigarette FMCG business, strong recovery in cigarette business sales in H2FY2021, and agri business posting robust performance in Q4. We expect cigarette sales volume to be affected by limited shops hours in key states in Q1. With no hike on cigarettes in the Union Budget, we do not expect any price hike in the cigarette portfolio, which will help cigarette sales volume to improve in the subsequent quarters with expected easing of state-wise restrictions. On the other hand, non-cigarette FMCG business would continue to maintain the double-digit growth momentum due to higher demand for essentials. FMCG business margins improved to ~9% in FY2021. We expect it to further improve with increased scale of business in the coming years.

■ Valuation - Retain Buy with an unchanged PT of Rs. 265

We have fine-tuned our earnings estimates to factor in better-than-expected revenue in the agri business, hotels and non-cigarette FMCG businesses and lower margins due to change in mix. With no major increase in taxes on cigarettes in Union Budget, we expect cigarette sales volume to normalise in the coming quarters (Q1FY2022 might see an impact of lesser operating hours of stores). Management's enhanced focus and redefined growth strategies have aided scale of the non-cigarette FMCG business margins. Higher focus is on supply agility and reduction in operating cost in the near term. The stock is currently trading at attractive valuations of 15.4x its FY2023E EPS. Any sustained scale-up in the margins of the cigarette business coupled with normalisation in the core cigarette business would be key triggers for valuation uptick. We maintain our Buy recommendation on the stock with an unchanged PT of Rs. 265.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Hindustan Unilever	68.1	55.7	47.5	48.5	40.3	34.5	36.5	27.3	31.5
ITC	20.1	18.3	15.4	15.4	13.2	10.9	21.5	25.9	30.4

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, respectively, 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 the past few years) by scaling up the fast-growing consumer goods and hotel businesses. The company has quickly rebound from the disruption caused by the lockdown and key businesses are operating at normal levels. Though FY2021/FY2022 is expected to be impacted by supply disruption, strong recovery is anticipated in FY2023. Further, scale up in the performance of the non-cigarette FMCG business and margin improvement would be triggers for the stock in the medium to long term. Moreover, strong cash flows and cheery dividend payout make it a 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 (Old data)

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

Sharekhan

by BNP PARIBAS

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