

Swift recovery in cigarettes, paperboard businesses

About the stock: ITC is the biggest cigarettes & second largest FMCG company in India with ~78% market share in cigarettes and presence in staples, biscuits, noodles, snacks, chocolate, dairy & personal care products.

- The company is also present in paperboard, printing & packaging business with revenues of ₹ 4549 crore and agri business with ₹ 8001 crore (FY21)
- ITC has more than 200 manufacturing facilities in India. It has a distribution reach of over 6 million retail outlets across various trade channels and 25 strong brands across various categories

Q1FY22 Results: ITC reported strong sales recovery in its Q1FY22 results.

- Sales were up 36.4% YoY; cigarettes sales recovered with 32.9% growth
- EBITDA was at ₹ 3992 crore, up 50.8% YoY, with margins at 30.8%
- Consequent PAT was at ₹ 3013.5 crore (up 28.6% YoY)

What should investors do? ITC's share price has underperformed the index with 16% negative return in last five years (from ₹ 250 in July 2016 to 212 in July 2021).

- We roll over to FY24 numbers with greater visibility of FMCG business margins and estimate complete recovery in cigarettes business in FY23-24
- We continue to maintain our HOLD rating on the stock

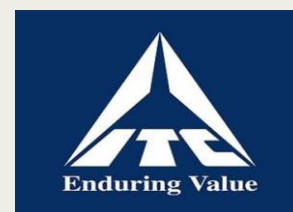
Target Price and Valuation: We value the stock at ₹ 240 on SOTP basis valuing cigarettes business at 10x FY24E earnings and FMCG business at 5x FY24E sales.

Key triggers for future price performance:

- FMCG business growing at a sustained pace with continuous improvement in margins. Opportunity size of foods portfolio is large
- Duties & taxes on cigarettes are expected to remain stable, given increasing prevalence of illicit and contraband cigarettes
- Swift recovery is expected in paperboard business with strong demand from user industry after Covid-19 recovery

Alternate Stock Idea: We like Zydus Wellness in our FMCG coverage.

- It is growing at a steady pace in nascent categories with a strong presence in health, nutrition space and margin expansion possibilities
- Trading at a significant discount to FMCG peers. BUY with TP of ₹ 2,800



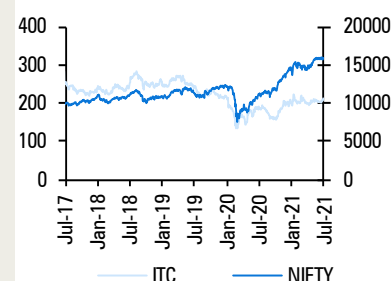
Particulars

Particulars (₹ crore)	Amount
Market Capitalization	261,086.3
Total Debt (FY21)	56.6
Cash and Investments (FY21)	18,048.2
EV	243,094.8
52 week H/L (₹)	239 / 163
Equity capital	1,230.9
Face value (₹)	1.0

Shareholding pattern

(in %)	Sep-20	Dec-20	Mar-21	Jun-21
Promoter	0.0	0.0	0.0	0.0
FII	13.0	13.3	12.8	11.7
DII	43.6	42.9	42.5	42.4
Others	43.4	43.8	44.7	45.9

Price Chart



Recent event & key risks

- Acquired brand 'Savlon' saw 4x sales growth in FY21
- Key Risk:** (i) Any other severe disruption due to Covid-19 (ii) elongated period of FMCG margin improvement

Research Analyst

Sanjay Manyal
sanjay.manyal@icicisecurities.com

Key Financial Summary

Key Financials	FY20	FY21	5 Year CAGR (%)	FY22E	FY23E	FY24E	CAGR (FY21-24E)
Net Sales	46323.7	48151.2	5.9	52486.8	57184.0	63322.6	9.6%
EBITDA	17904.3	15522.5	2.5	19226.7	21522.0	23984.0	15.6%
EBITDA Margin %	38.7	32.2		36.6	37.6	37.9	
Net Profit	15136.1	13031.6	6.9	14588.5	16378.9	18287.0	12.0%
EPS (₹)	12.5	10.7	6.9	12.0	13.5	15.1	12.0%
P/E	17.0	19.8		17.7	15.8	14.1	
RoNW %	23.8	22.1		24.2	25.9	27.4	
RoCE (%)	29.4	28.2		31.3	33.6	35.6	

Key takeaways of recent quarter

Q1FY22 Results: Robust performance continues

- Cigarettes sales witnessed growth of 33%, largely contributed by volume recovery from the lockdown impacted base quarter (~40% volume decline). Some of the markets like Kerala, Odisha & North East remain partially impacted by the second wave. Cigarette EBIT grew 37%. Segment margins were up 210 bps
- FMCG sales witnessed growth of 10.4% on the back of high demand for hygiene products and strong recovery of discretionary products from the low base last year. FMCG EBITDA grew 16% with a 40 bps improvement in margins. High commodity prices resulted in slower improvement in margins during the quarter. Education & stationary remained impacted due to closure of educational institutions
- The company launched several products under biscuits & cakes category under Sunfeast brand. It has also launched variants under Bingo snacks. 'Aashirvaad Svasti' in the Bengali desserts space with the launch of Aashirvaad Svasti Mishti Doi in select markets of West Bengal
- E-commerce sales of FMCG products has doubled and accounts for 8% of total sales. The company has started direct to consumer e-commerce sales through 'ITC e-Store, which is now operational in 11 cities
- Though the second wave has impacted growth, to some extent, rural markets have been witnessing stronger growth compared to urban markets. Within cigarettes segment, the company scaled up rural stockist network and rural servicing infrastructure to 3x & 1.2x, respectively
- Palm oil, edible oil, soap noodle & kraft paper prices are up 20-60% YoY. High commodity prices led to 311 bps contraction in gross margins
- Agri business witnessed growth of 9% on the back of high wheat, rice & leaf tobacco exports. The company clocked healthy soya sales in domestic markets. ITC is focusing on rapidly increasing value added products in fruits, vegetable & spices. its wholly owned subsidiary is constructing a facility for export of nicotine and its derivatives
- Paperboard business saw 54% growth largely led by value added paperboard, décor paper & carton packaging. It witnessed significant growth in exports. The company was safeguarded from high global pulp prices due to its in-house pulp capacity. Segment margins improved ~900 bps YoY & ~500 bps QoQ due to better product mix
- Hotels business revenue declined 56.7% sequentially, adversely impacted by second wave of pandemic. The YoY growth of 5x is immaterial given base quarter was complete washout due to national lockdown

Exhibit 1: Peer Comparison

Sector / Company	CMP	TP	Rating	M Cap	Sales growth (%)			EBITDA Margins (%)			P/E(x)			RoE (%)			RoCE (%)		
	(₹)	(₹)		(₹ Cr)	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Hindustan Unilever (HINLEV)	2358	2750	Buy	558687	18.4	16.0	7.8	25.0	25.6	26.2	70.2	58.7	52.8	17.1	20.0	21.6	18.9	25.6	27.7
Nestle (NESIND)	18143	19300	Hold	164840	7.9	11.1	9.4	24.1	24.8	25.1	79.2	67.1	60.2	103.1	124.2	142.1	54.6	62.7	69.1
VST Industries (VSTIND)	3501	3600	Hold	5090	-10.4	9.6	8.0	37.0	37.2	36.8	16.4	15.1	14.0	33.0	33.9	36.1	43.4	45.6	48.2

Source: Company, ICICI Direct Research

We believe the cigarettes business will fully recover with the aggressive vaccination drive & reduction in Covid-19 cases. We also believe elevated commodity prices would cool off in the next two to three quarters with considerable margin improvement in the FMCG business set to continue. However, investor perception of cigarettes business and its long term prospects has been one of the biggest drags for the stock price performance in the last five years. We maintain our **HOLD** recommendation and target price of ₹ 240/share on the stock.

Exhibit 2: Variance Analysis

	Q1FY22	Q1FY22E	Q1FY21	YoY (%)	Q4FY21	QoQ (%)	
Total Operating Income	12,959.2	12,284.9	9,501.8	36.4	14,157.0	-8.5	Revenue grew 36.4% on the back of strong recovery in cigarettes & paperboard businesses
Operating Income	74.7	115.3	66.1	12.9	133.6	-44.1	
Raw Material Expenses	5,786.1	4,898.0	3,946.9	46.6	6,076.2	-4.8	Gross margins contracted 311 bps mainly on account of incessant increase in commodity prices
Employee Expenses	734.1	754.0	696.9	5.3	735.6	-0.2	
Other operating Expenses	1,704.8	1,938.8	1,620.9	5.2	2,009.9	-15.2	Overhead spends declined sharply in a continued exercise of cost rationalisation
EBITDA	3,992.2	3,858.3	2,646.6	50.8	4,473.0	-10.8	
EBITDA Margin (%)	30.8	31.4	27.9	295 bps	31.6	-79 bps	Operating margins improved 295 bps
Depreciation	395.5	382.9	398.2	-0.7	388.0	1.9	
Interest	10.3	13.0	16.8	-38.5	3.1	228.7	
Other Income	429.0	715.4	896.8	-52.2	772.0	-44.4	Other income declined mainly on account of lower cash & cash equivalent after the company paid higher dividend last year
PBT	4,015.4	4,177.8	3,128.4	28.4	4,853.9	-17.3	
Tax Outgo	1,001.9	1,052.8	785.7	27.5	1,105.5	-9.4	
PAT	3,013.5	3,125.0	2,342.8	28.6	3,748.4	-19.6	Net profit grew by 28.6%
Adjusted PAT	3,013.5	3,125.0	2,342.8	28.6	3,748.4	-19.6	
Key Metrics YoY growth (%)							
Cigarette Growth (%)	32.9	33.7	-29.1		14.2		Strong recovery in cigarette business with stocking by dealers in April in anticipation of lockdown
FMCG (Others) Growth (%)	10.4	12.8	10.3		15.8		FMCG business witnessed moderate growth of 10.4%
Hotels Growth (%)	NM	NM	-94.2		-38.2		Hotels business adversely impacted by second wave
Agri Business Growth (%)	9.2	-19.6	3.7		78.5		
Paperboards Growth (%)	54.2	50.4	-32.8		13.5		Strong recovery in paperboard business with no major impact of second wave on user industries

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

	FY22E			FY23E			FY24E	
(₹ Crore)	Old	New	% Change	Old	New	% Change	New	Comments
Sales	52486.8	52486.8	0.0	57,184.0	57,184.0	0.0	63322.6	We are introducing FY24 numbers
EBITDA	19017.3	19226.7	1.1	21408.2	21522.0	0.5	23984.0	
EBITDA Margin (%)	35.9	36.3	40 bps	37.4	37.6	20 bps	37.9	
PAT	15181.0	14588.5	-3.9	16935.9	16378.9	-3.3	18287.0	We estimate lower other income on the back of reduced cash given the company has paid additional dividend in FY21
EPS (₹)	12.5	12.0	-3.9	13.8	13.3	-3.3	14.9	

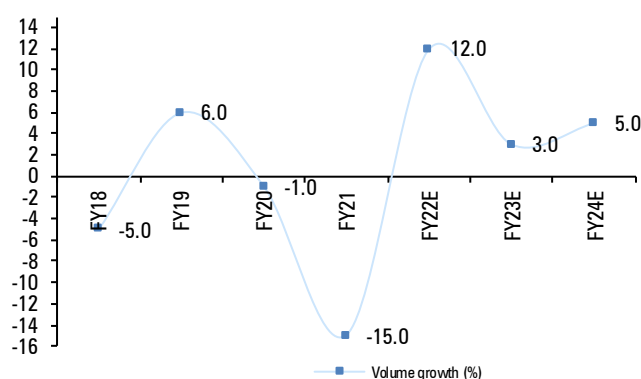
Source: ICICI Direct Research

Exhibit 4: Assumptions

	Current						Earlier			Comments
	FY18	FY19	FY20	FY21E	FY22E	FY23E	FY24E	FY22E	FY23E	
Cigarettes (₹ cr)	22,894.0	20,713.0	21,201.7	20,333.1	22,406.2	23,655.3	25,582.8	22,406.2	23,655.3	No change in estimates
Cigarette Vol. Growth (%)	-4.0	6.0	-1.0	-15.0	12.0	3.0	5.0	12.0	3.0	
Cigarette Price Growth (%)	12.0	9.5	4.0	10.0	1.0	2.5	3.0	1.0	2.5	
FMCG - Others (₹ cr)	11,314.4	12,505.3	12,844.2	14,728.2	16,555.4	18,849.1	21,461.4	16,555.4	18,849.1	
Hotels (₹ cr)	1,404.1	1,665.5	1,837.3	627.5	1,329.4	1,361.8	1,721.6	1,329.4	1,361.8	
Paperboards (₹ cr)	5,249.6	5,860.2	6,107.2	5,826.4	6,173.5	6,576.8	7,007.3	6,173.5	6,576.8	

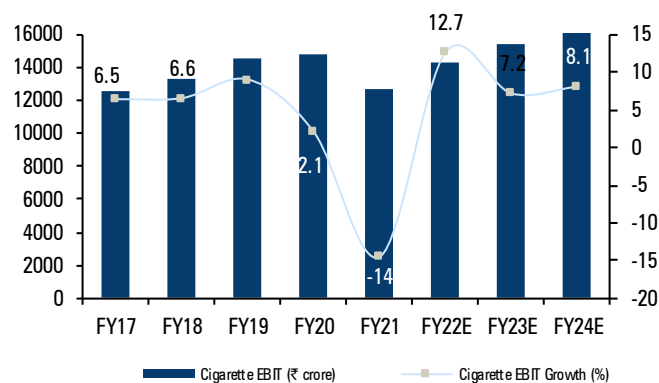
Source: ICICI Direct Research

Exhibit 5: Cigarette volume growth trend



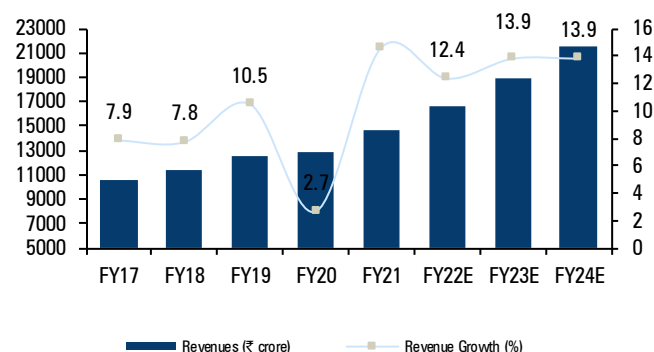
Source: ICICI Direct Research, Company

Exhibit 6: Cigarette EBIT growth trend



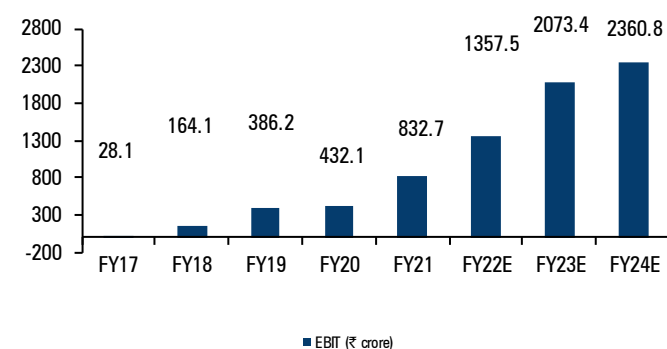
Source: ICICI Direct Research, Company

Exhibit 7: FMCG revenue (₹ crore) and growth (%) trend



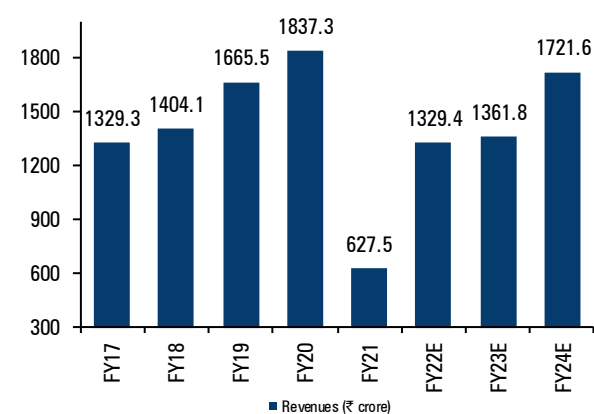
Source: ICICI Direct Research, Company

Exhibit 8: FMCG EBIT (₹ crore) trend



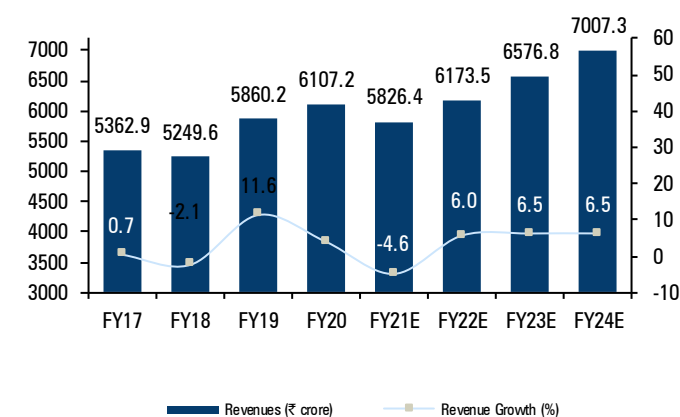
Source: ICICI Direct Research, Company

Exhibit 9: Hotel revenue (₹ crore) and growth (%) trend

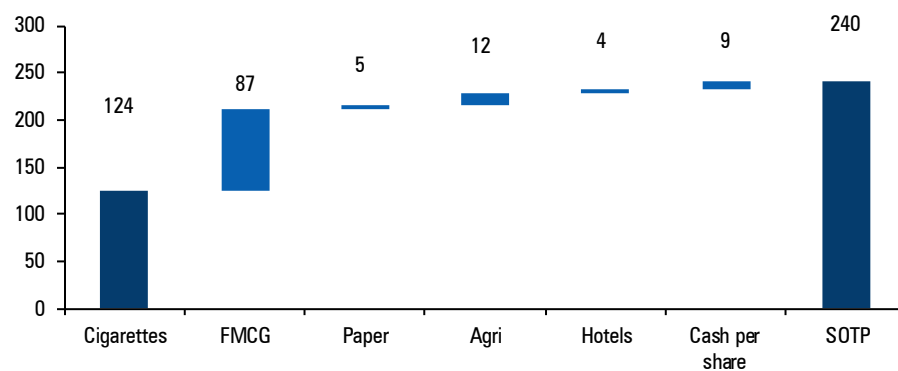


Source: ICICI Direct Research, Company

Exhibit 10: Paperboards revenue (₹ crore) and growth (%) trend



Source: ICICI Direct Research, Company

Exhibit 11: Sum of the part valuation


Source: Company, ICICI Direct Research

Exhibit 12: Valuations

	Sales	Growth	EPS	Growth	PE	EV/EBITDA	RoNW	RoCE
	(₹ cr)	(%)	(₹)	(%)	(x)	(x)	(%)	(%)
FY21	48151.2	3.9	10.7	-13.9	19.8	16.6	22.1	28.2
FY22E	52486.8	9.0	12.0	11.9	17.7	13.5	24.2	31.3
FY23E	57184.0	8.9	13.5	12.3	15.8	12.0	25.9	33.6
FY24E	63322.6	10.7	15.1	11.6	14.1	10.7	27.4	35.6

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 13: Profit and loss statement					₹ crore
(Year-end March)	FY21	FY22E	FY23E	FY24E	
Total operating Income	48,524.5	52,947.9	57,691.2	63,880.5	
Growth (%)	3.7	9.1	9.0	10.7	
Raw Material Expenses	19,974.6	19,592.0	20,661.4	22,159.7	
Employee Expenses	2,821.0	3,089.1	3,412.5	3,831.1	
Marketing Expenses	0.0	942.4	1,023.8	1,256.1	
Administrative Expenses	0.0	1,518.4	1,763.1	2,198.2	
Excise Duty	3039.4	3343.4	3677.7	4045.5	
Other expenses	7,167.1	5,235.8	5,630.7	6,406.0	
Total Operating Expenditure	33,002.1	33,721.2	36,169.2	39,896.5	
EBITDA	15,522.5	19,226.7	21,522.0	23,984.0	
Growth (%)	-13.3	23.9	11.9	11.4	
Depreciation	1,561.8	1,531.6	1,571.6	1,611.6	
Interest	47.5	51.9	56.6	62.8	
Other Income	3,251.0	1,860.1	2,003.2	2,138.3	
PBT	17,164.2	19,503.3	21,896.9	24,447.9	
Total Tax	4,132.5	4,914.8	5,518.0	6,160.9	
PAT	13,031.6	14,588.5	16,378.9	18,287.0	
Growth (%)	-13.9	11.9	12.3	11.6	
EPS (₹)	10.7	12.0	13.5	15.1	

Source: Company, ICICI Direct Research

Exhibit 14: Cash flow statement					₹ crore
(Year-end March)	FY21	FY22E	FY23E	FY24E	
Profit After Tax	13,207.5	14,588.5	16,378.9	18,287.0	
Add: Depreciation	1,561.8	1,531.6	1,571.6	1,611.6	
(Inc)/dec in Current Assets	-1,450.3	-2,056.7	-6.1	-1,699.3	
Inc/(dec) in CL and Provisions	1,055.4	260.6	-167.4	1,096.7	
CF from operating activities	11,494.0	14,324.0	17,776.9	19,296.0	
(Inc)/dec in Investments	0.0	-8,619.5	-1,930.4	-2,522.7	
(Inc)/dec in LT loans & advance	0.0	0.0	0.0	0.0	
(Inc)/dec in Fixed Assets	-2,176.3	-2,681.0	-1,020.0	-1,020.0	
Others	0.0	0.0	0.0	0.0	
CF from investing activities	6,497.9	-3,819.9	-3,050.4	-3,642.7	
Issue/(Buy back) of Equity	-2.3	0.0	0.0	0.0	
Inc/(dec) in loan funds	-52.0	10.0	10.0	10.0	
Dividend paid & dividend tax	-18,629.3	-13,232.0	-13,539.7	-14,770.6	
Others	14.0	18.0	21.5	22.9	
CF from financing activities	-18,378.9	-13,204.0	-13,508.2	-14,737.7	
Net Cash flow	-387.1	-2,699.9	1,218.4	915.6	
Opening Cash	561.4	174.3	-2,525.6	-1,307.2	
Cash with Bank	3,827.2	3,827.2	3,827.2	3,827.2	
Closing Cash	4,001.5	1,301.6	2,520.0	3,435.7	

Source: Company, ICICI Direct Research

Exhibit 15: Balance Sheet					₹ crore
(Year-end March)	FY21	FY22E	FY23E	FY24E	
Liabilities					
Equity Capital	1,230.9	1,230.9	1,230.9	1,230.9	
Reserve and Surplus	57,773.7	59,130.2	61,969.4	65,485.8	
Total Shareholders funds	59,004.6	60,361.1	63,200.3	66,716.7	
LT Borrowings & Provisions	5.3	15.3	25.3	35.3	
Deferred Tax Liability	1,727.7	1,727.7	1,727.7	1,727.7	
Others Non-current Liabilities	396.4	414.4	435.9	458.8	
Total Liabilities	61,134.0	62,518.5	65,389.2	68,938.5	
Assets					
Gross Block	34,960.5	38,290.5	39,290.5	40,290.5	
Less: Acc Depreciation	14,809.5	16,341.2	17,912.8	19,524.4	
Net Block	20,150.9	21,949.3	21,377.7	20,766.1	
Capital WIP	3,330.0	1,000.0	1,000.0	1,000.0	
Net Intangible Assets	2,731.2	2,751.2	2,771.2	2,791.2	
Non-current Investments	12,950.4	21,569.9	23,500.3	26,023.0	
LT loans & advances	2.4	2.4	2.4	2.4	
Current Assets					
Inventory	9,470.9	10,066.0	10,183.5	11,276.6	
Debtors	2,090.4	2,876.0	2,506.7	2,775.8	
Loans and Advances	2.8	5.9	6.5	7.2	
Other Current Assets	2,203.2	2,876.0	3,133.4	3,469.7	
Cash	4,001.5	1,301.6	2,520.0	3,435.7	
Current Investments	14,046.7	7,046.7	7,046.7	7,046.7	
Current Liabilities	10,174.2	10,434.7	10,267.3	11,364.0	
Creditors	4,119.5	4,601.6	3,916.7	4,337.2	
Provisions	169.1	29.8	32.5	36.0	
Short term debt & other CL	5,885.6	5,803.3	6,318.1	6,990.8	
Application of Funds	61,134.0	62,518.5	65,389.2	68,938.5	

Source: Company, ICICI Direct Research

Exhibit 16: Key ratios					
(Year-end March)	FY21	FY22E	FY23E	FY24E	
Per share data (₹)					
EPS	10.7	12.0	13.5	15.1	
Cash EPS	12.0	13.3	14.8	16.4	
BV	48.6	49.7	52.0	54.9	
DPS	10.8	11.0	12.0	14.0	
Cash Per Share	3.3	1.1	2.1	2.8	
Operating Ratios (%)					
EBITDA Margin	32.0	36.3	37.3	37.5	
PBT / Total Operating income	35.4	36.8	38.0	38.3	
PAT Margin	26.9	27.6	28.4	28.6	
Inventory days	71.8	70.0	65.0	65.0	
Debtor days	15.8	20.0	16.0	16.0	
Creditor days	31.2	32.0	25.0	25.0	
Return Ratios (%)					
RoE	22.1	24.2	25.9	27.4	
RoCE	28.2	31.3	33.6	35.6	
RoIC	25.6	30.8	33.9	36.4	
Valuation Ratios (x)					
P/E	19.8	17.7	15.8	14.1	
EV / EBITDA	16.6	13.5	12.0	10.7	
EV / Net Sales	5.3	5.0	4.5	4.1	
Market Cap / Sales	5.4	5.0	4.6	4.1	
Price to Book Value	4.4	4.3	4.1	3.9	
Solvency Ratios					
Debt/EBITDA	0.0	0.0	0.0	0.0	
Debt / Equity	0.0	0.0	0.0	0.0	
Current Ratio	2.7	2.2	2.2	2.2	
Quick Ratio	1.8	1.2	1.2	1.2	

Source: Company, ICICI Direct Research

Exhibit 17: ICICI Direct coverage universe (FMCG)

	CMP	TP	Rating	M Cap	EPS (₹)			P/E (x)			Price/Sales (x)			RoCE (%)			RoE (%)		
	(₹)	(₹)		(₹ Cr)	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Colgate (COLPAL)	1,795	1,900	Buy	42,892	38.1	39.1	42.7	47.2	46.0	42.0	8.9	8.3	7.7	106.4	110.4	111.7	88.8	85.1	86.1
Dabur India (DABIND)	590	620	Buy	94,540	9.6	10.9	12.2	61.5	53.9	48.3	9.9	8.7	7.9	24.5	26.5	27.1	22.1	22.9	23.2
Hindustan Unilever (HINLEV)	2,358	2,750	Buy	561,037	33.9	40.5	45.0	69.6	58.2	52.3	12.4	10.7	9.9	18.9	25.6	27.7	17.1	20.0	21.6
ITC Limited (ITC)	212	240	Hold	261,086	10.7	12.0	13.5	19.8	17.7	15.8	5.4	5.0	4.6	28.2	31.3	33.6	22.1	24.2	25.9
Jyothy Lab (JYOLAB)	174	160	Hold	5,324	5.2	6.3	7.1	33.6	27.6	24.5	2.8	2.6	2.4	26.0	27.2	28.5	20.4	22.7	23.7
Marico (MARLIM)	533	490	Buy	53,027	9.3	9.6	10.7	57.4	55.4	49.8	6.6	5.9	5.3	40.3	42.5	45.5	37.0	37.4	39.7
Nestle (NESIND)	18,143	19,300	Hold	164,840	216.0	254.8	283.8	84.0	71.2	63.9	12.4	11.2	10.2	54.6	62.7	69.1	103.1	124.2	142.1
Tata Consumer Products (TAT)	775	725	Buy	60,728	10.1	12.4	14.5	76.8	62.4	53.5	5.2	4.6	4.3	8.0	9.1	10.0	6.4	7.6	8.5
VST Industries (VSTIND)	3,501	3,600	Hold	5,090	201.3	218.8	234.9	17.4	16.0	14.9	4.6	4.2	3.9	43.4	45.6	48.2	33.0	33.9	36.1
Varun Beverage (VARBEV)	736	800	Buy	33,343	8.4	14.1	20.7	88.0	52.0	35.5	5.2	4.2	3.6	10.9	17.4	23.4	10.3	15.4	19.1
Zydus Wellness (ZYDWEL)	2,211	2,800	Buy	13,502	18.7	60.8	72.0	118.5	36.4	30.7	7.2	6.4	5.8	6.2	7.8	9.1	5.5	8.1	9.4

Source: Bloomberg, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

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