ITC (ITC)

CMP: ₹ 224 | Target: ₹ 250 (11%) | Target Period: 12 months | HOLD

December 15, 2021

Outlines capital allocation path…

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

- The company is also present in paperboard, printing & packaging business with revenues of ₹ 4549 crore, agri business with ₹ 8001 crore
- ITC has more than 200 manufacturing facilities in India. It has a distribution reach of over 6.6 million retail outlets across various trade channels & strong 25 brands across various categories

Key Highlights of analyst meet: We attended ITC's analyst meet on December 14, 2021. The management reiterated its strategies & focal points.

- Legal cigarettes constitute 8% of tobacco consumption & 80% of taxes
- FMCG business includes 25+ mother brands across foods, personal care & stationary products categories
- Hotels capex would be limited to ongoing expansions; open to M&A in FMCG & Infotech business

What should investors do? ITC's share price has given near zero return in the last five years (from ₹ 225 in December 2016 to 225 in December 2021)

- We continue to maintain our HOLD rating on the stock

Target Price and Valuation: We value the stock at ₹ 250 on SOTP basis valuing the cigarettes business at 12x FY24 earnings & FMCG business at 5x FY24 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 to remain stable given increasing prevalence of illicit & contraband cigarettes
- Strong growth 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 strong presence in health, nutrition space & margin expansion possibilities
- Trading at significant discount to FMCG peers. BUY with a TP of ₹ 2,800

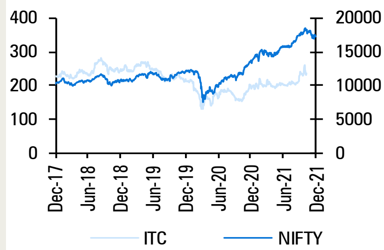
Particulars

Particulars (₹ crore)	Amount
Market Capitalization	2,75,345.3
Total Debt (FY21)	56.6
Cash and Investments (FY21)	18,048.2
EV	2,57,353.7
52 week H/L (₹)	265 / 196
Equity capital	1,230.9
Face value (₹)	1.0

Shareholding pattern

(in %)	Dec-20	Mar-21	Jun-21	Sep-21
Promoter	0.0	0.0	0.0	0.0
FII	13.3	12.8	11.7	10.8
DII	42.9	42.5	42.4	43.7
Others	43.8	44.7	45.9	45.5

Price Chart



Recent event & key risks

- ITC's annual consumer spend on FMCG brands is ~₹ 22000 core
- **Key Risk:** (i) Any increase in cigarette taxation in Budget (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	53460.9	58208.2	64423.7	10.2%
EBITDA	17904.3	15522.5	2.5	19244.1	21892.3	24417.6	16.3%
EBITDA Margin %	38.7	32.2		36.0	37.6	37.9	
Net Profit	15136.1	13031.6	6.9	14620.2	16676.1	18632.6	12.7%
EPS (₹)	12.5	10.7	6.9	12.0	13.7	15.3	12.7%
P/E	18.0	20.9		18.6	16.3	14.6	
RoNW %	23.8	22.1		24.2	26.2	27.6	
RoCE (%)	29.4	28.2		31.4	34.1	36.0	

Source: Company, ICICI Direct Research

Key takeaways from analyst meet on December 14, 2021

Analyst Meet update: Open to M&A in FMCG, IT businesses

We attended ITC's analyst meet on December 14, 2021 to get an understanding of the management's future strategies about business growth, margins territory of FMCG business, structure of hotels business, M&A possibilities & capital allocation. Some of the key highlights of the analyst meet:

- Legal cigarette industry accounts for 8% of total tobacco consumption but contributes 80% of government tax revenue. Per capita consumption of cigarettes is one of the lowest in the world

- High tax incidence leads to sub-optimal tax revenue for the government with illicit & contraband cigarettes gaining prominence during high tax rate scenario. During FY13-17, tax increased by 15.7% while government tax revenue increased by merely 4.7% whereas during April 2018 to January 2020, there was no change in taxation & tax revenue increased by 10.2%

- In the cigarette business, the company has leading brands in every segment with more than total 50+ brands. The company's distribution reach is closer to 7.1 million outlets. Total 11% of volumes comes from new launches

- There is no data to suggest that cigarette consumption is trending down structurally. In fact, cigarettes sales have come back closer to pre-Covid levels. The growth levers in the categories are volumes, pricing & mix. Increase in taxation is largely passed on in terms of price increase but volumes and mix are preferred levers during a stable taxation scenario. Product mix for cigarettes category is getting richer with 11% of volumes contributed by new products

- In the FMCG business, consumer spend for the company's brand is ₹ 22000 crore. The company's brands are market leader in atta, cream biscuits, bridges snacks and notebook categories. Its brands are No. 2 in noodles & instant sticks category

- FMCG business margins have increased by 640 bps in the last four years while ITC has been able to maintain its operating margins in H1FY22 despite high commodity inflation in edible oil, Kraft paper & soap noodle. Classmate & Mangaldeep brands are double digit margins brand. With focus on adjacencies of major brands, margins territory is moving upwards

- The company is focusing on adjacencies to leverage mother brand (Aashirwad, Sunfeast, Yippie, Bingo & Savlon). It is also building future brands in floor cleaners, juices, chocolates, dairy, deodorants and ready to eat foods (RTE)

- The growth potential in FMCG categories like snacks, spices, pulses, biscuits, branded atta, noodles, deodorants. floor cleaners, hand wash & body wash is 4-6x in the next decade

- The company has acquired brands like Savlon, Nimyle & Sunrise in the last five years whereas it has divested or shrunk brands like John Players, Wills lifestyle & Superia (shampoo) brands

- The Savlon brand has grown 14x (₹ 1000 crore consumer spends) since acquisition whereas Nimyle has grown 5x since acquisition. Savlon's margins have improved by 600 bps in the last five years. Though hygiene category sales have come down from peak, it is still substantially higher compared to pre-Covid levels

- Media spends towards FMCG brands are driven through digital channels, which is now 16% of the overall media spends

- FMCG business distribution reach has increased by 1.2x to 6.6 million retail outlets in last five years. Moreover, direct reach & stockist network has also increased by 1.4x & 6x respectively in similar period

- In agri business, the company is looking to move up the value chain & focusing on value added ingredient & niche products like spices, fruits, vegetable.

- In hotels business, occupancy levels have reached pre-Covid levels. Leisure hotels occupancies are high whereas business travel hotels are still at 40-50% of the pre-Covid levels

- In paperboard business, the company is focussing on speciality papers, pulp import substitution & scale up of value added product portfolio

- The opportunity in infotech business is immense. The company is open to M&A in the infotech business. It is open to listing possibilities

- The company keeps large wheat inventories to sharpen buying & timing of procurement. No debtors in general trade given it is cash & carry model

- Capex for FY21 was ₹ 1600 crore. Average capex per years would be ₹ 3000 crore per annum for the next three years. Of this, 35-40% would be for FMCG business, 25-30% for paper, paperboard business, 10% for the Hotels business mainly for ongoing projects. Rest of the capex amount would be spending on enhancing digital capabilities & infrastructure

- The company would continue to maintain 80-85% dividend payout and would prefer maintaining ordinary dividend instead of giving special dividend. Total cash on the books of ₹ 25000 crore would not increase, going forward

- De-merger plan of hotels business would be taken at an appropriate time once the business stabilises from the current disruption. The company is actively pursuing M&A opportunity in the FMCG & IT space

- The company is largest investor in PLI for foods, RTE & marine space. ITC would be focusing on exports of FMCG products in different countries largely catering to overseas Indians

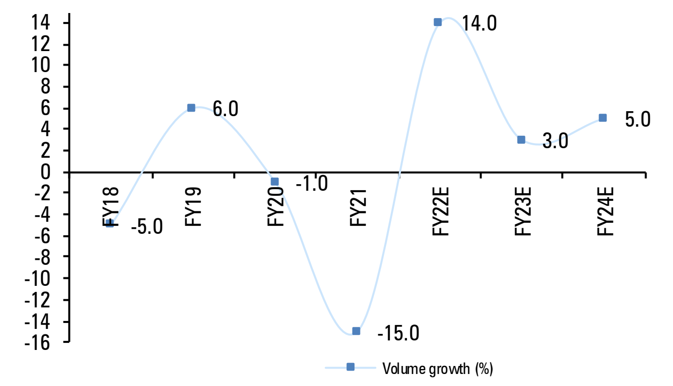
Exhibit 1: Peer Comparison

Sector / Company	CMP	TP		M Cap	Sales growth (%)			EBITDA Margins (%)			P/E(x)			RoE (%)			RoCE (%)		
	(₹)	(₹)	Rating	(₹ Cr)	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Hindustan Unilever (HINLEV)	2321	2750	Hold	582416	12.9	9.1	8.4	25.6	26.2	26.3	63.0	55.9	51.0	19.5	21.5	23.0	25.0	27.6	29.5
Nestle (NESIND)	19203	20450	Hold	183217	11.1	9.4	10.4	24.8	25.1	25.6	76.0	68.0	60.5	87.8	86.3	83.1	54.9	56.4	57.5
VST Industries (VSTIND)	3148	3700	Hold	5334	4.6	8.3	7.5	36.5	36.2	36.2	16.5	15.5	14.1	32.8	35.7	41.2	44.2	47.7	55.1
ITC Limited (ITC)	224	250	Hold	275345	11.1	8.9	10.7	36.0	37.6	37.9	18.6	16.3	14.6	24.2	26.2	27.6	30.6	34.2	36.8

Source: Company, ICICI Direct Research

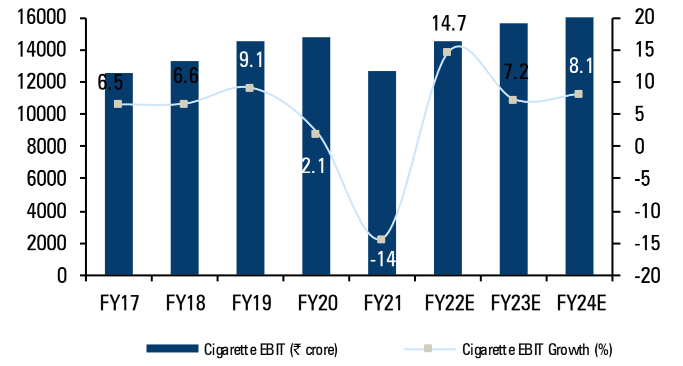
ITC is witnessing a recovery in cigarettes volumes & on full year basis FY23 volumes should be at the FY20 levels. We believe stable taxation would aid cigarette volume growth, going forward. FMCG business has witnessed continuous improvement in margins over the last four years. With focus on adjacencies of power brands and scale up newer categories, operating margins would improve over the next five years. We believe the company would be able to improve FMCG segment operating margins by 150-200 bps every year. Further, the possibility of de-merger of hotels, FMCG & infotech business can add shareholder's values in the longer run. Though, we remain optimistic on FMCG business growth & margin prospects de-rating of the cigarettes business globally due to emergence of e-cigarettes poses a greater threat. We maintain our **HOLD** rating and revise our target price on the stock to ₹ 250.

Exhibit 2: Cigarette volume growth trend



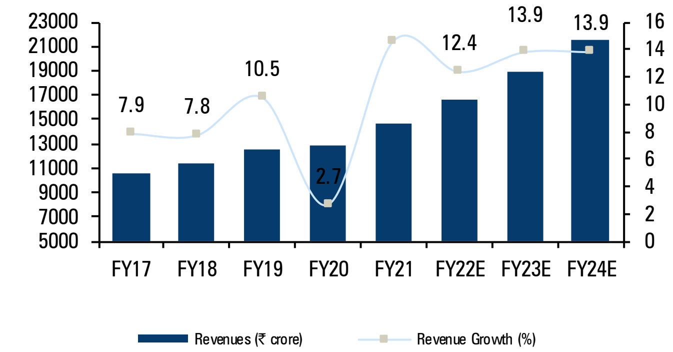
Source: ICICI Direct Research, Company

Exhibit 3: Cigarette EBIT growth trend



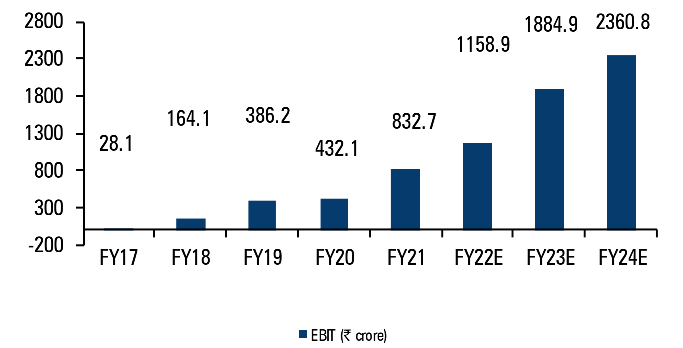
Source: ICICI Direct Research, Company

Exhibit 4: FMCG revenue (₹ crore) and growth (%) trend



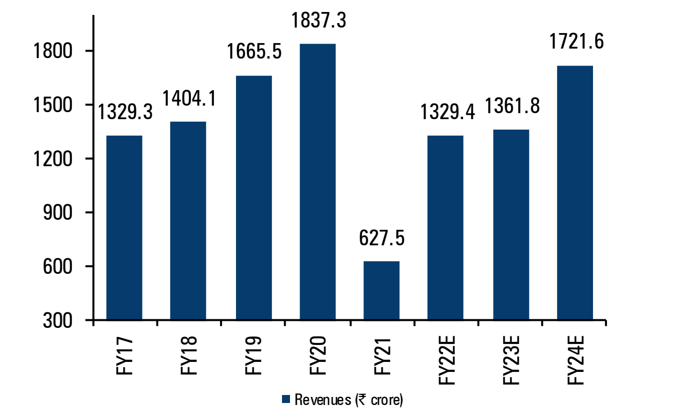
Source: ICICI Direct Research, Company

Exhibit 5: FMCG EBIT (₹ crore) trend



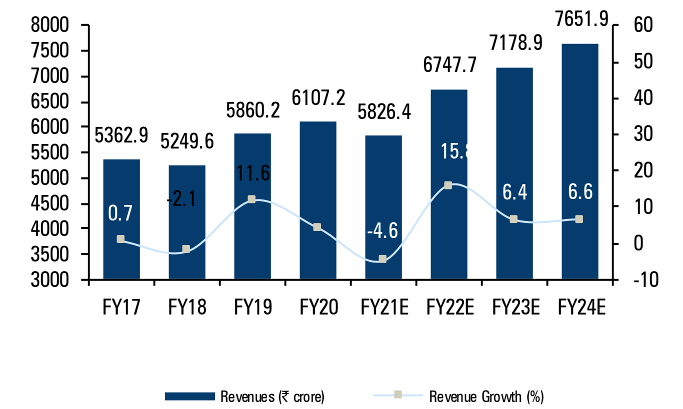
Source: ICICI Direct Research, Company

Exhibit 6: Hotel revenue (₹ crore) and growth (%) trend



Source: ICICI Direct Research, Company

Exhibit 7: Paperboards revenue (₹ crore) and growth (%)



Source: ICICI Direct Research, Company

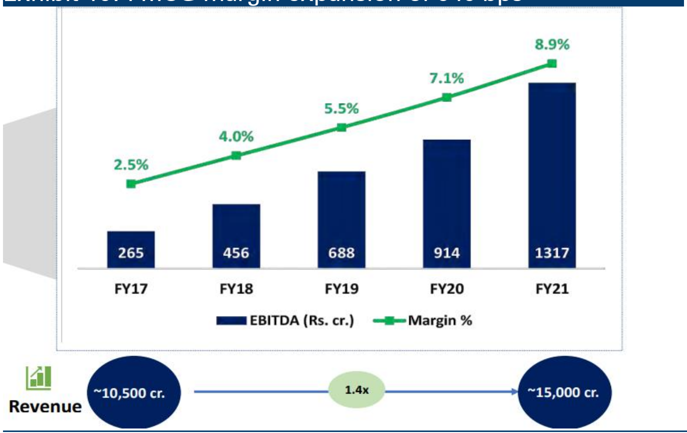
Exhibit 8: Major FMCG brands

Source: ICICI Direct Research, Company

Exhibit 9: Distribution reach at 6.6 million outlets

Source: ICICI Direct Research, Company

Exhibit 10: FMCG margin expansion of 640 bps

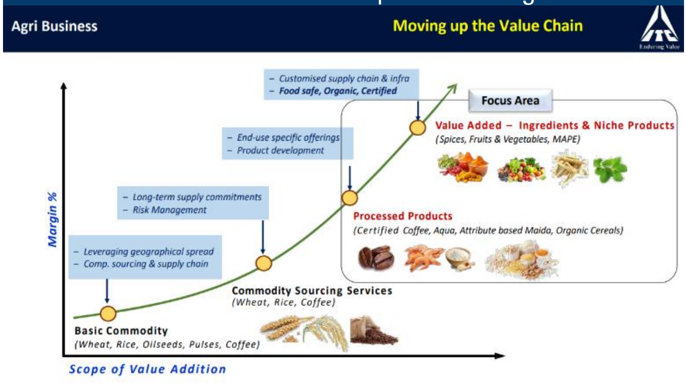


Source: ICICI Direct Research, Company

Exhibit 11: Adjacencies of major brands to perk up margins

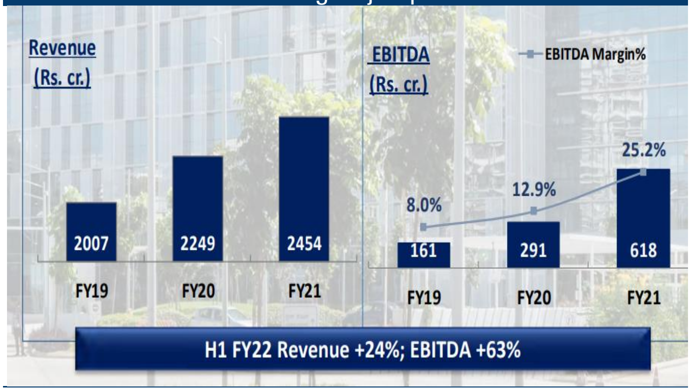
Source: ICICI Direct Research, Company

Exhibit 12: Focus on value added products in agri business



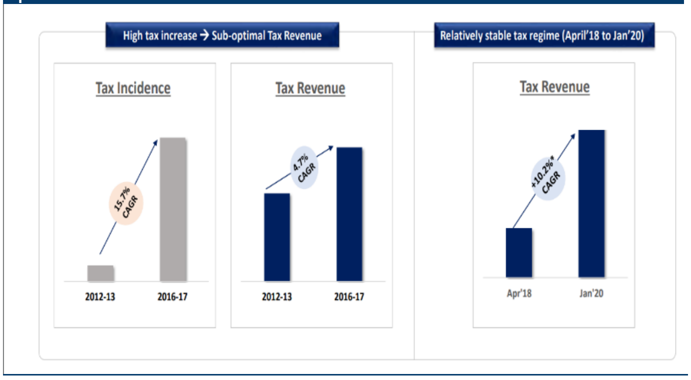
Source: ICICI Direct Research, Company

Exhibit 13: ITC Infotech margins jump to 25%



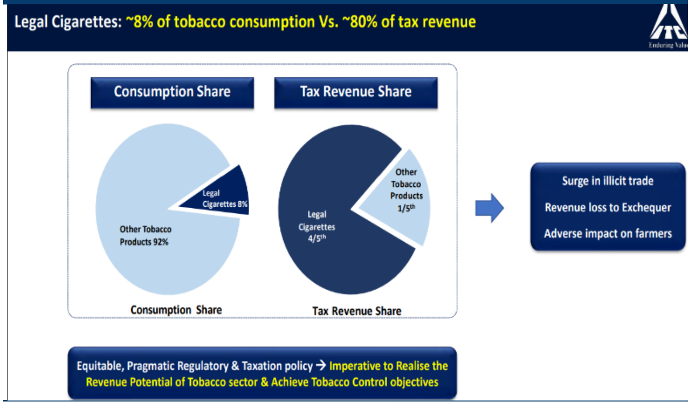
Source: ICICI Direct Research, Company

Exhibit 14: High tax incidence on cigarettes lead to sub-optimal tax revenue



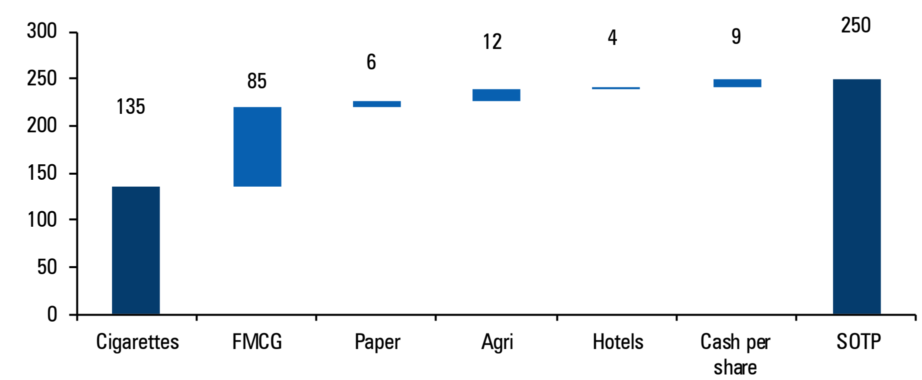
Source: ICICI Direct Research, Company

Exhibit 15: An 8% tobacco consumption vs. 80% tax revenues



Source: ICICI Direct Research, Company

Exhibit 16: Sum of the part valuation



Source: Company, ICICI Direct Research

Financial Summary

Exhibit 17: Profit and loss statement (₹ crore)

(Year-end March)	FY21	FY22E	FY23E	FY24E
Total operating Income	**48,524.5**	**53,922.0**	**58,715.4**	**64,981.6**
Growth (%)	3.7	11.1	8.9	10.7
Raw Material Expenses	19,974.6	20,387.5	21,144.1	22,634.0
Employee Expenses	2,821.0	3,135.3	3,461.9	3,885.1
Marketing Expenses	0.0	956.5	1,038.6	1,273.8
Administrative Expenses	0.0	1,541.1	1,788.7	2,229.2
Excise Duty	3039.4	3343.4	3677.7	4045.5
Other expenses	7,167.1	5,314.1	5,712.2	6,496.4
Total Operating Expenditure	33,002.1	34,677.9	36,823.2	40,564.0
EBITDA	**15,522.5**	**19,244.1**	**21,892.3**	**24,417.6**
Growth (%)	-13.3	24.0	13.8	11.5
Depreciation	1,561.8	1,531.6	1,571.6	1,611.6
Interest	47.5	52.9	57.6	63.9
Other Income	3,251.0	1,886.1	2,031.2	2,167.8
PBT	17,164.2	19,545.8	22,294.2	24,909.9
Total Tax	4,132.5	4,925.5	5,618.1	6,277.3
PAT	**13,031.6**	**14,620.2**	**16,676.1**	**18,632.6**
Growth (%)	-13.9	12.2	14.1	11.7
EPS (₹)	10.7	12.0	13.7	15.3

Source: Company, ICICI Direct Research

Exhibit 18: Cash flow statement (₹ crore)

(Year-end March)	FY21	FY22E	FY23E	FY24E
Profit After Tax	13,207.5	14,620.2	16,676.1	18,632.6
Add: Depreciation	1,561.8	1,531.6	1,571.6	1,611.6
(Inc)/dec in Current Assets	-1,450.3	-2,350.3	4.0	-1,720.6
Inc/(dec) in CL and Provisions	1,055.4	453.3	-177.2	1,110.4
CF from operating activities	**11,494.0**	**14,254.8**	**18,074.5**	**19,634.0**
(Inc)/dec in Investments	0.0	-9,019.9	-1,951.0	-2,554.3
(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**	**-4,220.2**	**-3,071.0**	**-3,674.3**
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	18.4	24.7	23.5
CF from financing activities	**-18,378.9**	**-13,203.6**	**-13,505.0**	**-14,737.1**
Net Cash flow	-387.1	-3,169.0	1,498.6	1,222.6
Opening Cash	561.4	174.3	-2,994.7	-1,496.1
Cash with Bank	3,827.2	3,827.2	3,827.2	3,827.2
Closing Cash	**4,001.5**	**832.5**	**2,331.1**	**3,553.7**

Source: Company, ICICI Direct Research

Exhibit 19: 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	59,162.0	62,298.3	66,160.4
Total Shareholders funds	59,004.6	60,392.8	63,529.2	67,391.2
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 Liabilitie	396.4	414.8	439.5	462.9
Total Liabilities	**61,134.0**	**62,550.6**	**65,721.7**	**69,617.2**
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	21,970.2	23,921.2	26,475.5
LT loans & advances	2.4	2.4	2.4	2.4
Current Assets				
Inventory	9,470.9	10,252.8	10,365.9	11,472.7
Debtors	2,090.4	2,929.4	2,551.6	2,824.1
Loans and Advances	2.8	6.0	6.6	7.3
Other Current Assets	2,203.2	2,929.4	3,189.5	3,530.1
Cash	4,001.5	832.5	2,331.1	3,553.7
Current Investments	14046.7	7046.7	7046.7	7046.7
Current Liabilities	10,174.2	10,627.4	10,450.3	11,560.7
Creditors	4,119.5	4,687.0	3,986.9	4,412.6
Provisions	169.1	30.4	33.1	36.6
Short term debt & other CL	5,885.6	5,910.1	6,430.3	7,111.5
Application of Funds	**61,134.0**	**62,550.6**	**65,721.7**	**69,617.2**

Source: Company, ICICI Direct Research

Exhibit 20: Key ratios

(Year-end March)	FY21	FY22E	FY23E	FY24E
Per share data (₹)				
EPS	10.7	12.0	13.7	15.3
Cash EPS	12.0	13.3	15.0	16.7
BV	48.6	49.7	52.3	55.5
DPS	10.8	11.0	12.0	14.0
Cash Per Share	3.3	0.7	1.9	2.9
Operating Ratios (%)				
EBITDA Margin	32.0	35.7	37.3	37.6
PBT / Total Operating income	35.4	36.2	38.0	38.3
PAT Margin	26.9	27.1	28.4	28.7
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	26.2	27.6
RoCE	28.2	31.4	34.1	36.0
RoIC	25.6	30.6	34.2	36.8
Valuation Ratios (x)				
P/E	20.9	18.6	16.3	14.6
EV / EBITDA	17.5	14.3	12.5	11.1
EV / Net Sales	5.6	5.1	4.7	4.2
Market Cap / Sales	5.7	5.2	4.7	4.3
Price to Book Value	4.6	4.5	4.3	4.0
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 21: ICICI Direct coverage universe (FMCG)

	CMP	TP		M Cap	EPS (₹)			P/E (x)			Price/Sales (x)			RoCE (%)			RoE (%)		
	(₹)	(₹)	Rating	(₹ Cr)	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Colgate (COLPAL)	1,449	1,800	Buy	42,088	38.1	38.3	41.1	38.1	37.8	35.2	8.7	8.1	7.5	106.4	110.5	113.2	88.8	84.8	87.0
Dabur India (DABIND)	573	745	Buy	1,05,726	9.6	10.5	12.1	59.8	54.4	47.4	11.1	9.6	8.7	24.5	25.7	27.3	22.1	22.2	23.3
Hindustan Unilever (HINLEV)	2,321	2,750	Hold	5,82,416	33.9	39.3	44.3	68.6	59.0	52.3	12.9	11.4	10.5	18.9	25.0	27.6	17.1	19.5	21.5
ITC Limited (ITC)	224	250	Hold	2,75,345	10.7	12.0	13.7	20.9	18.6	16.3	5.7	5.2	4.7	28.2	31.4	34.1	22.1	24.2	26.2
Jyothy Lab (JYOLAB)	150	170	Hold	5,728	5.2	5.0	6.7	28.9	30.2	22.5	3.0	2.7	2.4	26.0	21.5	27.3	20.4	18.8	23.7
Marico (MARLIM)	513	685	Buy	73,541	9.3	10.2	11.4	55.2	50.4	44.9	9.1	7.6	7.3	40.3	43.0	47.3	37.0	38.7	41.2
Nestle (NESIND)	19,203	20,450	Hold	1,83,217	216.0	249.9	279.6	88.9	76.8	68.7	13.8	12.4	11.3	50.9	54.9	56.4	86.5	87.8	86.3
Tata Consumer (TATGLO)	746	910	Buy	72,703	10.1	11.8	14.1	73.9	63.4	53.0	6.3	5.8	5.3	8.0	8.9	9.9	6.4	7.2	8.3
VST Industries (VSTIND)	3,148	3,700	Hold	5,334	201.3	208.8	223.1	15.6	15.1	14.1	4.8	4.6	4.2	43.4	44.2	47.7	33.0	32.8	35.7
Varun Beverage (VARBEV)	902	1,020	Buy	36,780	8.4	16.0	20.3	107.8	56.2	44.3	5.7	4.3	3.9	10.9	19.6	23.4	10.3	17.2	18.9
Zydus Wellness (ZYDWEL)	1,911	2,800	Buy	13,449	18.7	56.2	67.8	102.4	34.0	28.2	7.2	6.4	5.8	6.2	7.3	8.6	5.5	7.5	9.0

Source: Bloomberg, ICICI Direct Research

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Buy: >15%

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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