

ITC Ltd.



ITC Ltd – Event Update

Analyst Meet Key Takeaways

CMP INR 224	Target INR 310	Potential Upside 38.4%	Market Cap (INR Mn) INR 2,760,829	Recommendation BUY	Sector Consumer
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Key Highlights:

- ITC Ltd held its first ever virtual Investor & Analyst meet where the management set out key strategies for growth of the company.
- Multiple growth drivers, innovation and R&D, cost optimization, sustainability, digitization, and leveraging world-class talents are the six pillars on which ITC's future strategies are built.
- The 'ITC NEXT' is focusing on redefining its product portfolio, premiumization, exports business, identifying opportunities in proximal markets, identifying newer routes to the market, enhancing its distribution reach, and accelerating digitization to help drive revenue and profitability.

Restructuring Plan:

- Its being quite some time since the demerger news of ITC infotech and FMCG business was heard in the streets. During the analyst meet the management indicated the likely possibility of the demerger in the short term.
- ITC hasn't ruled out the prospect of listing its infotech division and is willing to do everything it takes to maximize value for its non-cigarette FMCG division, which has benefited from institutional synergies. However, the timeline of the demerger is yet to be disclosed.
- ITC would also examine value-accretive mergers and acquisitions opportunities in the FMCG and Infotech areas.
- Further, ITC plans to create an alternative structure for the hotel business in short to medium term as soon as the industry recovers.

Capex Plan:

- Over the next three years, the company would invest INR 100 bn to expand its capacity.
- The company plans to spend 35-40% of its capacity growth budget on adding new lines and improving capabilities in the FMCG business, with the remaining 25-30% going towards expanding capacity in the paperboards business.
- It plans to spend about 10% of its capex on hotels over the next three years, then taper down its expansion as it transitions to an asset-light business.

Financial Highlights:

- ITC has reported a robust financial performance track record in the last one decade, with gross sales value growing 2.2x from ~INR 340 bn in FY11 to ~INR 750 bn in FY21. Whereas PAT grew by 2.6x from ~INR 50 bn to ~INR 130 bn. This was largely an organic-led growth and funded through retained earnings.
- During H1FY22, gross sales value grew by 22% YoY from INR 333.7 bn in H1FY21 to INR 405.5 bn in H1FY22. PAT grew by 20% YoY from INR 60 bn in H1FY22 to INR 67.1 bn in H1FY22.
- The company has been able to generate a consistent strong cash flow, in the last 10 years ITC has generated a cumulative free cash of INR 740 bn.
- The company has also amended its dividend distribution policy, the dividend payout ratio (as a % of sales) has grown by ~3000 bps from 68% in FY17 to 102% in FY21.

Key Financials

INR Mn	FY21	FY22E	FY23E	FY24E
Revenue	531,551	573,837	625,125	678,430
EBITDA	170,027	200,903	223,170	248,984
PAT	131,612	154,758	173,980	195,904
EPS (INR)	10.7	12.6	14.2	15.9
EBITDA Margin	32.0%	35.0%	35.7%	36.7%
NPM	24.8%	27.0%	27.8%	28.9%

Source: KRChoksey Research

Shareholding Pattern

Particulars (%)	Sep-21	Jun-21	Mar-21
Promoters	0.00	0.00	0.00
FIIIs	10.8	11.7	12.8
DIIIs	43.7	42.4	42.5
Others	45.5	45.9	44.7
Total	100	100	100

Source: Bloomberg

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Cigarette

- The consumption share of legal cigarettes in the total tobacco basket comprises of only 8%; whereas the tax revenue share from the legal cigarettes is ~80% of the total tobacco products.
- It has been observed that during FY13 to FY17, a period of significant increases in cigarettes tax rates at a CAGR of 15.7%, has resulted in sub-optimal growth in tax revenue from cigarettes at a CAGR of only 4.7%. However, during a relatively stable tax regime between FY18 to FY20, the tax revenue from cigarettes witnessed a CAGR of 10.2%.
- The legal cigarette industry has been affected by a substantial increase in tax incidence over the years, and India is the fourth largest illicit cigarette market in the world.
- According to the company, high cigarette taxes lead to an increase in the illicit cigarette market. ITC aims to maximize cigarette potential in the tobacco basket, combat illegal trade, and maintain market dominance.
- The trajectory of recovery of cigarette sales post the second Covid wave is faster compared to the first wave, and the company strengthened its market share by over 100 bps over the last 18 months.
- Under its Classic brand, four new variants launched over last 5 years contribute to approximately 25% of the portfolio and under the Gold Flake Brand, new launches in the last 5 years account for 10% of the portfolio.
- The company is expanding the premium modern variants and addressing emerging trends in the segment and reaches 140,000 markets, it said.
- ITC is India's largest buyer, processor, consumer and exporter of cigarette tobacco, it is also the 5th largest leaf tobacco exporter in the world, contributing 40% of the total Indian exports.

FMCG

- FMCG's growth pillars will be fortifying the core and addressing adjacencies leveraging its mother brands and building categories in the future.
- The company is focusing on deepening penetration and accessibility of its products. In the last five years the total reach has increased by 1.2x, direct coverage by 1.4x and stockiest by 6x.
- The revenue of the segment grew by 1.4x from INR 105 bn in FY17 to INR 150 bn in FY21. Whereas the cost optimization strategy has led EBITDA margin expansion by 640 bps since FY17.
- The company said its ecommerce salience is 7%. It is looking at new market routes like direct marketing, tying up with QSR chains, strategic partnerships, climate-controlled supply chain and scaling up food services. ITC expects to grow in the top quartile and get to the best-in-class margins in its categories.
- In its foods business, export is a big area of focus, and its four brands are among the Top 20 trusted food brands in India. Its food brands are present in 5.63 mn stores across the country. It also said that it has 26% market share in the premium biscuit segment.
- In the personal care category, it is witnessing 14% contribution from ecommerce and has a direct-to-consumer reach through Dermafique and Mother Sparsh.

Other business areas

- In the agri business, ITC is focused on processing and value-added products. Its value-added products will drive growth and margins.
- In its paper and paper board business it said that it is the market leader in scale, profitability and sustainability. In the hotels business, it is exploring the take-away option aggressively to increase revenue.
- The company further mentioned that around 41% of ITC energy is from renewable sources. Under sustainability 2.0, it will have 50% of energy from renewable sources by 2030.

Valuation and view: Resilient business model, strong brand leadership position in cigarette business, product innovation track record & premiumization drive is helping the company establishing itself as a FMCG major. Despite the ongoing Covid related slowdown, we see recovery signs in recent months and the current valuation is attractive for long term investors. We value ITC shares using an SOTP (Sum of the parts) approach implying 10.1x EV/EBITDA on FY24E to Cigarette business; 18.8x EV/EBITDA on Hotel segment; an average 5.5x EV/EBITDA on Agri/Paper business; and 10.2x on EV/Revenue on FMCG segment – which yields a target price of INR 310 per share; an upside of 38.4% over the CMP. Accordingly, we re-iterate our “BUY” rating on the shares of ITC Ltd.

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Rating Legend (Expected over a 12-month period)	
Our Rating	Upside
Buy	More than 15%
Accumulate	5% – 15%
Hold	0 – 5%
Reduce	-5% – 0
Sell	Less than – 5%

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