Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

ITC Ltd

Resilient show in tough times

Consumer Goods	Sharekhan code: ITC
Reco/View: Buy ↔	CMP: Rs. 267
	Price Target: Rs. 320 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 27.48

Updated Feb 08, 2022

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

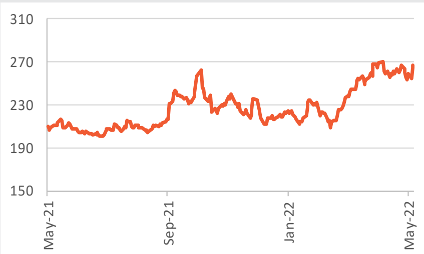
Company details

Market cap:	Rs. 3,28,415 cr
52-week high/low:	Rs. 273 / 201
NSE volume: (No of shares)	224.6 lakh
BSE code:	500875
NSE code:	ITC
Free float: (No of shares)	1,232.3 cr

Shareholding (%)

Promoters	0.0
FII	13.0
DII	42.7
Others	44.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-1.3	19.7	11.3	26.9
Relative to Sensex	3.8	26.1	20.9	18.9

Sharekhan Research, Bloomberg

Summary

- ITC posted a resilient performance in Q4FY2022 with gross revenues growing by growing by 16% (net revenues grew by 16.8%) largely led by strong double-digit growth across categories. OPM sustained at 33.6% on y-o-y basis despite high raw material inflation.
- Cigarette business sales volumes grew by ~9%; non-cigarette FMCG business grew by 12% and Agri business registered strong growth of 30% in Q4.
- Cigarette sales volumes are set to improve further as government has not hiked taxes on cigarettes for second consecutive year. Non-cigarette FMCG biz would grow in high single digit to low double digit while paperboard, paper & packaging business would clock strong double-digit growth in the near term.
- ITC paid a dividend of Rs. 11.5 per share for FY2022 (dividend yield of 4.3%). The stock is currently trading at 18.0x/16.3x its FY2023/24E EPS. We maintain Buy with revised PT of Rs. 320.

ITC put up a resilient show in Q4FY2022 with all businesses posting double digit revenue growth in Q4FY22. Gross revenues (including other operating income) grew by 16% y-o-y to Rs. 16,426.0 crore with a 10% growth in the cigarette business, strong 30% growth in Agri business and 32% growth in the paperboard, paper and packaging (PPP) business. Excluding agri business the gross revenues was up by 13.9% in Q4. Gross margins decreased by 117BPS due to higher inflationary pressures. OPM stood flat y-o-y at 13.6%. Operating profit and PAT grew by 16.8% y-o-y and 11.8% y-o-y, respectively. For FY2022, Revenues grew by ~23% (excluding agri business grew by 16.6%) and PAT grew by 15%. Total dividend for FY2022 stood at Rs. 11.5 per share vs. Rs. 10.75 per share in FY2021.

Key positives

- Non-cigarette FMCG business registered resilient performance with revenues growing by 12.3% and EBIDTA margins improving by 70 bps to 9.0%.
- Agri-business' revenues grew by 30% with EBIT margins stable at 5.7%.
- PPP business' revenue grew by 32% y-o-y with EBIT margins improving by 108 bps to 20.6% led by strong recovery across end-user segments.

Key negatives

- Gross margins decreased by 117 bps to 53.1%.

Management Commentary

- Stable taxes will help legal cigarette industry to compete with illicit trades. With no price hikes in the recent past, the cigarette business sales volume growth momentum to sustain in the quarters ahead. However, a tax rate hike in the upcoming GST Council meet has to be keenly monitored.
- Scale-up of stockist network by 1.4x, market coverage by 1.4x, strong traction to new product launches and increase in e-Commerce salience (sales grew by 1.5x) will help the non-cigarette FMCG business revenues to consistent improve in the medium term. Rural slowdown will lead to lower growth in the near term.
- With overall improvement in the mobility, the hotel business is expected to recover strong in FY2023. PPP business is expected to maintain the strong growth momentum.
- Net cash from operations stood at Rs. 13,000 crore (grew by 32% on y-o-y basis).

Revision in estimates – We have raised earnings estimates for FY2023/24 to factor in the strong all-round performance in Q4FY2022.

Our Call

View - Retain Buy with a revised price target of Rs. 320: Cigarette sales volume are expected to improve in the coming quarters. ITC has enhanced focus and redefined growth strategies for all its business vertical to improve growth prospects in the medium to long term. The stock is currently trading at 18.0x and 16.3x its FY2023E and FY2024 EPS, which is at a discount to some large consumer goods companies. Strong earnings visibility with improving growth prospects of core cigarette business and margin expansion in non-cigarette FMCG business and a high cash generation ability with strong dividend payout (dividend yield of 4.3% in FY2022) will reduce the valuation gap in the coming years. We maintain Buy on the stock with a revised price target of Rs. 320.

Key Risks

The government implementing policies to curb tobacco product consumption or a sustained slowdown in the consumer demand would act as key risk to our earnings estimates.

Valuation (Standalone)

Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenues	48,525	59,746	65,561	72,346
OPM (%)	32.0	31.7	35.1	35.3
Adjusted PAT	13,032	15,058	18,020	20,005
Adjusted EPS (Rs.)	10.7	12.3	14.8	16.4
P/E (x)	25.0	21.6	18.0	16.3
P/B (x)	5.6	5.3	5.1	4.8
EV/EBIDTA (x)	19.5	16.0	13.0	11.6
RoNW (%)	21.2	25.0	28.6	30.0
RoCE (%)	21.5	27.1	32.1	34.1

Source: Company; Sharekhan estimates

Resilient Q4 - Double-digit revenue growth across businesses; OPM sustained y-o-y

ITC's gross revenues grew by 16% y-o-y while net revenue grew by 16.8% y-o-y to Rs. 15,530.9 crore led by strong double digit growth across categories. The cigarette business' net revenues grew by 11% to Rs. 6,443.4 crore aided by volume growth of 9-9.5% (in-line with expectation of ~10%). Non-cigarette FMCG business grew by 12.3% y-o-y to Rs. 4,142.0 crore, agri business grew by 29.6% y-o-y to Rs. 4,366.3 crore, paper, paperboard & packaging (PPP) business reported revenue growth of 31.8% y-o-y to Rs. 2,182.8 crore, while hotel business grew by 35.4% y-o-y to Rs. 389.6 crore. Despite inflationary pressures, the company managed to maintain its OPM at 33.6% with improvement in the margins of cigarette business and non-cigarette FMCG business. The cigarette business' PBIT margin improved by 128 bps y-o-y to 63.9%. Non-cigarette FMCG business PBIT margin improved by 58 bps y-o-y to 5.7%, agri business margins sustained at 5.6% while PPP margins improved by 108 bps y-o-y to 20.6%. Operating profit grew by 17% y-o-y to Rs. 5,224.4 crore. Adjusted PAT grew by 11.8% y-o-y to Rs. 4,191.0 crore. Lower PAT growth was mainly due to lower other income. For the whole of FY2022, net revenue grew by 23.1% y-o-y to Rs. 59,745.6 crore. OPM sustained at 32% while operating profit grew by 22% y-o-y to Rs. 18,933.7 crore. Adjusted PAT registered a growth of 15.5% y-o-y to Rs. 15,057.8 crore. The board has recommended a final dividend of Rs. 6.25 per share. Including interim dividend of Rs. 5.25 per share, total dividend for FY2022 is Rs. 11.50 per share.

Cigarette volumes grew by ~9%; margins improved on y-o-y basis:

Cigarette business gross sales grew by 10.0% y-o-y to Rs. 6,443.4 crore (up by 3% Q-o-Q). Net revenue excluding excise duty grew by ~11%. Cigarette sales volume grew by 9-9.5%. Sales volume surpassed the pre-covid level sales volume. Cigarette business EBIT grew by 12.2% y-o-y. EBIT margins improved by 128 bps to 6.40%. With no increase in taxes on cigarette for second consecutive year, the cigarette sales volumes are expected to further improve in the coming quarters.

FMCG – Others Segment Q4 revenue growth at 12.3%; margins maintained at 9%

In Q4FY2022, revenues grew by 12.3% y-o-y and 30.1% over Q4FY2020 to Rs. 4,142 crore led by strong growth in the discretionary/out-of-home categories while re-opening educational institutions aided recovery in education and stationery products. Modern trade sales accelerated with improved mobility & store footfall and the e-commerce channel reported robust growth with sales growth at nearly 1.5x. ITC improved its market penetration in FY2022 with a scale-up of stockist network by 1.4x in FY2021, increase in direct coverage by 1.1x level of FY2021 and 1.4x growth in its market coverage. Q4FY2022 segment EBITDA up 22% y-o-y and 46% over Q4 FY20. EBITDA margins sustained at 9% (+75 bps y-o-y; up 100 bps versus Q4FY20) despite unprecedented inflationary headwinds aided by sharp focus on cost, better revenue mix and judicious pricing actions.

For the whole of FY2022, segment revenue grew by 8.6% y-o-y and 24.5% over FY2020. Staples and Convenience Foods remained resilient even as the pace of revenue growth witnessed moderation on a relatively high base. Discretionary/out-of-home categories recorded strong growth surpassing pre-pandemic levels driven by progressive improvement in mobility and favourable comparables. The Health & Hygiene portfolio witnessed demand volatility in line with COVID caseload intensity while remaining significantly above pre-pandemic levels. The Education & Stationery Products business saw a gradual recovery driven by progressive resumption of physical classes at educational institutions; however, sales remained below pre-pandemic levels. Segment EBITDA for FY2022 grew by 10.0% y-o-y to Rs. 1,448.97 crore with margins being sustained at 9.1% in spite of unprecedented inflationary headwinds. An unprecedented increase in prices of key inputs was mitigated through focused cost management interventions across the value chain, premiumisation, product mix enrichment, judicious pricing actions and fiscal incentives.

The company executed over 110 new product launches across target markets in FY2022. In line with ITCs Multi-channel GTM strategy, market and outlet coverage were stepped up to ~1.4x and 1.1x respectively over FY2021. Direct reach enhancement in rural markets was supported through a hub and spoke distribution model with the expansion of rural stockists network to 1.4x over FY2021 and collaborations with rural-focused eB2B players. Further, sales through e-Commerce channel increased 1.5x in FY2022, taking the channel salience to 7%.

Agri-business revenues up by 30% y-o-y while margins stayed stable at 5.6% in Q4

In Q4FY2022, the agri-business segment's revenue was up 29.6% y-o-y to Rs. 4,366.3 crore driven by wheat, rice, leaf tobacco exports, leveraging of strong customer relationships, investments in sustainable value chains, robust sourcing network and agile execution. ITC's proactive supply chain management ensured on-time execution despite significant operational challenges posed by container shortages, congestion in ports and elevated ocean freight costs. EBIT margins stayed steady at 5.6%. For the whole of FY2022, Agri Business Segment revenue and results grew by 28.7% and 25.6% y-o-y respectively driven by strong growth in wheat, rice, spices and leaf tobacco exports on the back of strong customer relationships, robust sourcing network and agile execution.

Domestic leisure and wedding segments drive recovery in Hotels

The hotel business' revenue grew by 35.4% y-o-y to Rs. 389.6 crore as domestic leisure and wedding segments drove recovery while progressive improvement was registered in business travel and nascent revival in international travel. Hotels witnessed smart recovery in spite of the third wave impacting recovery momentum in January-February 2022. As of Q4FY2022-end, occupancies surpassed pre-pandemic levels with sequential improvement in ARRs. Pick-up in revenues together with relentless focus on cost management resulted in a positive swing of Rs. 346.63 crore in the segment's EBITDA, despite considerable disruptions caused by the pandemic during the year. ITC continued its focus on cost control and reduced its controllable cash fixed costs by 20% vs FY20 levels in FY2022. During FY2022, nine new properties were added to the group portfolio, including four in the Welcomhotel portfolio at Bhubaneswar & Guntur (owned), and at Katra & Chail (managed). ITC Narmada project in Ahmedabad is progressing well and the hotel is expected to be commenced shortly.

Double-digit growth in PPP business in Q4; 108 bps y-o-y margin expansion

The paperboard & packaging (PPP) business reported revenue growth of 31.8% y-o-y to Rs. 2,182.8 crore driven by higher volumes and realization aided by demand revival across most end-user segments. Integrated business model, Digital & Industry 4.0 initiatives and proactive strategic interventions enabled 108 bps y-o-y margin expansion to 20.6% amidst commodity price escalation. For full year FY2022, the segment recorded strong revenue growth of 36.0% y-o-y and 54.7% y-o-y growth in segment results aided by demand revival across most end-user segments, higher realisations, product mix enrichment and exports. Greenfield project in Nadiad, Gujarat expected to be commissioned in Q2FY2023.

Results (Standalone) Rs cr

Particulars	Q4FY22	Q4FY21	Y-o-Y %	Q3FY22	Q-o-Q %
Gross revenue	**16,426.0**	**14,157.0**	**16.0**	**16,806.9**	**-2.3**
Excise duty	895.2	862.3	3.8	944.6	-5.2
Net revenue	**15,530.9**	**13,294.7**	**16.8**	**15,862.3**	**-2.1**
Raw Material Consumed	7,279.9	6,076.2	19.8	7,720.4	-5.7
Employee Expenses	809.5	735.6	10.1	765.2	5.8
Other Expenses	2,217.1	2,009.9	10.3	2,274.7	-2.5
Total expenditure	10,306.5	8,821.6	16.8	10,760.2	-4.2
Operating Profit	**5,224.4**	**4,473.0**	**16.8**	**5,102.1**	**2.4**
Other income	674.1	772.0	-12.7	809.9	-16.8
Interest	10.5	3.1	234.1	10.7	-1.9
Depreciation	445.9	388.0	14.9	409.3	8.9
Profit before tax	**5,442.0**	**4,853.9**	**12.1**	**5,492.0**	**-0.9**
Tax	1,251.1	1,105.5	13.2	1,335.8	-6.3
Adjusted PAT	**4,191.0**	**3,748.4**	**11.8**	**4,156.2**	**0.8**
EPS (Rs.)	3.4	3.0	11.8	3.4	0.8
			bps		**bps**
GPM (%)	53.1	54.3	-117	51.3	180
OPM (%)	33.6	33.6	-1	32.2	147
NPM (%)	27.0	28.2	-121	26.2	78
Tax rate (%)	23.0	22.8	21	24.3	-133

Source: Company; Sharekhan Research

Segment Revenue break up Rs cr

Particulars	Q4FY22	Q4FY21	Y-o-Y %	Q3FY22	Q-o-Q %
FMCG - cigarettes	6,443.4	5,859.6	10.0	6,244.1	3.2
FMCG - others	4,142.0	3,687.5	12.3	4,090.6	1.3
Hotels	389.6	287.8	35.4	473.4	-17.7
Agri	4,366.3	3,368.9	29.6	4,962.4	-12.0
Paperboard, Paper and Packaging	2,182.8	1,655.9	31.8	2,046.5	6.7
Total	**17,524.1**	**14,859.7**	**17.9**	**17,816.9**	**-1.6**
Less: Inter segment sales	1,297.5	836.3	55.1	1,183.1	9.7
Gross Sales	**16,226.6**	**14,023.4**	**15.7**	**16,633.9**	**-2.4**

Source: Company; Sharekhan Research

Segment PBIT and PBIT margins

Business	PBIT (Rs crore)		Y-o-Y %	Margins (%)		Chg in BPS
	Q4FY22	Q4FY21		Q4FY22	Q4FY21	
FMCG - cigarettes	4,114.3	3,666.5	12.2	63.9	62.6	128
FMCG - others	236.0	188.6	25.1	5.7	5.1	58
Hotels	-34.2	-40.1	-14.7	-8.8	-13.9	515
Agri	244.0	189.9	28.5	5.6	5.6	-5
Paperboard, Paper and Packaging	449.7	323.3	39.1	20.6	19.5	108
Total	**5,009.7**	**4,328.1**	**15.7**	**28.6**	**29.1**	**-53.9**

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector outlook – Cigarette remains a regulatory risk, FMCG long's-term growth prospects intact

The domestic cigarette industry is affected by a sustained increase in taxes and regulatory regime along with a sharp increase in illegal trade in recent years, especially at the premium end, which continue to pose significant challenges to the legal cigarette industry in the country. Though cigarettes were skipped from increased taxes in two consecutive Union Budget, there is sustained risk of regulatory hurdles implemented to curb tobacco product consumption. On the other hand, medium to long term 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 a sustainable revenue growth in the medium to long run.

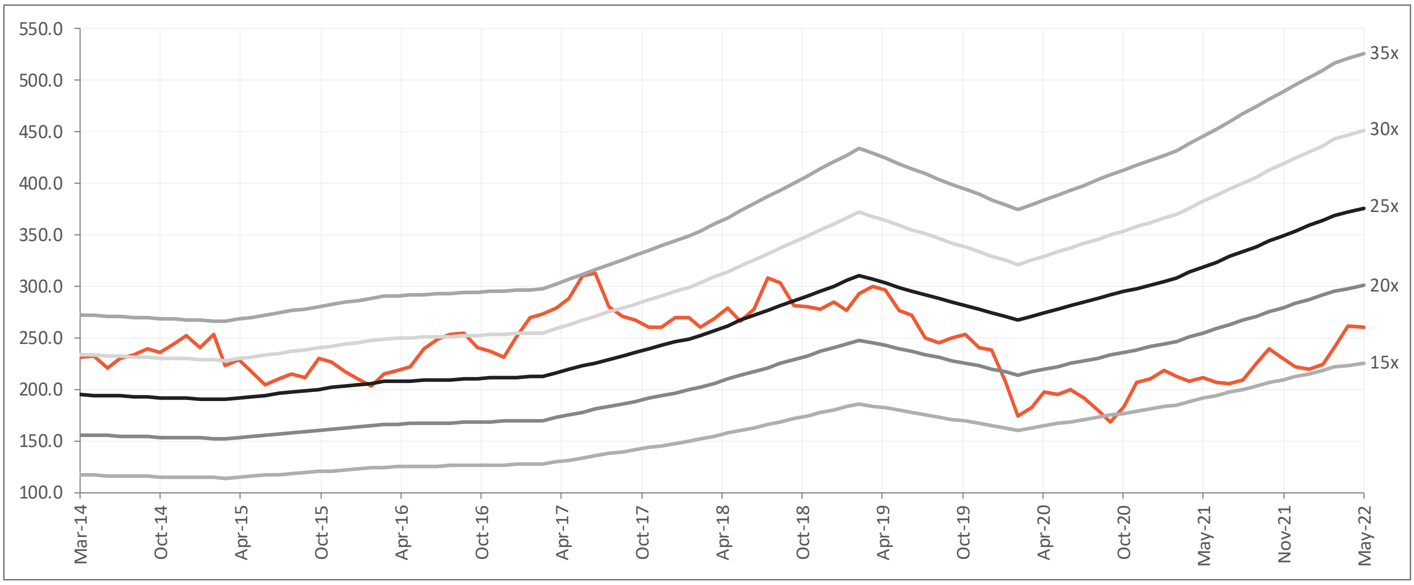
■ Company outlook – Cigarette business regaining normalcy; FMCG margins to scale up

Cigarette sales volume are expected to improve further with government not increasing taxes on cigarettes for the second consecutive year. Scale-up of stockiest network by 1.4x, market coverage by 1.4x, strong traction to new product launches and increase in e-Commerce salience (salience at 7% in FY2022) will help the non-cigarette FMCG business revenues to consistent improve in the coming quarters. PBIT margins of the business will improve led by efficiencies and scale-up in contribution of new businesses.

■ Valuation – Retain Buy with a revised price target of Rs. 320

Cigarette sales volume are expected to improve in the coming quarters. ITC has enhanced focus and redefined growth strategies for all its business vertical to improve growth prospects in the medium to long term. The stock is currently trading at 18.0x and 16.3x its FY2023E and FY2024 EPS, which is at a discount to some large consumer goods companies. Strong earnings visibility with improving growth prospects of core cigarette business and margin expansion in non-cigarette FMCG business and a high cash generation ability with strong dividend payout (dividend yield of 4.3% in FY2022) will reduce the valuation gap in the coming years. We maintain Buy on the stock with a revised price target of Rs. 320.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Hindustan Unilever	60.9	55.6	46.3	42.5	39.0	32.5	23.8	26.2	30.8
ITC	21.6	18.0	16.3	16.0	13.0	11.6	27.1	32.1	34.1

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, PPP and hotel businesses. The company has quickly rebound from disruption caused by the lockdown and key businesses are operating at normal levels. The company posted resilient performance in FY2022 with double-digit revenue and PAT growth. We expect the momentum to sustain in FY2023 and FY2024.. 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
Supratim Dutta	Chief Financial Officer
Nakul Anand	Executive Director
Sumant Bhargavan	Executive Director
Rajiv Tandon	Executive Director
Rajendra Kumar Singhi	Executive Vice President & Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	British American Tobacco PLC	29.37
2	Life Insurance Corp of India	15.83
3	Unit Trust of India	7.91
4	Capital Group of Cos Inc	3.04
5	SBI Funds Management Ltd	2.99
6	QIB Insurance Company	2.52
7	General Insurance Corp of India	1.76
8	HDFC AMC	1.64
9	New India Assurance Co Ltd	1.49
10	ICICI Prudential Asset Management Co.	1.45

Source: Bloomberg

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

Know more about our products and services

For Private Circulation only

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