Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

ITC Ltd

Strong all-round performance

Consumer Goods		Sharekhan code: ITC		
Reco/View: Buy	↔	CMP: Rs. 380	Price Target: Rs. 450	↑

↑ 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 28.03

Updated Dec 08, 2022

Medium Risk

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

Source: Morningstar

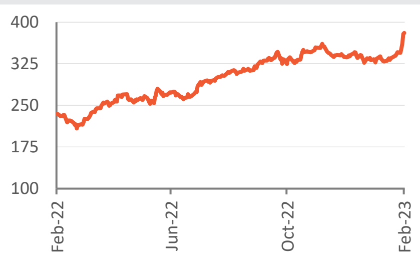
Company details

Market cap:	Rs. 4,72,276 cr
52-week high/low:	Rs. 384 / 207
NSE volume: (No of shares)	117.8 lakh
BSE code:	500875
NSE code:	ITC
Free float: (No of shares)	1241.2 cr

Shareholding (%)

Promoters	0.0
FII	43.8
DII	42.2
Others	14.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	16.4	7.6	22.5	62.4
Relative to Sensex	16.1	7.8	18.3	58.9

Sharekhan Research, Bloomberg

Summary

- ITC posted yet another quarter of strong performance in Q3FY2023 with revenue (excluding the agri business) up 17.5% and PAT up 21%, with sharp 619 bps y-o-y improvement in OPM to 38.4% (improved by 400 bps q-o-q).
- Cigarette business sales volumes grew by ~15% in Q3. With no significant tax rate hike on cigarettes in the Union Budget, the volume growth momentum is expected to sustain in the coming quarters.
- Non-cigarette FMCG business grew by 18% with EBIDTA margin improving to 10%. With a strong focus on innovations and distribution expansion growth momentum in non-cigarette FMCG business to sustain. Hotel business will continue to outperform on strong industry tailwinds.
- Despite strong run-up in ITC's stock price in recent times, valuations at 25x/23x/20x its FY2023E/FY2024E/FY2025E looks attractive in the backdrop strong earnings growth visibility. We maintain our Buy rating with revised PT of Rs. 450.

For Q3FY2023, ITC reported strong performance, ahead of our as well as street expectation, on account of better-than-expected volume growth in the core cigarette business, strong margin improvement in the non-cigarette FMCG business, and a stellar performance by the hotel business. Gross revenue grew by 2.7% y-o-y to Rs. 17,265.5 crore (13.5% growth on three-year CAGR basis). However, excluding the agri business, gross revenue growth stood at 17.5% y-o-y. Agri business had a strong base of high wheat exports in the corresponding quarter last year. Gross margin improved by 756 bps y-o-y to 58.9% and operating profit margin (OPM) improved by 619 bps to 38.4%. Operating profit grew by 22% y-o-y to Rs. 6,223.2 crore and reported PAT grew by 21% y-o-y to Rs. 5,031 crore. Growth in revenue and PAT was broad based, with all businesses (except for the agri business) registering strong double-digit revenue growth and expansion in PBIT margin. For 9MFY2023, gross revenue grew by 21.8% y-o-y to Rs. 52,745.2 crore, OPM expanded by 213 bps y-o-y to 35.7%, and reported PAT grew by 25.8% y-o-y to Rs. 13,665.9 crore.

Key positives

- Cigarette business sales volumes grew by ~15% as against our expectation of 8% and street expectation of 8-10%.
- Non-cigarette FMCG business registered resilient performance with revenue rising by 18%; EBIDTA margin stood at 10%, improving from 9.1% in Q3FY2022 (50 bps q-o-q).
- Hotels business revenue grew by 50.5% to Rs. 712 crore with RevPar ahead of pre-pandemic levels; EBIDTA margin stood strong at 31.5% (LY 24.7%).
- The company declared interim dividend of Rs. 6 per share (compared to Rs. 5.25 per share in Q3FY2022).

Key negatives

- Agri business revenue decreased by 37% y-o-y to Rs. 3,123 crore due to increased wheat exports in the base quarter.

Management Commentary

- Stable taxes will help the legal cigarette industry to compete with illicit traders. Further, enforcement agencies have taken stringent actions to curb consumption of illicit cigarettes. With no major tax rate hike in cigarette in the recent Union Budget, we expect the cigarette sales volume growth momentum to sustain in the coming quarters.
- Non-cigarette FMCG business witnessed strong growth across channels and markets, driven by expansion in outlet coverage, enhanced penetration, and superior last-mile execution. Overall, input costs remained elevated even as some commodities witnessed sequential moderation in prices.
- Non-cigarette FMCG business's profitability continued to improve on account of multiple initiatives such as strategic cost management, premiumisation, supply chain agility, judicious pricing actions, fiscal incentives, leveraging digital, and optimising channel assortments.

Revision in estimates – We have fine-tuned our earnings estimates for FY2023, FY2024, and FY2025 to factor in better-than-expected performance in Q3FY2023, driven by higher sales in cigarettes, better-than-expected margins in the non-cigarette FMCG business, and strong growth in the hotel business.

Our Call

View – Retain Buy with a revised PT of Rs. 450: With no price hikes in the near term and government action on curbing illicit cigarette will help ITC to maintain volume growth momentum in the cigarette business. Strong growth in the non-cigarette FMCG business, stellar recovery in the hotel business, and sustained strong growth in the PPP business will drive double-digit revenue and PAT growth over the next two years. The stock currently trades at 25.3x, 22.6x and 20.4x its FY2023E, FY2024, and FY2025E EPS, which is at a discount to some large consumer goods companies. Strong earnings visibility with improving growth prospects of the core cigarette business and margin expansion in the non-cigarette FMCG business, along with a high cash-generation ability and strong dividend payout, will consistently improve the valuations in the coming years. We maintain our Buy recommendation on the stock with a revised price target (PT) of Rs.450 (rolling it over to FY2025E earnings).

Key Risks

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

Valuation (standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E	FY25E
Revenues	48,525	59,746	69,951	77,000	84,898
OPM (%)	32.0	31.7	34.7	35.2	35.6
Adjusted PAT	13,032	15,058	18,347	20,524	22,769
Adjusted EPS (Rs.)	10.7	12.3	15.0	16.8	18.7
P/E (x)	35.6	30.8	25.3	22.6	20.4
P/B (x)	7.9	7.6	7.2	6.7	6.1
EV/EBIDTA (x)	28.5	23.4	18.1	16.1	14.5
RoNW (%)	21.2	25.0	29.0	30.5	31.3
RoCE (%)	21.5	27.1	33.9	36.1	37.3

Source: Company; Sharekhan estimates

Strong Q3 – Double-digit revenue growth (ex-agri business); OPM expanded strongly

ITC's net revenue (net of excise) grew by 2.3% y-o-y to Rs. 16,225.7 crore. Net revenue of the cigarette business grew by 18% y-o-y to Rs. 6,248.5 crore. We expect volume growth to be in double digits. Non-cigarette FMCG business grew by 18% y-o-y to Rs. 4,841.4 crore. Agri business revenue declined by 37% y-o-y on a high base of Q3FY2022. Paper, paperboard, and packaging (PPP) business revenue grew by 13% y-o-y. Despite inflationary pressures, gross margin improved by 756 bps y-o-y to 58.9% on account of better mix and strong sourcing ability. OPM improved by 619 bps y-o-y to 38.4%. Cigarette PBIT margin improved by 11 bps y-o-y to 63.4%. PBIT margin of the non-cigarette FMCG business improved by 128 bps y-o-y to 7.2%. Other businesses also saw strong improvement in EBIT margin during the quarter. Operating profit grew by 22% y-o-y to Rs. 6,223.2 crore. PAT grew by 21% y-o-y to Rs. 5,031 crore. The company declared interim dividend of Rs. 6 per share for FY2023.

Cigarette volumes grew by ~15%; Margins remained stable y-o-y

Gross cigarette sales grew by 16.7% y-o-y to Rs. 7,288.2 crore (up 5% q-o-q). Gross revenue grew by 11% on a three-year CAGR basis compared with Q3FY2020. Net revenue excluding excise duty grew by ~18%. Cigarette sales volumes grew by ~15% in Q3. The company has maintained strong sales volume growth for the past few quarters. Strong growth was registered across key regions and markets. Cigarette business PBIT grew by 16.9% y-o-y to Rs. 4,619.7 crore. PBIT margin stood flat with marginal improvement of 11 bps y-o-y to 63.4%. Stable taxes will help the legal cigarette industry to compete with illicit trades. Further, enforcement agencies have taken stringent actions to curb consumption of illicit cigarettes. The government has marginally increased the tax rate on cigarettes by 2% and, hence, price hikes will be minimal in the coming quarters. This will help the volume growth momentum to sustain in the cigarette business.

FMCG – Others segment's Q3 revenue growth at 18% y-o-y; PBIT margin up 128 bps y-o-y

In Q3FY2023, revenue grew by 18.4% y-o-y and by 1.5x over Q3FY2020 to Rs. 4,841 crore, driven by strong growth in staples, biscuits, noodles, snacks, dairy, beverages, and frozen foods. The hygiene portfolio continued to witness moderation in demand, while education and stationery products business continued to witness strong traction. Growth was broad-based with strong growth across channels and markets (both urban and rural), driven by ramp-up in outlet coverage, enhanced penetration, and superior last-mile execution. e-Commerce sales witnessed rapid growth, driven by account-specific strategies, new product introductions, and customised supply chain solutions. Modern trade sales accelerated with higher store footfalls and joint business planning with key accounts. The segment's PBIT margin grew by 128 bps y-o-y to 7.2%, driven by multi-pronged interventions, including strategic cost management, premiumisation, supply chain agility, judicious pricing actions, fiscal incentives, leveraging digital, and optimising channel assortments. EBIDTA margin for the quarter came at 10% in Q3FY2023 vs. 9.1% in Q3FY2022.

Agri-business revenue declined by 37% y-o-y, while PBIT margin improved by 658 bps y-o-y

In Q3FY2023, agri-business revenue declined by 37% y-o-y to Rs. 3,124 crore, impacted by restrictions imposed on wheat and rice exports. During the quarter, the business commissioned its new value-added spices processing facility in Guntur. ITC's facility to manufacture and export nicotine and nicotine-derivative products set up by the company's wholly owned subsidiary, ITC IndiVision Limited, is making steady progress. PBIT margin improved by 658 bps y-o-y to 12.5%, driven by growth in leaf tobacco exports and value-added agri products.

Hotel business's revenue grew by 50.5% y-o-y; PBIT expanded by 984 bps y-o-y

The hotel business's revenue grew by 50.5% y-o-y and 1.3x of Q3FY2020 to Rs. 712 crore, with strong growth registered across locations. RevPAR was registered ahead of pre-pandemic levels, driven by retail (packages), leisure, weddings, and MICE segments. Domestic business travel normalised, while inbound foreign travel witnessed pickup. Special occasions and festivals were effectively leveraged to drive demand. The company has a healthy pipeline of properties under Welcomhotel, Mementos, Storii, and Fortune, with phased openings over the next few quarters. The segment's PBIT margin grew by 984 bps y-o-y to 20.5%, driven by higher RevPAR, operating leverage, and structural cost interventions.

PPP business growth at 25% y-o-y; 518 bps y-o-y margin expansion

The paperboard and packaging (PPP) business reported revenue growth of 13% y-o-y to Rs. 2,306 crore, driven by higher realisations in domestic and export markets. Value Added Paperboard (VAP) recorded strong y-o-y growth, aided by higher realisations. The fine paper segment performed well, driven by pickup in the publications and notebooks segments. PBIT margin of the business expanded by 438 bps y-o-y to 26.3%. Strategic investments in capacity expansion in the VAP segment, pulp import substitution, cost-competitive fibre chain, decarbonisation of operations, sharper focus on operational efficiency leveraging data analytics, and Industry 4.0 enabled scaling up the business and margin expansion despite an escalation in key input prices.

Results (standalone) Rs cr

Particulars	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
Gross revenue	**17,265.5**	**16,806.9**	**2.7**	**17,159.6**	**0.6**
Excise duty	1,039.8	944.6	10.1	1,029.7	1.0
Net revenue	**16,225.7**	**15,862.3**	**2.3**	**16,129.9**	**0.6**
Raw Material Consumed	6,671.2	7,720.4	-13.6	6,938.0	-3.8
Employee Expenses	877.0	765.2	14.6	936.4	-6.3
Other Expenses	2,454.3	2,274.7	7.9	2,391.2	2.6
Total expenditure	10,002.5	10,760.2	-7.0	10,265.6	-2.6
Operating Profit	**6,223.2**	**5,102.1**	**22.0**	**5,864.3**	**6.1**
Other income	871.7	809.9	7.6	506.9	72.0
Interest	10.2	10.7	-4.8	10.7	-4.6
Depreciation	407.2	409.3	-0.5	422.0	-3.5
Profit before tax	**6,677.5**	**5,492.0**	**21.6**	**5,938.5**	**12.4**
Tax	1,646.5	1,335.8	23.3	1,472.5	11.8
Adjusted PAT	5,031.0	4,156.2	21.0	4,466.1	12.6
EPS (Rs.)	4.1	3.4	21.0	3.6	12.6
			bps		**bps**
GPM (%)	58.9	51.3	756	57.0	190
OPM (%)	38.4	32.2	619	36.4	200
NPM (%)	31.0	26.2	480	27.7	332
Tax rate (%)	24.7	24.3	33	24.8	-14

Source: Company; Sharekhan Research

Segment Revenue break up Rs cr

Particulars	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
FMCG - cigarettes	7,288.2	6,244.1	16.7	6,953.8	4.8
FMCG - others	4,841.4	4,090.6	18.4	4,884.8	-0.9
Hotels	712.4	473.4	50.5	536.0	32.9
Agri	3,123.8	4,962.4	-37.1	3,997.0	-21.8
Paperboard, Paper and Packaging	2,305.5	2,046.5	12.7	2,287.6	0.8
Total	**18,271.3**	**17,816.9**	**2.6**	**18,659.1**	**-2.1**
Less: Inter segment sales	1,187.6	1,183.1	0.4	1,687.9	-29.6
Gross Sales	**17,083.7**	**16,633.9**	**2.7**	**16,971.2**	**0.7**

Source: Company; Sharekhan Research

Segment PBIT and PBIT margins

Particulars	PBIT (Rs crore)			Margins (%)		
	Q3FY23	Q3FY22	YoY (%)	Q3FY23	Q3FY22	YoY (bps)
FMCG - cigarettes	4,619.7	3,950.7	16.9	63.4	63.3	11
FMCG - others	348.1	241.9	43.9	7.2	5.9	128
Hotels	146.2	50.6	189.1	20.5	10.7	984
Agri	391.5	295.3	32.6	12.5	6.0	658
Paperboard, Paper and Packaging	606.2	448.5	35.2	26.3	21.9	438
Total	**6,111.6**	**4,986.9**	**22.6**	**33.4**	**28.0**	**546**

Source: Company; Sharekhan Research

Outlook and Valuation

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

The domestic cigarette industry is affected by a sustained rise in taxes and regulatory regime along with a sharp increase in illegal trade in the past few years, especially at the premium end, which continues to pose significant challenges to the legal cigarette industry. However, in recent times, the government has undertaken stringent actions to curb illicit cigarette sales volume. This along with lower price hikes in the cigarette portfolio will help cigarette companies post better volume growth. On the FMCG front, a normal monsoon, cooling off of commodity prices, and improved consumer sentiments will help volume growth to recover in H2FY2023. Companies are witnessing margin expansion in H2FY2023. Overall, we expect H2FY2023 to be much better as compared to H1FY2023 with expected recovery in volume growth and likely expansion in margins in Q3FY2023/Q4FY2023.

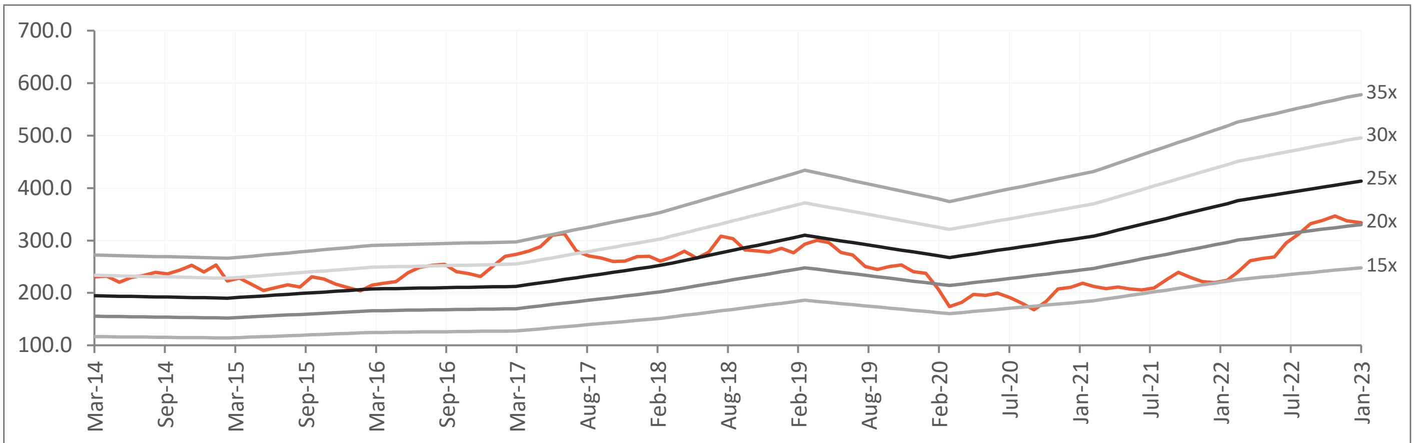
■ Company Outlook – Cigarette business sales momentum to sustain; FMCG margins to scale up

Cigarette sales volume is expected to improve further with the government not increasing taxes on cigarettes for the second consecutive year. Scale-up of the stockist network by 2.7x, market coverage by 2.0x, direct outlet servicing by 1.3x, strong traction to new product launches, and an increase in e-commerce salience to about ~7% will help the non-cigarette FMCG business's revenue to consistently improve in the medium term. Good monsoon will lead to recovery in rural demand. PBIT margin of the business will improve, led by efficiencies and scale-up in the contribution of new businesses. FY2023 and FY2024 will be strong years for the hotels business due to higher demand from domestic leisure travel.

■ Valuation – Retain Buy with a revised price target of Rs. 450

With no price hikes in the near term and government action on curbing illicit cigarette will help ITC to maintain volume growth momentum in the cigarette business. Strong growth in the non-cigarette FMCG business, stellar recovery in the hotel business, and sustained strong growth in the PPP business will drive double-digit revenue and PAT growth over the next two years. The stock currently trades at 25.3x, 22.6x and 20.4x its FY2023E, FY2024, and FY2025E EPS, which is at a discount to some large consumer goods companies. Strong earnings visibility with improving growth prospects of the core cigarette business and margin expansion in the non-cigarette FMCG business, along with a high cash-generation ability and strong dividend payout, will consistently improve the valuations in the coming years. We maintain our Buy recommendation on the stock with a revised price target (PT) of Rs.450 (rolling it over to FY2025E earnings).

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Hindustan Unilever	70.3	65.1	55.0	49.2	45.4	38.6	24.1	25.9	30.1
ITC	30.8	25.3	22.6	23.4	18.1	16.1	27.1	33.9	36.1

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
Rajendra Kumar Singhi	Executive Vice President & Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	British American Tobacco PLC	29.16
2	Life Insurance Corp of India	15.54
3	Unit Trust of India	7.85
4	SBI Funds Management Ltd.	3.18
5	Capital Group of Cos Inc.	2.94
6	General Insurance Corp of India	1.75
7	New India Assurance Co. Ltd.	1.48
8	HDFC AMC	1.26
9	GQG Partners LLC	1.14
10	GQG Partners EME Funds	1.14

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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