

BSE SENSEX 59,806
S&P CNX 17,590

CMP: INR388 TP: INR450 (+16%) Buy



Stock Info

	ITC IN
Bloomberg	ITC IN
Equity Shares (m)	12259
M.Cap.(INRb)/(USDb)	4817.4 / 58.8
52-Week Range (INR)	394 / 226
1, 6, 12 Rel. Per (%)	5/19/62
12M Avg Val (INR M)	4983
Free float (%)	100.0

Financials & Valuations (INR b)

Y/E March	2023E	2024E	2025E
Sales	675.3	734.6	808.4
Sales Gr. (%)	19.9	8.8	10.0
EBITDA	242.5	279.2	312.2
Margins (%)	35.9	38.0	38.6
Adj. PAT	185.1	215.1	243.1
Adj. EPS (INR)	15.0	17.5	19.7
EPS Gr. (%)	23.0	16.2	13.0
BV/Sh.(INR)	51.7	55.5	59.7

Ratios

RoE (%)	29.6	32.6	34.2
RoCE (%)	28.8	31.8	33.5

Valuation

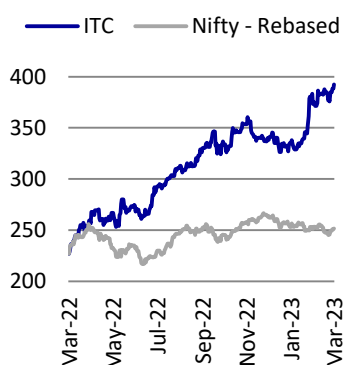
P/E (x)	25.8	22.2	19.7
P/BV (x)	7.5	7.0	6.5
EV/EBITDA (x)	18.3	15.7	13.9
Div. Yield (%)	3.5	3.6	4.1

Shareholding pattern (%)

As On	Dec-22	Sep-22	Dec-21
Promoter	0.0	0.0	0.0
DII	71.4	71.6	43.7
FII	13.9	13.5	10.1
Others	14.8	14.9	46.2

FII Includes depository receipts

Stock's performance (one-year)



Earnings visibility continues to drive outperformance

As consumer companies continue to struggle in an uncertain operating environment, ITC is better placed than peers with accelerated earnings growth over the past two years, especially in FY23, and strong earnings visibility compared to peers into FY24 as well. Key factors behind its positive outlook are:

- Healthy cigarette volume growth in the recent quarters is likely to sustain in the near term, leading to the best three-year and four-year average volume growth for over a decade.
- With no high indirect tax increase in the FY24 budget, the operating environment is far more conducive compared to the punitive regime of the preceding years.
- Over the past five to six quarters, the company has sparingly used its pricing lever and can continue to take leverage on the same going forward.
- Unlike staples peers, the company has displayed resilient operating performance of its 'Other FMCG' business in the past few quarters. If wheat costs decline sharply post the Rabi harvest, performance on the segmental margin front can be even better in FY24.
- Hotels business prospects are likely to be buoyant going forward as highlighted in our [thematic report on hotels](#) by our mid-cap team.
- We maintain our Buy rating on the stock as a result of (a) better earnings visibility over peers in the next few quarters, (b) inexpensive valuations; and (c) attractive dividend yield.

Cigarette business outlook remains healthy

At a time when consumer companies have witnessed a slowdown, cigarette volumes for ITC have registered a strong double-digit YoY growth in the recent quarters and three-year and four-year average volume growth have been in mid-single digits. This has been the best growth levels in over a decade and far superior to the flattish volumes of the past 10 and 20 years. In a relatively less stringent indirect tax environment, ITC is better placed owing to its judicious pricing actions and its recent recuperation of some temporary market share loss in the capsule segment. Smuggling has also been a relatively lower factor due to government crackdown as well as a less punitive indirect tax regime compared to the past.

Absence of material tax increases in the budget is a relief

In the FY24 national budget, National Calamity Contingent Duty (NCCD) on all four filter cigarette categories viz. less than 65mm, 65-70mm, 70-75mm, and above 75mm was increased by 15-16%. However, the total NCCD across these segments is less than 10% of the total indirect taxation, which is ~60% of MRP. Hence, the effective increase would be less than 1%, dodging a significant hurdle in the near term. While subsequent GST council meetings can drive up cigarette GST, the outlook on cigarette volumes looks positive as of now.

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

'Other FMCG' growth momentum remains strong; better times ahead

ITC's 'Other FMCG' segment (the second-largest contributor to sales) is also witnessing strong sales and earnings momentum unlike most consumer staples peers. Over the past three quarters, 'Other FMCG' Sales growth has been hovering in high teens to early 20% at a time when staples peer growth is much lower. This is also despite a significantly high base in terms of absolute scale. We expect 'Other FMCG' business to register revenue of over INR190b in FY23, the fourth largest in our coverage universe after HUVR, TTAN, and APNT. Margins have been resilient, registering a YoY growth in the recent quarters, despite steep inflation in commodity costs. The likelihood of a good Rabi season could lead to substantial cooling off in wheat prices from 1QFY24 onwards, which could boost 'Other FMCG' further in FY24.

Outlook for Hotel business bright

The Indian hospitality industry has been witnessing steady rise over the recent quarters as highlighted in our recent [Hotel business thematic note](#) by our mid cap team. For ITC, the Hotel business sales and EBIT are witnessing new highs after over a decade, with the adverse impact of overcapacity fading away. Within discretionary consumption, this segment has not been significantly impacted by the ongoing consumption slowdown and with various events such as the G20 summit, women's and men's IPL tournaments, and the Cricket World Cup in FY24, outlook for the industry appears to be bright.

Valuation and view

- ITC has demonstrated a healthy 23% EPS growth in FY23E and we expect a likely EPS CAGR of ~15% over the next two years as well. ITC's earnings outlook is better than other large cap staples players both on a two-year CAGR ending FY23E as well as FY24 earnings growth expectations.
- At a time when uncertainty looms over the industry, led by high inflation, unpredictable monsoons, continued weak rural sales, and delay in commodity costs decline, ITC's earnings performance in the last couple of years and in FY24 shines like a beacon.
- The stock has done well [since our detailed upgrade](#) note in Jun'22 with ~45% stock price appreciation at a time when consumer peers both staples, and recently, discretionaries have struggled. ITC's dividend yield is healthy at 3.5-4% despite the stock price appreciations and valuations remain inexpensive at 22.2x FY24 EPS and less than 20x FY25 EPS.
- The challenges for ITC led by (a) an extremely punitive tax regime of the past, (b) covid related disruptions and (c) commodity cost inflation now seems to be receding. **We maintain BUY rating and our target price of INR450.**

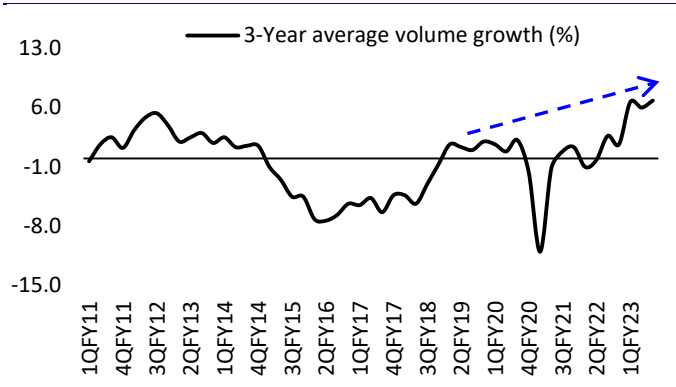
Cigarettes business is witnessing remarkable traction

- Over the last few quarters, the cigarette business of ITC has been doing remarkably well, led by a series of events in the recent years:
 - Absence of steep GST/NCCD increases since Jul’17
 - Absence of steep price hike by the company
 - The recuperation of some temporary market share loss in the capsule segment with ITC augmenting its domestic manufacturing capability.
- Unlike the period before Jul’17, where a series of steep excise/VAT increases led to an intensification of smuggling activity, the less onerous regime of recent years has meant that contraband proportion has not intensified.
- Government actions to check the smuggling of illegal cigarettes into the country.
- This has manifested into better numbers for ITC’s cigarette business in myriad ways, starting with volume growth.

Volume growth trend is the best in over a decade

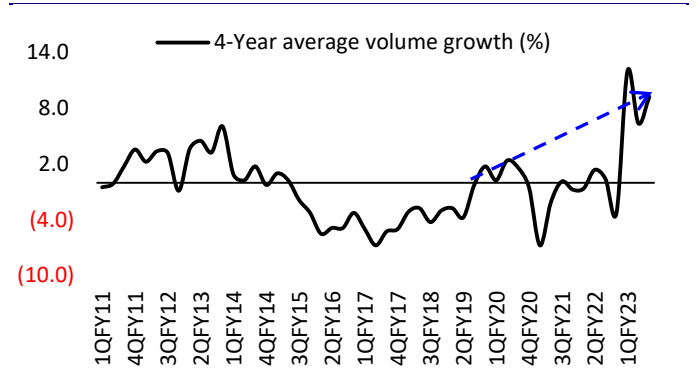
- To smoothen the impact of Covid-related disturbances in FY21 and FY22, we look at three-and four-year average volume growth on a quarterly basis. On both these metrics, ITC’s performance in recent quarters has been its best in over a decade.

Exhibit 1: Average volume growth rate at decadal highs from 3 year perspective...



Source: MOFSL, Company

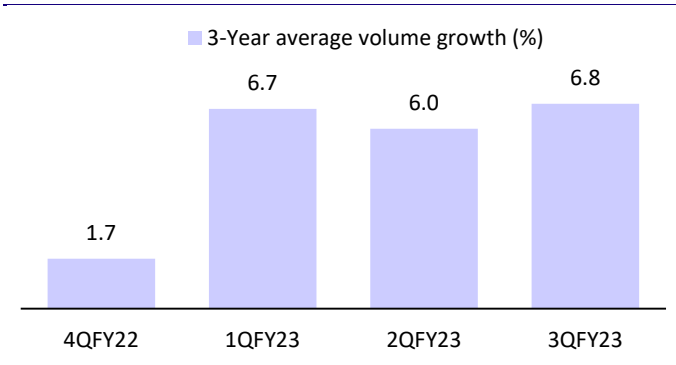
Exhibit 2: ...as well as from four years perspective



Source: MOFSL, Company

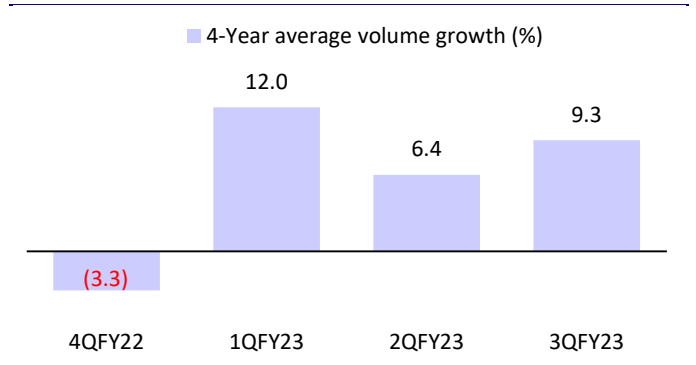
- Importantly, unlike other consumer peers, which are bearing the brunt of inflation, there has been no let-up in momentum in the past three to four quarters.

Exhibit 3: Robust cigarette volume growth witnessed in the past four quarters...



Source: Company, MOFSL

Exhibit 4: ...indicating better performance than staple peers

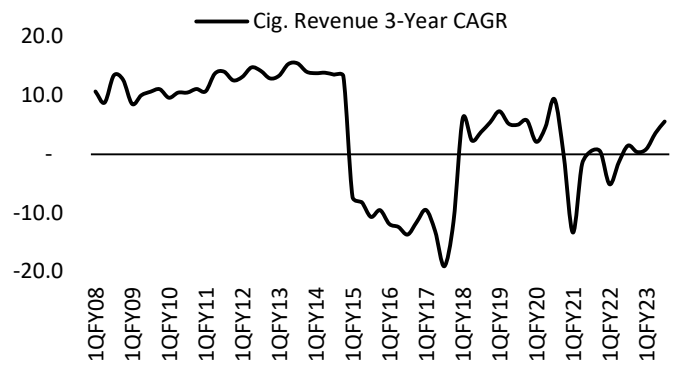


Source: Source: Company, MOFSL

Other cigarette metrics are also at their best levels

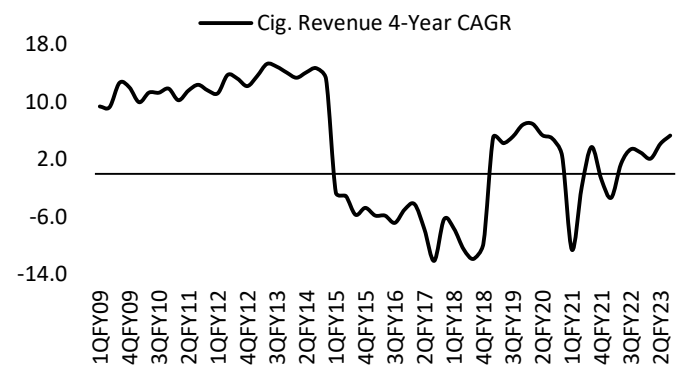
- Three-and four-year cigarette sales CAGR are at their best levels since FY15 despite the company not taking material price increases over the last 13-14 months. Given healthy volume growth and the absence of any material indirect tax increases over this period, the company can utilize modest price increases lever if need be.

Exhibit 5: Outstanding cigarette revenue growth in three...



Source: MOFSL, Company

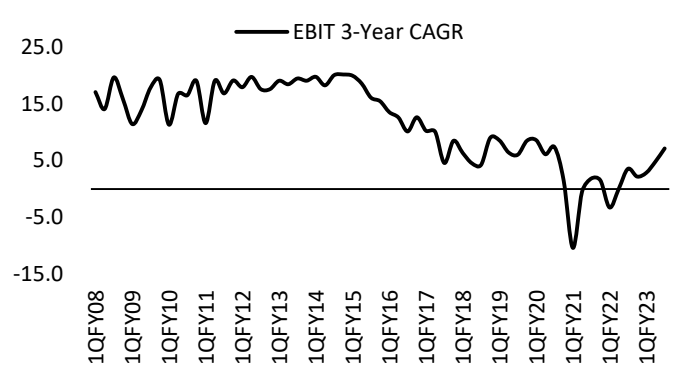
Exhibit 6: ...as well as four years



Source: MOFSL, Company

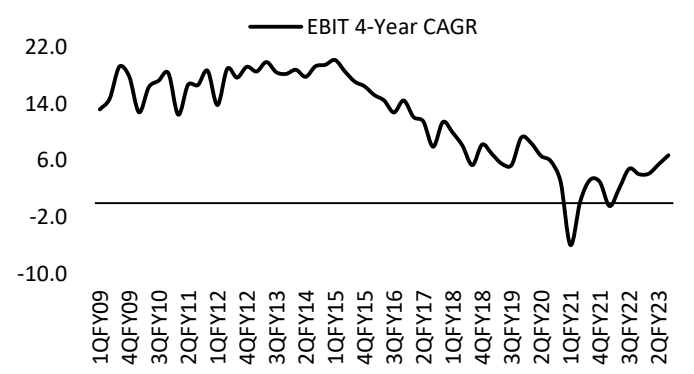
- Cigarette EBIT growth has returned to its healthy levels in the recent quarters despite the company not taking price increases for several quarters now.

Exhibit 7: Despite not taking a price hike in the recent quarters, EBIT performance has been robust in three...



Source: MOFSL, Company

Exhibit 8: ...as well as four years



Source: MOFSL, Company

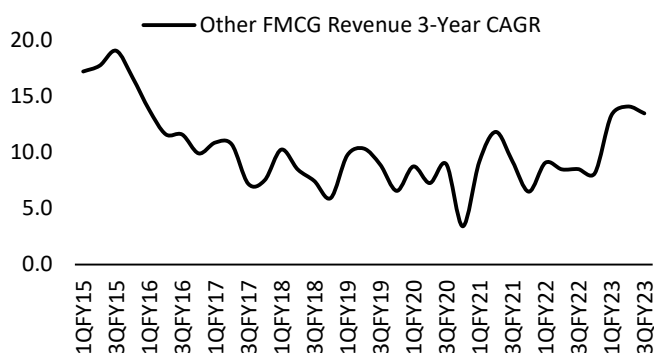
FY24 budget: No steep increase in indirect tax

- In the FY24 national budget, National Calamity Contingent Duty (NCCD) on all four filter cigarette categories viz. less than 65mm, 65-70mm, 70-75mm, and above 75mm was increased by 15-16%. However, total NCCD across these segments is less than 10% of the total indirect taxation, which is ~60% of MRP. Hence, effective increase would be less than 1%.
- Thus, a significant hurdle to the near-term Cigarette volume momentum was surmounted.

Other FMCG momentum remains strong; better times ahead

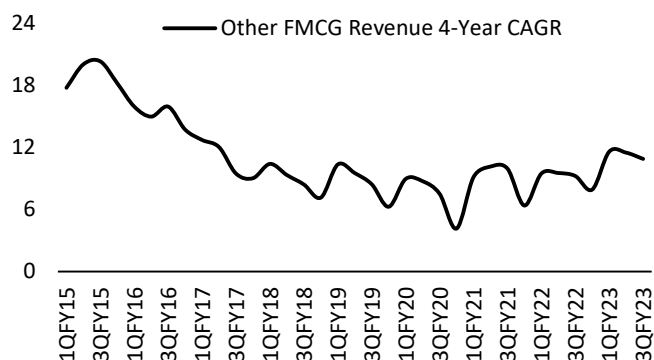
- ITC’s Other FMCG segment (the second largest contributor to sales) is also witnessing strong earnings and growth momentum unlike most consumer staples peers.
- Other FMCG sales growth over the past three quarters has been in high teens to early 20% at a time when staples peer growth is much lower. This is also despite a significant base. ITC’s Other FMCG business revenue is expected to be over INR190b in FY23, the fourth largest in our coverage universe after HUVR, TTAN, and APNT.

Exhibit 9: Other FMCG business delivering strong performance in three...



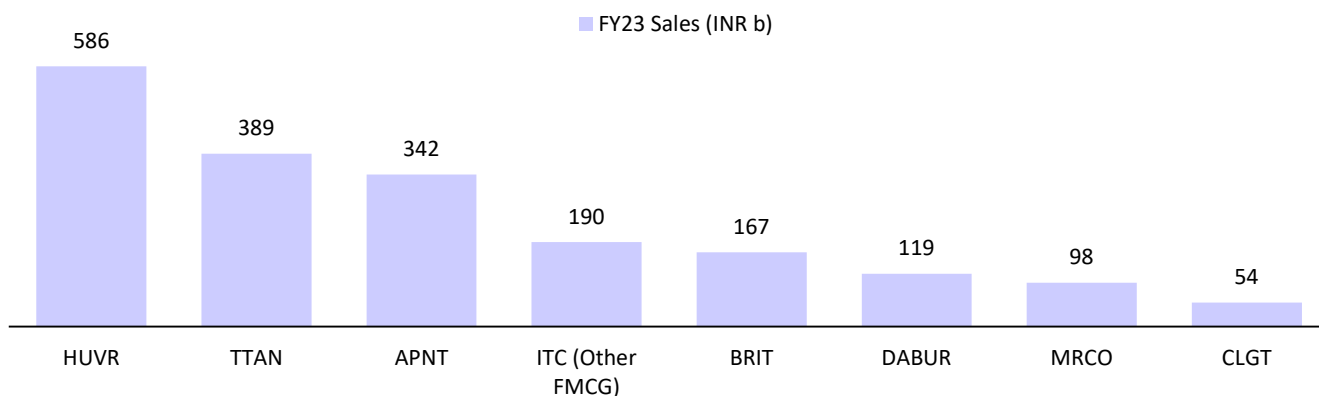
Source: Company, MOFSL

Exhibit 10: ...as well as four years



Source: Company, MOFSL

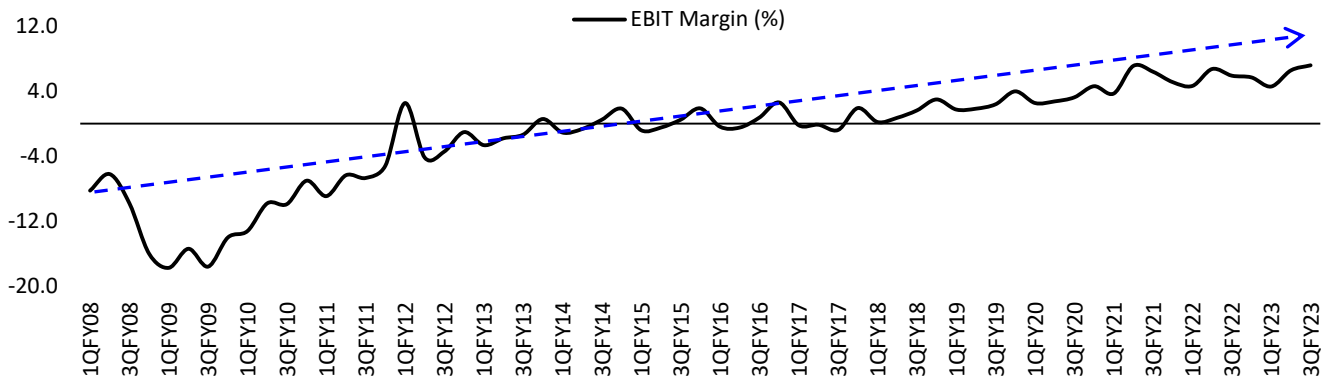
Exhibit 11: ITC other FMCG business growth has been phenomenal and it is the fourth largest in our coverage Universe



Source: Company, MOFSL

- Despite intense commodity costs pressures, EBIT/EBITDA margins have been stable or growing unlike peers.
- This has meant that the gradual but continued improvement in Other FMCG EBIT margin has continued in recent years as well despite severe commodity cost increases.

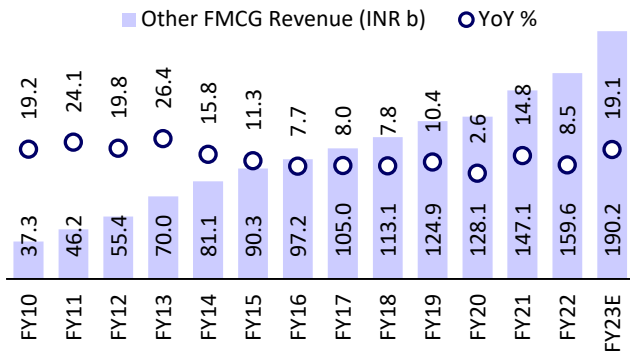
Exhibit 12: Even in the times of elevated input costs, EBIT margin has been stable and gradually expanding



Source: Company, MOFSL

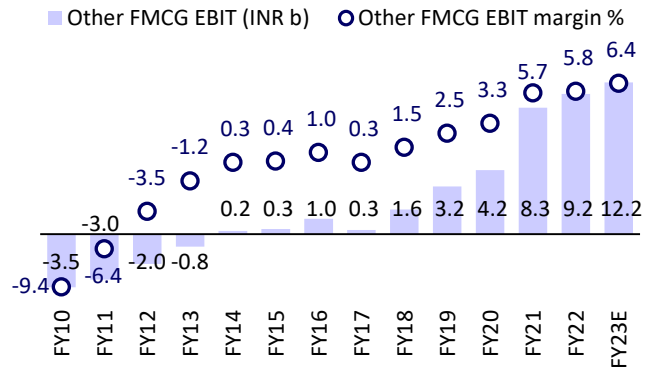
- Healthy sales growth and steady EBIT margin improvement are also visible in annual performance charts of these segments.

Exhibit 13: Robust growth even during uncertain times...



Source: Company, MOFSL

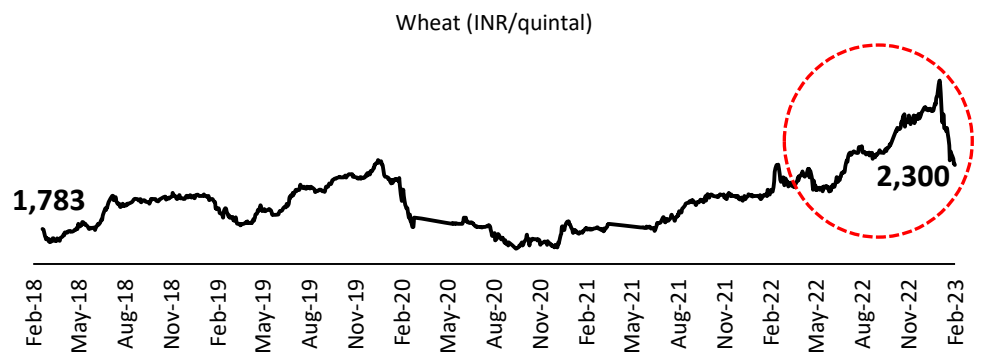
Exhibit 14: ...along with steady growth in EBIT margin



Source: Company, MOFSL

- The likelihood of a good Rabi season could lead to substantial cooling off in wheat prices from 1QFY24 onwards. ITC has been able to maintain/grow Other FMCG margins despite extremely high wheat costs inflation and profitability could be higher in subsequent years, if wheat costs decline sharply.

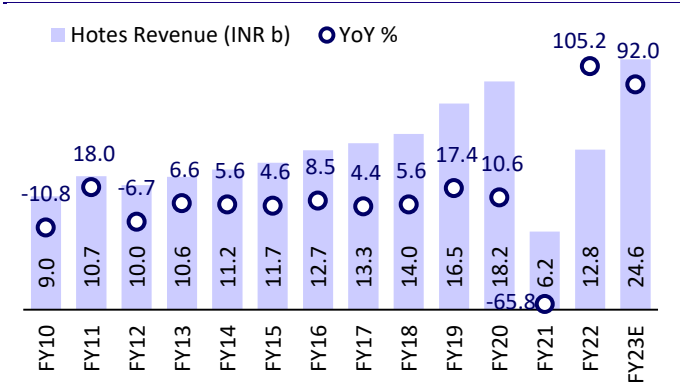
Exhibit 15: Other FMCG margin could expand, if wheat costs come down post rabi season



Hotels

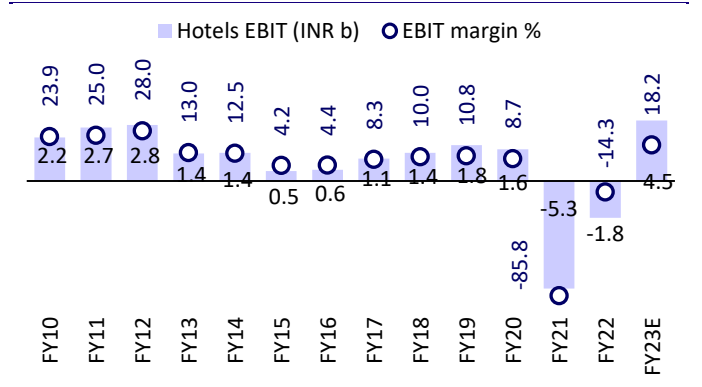
- While small as a proportion of the overall business the operating environment of the Hotel business in India has clearly taken a turn for the better as highlighted in our recent [Hotel business thematic note](#) by our mid cap team.
- Hotel business sales and EBIT are witnessing new highs after over a decade with the adverse impact of overcapacity fading away.

Exhibit 16: Hotel business revenue is showing signs of resilience



Source: Company, MOFSL

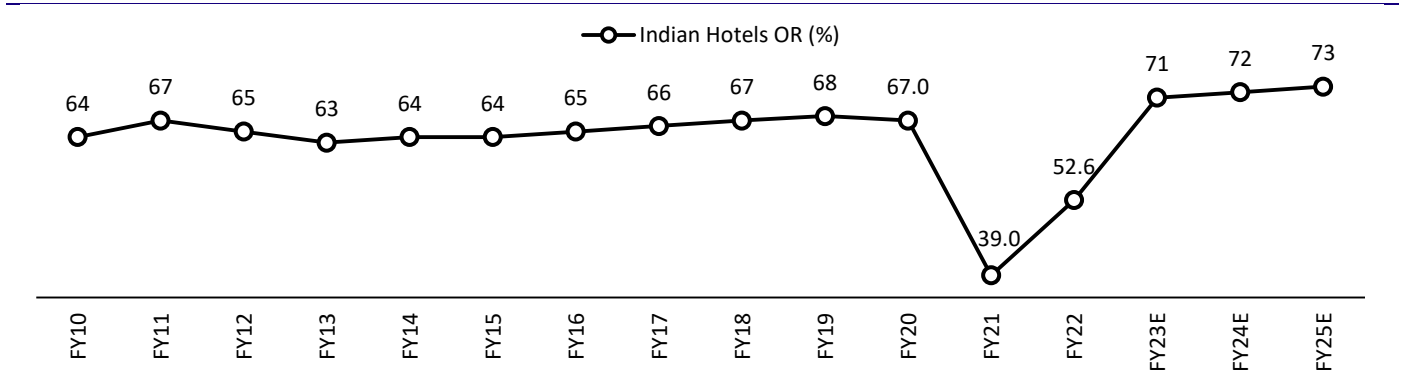
Exhibit 17: EBIT margin to expand going ahead



Source: Company, MOFSL

- ITC, equipped with the second largest number of rooms (both owned and managed) among leading hotel companies in India, is also witnessing buoyancy in the last few quarters.
- Within discretionary consumption, this segment has not experienced the impact of the slowdown and with various events such as the G20 summit, women’s and men’s IPL tournaments, and the Cricket World Cup in FY24, the industry outlook appears bright.
- While granular data on ITC’s Hotel business is not available, it is evident from the key parameters of Indian Hotels, the largest hotel chain in the country, that after a decade of occupancy rate languishing in the mid-60s, we expect to cross 70% levels in FY23 and continue at similar levels going forward.

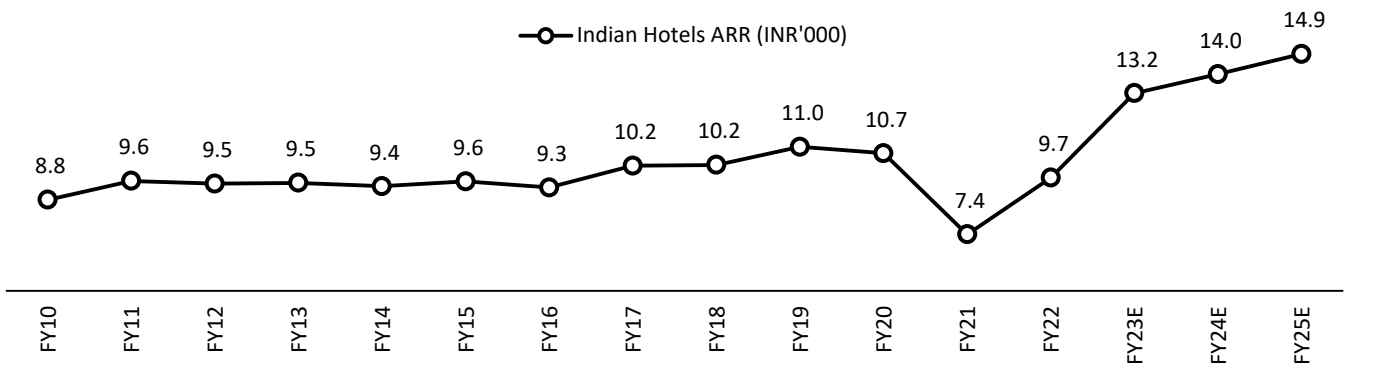
Exhibit 18: Occupancy rates to gradually improve going ahead



Source: Company, MOFSL

- The improvement in Average Room Rates (ARRs) for Indian Hotels has been even more remarkable and if our hotel business analyst’s projections come through, then bountiful growth are likely for leading category players.

Exhibit 19: ARR is expected to be decadal high in FY23 and the momentum is expected to continue going ahead

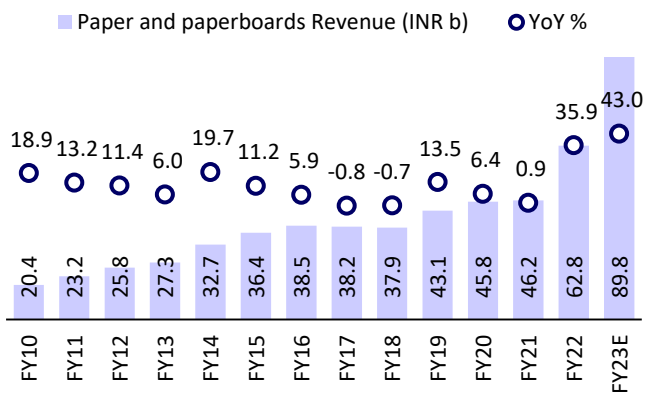


Source: Company, MOFSL

Other businesses

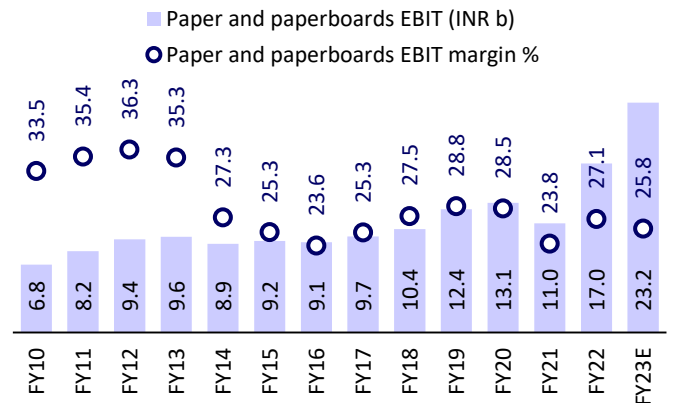
- Performance outlook continues to be positive in both the paper and paperboard business and the agri business.
- While extraordinarily high EBIT margins for paper and paperboard business are likely to slide down to more normalized levels from 4QFY23 onwards, demand outlook remains healthy.

Exhibit 20: Paper and paperboards sales remain healthy



Source: Company, MOFSL

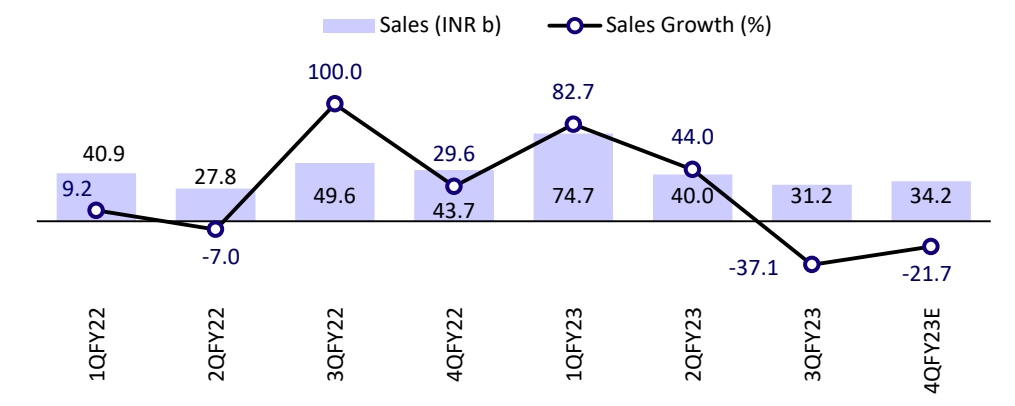
Exhibit 21: Normalized realizations to bring EBIT margin to normal levels



Source: Company, MOFSL

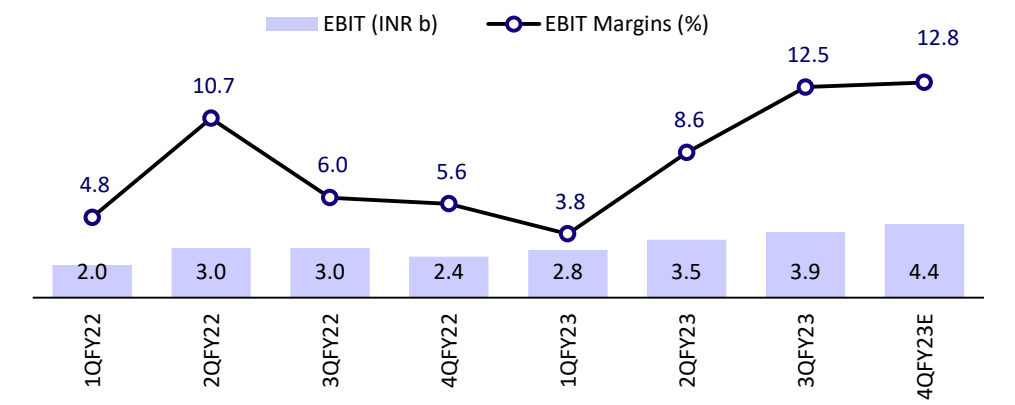
- On the other hand, while the absence of wheat and rice exports would lead to a decline in agri business sales as was witnessed in 3QFY23, it could also lead to improving agri business margins (wheat and rice exports are far lower margin businesses compared to leaf tobacco trade) and also overall EBITDA margins for ITC. An extraordinarily strong growth in agri business sales in 3QFY22, 4QFY22, and 1QFY23 led to a lower-than-usual overall EBITDA margin for the company.

Exhibit 22: Lower exports to lead to lower revenues...



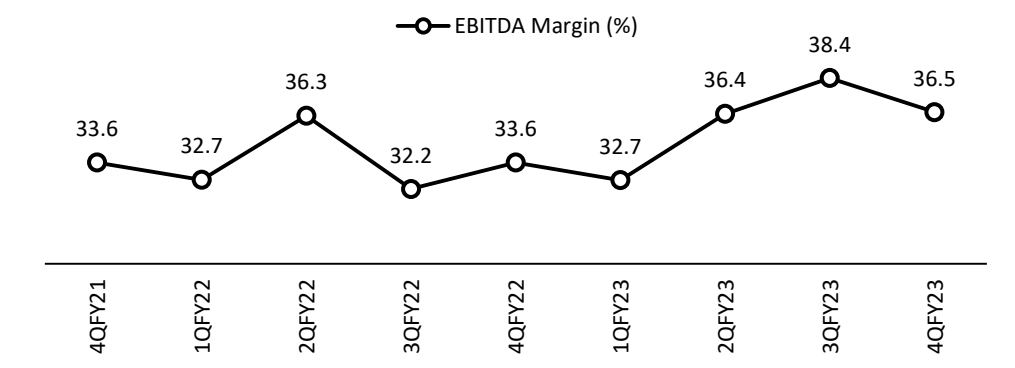
Source: Company, MOFSL

Exhibit 23: ...but improving margins...



Source: Company, MOFSL

Exhibit 24: ...which is leading to superior EBITDA margin for ITC



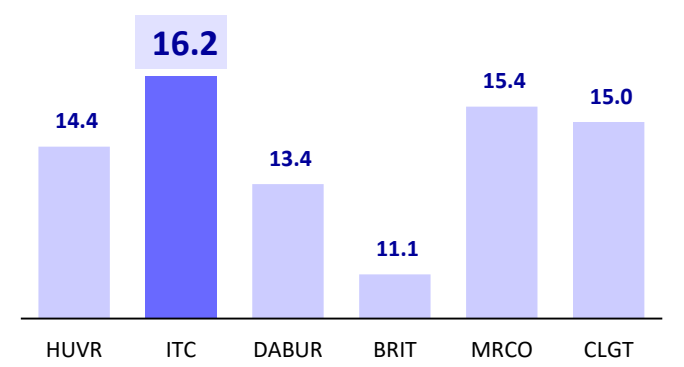
Source: MOFSL, Company

- All in all, we do not expect and paper and paperboard business or the Agri business to detract from the likely strong performance in the Cigarettes, Other FMCG, and Hotels business going forward.

Earnings visibility and outlook better than peers

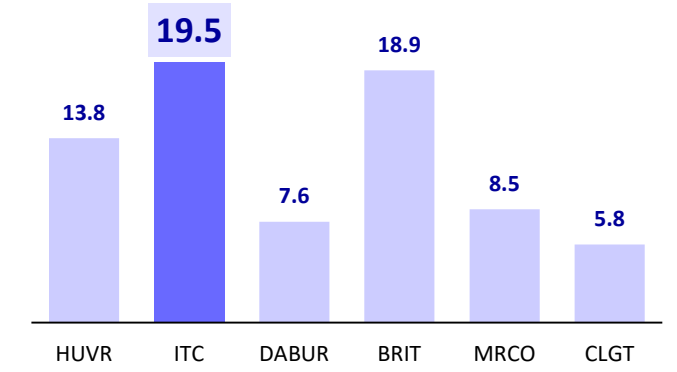
- ITC has demonstrated a healthy 23% EPS growth in FY23 and is likely to register an EPS CAGR of ~15% over the next two years as well.
- ITC’s earnings outlook is better than other large cap staples players both on two-year CAGR ending FY23E as well as FY24 earnings growth expectations.

Exhibit 25: ITC FY24 EPS growth is the highest compared to peers...



Source: Company, MOFSL

Exhibit 26: ...along with the highest 2-year EPS CAGR ending FY23E



Source: Company, MOFSL

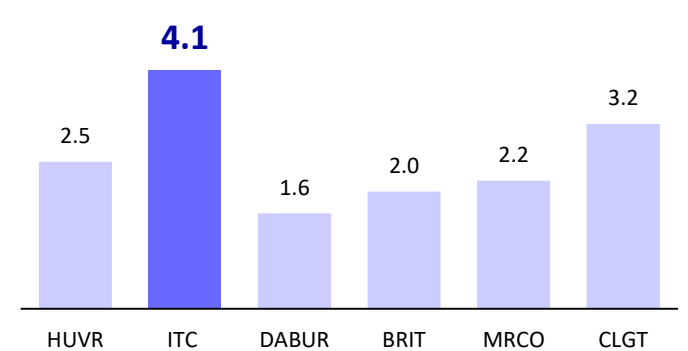
- With uncertainty looming over the industry, led by high inflation, unpredictable monsoon, continued weak rural sales, and delay in commodity costs decline, ITC’s earnings performance in the last couple of years and in FY24 shines like a beacon.

Exhibit 27: Valuation far cheaper than peers

Company	P/E (x)		
	FY23E	FY24E	FY25E
Hind. Unilever	57.7	50.4	43.6
ITC	25.8	22.2	19.7
Dabur India	50.1	44.1	36.7
Britannia Inds.	53.6	48.2	42.2
Marico	50.9	44.1	39.0
Colgate-Palm.	39.7	34.5	31.4

Source: Company, MOFSL

Exhibit 28: Attractive dividend yield (FY25, %) compared to peers



Source: Company, MOFSL

Financials and valuations

Income Statement								(INR b)
Y/E March	2018	2019	2020	2021	2022	2023E	2024E	2025E
Net Sales	402.5	444.3	451.4	451.1	557.0	668.5	727.5	801.0
Operational Income	3.7	5.6	4.8	3.7	6.4	6.8	7.1	7.5
Total Revenue	406.3	450.0	456.2	454.9	563.4	675.3	734.6	808.4
Change (%)	1.3	10.8	1.4	-0.3	23.9	19.9	8.8	10.0
Gross Profit	240.1	268.3	275.5	248.4	292.9	375.5	431.5	481.0
Margin (%)	59.1	59.6	60.4	54.6	52.0	55.6	58.7	59.5
Other operating expenditure	84.5	95.0	96.2	93.0	103.4	132.9	152.3	168.8
EBITDA	155.6	173.3	179.3	155.3	189.5	242.5	279.2	312.2
Change (%)	6.6	11.3	3.5	-13.4	22.0	28.0	15.1	11.8
Margin (%)	38.3	38.5	39.3	34.2	33.6	35.9	38.0	38.6
Depreciation	11.5	13.1	15.6	15.6	16.5	17.2	18.3	19.2
Int. and Fin. Charges	1.1	0.6	0.8	0.6	0.6	0.4	0.4	0.3
Other Inc. - Recurring	21.3	24.8	30.1	32.5	25.9	22.5	26.9	32.1
Profit before Taxes	164.4	184.4	193.0	171.6	198.3	247.4	287.4	324.9
Change (%)	6.0	12.2	4.6	-11.1	15.5	24.8	16.2	13.0
Margin (%)	40.5	41.0	42.3	37.7	35.2	36.6	39.1	40.2
Tax	56.0	58.5	44.4	40.4	48.3	62.3	72.3	81.8
Deferred Tax	0.3	1.3	-4.1	1.0	-0.6	0.0	0.0	0.0
Tax Rate (%)	34.2	32.4	20.9	24.1	24.1	25.2	25.2	25.2
Profit after Taxes	108.1	124.6	152.7	130.3	150.6	185.1	215.1	243.1
Change (%)	6.0	15.3	22.5	-14.6	15.5	23.0	16.2	13.0
Margin (%)	26.6	27.7	33.5	28.7	26.7	27.4	29.3	30.1
Non-rec. (Exp)/Income	4.1	0.0	-1.3	0.0	0.0	0.0	0.0	0.0
Reported PAT	112.2	124.6	151.4	130.3	150.6	185.1	215.1	243.1

Balance Sheet								(INR b)
Y/E March	2018	2019	2020	2021	2022	2023E	2024E	2025E
Share Capital	12.2	12.3	12.3	12.3	12.3	12.3	12.3	12.3
Reserves	501.8	567.2	628.0	577.7	601.7	624.2	671.2	723.8
Net Worth	514.0	579.5	640.3	590.0	614.0	636.5	683.5	736.1
Loans	0.1	0.0	3.3	3.3	3.1	0.0	0.0	0.0
Deferred Liability	19.2	20.4	16.2	17.3	16.7	16.7	16.7	16.7
Capital Employed	533.2	600.0	659.8	610.6	633.8	653.2	700.2	752.8
Gross Block	258.1	300.4	336.3	362.7	389.7	405.7	425.7	445.7
Less: Accum. Deprn.	102.3	115.5	131.1	146.7	163.2	180.5	198.8	218.0
Net Fixed Assets	155.7	185.0	205.2	216.0	226.4	225.2	226.9	227.7
Capital WIP	50.2	33.9	27.8	33.3	24.7	24.7	24.7	24.7
Goodwill	0.0	0.0	0.0	5.8	5.8	5.8	5.8	0.0
Investments	234.0	265.8	306.3	270.0	272.8	265.0	297.9	333.8
Curr. Assets, L&A	183.9	213.3	213.1	190.8	221.2	275.5	296.9	332.4
Inventory	72.4	75.9	80.4	94.7	100.0	121.6	124.9	136.4
Account Receivables	23.6	36.5	20.9	20.9	19.5	31.1	33.9	37.3
Cash and Bank Balance	25.9	37.7	68.4	40.0	38.8	52.3	65.8	84.5
Others	62.0	63.3	43.3	35.1	63.0	70.5	72.3	74.2
Curr. Liab. and Prov.	90.6	98.0	92.6	105.2	117.1	143.0	151.9	165.8
Account Payables	33.8	33.7	34.5	41.2	42.2	60.8	61.8	66.9
Other Liabilities	56.7	64.3	58.1	64.0	74.9	82.2	90.1	98.9
Net Current Assets	93.4	115.3	120.5	85.6	104.1	132.6	145.0	166.6
Application of Funds	533.2	600.0	659.8	610.6	633.8	653.2	700.2	752.8

E: MOFSL Estimates

Financials and valuations

Ratios

Y/E March	2018	2019	2020	2021	2022	2023E	2024E	2025E
Basic (INR)								
EPS	8.9	10.2	12.4	10.6	12.2	15.0	17.5	19.7
Cash EPS	9.8	11.2	13.7	11.9	13.6	16.4	18.9	21.3
BV/Share	42.1	47.3	52.1	47.9	49.8	51.7	55.5	59.7
DPS	6.2	6.9	10.2	10.8	11.5	13.5	14.0	15.8
Payout %	68	68	82	102	94	90	80	80
Valuation (x)								
P/E	43.8	38.1	31.2	36.6	31.7	25.8	22.2	19.7
Cash P/E	39.6	34.5	28.3	32.7	28.6	23.6	20.5	18.2
EV/Sales	11.2	10.0	9.7	9.9	8.0	6.6	6.0	5.4
EV/EBITDA	28.9	25.7	24.5	28.6	23.5	18.3	15.7	13.9
P/BV	9.2	8.2	7.4	8.1	7.8	7.5	7.0	6.5
Dividend Yield (%)	1.6	1.8	2.6	2.8	3.0	3.5	3.6	4.1
Return Ratios (%)								
RoE	22.3	22.8	25.0	21.2	25.0	29.6	32.6	34.2
RoCE	21.6	22.1	24.3	20.6	24.3	28.8	31.8	33.5
RoIC	42.4	44.6	49.8	40.4	46.5	55.4	62.6	70.5
Working Capital Ratios								
Debtor (Days)	21	25	23	17	13	14	16	16
Asset Turnover (x)	0.8	0.7	0.7	0.7	0.9	1.0	1.0	1.1

Cash Flow Statement

(INR b)

Y/E March	2018	2019	2020	2021	2022	2023E	2024E	2025E
OP/(loss) before Tax	168.5	184.4	191.7	171.6	198.3	247.4	287.4	324.9
Financial other income	7.2	8.1	13.1	17.0	13.9	22.5	26.9	32.1
Depreciation and Amort.	11.5	13.1	15.6	15.6	16.5	17.2	18.3	19.2
Interest Paid	-8.3	-12.1	-13.8	-11.8	-9.6	0.4	0.4	0.3
Direct Taxes Paid	57.2	54.9	46.5	39.6	45.1	62.3	72.3	81.8
Incr in WC	-19.2	5.0	-4.2	3.9	-1.8	15.0	-1.1	2.9
CF from Operations	126.5	117.5	138.1	114.9	148.1	165.3	207.9	227.5
Other items	-7.6	3.2	44.6	-30.8	12.4	-1.5	22.3	16.4
Incr Decr in FA	25.5	27.6	21.1	15.8	16.7	16.0	20.0	20.0
Free Cash Flow	101.0	89.9	116.9	99.1	131.3	149.2	187.9	207.5
Pur of Investments	34.8	15.3	51.9	-87.0	11.6	-7.9	32.9	35.9
CF from Invest.	-67.8	-39.7	-28.4	40.4	-15.9	-9.7	-30.6	-39.6
Issue of shares	9.1	9.7	6.3	2.9	2.9	3.0	3.0	3.0
Incr in Debt	-0.1	-0.1	-0.5	-0.5	-0.5	-3.1	0.0	0.0
Net Interest Paid	0.5	0.9	0.5	0.4	0.4	0.4	0.4	0.3
Dividend Paid	57.7	62.9	84.2	186.2	135.5	141.7	166.6	172.1
Others	-11.1	-11.9	0.0	0.4	0.2	0.2	0.2	0.2
CF from Fin. Activity	-60.2	-66.0	-78.9	-183.8	-133.4	-142.1	-163.8	-169.2
Incr of Cash	-1.5	11.7	30.7	-28.4	-1.2	13.5	13.5	18.7
Add: Opening Balance	27.5	25.9	37.7	68.4	40.0	38.8	52.3	65.8
Closing Balance	25.9	37.7	68.4	40.0	38.8	52.3	65.8	84.5

E: MOSL Estimates

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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