Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

ITC Ltd

Cigarettes continues to perform well; FMCG margin expansion sustains

Consumer Goods		Sharekhan code: ITC	
Reco/View: Buy	↔	CMP: Rs. 450	Price Target: Rs. 515 ↑

↑ 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 Aug 08, 2023

Medium Risk

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

Source: Morningstar

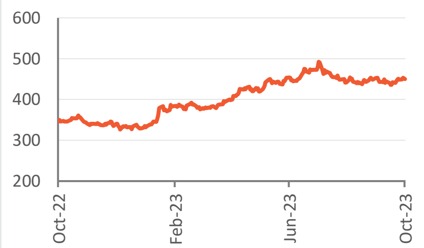
Company details

Market cap:	Rs. 5,60,149 cr
52-week high/low:	Rs. 500 / 325
NSE volume: (No of shares)	107.0 lakh
BSE code:	500875
NSE code:	ITC
Free float: (No of shares)	1,243.9 cr

Shareholding (%)

Promoters	0.0
FII	44.5
DII	41.9
Others	13.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.4	-8.2	12.5	30.0
Relative to Sensex	2.5	-6.6	2.4	19.0

Sharekhan Research, Bloomberg

Summary

- ITC's Q2FY24 operating performance was largely in line with our expectation with net revenues and operating profit growing by ~3% each. Higher other income led to 10% y-o-y growth in PAT.
- Cigarette sales volumes grew by ~5%, while non-cigarette FMCG business revenues grew by 8% with EBIDTA margins sustaining at 11%. Hotels business clocked a strong performance with revenues and PBIT growing by 21% and 50%, respectively.
- Cigarette volume growth to stay steady, non-cigarette FMCG performance to improve with sustained expansion in margins, while performance of paperboard, paper and packaging is expected to improve as fall in the global paper pulp prices have bottomed out.
- Stock trades at 26x/23x its FY2024E and FY2025E earnings. We maintain a Buy rating with a revised SOTP-based PT of Rs. 515.

ITC's Q2FY2024 numbers were marginally ahead of expectation due to higher other income (77% y-o-y) while operating performance was largely in-line with expectation. Its gross revenues grew by 3.2% (net revenues grew by 2.6%); excluding wheat and rice exports, gross revenues rose 9%. Cigarette business gross revenues grew by 10% y-o-y to Rs.7657.7 crore and non-cigarette FMCG business' revenues grew by 8.3% y-o-y to Rs. 5,292 crore. Volume growth of core cigarette business stood at 5% in-line with our as well as street expectation of 5-6%. Gross margins improved by 33 bps y-o-y to 57.3% while OPM stood almost flat 36.5%. Operating profit grew by 3% y-o-y to Rs. 6,041.6 crore and PAT grew by 10.3% y-o-y to Rs. 6,041.6 crore (with other income growing by 77%). For H1FY2024, gross revenues decreased by 2.2% y-o-y (due to high base of agri business), OPM improved by 352 bps y-o-y to 38.0% and the adjusted PAT grew by 14% y-o-y.

Key positives

- Non-cigarette FMCG business EBIDTA margins improved by 150 bps y-o-y to 11%; stood flat q-o-q.
- Hotel business revenues and EBIT grew by 21% and 50% respectively.
- Agri business' excluding wheat and rice exports grew by 26% driven by value added agri & leaf tobacco.

Key negatives

- Paperboard, paper and packaging (PPP) business registered a muted performance with revenue decreasing by ~10%; EBIT margins down to 15.3% in Q2FY24 versus 27.5% in Q2FY23.

Management Commentary

- Certain FMCG categories such as biscuits, snacks, noodles, popular Soaps witnessed increasing competitive intensity including from local/regional players in the backdrop of commodity price deflation.
- Non-cigarette FMCG business maintained its focus on boosting profitability through multi-pronged interventions such as premiumisation, supply-chain optimisation, strategic cost management and judicious pricing actions.
- In core cigarettes business, a sharp increase in costs of leaf tobacco and certain other inputs, along with increase in taxes was largely mitigated through an improved mix, strategic cost management and calibrated pricing.
- Sharp drop in global pulp prices and realisation drop of PPP products have bottomed out. The additional capacity of ~20% of chemical pulp, will enable higher import substitution and reduce operating costs. The company expects performance of PPP business to improve in the coming quarters.

Revision in earnings estimates – We have broadly maintained our earnings estimates for FY2024 and FY2025 will keenly monitor the performance in the quarters ahead.

Our Call

View – Retain Buy with a revised PT of Rs. 515: ITC's core businesses of cigarette and non-cigarette FMCG continue perform well. Post demerging of asset-heavy hotels business, the return profile of ITC will substantially improve in the coming years. The improving margins in the non-cigarette FMCG business will also add to improvement in return ratios and valuation multiples of ITC. Large focus will be on improving on growth prospects of cigarettes, non-cigarette FMCG and PPP businesses through high cash flow generation. We should expect dividend payout to further improve in the coming years. Post recent fall stock is attractively valued at 26x/23x its FY2024E and FY2025E earnings. We maintain a Buy recommendation on the stock with revised SOTP-based PT of Rs. 515 (rolling it over to September 2025 earnings).

Key Risks

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	FY22	FY23	FY24E	FY25E
Revenues	59,746	70,251	75,693	85,550
OPM (%)	31.7	34.1	36.6	37.1
Adjusted PAT	15,058	18,700	21,412	24,229
Adjusted EPS (Rs.)	12.2	15.1	17.2	19.5
P/E (x)	36.5	29.3	25.7	22.7
P/B (x)	9.0	8.3	7.7	6.9
EV/EBIDTA (x)	28.6	22.8	19.7	17.2
RoNW (%)	25.0	29.1	30.5	31.5
RoCE (%)	27.1	32.7	35.1	37.1

Source: Company; Sharekhan estimates

Soft Q2 on a high base - Revenue growth at 3% y-o-y; OPM flat y-o-y

ITC's net revenues (net of excise) grew 2.6% y-o-y to Rs. 16,550 crore in Q2FY2024 impacted by a challenging operating environment and a high base effect in some of the businesses, as against our expectation of Rs. 16,326 crore and average consensus estimates of Rs. 16,777 crore. Gross revenue (ex-wheat and rice exports) is up by 8.9% y-o-y. Cigarette business grew by 10.1% y-o-y to Rs. 7,658 crore, with volume growth at 5%, in-line with our expectation of a 5-6% growth. Non-cigarette FMCG business grew by 8.3% y-o-y to Rs. 5,292 crore. Agri-business marginally fell by 1.7% y-o-y to Rs. 3,931 crore on a high base of Q2FY2023. The paper, paperboard, and packaging (PPP) business registered 9.5% y-o-y revenue decline to Rs. 2,070 crore, while hotels business grew by 21.2% y-o-y to Rs. 649 crore. Gross margin improved by 33 bps y-o-y to 57.3%, while OPM stood flat at 36.5%, against our expectation of 37.8% and average street expectation of 38.1%. Operating profit grew by 3% y-o-y to Rs. 6,042 crore. This coupled with higher other income and lower depreciation cost led to 10.3% y-o-y growth in the PAT to Rs. 4,927 crore, versus our expectation of Rs. 4,793 crore and street average expectation of Rs. 4,976 crore. In H1FY2024, revenues declined by 2.2% y-o-y to 34,701 crore, OPM expanded by 352 bps y-o-y to 38% and PAT grew by 13.8% y-o-y to Rs. 9,830 crore.

Cigarette volumes grew by 5%; net revenues grew by 8.5%

Cigarette business gross revenues grew by 10% y-o-y to Rs. 7,657.7 crore (net revenues grew by 8.5%). Cigarette sales volumes grew by ~5% and realisation grew by 3.5%. Several differentiated variants which were launched recently continued to perform well. The business continued to counter illicit trade and reinforce market standing by fortifying the product portfolio through innovation, democratising premiumisation across segments and enhancing product availability backed by superior on-ground execution. Sharp escalation in costs of leaf tobacco and certain other inputs, along with increase in taxes, led to 25 bps y-o-y decline in margins to 62.4%, which was largely mitigated through improved mix, strategic cost management and calibrated pricing. We expect cigarette business volume growth momentum to sustain as the company is gaining share from illicit players in the market.

FMCG – Others business revenue grew 8% y-o-y; EBITDA margin up 150 bps y-o-y

Revenue grew by 8.3% y-o-y (two-year CAGR at 14.5%) to Rs. 5,292 crore, driven by strong growth in atta, spices, personal wash and Agarbatti. Notebooks and pens continued to witness strong traction. ITC witnessed strong traction in both traditional and emerging channels (viz. modern trade, e-Commerce, Quick Commerce) with 1.25x rise in direct outlets and a 1.12x increase in total outlets over pre-pandemic level. EBITDA grew by 25% y-o-y to Rs. 581 crore. Margins expanded by 150 bps y-o-y to 11%, driven by multi-pronged interventions viz. premiumisation, supply chain agility, judicious pricing actions, digital initiatives and strategic cost management.

Agri-business revenue declined by 24% y-o-y, PBIT margin higher by 244 bps y-o-y

Revenues fell by 1.7% y-o-y to Rs. 3,931 crore, hit by restrictions imposed on wheat & rice exports amid inflationary headwinds & food security concerns. Excluding wheat exports in base quarter, agri-business revenues grew by ~26% y-o-y driven by value-added agri products and leaf tobacco. During the quarter, stock limits on wheat, ban on non-basmati rice exports and export duty on parboiled rice, further limited business opportunities for the Agri Business. Capacity utilisation of recently-commissioned state-of-the-art value-added Spices processing facility in Guntur has been ramped up. PBIT is up 3.3% y-o-y to Rs. 357 crore, with margins higher by 44 bps y-o-y to 9.1%.

Hotels' revenues grew 21% y-o-y; EBITDA margin expanded by 370 bps y-o-y

Revenue grew by 21.2% y-o-y and 1.5x Q2FY2020 to Rs. 649 crore largely driven by strong growth in ARRs across properties. Occupancy stood flat y-o-y mainly due to renovations and relatively fewer wedding dates. ITC witnessed stellar performance across properties driven by retail and MICE segments. In line with its 'asset-right' strategy, the business added three new properties to the portfolio including 'WelcomHeritage Santa Roza, Kasauli', 'Fortune Park Hoshiarpur' and 'Fortune Ranjit Vihar, Amritsar' in Q2FY2024. The company has a healthy pipeline of management contracts under Mementos, Welcomhotel, Storii, Fortune and WelcomHeritage brands, with phased openings over the next few quarters Segment EBITDA margin expanded by 170 bps y-o-y to 30.7% driven by higher RevPAR, curated packages, finest F&B offerings and strategic cost management initiatives. Scheme of demerger which was approved by board in August 2023 is progressing as per scheduled timelines.

Weak Q2 for PPP business; green shoots of recovery visible

Revenues declined by 9.5% y-o-y to Rs. 2,070 crore as low-priced Chinese supplies in global markets, drop in Chinese domestic demand and slump in EU markets exerted pressure on exports. Further, subdued consumer demand in domestic markets impacted customer offtake. Sharp drop in net sales realisation and global pulp prices witnessed during the quarter are likely to have bottomed out; green shoots of revival in demand for VAP and recycled boards were visible towards the end of the quarter. Margins sharply from 27.5% in Q2FY2023 to 15.3% in Q2FY2024 largely due to a sharp drop in realisations and increased cost of inputs (primarily wood and coal). Segment PBIT declined 49.9% y-o-y.

Results (Standalone) Rs cr

Particulars	Q2FY24	Q2FY23	Y-o-Y %	Q1FY24	Q-o-Q %
Gross revenue	**17,705.1**	**17,159.6**	**3.2**	**16,995.5**	**4.2**
Excise duty	1,155.0	1,029.7	12.2	1,167.3	-1.1
Net revenue	**16,550.1**	**16,129.9**	**2.6**	**15,828.2**	**4.6**
Raw Material Consumed	7,064.2	6,938.0	1.8	6,415.5	10.1
Employee Expenses	909.2	936.4	-2.9	903.8	0.6
Other Expenses	2,535.0	2,391.2	6.0	2,258.8	12.2
Total expenditure	10,508.5	10,265.6	2.4	9,578.1	9.7
Operating Profit	**6,041.6**	**5,864.3**	**3.0**	**6,250.1**	**-3.3**
Other income	895.6	506.9	76.7	708.7	26.4
Interest	10.5	10.7	-1.5	10.7	-2.0
Depreciation	413.2	422.0	-2.1	402.5	2.7
Profit before tax	**6,513.5**	**5,938.5**	**9.7**	**6,545.6**	**-0.5**
Tax	1,586.5	1,472.5	7.7	1,642.6	-3.4
Adjusted PAT	**4,927.0**	**4,466.1**	**10.3**	**4,903.0**	**0.5**
EPS (Rs.)	4.0	3.6	10.0	4.0	-1.0
			bps		**bps**
GPM (%)	57.3	57.0	33	59.5	-215
OPM (%)	36.5	36.4	15	39.5	-298
NPM (%)	29.8	27.7	208	31.0	-121
Tax rate (%)	24.4	24.8	-44	25.1	-74

Source: Company; Sharekhan Research

Segment-wise revenue break-up Rs cr

Particulars	Q2FY24	Q2FY23	Y-o-Y %	Q1FY24	Q-o-Q %
FMCG – cigarettes	7,657.7	6,953.8	10.1	7,465.3	2.6
FMCG – others	5,291.6	4,884.8	8.3	5,166.0	2.4
Hotels	649.4	536.0	21.2	600.2	8.2
Agri	3,931.0	3,997.0	-1.7	5,705.4	-31.1
Paperboard, Paper and Packaging	2,069.9	2,287.6	-9.5	2,120.8	-2.4
Total	**19,599.5**	**18,659.1**	**5.0**	**21,057.6**	**-6.9**
Less: Inter segment sales	2,050.8	1,687.9	21.5	4,214.7	-51.3
Gross Sales	**17,548.8**	**16,971.2**	**3.4**	**16,842.9**	**4.2**

Source: Company; Sharekhan Research

Segment PBIT and PBIT margins

Business	PBIT (Rs crore)			Margins (%)		
	Q2FY24	Q2FY23	YoY %	Q2FY24	Q2FY23	Chg in BPS
FMCG - cigarettes	4,781.7	4,429.3	8.0	62.4	63.7	-125
FMCG - others	438.6	320.6	36.8	8.3	6.6	173
Hotels	125.8	84.0	49.8	19.4	15.7	370
Agri	356.7	345.2	3.3	9.1	8.6	44
Paperboard, Paper and Packaging	315.8	629.8	-49.9	15.3	27.5	-
Total	**6,018.6**	**5,808.8**	**3.6**	**30.7**	**31.1**	**-42**

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector Outlook – Tax rate hike remains a risk for cigarettes; FMCG to perform well

The domestic cigarette industry in the past was 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, normal, widespread monsoons and government support (especially prior to elections) might help rural demand to gradually pick up. For margins, stable raw-material prices post the recent correction in some of the key inputs (including crude oil and vegetable oils) will help margins consistently improve in the coming quarters.

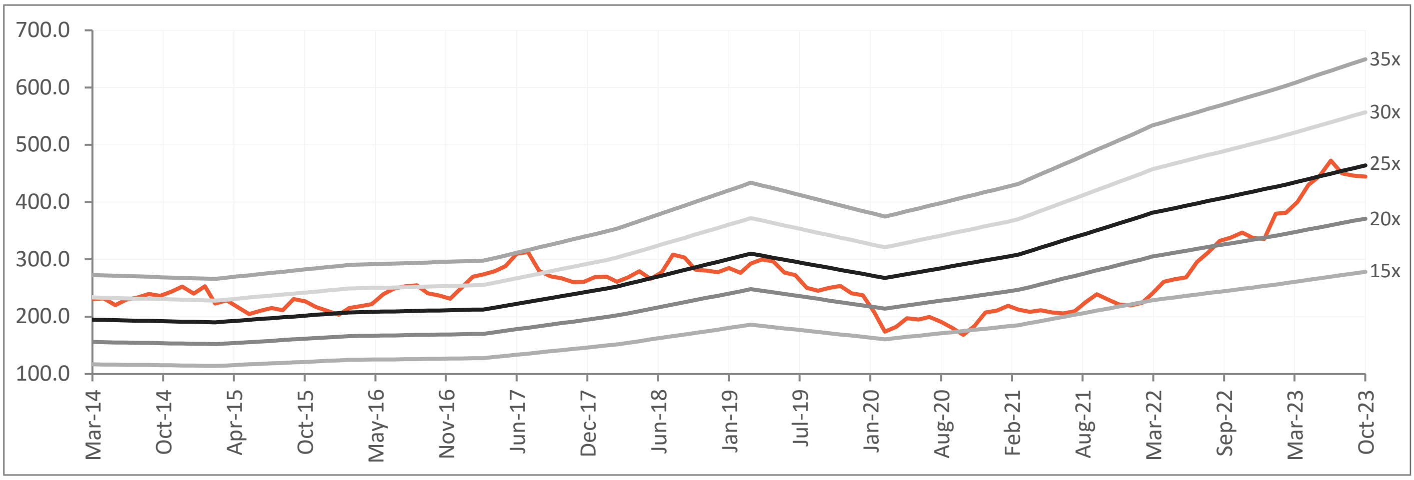
■ Company Outlook – Cigarette sales momentum to sustain; FMCG margins to scale up

In H1FY2024, revenues declined by 2.2% y-o-y to 34,701 crore, OPM expanded by 352 bps y-o-y to 38% and PAT grew by 13.8% y-o-y to Rs. 9,830 crore. Cigarette volume growth momentum to sustain with the government not increasing taxes on cigarettes for the second consecutive year. Market coverage for FMCG products was stepped up to 2x pre-pandemic levels. Direct reach enhancement was around 1.25x over pre-pandemic levels, strong traction to product launches, and an increase in e-commerce salience to ~10% will help the non-cigarette FMCG business's revenue to consistently grow in mid-teens to high teens in the coming years. A 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. FY2024 and FY2025 will continue to be strong years for the hotels business due to higher demand from domestic leisure travel, improvement in MICE segment and corporate travels, and expected comeback in foreign tourist arrivals.

■ Valuation – Retain Buy with a revised PT of Rs. 515

ITC's core businesses of cigarette and non-cigarette FMCG continue perform well. Post demerging of asset-heavy hotels business, the return profile of ITC will substantially improve in the coming years. The improving margins in the non-cigarette FMCG business will also add to improvement in return ratios and valuation multiples of ITC. Large focus will be on improving on growth prospects of cigarettes, non-cigarette FMCG and PPP businesses through high cash flow generation. We should expect dividend payout to further improve in the coming years. Post recent fall stock is attractively valued at 26x/23x its FY2024E and FY2025E earnings. We maintain a Buy recommendation on the stock with revised SOTP-based PT of Rs. 515 (rolling it over to September 2025 earnings).

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E
Hindustan Unilever	59.7	55.0	48.1	43.5	39.4	34.0	25.6	28.0	31.1
ITC	29.3	25.7	22.7	22.8	19.7	17.2	32.7	35.1	37.1

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 FY2023 with double-digit revenue and PAT growth. We expect the momentum to sustain in 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. Post demerging of asset-heavy hotels business, the return profile of ITC will substantially improve in the coming years.

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	29.02
2	Life Insurance Corp of India	15.21
3	Unit Trust of India	7.81
4	SBI Funds Management Ltd	3.12
5	Capital Group of Cos Inc	1.76
6	General Insurance Corp of India	1.73
7	GQG Partners LLC	1.48
8	New India Assurance Co Ltd	1.48
9	HDFC AMC	1.10
10	Oriental Insurance Co Ltd	1.09

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

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Correspondence/Administrative Office: Gigaplex IT Park, Unit No 1001, 10th Floor, Building No.9, TTC Industrial Area, Digha, Airoli-West, Navi Mumbai – 400 708. Tel: 022 61169000 / 61150000, Fax No. 61169699.

Other registrations of Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669.

Compliance Officer: Ms. Binkle Oza; Tel: 022-62263303; email id: complianceofficer@sharekhan.com

For any complaints/grievance, email us at igc@sharekhan.com or you may even call Customer Service desk on - 022-41523200 / 022-69920600.