



TM

SYSTEMATIX INSTITUTIONAL EQUITIES

Systematix

Institutional Equities

ITC

18 May 2023

FMCG and hotel divisions drive earnings beat; cigarette volume trajectory remains healthy

RESULT UPDATE

Sector: FMCG Rating: BUY

CMP: Rs 420 Target Price: Rs 474

Stock Info

Sensex/Nifty	61,431/ 18,130
Bloomberg	ITC IN
Equity shares (mn)	12428
52-wk High/Low	Rs 433/ 258
Face value	Rs 1
M-Cap	Rs 5215bn/US\$ 64bn
3-m Avg volume	US\$ 52mn

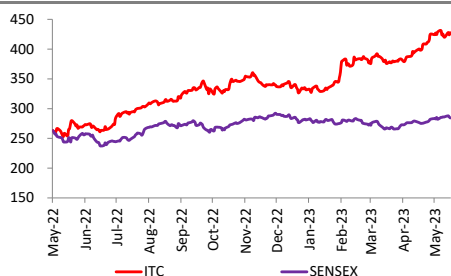
Financial Snapshot (Rs mn)

Y/E Mar	FY23	FY24E	FY25E
Sales	709,369	774,858	848,281
PAT	193,549	213,209	235,529
EPS (Rs)	15.6	17.2	19.0
PE (x)	27.0	24.5	22.2
EV/EBITDA (x)	20.1	18.2	16.4
P/BV (x)	7.5	7.3	7.1
EV/Sales	7.3	6.7	6.1
RoE (%)	29.4	30.4	32.5
RoCE (%)	39.0	40.3	43.2
NWC (days)	52	60	61
Net gearing (x)	0.0	0.0	0.0

Shareholding pattern (%)

	Mar 23	Dec 22	Sept 22
Promoter	-	-	-
-Pledged	-	-	-
FII	43.4	43.0	42.7
DII	42.1	42.2	42.4
Others	14.6	14.8	14.9

Stock Performance (1-year)



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ITC's overall 4QFY23 revenue/EBITDA/PAT growth of 5.6%/18.9%/19.6%, respectively, was ahead of our estimates, with better-than-expected growth and best-ever margins in the FMCG and hotels segments. Soft margins in cigarettes and paper limited the yoy margin improvement to 430bps, which was down 50bps qoq. Key highlights: 1) Cigarette volume/EBIT growth of ~12%/14% (4.1% 4-yr volume CAGR) demonstrates a claw back of market share from illicit industry given stable taxation regime backed by deterrent government actions driving improved volume growth trajectory, 2) FMCG grew at a solid 19.4%, led by growth in foods and discretionary/out-of-home (OOH) categories, with 445bps margin expansion led by premiumisation, supply chain agility and strategic cost management 3) hotels business continued a strong rebound, generating 100% YoY revenue growth with sharp swing in margins led by higher ARR, occupancy and cost interventions, 4) agri business declined 18%, due to export restrictions on wheat imposed by the Government, 5) paper segment revenue was up mere 1.8% due to planned shutdown of mill and high base with margins down by 60bps and, 6) ITC Infotech posted revenue growth of 30% with EBITDA growth of 33%.

We expect the volume momentum on cigarettes to sustain, while FMCG traction should continue given the distribution ramp-up alongside a continued improvement in margins. Strong cash generation and a solid dividend yield should continue to provide downside support, as the stock continues its journey of a gradual re-rating. Any other value unlocking initiatives like demerger could be further positive triggers for the stock. We are building in revenue/PAT CAGR of 9%/10% over FY23-25E, respectively. We expect the recent outperformance to continue and maintain our BUY rating with a revised target price of Rs 474 (Rs 430 earlier), based on 25x FY25E earnings, in line with long-period average multiple.

Cigarette growth picking up given favorable government action: Cigarette revenue was up 14.2% with volumes growing around 12% and pricing/mix contributing about 2% in our view, indicating share gains from illicit trade. Growth was broad-based across regions and markets with innovation and premiumization helping profitability as well. Cigarette EBIT grew 14% YoY, led by a stable mix. The numbers indicate superior execution, focused portfolio/market interventions and traction in new innovative launches like *Classic Connect*, *Gold Flake Indie Mint*, *Gold Flake Kings Mixpod*, *Classic Alphatec*, *Gold Flake Smart Mintz*, *Wills Fab* and *Lucky Strike*. Taxation stability and enforcement action are countering illicit trade and driving volume recovery for the legal cigarettes industry.

FMCG business tracking well: FMCG revenue grew 19.4% YoY (on a base of 12.3% YoY). We estimate higher pricing growth vs volumes. EBIT grew 112.6%, with EBIT margin expanding to a record high of 10.1% due to easing of RM inflation. Staples and convenience foods, Discretionary and OOH categories saw robust growth, hygiene portfolio sales remained subdued (however above pre-pandemic level), while stationary products saw strong traction. Emerging channels of modern trade, quick commerce and e-commerce saw rapid growth.

Hotel business ARR and occupancy sustains above pre-pandemic levels: Hotel business revenue grew 100% YoY led by retail, leisure, weddings and MICE segments. Operating leverage, higher room rates and structural cost management resulted in EBIT margins of 25.5%, a new record for the company.

Paperboards, Paper & Packaging performance were muted: Paperboard revenue grew 1.8% YoY (on a high base of 31.8% YoY) due to impact of planned shutdown of pulp mills and muted demand in global markets. EBIT margin contracted 56bps YoY to 20%. Fine paper segment remained strong. During the quarter, company received Insurance claim amount of Rs 728mn towards lead tobacco stock, which were destroyed due to fire at a third party owned warehouse last year. ITC commissioned greenfield manufacturing plant in Nadiad, Gujarat with state-of-the-art equipment for the Cartons platform and capacity utilization is scaling up.

Export restrictions on wheat impacted agri-business: Agri business revenue declined 18% YoY (on a base of 30% YoY), while EBIT margin expanded 300bps YoY to 8.6%. Ex-wheat exports, revenue was up 20% yoy. Leaf tobacco exports and value-added agri products witnessed strong growth, however restrictions on exports of wheat and rice by the Government impacted business. The business continues to provide strategic sourcing support to the branded packaged foods business leveraging the e-Choupal network. The company remained focused on its strategy of rapidly scaling up its VAP portfolio to accelerate growth and enhance value capture in segments like spices, coffee, marine products and processed fruits.

Continued earnings traction amidst still attractive valuation merits maintaining BUY rating: We maintain our **BUY** rating on the stock despite the recent outperformance, with a revised target price of Rs 474 (from Rs 430 earlier), based on 25x FY25E earnings, in line with its long-term multiple of 24x. Despite the strong performance in past 12 months, we remain constructive on the stock, considering better-than-expected volume delivery and outlook in cigarettes, continued sales momentum in FMCG with rapidly improving margins, robust performance of paper business, turnaround in hotels business and improving capital allocation. The resilience of the cigarettes business in the current soft demand environment, recovery in valuations of global tobacco peers and a strong dividend yield makes us sanguine on the stock's continued outperformance.

Risks: 1) Sharp increase in cigarette taxes, 2) regulatory norms such as implementation of plain packaging or other stricter norms to curb tobacco consumption, and 3) slowdown in consumer spending, impacting growth rate in the FMCG business.

Exhibit 1: Quarterly performance

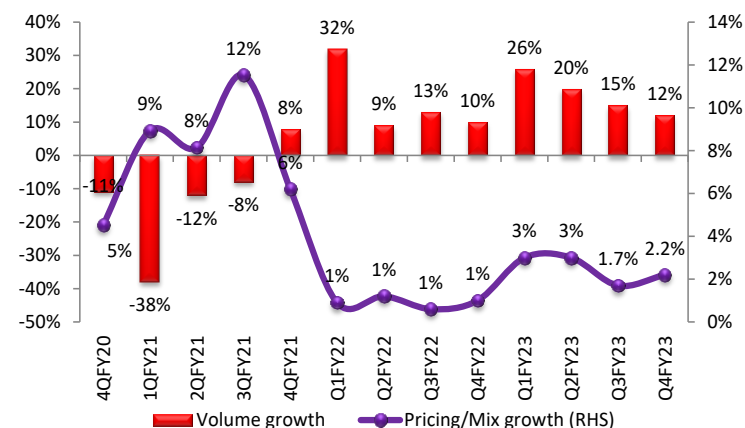
YE March (Rs mn)	Q4FY23	Q4FY22	Q3FY23	y-y (%)	q-q (%)
Net sales	172,240	162,266	171,222		
Excise duty	11,081	8,952	10,398		
Other operating income	2,821	1,994	1,433		
Net Revenues	163,980	155,309	162,257	5.6	1.1
Cost of materials	50,077	42,838	52,849	16.9	(5.2)
(% of sales)	29.1	26.4	30.9		
Purchase of stock in trade	17,864	29,961	13,864	(40.4)	28.9
(% of sales)	10.9	19.3	8.5		
Gross profit	96,038	82,510	95,545	16.4	0.5
Gross margin (%)	58.6	53.1	58.9		
Employee cost	8,940	8,095	8,770	10.4	1.9
(% of sales)	5.5	5.2	5.4		
Others	25,005	22,171	24,543	12.8	1.9
(% of sales)	15.2	14.3	15.1		
EBITDA	62,094	52,244	62,232	18.9	(0.2)
EBITDA margin (%)	37.9	33.6	38.4		
Other income	7,463	6,741	8,717	10.7	(14.4)
PBITD	69,557	58,984	70,949	17.9	(2.0)
Depreciation	4,219	4,459	4,072	(5.4)	3.6
Interest	118	105	102	12.8	16.2
PBT	65,219	54,420	66,775	19.8	(2.3)
Tax	15,847	12,792	16,010	23.9	(1.0)
ETR (%)	24.3	23.5	24.0		
Deferred tax	(768)	(282)	455	172.5	(268.8)
P/L of associate and JV	-	-	-		
Adjusted PAT	50,140	41,910	50,310	19.6	(0.3)
PATAMI margin	30.6	27.0	31.0		
Exceptional item	(729)				
Reported PAT	50,869	41,910	50,310	21.4	1.1
No. of shares (mn)	12,428	12,323	12,428		
Adj EPS (Rs)	4.1	3.4	4.1		

Source: Company, Systematix Institutional Research

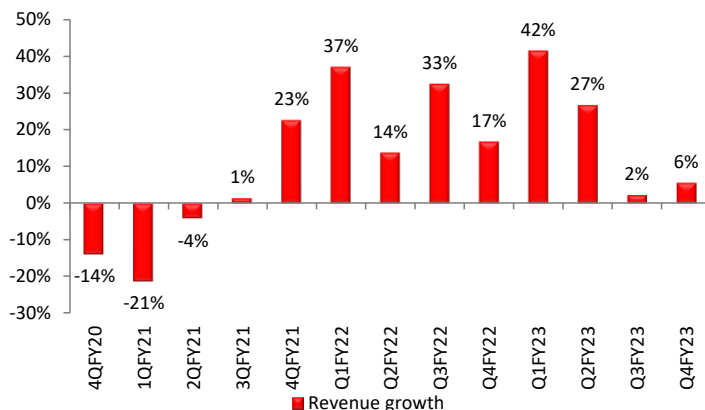
Exhibit 2: Change in estimates (Rs mn)

	Old estimates		Revised estimates		Variation (%)	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Net sales	782,987	836,589	774,858	848,281	-1%	1%
EBITDA	266,206	290,286	284,943	315,336	7%	9%
EBITDA margin	34.0%	34.7%	36.8%	37.2%		
Adj. PAT	199,254	216,840	213,209	235,529	7%	9%

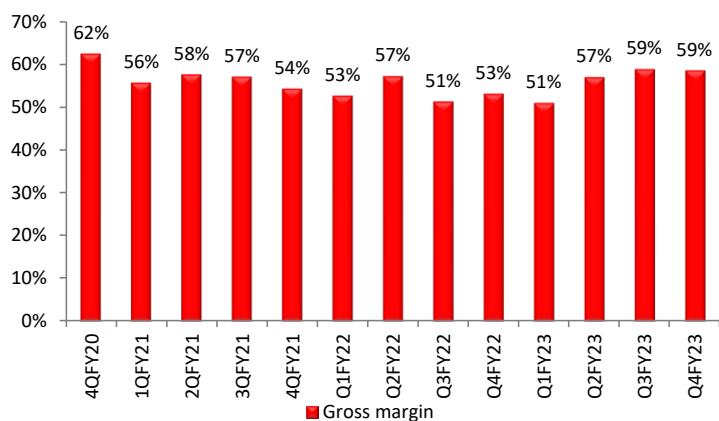
Source: Company, Systematix Institutional Research

Exhibit 3: Cigarette volume growth at 12%

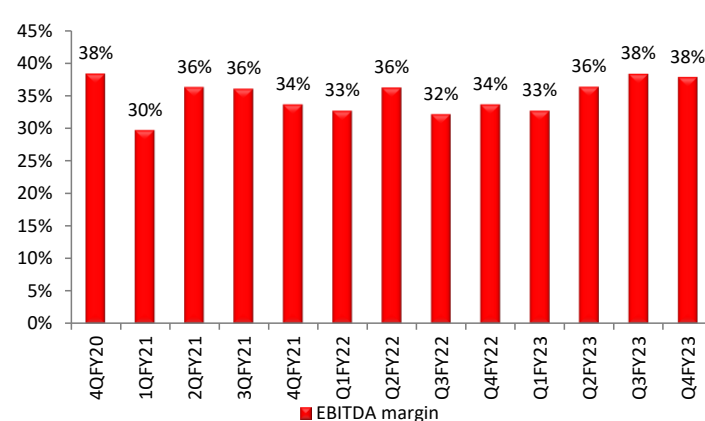
Source: Company, Systematix Institutional Research

Exhibit 4: Revenue up 6% YoY given decline in agribusiness

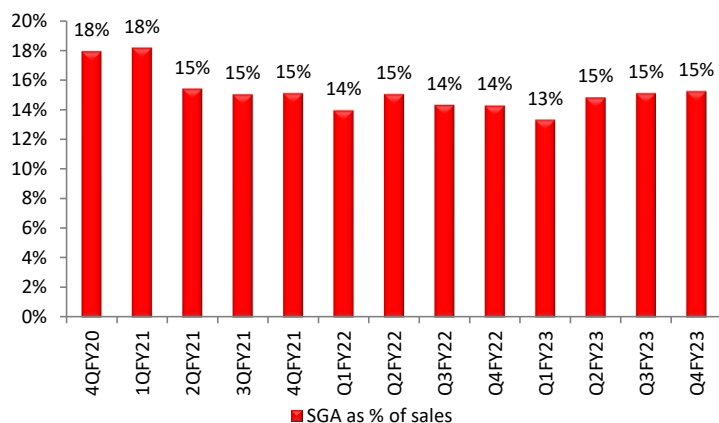
Source: Company, Systematix Institutional Research

Exhibit 5: Gross margin expands 544bps YoY

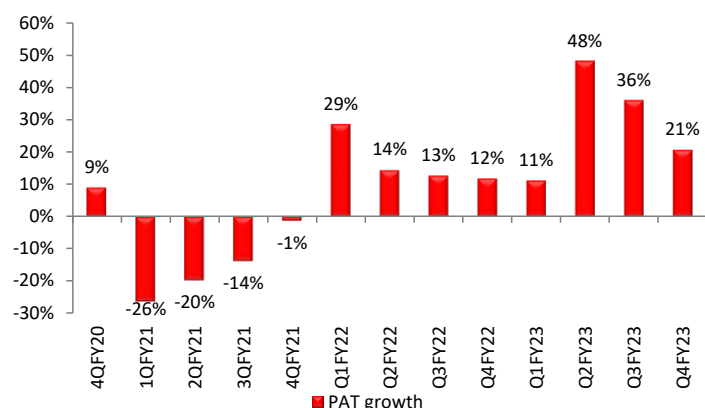
Source: Company, Systematix Institutional Research

Exhibit 6: EBITDA margin up 422bps YoY

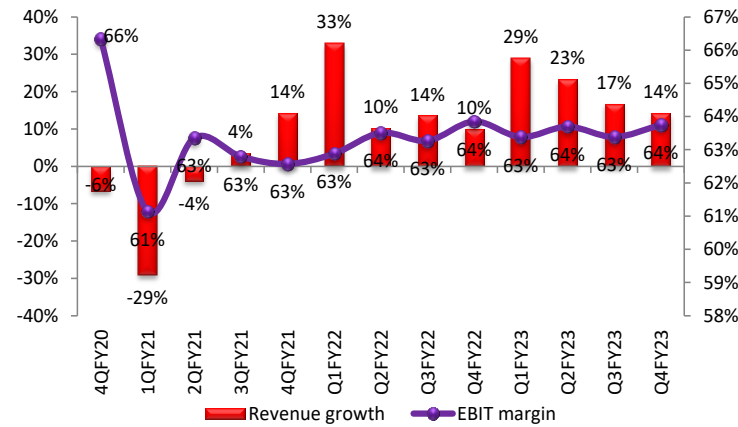
Source: Company, Systematix Institutional Research

Exhibit 7: SGA expenses increased 97 bps YoY

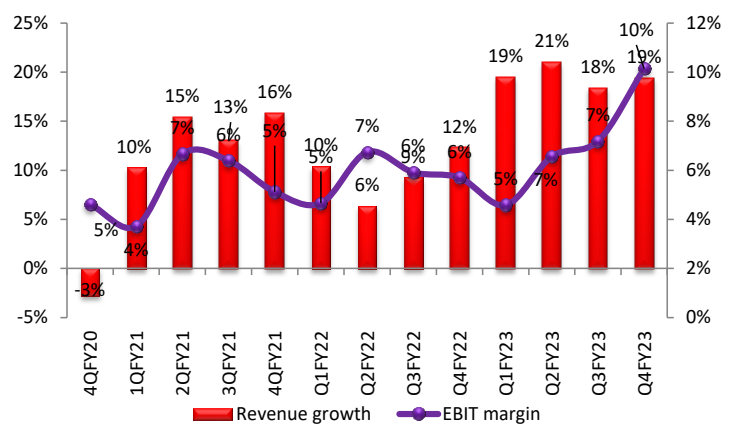
Source: Company, Systematix Institutional Research

Exhibit 8: PAT grew 21% YoY

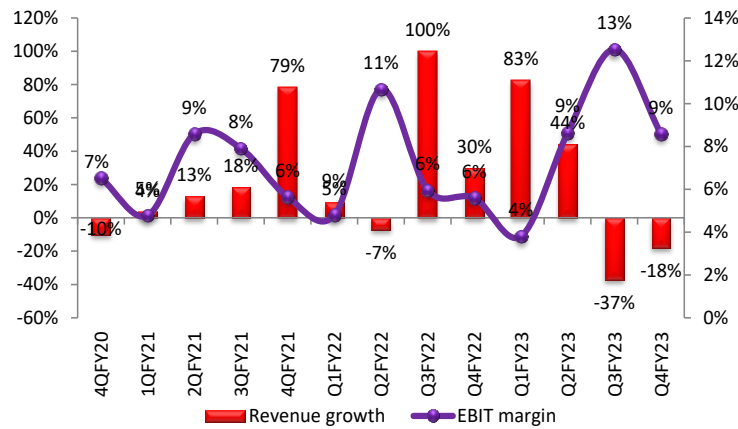
Source: Company, Systematix Institutional Research

Exhibit 9: Cigarette revenue grew 14% YoY

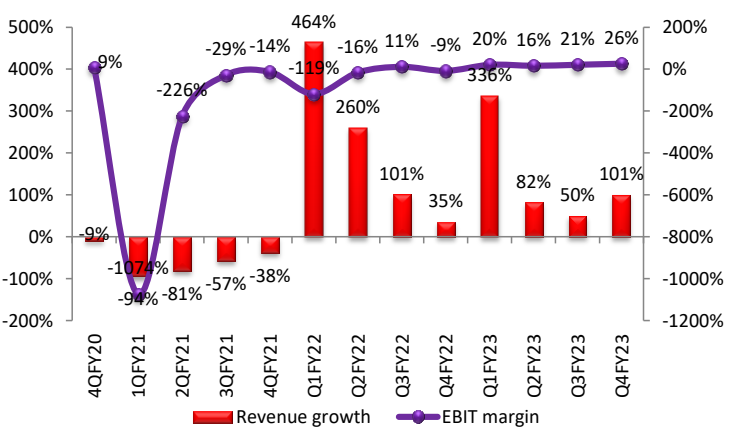
Source: Company, Systematix Institutional Research

Exhibit 10: FMCG revenue grew 19% YoY

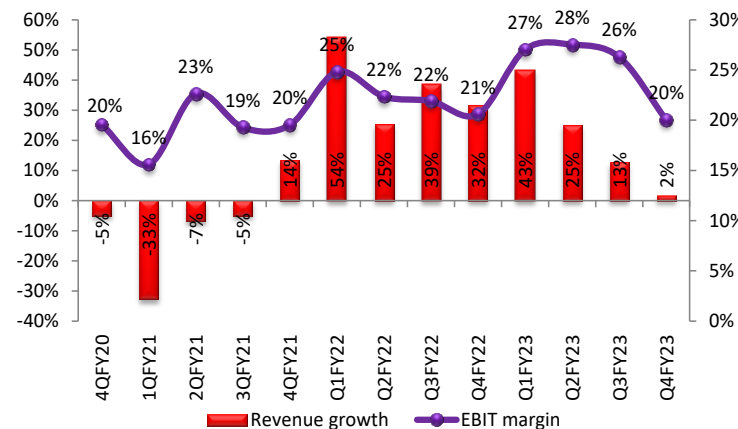
Source: Company, Systematix Institutional Research

Exhibit 11: Agri business declines 18% YoY

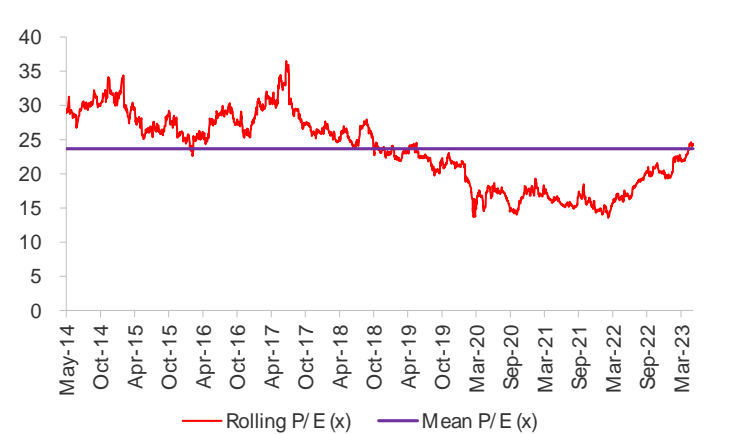
Source: Company, Systematix Institutional Research

Exhibit 12: Hotel business grew 101% YoY

Source: Company, Systematix Institutional Research

Exhibit 13: Paper business grew 2% due to high base

Source: Company, Systematix Institutional Research

Exhibit 14: Currently trades at 26x one year forward P/E

Source: Company, Systematix Institutional Research

FINANCIALS

Profit & Loss Statement

YE: Mar (Rs mn)	FY21	FY22	FY23	FY24E	FY25E
Revenue	4,92,728	6,06,681	7,09,369	7,74,858	8,48,281
Gross profit	2,91,413	3,42,830	4,19,311	4,61,816	5,09,817
GP margin (%)	59.1%	56.5%	59.1%	59.6%	60.1%
Operating profit	1,70,027	2,06,584	2,56,649	2,84,943	3,15,336
OP margin (%)	34.5%	34.1%	36.2%	36.8%	37.2%
Depreciation	16,456	17,324	18,090	21,006	22,656
Interest expense	446	394	432	454	476
Other income	26,326	18,364	19,805	20,795	21,835
Profit before tax	1,79,451	2,07,230	2,57,932	2,84,279	3,14,039
Taxes	45,553	52,373	64,384	71,070	78,510
Tax rate (%)	25.4%	25.3%	25.0%	25.0%	25.0%
Adj. PAT	1,31,612	1,52,427	1,93,549	2,13,209	2,35,529
Exceptional loss	69	-	(729)	-	-
Net profit	1,31,543	1,52,427	1,94,277	2,13,209	2,35,529
EPS	10.7	12.4	15.6	17.2	19.0

Source: Company, Systematix Institutional Research

Balance Sheet

YE: Mar (Rs mn)	FY21	FY22	FY23	FY24E	FY25E
Equity capital	12,309	12,323	12,428	12,428	12,428
Reserves	5,91,165	6,12,232	6,79,125	7,00,445	7,23,998
Debt	95	56	388	388	388
Minority Int	3,468	3,663	3,835	3,835	3,835
Deffered tax Liab	16,779	16,099	15,770	15,770	15,770
Other non current liabilities	6,935	5,957	9,723	10,209	10,719
Total liabilities	6,30,750	6,50,331	7,21,269	7,43,076	7,67,139
Fixed Asset	2,59,560	2,62,258	2,76,274	2,85,268	2,92,613
Investments	2,52,474	2,52,052	2,97,673	2,97,673	2,97,673
Other Non-current Assets	24,117	37,968	59,982	62,981	66,130
Inventories	1,03,972	1,08,642	1,17,712	1,37,988	1,53,388
Sundry debtors	25,017	24,619	29,562	42,458	48,805
Cash & equivalents	46,590	46,544	48,802	36,508	43,285
Loans and Advances	25,878	39,877	28,305	29,858	33,684
Sundry creditors	43,187	44,173	46,590	53,072	60,425
Other current liabilities	63,671	77,457	90,451	96,586	1,08,015
Total Assets	6,30,750	6,50,331	7,21,269	7,43,076	7,67,138

Source: Company, Systematix Institutional Research

Cash Flow

YE: Mar (Rs mn)	FY21	FY22	FY23	FY24E	FY25E
PBIT	1,79,897	2,07,624	2,58,364	2,84,732	3,14,515
Depreciation	16,456	17,324	18,090	21,006	22,656
Tax paid	(45,553)	(52,373)	(64,384)	(71,070)	(78,510)
Working capital Δ	30,225	22,321	(36,716)	(22,108)	(6,791)
Other operating items	-	-	-	-	-
Operating cashflow	1,81,025	1,94,895	1,75,355	2,12,561	2,51,870
Capital expenditure	(39,843)	(20,022)	(32,106)	(30,000)	(30,001)
Free cash flow	1,41,181	1,74,873	1,43,249	1,82,561	2,21,869
Equity raised	(48,482)	10,374	65,354	0	0
Investments	6,993	(25,398)	4,065	-	-
Debt financing/disposal	21	(39)	332	-	-
Interest Paid	(446)	(394)	(432)	(454)	(476)
Dividends paid	(1,32,320)	(1,41,718)	(1,92,634)	(1,91,888)	(2,11,976)
Other items	6,869	(17,745)	(17,676)	(2,513)	(2,639)
Net Δ in cash	(26,183)	(46)	2,258	(12,294)	6,778

Source: Company, Systematix Institutional Research

Ratios

YE: Mar	FY21	FY22	FY23	FY24E	FY25E
Revenue growth (%)	-0.3	23.1	16.9	9.2	9.5
Op profit growth (%)	-11.7	21.5	24.2	11.0	10.7
Net profit growth (%)	-16.3	15.8	27.0	10.2	10.5
OPM (%)	34.5	34.1	36.2	36.8	37.2
Net profit margin (%)	26.7	25.1	27.3	27.5	27.8
RoCE (%)	28.5	33.6	39.0	40.3	43.2
RoNW (%)	21.0	24.8	29.4	30.4	32.5
EPS (Rs)	10.7	12.4	15.6	17.2	19.0
DPS (Rs)	10.8	11.5	15.5	15.4	17.1
BVPS (Rs)	49.3	51.0	56.0	57.7	59.6
Debtor days	19	15	15	20	21
Inventory days	77	65	61	65	66
Creditor days	32	27	24	25	26
P/E (x)	39.3	34.0	27.0	24.5	22.2
P/B (x)	8.5	8.2	7.5	7.3	7.1
EV/EBITDA (x)	30.1	24.8	20.1	18.2	16.4

Source: Company, Systematix Institutional Research

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DISCLOSURES/APPENDIX

I. ANALYST CERTIFICATION

I, **Himanshu Nayyar, Rajesh Mudaliar**; hereby certify that (1) views expressed in this research report accurately reflect my/our personal views about any or all of the subject securities or issuers referred to in this research report, (2) no part of my/our compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this research report by **Systematix Shares and Stocks (India) Limited (SSSIL)** or its group/associate companies, (3) reasonable care is taken to achieve and maintain independence and objectivity in making any recommendations.

Disclosure of Interest Statement	Update
Analyst holding in the stock	No
Served as an officer, director or employee	No

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