Contraire

BONANZA WEALTH MANAGEMENT RESEARCH

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15th February 2021

ITC - Buy

CMP : 215
Target Price : 261
Upside : 21%
Stop Loss : 199 (closing basis)

Investment Thesis

Sales grew 4% YoY to Rs 5490Cr; however, adjusted for NCCD/ excise gross-up in revenue, underlying cigarette revenue fell 8% YoY vs 14% YoY in Q2, on the back of MoM improvement in volume since October. Price/ mix was broadly flat YoY and improved QoQ as metros started to recover. Cigarette EBIT declined 8% YoY. Underlying EBIT margin was flat; reported margin was down 790 bps YoY at 62.8% due to NCCD spike and volume decline,3QFY21 FMCG business adjusted revenue grew 11% YoY on back of broad-based growth across key categories; however, revenue growth trends have moderated from 1HFY21 levels owing to reduced in-home consumption, which has taken a hit due to improved mobility; at the same time, discretionary and out of home consumption grew 11% YoY, after facing tough time in 1HFY21. Essentials portfolio (biscuits, noodles, Atta, Snacks etc which contributes 75% of FMCG sales) grew 11% YoY, seeing significant moderation of 30% growth seen in 1HFY21. EBITDA margin expanded 142ps to 9.2% owing to operating leverage, sustained premiumization trends and integrated manufacturing facilities despite scaling up of new categories (Dairy, hygiene range, frozen foods etc). Interestingly, management stated Savlon is expected to achieve consumer spend of Rs 10 bn in FY21 (vs Rs 2.5 bn in FY20). We believe healthy revenue trends to sustain for FMCG in FY22 as well given consumer preference for essentials.Agri revenue was driven by higher wheat supplies for Aashirvaad atta and trading opportunities in rice, soya and wheat exports. While revenue grew 18.5% YoY, EBIT declined by 8% due to 230 bps dip in margin due to weaker mix. During the quarter, leaf exports were impacted by lower volumes and adverse crop/ grade mix. Paperboard, paper and packaging posted 5%/ 15 YoY decline in revenue/ EBIT. Robust growth in exports was partly offset by weak domestic demand. Company witnessed QoQ recovery across segments. Speciality papers – pharma and decorative saw strong growth while liquor, publications, notebooks, and wedding card segments remain subdued. expect hotels business to see gradual demand revival in FY22 as travel related restrictions are lifted.Moreover, management highlighted hotel business had become Ebitda positive in Dec,2020 owing to improved occupancy levels and strong response to F&B Initiatives.

Stock Details	
Market Cap (RsCr)	267580
BSE Code	500875
NSE Code	ITC
Sector/Index	Tabacco / S&P BSE
Year End	March
52 w.High/Low	135/239
Outstanding shares	1230(cr)
BSE Sensex	51544
NSE Nifty	15163

Shareholding Pattern	
Promoters	00.00%
DIIs	39.60%
FIIs	13.00%
Others	47.40%

Price Performance (%)	1M	3M	12M
Absolute	2.4	-11.0	-33.4
Rel To Sensex	-3.5	-21.1	-36.9

During the past 5 years,Revenue of grew at a CAGR of 5% while Net Profit grew at a CAGR of 8% in the same period.

Particulars(RsCr)	FY19	FY20	FY21E	FY22E	FY23E
Revenue	44433	45136	43568	49275	53710
Net Profit	12464	14401	12733	15575	17295
EPS(Rs)	10.2	11.7	10.6	12.5	13.7
PE(x)	16.7	14.5	16.4	13.9	12.7
Dividend yield (%)	3.4	6.0	5.3	6.3	6.9
FCF yeild (%)	4.1	5.5	4.9	5.4	5.9
PB(x)	3.6	3.3	3.2	3.0	2.8
ROE(%)	22.8	23.6	19.7	23.1	23.5

Key Business Highlights

ITC has used a small portion of its core business operating cashflow to incubate and scale up its FMCG business, which in terms of revenue is now the second largest in India. The FMCG business has built a strong brand portfolio, largely organically, and revenue contribution from FMCG expanded from 20% in FY10 to 28% in FY20. Similarly, its Ebitda contribution expanded from -6% in FY10 to +7% in FY20. ITC's cigarettes business remains a cash cow and is providing capital to support FMCG's big drives. ITC has helped to generate steady free cash flow generates US$1.5bn, a clear path towards the profitable scaling-up of the FMCG business, and improving capital allocation provide a much-needed supportive narrative for ITC against a backdrop of subdued valuations including 5.4% free cashflow yield, 6.3% dividend yield in FY22E.

Risk & Concern

Increase in cigarette taxes higher than inflation or implementation of plain packaging.

Stricter norms to curb tobacco consumption.

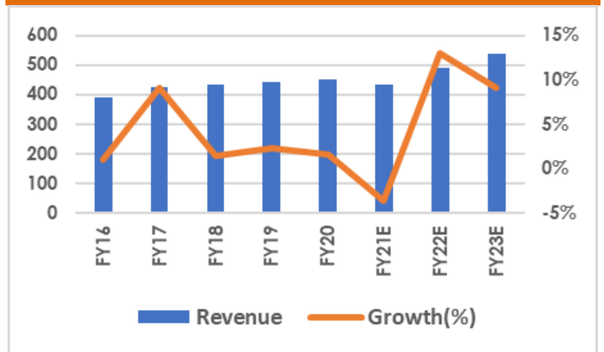
Stock overhang from the possible sale of the government's 7.9% stake in ITC (that it owns through the Specified Undertaking of Unit Trust of India -SUUTI)

Valuation

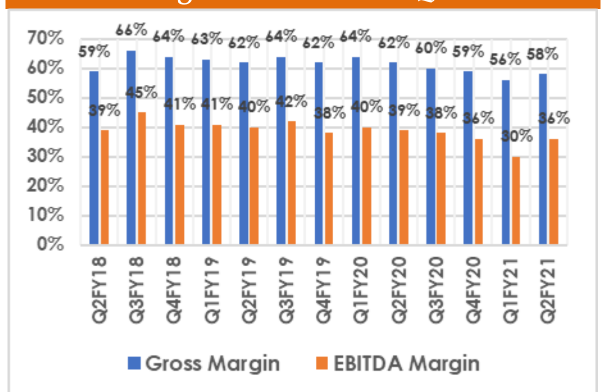
it is witnessing smart recovery in metros/ large towns after a soft H1,metro markets remain relatively more impacted vs pre-Covid levels,focused portfolio/ market interventions, small packs, innovative and competitive offerings aided market share gains; (revenue at 9x compared to nearest competition). ITC can comfortably pass any tax-hikes to customers by raising prices. Business recovery in Cigarette business has been better than expected while Hotel segment recovery is likely to be delayed. ITC's cigarette business allows the company to have a consistent strong cash flow (FY17-20 FCF CAGR 18%, FY20 FCF Rs.11600Cr) which should continue to help FMCG business, good management, High Free cash flow yield (5.4%), high dividend yield (6.3%) and strong business moat, that gives confidence to call it a high conviction buy at inexpensive valuation 19x its FY23E EPS. As budget uncertainty relating to taxation behind us at least in the short term, we expect ITC stock to see decent performance.

Graphs & Charts

Revenue CAGR of 5% between FY19 -FY23E

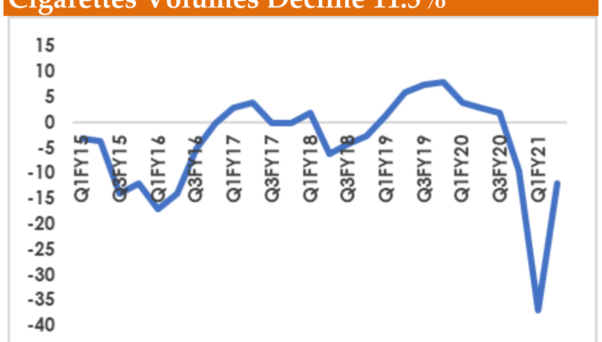


EBITDA margin contracted in 2QFY21



Contribution of cigarettes to revenue decline

Cigarettes Volumes Decline 11.5%



Disclosure:

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