BONANZA WEALTH MANAGEMENT RESEARCH

11th November '20

ITC - Buy

CMP : 181
Target Price : 219
Upside : 21%
Stop Loss : 155 (closing basis)

Investment Thesis

Revenue declined 4%YoY (vs -21%YoY 1QFY21) driven by strong growth in branded FMCG and Agri business at 15.4% YoY and 12.8% YoY respectively. FMCG reported business grew 15.4% YoY (comparable sales up 18.4%), supported by 25% YoY growth in staples, convenience foods and hygiene products. Out of home category sales declined 2%. EBIDTA margins expanded 290bps to 9.7% (8.7% in 1H21), highest ever EBIDTA margins by FMCG business. Margin expansion was driven by higher operating leverage, enhanced operational efficiencies, premiumisation and better product mix. The EBITDA margin dropped by 400 bps to 36.3% especially on account of loss in Cigarette business dropped by 860 bps on year to 60.6% and Hotels business due to lockdowns (Covid 19). Sales on the e-commerce channel grew more than 2x, the quality of being particularly noticeable to over 5% of segment sales. Paperboards, Paper & Packaging – strong sequential recovery: Revenue grew 42% QoQ and declined 7% YoY. Consumer offtake in pharma, homecare, packaged foods and personal care returned to pre-Covid levels. Wedding cards, publication, notebooks remain subdued while exports grew strongly. Cigarette business net revenue declined 14% YoY (vs. -37% in 1QFY21); however, sales are recovering sequentially. Better cost management led to a 221bps QoQ improvement in EBIT margin. Localised lockdowns and restricted hours of convenience store operations impacted the recovery momentum seen at the end of 1QFY21. Certain markets in the South, metros and large towns were relatively more impacted due to disruption in sales operations. Temporary disruption in some wholesale markets also impacted sales. Easing of restrictions from September'20 has enhanced the ability to service markets more effectively and address emerging demand. It Strengthened direct reach in target markets across all traditional trade channels; stockist network augmented to service rural/semi-urban markets more efficiently. ITC has launched new product such as Gold Flake Luxury Filter, Navy Cut Deluxe Filter and Gold Flake Star to cater to the evolving needs of customer. Restrictions on travel and tourism affected the quarterly performance of the hotels business, Sales down 80.8% YoY with EBIT loss of Rs 1.85bn. Aggressive cost reduction measures led to 50% reduction in controllable cash fixed costs.Declining in ROE and has taken steps such as shifting to an asset light model for Hotels.

Stock Details	
Market Cap (RsCr)	2,32,135
BSE Code	500875
NSE Code	ITC
Sector/Index	Tabacco / S&P BSE
Year End	March
52 w.High/Low	135/256
Outstanding shares	1230(cr)
BSE Sensex	43638
NSE Nifty	12780

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.

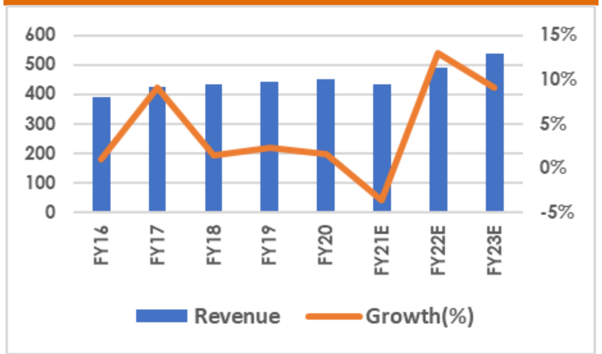
Stock overhang from the possible sale of the government's 7.9% stake in ITC (that it owns through the Specified Undertaking of Unit Trust of India -SUUTI)

Valuation

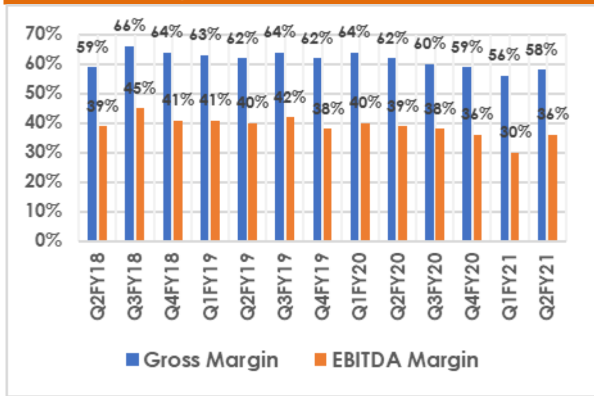
Cigarette volume went down in July and August due to covid, cigarette volume trends are back to normal levels since September. Being category leader in cigarettes (revenue at 9x compared to nearest competition). ITC can comfortably pass any tax-hikes to customers by raising prices. Business recovery 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 18x its FY22E EPS

Graphs & Charts

Revenue CAGR of 5% between FY19 -FY23E

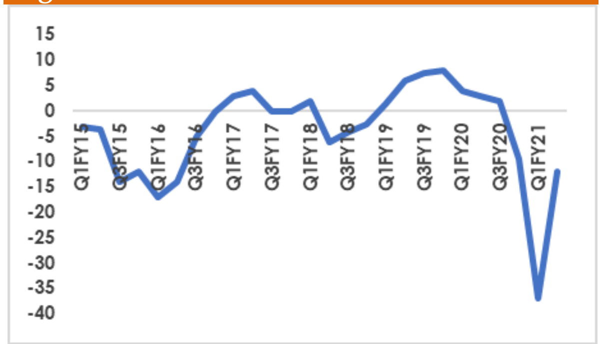


EBITDA margin contracted in 2QFY21



Contribution of cigarettes to revenue decline

Cigarettes Volumes Decline 11.5%



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