

22 September 2023

India | Equity Research | Company Update

## ITC

Consumer Staples &amp; Discretionary

## CXO 1\*1: Supratim Dutta, CFO

We launch a new report series on CXO 1x1. We met Supratim Dutta, ED & CFO, ITC. Takeaways: 1) Volume growth momentum in cigarettes is likely to continue driven by a stable tax environment and relative end price stability. 2) Premiumisation across segments driven by innovation and differentiation. 3) Growth in FMCG segment to be driven by fortifying core categories (Staples, Biscuits, Noodles, Snacks, Personal Care) while expanding into adjacencies. In smaller categories (Beverages, Chocolates etc.) that have expanded their salience in the portfolio over the last few years, the strategy is to drive growth in select regions with focus on unit economics. 4) ITC continues to aim for ~80-100bps average annual margin expansion in FMCG. 5) On Electronic Nicotine Delivery System (ENDS), which is currently banned in India, policy stability is expected. Maintain **ADD**.

## Stable tax environment likely to continue (formal sector gains)

High taxation on cigarettes between FY13–FY18 (~15% CAGR) had led to an accelerated shift from legal cigarettes to illicit. Consequently, tax collections also turned sub-optimal, while the share of illicit cigarettes (in overall industry; India is the fourth-largest illicit cigarette market) increased from mid to high teens to >25%. Illicit cigarettes neither leads to tax revenue generation, nor compliance with tobacco regulations.

Post-FY18, the government has been focusing on curtailing illicit cigarettes (exponential increase in seizures) which has led to a relatively stable tax regime over the last 3-5 years. This has helped legal cigarette industry to partially claw back volumes from illicit trade. Though opportunities for price increases exists (given the overall inflationary environment), price increases have been moderate and, in our opinion, volume growth momentum is likely to continue given the relatively stable tax environment. We note that cigarettes volumes have not yet crossed the peak levels of FY13.

## Financial Summary

Y/E March (INR mn)	FY22A	FY23A	FY24E	FY25E
Net Revenue	5,56,968	6,52,729	7,19,170	7,93,394
EBITDA	1,82,892	2,31,741	2,66,459	2,95,319
EBITDA Margin (%)	32.8	35.5	37.1	37.2
Net Profit	1,50,578	1,86,804	2,13,678	2,35,102
EPS (Rs)	12.2	15.2	17.3	19.0
EPS % Chg YoY	15.4	23.0	14.4	10.0
P/E (x)	36.6	29.8	26.0	23.7
EV/EBITDA (x)	29.6	23.1	20.1	18.1
RoCE (%)	21.0	25.2	27.6	30.3
RoE (%)	25.0	29.0	31.4	34.1

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## Market Data

Market Cap (INR)	5,580bn
Market Cap (USD)	67,191mn
Bloomberg Code	ITC IN
Reuters Code	ITC.BO
52-week Range (INR)	500 /321
Free Float (%)	71.0
ADTV-3M (mn) (USD)	64.1

Price Performance (%)	3m	6m	12m
Absolute	0.1	21.2	36.1
Relative to Sensex	4.7	15.1	12.9

ESG Disclosure	2021	2022	Change
ESG score	66.1	66.9	0.8
Environment	69.6	67.9	(1.7)
Social	38.8	43.0	4.2
Governance	89.9	89.9	-

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

## Previous Reports

15-08-2023: [Q1FY24 results review](#)

19-05-2023: [Q4FY23 results review](#)

### Premiumisation across segments driven by innovation and differentiation

ITC is witnessing a trend of premiumisation from largely driven by holding on to the INR 10 price point in the segment under the Gold Flake franchise. As mentioned earlier, price increases have been moderate as ITC continues to focus on volume growth amidst relative tax stability (gains for formal sector). King Size Filter Tip (KSFT or 84mm) and Mini King Size Filter Tip (MKSFT or 74mm) segments continue to mirror overall growth with ~20% share in ITC's Cigarettes business.

### FMCG growth strategy

ITC plans to grow its FMCG business through four pillars: 1) Fortify the core (Staples, Biscuits, Noodles, Snacks, Personal Care). 2) Expand into adjacent spaces (e.g.: wheat and wheat derivatives with Aashirvaad, Premium dairy beverages with Dark Fantasy). 3) Grow the new core in categories such as Beverages, Chocolates, Confectionary and Dairy in chosen regions with a focus on the right unit economics. These categories have grown relatively larger (from <5% salience to ~7-8%). 4) Continue margin expansion of ~80-100bps annually on an average via improvement in logistics cost, premiumisation and scale benefits (certain gestating categories have reduced the profitability drag with increased size and scale).

### Regulations on ENDS unlikely to change in the near term

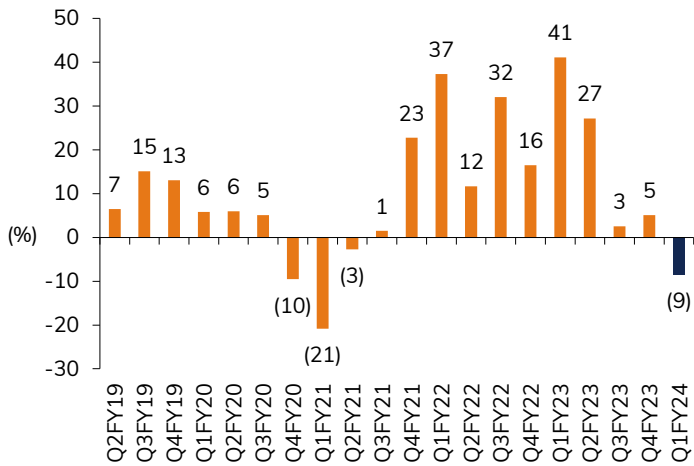
India enacted the Prohibition of Electronic Cigarettes Act, 2019 which banned a broad category of ENDS (Electronic Nicotine Delivery System) including electronic cigarettes, vaping devices, and Heat Not Burn (HNB) products. The government justified the ban on the basis of certain risks, including their potential impact on health, ability to attract youth, and concern that ENDS would undermine tobacco control efforts. Further, in May'23, the central government issued a public notice (as per media reports - [link](#)) for stricter implementation of the Act. These was triggered by easy availability of these products in tobacco shops, general stores, online providers etc. and their sale to children below 18 years of age.

ITC had forayed into electronic cigarettes in 2014 with launch of two electronic-vaping devices, or electronic cigarettes, under 'Eon' brand. The product was not very successful due to higher cost per puff vs conventional cigarettes before the category was banned by the Government of India. However, ITC's 100+ years of experience in tobacco industry along with its distribution reach will likely be key to manage such disruptions (if any). Before ENDS was banned in India, ITC had initiated appropriate investments, enhancing capacity and was gearing up to be in a state of readiness in this emerging segment. Another aspect that the government is likely to consider would be the impact on tobacco farmers and taxation on these products. ENDS uses reconstituted tobacco which is a global technology which reduces use of leaf tobacco in these products which could likely impact income of tobacco farmers in India.

### Valuation and risks

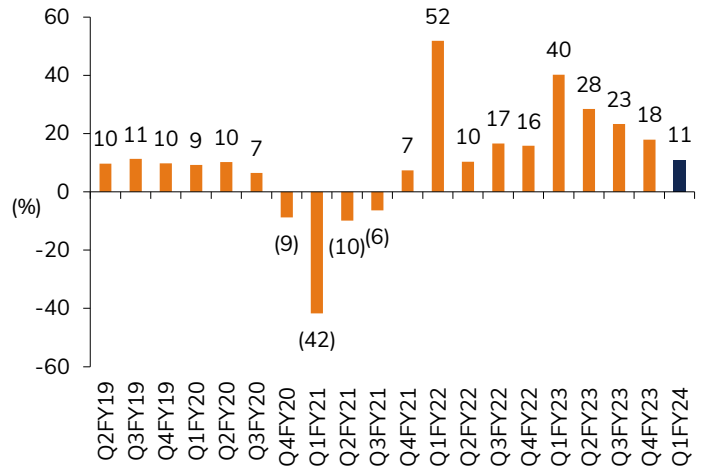
Our earnings estimates are unchanged. Maintain **ADD** with a DCF-based unchanged target price of INR 500. At our target price, the stock will trade at 26x P/E multiple Mar'25E. Key downside risk is tax hikes materially ahead of inflation leading to lower volume growth (on cigarettes) as price elasticity turns unfavourable.

**Exhibit 1: Revenue growth**



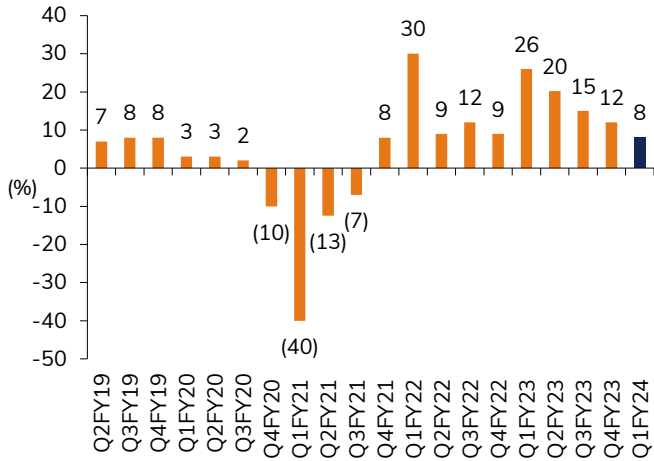
Source: Company data, I-Sec research

**Exhibit 2: EBITDA growth**



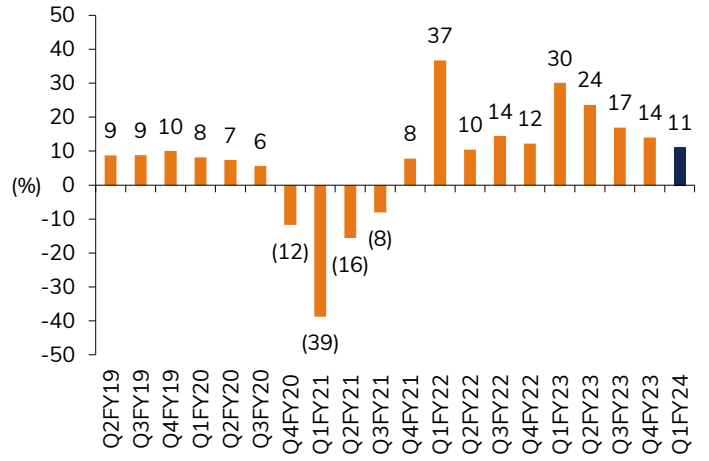
Source: Company data, I-Sec research

**Exhibit 3: Cigarette volume growth**



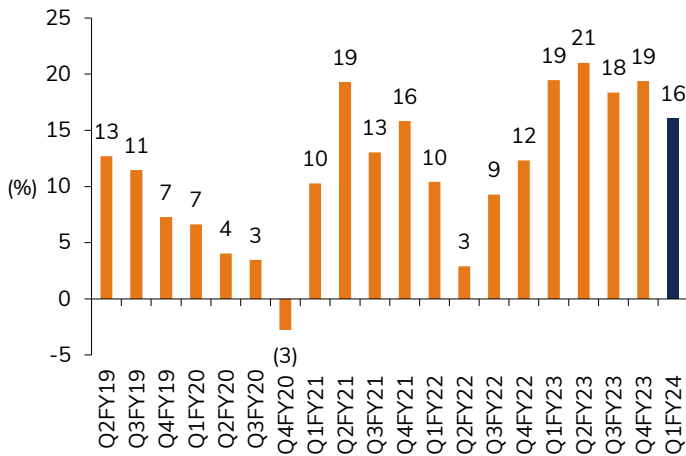
Source: Company data, I-Sec research

**Exhibit 4: Cigarette EBIT growth**



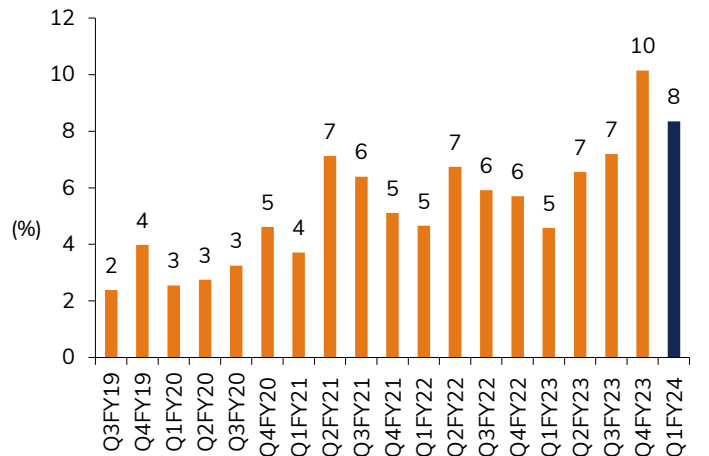
Source: Company data, I-Sec research

**Exhibit 5: FMCG revenue growth**



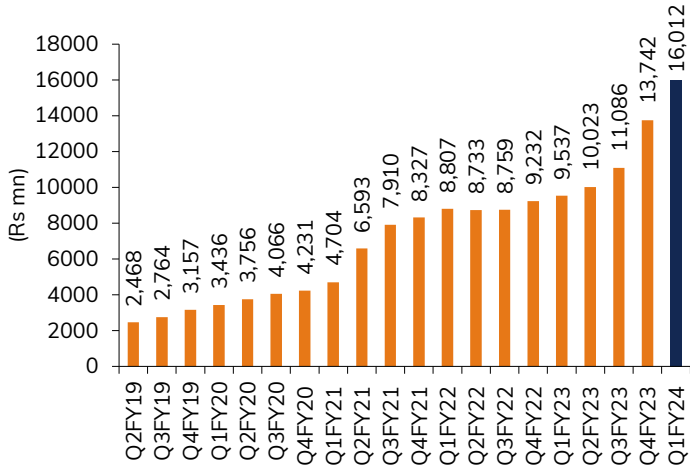
Source: Company data, I-Sec research

**Exhibit 6: FMCG EBIT margin**



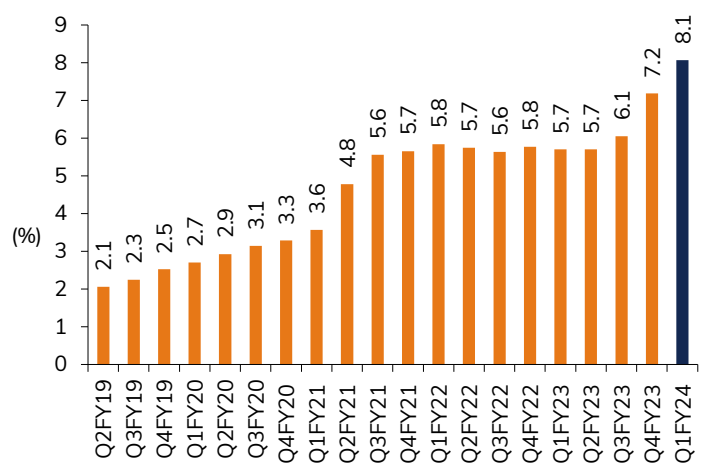
Source: Company data, I-Sec research

**Exhibit 7: FMCG – EBIT (TTM)**



Source: Company data, I-Sec research

**Exhibit 8: FMCG – EBIT margin (TTM)**



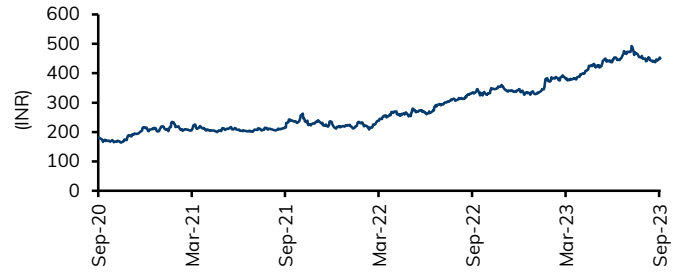
Source: Company data, I-Sec research

**Exhibit 9: Shareholding pattern**

%	Dec'22	Mar'23	Jun'23
Promoters	-	-	-
Institutional investors	85.0	85.5	85.6
MFs and others	9.7	9.5	9.2
FIs/Banks	11.9	12.0	0.1
Insurance	20.4	20.4	20.4
FIIIs	43.0	43.6	56.0
Others	15.0	14.5	14.4

Source: Bloomberg

**Exhibit 10: Price chart**



Source: Bloomberg

## Financial Summary

### Exhibit 11: Profit & Loss

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Net Sales	5,56,968	6,52,729	7,19,170	7,93,394
<b>Operating Expenses</b>	<b>3,74,076</b>	<b>4,20,988</b>	<b>4,52,710</b>	<b>4,98,075</b>
EBITDA	1,82,892	2,31,741	2,66,459	2,95,319
<b>EBITDA Margin (%)</b>	<b>32.8</b>	<b>35.5</b>	<b>37.1</b>	<b>37.2</b>
Depreciation & Amortization	16,522	16,627	18,106	19,412
EBIT	1,66,370	2,15,114	2,48,353	2,75,907
Interest expenditure	420	418	416	414
Other Non-operating Income	32,344	32,080	34,339	35,085
Recurring PBT	1,98,295	2,46,775	2,82,276	3,10,578
<b>Profit / (Loss) from Associates</b>	-	-	-	-
<b>Less: Taxes</b>	<b>47,717</b>	<b>59,971</b>	<b>68,598</b>	<b>75,476</b>
PAT	1,50,578	1,86,804	2,13,678	2,35,102
Less: Minority Interest	-	-	-	-
Extraordinaries (Net)	-	729	-	-
Net Income (Reported)	1,50,578	1,87,533	2,13,678	2,35,102
<b>Net Income (Adjusted)</b>	<b>1,50,578</b>	<b>1,86,804</b>	<b>2,13,678</b>	<b>2,35,102</b>

Source Company data, I-Sec research

### Exhibit 12: Balance sheet

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Total Current Assets	3,09,420	3,52,034	3,70,502	3,92,745
of which cash & cash eqv.	1,55,029	2,01,883	2,06,545	2,13,496
Total Current Liabilities & Provisions	1,14,313	1,23,678	1,36,760	1,51,418
<b>Net Current Assets</b>	<b>1,95,108</b>	<b>2,28,356</b>	<b>2,33,742</b>	<b>2,41,327</b>
Investments	1,60,215	1,67,158	1,67,158	1,67,158
Net Fixed Assets	1,95,592	2,04,913	2,04,827	2,04,935
ROU Assets	7,128	7,159	7,159	7,159
Capital Work-in-Progress	24,423	16,815	16,815	16,815
Total Intangible Assets	26,083	26,298	26,298	26,298
Long Term Loans & Advances	28,064	48,240	51,917	56,025
Deferred Tax assets	-	-	-	-
<b>Total Assets</b>	<b>6,36,612</b>	<b>6,98,939</b>	<b>7,07,916</b>	<b>7,19,717</b>
<b>Liabilities</b>				
<b>Borrowings</b>	<b>53</b>	<b>45</b>	<b>45</b>	<b>45</b>
<b>Deferred Tax Liability</b>	<b>16,671</b>	<b>16,211</b>	<b>16,211</b>	<b>16,211</b>
Provisions	1,869	2,018	2,224	2,453
Other Liabilities	4,024	4,726	4,881	5,055
Equity Share Capital	12,323	12,428	12,428	12,428
Reserves & Surplus	6,01,672	6,63,510	6,72,126	6,83,524
<b>Total Net Worth</b>	<b>6,13,996</b>	<b>6,75,938</b>	<b>6,84,554</b>	<b>6,95,952</b>
Minority Interest	-	-	-	-
<b>Total Liabilities</b>	<b>6,36,612</b>	<b>6,98,939</b>	<b>7,07,916</b>	<b>7,19,717</b>

Source Company data, I-Sec research

### Exhibit 13: Quarterly trend

(INR mn, year ending March)

	Sep-22	Dec-22	Mar-23	Jun-23
Net Sales	159,415	160,824	161,159	156,756
% growth (YOY)	27.2	2.5	5.1	(8.5)
EBITDA	56,760	60,799	59,273	60,975
Margin %	35.6	37.8	36.8	38.9
Other Income	5,069	8,717	7,463	7,087
Extraordinaries	-	-	729	-
Adjusted Net Profit	44,661	50,310	50,140	49,027

Source Company data, I-Sec research

### Exhibit 14: Cashflow statement

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
<b>Operating Cashflow</b>	<b>1,48,078</b>	<b>1,79,117</b>	<b>2,07,048</b>	<b>2,29,723</b>
Working Capital Changes	1,841	(4,441)	(4,041)	(4,338)
Capital Commitments	18,120	18,583	18,020	19,520
<b>Free Cashflow</b>	<b>1,29,958</b>	<b>1,60,534</b>	<b>1,89,028</b>	<b>2,10,203</b>
<b>Other investing cashflow</b>	<b>2,950</b>	<b>(33,011)</b>	<b>21,111</b>	<b>20,867</b>
Cashflow from Investing Activities	(15,171)	(51,594)	3,091	1,346
Issue of Share Capital	2,918	24,774	-	-
Interest Cost	(421)	(400)	(416)	(414)
Inc (Dec) in Borrowings	(4)	(7)	-	-
Dividend paid	(1,35,471)	(1,51,300)	(2,05,062)	(2,23,704)
Others	(393)	(370)	-	-
Cash flow from Financing Activities	(1,33,370)	(1,27,304)	(2,05,478)	(2,24,118)
<b>Chg. in Cash &amp; Bank balance</b>	<b>(463)</b>	<b>219</b>	<b>4,661</b>	<b>6,952</b>
Closing cash & balance	39,552	38,998	42,974	49,926

Source Company data, I-Sec research

### Exhibit 15: Key ratios

(Year ending March)

	FY22A	FY23A	FY24E	FY25E
<b>Per Share Data (INR)</b>				
Reported EPS	12.2	15.0	17.2	18.9
Adjusted EPS (Diluted)	12.2	15.2	17.3	19.0
Cash EPS	13.6	16.4	18.7	20.5
Dividend per share (DPS)	11.5	15.5	16.5	18.0
Book Value per share (BV)	49.8	54.4	55.1	56.0
Dividend Payout (%)	94.1	103.1	96.0	95.2
<b>Growth (%)</b>				
Net Sales	23.5	17.2	10.2	10.3
EBITDA	20.7	26.7	15.0	10.8
EPS (INR)	15.4	23.0	14.4	10.0
<b>Valuation Ratios (x)</b>				
P/E	36.6	29.8	26.0	23.7
P/CEPS	33.0	27.3	24.0	21.9
P/BV	9.0	8.2	8.1	8.0
EV / EBITDA	29.6	23.1	20.1	18.1
P / Sales	10.0	8.5	7.7	7.0
Dividend Yield (%)	2.6	3.5	3.7	4.0
<b>Operating Ratios</b>				
Gross Profit Margins (%)	52.9	55.8	56.7	56.7
EBITDA Margins (%)	32.8	35.5	37.1	37.2
Effective Tax Rate (%)	24.1	24.3	24.3	24.3
Net Profit Margins (%)	27.0	28.6	29.7	29.6
Net Debt / Equity (x)	(0.3)	(0.3)	(0.3)	(0.3)
Net Debt / EBITDA (x)	(0.8)	(0.9)	(0.8)	(0.7)
Fixed Asset Turnover (x)	2.1	2.3	2.3	2.4
Working Capital Days	29	16	14	13
Inventory Turnover Days	72	64	62	61
Receivables Days	14	14	13	13
Payables Days	31	26	26	26
<b>Profitability Ratios</b>				
RoCE (%)	21.0	25.2	27.6	30.3
RoE (%)	25.0	29.0	31.4	34.1
RoIC (%)	43.9	53.8	60.9	66.7

Source Company data, I-Sec research

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