YES SECURITIES
INSTITUTIONAL EQUITIES

December 13, 2023

INVESTOR & ANALYST DAY | Sector: Consumer Staples

ITC Ltd.

New opportunities - Food Tech & Nicotine exports

We participated in the Institutional Investors & Financial Analysts Day held by ITC Ltd. (ITC) in Mumbai. The management team took us through the current market standing across business segments, capabilities in innovation, growth vectors (core, emerging, future), digital initiatives, structural interventions taken across value chain and sustainability initiatives. We haven't made any major changes to our earnings estimates through this update. The stock is currently trading at ~27x/24x/23x FY24E/FY25E/FY26E EPS. Based on target multiple of ~26x (3yr/5yr avg fwd. multiple ~20x), we arrive at a target price (TP) of Rs505, maintaining our ADD rating.

Analyst Meet – Key updates: -

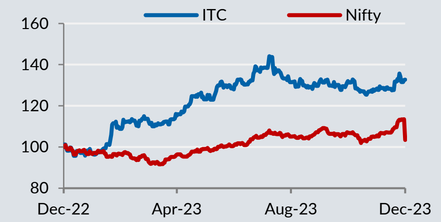
- There are some greenshoots visible in rural areas post correction in product prices, but no major recovery seen. ITC is expecting better growth in couple of quarters.
- There is continuous engagement with the policy makers and a sense of understanding regarding illicit trade. There is also data to show that there is increase in tax revenues to exchequer from the legal cigarette industry during periods of tax stability (Period 1: Apr 18 to Jan 20 over Jul 17 to Mar 18 and Period 2: Apr 22 to Jan 23 over Oct 21 to Mar 22) led by recouping volumes from illicit trade. Relative stability in taxes, claw back from illicit trade, focused portfolio/market interventions and agile execution has meant that cigarette volumes have reached almost similar levels (0.96x in FY23) of FY13 volumes.
- New launch offers in cigarettes have increased >5x over the last 5 years and now account for ~17% of the overall volumes.
- Company continues to aspire 80-100bps annual expansion in FMCG-Other (FMCGO) segment margins led by value-added products (VADP)/premiumization contributing to around 30-40bps, scale contributing to ~20bps and cost optimization (freight optimization, ICML efficiencies, etc.) contributing for the rest.
- Paperboards, Paper & Packaging (PPP) is a cyclical business and has hit a downcycle in recent times, impact of which is sharper this time. Management believes this impact to have bottomed-out and will start seeing an improvement from next quarter.
- ITC has identified Food Tech services as a new vector of growth and believes the opportunity is big. Started from the Cloud Kitchen of ITC Windsor in 2021, it currently has three brands– ITC Aashirvaad Soul Creations, ITC Master Chef Creations and ITC Sunfeast Baked Creations. Some of the older kitchens are already doing ~15% margins at kitchen level. It believes there are multiple levers to grow the business. Company has already figured out the product-market fit through the Bangalore market with a current footprint of 19 Cloud Kitchens catering to almost the entire city (opening cloud kitchens in Chennai now and then Mumbai). Currently trying to build a strong back-end for scaling-up but in an efficient manner. It believes the biggest challenge in the business is getting the right real estate.
- ITC is looking at Nicotine & Derivatives in Value-added Tobacco as a big new opportunity for exports. High-end Nicotine and nicotine-based products are a huge market opportunity due to the increased use of vapes and oral pouches. It is a niche segment and requires pharma-level sophistication. There is a shortage of high-quality Nicotine producers globally. Management believes Indian tobaccos are at the sweet spot (in terms of nicotine content vs price equation). Conventional exports are largely at the commodity end. Companies are looking for ESG-compliant supply chains. There are also high barriers to entry for high-end Nicotine extraction in India mostly led by sourcing capabilities. ITC has still not started bulk shipments but aims to double the nicotine business in the medium-term. It also has sustainable high margins (50%) compared to traditional tobacco.

Reco	:	**ADD**
CMP	:	Rs 453
Target Price	:	Rs 505
Potential Return	:	+11.5%

Stock data (as on Dec 12, 2023)

Nifty	19,122
52 Week h/l (Rs)	500 / 323
Market cap (Rs/USD mn)	5643397 / 67886
Outstanding Shares (mn)	12,473
6m Avg t/o (Rs mn):	4,650
Div yield (%):	3.5
Bloomberg code:	ITC IN
NSE code:	ITC

Stock performance



	1M	3M	1Y
Absolute return	3.3%	0.4%	32.0%

Shareholding pattern (As of Sep'23 end)

Promoter	0.0%
FII+DII	85.3%
Others	14.7%

∆ in stance

(1-Yr)	New	Old
Rating	ADD	ADD
Target Price (Rs)	505	500

∆ in earnings estimates

	FY24e	FY25e	FY26e
EPS (New)	16.5	18.6	20.2
EPS (Old)	16.5	18.6	20.1
% change	0.0	+0.1	+0.5

Financial Summary (Standalone)

(Rs mn)	FY24e	FY25e	FY26e
Revenue	677,838	755,899	813,668
YoY Growth (%)	2.6	11.5	7.6
EBIDTA	260,284	294,804	319,727
Margins (%)	38.4	39.0	39.3
PAT	205,564	231,314	250,529
EPS	16.5	18.6	20.2
YoY Growth (%)	9.6	12.5	8.3
ROCE (pre-tax)	38.9	42.4	44.7
ROE	29.9	32.5	34.2
P/E	27.4	24.3	22.4
EV/EBITDA	20.1	17.6	16.2

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DETAILED TAKEAWAYS FROM INVESTOR/ ANALYST MEET

- **Environment**: High prices and in recent quarters weather conditions impacted rural growth which was visible in recent quarters reported growth. Urban areas are holding better and growing ahead of rural. There are some greenshoots visible in rural areas post correction in product prices, but no major recovery seen. Company is expecting better growth in couple of quarters.
- **Portfolio transformation**: Revenues of non-cigarette businesses have gone up by 2.5x over FY13-23 and have grown by ~14% CAGR over the last five years versus ~11% for the overall business. Even in terms of profitability there is an improvement with share of non-cigarette businesses in segmental EBITDA improving from 18.1% in FY18 to 27.3% in FY23.
- **Drivers of growth**
    - Keep on extending and defending its core businesses.
    - Build emerging businesses (beverages, frozen foods, liquid wash, homecare, nicotine, value-added agri).
    - Create viable options for future growth opportunities (chocolates, premium skincare, food tech, ITCMAARS).
- **Cigarettes**: Legal cigarettes form just 9% of total tobacco consumption in India but contribute to ~80% of Government tobacco tax revenue. Illicit is 1/3rd of legal industry in India and is the 3rd largest illicit cigarette market globally. There is continuous engagement with the policy makers and a sense of understanding regarding illicit trade. There is also data to show that there is increase in tax revenues to exchequer from the legal cigarette industry during periods of tax stability (Period 1: Apr 18 to Jan 20 over Jul 17 to Mar 18 and Period 2: Apr 22 to Jan 23 over Oct 21 to Mar 22) led by recouping volumes from illicit trade. Relative stability in taxes, claw back from illicit trade, focused portfolio/market interventions and agile execution has meant that cigarette volumes have reached almost similar levels (0.96x in FY23) of FY13 volumes. New launch offers have increased >5x over the last 5 years and now account for ~17% of the overall volumes. ITC continues to have the best-in-class reach ITC brands available across 7mn+ outlets (direct network reaching to over 1.4 lac markets) with ~120 sku's. Recent 4 launches in 'Classic' in the last 5 years contribute to about ~25% of its portfolio. Recent 4 launches in 'Gold Flake' in the last 5 years contribute to ~19% of its portfolio. More than 6,40,000+ outlets are services daily which is a competitive moat for the company.
- **FMCG-Others (OFMCG)**: Company continues to aspire 80-100bps annual expansion in FMCG-Other segment margins led by value-added products (VADP)/premiumization contributing to around 30-40bps, scale contributing to ~20bps and cost optimization (freight optimization, ICML efficiencies, etc.) contributing for the rest.
- **Foods business**: Started 20 years ago in Bangalore. While power brands (Aashirvaad, Sunfeast, Bingo and Yippee) has grown at a decent 12% CAGR over FY13-23., new engines (categories launched since 2015) have grown by 47% over the last 5 years. Unbranded (82% of F&B market) to branded conversion remains a key growth vector for the business. Penetrating emerging market (wider distribution & tailored products) will be the next key growth driver. E-commerce channel has grown at 53% CAGR contributing to 10% in 2023 (5% in 2021). ITC currently exports in 68 countries mostly Aashirvaad. It will next look to expand biscuits and snacks for exports market. Company is addressing adjacencies (e.g., launched besan) along with launching value-added offerings through its core brand Aashirvaad. ITC has launched Namma chakki in Bengaluru for people who prefer chakki flour over packaged flour.
- **Paperboards, Paper & Packaging (PPP)**: Company has already exhausted its current capacity and will now be investing for the next two decades (sites last for around 2 decades as

company keeps on adding lines; entire capex is not done in one go). Investment in PPP thus tends to be lumpy. Cost is an important factor for this business. The business margins are ~500bps better than industry because of the upfront investments done by the company. It is a cyclical business and has hit a downcycle in recent times, impact of which is sharper this time. Management believes this impact to have bottomed-out and will start seeing an improvement from next quarter.

- **ITCMAARS**: ITCMAARS platform was introduced so that all stakeholders get on to a common platform, deal directly and solve one-another's problems. ITC has the incentive and power to manage this platform with its reach, farmer connect and crop knowledge. ITCMAARS platform has a crop doctor, crop calendar, and hyperlocal weather forecast alerts which empowers the farmers to forward demand-based decisions. It helps ITC in cost-quality optimization, traceability in sourcing and new platform businesses.

- **Hotels**: The business currently has 131 hotels (~12k rooms) across brands. Luxury brands (ITC Hotels and Momentos) contribute to 38% of the keys, upper scale brand (WelcomHotel) & Boutique brand (Storii) contributing to 23% of keys and mid-scale brand (Fortune) & Heritage brand (WelcomHeritage) contributing 39% of keys. 20% of inventory <5 years old (Gestating). It has robust pipeline of managed hotels (35 hotels, 3,200+ keys). Targeting to reach 200 hotels with 18,000 keys over 5 years, with 2/3rd keys in the managed portfolio. In the next 5 years, the premium hotel keys would constitute 45% of the total managed portfolio, up from 30% today. Business has delivered superior competitive performance post pandemic across metrics and has improved capital RoCE.

- **Return ratios:** ITC is driving capital efficiencies across its non-cigarette business. There is 1,000-2,000bps improvement in ROCE across OFMCG, Agri, Paper and Hotels (for gestated properties). RoCE of OFMCG (ex-intangibles acquired) stands at 18% in FY23. Together the non-cigarette businesses have seen an improvement to ~22% in FY23 from 11% in FY18.

- **Food Tech**: ITC has identified Food Tech services as a new vector of growth and believes the opportunity in Foodtech is big. Started from the Cloud Kitchen of ITC Windsor in 2021, it currently has three brands– ITC Aashirvaad Soul Creations, ITC Master Chef Creations and ITC Sunfeast Baked Creations. Some of the older kitchens are already doing ~15% margins at kitchen level. It believes there are multiple levers to grow the business. Company has already figured out the product-market fit through the Bangalore market with a current footprint of 19 Cloud Kitchens catering to almost the entire city (opening cloud kitchens in Chennai now and then Mumbai). Currently trying to build a strong back-end for scaling-up but in an efficient manner. Over the years, the company has learned to leverage its institutional strengths better (i.e., in an efficient manner). It believes the biggest challenge in the business is getting the right real estate.

- **Nicotine & Derivatives in Tobacco:** ITC is looking at Nicotine & Derivatives in Value-added Tobacco as a big new opportunity for exports. High-end Nicotine and nicotine-based products are a huge market opportunity due to the increased use of vapes and oral pouches. It is a niche segment and requires pharma-level sophistication. There is a shortage of high-quality Nicotine producers globally. Management believes Indian tobaccos are at the sweet spot (in terms of nicotine content vs price equation). Conventional exports are largely at the commodity end. Companies are looking for ESG-compliant supply chains. There are also high barriers to entry for high-end Nicotine extraction in India mostly led by sourcing capabilities. ITC has still not started bulk shipments but aims to double the nicotine business in the medium-term. It also has sustainable high margins (50%) compared to traditional tobacco.

- **Agri business**: The business has grown revenues by 18% CAGR over the last five years but EBITDA growth has been lower at 9% as the revenue growth was helped by lower margin trading opportunities.

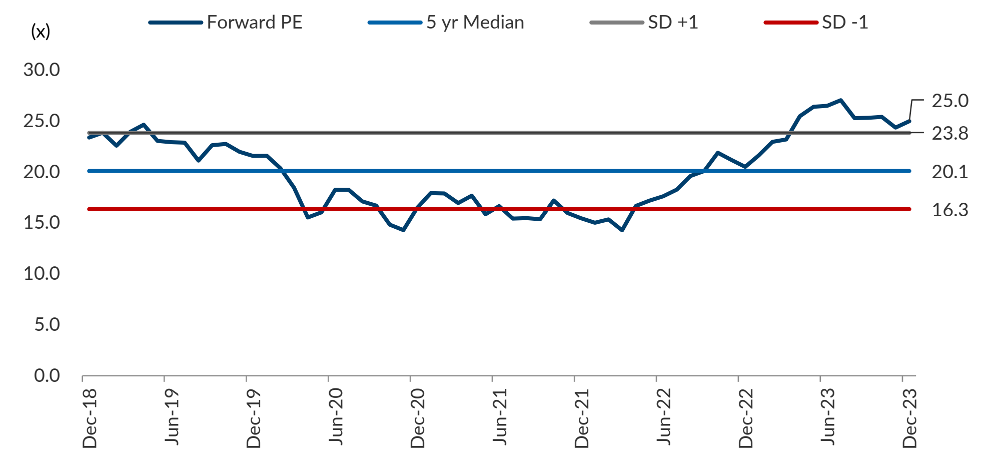
- **Capital allocation**: Capital allocation will be towards existing business growth opportunities, future vectors of growth, and M&A opportunities. Out of the ~Rs30bn capex, 1/3rd will go towards FMCG, 30-35% will be towards PPP and rest will be for Agri & new vectors of growth.

- **M&A**: Management is actively looking at M&A opportunities. It will not get into unrelated areas and will go after mega-trends where ITC's institutional strengths can be leveraged.
- **Management incentive structure**: With evolving business environment, managements incentive structure also evolves. There is now a sharper linkage to financial outcomes. There is also a weightage for sustainability metrics. ITC also has ESOP plans in place to align the linkages to performance.
- **ITC Infotech**: Business is doing very well and is a great growth opportunity. The margins are closing to ~20% with Rs30bn+ revenue. It did two transformational deals last year. The company is looking at inorganic opportunities to acquire new capabilities.
- **DigiArc ecosystem**: The DigiArc ecosystem today encompasses 200 factories, 50 warehouses, nearly 3,000 distributors and 2.6 million retailers driving real-time, data-led intelligence across the extended enterprise. Embedded with technologies in AI/ML together with Centres of Excellence in Industry 4.0, Advanced Analytics and Data Sciences as well as the 6th Sense Marketing Command Centre, DigiArc empowers mainstreaming of the digital-first culture to create new sources of competitive advantage.
- **New channels of distribution**: Share of alternate channels has continuously risen from 17% in FY20 to 25% in FY23 led by rapid scale-up of MT+E-com.

View and Valuation

There is no major change in our FY24E/FY25E/FY26E EPS. What worked well for ITC in FY22/FY23: (1) Stable taxation regime, share gains from illicit trade and portfolio interventions supported cigarette business. (2) FMCG-Others business growing at healthy rate and now also showing signs of better profitability led by structural investments of the past along with scale, innovations, growing reach, moderating inflation, etc. (3) Strong overall performance in the Hotels business post Covid recovery. Some of these factors have now normalized. PPP business has been facing near term pressure from multiple issues but looks to have bottomed-out. On the other hand, Agri business will see strong growth going forward as export ban comes into base from 3Q. Return ratios have improved in FY23 and are expected to improve further led by hotel business demerger and no major capex in near term. We build a relatively subdued 10.2% EPS CAGR led by 7.2% revenue CAGR over FY23-FY26E (9.6% over FY24E-FY26E). The stock is currently trading at ~27x/24x/23x FY24E/FY25E/FY26E EPS. Based on target multiple of ~26x (3yr/5yr avg fwd. multiple ~20x), we arrive at a revised target price (TP) of Rs505 (Rs500 earlier), thus maintain our ADD rating.

Exhibit 1: Currently trading at ~25x on our 1-yr fwd EPS



Source: Company, YES Sec

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Exhibit 2: Balance Sheet

Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Share capital	12,323	12,428	12,428	12,428	12,428
Reserves	601,672	663,510	688,011	710,203	728,729
Net worth	613,996	675,938	700,439	722,631	741,157
Total debt	45	33	33	33	33
Lease liability	3,059	3,201	3,041	2,889	2,745
Deferred tax liability	16,671	16,211	16,211	16,211	16,211
Total liabilities	**633,771**	**695,383**	**719,724**	**741,764**	**760,146**
Gross block	384,914	411,077	429,077	444,077	459,077
Depreciation	163,239	179,867	196,601	214,364	232,727
Net block	221,674	231,211	232,477	229,714	226,350
Capital work-in-progress	24,423	16,815	16,815	16,815	16,815
Other long-term assets	10,770	10,682	10,682	10,682	10,682
Investments	272,823	327,206	348,744	374,028	395,821
Inventories	99,978	105,939	103,914	110,210	115,204
Debtors	19,525	23,213	24,221	27,035	29,109
Cash	38,779	38,313	45,539	46,607	50,303
Loans & advances	51,001	55,358	56,465	57,595	58,747
Other current assets	11,952	13,881	14,575	15,304	16,069
Total current assets	221,234	236,704	244,714	256,751	269,432
Creditors	42,234	43,513	41,980	45,581	48,500
Other current liabilities & provisions	74,920	83,721	91,727	100,645	110,454
Total current liabilities	117,154	127,234	133,707	146,225	158,954
Net current assets	104,081	109,470	111,007	110,526	110,478
Total assets	**633,771**	**695,383**	**719,724**	**741,764**	**760,146**

Source: Company, YES Sec
Note: Through this note, we introduce FY26 estimates

Exhibit 3: Income statement

Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Revenue	563,413	660,433	677,838	755,899	813,668
% Growth	***23.9***	***17.2***	***2.6***	***11.5***	***7.6***
COGS	270,469	298,219	287,080	310,548	329,450
Other expenses	103,421	122,451	130,475	150,547	164,492
Total expenses	373,890	420,670	417,554	461,096	493,941
EBITDA	189,522	239,762	260,284	294,804	319,727
% growth	***22.0***	***26.5***	***8.6***	***13.3***	***8.5***
EBITDA margin (%)	***33.6***	***36.3***	***38.4***	***39.0***	***39.3***
Other income	25,900	24,376	31,946	32,922	34,334
Interest costs	605	736	787	842	901
Depreciation	16,522	16,627	16,734	17,763	18,363
Profit before tax	198,295	246,775	274,708	309,120	334,797
Exceptional items	0	550	0	0	0
Tax	47,717	59,792	69,144	77,805	84,268
PAT	150,578	187,533	205,564	231,314	250,529
Adj PAT	150,578	186,983	205,564	231,314	250,529
Adj PAT margin (%)	***25.6***	***27.3***	***29.0***	***29.3***	***29.5***
% Growth	***15.5***	***24.2***	***9.9***	***12.5***	***8.3***

Source: Company, YES Sec

Note: Full year COGS also includes contract processing charges (included in other op. exps. in quarterly)

Exhibit 4: Cash flow statement

Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
PBT	198,295	247,504	274,708	309,120	334,797
Depreciation	16,522	16,627	16,734	17,763	18,363
Other income	(13,853)	(8,640)	(31,946)	(32,922)	(34,334)
(Inc.)/dec. in working capital	1,841	(4,441)	(516)	(5,510)	(4,149)
Other items	(54,727)	(71,933)	(68,357)	(76,963)	(83,367)
Cash flow from operations	**148,078**	**179,117**	**190,624**	**211,488**	**231,310**
Capital expenditure (-)	(16,748)	(18,095)	(18,000)	(15,000)	(15,000)
Net cash after capex	**131,330**	**161,022**	**172,624**	**196,488**	**216,310**
Inc./(dec.) in other inv. & assets	805	(34,185)	22,586	(12,869)	(1,944)
Cash flow from investment activities	**(15,943)**	**(52,280)**	**4,586**	**(27,869)**	**(16,944)**
Issue of share capital (incl premium)	2,918	24,774	5,000	5,000	5,000
Dividends paid (-)	(135,471)	(151,504)	(192,550)	(187,063)	(215,122)
Other items	(818)	(574)	(434)	(489)	(548)
Cash from financial activities	**(133,370)**	**(127,304)**	**(187,984)**	**(182,552)**	**(210,670)**
Opening cash balance	40,015	38,779	38,313	45,539	46,607
Closing cash balance	38,779	38,313	45,539	46,607	50,303
Change in cash balance	(1,236)	(467)	7,226	1,068	3,696

Exhibit 5: Growth and Ratio matrix

Y/E March	FY22	FY23	FY24E	FY25E	FY26E
Per share (Rs)					
EPS	12.2	15.1	16.5	18.6	20.2
Book value	49.8	54.4	56.4	58.1	59.6
DPS	11.5	15.5	15.1	17.3	19.2
Valuation (x)					
EV/sales	9.6	8.1	7.8	7.0	6.4
EV/EBITDA	28.1	22.0	20.1	17.7	16.2
P/E	37.1	30.1	27.4	24.3	22.5
P/BV	9.1	8.3	8.0	7.8	7.6
Return ratios (%)					
RoCE*	32.0	37.2	38.9	42.4	44.7
RoE	25.0	29.0	29.9	32.5	34.2
RoIC*	61.2	73.1	78.4	90.4	100.2
Profitability ratios (%)					
Gross margin	52.0	54.8	57.6	58.9	59.5
EBITDA margin	33.6	36.3	38.4	39.0	39.3
EBIT margin	30.7	33.8	35.9	36.7	37.0
PAT margin	25.6	27.3	29.0	29.3	29.5
Liquidity ratios (%)					
Current ratio	1.9	1.9	1.8	1.8	1.7
Quick ratio	1.0	1.0	1.1	1.0	1.0
Turnover ratios					
Total asset turnover ratio (x)	0.9	0.9	0.9	1.0	1.1
Fixed asset turnover ratio (x)	2.5	2.9	2.9	3.3	3.6
Inventory days	131	126	133	126	125
Debtors days	13	12	13	12	13
Creditor days	56	52	54	51	52

Source: Company, YES Sec; * ROCE & ROIC are on pre-tax basis

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Name of the Research Analyst : Vishal Punmiya

The analyst hereby certifies that opinion expressed in this research report accurately reflect his or her personal opinion about the subject securities and no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendation and opinion expressed in this research report.

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Analysts assign ratings to the stocks according to the expected upside/downside relative to the current market price and the estimated target price. Depending on the expected returns, the recommendations are categorized as mentioned below. The performance horizon is 12 to 18 months unless specified and the target price is defined as the analysts' valuation for a stock. No benchmark is applicable to the ratings mentioned in this report.

BUY: Upside greater than 20% over 12 months

ADD: Upside between 10% to 20% over 12 months

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