

### Cigarette volumes grew at 8.0%; margin slipped

Godfrey Phillips (GP) reported Q2FY24 revenues ahead of our estimates, though margins declined sharply; Revenue grew 13.7% while EBITDA dropped by 5.4%. Tobacco segment gross revenues grew 16.7%, driven by 8% growth in cigarette volumes and 17% growth in leaf tobacco exports to Rs3.7bn. Non-tobacco (TFS+Funda Goli) grew 4.3%. GP's performance was driven by, (1) clear focus on strengthening core cigarette business, (2) expanded distribution for Marlboro led to 33% contribution, (3) strong exports of leaf tobacco and (4) launch products to attract new users. Gross margin declined by 380bp to 42.4% due to higher RM inflation coupled with higher exports of leaf tobacco and cigarettes. EBITDA at Rs2.2bn cut by 5.4% due to higher other exp. (+27.1%) and employee cost (+15.8%) settling EBITDA margin at 18.8% (-379bp). GP has strong focus on RSFT segment, yet expanded footprint for TFS (152 stores) to reflect lowering of losses. With weak 1HFY24 profits, we cut our earnings and retain BUY, with a revised DCF-based TP Rs2,530 (implying avg. of 13.8x avg. of FY25/26E EPS).

**Cigarette net sales/volumes grew at 14.9%/8.0% led by Marlboro; TFS growth was muted**  
In Q2FY24 GP's net sales grew 13.7% to Rs11.5bn, driven by 8.0% growth in cigarette volumes yet it saw 17% rise in cut and unmanufactured tobacco exports. With closure of chewing business, GP has clear focus on driving cigarette business coupled with expanded distribution saw 1HFY24 cigarette volume growth at 22.8% led by Marlboro portfolio which grew +27% in volumes. Marlboro franchise now make up 33% contribution led by strong growth in 'Marlboro-Compact' priced at Rs10. Management said growth was led by, (1) normalised consumer activities, (2) higher demand in core markets J&K/MH/ Guj/Raj, (3) faster growth in Marlboro, (4) growing reach for 'Focus' brand and 'Stellar' in south, and (5) 24Seven (TFS) including 'Goli' grew 4.3% to Rs1.2bn. GP saw strong recovery in footfalls in TFS and stores/kiosks stood at 152.

#### Higher share of unmanufactured tobacco sales cut gross margin by 380bp

In Q2, GP's gross margin declined to 42.4% (-380bp), led by 17% growth (Rs3.3bn) in cut and unmanufactured tobacco exports and also sharp increase in prices for leaf tobacco and cigarette packaging prices. EBITDA at Rs2.2bn declined 5.4% due to higher other expenses (+27.1%) and employee cost (+15.8%); EBITDA margin slipped to 18.8% (-379bp). With 19.2% EBIT margin for tobacco business, losses in TFS retail business dropped at Rs172.7mn. We expect operating leverage and higher contribution margin from prepared foods to lift profitability for TFS in Q3.

#### Management expects sustained growth momentum, as long-term growth drivers are intact

We reckon GP's growth strategy is driven by (1) focusing on new markets to capture shift in demand towards value-for-money cigarettes, (2) reinforcing partnership with Phillip Morris, acting as key growth engine, (3) strengthening export markets, and (4) capitalizing on fast-growing TFS business. We expect cigarette industry to effect price increase across portfolio in 2HFY24 given rising RM/PM prices. Though steady dividend income from associate company would aid PAT.

#### Valuation and risks

In line with our argument, cigarette industry witnessed strong volume growth in FY23 and GP saw premiumisation (Marlboro) and higher sales in RSFT segment, and the trend would continue in FY24 as well. We believe strong tailwinds for RSFT segment and also Marlboro entry into the DSFT segment (64mm). With increased footprint for TFS we expect operating leverage to drive profitability, yet cut losses. We remain hopeful on rural recovery which could provide strong tailwinds for GP. Considering pressure on margin and stable income from associate, we cut earnings for FY24E/25E by 2.6/2.1% and introduce FY26E and retain BUY with a revised DCF-based TP Rs2,530 (implying 13.8x avg. FY25E/FY26E EPS). Risk: sharp increase in taxation and higher competition.

#### Financial and valuation summary

YE Mar (Rs mn)	2QFY24A	2QFY23A	YoY (%)	1QFY24A	QoQ (%)	FY24E	FY25E	FY26E
Revenues	11,505	10,121	13.7	10,341	11.3	41,722	45,304	48,973
EBITDA	2,148	2,287	(6.1)	2,398	(10.4)	8,969	10,193	11,772
EBITDA margin (%)	18.7	22.6	(393bp)	23.2	(452bp)	21.5	22.5	24.0
Adj. Net profit	1,633	1,750	(6.6)	2,935	(44.4)	7,664	8,916	10,193
Adj. EPS (Rs)	31.4	33.6	(6.6)	56.4	(44.4)	147.4	171.5	196.0
EPS growth (%)						26.0	16.3	14.3
PE (x)						14.2	12.2	10.7
EV/EBITDA (x)						9.3	7.5	6.0
PBV (x)						2.9	2.4	2.0
RoE (%)						21.9	21.3	20.4
RoCE (%)						21.1	21.2	20.5

Source: Company, Centrum Broking

#### Result Update

India | Consumer

08 November, 2023

**BUY**

Price: Rs2,090

Target Price: Rs2,530

Forecast return: 21%

Institutional Research

#### Market Data

Bloomberg:	GP IN
52 week H/L:	2,405/1,571
Market cap:	Rs108.7bn
Shares Outstanding:	52.0mn
Free float:	41.7%
Avg. daily vol. 3mth:	1,21,662
Source:	Bloomberg

#### Changes in the report

Rating:	Unchanged
Target price:	Rs2,530 from Rs2,383
EPS:	FY24E: Rs147.4; down 2.6% FY25E: Rs171.5; down 2.1%
Source:	Centrum Broking

#### Shareholding pattern

	Sep-23	Jun-23	Mar-23	Dec-22
Promoter	72.6	72.6	72.6	72.6
FIIs	9.9	10.1	10.1	9.9
DIIIs	1.5	1.5	1.6	1.9
Public/other	16.0	15.8	15.7	15.6
Source:	BSE			

#### Centrum estimates vs Actual results

YE Mar (Rs mn)	Centrum Q2FY24	Actual Q2FY24	Variance (%)
Revenue	10,950	11,505	5.1
EBITDA	2,464	2,148	(12.8)
EBITDA margin (%)	22.5	18.7	-383bps
Other Income	610	460	(24.5)
Interest	68	66	(3.2)
Depreciation	391	357	(8.7)
PBT	2,615	2,186	(16.4)
Tax	641	552	(13.8)
Rep. PAT	1,974	1,633	(17.3)
Adj. PAT	1,974	1,633	(17.3)

Source: Bloomberg, Centrum Broking



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## Estimate revision

YE Mar (Rs mn)	FY24E New	FY24E Old	% chg	FY25E New	FY25E Old	% chg
Revenue	41,722	41,058	1.6	45,304	44,299	2.3
EBITDA	8,969	9,237	-2.9	10,193	10,410	-2.1
EBITDA margin %	21.5	22.5	(100bp)	22.5	23.5	(100bp)
Adj. PAT	7,664	7,872	-2.6	8,916	9,103	(2.1)
Diluted EPS (Rs)	147.4	151.4	-2.6	171.5	175.1	(2.1)

Source: Centrum Broking

## Godfrey Phillips India versus NIFTY Midcap 100

	1m	6m	1 year
GP IN	(0.8)	23.8	26.8
NSE Midcap 100	(1.1)	6.5	6.8

Source: Bloomberg, NSE

## Key assumptions

Y/E Mar	FY24E	FY25E
Volume growth	9.0	6.0

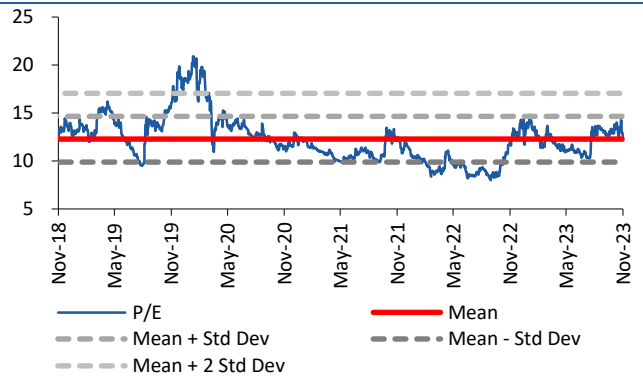
Source: Centrum Broking

## Valuations

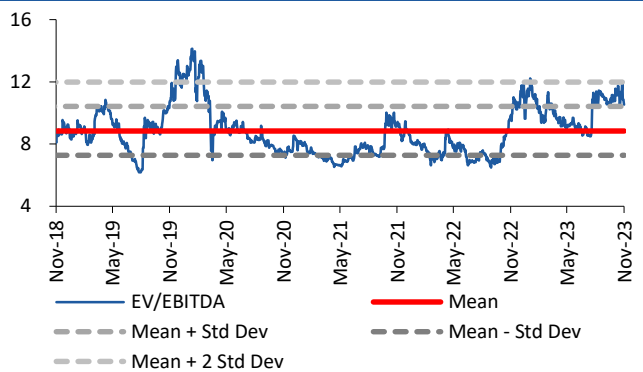
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Valuations	Rs/share
DCF-based target price	2537
WACC (%)	13.5
Terminal growth rate (%)	2.5

### P/E mean and standard deviation



### EV/EBITDA mean and standard deviation



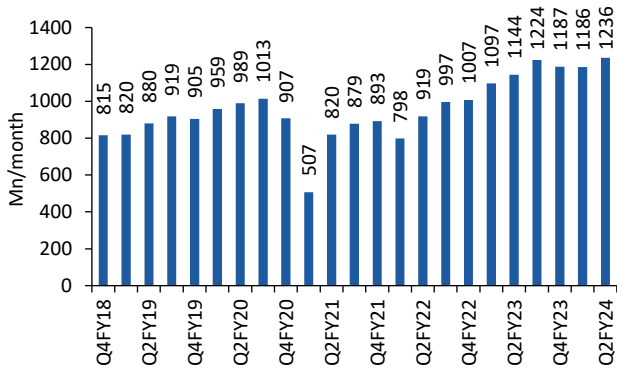
Source: Bloomberg, Centrum Broking

## Peer comparison

Company	Mkt Cap	CAGR (FY23-25E)				P/E (x)			EV/EBITDA (x)			ROE(%)		
	(Rs bn)	Sales	EBITDA	EPS	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E	
ITC	5,620.0	11.3	13.5	11.5	30.0	26.2	23.3	24.9	21.6	19.0	29.0	30.0	32.1	
<b>Godfrey Phillip</b>	<b>10.9</b>	<b>13.3</b>	<b>15.0</b>	<b>21.1</b>	<b>18.0</b>	<b>14.3</b>	<b>12.3</b>	<b>11.6</b>	<b>9.4</b>	<b>7.8</b>	<b>20.6</b>	<b>21.9</b>	<b>21.3</b>	
VST Industries	51.1	7.6	14.0	9.7	16.9	16.2	14.1	13.5	11.3	9.8	29.0	27.5	28.3	

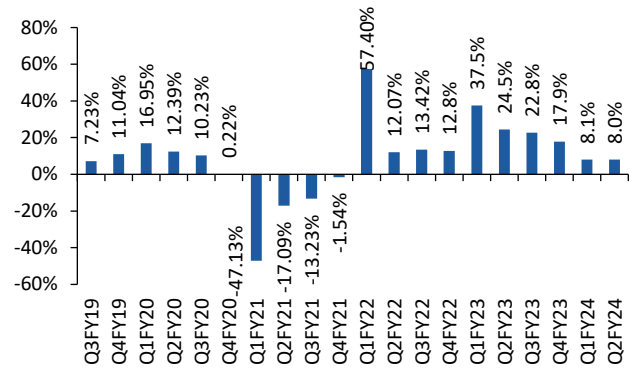
Source: Company, Centrum Broking

**Exhibit 1: Average monthly volume (mn), quarter-wise**



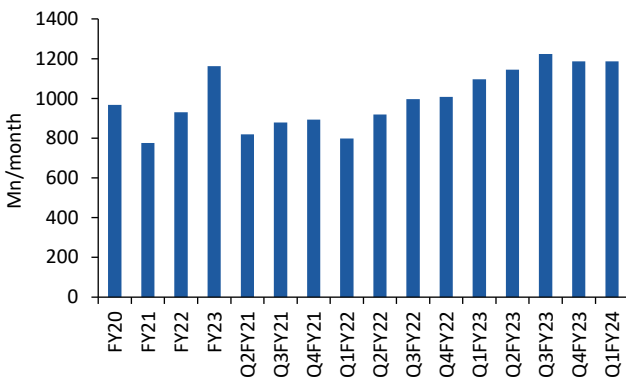
Source: Company Data, Centrum Broking

**Exhibit 2: YoY volume growth (%)**



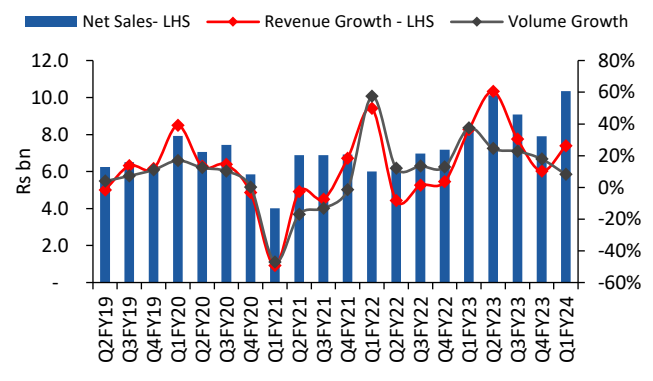
Source: Company Data, Centrum Broking

**Exhibit 3: Average monthly volume (mn), year-wise**



Source: Company Data, Centrum Broking

**Exhibit 4: Quarterly revenue and volume growth trends**



Source: Company Data, Centrum Broking



**Exhibit 8: Segmental performance**

Rs mn	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24
Revenue					
Tobacco	10,788	10,005	8,742	11,289	12,584.8
Less ED	1,723	1,925	1,783	1,989	2,169.1
Net Tobacco revenue	9,065	8,080	6,959	9,300	10416
Tea and other retail products	1,124	1,093	1,010	1,130	1,173
YoY					
Tobacco	59.5	30.1	13.8	28.7	16.7
Tea and other retail products	24.2	12.0	21.4	8.1	4.3
EBIT					
Tobacco	2,135	2,179	1,397	2,232	1,995.1
Tea and other retail products	-193	-208	-182	-165	-159
EBIT Margin					
Tobacco	23.5	27.0	20.0	24.0	19.2
Tea and other retail products	-17.2	-19.0	-18.1	-14.6	-13.6

Source: Company Data, Centrum Broking

**Exhibit 9: Quarterly financials – Standalone**

(Rs mn)	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24
<b>Net Sales</b>	<b>6968</b>	<b>7172</b>	<b>8194</b>	<b>10121</b>	<b>9086</b>	<b>7901</b>	<b>10341</b>	<b>11505</b>
Cost of goods sold	3174	3412	3968	5450	4521	3873	5535	6626
Employee Expenses	686	501	656	722	781	686	733	786
A&SP	179	205	237	184	205	0	0	0
Other Exp	1262	1462	1352	1478	1635	1841	1675	1944
<b>Operating Profit (Core EBITDA)</b>	<b>1668</b>	<b>1591</b>	<b>1982</b>	<b>2287</b>	<b>1944</b>	<b>1501</b>	<b>2398</b>	<b>2148</b>
Depreciation	367	364	377	383	380	367	360	357
EBIT	<b>1301</b>	<b>1227</b>	<b>1605</b>	<b>1904</b>	<b>1564</b>	<b>1135</b>	<b>2038</b>	<b>1791</b>
Interest	76	113	64	67	66	92	67	66
Other Income	354	293	99	500	871	508	1370	460
<b>Profit Before Tax</b>	<b>1579</b>	<b>1407</b>	<b>1640</b>	<b>2337</b>	<b>2369</b>	<b>1550</b>	<b>3341</b>	<b>2186</b>
Tax	399	368	279	587.3	548	399	406	552
Tax rate (%)	25.3	26.2	17.0	25.1	23.1	25.7	12.1	25.3
<b>Adjusted PAT</b>	<b>1180</b>	<b>1039</b>	<b>1362</b>	<b>1750</b>	<b>1821</b>	<b>1151</b>	<b>2935</b>	<b>1633</b>
Growth (%)								
Net Sales	1.3	3.6	36.4	60.5	30.4	10.2	26.2	13.7
EBITDA	9.9	6.9	43.7	70.3	16.6	(5.6)	21.0	-6.1
Adj. PAT	3.4	8.9	26.0	71.5	54.4	10.8	115.5	-6.6
Margin (%)								
Gross Margin	54.5	52.4	51.6	46.2	50.2	51.0	46.5	42.4
EBITDA	23.9	22.2	24.2	22.6	21.4	19.0	23.2	18.7
EBIT	18.7	17.1	19.6	18.8	17.2	14.4	19.7	15.6
PAT	16.9	14.5	16.6	17.3	20.0	14.6	28.4	14.2

Source: Company Data, Centrum Broking

<b>P&amp;L</b>					
YE Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
<b>Revenues</b>	<b>26,453</b>	<b>35,302</b>	<b>41,722</b>	<b>45,304</b>	<b>48,973</b>
Operating Expense	15,740	17,812	23,427	24,880	25,543
Employee cost	2,510	2,845	3,516	3,922	4,545
Others	2,223	6,932	5,810	6,308	7,113
<b>EBITDA</b>	<b>5,981</b>	<b>7,714</b>	<b>8,969</b>	<b>10,193</b>	<b>11,772</b>
Depreciation & Amortisation	1,422	1,507	1,701	1,828	1,987
<b>EBIT</b>	<b>4,559</b>	<b>6,208</b>	<b>7,268</b>	<b>8,365</b>	<b>9,785</b>
Interest expenses	338	289	368	376	383
Other income	1,395	1,978	3,067	3,605	3,853
<b>PBT</b>	<b>5,616</b>	<b>7,896</b>	<b>9,966</b>	<b>11,594</b>	<b>13,254</b>
Taxes	1,296	1,812	2,302	2,678	3,062
Effective tax rate (%)	23.1	23.0	23.1	23.1	23.1
<b>PAT</b>	<b>4,320</b>	<b>6,084</b>	<b>7,664</b>	<b>8,916</b>	<b>10,193</b>
Minority/Associates	0	0	0	0	0
<b>Recurring PAT</b>	<b>4,320</b>	<b>6,084</b>	<b>7,664</b>	<b>8,916</b>	<b>10,193</b>
Extraordinary items	0	0	0	0	0
<b>Reported PAT</b>	<b>4,320</b>	<b>6,084</b>	<b>7,664</b>	<b>8,916</b>	<b>10,193</b>
<b>Ratios</b>					
YE Mar	FY22A	FY23A	FY24E	FY25E	FY26E
<b>Growth (%)</b>					
Revenue	7.2	33.5	18.2	8.6	8.1
EBITDA	20.7	29.0	16.3	13.7	15.5
Adj. EPS	21.0	40.8	26.0	16.3	14.3
<b>Margins (%)</b>					
Gross	53.7	49.5	51.7	52.7	53.2
EBITDA	22.6	21.9	21.5	22.5	24.0
EBIT	17.2	17.6	17.4	18.5	20.0
Adjusted PAT	16.3	17.2	18.4	19.7	20.8
<b>Returns (%)</b>					
ROE	16.8	20.6	21.9	21.3	20.4
ROCE	15.8	19.1	21.1	21.2	20.5
ROIC	26.8	38.2	45.8	49.2	52.0
<b>Turnover (days)</b>					
Gross block turnover ratio (x)	1.7	2.1	2.2	2.2	2.1
Debtors	19	16	14	15	15
Inventory	213	165	165	170	169
Creditors	74	65	71	73	74
Net working capital	283	268	262	300	328
<b>Solvency (x)</b>					
Net debt-equity	(0.5)	(0.6)	(0.7)	(0.7)	(0.7)
Interest coverage ratio	17.7	26.7	24.3	27.1	30.7
Net debt/EBITDA	(2.4)	(2.6)	(2.9)	(3.2)	(3.3)
<b>Per share (Rs)</b>					
Adjusted EPS	83.1	117.0	147.4	171.5	196.0
BVPS	523.8	613.2	732.8	876.4	1,044.6
CEPS	110.4	146.0	180.1	206.6	234.3
DPS	28.0	46.0	58.0	67.0	77.0
Dividend payout (%)	33.7	39.3	39.3	39.1	39.3
<b>Valuation (x)</b>					
P/E	25.3	17.9	14.2	12.2	10.7
P/BV	4.0	3.4	2.9	2.4	2.0
EV/EBITDA	15.9	11.5	9.3	7.5	6.0
Dividend yield (%)	1.3	2.2	2.8	3.2	3.4

Source: Company, Centrum Broking

<b>Balance sheet</b>					
YE Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Equity share capital	104	104	104	104	104
Reserves & surplus	27,133	31,780	37,995	45,463	54,206
Shareholders fund	27,237	31,884	38,099	45,567	54,310
Minority Interest	0	0	0	0	0
Total debt	3,358	3,538	1,683	1,683	967
Non Current Liabilities	254	227	227	227	227
Def tax liab. (net)	52	20	20	20	20
<b>Total liabilities</b>	<b>30,901</b>	<b>35,669</b>	<b>40,030</b>	<b>47,497</b>	<b>55,525</b>
Gross block	15,593	16,688	18,649	20,734	23,193
Less: acc. Depreciation	(6,114)	(7,707)	(9,408)	(11,236)	(13,223)
Net block	9,478	8,982	9,241	9,498	9,970
Capital WIP	415	211	211	211	211
Net fixed assets	9,893	9,193	9,452	9,709	10,181
Non Current Assets	476	576	576	576	576
Investments	0	0	0	0	0
Inventories	7,564	8,560	9,663	10,276	10,987
Sundry debtors	1,556	1,495	1,767	1,919	2,074
Cash & Cash Equivalents	17,549	23,962	27,344	34,013	40,876
Loans & advances	17	9	9	9	9
Other current assets	1,407	1,590	1,335	1,450	1,567
Trade payables	2,592	3,740	4,141	4,479	4,770
Other current liab.	4,822	5,823	5,823	5,823	5,823
Provisions	148	152	152	152	152
Net current assets	20,531	25,901	30,002	37,212	44,769
<b>Total assets</b>	<b>30,901</b>	<b>35,669</b>	<b>40,030</b>	<b>47,497</b>	<b>55,525</b>
<b>Cashflow</b>					
YE Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Profit Before Tax	5,616	7,896	9,966	11,594	13,254
Depreciation & Amortisation	1,422	1,507	1,701	1,828	1,987
Net Interest	(657)	(1,100)	(2,699)	(3,229)	(3,469)
Net Change – WC	(174)	973	(718)	(541)	(694)
Direct taxes	(1,386)	(1,887)	(2,302)	(2,678)	(3,062)
<b>Net cash from operations</b>	<b>4,820</b>	<b>7,390</b>	<b>5,948</b>	<b>6,974</b>	<b>8,016</b>
Capital expenditure	(707)	(831)	(1,960)	(2,086)	(2,459)
Acquisitions, net	0	0	(2,227)	(2,450)	(2,695)
Investments	(1,671)	(4,664)	0	0	0
Others	54	137	0	0	0
<b>Net cash from investing</b>	<b>(2,325)</b>	<b>(5,359)</b>	<b>(4,187)</b>	<b>(4,535)</b>	<b>(5,153)</b>
<b>FCF</b>	<b>2,496</b>	<b>2,031</b>	<b>1,761</b>	<b>2,439</b>	<b>2,863</b>
Issue of share capital	0	0	0	0	0
Increase/(decrease) in debt	(761)	(355)	515	1,004	1,263
Dividend paid	(1,239)	(1,449)	(1,449)	(1,449)	(1,449)
Interest paid	(380)	(259)	(368)	(376)	(383)
Others	0	0	0	0	0
<b>Net cash from financing</b>	<b>(2,380)</b>	<b>(2,063)</b>	<b>(1,303)</b>	<b>(821)</b>	<b>(570)</b>
Net change in Cash	116	(32)	459	1,618	2,293

Source: Company, Centrum Broking

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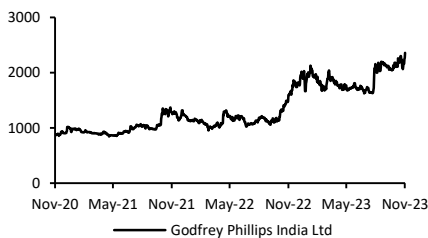
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**Godfrey Phillips India**



Source: Bloomberg



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