

BSE Code: 500875
NSE Code: ITC
Reuters Code: ITC.NS
Bloomberg Code: ITC:IN

ITC is a diversified conglomerate, present across categories— Cigarettes, Other FMCG, Hotels, Paper & Agri-business. ITC is a market leader in the cigarettes category with volume market share of ~75%.

Investment Rationale

Decent growth in topline

Net sales grew by 7.6% YoY in Q1FY19 led by 14% YoY growth in FMCG (like-to-like basis), 12% YoY in hotels and modest 2.2% (our calculation) in cigarettes. Cigarette volumes surprised positively with growth of 1% YoY (our estimate) after 3 consecutive quarters of steep decline (-6% to -3%). FMCG segment also grew by impressive 14.3% YoY (like-to-like basis) with strong performance across Branded Packaged foods and personal care products. The company improved its market standing across segments driven by new product launches. Hotels segment also posted healthy growth in topline led by higher room rates and strong food and beverage sales. Agribusiness reported 14.2% YoY growth while Paperboards and Packaging segment witnessed muted performance (flat revenue) during the quarter as demand remained weak from end user industries.

Recovery in cigarette volumes and better profitability in FMCG segment to aid margin growth

EBITDA margin expanded by 161 bps YoY to 39.2% led by improved profitability in cigarettes, FMCG, hotels and paperboard segments. However, Agribusiness reported tepid performance due to pressure on legal cigarette industry volumes leading to adverse mix and lower export incentives. Further, PAT growth was restricted to 10.1% YoY in Q1FY19 due to lower other income. With recovery in cigarette volumes coupled with better profitability in FMCG segment, we expect EBITDA margin to expand to 38.9%/39.9% in FY19E/20E.

Performance to only get better

In Q1FY19 the company reported healthy performance across segments. Going ahead, we expect volume recovery to sustain in cigarettes and strong performance in FMCG segment to continue and as a result, factor revenue CAGR of 8.2%/14.2%, respectively over FY18-20E. This will drive overall revenue CAGR of 9.6% over FY18-20E.

Valuation:

Given ITC's leadership position in cigarette category, continued investment in FMCG business and favourable risk reward, we recommend 'BUY' rating on the stock with a target price of Rs. 336 based on 30.5x FY20E EPS.

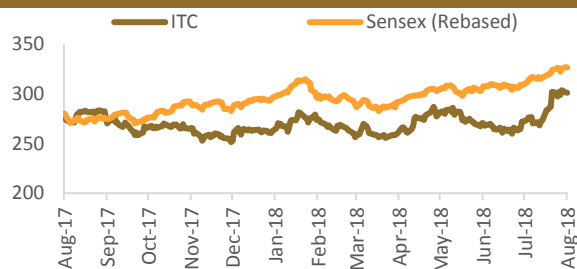
Market Data

Rating	BUY
CMP (Rs.)	304
Target (Rs.)	336
Potential Upside(%)	11%
Duration	Long Term
Face Value (Rs.)	1.0
52 week H/L (Rs.)	323/250
Decline from 52WH (%)	7.1
Rise from 52WL (%)	20.0
Beta	1.2
Mkt. Cap (Rs.Cr)	370,800

Fiscal Year Ended

Y/E	FY17	FY18	FY19E	FY20E
Revenue (Rs.Cr)	40,089	40,628	44,193	48,806
Adj. Net profit (Rs.Cr)	10,201	10,810	11,908	13,449
EPS (Rs.)	8.4	8.9	9.8	11.0
P/E (x)	36.2	34.3	31.1	27.6
P/BV (x)	8.1	7.2	6.7	6.3
ROE (%)	23.5	22.3	22.4	23.6

One year Price Chart



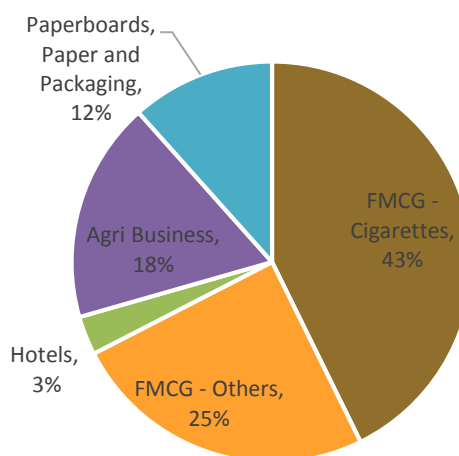
Shareholding Pattern

	Jun-18	Mar-18	Chg.
Promoters (%)	0.0	0.0	-
FII (%)	17.5	18.0	(0.5)
DII (%)	37.6	37.1	0.5
Public (%)	9.8	9.8	-
Other (%)	35.1	35.1	-

ITC Ltd: Business Overview

ITC is a diversified conglomerate, present across categories– Cigarettes, Other FMCG, Hotels, Paper & Agri-business. ITC is a market leader in the cigarettes category with volume market share of ~75%. The company's consistent focus on research & development and brand building has resulted in creating aashirvaad the no. 1 in branded atta, bingo! the no. 1 in bridges segment of snack foods (no.2 overall), sunfeast the no. 1 in the premium cream biscuits segment, classmate the no. 1 in notebooks, yippee! the no. 2 in noodles, engage the no. 2 in deodorants (no. 1 in women's segment) and mangaldeep the no. 2 in agarbattis (no. 1 in dhoop segment).

ITC's revenue mix



Source: Company, In-house research

Quarterly Financials (Standalone)

(Rs cr)	Q1FY19	Q1FY18	YoY Growth %	Q4FY18	QoQ Growth %
Sales	10,707	9,955	7.6	10,587	1.1
EBITDA	4,202	3,746	12.2	4,144	1.4
Margin (%)	39.2	37.6	161bps	39.1	10bps
Depreciation	299	268	11.4	304	(1.7)
EBIT	3,903	3,478	12.2	3,840	1.7
Interest	7	10	(29.3)	23	(68.4)
Other Income	404	477	(15.3)	517	(21.8)
Exceptional Items	-	-	-	-	-
PBT	4,300	3,945	9.0	4,333	(0.8)
Tax	1,481	1,384	7.0	1,401	5.8
PAT	2,819	2,561	10.1	2,933	(3.9)
Minority Interest	-	-	-	-	-
Reported PAT	2,819	2,561	10.1	2,933	(3.9)
Adjustment	-	-	-	-	-
Adj PAT	2,819	2,561	10.1	2,933	(3.9)

Source: Company, In-house research

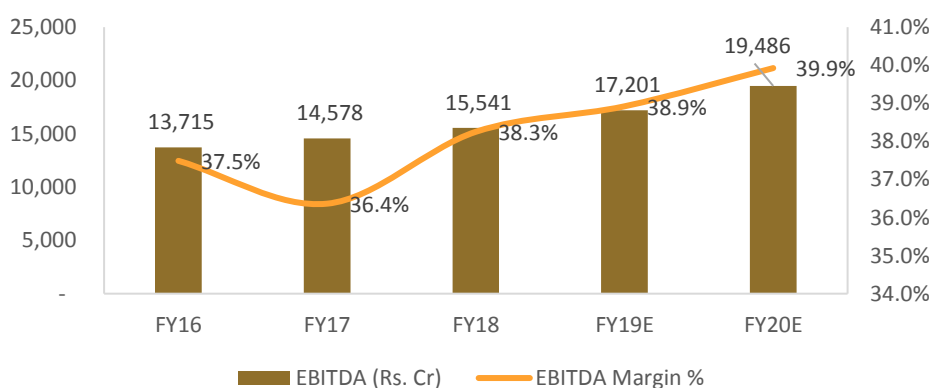
Decent growth in topline

Net sales grew by 7.6% YoY in Q1FY19 led by 14% YoY growth in FMCG (like-to-like basis), 12% YoY in hotels and modest 2.2% (our calculation) in cigarettes. Cigarette volumes surprised positively with growth of 1% YoY (our estimate) after 3 consecutive quarters of steep decline (-6% to -3%). FMCG segment also grew by impressive 14.3% YoY (like-to-like basis) with strong performance across Branded Packaged foods and personal care products. The company improved its market standing across segments driven by new product launches. Hotels segment also posted healthy growth in topline led by higher room rates and strong food and beverage sales. Agribusiness reported 14.2% YoY growth while Paperboards and Packaging segment witnessed muted performance (flat revenue) during the quarter as demand remained weak from end user industries.

Recovery in cigarette volumes and better profitability in FMCG segment to aid margin growth

EBITDA margin expanded by 161 bps YoY to 39.2% led by improved profitability in cigarettes, FMCG, hotels and paperboard segments. Cigarette business witnessed EBIT margin improvement of 415 bps YoY to 69.4% (our calculation) on the back of volume growth. Despite sustained investments behind brands and gestation cost of new categories, FMCG segment reported 153 bps YoY increase in EBIT margin to 1.7% (our calculation) led by product mix enrichment and cost management initiatives. Hotel segment performance was boosted by higher room rates and operating leverage resulting in EBIT expansion of 213 bps YoY to 3.9%. Paperboard and packaging segment also saw healthy 289 bps YoY expansion in EBIT margin to 21.8% driven by strategic investments in imported pulp substitution, improving pulp yield and higher realization. However, Agribusiness reported tepid performance due to pressure on legal cigarette industry volumes leading to adverse mix and lower export incentives. Further, PAT growth was restricted to 10.1% YoY in Q1FY19 due to lower other income. With recovery in cigarette volumes coupled with better profitability in FMCG segment, we expect EBITDA margin to expand to 38.9%/39.9% in FY19E/20E.

EBITDA margin to grow by 167 bps over FY18-20E

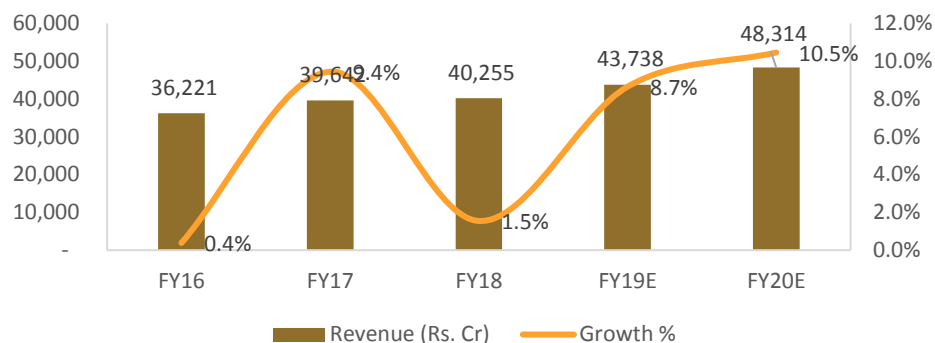


Source: Company, In-house research

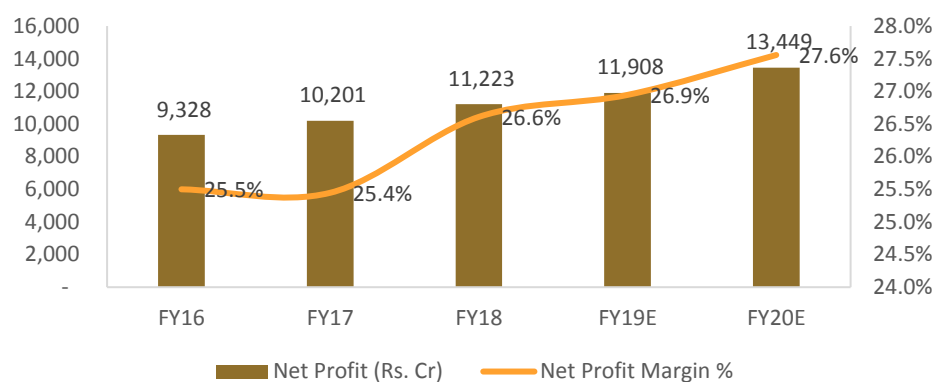
Performance to only get better

In Q1FY19 the company reported healthy performance across segments. Going ahead, we expect volume recovery to sustain in cigarettes and strong performance in FMCG segment to continue and as a result, factor revenue CAGR of 8.2%/14.2%, respectively over FY18-20E. This will drive overall revenue CAGR of 9.6% over FY18-20E.

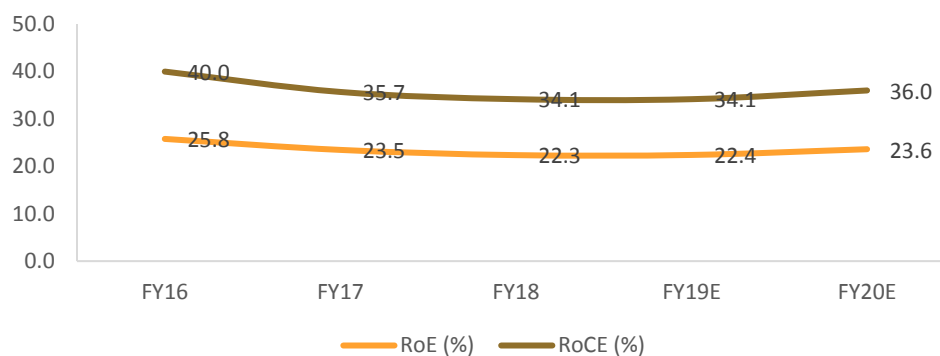
Revenue to grow at a CAGR of 10% over FY18-20E



Strong growth in profitability going forward



Return ratios trend



Source: Company, In-house research

Key Risks:

- Adverse cross-currency foreign exchange rate fluctuation.
- Higher taxation and stringent regulatory norms on cigarette.
- Slowdown in macro-economic environment would impact hotels business.

Profit & Loss Account (Standalone)

Y/E (Rs.Cr)	FY17	FY18	FY19E	FY20E
Total operating Income	40,089	40,628	44,193	48,806
Raw Material cost	15,976	15,790	17,058	18,698
Employee cost	2,444	2,487	2,624	2,851
Other operating expenses	7,090	6,809	7,310	7,772
EBITDA	14,578	15,541	17,201	19,486
Depreciation	1,038	1,145	1,273	1,399
EBIT	13,540	14,396	15,928	18,087
Interest Cost	23	87	60	60
Other income	1,986	2,130	2,240	2,424
Profit before tax	15,503	16,439	18,108	20,451
Tax	5,302	5,628	6,200	7,002
PAT	10,201	10,810	11,908	13,449
Minority Interest	-	-	-	-
P/L from Associates	-	-	-	-
Adjusted PAT	10,201	10,810	11,908	13,449
E/o income / (Expense)	-	413	-	-
Reported PAT	10,201	11,223	11,908	13,449

Balance Sheet (Standalone)

Y/E (Rs.Cr)	FY17	FY18	FY19E	FY20E
Paid up capital	1,215	1,220	1,221	1,221
Reserves and Surplus	44,126	50,180	53,749	57,779
Net worth	45,341	51,400	54,970	59,000
Minority interest	-	-	-	-
Total Debt	26	18	18	18
Other non-current liabilities	2,027	2,114	2,114	2,114
Total Liabilities	47,394	53,532	57,101	61,132
Total fixed assets	14,926	15,566	17,319	19,120
Capital WIP	3,491	5,026	5,000	4,800
Goodwill	-	-	-	-
Investments	18,585	23,397	24,697	26,197
Net Current assets	7,615	5,750	6,292	7,222
Other non-current assets	2,776	3,793	3,793	3,793
Total Assets	47,394	53,532	57,101	61,132

Cash Flow Statement (Standalone)

Y/E (Rs.Cr)	FY17	FY18	FY19E	FY20E
Pre-tax profit	15,503	16,852	18,108	20,451
Depreciation	1,038	1,145	1,273	1,399
Chg in Working Capital	63	1,920	(231)	(639)
Others	(1,389)	(1,547)	(2,180)	(2,364)
Tax paid	(5,213)	(5,720)	(6,200)	(7,002)
Cash flow from operating activities	10,002	12,651	10,770	11,845
Capital expenditure	(2,825)	(2,826)	(3,000)	(3,000)
Chg in investments	(975)	(5,036)	(1,300)	(1,500)
Other investing cashflow	1,019	1,170	2,240	2,424
Cash flow from investing activities	(2,780)	(6,691)	(2,060)	(2,076)
Equity raised/(repaid)	1,067	913	50	-
Debt raised/(repaid)	(13)	(8)	-	-
Dividend paid	(8,174)	(6,880)	(8,389)	(9,419)
Other financing activities	(18)	(45)	(60)	(60)
Cash flow from financing activities	(7,138)	(6,020)	(8,398)	(9,479)
Net chg in cash	84	(60)	312	291

Key Ratios (Standalone)

Y/E	FY17	FY18	FY19E	FY20E
Growth (%)				
Net Sales	9.4	1.5	8.7	10.5
EBITDA	6.3	6.6	10.7	13.3
Net profit	9.4	6.0	10.2	12.9
Margin (%)				
EBITDA	36.4	38.3	38.9	39.9
EBIT	33.8	35.4	36.0	37.1
NPM	25.4	26.6	26.9	27.6
Return Ratios (%)				
RoE	23.5	22.3	22.4	23.6
RoCE	35.7	34.1	34.1	36.0
Per share data (Rs.)				
EPS	8.4	8.9	9.8	11.0
DPS	4.7	5.1	5.7	6.4
Valuation(x)				
P/E	36.2	34.3	31.1	27.6
EV/EBITDA	25.1	23.7	21.4	18.9
EV/Net Sales	9.2	9.1	8.4	7.6
P/B	8.1	7.2	6.7	6.3
Turnover Ratios (x)				
Net Sales/GFA	2.5	2.3	2.2	2.1
Sales/Total Assets	0.8	0.7	0.7	0.7

Rating Criteria

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	Buy	More than equal to 15%
Hold	Between 10% & -5%	Accumulate*	Upside between 10% & 15%
Reduce	Less than -5%	Hold	Between 0% & 10%
		Reduce/sell	Less than 0%

* To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

* ITC is a large-cap company.

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