

Stock Update

Mixed Quarter

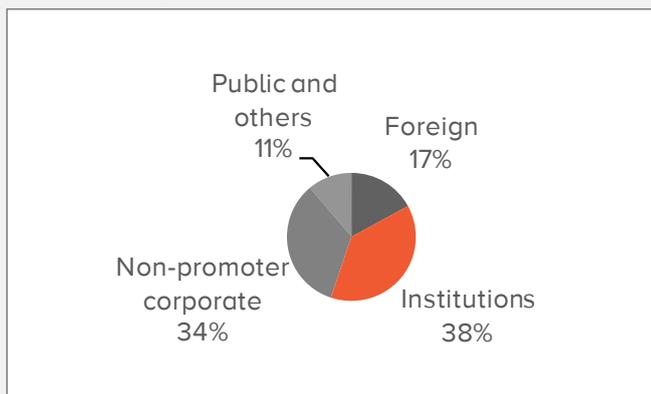
ITC

Reco: Buy | CMP: Rs290

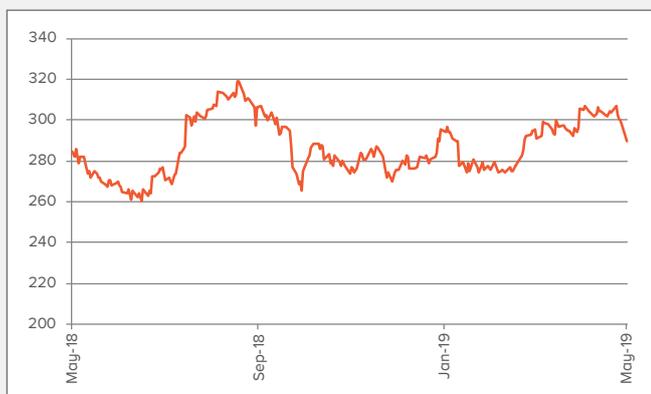
Company details

Price target:	Rs347
Market cap:	Rs355,500 cr
52-week high/low:	Rs323/259
NSE volume: (No of shares)	114.2 lakh
BSE code:	500875
NSE code:	ITC
Sharekhan code:	ITC
Free float: (No of shares)	1225.9 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.0	8.1	7.4	8.3
Relative to Sensex	4.1	5.3	0.6	0.6

Key points

- Revenue grew strongly by ~13%, but unfavourable mix affected profitability:** In Q4FY2019, ITC's net revenue grew by 12.9%, driven by 11.1% growth in the core cigarette business, ~25% growth in the hotel business and high-teen growth in both the agri and paperboard, paper & packaging (PPP) business. The core cigarette business volumes grew by 8-9%, better than our as well as the street's expectation of mid single-digit volume growth. Gross margins declined by 47 bps y-o-y to 60.4% due to an unfavourable revenue mix. Operating profit margin (OPM) declined by 87 bps to 37.5% mainly on account of a decline in margins of the cigarette and hotels businesses. Other income grew by 29.7% y-o-y to Rs. 669.7 crore. This led to a 17% growth in the adjusted PAT to Rs. 3,434.7 crore. A post-tax exceptional item worth Rs. 47.2crore (pre-tax amount stood at Rs. 76.6 crore) towards net gain for restructuring of lifestyle business (comprising sales proceeds of *John Players* brand trademarks and copyrights) drove up reported PAT by 18.7% to Rs. 3481.9 crore.
- Cigarette sales volumes grew by 8-9%; non-cigarette FMCG sales grew in single digits; PPP business outperformed:** Cigarette business revenue grew by 11.1%, with sales volumes rising 8-9%. PBIT of this business grew by 10 y-o-y, lagging revenue growth mainly on account of downtrading to low-price cigarettes (largely to 64 mm cigarettes). The FMCG business revenue grew by 7.3% lower than anticipated due to slowdown in demand in the domestic market, restructuring of the lifestyle business and pipeline calibration in education & stationery products. PBIT of the non-cigarette FMCG business grew by 43.1% to Rs. 130.5 crore . Revenue of the agri-business grew by 18.8% y-o-y, largely on account of rising opportunities in trading of oilseeds, rice, spices and coffee. PBIT margins of the agri business stood flat at 7.0%. Revenue of the PPP business grew by ~18%, while PBIT grew by 24.0% y-o-y, driven by a richer product mix, higher realisation and higher sales volumes. The hotels business performed strongly with revenue growing by 24.9% and the PBIT growing by 17.5%.
- Outlook – Cigarette sales to grow in mid single-digits; hotels and PPP business to perform well:** Cigarette sales volumes grew in high single digit in last two quarters as no significant price hikes were undertaken in the recent past

(average price increase of 2% was taken in 20% of cigarettes portfolio in March 2019). However, margins of the cigarette business are expected to be lower due shift happening from long/King size cigarettes to smaller variants. We expect cigarette sales volume to grow in mid-single digit in the near term. Revenues of the non-cigarette FMCG business are expected to grow in high single digits to low double digits in the near term as the slowdown in demand is likely to persist in the near term. However, a higher scale will support the business' overall margins in the medium term. With demand for rooms likely to exceed room supply, we expect the company's hotel business to deliver strong performance in FY2019/20. The PPP business will continue to post better profitability led by an improved revenue mix and benign input costs.

- ♦ **Broadly maintained earnings estimates; Maintain Buy with unchanged PT of Rs. 347:** We have broadly maintained our earnings estimates for FY2020 and FY2021 and we expect revenues and earnings to clock a CAGR of 12% each over FY2019-21. the company's focus on become a diversified play by investing higher in businesses such as the Non-cigarette FMCG and Hotel augurs well for the company in long run. ITC is currently trading at 23x its FY2021E earnings, at a stark discount to some of the large FMCG stocks. In view of its steady performance in the core cigarette business and discounted valuations we maintain our Buy recommendation on the stock with an unchanged price target (PT) of Rs. 347.

Valuations (standalone)

Particulars	Rs cr				
	FY2017	FY2018	FY2019	FY2020E	FY2021E
Revenues	40,088.7	40,627.5	45,784.4	51,244.2	57,776.5
Net profit	10,200.9	10,397.5	12,309.9	13,773.0	15,520.7
OPM (%)	36.4	38.3	37.8	38.6	39.1
EPS (Rs.)	8.4	8.5	10.1	11.3	12.7
PE(x)	34.7	34.0	28.8	25.7	22.8
P/BV (X)	7.8	6.9	6.1	5.7	5.2
EV/EBITDA (x)	22.9	21.3	19.1	16.7	14.6
RoCE (%)	29.8	28.4	27.8	28.9	30.7
RoNW (%)	23.5	21.5	22.5	22.9	23.8

Results (standalone)

Particulars	Rs cr				
	Q4FY19	Q4FY18	YoY %	Q3FY19	QoQ %
Net Sales	12206.0	10813.2	12.9	11431.3	6.8
Total expenditure	7634.4	6669.2	14.5	7105.5	7.4
Operating Profit	4571.7	4144.0	10.3	4325.8	5.7
Other income	669.7	516.5	29.7	836.4	-19.9
Interest	7.7	23.2	-66.7	5.6	38.0
Depreciation	350.2	304.0	15.2	335.4	4.4
Profit before tax	4883.4	4333.3	12.7	4821.2	1.3
Tax	1448.8	1400.6	3.4	1612.1	-10.1
Adjusted PAT	3434.7	2932.7	17.1	3209.1	7.0
Exceptional item	47.2	0.0	-	0.0	-
Reported PAT	3481.9	2932.7	18.7	3209.1	8.5
EPS (Rs.)	2.8	2.4	17.1	2.6	7.0
			BPS		BPS
GPM (%)	60.4	60.9	-47	60.6	-16
OPM (%)	37.5	38.3	-87	37.8	-39

Segment-wise performance**Cigarette business: Sales volume grew by 8-9%; Lower realisation marred margins**

- ♦ Revenue of the cigarette business grew by 11.1%, with sales volumes easing 8-9% in Q4FY2019. Growth in sales volume was on back of no

substantial price increase in the portfolio in the recent past and low base of Q3FY2018.

- ♦ However, the downtrading in cigarette sales to low-price cigarettes (largely to 64 mm cigarettes) lowered realisations. This led to PBIT of the cigarette business growing by just 10%

y-o-y as against revenue growth of ~11% (PBIT margins declined by 77 bps y-o-y).

- ◆ With no significant price hikes in the portfolio in recent times, we expect volume growth to sustain in mid-to-high single digit in the coming quarters. However, the downtrading to low-price cigarettes would drag down realisations and would keep a check on margins in the coming quarters.

Non-cigarette FMCG business - Revenue grows in double digits; Profit saw a huge jump

- ◆ In Q4FY2019, the non-cigarette FMCG business grew by 11% y-o-y to Rs. 3,274 crore with most major categories performing well. EBITDA of the non-cigarette FMCG business grew by 31% to Rs. 228 crore. This was mainly driven by enhanced scale, a richer product mix and sustained investments in brand-building.
- ◆ Overall performance was impacted by slowdown in consumption in the domestic market, restructuring of lifestyle business and pipeline calibration in the education & stationery products business.
- ◆ In the staples, snacks and meals business, *Aashirvaad atta* fortified its leadership position in the industry and market standing across regions with a continued uptick in sales momentum whereas *Aashirwad* range of spices registered robust revenue growth.
- ◆ In the snacks and meals business, greater consumer traction for *Bingo! Potato Chips* and *Tedhe Medhe* continued to drive growth in the snacks business, with *Tedhe Medhe* emerging as India's most distributed brand. In the instant noodles category, the product portfolio was augmented with the launch of *YiPPee! 'My' range* noodles, which have been crafted keeping in mind the taste preferences of young adults that sustained the growth momentum despite increasing competitive intensity from other players.
- ◆ The confections business continued to pursue portfolio premiumisation and introduced low-unit packs and channel-specific stock-keeping units (SKUs) to its assortment. *Dark Fantasy Choco Fills* saw growth momentum accelerate further, driven by superior product attributes, focused communication and consumer activation. Various innovative and first-to-market launches such as *Bounce Minifills*, *Dark Fantasy Jellifill* and, *Candyman Fantastik* also led to premiumisation of the portfolio.

- ◆ In the dairy & beverages business, the *B Natural* range of juices was extended to the transparent bottle format. *Aashirwad* pouch milk was introduced in Kolkata and Patna. *Aashirwad Swasti Ghee* continued to gain traction too. The business also forayed into the Dairy Beverages segment with the launch of four differentiated variants of milkshakes under the '*Sunfeast Wonderz*' brand.
- ◆ During the quarter, the company also launched several chocolate variants under the '*Fabelle*' range. In the boxed chocolate range, the Business launched *Ruby Gianduja* - a blended chocolate with rich Turkish hazelnut paste. Premium chocolate bars were also launched, crafted in two unique formats - centre-filled bars (*Fabelle Soft Centres*) and multi-layered bars (*Fabelle Choco Deck*).
- ◆ The personal care products business enhanced its market standing during the quarter with healthy performance of hand hygiene, fragrances, body wash and skin care categories driven by innovation, premiumisation and expansion of distribution reach. In the fragrances category, the highly innovative range of pocket perfumes, continued to show strong growth despite intense competition in recent months. The business strengthened its presence in skin-care category with the launch of *Dermafique* range. *Vivel Cool* and *Fiama* continued to garner positive response. Several new and exciting consumer-friendly offerings were launched, which includes *Savlon Hand Sanitiser* in a child-friendly pen format.

Agri business – revenues grew in double digit; margins remained flat

- ◆ The agri-business registered strong double digit revenue growth of 16.2% in Q4FY2019 leveraging upon trading opportunities in wheat, coffee, oilseeds and aqua categories.
- ◆ However, a steeper depreciation in competing currencies, subdued demand for leaf tobacco in international markets and escalation in tobacco leaf cost pertaining to Andhra 2017 crop continued to weigh on PBIT margins. The PBIT margins of the cigarette business stood flat at 7%, falling 157 bps y-o-y.
- ◆ The company is scaling up the recently launched range of 10 variants of vegetarian and non-vegetarian snacks under the ITC Master Chef brand after receiving encouraging consumer traction in the launch markets. The company

is also stepping up initiatives in value-added agriculture products, which include packaged prawns, fruit puree, fresh fruits and vegetables and dehydrated onions.

Hotel business – Strong revenue growth

- ◆ The hotels business saw revenue grow by ~25% y-o-y to Rs. 509.8 crore and double-digit growth of 17.5% y-o-y in PBIT (excluding gestation cost of new properties) in Q4FY2019, driven by strong RevPAR growth.
- ◆ The business made steady progress during the quarter with the construction of ITC Hotels at Kolkata and Ahmedabad and WelcomHotels in Guntur and Bhubaneswar. Construction of ITC Royal Bengal in Kolkata is nearing completion and is expected to commission in Q1FY2020.
- ◆ Further, the company is focusing on enhancing the scale of business by adopting asset-light-model and growing footprints through management contracts.

Paperboard, paper and packaging business – Revenues and PBIT grew in strong double digits

- ◆ The PPP business revenue grew by 18.2% y-o-y in Q4FY2019 to Rs. 1,537.4 crore on account of strong demand and capacity augmentation in value-added paperboard and décor segments. PBIT grew by a healthy 24.0% y-o-y to Rs. 300.5 crore, driven by product mix enrichment, higher realisation and higher sales volume growth.
- ◆ The Business continues to make structural interventions in the areas of strategic cost management and import substitution. These include augmentation of in-house pulp manufacturing capacity, efficiency improvements of existing equipment and developing alternative sources of supply for key inputs on an ongoing basis. Capacity utilisation of the bleached chemi-thermo mechanical pulp mill (BCTMP) at Bhadrachalam was further scaled up during the year, leading to reduced dependence on imported pulp resulting in the cost savings.
- ◆ We expect the PPP business revenue and PBIT to grow in double digits in FY2020 and FY2021.

Segmental revenues

Particulars	Rs cr				
	Q4FY19	Q4FY18	YoY %	Q3FY19	QoQ %
FMCG - cigarettes	5,485.9	4,936.5	11.1	5,073.4	8.1
FMCG - others	3,273.9	3,051.8	7.3	3,201.0	2.3
Hotels	509.8	408.0	24.9	451.9	12.8
Agri	2,100.9	1,808.3	16.2	1,924.6	9.2
Paperboard, Paper and Packaging	1,537.4	1,300.8	18.2	1,542.5	-0.3
Total	12,907.9	11,505.4	12.2	12,193.3	5.9
Less: inter segment sales	843.7	799.6	5.5	853.2	-1.1
Gross Sales	12,064.2	10,705.8	12.7	11,340.2	6.4

Segment profits

Particulars	Rs cr					
	PBIT			Margins (%)		Chg in BPS
	Q4FY19	Q4FY18	YoY %	Q4FY19	Q4FY18	
FMCG - cigarettes	3856.0	3505.8	10.0	70.3%	71.0%	-73
FMCG - others	130.5	91.2	43.1	4.0%	3.0%	100
Hotels	88.7	75.5	17.5	17.4%	18.5%	-110
Agri	147.2	124.0	18.8	7.0%	6.9%	15
Paperboard, Paper and Packaging	300.5	242.4	24.0	19.5%	18.6%	91
Total	4522.9	4038.8	12.0	35.0%	35.1%	-

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