

ITC Ltd.

03 February 2020

Reuters: ITC.BO; Bloomberg: ITC IN

A big blow after a stable regime

Duties raised on cigarettes: The finance minister in the Union Budget 2020-21 has proposed to raise excise duty, by way of National Calamity Contingent Duty (NCCD) on Cigarettes and other tobacco products. However, no change is being made in the duty rates of bidis. NCCD is being increased on filter cigarettes from Rs90 to Rs440 per thousand cigarettes for length not exceeding 65mm, from Rs90 to Rs440 per thousand cigarettes for length exceeding 65mm but not exceeding 70mm, from Rs145 to Rs545 per thousand cigarettes for length exceeding 70mm but not exceeding 75mm and from Rs235 to Rs735 per thousand cigarettes for Others.

Hikes higher in smaller size filters: Based on our internal calculation after assuming weights for the various filters, the impact of the tax hike comes at around 9%. The increase in the smaller size filters (DSFT and RSFT) is higher. This steep duty increase on cigarette has come as a negative for the sector after more than two and half years of no major change in rates. In recent times (last 9MFY20) cigarette EBIT growth has actually come-off from 8-10% to 6-8%. We believe ITC will be required to take a price hike to mitigate the duty increase which will put volumes under pressure. We thus build in 3% volume decline for FY21 from a 4% growth earlier and reduce our volume growth estimate slightly for FY22 as well to 3% as the price hike will lead to illegal cigarettes to even gain more ground. According to Tobacco Institute of India (TII), illegal cigarettes have grown consistently in the country and now account for one fourth of the Indian cigarette market. The illicit cigarettes have increased from a level of 11.1bn sticks in 2004 to 25.6bn sticks in 2018 (CAGR of ~6%).

Outlook and Valuation: Changes in the model have led to ~4% cut to our FY21E/FY22E EPS. The excise hike will put the cigarette business under more pressure in a scenario where illegal cigarettes have been growing and business witnessing a slowdown. We are now building in 8.5% EPS CAGR over FY20-22E. FMCG-Others business has ramped up well over the years and now contributes ~32% to the company's topline but has lagged the industry growth in the few quarters. It will also take the segment a few more years to contribute meaningfully to the company's profit (Cigarette EBIT still contributes ~85% to overall EBIT while FMCG-Other EBIT contribution stands at a paltry 2% as on 9MFY20). With the sharp correction post the announcement of Budget and changes to our numbers, ITC is now trading at 17.8x/16.6x/15.2x FY20E/FY21E/FY22E EPS. We maintain Buy with a revised target price (TP) of Rs260 (based on 19x September'21 EPS), indicating an upside of 19% from the current market price (CMP).

BUY

Sector: FMCG

CMP: Rs219

Target Price: Rs260

Upside: 19%

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Key Data

Current Shares O/S (mn)	12,292.1
Mkt Cap (Rsbn/US\$bn)	2692/37.7
52 Wk H / L (Rs)	310/216
Daily Vol. (3M NSE Avg.)	11,679,260

Price Performance (%)

	1 M	6 M	1 Yr
ITC	(8.2)	(17.2)	(22.0)
Nifty Index	(4.6)	6.0	7.1

Source: Bloomberg

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Net sales	406,275	449,957	481,304	530,479	585,337
YoY growth (%)	1.3	10.8	7.0	10.2	10.3
EBITDA	155,639	173,294	186,746	200,095	220,641
EBITDA margin (%)	38.3	38.5	38.8	37.7	37.7
Reported PAT	112,233	124,643	150,418	161,518	177,058
Adjusted PAT	108,104	124,643	150,418	161,518	177,058
EPS	8.9	10.2	12.3	13.2	14.4
YoY change (%)	5.5	14.8	20.7	7.4	9.6
RoCE (%)	21.6	22.1	24.1	24.0	24.8
RoE (%)	22.3	22.8	24.9	24.7	25.5
P/E (x)	24.7	21.5	17.8	16.6	15.2
P/B (x)	5.2	4.6	4.3	4.0	3.8
EV/EBITDA (x)	15.6	13.7	12.5	11.5	10.3

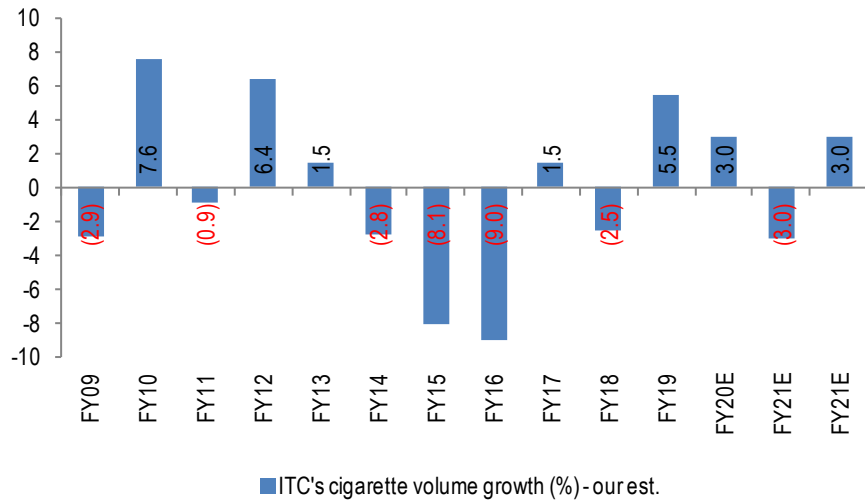
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Change in our estimates

Y/E March (Rsmn)	Old estimates			New estimates			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Net sales	475,674	527,791	584,941	475,674	524,567	579,131	0.0	-0.6	-1.0
EBITDA	186,746	208,401	231,564	186,746	200,095	220,641	0.0	-4.0	-4.7
EBITDA (%)	38.8	39.0	39.2	38.8	37.7	37.7	0.0bps	-130bp	-150bps
PAT	150,418	167,733	185,231	150,418	161,518	177,058	0.0	-3.7	-4.4

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Cigarette volume growth trend



Source: Nirmal Bang Institutional Equities Research Estimates

Financials (Standalone)

Exhibit 4: Income statement

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Net sales	406,275	449,957	481,304	530,479	585,337
% Growth	1.3	10.8	7.0	10.2	10.3
COGS	209,651	229,854	240,564	265,126	291,676
Other expenses	40,986	46,809	53,994	65,258	73,021
Total expenses	250,636	276,663	294,558	330,384	364,696
EBITDA	155,639	173,294	186,746	200,095	220,641
% growth	6.6	11.3	7.8	7.1	10.3
EBITDA margin (%)	38.3	38.5	38.8	37.7	37.7
Other income	21,298	24,845	30,549	31,429	32,481
Interest costs	1,096	580	531	478	430
Depreciation	11,454	13,117	15,751	15,199	16,079
Profit before tax (before exceptional items)	164,388	184,442	201,013	215,847	236,613
Exceptional items	4,129	0	0	0	0
Tax	56,285	59,798	50,595	54,329	59,556
PAT	112,233	124,643	150,418	161,518	177,058
Adj PAT	108,104	124,643	150,418	161,518	177,058
Adj. PAT margin (%)	25.3	26.3	29.4	28.7	28.7
% Growth	6.0	15.3	20.7	7.4	9.6

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Balance sheet

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Share capital	12,204	12,259	12,259	12,259	12,259
Reserves	501,796	567,239	618,042	663,993	702,634
Minority interest	0	0	0	0	0
Net worth	514,001	579,498	630,300	676,251	714,893
Total debt	69	32	32	32	32
Deferred tax liability	19,179	20,441	20,441	20,441	20,441
Total liabilities	533,249	599,972	650,774	696,725	735,366
Gross block	258,097	300,430	325,430	345,430	365,430
Depreciation	102,350	115,467	131,218	146,417	162,496
Net block	155,747	184,963	194,212	199,013	202,934
Capital work-in-progress	50,169	33,915	33,915	33,915	33,915
Investments	233,972	265,780	299,807	333,538	358,889
Inventories	72,372	75,872	78,777	84,291	92,491
Debtors	23,570	36,462	41,703	48,864	53,946
Cash	25,949	37,687	46,136	51,159	57,428
Loans & advances	49,451	56,351	57,478	58,627	59,800
Other current assets	12,584	6,949	7,297	7,661	8,044
Total current assets	183,925	213,322	231,390	250,603	271,709
Creditors	33,823	33,683	37,950	42,842	46,987
Other current liabilities & provisions	56,742	64,325	70,599	77,501	85,094
Total current liabilities	90,564	98,008	108,550	120,344	132,081
Net current assets	93,361	115,314	122,840	130,259	139,628
Total assets	533,249	599,972	650,774	696,725	735,366

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Cash flow

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
PAT	168,517	184,442	201,013	215,847	236,613
Depreciation	11,454	13,117	15,751	15,199	16,079
Other income	7,157	8,128	30,549	31,429	32,481
(Inc.)/dec. in working capital	(19,202)	4,997	(922)	2,396	3,101
Cash flow from operations	126,509	117,491	137,073	143,371	157,985
Capital expenditure (-)	17,891	30,769	28,330	29,526	20,960
Net cash after capex	101,030	89,896	112,073	123,371	137,985
Dividends paid (-)	9,128	9,691	10,000	10,000	10,000
DDT paid (-)	(57,700)	(62,852)	(70,487)	(91,755)	(104,987)
Inc./(dec.) in investments	(34,769)	(15,325)	(34,027)	(33,731)	(25,351)
Cash from financial activities	(60,199)	(66,006)	(72,928)	(94,142)	(107,326)
Opening cash balance	27,473	25,949	37,687	46,136	51,159
Closing cash balance	25,949	37,687	46,136	51,159	57,428
Change in cash balance	(1,524)	11,739	8,449	5,023	6,268

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Key ratios

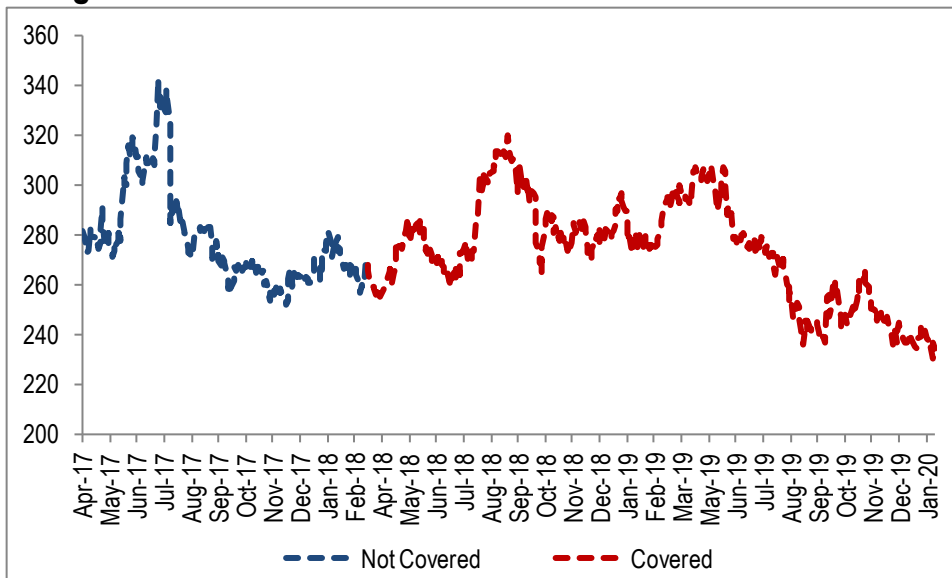
Y/E March	FY18	FY19	FY20E	FY21E	FY22E
Per share (Rs)					
EPS	8.9	10.2	12.3	13.2	14.4
Book value	42.1	47.3	51.4	55.2	58.3
DPS	6.2	6.9	9.0	10.3	12.2
Valuation (x)					
EV/sales	6.0	5.4	4.9	4.4	3.9
EV/EBITDA	15.6	13.7	12.5	11.5	10.3
P/E	24.7	21.5	17.8	16.6	15.2
P/BV	5.2	4.6	4.3	4.0	3.8
Return ratios (%)					
RoCE	21.6	22.1	24.1	24.0	24.8
RoE	22.3	22.8	24.9	24.7	25.5
Profitability ratios (%)					
Gross margin	59.1	59.6	60.4	60.7	60.9
EBITDA margin	38.3	38.5	38.8	37.7	37.7
EBIT margin	35.5	35.6	35.5	34.9	34.9
PAT margin	25.3	26.3	29.4	28.7	28.7
Liquidity ratios (%)					
Current	2.0	2.2	2.1	2.1	2.1
Quick	1.2	1.4	1.4	1.4	1.4
Solvency ratio (%)					
Debt-to-equity	0.0	0.0	0.0	0.0	0.0
Turnover ratios					
Total asset turnover (x)	0.8	0.7	0.7	0.8	0.8
Fixed asset turnover (x)	2.6	2.4	2.5	2.7	2.9
Inventory days	126	120	120	116	116
Debtor days	21	25	30	32	32
Creditor days	59	53	58	59	59

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
13 March 2018	Accumulate	270	290
17 May 2018	Accumulate	286	290
27 July 2018	Accumulate	287	300
29 October 2018	Accumulate	281	310
24 January 2019	Accumulate	277	310
9 April 2019	Accumulate	292	320
14 May 2019	Accumulate	289	320
5 August 2019	Accumulate	264	300
25 October 2019	Buy	249	300
1 February 2020	Buy	235	285
3 February 2020	Buy	219	260

Rating chart



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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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