

Re-strategising capital allocation...

ITC has declared its dividend policy, increasing its payout to 80-85% of earnings. Moreover, it is expected to pay out a special dividend along with its fourth quarter results. The company is holding cash & investments of ~₹ 16000 crore as on September 2020. We believe the company could pay 50% of its cash & investments as special dividend, which translates to dividend per share of ₹ 6 /share. This, along with the 80% payout, is expected to result in dividend of ₹ 16/share and a dividend yield of 10%. Even without this, special dividend yield is at 7%. Currently, the stock is trading at 10x FY22E earnings.

FMCG margins to witness significant improvement

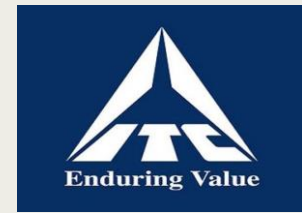
The company has witnessed operating margin (EBITDA) improvement in the FMCG segment from 4.2% in Q3FY18 to 7.7% in Q3FY20. With the strong distribution network of ~6.0 million outlets along with the robust & wide food portfolio, we expect margins to further improve to double digits in the next four to five quarters. Given the continuous improvement in FMCG margins along with sustainable growth, it would start contributing to earnings. The company has a vision of reaching 1.0 lakh crore FMCG sales by 2030. Though we believe the company would witness sustainable growth in the next decade, it would still be dependent on acquisitions to reach this ambitious milestone.

Cigarettes margins to improve

With the excise duty increase in Budget 2020, the company has taken a hike of 12-20%. This hike would pass on the entire excise increase in Budget but would also improve the margins of the cigarette business. Though we believe the company would witness lower volume growth in FY21E, it would be able to increase the operating margins of the cigarettes segment. The biggest challenge for the cigarettes industry remains the illicit cigarettes market, which is contributing more than 25% of industry volumes. Moreover, smaller peers of the company have also gained market share at the expense of ITC in the last two years.

Valuation & Outlook

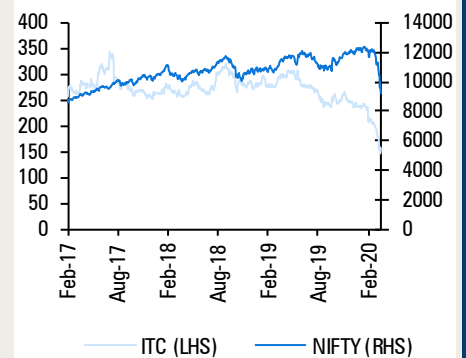
In the recent market fall, ITC witnessed a significant correction of ~30%. At the current price, the stock is trading at 11x & 10x its FY20E & FY21E earnings. Though the current economic conditions would have an adverse impact on ITC's earnings for a quarter or two, we believe the company would be able to sustain the earnings growth in the long run backed by improvement in cigarettes as well as FMCG segments. Moreover, with the recent change in dividend policy, the stock is trading at attractive dividend yield (on account of dividend policy & special dividend). We value the stock at sum of the part valuation method (valuing cigarettes business at 14x FY22 earnings, FMCG at 5x price to sales) and arrive at a target price of ₹ 230 per share with a **BUY** recommendation.



Particulars

Particulars (₹ crore)	Amount
Market Capitalization	191,928.9
Total Debt (FY19)	7.9
Cash and Investments (FY19)	16,275.3
EV	175,661.5
52 week H/L (₹)	310 / 216
Equity capital	1,225.9
Face value (₹)	1.0

Key Highlights



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Key Financial Summary

Key Financials	FY18	FY19	FY20E	FY21E	FY22E	CAGR (FY19-22E)
Net Sales	40254.7	44432.7	47764.2	52050.3	56893.2	8.6%
EBITDA	15541.0	17305.5	18625.7	20656.6	23145.5	10.2%
EBITDA Margin %	38.6	38.9	39.0	39.7	40.7	
Net Profit	11223.3	12464.3	15535.7	16666.0	18779.0	14.6%
EPS (₹)	9.24	10.26	12.79	13.72	15.46	
P/E	17.1	15.4	12.4	11.5	10.2	
RoNW %	21.3	21.5	24.1	23.0	23.2	
RoCE (%)	30.9	30.8	30.4	30.0	30.3	

Financial summary

Exhibit 1: Profit and loss statement				
	₹ crore			
(Year-end March)	FY19	FY20E	FY21E	FY22E
Total operating income	44,995.7	48,270.9	52,643.1	57,586.8
Growth (%)	10.8	7.3	9.1	9.4
Raw Material Expenses	17,305.2	18,017.1	20,162.9	21,571.6
Employee Expenses	2,728.4	2,803.4	3,280.0	3,570.1
Marketing Expenses	976.5	975.1	1,058.0	1,151.7
Administrative Expenses	4,518.4	1,852.7	1,825.1	1,986.6
Excise Duty	788.7	788.7	788.7	788.7
Other expenses	2,161.6	5,996.9	5,660.6	6,161.4
Total Operating Expenditure	27,690.1	29,645.2	31,986.5	34,441.3
EBITDA	17,305.5	18,625.7	20,656.6	23,145.5
Growth (%)	11.4	7.6	10.9	12.0
Depreciation	1,311.7	1,569.1	1,526.4	1,646.4
Interest	34.2	59.0	58.0	56.5
Other Income	2,484.5	3,310.8	3,208.6	3,663.0
PBT	18,444.2	20,176.2	22,280.7	25,105.6
Total Tax	5,979.8	4,640.5	5,614.7	6,326.6
PAT	12,464.3	15,535.7	16,666.0	18,779.0
Growth (%)	11.1	24.6	7.3	12.7
EPS (₹)	10.3	12.8	13.7	15.5

Source: Company, ICICI Direct Research

Exhibit 2: Cash flow statement				
	₹ crore			
(Year-end March)	FY19	FY20E	FY21E	FY22E
Profit After Tax	12,958.3	15,535.7	16,666.0	18,779.0
Add: Depreciation	1,311.7	1,569.1	1,526.4	1,646.4
(Inc)/dec in Current Assets	-1,048.8	-2,340.2	-2,525.2	-3,632.6
Inc/(dec) in CL and Provisions	549.1	351.0	181.9	9.6
CF from operating activities	11,749.1	15,115.5	15,849.1	16,802.4
(Inc)/dec in Investments	0.0	-977.5	-2,063.4	-2,371.6
(Inc)/dec in LT loans & advances	0.0	-50.0	0.0	0.0
(Inc)/dec in Fixed Assets	-2,759.5	-5,149.2	-3,020.0	-3,520.0
Others	0.0	0.0	0.0	0.0
CF from investing activities	-5,081.8	-6,276.7	-5,183.4	-5,991.6
Issue/(Buy back) of Equity	5.4	0.0	0.0	0.0
Inc/(dec) in loan funds	-6.9	10.0	10.0	10.0
Dividend paid & dividend tax	-7,486.9	-8,497.2	-9,346.9	-10,281.6
Others	0.0	55.0	12.3	25.4
CF from financing activities	-5,493.4	-8,432.2	-9,324.6	-10,246.3
Net Cash flow	1,173.9	406.6	1,341.1	564.6
Opening Cash	95.9	1,269.8	1,676.4	3,017.5
Cash with Bank	2,498.9	2,498.9	2,498.9	2,498.9
Closing Cash	3,768.7	4,175.3	5,516.4	6,081.0

Source: Company, ICICI Direct Research

Exhibit 3: Balance sheet				
	₹ crore			
(Year-end March)	FY19	FY20E	FY21E	FY22E
Liabilities				
Equity Capital	1,225.9	1,225.9	1,225.9	1,225.9
Reserve and Surplus	56,723.9	63,762.4	71,081.5	79,578.9
Total Shareholders funds	57,949.8	64,988.3	72,307.4	80,804.7
LT Borrowings & Provisions	7.9	17.9	27.9	37.9
Deferred Tax Liability	2,044.1	2,044.1	2,044.1	2,044.1
Others Non-current Liabilities	174.5	229.5	241.9	267.2
Total Liabilities	60,176.4	67,279.9	74,621.3	83,154.0
Assets				
Gross Block	32,259.3	35,660.7	38,160.7	41,160.7
Less: Acc Depreciation	11,684.4	13,253.5	14,779.9	16,426.4
Net Block	20,574.9	22,407.1	23,380.7	24,734.3
Capital WIP	3,401.4	2,500.0	3,000.0	3,500.0
Net Intangible Assets	540.8	560.8	580.8	600.8
Non-current Investments	14,071.5	15,049.0	17,112.4	19,484.0
LT loans & advances	6.2	56.2	56.2	56.2
Current Assets				
Inventory	7,587.2	7,851.6	8,556.2	9,352.3
Debtors	3,646.2	3,925.8	4,278.1	4,676.2
Loans and Advances	5.0	5.4	5.9	6.4
Other Current Assets	2,055.2	2,617.2	2,852.1	3,117.4
Cash	3,768.7	4,175.3	5,516.4	6,081.0
Current Investments	12,506.6	13,740.4	14,973.4	17,145.9
Current Liabilities	9,621.6	9,972.6	10,154.4	10,164.0
Creditors	3,368.3	3,402.4	3,707.7	3,896.8
Provisions	25.2	27.1	29.6	32.3
Short term debt & other CL	6,228.0	6,543.0	6,417.2	6,234.9
Application of Funds	60,176.4	67,279.9	74,621.3	83,154.0

Source: Company, ICICI Direct Research

Exhibit 4: Key ratios				
	₹ crore			
(Year-end March)	FY19	FY20E	FY21E	FY22E
Per share data (₹)				
EPS	10.3	12.8	13.7	15.5
Cash EPS	11.3	14.1	15.0	16.8
BV	47.7	53.5	59.5	66.5
DPS	5.8	6.3	7.0	7.7
Cash Per Share	3.1	3.4	4.5	5.0
Operating Ratios (%)				
EBITDA Margin	38.5	38.6	39.2	40.2
PBT / Total Operating income	41.0	42.1	42.3	43.6
PAT Margin	27.7	32.2	31.7	32.6
Inventory days	62.3	60.0	60.0	60.0
Debtor days	30.0	30.0	30.0	30.0
Creditor days	27.7	26.0	26.0	25.0
Return Ratios (%)				
RoE	21.5	24.1	23.0	23.2
RoCE	30.8	30.4	30.0	30.3
RoIC	29.5	29.3	29.9	29.9
Valuation Ratios (x)				
P/E	15.4	12.4	11.5	10.2
EV / EBITDA	10.9	10.1	9.0	8.0
EV / Net Sales	4.2	3.9	3.6	3.3
Market Cap / Sales	4.3	4.0	3.7	3.4
Price to Book Value	3.3	3.0	2.7	2.4
Solvency Ratios				
Debt/EBITDA	0.0	0.0	0.0	0.0
Debt / Equity	0.0	0.0	0.0	0.0
Current Ratio	2.7	2.8	3.0	3.4
Quick Ratio	1.9	2.0	2.2	2.5

Source: Company, ICICI Direct Research

Exhibit 5: ICICI Direct coverage universe (FMCG)

Sector / Company	CMP	TP	M Cap	EPS (₹)			P/E (x)			Price/Sales (x)			RoCE (%)			RoE (%)			
	(₹)	(₹) Rating		(₹ Cr)	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Colgate (COLPAL)	1,122	1,430	Hold	36,990	28.5	30.6	32.6	39.3	36.6	34.4	8.3	8.0	7.4	70.7	75.5	82.9	52.2	59.7	65.1
Dabur India (DABIND)	423	550	Buy	84,312	8.2	9.3	10.3	51.7	45.6	41.1	9.9	9.0	8.2	29.6	29.9	30.0	25.7	26.8	26.7
GSK CH (GLACON)	8,053	8,780	Hold	35,327	233.7	272.5	N.A.	34.5	29.6	N.A.	7.4	6.8	N.A.	36.1	32.6	N.A.	24.0	24.8	N.A.
Hindustan Unilever (HINLEV)	1,845	2,150	Hold	448,200	27.9	33.6	37.0	66.0	54.8	49.8	11.9	11.1	9.8	85.3	105.8	115.0	80.9	90.6	100.3
ITC Limited (ITC)	158	230	Buy	191,929	10.3	12.8	13.7	15.4	12.4	11.5	4.3	4.0	3.7	30.8	30.4	30.0	21.5	24.1	23.0
Jyothy Lab (JYOLAB)	94	185	Hold	6,363	5.3	5.9	6.5	17.7	15.9	14.4	3.6	3.3	3.0	28.6	28.5	30.6	22.6	22.4	23.5
Marico (MARLIM)	250	350	Hold	40,641	8.8	8.4	8.7	28.4	29.9	28.6	5.5	5.4	4.9	38.0	41.2	41.9	31.6	33.9	34.4
Nestle (NESIND)	13,150	18,000	Hold	159,093	166.7	204.3	242.4	78.9	64.4	54.2	14.2	12.9	11.4	42.9	56.9	61.0	45.6	101.9	113.3
Tata Global Bev (TATGLO)	256	450	Buy	24,613	7.2	8.0	9.5	35.4	32.2	26.9	3.4	3.3	2.4	8.4	8.7	8.6	6.5	6.8	6.5
VST Industries (VSTIND)	3,373	5,200	Buy	6,949	146.9	198.4	218.4	23.0	17.0	15.4	6.3	5.5	5.1	51.4	53.6	50.2	34.2	38.8	37.0
Varun Beverage (VARBEV)	655	950	Buy	23,427	11.7	16.4	16.6	55.9	39.9	39.4	5.9	4.6	3.3	12.7	14.2	15.5	12.1	15.0	14.2

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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