

Margins came below expected
Summary

ITC Limited (ITC) result was below our expectations. Overall revenue reached pre-covid levels. FMCG: others continues to grow at strong double digit driven by positive tailwind in health, hygiene and food portfolio. Revenue from Cigarettes grew at 4%YoY (vs -4% in 2QFY21). Recovery in Hotel business remained below expected; revenue stood at 43% of 3QFY20. However, ITC turned EBITDA positive on Hotels segment during Dec'20. Agri Business also grew at 18% driven by trading opportunities in rice, soya and wheat for Aashivad atta. Revenue from Paper segment continues to decline driven by subdued demand in domestic market. On margins; except FMCG-non-cigarette business, all other segments witnessed margin decline YoY. We have adjusted our EPS estimates downwards by 8% in FY21E, and 5% in FY22E and FY23E driven by slower than expected recovery in hotel business and decline in overall profitability in cigarettes. We maintain our BUY rating due to in-expensive valuation with TP of Rs276 (prev TP Rs295).

Key Highlights and Investment Rationale
Business recovery reaches pre-covid levels; cigarettes back on growth track

Overall revenue reached pre-covid levels driven by strong growth in branded FMCG (+11% LTL), Agri business (+ 18% YoY) and cigarette (+4% YoY). Positively, cigarette business (41% of revenue & 71% of EBIT) is back on growth trajectory after 3 consecutive quarters of decline. Hotel business continues to be severely impacted by COVID; revenue stands at 43% of 3QFY20. Revenue from paperboard & packaging declined 5%YoY (vs 7% decline in 2QFY21).

Operating profit margin declines

Gross margin contracted 402bp to 57.5% (3rd consecutive quarter of contraction) while EBITDA margin witnessed 200bp contraction to 36%. Decline in margins was led by EBIT loss in Hotel Business Rs0.6bn (due to negative operating leverage) followed by 793bp contraction in EBIT margin of Cigarette business. EBIT margin of Agri and Paper Board business also declined by 229bp and 218bp YoY respectively. EBIT margin of branded FMCG segment expanded 257bp to 5.8%.

Revise estimates downwards; maintain BUY

We have adjusted our EPS estimates for FY21-23E downward by 5-8% due to slower recovery in hotel and lower than expected margins in cigarettes. We maintain our BUY rating on the stock with a revised TP of Rs 276 (20x FY23E).

TP	Rs276
CMP	Rs226
Potential upside / downside	+22%
Previous Rating	BUY

V/s Consensus

	EPS (Rs)	FY21E	FY22E	FY23E
IDBI Capital	10.5	12.6	13.8	
Consensus	10.9	12.9	14.1	
% difference	(3.4)	(2.5)	(2.3)	

Shareholding Pattern (%)

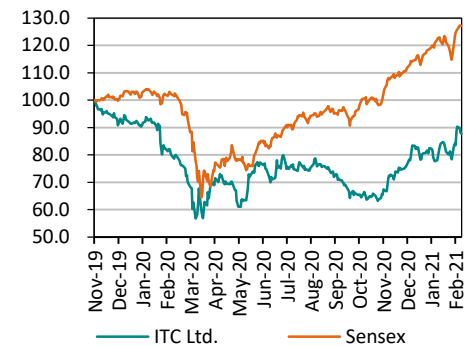
Promoters	0.0
FII	13.3
DII	38.9
Public	47.8

Price Performance (%)

	-1m	-3m	-12m
Absolute	11.9	22.2	6.5
Rel to Sensex	7.3	4.0	(18.6)

Key Stock Data

Bloomberg / Reuters	ITC IN / ITC.BO
Sector	FMCG
Shares o/s (mn)	12,305
Market cap. (Rs mn)	27,86,549
Market cap. (US\$ mn)	38,245
3-m daily average value (Rs mn)	4,704.6
52-week high / low	Rs 239 / 135
Sensex / Nifty	51,532 / 15,173

Relative to Sensex (%)

Financial snapshot

Year	FY19	FY20	FY21E	FY22E	FY23E
Revenue	4,57,844	4,56,197	4,40,702	5,15,513	5,67,338
EBITDA	1,73,055	1,79,044	1,55,421	1,92,794	2,12,800
EBITDA (%)	37.8	39.2	35.3	37.4	37.5
Adj. PAT	1,24,643	1,51,362	1,28,944	1,55,004	1,70,021
EPS (Rs)	10.2	12.3	10.5	12.6	13.8
EPS Growth (%)	10.4	21.2	(14.8)	20.2	9.7
PE (x)	22.3	18.4	21.6	17.9	16.4
Dividend Yield (%)	2.3	2.5	3.7	4.6	5.0
EV/EBITDA (x)	15.8	15.2	17.3	13.9	12.5
RoE (%)	22.8	24.8	19.7	22.8	24.0
RoCE (%)	28.1	25.9	20.7	24.9	26.4

Source: Company; IDBI Capital Research

Key takeaway from Press release

Cigarette Business

- Company witnessed strong sequential recovery aided by progressive easing of lockdown. Metros and large towns saw smart recovery after a soft H1.
- Launched innovative variants such as ‘Gold Flake Neo’ in a new format, ‘Classic Connect’, ‘American Club Clove Mint’, ‘Gold Flake Indie Mint’ and ‘Capstan Fresh Flavour’ in recent months to cater to consumer preference and reinforce market standing
- ITC has strengthened direct reach in target markets across all traditional channels and augmented stockist network in rural/semi-urban markets.

FMCG: Others

- Surge in demand for staples and convenience foods witnessed during the lockdown phase ebbed during the quarter with consumers broadening their purchase assortment and lower ‘at-home’ consumption on the back of increased mobility.
- On YTD basis, Staples, convenience food, health & hygiene products (~75% of revenue) grew by 23% whereas discretionary/OOH products (~25% of portfolio) declined by 5%. In Q3FY21, both the segments grew by 11% YoY.
- Market and outlet coverage has increased by 1.3x and 1.1x respectively compared to pre-covid levels. Direct to market shipment have been scaled up to ensure freshness and reduced time-to-market in categories like atta, snacks and biscuits.
- Ecommerce sales doubled during the quarter, with its contribution to segment revenue standing at 5%. The Modern Trade channel, staged a strong recovery after a soft H1. Sales in rural markets remained strong while urban markets witnessed progressive improvement aided by increased mobility and easing of restrictions.
- The company launched +100 products in 9MFY21.

Hotel business

- Hotel revenue witnessed progressive recovery aided by higher RevPar and F&B business across most locations. The segment turned EBITDA positive in Dec’20 and break-even for the quarter.
- Wedding business, staycations/motorable getaways were the key drivers besides healthcare/quarantine related business.

- Aggressive cost reduction measures led to ~44% reduction in controllable cash fixed costs. Hotel EBIT witnessed significant sequential recovery (3x Q2), however still remains below pre-covid levels.

Agri-Business

- Revenue growth was led by higher wheat supplies for Ashirvaad atta and trading opportunities in rice, soya and wheat exports.
- Leaf exports impacted by subdued demand in international markets. Adverse business mix impacted segmental margins.
- Exports of Value added spices to Food Safe Markets continue to gain strong traction.

Paperboard, paper & packaging

- Paperboards and Specialty Papers business recorded strong recovery in volumes with exports continuing to grow at a rapid pace. Softer realizations weighed on revenue growth.
- Consumer off take continued to improve across most major end user segments in paperboards barring publication, notebooks and wedding cards. Specialty papers witnessed strong growth driven by pharma and décor segments.
- The cartons segment of the Packaging and Printing Business recorded robust growth led by exports.
- Higher operational efficiencies partially mitigate impact of softer realizations, negative operating leverage and adverse business mix

Exhibit 1: Standalone Quarterly Snapshot

(INR m)	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	YTD FY21	YTD FY20	YoY (%)
Revenues	1,17,874	1,18,056	-0.2	1,11,831	5.4	3,18,818	3,47,774	-8.3
COGS	50,131	45,465	10.3	47,370	5.8	1,36,969	1,31,681	4.0
Gross profit	67,743	72,592	-6.7	64,461	5.1	1,81,849	2,16,094	-15.8
<i>Gross Margin (%)</i>	<i>57.5</i>	<i>61.5</i>	<i>-402 bps</i>	<i>57.6</i>	<i>-17 bps</i>	<i>57.0</i>	<i>62.1</i>	<i>-510 bps</i>
Employee expenses	7,201	6,691	7.6	6,610	8.9	20,780	19,917	4.3
<i>% of net sales</i>	<i>6.1</i>	<i>5.7</i>	<i>44 bps</i>	<i>5.9</i>	<i>20 bps</i>	<i>6.5</i>	<i>5.7</i>	<i>79 bps</i>
Other Expenses	17,729	19,774	-10.3	17,245	2.8	51,183	58,770	-12.9
<i>% of net sales</i>	<i>15.0</i>	<i>16.7</i>	<i>-171 bps</i>	<i>15.4</i>	<i>-38 bps</i>	<i>16.1</i>	<i>16.9</i>	<i>-84 bps</i>
EBITDA	42,814	46,127	-7.2	40,606	5.4	1,09,886	1,37,407	-20.0
<i>EBITDA Margin (%)</i>	<i>36.3</i>	<i>39.1</i>	<i>-275 bps</i>	<i>36.3</i>	<i>1 bps</i>	<i>34.5</i>	<i>39.5</i>	<i>-504 bps</i>
Depreciation	3,909	4,162	-6.1	3,825	2.2	11,716	11,708	0.1
EBIT	38,904	41,965	-7.3	36,781	5.77	98,170	1,25,700	-21.9
Other Income	9,710	9,836	-1.3	6,100	59.2	24,778	22,581	9.7
Interest Expenses	138	124	10.8	138	0.1	443	410	8.1
PBT	48,476	51,676	-6.2	42,743	13.4	1,22,504	1,47,871	-17.2
Taxes	11,848	8,936		10,419		30,124	33,160	
Adjusted PAT	36,629	42,740	-14.3	32,324	13.3	92,380	1,14,711	-19.5
Extra-ordinary items	0	-1,321		0		0	-1,321	
Reported PAT	36,629	41,419	-11.6	32,324	13.3	92,380	1,13,390	-18.5
EPS	2.98	3.37	-11.6	2.63	13.3	7.5	9.2	-18.6

Source: Company; IDBI Capital Research

Exhibit 2: Standalone Quarterly Snapshot

Segmental Revenue	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	YTD FY21	YTD FY20	YoY (%)
FMCG: Cigarette	54,984	53,110	3.5	51,213	7.4	1,44,735	1,60,712	-9.9
FMCG: Others	35,618	33,123	7.5	37,950	-6.1	1,07,314	96,607	11.1
Hotels	2,352	5,523	-57.4	820	187.0	3,397	13,715	-75.2
Agri business	24,818	20,947	18.5	29,853	-16.9	92,133	83,535	10.3
Paperboard, paper & packaging	14,775	15,554	-5.0	14,583	1.3	39,622	46,483	-14.8
Total	1,32,548	1,28,257	3.3	1,34,417	-1.4	3,87,202	4,01,052	-3.5
Less: Inter segment revenue	7,631	9,135		15,502		49,014	50,815	
Total revenue	1,24,916	1,19,122	4.9	1,18,915	5.0	3,38,187	3,50,237	-3.4
Segmental EBIT	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	YTD FY21	YTD FY20	YoY (%)
FMCG: Cigarette	34,528	37,560	-8.1	32,448	6.4	56,012	76,936	-27.2
FMCG: Others	2,074	1,076	92.7	2,527	-17.9	3,781	1,685	124.4
Hotels	-673	873	-177.1	-1,849	-63.6	-4,275	278	-1636.6
Agri business	1,961	2,134	-8.1	2,561	-23.4	4,348	4,524	-3.9
Paperboard, paper & packaging	2,850	3,340	-14.7	3,303	-13.7	4,904	6,857	-28.5
Segmental Margins	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	YTD FY21	YTD FY20	YoY (%)
FMCG: Cigarette	62.8%	70.7%	-793 bps	63.4%	-56 bps	38.7%	47.9%	-917 bps
FMCG: Others	5.8%	3.2%	257 bps	6.7%	-84 bps	3.5%	1.7%	178 bps
Hotels	-28.6%	15.8%	-4444 bps	-225.6%	19697 bps	-125.8%	2.0%	-12785 bps
Agri business	7.9%	10.2%	-229 bps	8.6%	-68 bps	4.7%	5.4%	-70 bps
Paperboard, paper & packaging	19.3%	21.5%	-218 bps	22.6%	-336 bps	12.4%	14.8%	-237 bps

Source: Company; IDBI Capital Research

Exhibit 3: Actual vs. Estimates

(Rs mn)

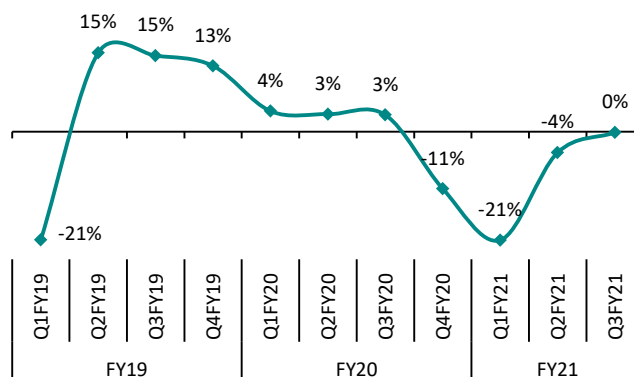
Particulars	Actual	IDBI Estimate	% variation IDBI
Revenue	1,17,874	1,21,191	-2.7%
EBITDA	42,814	46,659	-8.2%
Margin (%)	36.3%	38.5%	
PAT	36,629	36,597	0.1%

Source: Company; IDBI Capital Research

Exhibit 4: Change in estimates

	FY21E			FY22E			FY23E		
	Old	New	(%) Chg	Old	New	(%) Chg	Old	New	(%) Chg
Revenue (Rs mn)	4,69,876	4,40,702	-6.2	5,32,293	5,15,513	-3.2	5,85,973	5,67,338	-3.2
EBITDA (Rs mn)	1,73,362	1,55,421	-10.3	2,03,826	1,92,794	-5.4	2,24,937	2,12,800	-5.4
EBITDA margin (%)	36.9	35.3		38.3	37.4		38.4	37.5	
Net profit (Rs mn)	1,40,288	1,28,944	-8.1	1,63,120	1,55,004	-5.0	1,78,906	1,70,021	-5.0
EPS (Rs)	11.4	10.5	-8.1	13.3	12.6	-5.0	15	14	-5.0

Source: Company; IDBI Capital Research

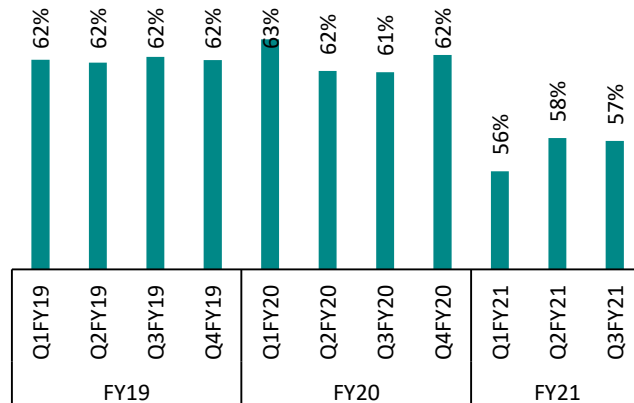
Exhibit 5: Revenue growth trend (% YoY)


Source: Company; IDBI Capital Research

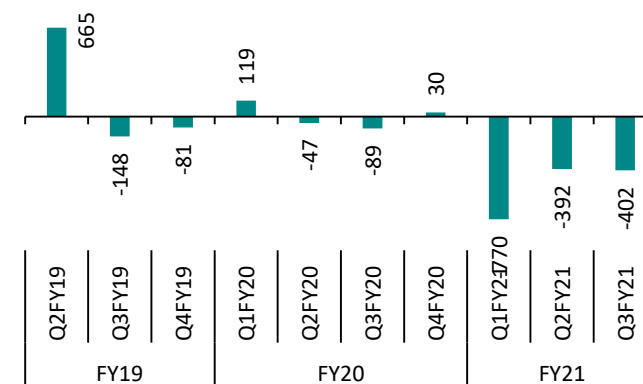
Exhibit 6: Segmental revenue growth trend

Revenue growth (%YoY)	FMCG:Cigarette	FMCG: Others	Hotel	Agribusiness	Paperboard, paper and packaging
Q1FY20	6%	7%	15%	15%	13%
Q2FY20	6%	4%	18%	19%	10%
Q3FY20	5%	3%	22%	9%	1%
Q4FY20	-6%	-3%	-9%	-10%	-5%
Q1FY21	-29%	10%	-94%	4%	-33%
Q2FY21	-4%	15%	-81%	13%	-7%
Q3FY21	4%	8%	-57%	18%	-5%

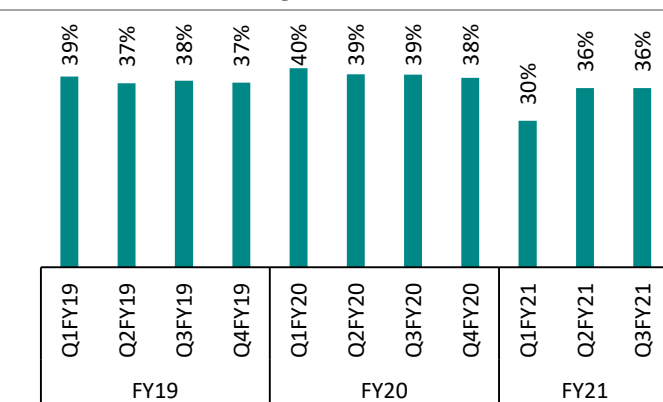
Source: Company; IDBI Capital Research

Exhibit 7: Gross Margin (%)


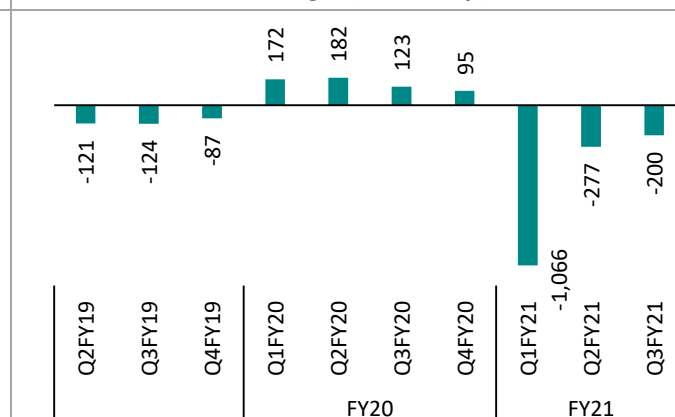
Source: Company; IDBI Capital Research

Exhibit 8: Gross Margin (YoY in bp)


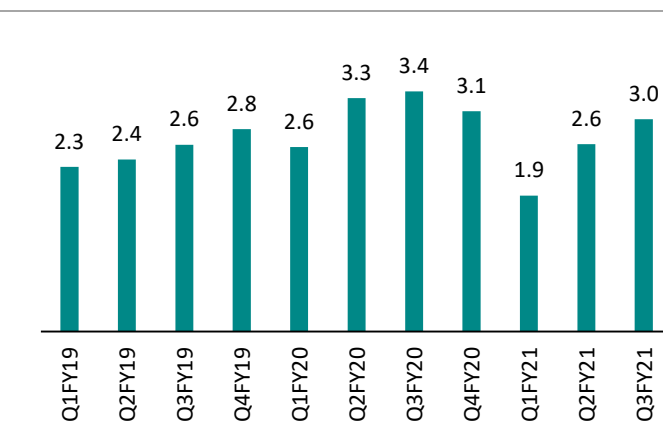
Source: Company; IDBI Capital Research

Exhibit 9: EBITDA Margin (%)


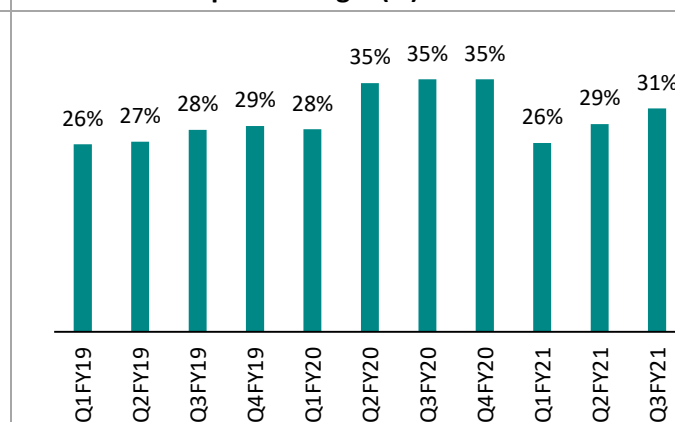
Source: Company; IDBI Capital Research

Exhibit 10: EBITDA Margin (YoY in bp)


Source: Company; IDBI Capital Research

Exhibit 11: EPS trend


Source: Company; IDBI Capital Research

Exhibit 12: Net profit Margin (%)


Source: Company; IDBI Capital Research

Financial Summary

Profit & Loss Account (Rs mn)

Year-end: March	FY20	FY21E	FY22E	FY23E
Net sales	456,197	4,40,702	5,15,513	5,67,338
<i>growth (%)</i>	<i>(0.4)</i>	<i>(3.4)</i>	<i>17.0</i>	<i>10.1</i>
Operating expenses	(277,153)	(2,85,281)	(3,22,719)	(3,54,538)
EBITDA	179,044	1,55,421	1,92,794	2,12,800
<i>growth (%)</i>	<i>3.5</i>	<i>-13.2</i>	<i>24.0</i>	<i>10.4</i>
Depreciation	(15,633)	(15,692)	(18,180)	(19,741)
EBIT	163,411	1,39,728	1,74,614	1,93,060
Interest paid	(557)	(585)	(614)	(645)
Other income	30,137	31,643	33,226	34,887
Pre-tax profit	192,990	1,70,787	2,07,225	2,27,301
Tax	(40,308)	(41,843)	(52,221)	(57,280)
<i>Effective tax rate (%)</i>	<i>20.9</i>	<i>24.5</i>	<i>25.2</i>	<i>25.2</i>
Minority Interest	-	-	-	-
Net profit	152,683	1,28,944	1,55,004	1,70,021
Exceptional items	1,321	-	-	-
Adjusted net profit	151,362	1,28,944	1,55,004	1,70,021
<i>growth (%)</i>	<i>21.4</i>	<i>(14.8)</i>	<i>20.2</i>	<i>9.7</i>
<i>Shares o/s (mn nos)</i>	<i>12,287</i>	<i>12,287</i>	<i>12,287</i>	<i>12,287</i>

Cash Flow Statement (Rs mn)

Year-end: March	FY20	FY21E	FY22E	FY23E
Pre-tax profit	191,669	1,70,787	2,07,225	2,27,301
Depreciation	15,633	15,692	18,180	19,741
Tax paid	(46,501)	(41,843)	(52,221)	(57,280)
Chg in working capital	4,180	4,411	(10,597)	(7,341)
Other operating activities	(26,919)	585	614	645
Cash flow from operations (a)	138,062	1,49,632	1,63,202	1,83,067
Capital expenditure	(21,404)	(18,706)	(22,602)	(24,769)
Chg in investments	(39,275)	-	-	-
Other investing activities	5,511	-	-	-
Cash flow from investing (b)	(55,167)	(18,706)	(22,602)	(24,769)
Equity raised/(repaid)	6,253	-	-	-
Debt raised/(repaid)	-	-	-	-
Dividend (incl. tax)	(70,487)	(1,03,155)	(1,27,104)	(1,39,418)
Chg in minorities	-	-	-	-
Other financing activities	(14,675)	(585)	(614)	(645)
Cash flow from financing (c)	(78,909)	(1,03,740)	(1,27,718)	(1,40,063)
Net chg in cash (a+b+c)	3,986	27,185	12,882	18,235

Balance Sheet

(Rs mn)

Year-end: March	FY20	FY21E	FY22E	FY23E
Net fixed assets	222,322	2,25,336	2,29,758	2,34,786
Investments	138,410	1,38,410	1,38,410	1,38,410
Other non-curr assets	26,553	26,553	26,553	26,553
Current assets	365,069	3,85,976	4,14,989	4,44,399
Inventories	80,381	75,704	88,555	97,458
Sundry Debtors	20,920	19,318	22,598	24,870
Cash and Bank	68,433	95,618	1,08,501	1,26,736
Total assets	752,354	7,76,275	8,09,710	8,44,147
Shareholders' funds	640,292	6,66,080	6,93,981	7,24,585
Share capital	12,292	12,292	12,292	12,292
Reserves & surplus	627,999	6,53,788	6,81,689	7,12,293
Total Debt	56	56	56	56
Secured loans	56	56	56	56
Other liabilities	21,112	21,112	21,112	21,112
Curr Liab & prov	90,894	89,027	94,561	98,394
Current liabilities	89,715	87,847	93,381	97,215
Provisions	1,179	1,179	1,179	1,179
Total liabilities	112,062	1,10,194	1,15,728	1,19,562
Total equity & liab.	752,354	7,76,275	8,09,710	8,44,147
Book Value (Rs)	52	54	56	59

Source: Company; IDBI Capital Research

Financial Ratios

Year-end: March	FY20	FY21E	FY22E	FY23E
Adj. EPS (Rs)	12.3	10.5	12.6	13.8
Adj. EPS growth (%)	21.2	(14.8)	20.2	9.7
EBITDA margin (%)	39.2	35.3	37.4	37.5
Pre-tax margin (%)	42.3	38.8	40.2	40.1
ROE (%)	24.8	19.7	22.8	24.0
ROCE (%)	25.9	20.7	24.9	26.4
Turnover & Leverage ratios (x)				
Asset turnover (x)	0.6	0.6	0.7	0.7
Leverage factor (x)	1.2	1.2	1.2	1.2
Net margin (%)	33.2	29.3	30.1	30.0
Net Debt/Equity (x)	(0.1)	(0.1)	(0.2)	(0.2)
Working Capital & Liquidity ratio				
Inventory days	64	63	63	63
Receivable days	17	16	16	16
Payable days	45	42	43	43

Valuation

Year-end: March	FY20	FY21E	FY22E	FY23E
P/E (x)	18.4	21.6	17.9	16.4
Price / Book value (x)	4.3	4.2	4.0	3.8
PCE (x)	16.7	19.2	16.1	14.7
EV / Net sales (x)	5.9	6.1	5.2	4.7
EV / EBITDA (x)	15.2	17.3	13.9	12.5
Dividend Yield (%)	2.5	3.7	4.6	5.0



Notes

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Key to Ratings Stocks:

BUY: Absolute return of 15% and above; **ACCUMULATE:** 5% to 15%; **HOLD:** Upto $\pm 5\%$; **REDUCE:** -5% to -15%; **SELL:** -15% and below.

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