



In partnership. With trust.

ITC

Q1FY17 Result Update

“Healthy Operational Performance; Maintain BUY”

Sector: FMCG

CMP: ₹ 251

Recommendation: BUY

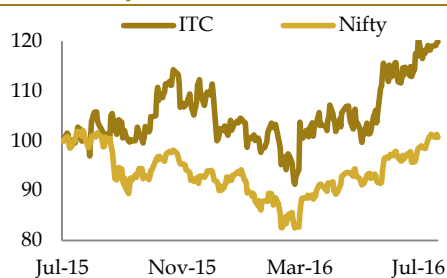
Market statistics

Current stock price (₹)	251
Shares O/S (cr.)	1207.1
Mcap (₹ cr)	302,495
52W H/L (₹)	260/178
6m avg. volume	13,296,228
Bloomberg	ITC IN

Shareholding pattern

Promoters	--
Domestic Institution	35.04
Foreign Institution	20.60
Non-institution	44.36
of which more than 1%	
Tobacco Manufacturers India Ltd	24.71
Life Insurance Corporation of India	14.37

ITC vs Nifty



Capital efficiency & valuations

Particulars	FY16	FY17E	FY18E
RoE (%)	29.2	29.2	30.5
RoCE (%)	42.9	43.0	44.1
P/B (x)	7.5	8.0	7.3
EV/OCF (x)	23.8	24.8	19.1
EV/EBITDA (x)	16.0	17.2	15.0
P/E (x)	25.6	27.5	23.9

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ITC, based on IND AS, has reported net sales growth of 8.3% YoY to ₹131.5bn - largely in-line with our expectation of 9%. Net sales for Cigarette, FMCG, Hotel, Agri and Paper business were at 6.4%, 9.5%, -0.2%, 20.2% & -1.6%, respectively.

Gross Margin contracted by 145bps YoY vs. our expectation of -10bps. Employee & Other expenses (% of sales) changed by 15bps & -163bps YoY. Hence, EBITDA Margin was marginally up by 2bps to 26.6% - lower expansion than our expectation. EBITDA grew by healthy 8.4% that was much better than the last 6 quarters average growth of 2.5% barring Q4FY16.

EBIT Margin for Cigarette, FMCG, Hotel, Agri and Paper business were up by 54bps, 18bps, 294bps, -156bps & -21bps YoY.

Higher other income (+18%) & lower interest cost (-3.4%) helped in better PAT performance of 10.1% to ₹23.8bn. Other comprehensive income was at ₹635mn in Q1FY17 vs. loss of ₹847mn in Q1FY16. Hence PAT (post other comprehensive income) has increased by 17.6% YoY to ₹24.5bn.

Cigarette growth was moderate with 6.4% growth, Cigarette EBIT Margins improves

ITC's cigarette net sales grew moderate by 6.4% in Q1FY17-much better than last 6 qtrs average of 2.5% barring Q4FY16. Cigarette volume growth improved to ~3% on account of base benefits. Cigarette sales have been under pressure in the last several quarters due to consistent excise & VAT hike, strong growth for illegal cigarette & more stringent rules for smoking in public places. Cigarette EBIT Margin improved by 50bps to 36.5%.

Non-Cigarette Sales up by 10.7%

ITC's non-Cigarette business grew by 10.7% driven by FMCG & Agribusiness healthy performance. FMCG business grew by 9.5%YoY despite weak environment. Packaged foods, Snacks & Meals, Confections business registered healthy growth while personal care business showed robust revenue growth despite facing price deflation in the category. Agribusiness continues to display robust growth of 20% largely due to favorable base of last year and healthy domestic agri commodity sales and leaf tobacco exports. Hotel business got adversely impacted and showed negative growth of 0.2% due to weak pricing scenario on back of high room inventory. Paper business too disappointed with negative growth of 1.6% impacted by subdued demand prevailing in FMCG & Cigarette industries & cheap imports from China. Non - Cigarette EBIT grew slow by 1.8% YoY.

RoCE Improves - 20% Addition in the Last 7 Years

ITC's RoCE has been consistently improving and has reached to 61% in FY15, +183bps YoY. In the last 7 years, ITC has added 20% RoCE largely added by Cigarette, FMCG and Agri-business. We expect improvement in overall RoCE for ITC on the anticipation of improvement in Non-Cigarette RoCE in the coming years.

Valuation & Outlook: Although ITC is a dominant player in cigarette business - with >75% market share - high increase in excise & VAT rate along with social & regulatory pressure has been impacting ITC's cigarette growth. However, cigarette growth has improved during Q1FY17 and we expect it would sustain in the coming quarters. However, we maintain our view that long term historical cigarette net sales growth (10-12%) would reduce to single digit growth going ahead. We expect ITC's non-cigarette business should pick-up gradually.

ITC is well placed as compared to HUL in the Large Cap FMCG space. Despite huge valuation difference of ~40% from HU. ITC's business has more scope for better operating performance in the coming years. ITC's FCF yield is ~4.5% as compared to <3% for HUL. Despite considering slow cigarette growth, ITC still trades at a P/E of 27.5x and 23.9x P/E of FY17 & FY18, respectively. **We maintain BUY rating.**



Segmental Performance

Segmental Analysis (IND AS)	Q1FY16	Q4FY16	Q1FY17	YoY Chg. (%)	FY16
Net Revenue (₹ mn)					
FMCG	99,109	112,562	106,158	7.1%	420,795
Cigarettes	77,334	85,455	82,306	6.4%	323,483
Others	21,775	27,108	23,852	9.5%	97,312
Hotels	2,878	3,630	2,874	-0.2%	12,862
Agribusiness	23,254	18,068	27,941	20.2%	74,569
Paperboards, Paper & Packaging	13,440	13,150	13,229	-1.6%	53,277
Total	138,681	147,410	150,201	8.3%	561,502
Less: Inter Segment Revenue (net)	17,177	7,086	18,634	8.5%	45,677
Total Net Sales	121,505	140,324	131,567	8.3%	515,825
EBIT (₹ mn)					
FMCG	27,731	30,894	30,001	8.2%	118,229
Cigarettes	27,811	30,186	30,046	8.0%	117,524
Others	(80)	708	(45)	-43.3%	705
Hotels	(73)	427	12	-116.8%	557
Agribusiness	2,339	1,703	2,373	1.5%	9,330
Paperboards, Paper & Packaging	2,544	2,030	2,477	-2.6%	9,076
Total	32,541	35,053	34,863	7.1%	137,192
Other un-allocable income (net)	(969)	(2,200)	(1,992)	105.6%	(7,360)
Total	33,510	37,253	36,855	10.0%	144,552
EBIT Margin (%)					
FMCG	28.0%	27.4%	28.3%	28bps	28.1%
Cigarettes	36.0%	35.3%	36.5%	54bps	36.3%
Others	-0.4%	2.6%	-0.2%	18bps	0.7%
Hotels	-2.5%	11.8%	0.4%	294bps	4.3%
Agribusiness	10.1%	9.4%	8.5%	-156bps	12.5%
Paperboards, Paper & Packaging	18.9%	15.4%	18.7%	-21bps	17.0%
Total	23.5%	23.8%	23.2%	-25bps	24.4%
Total (Net)	27.6%	26.5%	28.0%	43bps	28.0%

Cigarette Business - Moderate growth of 6.4% in Q1FY17

- ❖ Cigarette business grew moderately by 6.4% in Q1FY17 as industry volumes remain under pressure due to sharp increase in excise duty and intense regulatory pressures.
- ❖ Illegal trade continues to grow tremendously.
- ❖ EBIT Margin improved by 50bps to 36.5%.

FMCG Business - Healthy growth across all segments

- ❖ Although, sluggish demand persists; price deflation arising in personal care, ITC reported healthy sales growth of 9.5% YoY in FMCG segment
- ❖ EBIT Margin improved by 18bps as most categories witnessed margin expansion driven by higher scale of operations and product mix enrichment
- ❖ The Branded Packaged Foods Businesses posted healthy growth in revenue led by Staples, Snacks and Noodles categories despite sluggish demand conditions while in Staples, Snacks and Meals Business, 'Aashirvaad' Atta continued to perform well consolidating its leadership position across markets.
- ❖ The Personal Care Products Business posted robust revenue growth during the quarter driven by higher volumes and richer product mix.



Hotel Business – Disappointing Performance due to weak demand

- ❖ Hotel business continues to display slow growth of -0.2% due to weak demand and pricing scenario on back of excessive room inventory in domestic markets and sluggish macroeconomic environment both in India and key source markets.
- ❖ EBIT Margin improved to mere 0.4% due to challenging business context as afore stated and gestation costs of the recently commissioned ITC Grand Bharat, Gurgaon.

Agri-Business – Robust sales growth of 20% in Q1FY17

- ❖ Agribusiness sales improved in Q1FY17 due to high negative base of last year. Healthy growth in domestic agri commodities & leaf tobacco exports led the growth in the segment.
- ❖ EBIT Margin contracted by 156bps to 8.5% YoY
- ❖ The Business continues to provide strategic sourcing support to the Company's Cigarette business and leverage its deep rural linkages to source superior quality wheat, chip stock potato, spices and fruit pulp at competitive prices for the Branded Packaged Foods Businesses

Paper Business – Continue to face sales pressure

- ❖ Paper business remained muted due to slowdown in FMCG industry and legal Cigarette industry
- ❖ Zero duty imports under Free Trade Agreement with ASEAN countries and cheap imports from China along with capacity expansion / ramp-up by other industry players, continued to adversely impact the Paper and Paperboard industry.
- ❖ EBIT Margin declined by 21bps to 18.7% in Q1FY17



Result Highlights

Particulars (₹ mn) - (IND AS)	Q1FY16	Q4FY16	Q1FY17	YoY Chg. (%)	FY16
Net Sales	121,505	140,324	131,567	8.3%	515,825
Other Operating Income	822	1,064	964	17.3%	3,621
Total Income	122,327	141,388	132,531	8.3%	519,446
Total RM cost	37,413	35,672	42,455	13.5%	134,500
Gross profit	84,914	105,716	90,076	6.1%	384,946
Gross margin %	69.4%	74.8%	68.0%	-145bps	74.1%
Employee Expenses	6,275	5,514	7,003	11.6%	23,283
(% of Sales)	5.1%	3.9%	5.3%	15bps	4.5%
Excise Duty	30,726	43,821	31,990	4.1%	153,619
(% of Sales)	25.1%	31.0%	24.1%	-98bps	29.6%
Other Expenses	15,390	20,297	15,819	2.8%	70,865
(% of Sales)	12.6%	14.4%	11.9%	-64bps	13.6%
EBITDA	32,523	36,084	35,263	8.4%	137,179
EBITDA Margin %	26.6%	25.5%	26.6%	2bps	26.4%
Depreciation	2,576	2,543	2,613	1.4%	10,319
Other Income	3,565	3,712	4,205	18.0%	17,693
Interest	105	123	101	-3.4%	491
PBT	33,407	37,132	36,755	10.0%	144,062
Total tax	11,746	13,342	12,907	9.9%	50,949
Effective Tax Rate (%)	35%	36%	35%	-4bps	35%
Reported PAT	21,662	23,790	23,848	10.1%	93,113
Other comprehensive income	(848)	(2,491)	636	-175.0%	(665)
Total comprehensive income	20,814	21,299	24,484	17.6%	92,448



Consolidated Financials

Income Statement

Y/E Mar (₹ mn)	FY14	FY15	FY16	FY17E	FY18E
Net Revenues	349,847	384,333	390,669	432,544	479,861
% Growth	11.7	9.9	1.6	10.7	10.9
Raw Material	132,403	147,722	138,055	154,221	167,689
Staff	25,042	27,723	29,466	31,638	34,778
Other Expenses	64,978	70,659	75,941	82,898	91,808
Total Expenditures	222,423	246,104	243,461	268,758	294,275
EBITDA	127,424	138,229	147,207	163,786	185,586
% Growth	17.2	8.5	6.5	11.3	13.3
EBITDA Margins (%)	36.4	36.0	37.7	37.9	38.7
Other Income	13,033	16,580	19,089	19,575	21,787
Interest	64	910	830	681	572
Depreciation	9,649	10,279	11,134	11,723	12,549
Profit Before Tax	130,745	143,621	154,332	170,958	194,252
Provision for tax	40,609	45,964	53,720	59,507	66,046
Effective tax rate (%)	31.1	32.0	34.8	34.8	34.0
Reported PAT	89,143	96,632	99,116	109,722	126,210
% Growth	17.2	8.4	2.6	10.7	15.0
Adjusted Net Profit	89,143	96,632	99,116	109,722	126,210
% Growth	17.2	8.4	2.6	10.7	15.0

Balance Sheet

Y/E Mar (₹ mn)	FY14	FY15	FY16	FY17E	FY18E
Equity Share Capital	7,953	8,016	8,047	12,071	12,071
Reserves & surplus	264,416	309,339	331,597	363,965	401,197
Shareholders' funds	272,370	317,355	339,644	376,036	413,268
Minorities interests	2,030	2,251	2,623	4,438	6,526
Total Debt	1,191	1,034	937	679	679
Capital Employed	275,591	320,640	343,205	381,153	420,473
Net fixed assets	160,386	180,056	185,119	194,195	206,746
Cash & Cash Eq.	34,902	78,962	70,129	72,418	86,831
Net Other current assets	20,176	8,238	(5,472)	7,273	5,671
Investments	72,840	69,428	111,621	127,827	144,327
Net Deferred tax Assets	(12,715)	(16,042)	(18,205)	(20,559)	(23,102)
Total Assets	275,589	320,642	343,193	381,153	420,473



Cash Flow Statement

Y/E Mar (₹ mn)	FY14	FY15	FY16	FY17E	FY18E
Pre-tax profit	130,516	143,621	154,332	170,958	194,252
Depreciation	9,649	10,280	11,134	11,723	12,549
Total Tax Paid	(39,845)	(44,486)	(50,812)	(57,152)	(63,503)
Chg in working capital	(18,444)	312	(1,666)	(12,744)	1,602
Other operating activities	(8,441)	(11,294)	(14,207)	767	663
Cash flow from oper (a)	73,436	98,432	98,782	113,552	145,563
Capital Expenditure	(28,489)	(32,913)	(23,835)	(20,800)	(25,100)
Chg in investments	(9,495)	9,165	(34,379)	(16,206)	(16,500)
Other investing activities	5,444	(29,006)	18,558	-	-
Cash flow from inv.(b)	(32,541)	(52,754)	(39,657)	(37,005)	(41,600)
Free cash flow (a+b)	40,895	45,678	59,125	76,547	103,963
Equity raised/(repaid)	6,911	9,788	5,317	4,024	(0)
Debt raised/(repaid)	(92)	315	(127)	(258)	-
Interest paid	(477)	(161)	(324)	(681)	(572)
Dividend (incl. Tax)	(42,386)	(48,756)	(61,258)	(65,833)	(75,726)
Other financing activities	(5,171)	(7,796)	(1,300)	(11,521)	(13,252)
Cash flow from fin. (c)	(41,215)	(46,610)	(57,692)	(74,270)	(89,550)
Net chg in cash (a+b+c)	(320)	(932)	1,434	2,277	14,413

Key Ratios

Y/E Mar	FY14	FY15	FY16	FY17E	FY18E
Raw Material Cost/Sales (%)	37.8	38.4	35.3	35.7	34.9
Manpower Cost/Sales (%)	7.2	7.2	7.5	7.3	7.2
Operating & Other Cost/Sales (%)	18.6	18.4	19.4	19.2	19.1
Revenue Growth (%)	11.7	9.9	1.6	10.7	10.9
EBITDA Margins (%)	36.4	36.0	37.7	37.9	38.7
Net Income Margins (%)	25.5	25.1	25.4	25.4	26.3
ROCE (%)	46.2	43.1	42.9	43.0	44.1
ROE (%)	32.7	30.4	29.2	29.2	30.5

Valuation Parameters

Y/E Mar	FY14	FY15	FY16	FY17E	FY18E
EPS (₹.)	7.5	8.0	8.2	9.1	10.5
P/E (x)	31.5	27.4	25.6	27.5	23.9
BV (₹)	22.8	26.4	28.1	31.2	34.2
P/BV (x)	10.3	8.3	7.5	8.0	7.3
EV/EBITDA (x)	21.2	18.1	16.0	17.2	15.0
Fixed assets turnover ratio (x)	2.2	2.1	2.1	2.2	2.3
Net Debt/Equity (x)	(0.1)	(0.2)	(0.2)	(0.2)	(0.2)
EV/Sales	7.7	6.5	6.0	6.5	5.8



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