



ITC

Q4FY16 Result Update

“Improved performance; Risk-reward favorable”

Sector: FMCG

CMP: ₹ 330

Recommendation: BUY

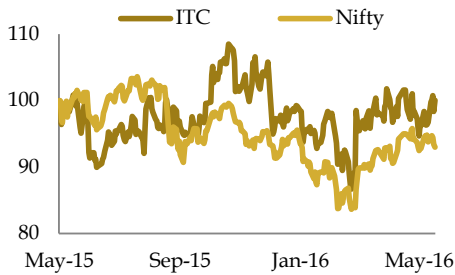
Market statistics

Current stock price (₹)	330
Shares O/S (cr.)	804.7
Mcap (₹ cr)	265,839
52W H/L (₹)	360/268
6m avg. volume	8,401,057
Bloomberg	ITC IN

Shareholding pattern

Promoters	--
Domestic Institution	35.25
Foreign Institution	20.49
Non-institution	44.26
of which more than 1%	
Tobacco Manufacturers India Ltd	24.73
Life Insurance Corporation of India	14.39

ITC vs Nifty



Capital efficiency & valuations

Particulars	FY16P	FY17E	FY18E
RoE (%)	29.5	30.6	32.0
RoCE (%)	43.1	44.5	45.8
P/B (x)	7.3	6.6	6.0
EV/OCF (x)	16.8	18.2	14.4
EV/EBITDA (x)	15.4	13.4	11.6
P/E (x)	24.7	21.7	18.7

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ITC performance improved during Q4FY16 after weak show in the last 5 qtrs. Revenue grew by healthy 9.4% YoY to ₹101.6bn as compared to our expectation of ₹98.6bn (+6.2% YoY). Cigarette & FMCG business reported 10.2% & 5.4% while Hotels & Papers remained displayed slow growth of 4.8% & 3.0%, respectively. Agribusiness which was de-growing during the last 5 quarters has shown robust growth of 26%. Non-cigarette business (57% of total sales) has also shown healthy 10.3% growth as compared to 3.6% contraction in 9MFY16.

Gross Margin expanded and registered 27bps YoY expansion to 60.9% (lower than our expectation was ~62%). Employee & other expenses contracted by 31bps & 78bps YoY, respectively and resulted into 136bps expansion in EBITDA Margin to 36.3% (in line with our expectation of 36.1%). PBT grew by 14.4% to ₹38.3bn (our expectation was ₹37.0). High taxes (ETR was 34.9% in Q4FY16 vs. 29.5% in Q4FY15) has impacted the PAT growth during the quarter. Reported PAT grew by mere 5.7% to ₹24.9bn - in-line with our expectation of ₹25.0bn.

Cigarette growth bounces back with 10% growth, Cigarette EBIT Margins improves

ITC's cigarette net sales grew healthy by 10.2% in Q4FY16-much better than last 5 qtrs average of 2%. Cigarette sales have been under pressure in the last several quarters due to consistent excise & VAT hike (75% & 165% during the last 3 years), strong growth for illegal cigarette & more stringent rules for smoking in public places. However, healthy come back in Q4FY16 is highly encouraging. Cigarette EBIT Margin improved by 73bps to 65.1%.

Non-Cigarette Sales & EBIT inched up by 10%

ITC's non-Cigarette business grew by 10.3% after posting negative growth in last 5 qtrs barring Q3FY16. Agribusiness showed positive surprise with robust growth of 26.5% largely due to high negative base of last year. However, Agri-segment is still facing challenging environment due to lack of trading opportunities in Wheat, Coffee & Soya. Hotel business continues to display slow growth of 4.8% due to weak pricing scenario on back of high room inventory. Paper business posted mere 3.0% growth despite low base benefits, impacted by weak demand from FMCG & Cigarette industries & cheap imports from China. Non - Cigarette EBIT grew healthy by 10.2%.

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: ITC's cigarette performance have been impacting in the last 6-8 quarters due to (1) Rise in indirect taxes & mandatory posting of large size health warnings on cigarette pack, (2) rising penalty on smoking in public places, (3) plans to ban loose cigarette sell at retail level and (4) increasing share of illegal cigarette. ITC underperformed Nifty by 2% in 1 Yr. while outperformed by 10% in the last 6M.

Although ITC is a dominant player in cigarette business - with >75% market share - the ongoing regulatory & social pressure has been impacting ITC's sales growth We anticipate long term historical cigarette net sales growth (10-12%) would reduce to single digit growth going ahead. Besides, we expect ITC's non-cigarette business - with ~75% contribution of FMCG & Agribusiness - should pick-up gradually.

ITC is well placed as compared to HUL in the Large Cap FMCG space. Despite huge valuation difference of ~50% from HUL - one of the highest gap - 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 very attractive valuation of 21.7x and 18.7x P/E of FY17 & FY18, respectively. **We maintain BUY rating.**



Segmental Performance

Exhibit 1: Cigarette Business

Particulars	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Net Sales (₹mn)	40,788	42,011	42,509	41,419	42,107	41,496	43,172	43,799	46,392
Net Sales Growth (%)	12.6	18.8	14.2	0.6	3.2	(1.2)	1.6	5.7	10.2
Net Sales Mix (%)	40.9	38.3	42.3	43.2	43.2	40.7	42.9	44.0	43.1
EBIT Margin (%)	62.6	64.8	67.8	69.7	64.3	67.0	68.8	68.1	65.1
EBIT Mix (%)	85.4	85.8	84.7	85.4	85.9	85.5	85.9	85.2	86.0
EBIT Growth (%)	20.8	21.4	12.2	8.8	6.0	2.2	3.0	3.4	11.5

Source: Company, Trust

Cigarette business continue to improve during the quarter but lower than historical performance as cigarette industry volumes remain under pressure due to sharp increase in excise duty. Illegal trade grew tremendously. EBIT Margin declined by 80bps to 65.1%.

Exhibit 2: FMCG Business

Particulars	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Net Sales (₹ mn)	23,145	19,346	21,960	23,141	25,665	21,710	23,516	24,777	27,041
Net Sales Growth (%)	13.7	10.9	11.9	11.4	10.9	12.2	7.1	7.1	5.4
Net Sales Mix (%)	23.2	17.6	21.8	24.1	26.3	21.3	23.4	24.9	25.2
EBIT Margin (%)	1.9	(0.8)	(0.5)	0.5	1.9	(0.4)	(0.5)	0.8	2.6
EBIT Mix (%)	1.4	(0.5)	(0.3)	0.3	1.5	(0.2)	(0.3)	0.5	2.0

Source: Company, Trust

Sluggish demand, price deflation environment and trade pipeline synchronization in the Notebooks category into slow 5.4% sales growth. EBIT Margin improved by 73bps driven by higher scale and gross margin expansion

Exhibit 3: Hotel Business

Particulars	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Net Sales (₹ mn)	3,205	2,487	2,616	3,303	3,464	2,878	2,900	3,453	3,630
Net Sales Growth (%)	1.6	(0.5)	5.9	4.7	8.1	15.7	10.9	4.5	4.8
Net Sales Mix (%)	3.2	2.3	2.6	3.4	3.6	2.8	2.9	3.5	3.4
EBIT Margin (%)	18.7	(4.9)	(3.7)	8.7	12.1	(2.5)	(1.9)	7.5	11.8
EBIT Mix (%)	2.0	(0.4)	(0.3)	0.8	1.3	(0.2)	(0.2)	0.7	1.2

Source: Company, Trust

Hotel business continues to display slow growth of 4.8% due to weak pricing scenario on back of high room inventory. EBIT Margin declined by 39bps to 11.8% YoY.

Exhibit 4: Agribusiness

Particulars	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Net Sales (₹ mn)	20,042	32,961	20,587	15,979	14,279	23,254	18,437	14,810	18,068
Net Sales Growth (%)	8.1	50.6	16.1	(10.6)	(28.8)	(29.4)	(10.4)	(7.3)	26.5
Net Sales Mix (%)	20.1	30.0	20.5	16.7	14.6	22.8	18.3	14.9	16.8
EBIT Margin (%)	7.3	6.1	14.5	14.9	11.5	10.1	15.9	15.6	9.7
EBIT Mix (%)	4.9	6.4	8.8	7.1	5.2	7.2	8.5	6.6	5.0

Source: Company, Trust

Agribusiness sales improved in Q4FY16 due to high negative base of last year. However segment still remains under pressure due to lack of export opportunities in Wheat, Coffee & Soya. EBIT Margin contracted by 186bps to 9.7% YoY

Exhibit 5: Paper, Paperboard & Packaging Business

Particulars	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Net Sales (₹ mn)	12,612	12,885	12,841	11,988	12,026	12,650	12,541	12,600	12,382
Net Sales Growth (%)	19.3	10.8	8.9	(4.7)	(4.6)	(1.8)	(2.3)	5.1	3.0
Net Sales Mix (%)	12.6	11.7	12.8	12.5	12.3	12.4	12.5	12.7	11.5
EBIT Margin (%)	14.9	21.3	18.9	17.8	15.8	20.1	16.7	19.1	16.4
EBIT Mix (%)	6.3	8.7	7.1	6.3	6.0	7.8	6.1	6.9	5.8

Source: Company, Trust

Paper business remained muted due to slowdown in FMCG industry, reduction of import duty & cheap imports from China. EBIT Margin improved by 54bps due to better product mix & benign input prices



Result Highlights

Exhibit 6: Quarter Performance

Particulars (₹ mn)	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Net Sales	91,451	91,644	89,303	88,002	91,883	85,055	88,047	91,027	100,624
YoY Gr %	11.8	24.9	14.8	2.1	0.5	(7.2)	(1.4)	3.4	9.5
Gross profit	53,689	52,707	54,686	54,651	56,311	54,187	56,854	58,412	61,892
Gross margin %	58.1	57.0	60.6	61.1	60.6	63.1	63.9	63.7	60.9
Gross margin expansion (YoY)	108bps	-430bps	-150bps	52bps	248bps	611bps	325bps	254bps	27bps
EBITDA	32,034	32,776	34,887	34,642	32,432	33,859	35,601	36,052	36,872
YoY Gr %	18.4	17.4	10.0	5.5	1.2	3.3	2.0	4.1	13.7
EBITDA Margin %	34.7	35.4	38.7	38.7	34.9	39.4	40.0	39.3	36.3
Adjusted PAT	22,780	21,864	24,252	26,350	23,612	22,654	24,313	26,528	24,953
YoY Gr %	18.2	15.6	10.0	10.5	3.7	3.6	0.3	0.7	5.7

Source: Company, Trust



Consolidated Financials

Income Statement

Y/E Mar (₹ mn)	FY14	FY15	FY16P	FY17E	FY18E
Net Revenues	349,847	384,333	390,671	436,856	485,056
% Growth	11.7	9.9	1.6	11.8	11.0
Raw Material	132,403	147,722	139,320	152,555	166,316
Staff	25,042	27,723	30,467	34,411	37,183
Other Expenses	64,978	70,660	73,945	82,528	90,989
Total Expenditures	222,423	246,104	243,732	269,493	294,489
EBITDA	127,424	138,229	146,939	167,363	190,567
% Growth	17.2	8.5	6.3	13.9	13.9
EBITDA Margins (%)	36.4	36.0	37.6	38.3	39.3
Other Income	13,033	16,580	19,165	21,332	23,834
Interest	64	910	773	702	702
Depreciation	9,649	10,279	11,134	11,970	12,892
Profit Before Tax	130,745	143,620	154,197	176,023	200,808
Provision for tax	40,609	45,964	53,720	61,324	68,275
Effective tax rate (%)	31.1	32.0	34.8	34.8	34.0
Reported PAT	89,143	96,632	99,177	113,197	130,796
% Growth	17.2	8.4	2.6	14.1	15.5
Adjusted Net Profit	89,143	96,632	99,177	113,197	130,796
% Growth	17.2	8.4	2.6	14.1	15.5

Balance Sheet

Y/E Mar (₹ mn)	FY14	FY15	FY16P	FY17E	FY18E
Equity Share Capital	7,953	8,016	8,037	8,037	8,037
Reserves & surplus	264,416	309,339	328,247	361,640	400,225
Shareholders' funds	272,370	317,355	336,284	369,677	408,262
Minorities interests	2,030	2,251	3,631	5,218	7,043
Total Debt	1,191	1,034	858	858	858
Capital Employed	275,591	320,640	340,773	375,753	416,163
Net fixed assets	160,386	180,035	185,057	198,187	210,395
Cash & Cash Eq.	34,902	78,962	74,732	75,845	95,238
Net Other current assets	20,177	8,249	(10,324)	(1,793)	(4,845)
Investments	72,840	69,428	111,327	127,827	144,327
Net Deferred tax Assets	(12,715)	(16,042)	(20,019)	(24,313)	(28,952)
Total Assets	275,589	320,632	340,773	375,753	416,163



Cash Flow Statement

Y/E Mar (₹ mn)	FY14	FY15	FY16P	FY17E	FY18E
Pre-tax profit	130,516	143,621	154,197	176,023	200,808
Depreciation	9,649	10,280	11,134	11,970	12,892
Total Tax Paid	(39,845)	(44,486)	(49,743)	(57,029)	(63,636)
Chg in working capital	(18,444)	312	18,573	(8,532)	3,053
Other operating activities	(8,441)	(11,294)	853	786	790
Cash flow from oper (a)	73,436	98,432	135,014	123,218	153,906
Capital Expenditure	(28,489)	(32,913)	(16,156)	(25,100)	(25,100)
Chg in investments	(9,495)	9,165	(41,899)	(16,500)	(16,500)
Other investing activities	5,444	(29,006)	-	-	-
Cash flow from inv.(b)	(32,541)	(52,754)	(58,055)	(41,600)	(41,600)
Free cash flow (a+b)	40,895	45,678	76,959	81,618	112,306
Equity raised/(repaid)	6,911	9,788	21	(0)	(0)
Debt raised/(repaid)	(92)	315	(176)	-	-
Interest paid	(477)	(161)	(773)	(702)	(702)
Dividend (incl. Tax)	(42,386)	(48,756)	(68,315)	(67,918)	(78,478)
Other financing activities	(5,171)	(7,796)	(11,955)	(11,886)	(13,734)
Cash flow from fin. (c)	(41,215)	(46,610)	(81,197)	(80,505)	(92,913)
Net chg in cash (a+b+c)	(320)	(932)	(4,238)	1,113	19,393

Key Ratios

Y/E Mar	FY13	FY14	FY15	FY16E	FY17E
Raw Material Cost/Sales (%)	37.8	38.4	35.7	34.9	34.3
Manpower Cost/Sales (%)	7.2	7.2	7.8	7.9	7.7
Operating & Other Cost/Sales (%)	18.6	18.4	18.9	18.9	18.8
Revenue Growth (%)	11.7	9.9	1.6	11.8	11.0
EBITDA Margins (%)	36.4	36.0	37.6	38.3	39.3
Net Income Margins (%)	25.5	25.1	25.4	25.9	27.0
ROCE (%)	46.2	43.1	43.1	44.5	45.8
ROE (%)	32.7	30.4	29.5	30.6	32.0

Valuation Parameters

Y/E Mar	FY13	FY14	FY15	FY16E	FY17E
EPS (₹.)	11.2	12.1	12.3	14.1	16.3
P/E (x)	31.5	27.4	24.7	21.7	18.7
BV (₹)	34.2	39.6	41.8	46.0	50.8
P/BV (x)	10.3	8.3	7.3	6.6	6.0
EV/EBITDA (x)	21.2	18.1	15.4	13.4	11.6
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	5.8	5.1	4.6



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