

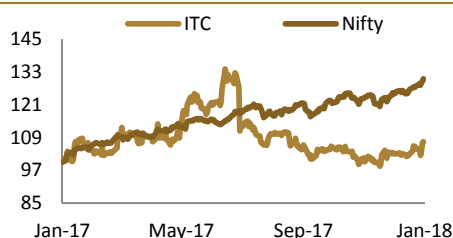
**Market statistics**

Current stock price (₹)	275
Shares O/S (cr.)	1219.0
Mcap (₹cr)	334,689
52W H/L (₹)	368/250
6m avg. volume	12,152,365
Bloomberg	ITC in

**Shareholding pattern**

Promoters	0.00
Domestic Institution	36.68
Foreign Institution	18.60
Non-institution	44.72
of which more than 1%	
Life Insurance Corporation of India	16.29
General Insurance Corporation of India	1.75

**ITCvs Nifty**



**Capital efficiency & valuations**

Particulars	FY17	FY18E	FY19E
RoE (%)	22.7	22.2	23.9
RoCE (%)	33.0	31.7	34.6
P/B (x)	6.8	6.8	6.3
EV/OCF (x)	27.8	30.0	25.2
EV/EBITDA (x)	19.1	19.9	17.0
P/E (x)	30.0	30.5	26.4

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ITC, based on IND AS, has reported net sales growth of 5.7% YoY to ₹97.7bn – lower than our expectation of 9.7%. Sales for FMCG, Hotel, Agri and Paper business were at 11.8%, 9.2%, -8.4% & -4.2% respectively. Gross Margin contracted by 14bps YoY to 63.4%. Employee & Other expenses (% of sales) moved by -10bps & -165bps YoY. Hence, EBITDA Margin expanded by 161bps to 40%. EBITDA grew by 10.1% YoY to Rs39bn.

There was an exceptional item of Rs 4,129mn on account of tax write back of TN entry tax. Hence, Reported PAT grew by 16.8% to ₹ 30.9bn. Other comprehensive income was at ₹ -1,616mn in Q3FY17 vs. ₹ -869mn in Q3FY18. Hence APAT (adjusting comprehensive income & exceptional item) has increased by 16.8% YoY to ₹29bn.

**Higher tax keeps Cigarette revenues under pressure:** ITC’s cigarette sales were under pressure in Q3FY18, it’s difficult to assess actual impact because the difference between the gross sales in Q3FY17 and net sales reported in Q3FY18. Company has to face incremental tax burden of 20% due to combined impact of increase in excise duty in budget 2017 & revision in GST compensation cess on cigarettes. There was an additional burden on the business due to non-availability of Additional duty surcharge credit on transition stock & adverse impact on pipeline stock due to unanticipated revision in GST rates. The cumulative growth in tax incidence combined with latest increase in cess rates stood at 202% since last 6 years. ITC reacted by taking price hike to the range of 5-8% depending on length size to absorb the additional cost in Q1FY18. We believe this price hike would have further dented the volumes as overall consumer demand has improved post GST. Management stated that huge tax arbitrage would further accelerate the illegal cigarette industry and impact their cigarette volumes. However, ITC’s ability to maintain leadership in this challenging situation is encouraging. We expect to volume to pick up in coming qtrs

**Healthy growth in FMCG & Hotels biz; Agri & Paper segments declines:** ITC’s non-Cigarette Business grew by slow 2.3% YoY. **FMCG business showed strong growth of 16.2%YoY** on comparable basis while on reported numbers it grew by 11.8%. This performance is led by better growth in packaged foods, personal products and stationary products. FMCG biz forms 26.8% of sales in Q3FY18 vs 18.6% in Q2FY17. They reported positive EBIT of Rs 469mn vs Rs -196mn in FMCG is due to enhanced scale, product mix enrichment & cost management initiatives. **Hotel Biz(3.8% of Sales) growth** reported healthy growth of 9.2% led by improvement in ARR & robust growth in F&B revenue growth. Hotel segment EBIT grew by 30% led by ARR rise & operating leverage. **Agribusiness (14% of sales)** impacted and de-grew by 8.4% caused by shortage of leaf tobacco in AP and successive reductions in authorized crop size exacerbated by drought in 2016. Lower export incentives & limited trading opportunities in other agri-commodities also impacted the Agri-biz. **Paper business(12% of sales)** too showed weak performance and declined by 4.2%YoY led by subdued demand in FMCG, legal Cigarette industry, surplus capacity in domestic & zero imports duty under FTA with ASEAN countries. EBIT grew by 9% due to healthy volumes, imported pulp substitution and benign input costs

**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 from Q2FY17 led by pick up in volumes. With current revised GST rates on Cigarettes, tax rate have moved up significantly by 20% and hence, ITC took price hike to combat the effect. We expect 4% & 6% volume growth in FY18 & FY19. FMCG business growth of 10-12 is highly encouraging and we expect it improve further in coming quarters and believe FMCG would be next driver of growth. We expect Sales, EBITDA & PAT to show CAGR of 8%, 9% & 10% from FY17-FY19E.

ITC is well placed as compared to HUL in the Large Cap FMCG space. Despite huge valuation difference of ~40% from HUL. ITC’s FCF yield is ~4.5% as compared to <3% for HUL. ITC still trades at a P/E of 30x and 26x of FY18& FY19 estimated EPS, respectively. **We maintain BUY rating.**

**Result Highlights**

Particulars (₹ mn) - (IND AS)	Q3FY17	Q2FY18	Q3FY18	YoY Chg. (%)
<b>Total Income</b>	92,484	103,141	97,720	5.7%
Total RM cost	33,766	43,564	35,810	6.1%
Gross profit	58,718	59,578	61,910	5.4%
Gross margin %	63.5%	57.8%	63.4%	-14bps
Employee Expenses	5,723	6,065	5,950	4.0%
(% of Sales)	6.3%	5.9%	6.2%	-10bps
Other Expenses	17,531	15,897	16,915	-3.5%
(% of Sales)	19.2%	15.5%	17.5%	-167bps
<b>EBITDA</b>	<b>35,464</b>	<b>37,615</b>	<b>39,045</b>	<b>10.1%</b>
EBITDA Margin %	38.3%	36.5%	40.0%	161bps
Depreciation	2,665	2,824	2,908	9.1%
Other Income	6,879	4,942	6,269	-8.9%
Interest	136	290	240	76.7%
<b>PBT</b>	<b>39,542</b>	<b>39,443</b>	<b>46,296</b>	<b>17.1%</b>
Total tax	13,075	13,045	15,393	17.7%
Effective Tax Rate (%)	33.1%	33.1%	33.2%	18bps
<b>Reported PAT</b>	<b>26,467</b>	<b>26,398</b>	<b>30,903</b>	<b>16.8%</b>
Other comprehensive income	(1,616)	290	(869)	-46.3%
<b>Total comprehensive income</b>	<b>24,851</b>	<b>26,108</b>	<b>29,015</b>	<b>16.8%</b>



## Consolidated Financials

### Income Statement

Y/E Mar (₹ mn)	FY15	FY16	FY17	FY18E	FY19E
<b>Net Revenues</b>	<b>384,333</b>	<b>391,921</b>	<b>428,036</b>	<b>442,873</b>	<b>499,678</b>
% Growth	9.9	2.0	9.2	3.5	12.8
Raw Material	147,722	135,685	160,492	170,779	187,464
Staff	27,723	34,410	36,317	36,782	41,300
Other Expenses	70,396	77,197	76,621	76,971	85,634
Total Expenditures	245,841	247,292	273,429	284,532	314,398
<b>EBITDA</b>	<b>138,493</b>	<b>144,629</b>	<b>154,607</b>	<b>158,341</b>	<b>185,279</b>
% Growth	8.2	4.4	6.9	2.4	17.0
EBITDA Margins (%)	36.0	36.9	36.1	35.8	37.1
Other Income	16,580	15,308	17,615	19,886	20,511
Interest	910	781	490	490	490
Depreciation	10,279	10,774	11,528	11,345	12,920
<b>Profit Before Tax</b>	<b>143,884</b>	<b>148,382</b>	<b>160,204</b>	<b>166,392</b>	<b>192,380</b>
Provision for tax	45,964	53,582	55,491	56,573	65,409
Effective tax rate (%)	31.9	36.1	34.6	34.0	34.0
<b>Reported PAT</b>	<b>96,895</b>	<b>94,085</b>	<b>105,196</b>	<b>109,881</b>	<b>127,037</b>
% Growth	8.0	(2.9)	11.8	4.5	15.6
<b>Adjusted Net Profit</b>	<b>96,895</b>	<b>94,085</b>	<b>105,196</b>	<b>109,881</b>	<b>127,037</b>
% Growth	8.0	(2.9)	11.8	4.5	15.6

### Balance Sheet

Y/E Mar (₹ mn)	FY15	FY16	FY17	FY18E	FY19E
Equity Share Capital	8,016	8,016	12,147	12,173	12,173
Reserves & surplus	375,332	418,748	451,982	483,313	519,536
<b>Shareholders' funds</b>	<b>383,347</b>	<b>426,764</b>	<b>464,129</b>	<b>495,486</b>	<b>531,709</b>
Minorities interests	2,251	2,609	2,947	2,947	2,947
Total Debt	824	776	774	774	774
<b>Capital Employed</b>	<b>386,423</b>	<b>430,148</b>	<b>467,851</b>	<b>499,207</b>	<b>535,430</b>
Net fixed assets	171,344	176,664	196,234	209,386	224,566
Cash & Cash Eq.	65,712	60,633	29,674	31,170	36,573
Net Other current assets	75,251	83,390	89,010	105,750	121,424
Investments	90,630	127,856	171,271	171,271	171,271
Net Deferred tax Assets	(16,516)	(18,395)	(18,338)	(18,370)	(18,404)
<b>Total Assets</b>	<b>386,423</b>	<b>430,148</b>	<b>467,851</b>	<b>499,207</b>	<b>535,430</b>

**Cash Flow Statement**

Y/E Mar (₹ mn)	FY15	FY16	FY17	FY18E	FY19E
Pre-tax profit	143,621	148,591	160,263	166,392	192,380
Depreciation	10,280	10,774	11,528	11,345	12,920
Total Tax Paid	(44,486)	(50,778)	(54,916)	(56,542)	(65,375)
Chg in working capital	312	(2,770)	444	(16,740)	(15,674)
Other operating activities	(11,294)	(7,826)	(11,046)	552	556
<b>Cash flow from oper (a)</b>	<b>98,432</b>	<b>97,990</b>	<b>106,273</b>	<b>105,008</b>	<b>124,806</b>
Capital Expenditure	(32,913)	(23,402)	(30,715)	(24,498)	(28,099)
Chg in investments	9,165	(34,379)	(50,196)	-	1
Other investing activities	(29,006)	18,573	48,402	-	-
<b>Cash flow from inv.(b)</b>	<b>(52,754)</b>	<b>(39,208)</b>	<b>(32,509)</b>	<b>(24,498)</b>	<b>(28,098)</b>
<b>Free cash flow (a+b)</b>	<b>45,678</b>	<b>58,782</b>	<b>73,764</b>	<b>80,511</b>	<b>96,708</b>
Equity raised/(repaid)	9,788	5,317	10,670	26	-
Debt raised/(repaid)	315	(104)	(132)	-	-
Interest paid	(161)	(275)	(255)	(490)	(490)
Dividend (incl. Tax)	(48,756)	(51,327)	(69,941)	(65,929)	(76,222)
Other financing activities	(7,796)	(9,736)	(13,353)	(12,621)	(14,592)
<b>Cash flow from fin. (c)</b>	<b>(46,610)</b>	<b>(56,125)</b>	<b>(73,010)</b>	<b>(79,014)</b>	<b>(91,304)</b>
<b>Net chg in cash (a+b+c)</b>	<b>(932)</b>	<b>2,657</b>	<b>754</b>	<b>1,496</b>	<b>5,404</b>

**Key Ratios**

Y/E Mar	FY15	FY16	FY17	FY18E	FY19E
Raw Material Cost/Sales (%)	38.4	34.6	37.5	38.6	37.5
Manpower Cost/Sales (%)	7.2	8.8	8.5	8.3	8.3
Operating & Other Cost/Sales (%)	18.3	19.7	17.9	17.4	17.1
Revenue Growth (%)	9.9	2.0	9.2	3.5	12.8
EBITDA Margins (%)	36.0	36.9	36.1	35.8	37.1
Net Income Margins (%)	25.2	24.0	24.6	24.8	25.4
ROCE (%)	35.8	33.6	33.0	31.7	34.6
ROE (%)	25.3	22.0	22.7	22.2	23.9

**Valuation Parameters**

Y/E Mar	FY15	FY16	FY17	FY18E	FY19E
EPS (₹.)	8.1	7.8	8.7	9.0	10.4
P/E (x)	27.3	26.8	30.0	30.5	26.4
BV (₹.)	31.9	35.5	38.2	40.7	43.7
P/BV (x)	6.9	5.9	6.8	6.8	6.3
EV/EBITDA (x)	18.0	16.2	19.1	19.9	17.0
Fixed assets turnover ratio (x)	2.2	2.2	2.2	2.1	2.2
Net Debt/Equity (x)	(0.2)	(0.1)	(0.1)	(0.1)	(0.1)
EV/Sales	6.5	6.0	6.9	7.1	6.3



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Buy                      More than 15%

Hold                     15% to -15%

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