

## FMCG a star performer; Cigarettes trudging along

ITC reported broadly in-line results for Q2FY21, Revenue at Rs 11,892 crs vs est. 11,727crs (1.4% higher vs our estimates), up 1.2% YoY impacted by disruptions in operations due to sporadic and localized lockdowns in July/Aug with improving trends now from Sept '20 onwards owing to easing of restrictions. The marginal beat on estimates was majorly on the back of better than expected performance of its FMCG business while cigarette volume decline of 12% was in-line with our estimates of 12.5% YoY. GM at 60.2% (est. 61.6%) fell by 169 bps YoY impacted by negative operating leverage and adverse product mix. EBIT declined 17% at Rs 3,678crs (Rs. 3,509 our estm) while EBIT margins fell by 453bps YoY at 31% (est. 30%) impacted by 16% YoY fall in cigarette EBIT, partially mitigated through aggressive cost control measures. PAT of Rs 3,232crs vs est. Rs 3,125crs was down 20% YoY. The strong performance by the FMCG segment was on the back of a surge in demand for health and hygiene products and consumers' preference towards trusted brands. Hotel segment witnessed a recovery QoQ although YoY was adversely impacted given restrictions on travel and tourism. Agri biz grew 13% led by trading opportunities, while the paper boards biz. continued to be subdued (33% fall in revenue) owing to decline in demand from end user industries. Management indicated that the online channel has emerged as the most preferred channel for shopping and grew 2x for ITC in Q2. **Maintain BUY with a revised TP of Rs. 215 (Rs. 243 earlier) as we tweak our FY21/22E to factor in H1 performance. However, undemanding valuations, +5% dividend yield and visible recovery across key businesses makes it an attractive bet.**

### Key takeaways

- Cigarette growth trudging along:** Cigarette biz volume declined ~12% in our view (12.5% decline in our estimate). Net Revenues down 14% as localized lockdowns in July/Aug, restrictions on operating hours of convenience stores and temporary disruption in certain wholesale markets impacted recovery trends seen in end of Q1FY21. South India, Metro and large towns saw a higher impact which likely impacted mix, in our view. Cigarette EBIT declined 16% YoY, 5% below our estimate. Easing of lockdown restriction in Sept '20 has enhanced ability to service markets effectively and address emerging demand.
- FMCG-Others significant margin beat:** FMCG-Others Segment delivered a strong performance with its LTL sale growth of 15% (underlying sales growth 18% excl education and retail) driven by robust growth in staples (25% growth), convenience foods (noodles), health & hygiene products (Savlon), new products launches (70+ in H1FY21) and consumers' preference towards trusted and well established brands. **EBITDA Margin was a significant beat to our and street estimates as it grew 300bps YoY at 9.7% in Q2.** This was supported by higher op. leverage and strong cost efficiency. Discretionary/OOH portfolio witnessed smart recovery led by Bingo and is back to normalcy (-2% YoY).
- Hotels sequential improvement:** QoQ Hotels revenue grew 3.5x on the back of gradual recovery and leisure locations gaining traction QoQ. However, YoY revenues continued to be adversely impacted (down 81% YoY). Reported EBIT Loss at Rs. 185crs was lower than Q1EBIT Loss of Rs. 235cr. ITC reported ~50% reduction in controllable cash fixed costs that partly mitigated the impact on a sequential basis.
- Others:** Agri revenues up 13% YoY, led by trading opportunities in rice, mustard, coffee and higher wheat supplies for Aashirvaad Atta. Leaf exports remained flattish YoY but better QoQ. Agri EBIT reported 3% YoY growth. Paperboard reported 7% decline in revenue with flat EBIT Margins despite pricing pressure and negative operating leverage.

### Our View:

Progressive normalization of operations across segments, share gain possibilities in core cigarette business due to innovative products/format launches, faster growth in FMCG sales vs peers could support earnings trajectory going ahead. However, near term uncertainty remains given concerns on spread of COVIDs 2nd wave in the country and the ensuing lockdowns if any, posing operational challenges. At CMP, stock trades at 14x FY22E EPS which is a fairly attractive valuation alongside a +5% dividend yield and gradual improvement across business segments albeit cigarettes trudging along. Key risks to our call: 1) rise in compensation cess, 2) concerns on spread of COVID 2nd wave

### Key Financials (Consolidated)

(Rs. Cr)	FY19	FY20	FY21E	FY22E
Net Sales	48,353	49,529	44,880	49,450
EBITDA	18,406	19,385	15,167	18,430
Net Profit	12,824	15,842	12,200	14,875
EPS (Rs.)	10.5	12.9	9.9	12.1
PER (x)	16.6	13.5	17.5	14.3
EV/EBITDA (x)	11.3	10.6	13.8	11.4
P/BV (x)	3.6	3.3	3.3	3.3
ROE (%)	21.7	24.3	18.8	23.0

Source: Company, Axis Research

(CMP as of Nov 06, 2020)

CMP (Rs)	174
Upside /Downside (%)	24%
High/Low (Rs)	266/135
Market cap (Cr)	2,45,546
Avg. daily vol. (6m) Shrs.	2,98,26,240
No. of shares (Cr)	1,229

### Shareholding (%)

	Mar-20	Jun-20	Sep-20
Promoter	-	-	-
FII	14.6	14.6	12.9
MFs / UTI	9.9	9.4	9.9
Banks / FI	8.0	8.0	8.0
Others	67.4	67.9	69.1

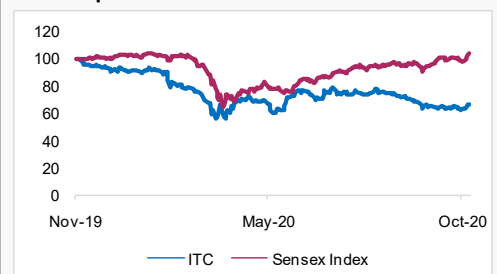
### Financial & Valuations

Y/E Mar (Rs. bn)	2020	2021E	2022E
Net Sales	495.3	448.8	494.5
EBITDA	193.9	151.7	184.3
Net Profit	158.4	122.0	148.7
EPS (Rs.)	12.9	10.0	12.1
PER (x)	13.5	17.5	14.3
EV/EBITDA (x)	10.6	13.8	11.4
P/BV (x)	3.3	3.3	3.3
ROE (%)	24.3	18.8	23.0

### Axis vs Consensus

EPS Estimates	2021E	2022E
Axis	10.0	12.1
Consensus	11.1	12.9
<b>Mean Consensus TP (12M)</b>		<b>232</b>

### Relative performance



Source: Capitaline, Axis Securities

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**Q2FY21 Key Financials (Standalone)**

(Rs cr)	Q2FY21	Axis Sec Estm	Axis Sec Estm Var (%)	Q2FY20	YoY growth %	Q1FY21	QoQ growth %
Volume Growth YoY (%)	-12.5	-12.0	-50 bps	3.0	-1,550 bps	-40.0	2,750 bps
<b>Net Sales</b>	<b>11,892</b>	<b>11,727</b>	<b>1.4</b>	<b>11,750</b>	<b>1.21</b>	<b>9,436</b>	<b>26.03</b>
Gross Profit	7,155	7,224	(1.0)	7,268	(1.6)	5,489	30.4
<b>Gross Margin (%)</b>	<b>60.2</b>	<b>61.6</b>	<b>-143 bps</b>	<b>61.9</b>	<b>-169 bps</b>	<b>58.2</b>	<b>200 bps</b>
Staff costs	661			632	4.6	697	(5.1)
Other operating expenses	2,518			2,195	14.7	2,211	13.9
<b>EBITDA</b>	<b>4,061</b>	<b>3,978</b>	<b>2</b>	<b>4,562</b>	<b>(11.0)</b>	<b>2,647</b>	<b>53.4</b>
<b>EBITDA margin (%)</b>	<b>34.1</b>	<b>33.9</b>	<b>22 bps</b>	<b>38.8</b>	<b>-468 bps</b>	<b>28.0</b>	<b>610 bps</b>
Other Income	610			654	(6.8)	897	(32.0)
Interest	14			13	3.5	17	(18.0)
Depreciation	383			396	(3.3)	398	(3.9)
<b>PBT</b>	<b>4,274</b>			<b>4,808</b>	<b>(11.1)</b>	<b>3,128</b>	<b>36.6</b>
Tax	1,042			785	32.8	786	32.6
<b>Tax rate (%)</b>	<b>24.4</b>			<b>16.3</b>	<b>806 bps</b>	<b>25.1</b>	<b>-74 bps</b>
Adj. PAT	3,232	3,125	3.4	4,023	(19.7)	2,343	38.0
<b>Adj. EPS</b>	<b>2.6</b>	<b>2.5</b>	<b>3.4</b>	<b>3.3</b>	<b>(19.7)</b>	<b>1.9</b>	<b>38.0</b>

(Rs cr)	Q2FY21	Axis Sec Estm	Axis Sec Estm Var (%)	Q2FY20	YoY growth %	Q1FY21	QoQ growth %
<b>Profitability Analysis (%)</b>							
Gross Margin	60.2	61.6	-143 bps	61.9	-169 bps	58.2	200 bps
EBITDA Margin	34.1	33.9	22 bps	38.8	-468 bps	28.0	610 bps
EBIT Margin	30.9	29.9	101 bps	35.5	-453 bps	23.8	710 bps
PAT Margin	27.2	26.6	53 bps	34.2	-706 bps	24.8	235 bps
<b>Cost Analysis (%)</b>							
COGS	39.8	38.4	143 bps	38.1	169 bps	41.8	-200 bps
Staff Costs	5.6	7.2	-164 bps	5.4	18 bps	7.4	-183 bps
Other Expenses	21.2	21.5	-32 bps	18.7	249 bps	23.4	-226 bps
Effective Tax rate (ETR)	24.4	25.5	-112 bps	16.3	806 bps	25.1	-74 bps

Source: Company; Axis Securities

## Q2FY21 Segmental Performance

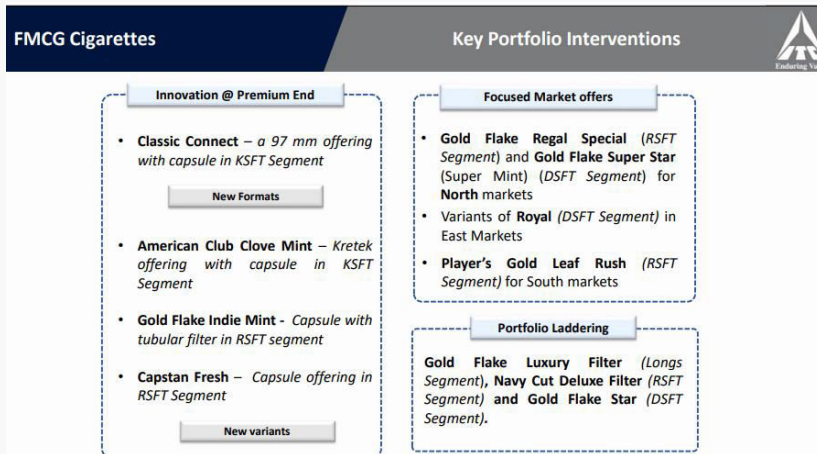
	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)
<b>Segment Revenue</b>					
Cigarette	5,121	5,327	-3.9%	3,854	32.9%
FMCG Others	3,795	3,288	15.4%	3,375	12.5%
Hotel	82	427	-80.8%	23	263.0%
Agri Business	2,985	2,648	12.8%	3,746	-20.3%
Paper Board	1,459	1,565	-6.8%	1,026	42.1%
<b>Total</b>					
<b>% Revenue</b>					
Cigarette	38.1%	40.2%	-209bps	32.1%	605bps
Other FMCG	28.2%	24.8%	342bps	28.1%	17bps
Hotel	0.6%	3.2%	-261bps	0.2%	42bps
Agri Business	22.2%	20.0%	223bps	31.2%	-895bps
Paper Board	10.9%	11.8%	-96bps	8.5%	231bps
<b>Total</b>					
<b>Segment EBIT</b>					
Cigarette	3,245	3,845	-15.6%	2,356	37.7%
FMCG Others	253	90	179.3%	125	101.5%
Hotel	-185	17	NM	-243	NM
Agri Business	256	249	2.7%	179	43.3%
Paper Board	330	356	-7.2%	286	15.6%
<b>Total</b>					
<b>Segment EBIT Margin %</b>					
Cigarette	63.4%	72.2%	-881bps	61.1%	221bps
FMCG Others	6.7%	2.8%	391bps	3.7%	294bps
Hotel	NM	4.1%	NM	-1074.3%	NM
Agri Business	8.6%	9.4%	-84bps	4.8%	381bps
Paper Board	22.6%	22.7%	-9bps	27.8%	-519bps

Source: Company; Axis Securities

## Key Takeaways

- 1) **Cigarette business:** Cigarette Revenues were down 3.9% at Rs. 5,121cr (Rs. 5,199cr our estm) while EBIT came in at Rs. 3,245cr (Rs. 3,421 our estm). While, localized restrictions in July/Aug impacted recovery momentum, with easing seen in Sept '20 ITCs enhanced service frequency, augmentation of stockist network in rura/semi-urban markets and strengthening direct reach in target markets across traditional markets should aid recovery in H2FY21. ITC also introduced new products/formats across KSFT/RSFT cigarette segment. This we believe will likely strengthen ITCs competitive position in the market. In Q2FY21, ITC further consolidated market standing, with appreciable progress in the capsule segment, leveraging a well-laddered portfolio, wide distribution reach, superior market servicing infrastructure and portfolio interventions.

**Exhibit 1: Cigarette actions taken in Q2FY21**



- 2) **FMCG – Others Q2s star performing segment:** FMCG-Others segment revenue was up 15% YoY to Rs. 3,750cr on a comparable basis (up 18.4% excl. Education and Stationery Products Business (ESPB) and Lifestyle Retailing). Staples, Convenience Foods and Health & Hygiene products, representing around 75% of the portfolio (in base period excl. ESPB), recorded robust growth of 25%; Discretionary categories with higher 'out-of-home' consumption however, have come to near normalcy levels with 2% YoY degrowth in Q2FY21. **FMCG EBITDA grew 66% YoY leading to EBITDA Margin of 9.7% +300bps highest ever recorded by ITCs FMCG division driven by operating leverage, enhanced operational efficiencies, portfolio premiumization and product mix enrichment notwithstanding incremental operating and gestation costs of new categories.** Staples, noodles, biscuits, dairy, sanitizers, hand wash, floor cleaners, etc. witnessed robust demand on the back of rising awareness towards health and hygiene and consumers' preference for trusted brands. Management highlighted that demand for essential products 'at-home' consumption witnessed moderation during the quarter, however the same is off-set by strong recovery in discretionary / OOH consumption products Most major categories enhanced their market standing during the quarter. In H1FY21, ITC launched more than 70+ new products/variants. Division wise -

- ✓ **Branded Packaged Foods** business delivered a robust performance during the quarter driven by staples and convenience foods. Sales of discretionary products like Bingo gained momentum recovering from subdued levels in Q1. Most categories in which ITC operates gained market share in Q1FY21. 'Aashirvaad Atta' posted strong growth and further fortified its leadership position in the branded packaged atta industry. Yippie Noodles sustained high growth trajectory. 'Aashirvaad Svasti' range of fresh dairy products and ghee posted robust growth in both Bihar and Bengal markets. 'Sunfeast' Biscuits and Cakes delivered steady growth even as the industry witnessed moderation in demand towards end of Q2FY21.
- ✓ **Personal Care Products** business continued to grow at a rapid pace driven by Savlon range of products (sanitizer, anti-spetic liquids, soaps and handwash). Savlong to become a Rs. 1,000cr brand in FY21 and it continued to record market share gains. With growing preference for natural products, Nimyle, a 100% natural floor cleaner grew rapidly strengthening its market standing in the East; the brand also continues to gain robust traction in new markets in the South. Nimwash, a 100% natural action product for cleaning fruits and vegetables,

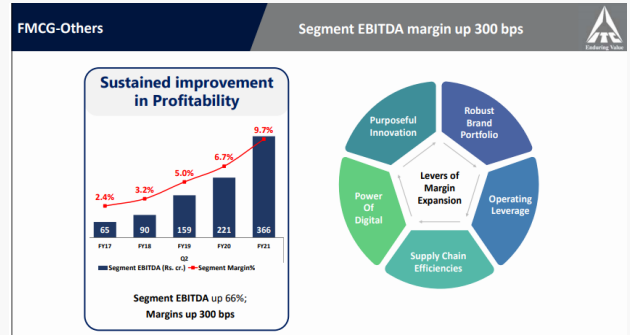
is also gaining consumer franchise. ITC rapidly expanded manufacturing capacity manifold and enhanced availability of 'Savlon' and 'Fiamo' range of products.

- ✓ **Fragrances:** witnessed progressive recovery as demand for on-the-go consumption products picked up. However, it continues to still be below pre-COVID levels.
- ✓ **Distribution channels:** In Q2FY21, ITC's sales from e-commerce channel grew more than 2x; e-commerce sales contributed 5% of FMCG revenues. Sales in rural markets grew rapidly leveraging the stockist channel. During the lockdown phase, nearly 2/3rd of the throughput was delivered direct to customer/market from factories leading to reduction in time-to-market.

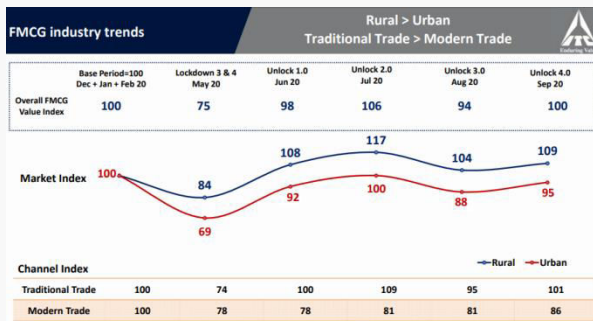
**Exhibit 2: Robust growth in FMCG segment**



**Exhibit 3: Sustainable improvement in Op. Margins**



**Exhibit 4: Rural continues to outpace Urban**



**Exhibit 5: 70+ New product/variant launches in H1**



**Exhibit 6: 70+ New product/variant launches in H1**



Source: Company; Axis Securities

- Hotels business:** Operations during the quarter continue to be impacted on YoY basis. However, QoQ the business performance has been improving drastically with occupancy and revenue seeing an improvement MoM with leisure locations witnessing a marked uptick. F&B Revenue, including banquets, continue to improve with the easing of restrictions and increasing mobility. ITC Hotels launched 'Flavours' and 'Gourmet Couch' menus as home delivery and takeaway offerings which received encouraging response.
- Paper boards :** Segment Revenue/EBIT declined by 6.8%/7.2% YoY basis largely on account of the disruptions caused by the outbreak of the COVID-19 pandemic and subsequent fall in demand from end user industry (educational institutes, printing businesses, FMCG packaging, liquor, cupstone, hosiery etc.). Robust exports growth partially offset the weak

domestic demand environment. However, despite volume and pricing pressures the EBIT Margin YoY were flat at 22.6%. Market share in value paperboard market was up by 500bps.

- 5) **Agri Business:** The Agri Business recorded a growth of 13% YoY in revenue driven by trading opportunities mainly in rice, mustard, coffee & wheat for Aashirvaad Atta. **Value added portfolio (ex. aqua) comprising spices for 'food-safe' markets, processed fruits, frozen snacks etc. posted 25% growth in revenue.** ITC Master Chef Frozen Snacks comprising 30 differentiated variants continues to garner increasing consumer franchise. During the year, product range was augmented with the introduction of 13 variants while availability was extended to 116 new markets in a short span of time taking the aggregate to 128 towns.

## Valuation & Outlook

**To factor in the H1 performance we tweak our estimates for FY21/22E. This leads to a TP revision to Rs. 215/share with BUY as we continue to value it at 18x FY22E EPS.** We see multiple positives for ITC and believe it is better placed in the FMCG Staples as well as discretionary space given 1) slow and gradual recovery in cigarette business going ahead, 2) sustainably improving FMCG segment profitability with share gains in key categories, 3) compelling valuations vs FMCG peers; 4) +5% dividend yield. Key risks to our call are: 1) SUUTI stake sale overhang, 2) adverse government regulation on sin goods/ compensation cess (largely factored in the price), 3) quicker resumption and scale up of competition's manufacturing and increased sale of illicit cigarette trade, 4) concerns on spread of COVIDs second wave in the country.

## Financials

### Profit & Loss

(Rs Cr)

Y/E March	FY19	FY20E	FY21E	FY22E
<b>Net sales</b>	<b>48,353</b>	<b>49,529</b>	<b>44,880</b>	<b>49,450</b>
Growth, %	11.3	2.4	-9.4	10.2
Other income	0	0	0	0
Total income	48,353	49,529	44,880	49,450
Raw material expenses	-17,420	-17,345	-17,119	-17,975
Employee expenses	-4,178	-4,296	-4,254	-4,429
Other Operating expenses	-8,348	-8,503	-8,340	-8,616
<b>EBITDA (Core)</b>	<b>18,406</b>	<b>19,385</b>	<b>15,167</b>	<b>18,430</b>
Growth, %	11.7	5.3	-21.8	21.5
Margin, %	38.1	39.1	33.8	37.3
Depreciation	-1,397	-1,645	-1,659	-1,631
<b>EBIT</b>	<b>17,010</b>	<b>17,740</b>	<b>13,508</b>	<b>16,799</b>
Growth, %	11.6	4.3	-23.9	24.4
Margin, %	35.2	35.8	30.1	34.0
Interest paid	-45	-55	-56	-57
Other Non-Operating Income	2,174	2,598	2,858	3,143
<b>Pre-tax profit</b>	<b>19,138</b>	<b>20,284</b>	<b>16,310</b>	<b>19,886</b>
Tax provided	-6,314	-4,442	-4,110	-5,011
Profit after tax	12,824	15,842	12,200	14,875
<b>Net Profit</b>	<b>12,824</b>	<b>15,842</b>	<b>12,200</b>	<b>14,875</b>
Growth, %	15.8	23.5	-23.0	21.9
<b>Net Profit (adjusted)</b>	<b>12,824</b>	<b>15,842</b>	<b>12,200</b>	<b>14,875</b>
Unadj. shares (cr)	1,226	1,229	1,229	1,229

Source: Company, Axis Securities

### Balance Sheet

(Rs Cr)

As at 31 <sup>st</sup> Mar	FY19	FY20E	FY21E	FY22E
Cash & bank	4,152	7,277	4,721	2,599
Debtors	4,035	2,562	2,090	2,303
Inventory	7,860	8,879	7,035	7,387
Loans & advances	7,197	5,015	5,181	5,181
Total current assets	23,152	23,642	18,935	17,378
Investments	25,043	29,049	29,049	29,049
Gross fixed assets	23,888	26,618	29,618	32,618
Less: Depreciation	-4,716	-6,018	-7,676	-9,307
Add: Capital WIP	4,136	3,256	3,730	3,730
Net fixed assets	23,308	23,857	25,671	27,040
<b>Total assets</b>	<b>71,504</b>	<b>76,547</b>	<b>73,655</b>	<b>73,467</b>
Current liabilities	9,990	9,442	4,675	4,907
Provisions	51	148	148	148
Total current liabilities	10,042	9,590	4,823	5,055
Non-current liabilities	2,304	2,158	2,158	2,158
Total liabilities	12,346	11,748	6,981	7,213
Paid-up capital	1,226	1,229	1,229	1,229
Reserves & surplus	57,915	64,044	63,790	63,371
Shareholders' equity	59,158	64,799	66,674	66,254
<b>Total equity &amp; liabilities</b>	<b>71,504</b>	<b>76,547</b>	<b>73,655</b>	<b>73,467</b>

Source: Company, Axis Securities

**Cash Flow**

(Rs Cr)

Y/E March	FY19	FY20E	FY21E	FY22E
Pre-tax profit	19,138	20,284	16,310	19,886
Depreciation	1,397	1,645	1,659	1,631
Chg in working capital	-1,056	2,279	-2,617	-332
Total tax paid	-6,185	-4,867	-4,110	-5,011
<b>Cash flow from operating activities</b>	<b>13,175</b>	<b>20,473</b>	<b>11,360</b>	<b>16,173</b>
Capital expenditure	-2,875	-2,193	-3,473	-3,000
Chg in investments	-2,991	-4,005	0	0
<b>Cash flow from investing activities</b>	<b>-5,866</b>	<b>-6,199</b>	<b>-3,473</b>	<b>-3,000</b>
Free cash flow	7,309	14,275	7,886	13,173
Equity raised/(repaid)	6,648	5,641	1,875	-420
Dividend (incl. tax)	-8,498	-12,477	-10,325	-15,295
<b>Cash flow from financing activities</b>	<b>4,412</b>	<b>-3,970</b>	<b>-7,160</b>	<b>-15,715</b>
Net chg in cash	11,721	10,305	726	-2,541

Source: Company, Axis Securities

**Ratio Analysis**

(%)

Y/E Mar	FY19	FY20E	FY21E	FY22E
<b>Per Share data</b>				
EPS (INR)	10.5	12.9	9.9	12.1
Growth, %	13.6	23.2	(23.0)	21.9
Book NAV/share (INR)	48.3	52.7	54.2	53.9
FDEPS (INR)	10.5	12.9	9.9	12.1
CEPS (INR)	11.6	14.2	11.3	13.4
DPS (INR)	9.1	13.8	6.8	10.6
<b>Return ratios</b>				
Return on assets (%)	19.0	21.4	16.3	20.3
Return on equity (%)	21.7	24.4	18.3	22.5
Return on capital employed (%)	22.1	24.7	18.0	21.7
<b>Turnover ratios</b>				
Asset turnover (x)	1.6	1.6	1.4	1.4
Sales/Net FA (x)	2.1	2.1	1.8	1.9
Working capital/Sales (x)	0.2	0.1	0.2	0.2
Working capital days	68.0	51.0	77.6	72.9
<b>Liquidity ratios</b>				
Current ratio (x)	2.3	2.5	4.1	3.5
Quick ratio (x)	1.5	1.6	2.5	2.0
Dividend cover (x)	1.8	1.3	1.2	1.2
<b>Valuation</b>				
PER (x)	16.6	13.5	17.5	14.3
Price/Book (x)	3.6	3.3	3.2	3.2
Yield (%)	3.3	5.9	4.8	6.1
EV/Net sales (x)	4.3	4.2	4.6	4.3
EV/EBITDA (x)	11.3	10.6	13.8	11.4
EV/EBIT (x)	12.3	11.6	15.4	12.5

Source: Company, Axis Securities



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