

## ITC Limited

### Best in Class on ESG - Summit Takeaway

8 December 2020

#### Key Takeaway

Presenting at Jefferies India ESG Conference, Mr. Nazeeb Arif (Head – Corp. Communications) and Mr. Sanjib Bezbaroa (EVP - Corp. EHS) highlighted the role of ESG at ITC, with noteworthy achievements of being water/carbon/solid waste positive for well over a decade. This is evident from ITC's industry-leading ESG score across most Indian FMCG and global tobacco firms, and there are ambitious targets for 2030 as well.

**Better than peers:** ITC is rated AA by MSCI on ESG, the highest among global tobacco players and better than most Indian FMCG companies. This is backed by its strong credentials – ITC has been carbon positive for 15 years, water positive for 18 years and solid waste recycling positive for 13 years.

**Carbon footprint:** ITC focuses on both reducing own carbon footprint and increasing sequestration through afforestation. c.41% of its energy use comes from renewable sources and efficiency is engrained in all its offices, hotels and even data centers. It works with local communities to drive afforestation – 820,000 acres of forest have been created till date leading to 150 million days of employment. ITC sequesters 2x the amount of carbon dioxide it emits, with a target to reach 4x by 2030.

**Water usage:** Apart from reducing its own consumption, ITC has created 19,000 rainwater harvesting structures, covering 1.2 million acres. In fact, it harvests 3x its net water consumption, which should increase to 5x by 2030. ITC also works with farmers to improve water efficiency in agriculture. Started a year ago, the program has covered c.200,000 acres and substantial water savings have been achieved.

**Waste:** ITC runs a 'Well-being out of waste (WOW)' program, which covers 12.5 million citizens and provides livelihoods to 16,200 waste collectors. Its R&D is also working on new-age bio-degradable and recyclable boards and sustainable packaging materials.

**E-Choupal:** ITC's E-Choupal platform, through its 6,100 centers, focuses on improved market access and productivity for c.4 million farmers across 35,000 villages.

**Social initiatives:** Some of ITC's social initiatives include; i). Supplementary education provided to 781,000 children; ii). Sustainable livelihood opportunities for 76,000 women; iii). 86,000 youth trained through vocational training program; and, iv) 37,700 sanitation units created. ITC promotes greater women participation, even in its manufacturing facilities - for example, 60% of the workforce in its Nanjangud unit are women.

**Governance:** Independent directors have a 50% representation on ITC's board. It follows a 3-tiered management structure, which allows each business to function independently and yet ensure synergies across the business are tapped. Policies on sustainability and other aspects of corporate governance are clearly defined.

**Aggressive future targets:** By 2030, ITC intends to increase the share of renewable energy to 50% (vs. 41% now), reduce specific energy consumption by 30%, specific GHG emission by 50% and specific water consumption by 40% over FY19 levels. It would also move to 100% recyclable, reusable or compostable plastic packaging by 2030.

#### COMPANY UPDATE

India | Consumer Staples

RATING	BUY
PRICE	INR203.10 <sup>^</sup>
MARKET CAP	INR2.5T / INR2.5T
PRICE TARGET (PT)	INR265
UPSIDE SCENARIO PT	INR320.00
DOWNSIDE SCENARIO PT	INR155.00

<sup>^</sup>Prior trading day's closing price unless otherwise noted.

#### FY Mar

INR	2020A	2021E	2022E	2023E
EPS	11.59	10.71	12.11	13.26
FY P/E	17.5x	19.0x	16.8x	15.3x

#### Speaker Profile

**Mr. Nazeeb Arif** is the EVP and Head of Corporate Communications of ITC. He is a Member of ITC's Sustainability Compliance Review Committee and is also the Liaison Delegate in the World Business Council for Sustainable Development, Geneva, representing ITC. Mr Arif's professional experience spans 34 years. Prior to joining ITC in 2006, he led the Indian Chamber of Commerce (ICC) as its Secretary-General and CEO. At ICC, he was awarded the United States Asia Environmental Partnership –“Environmental Leadership Award”.

**Mr. Sanjib Bezbaroa** is the EVP - Corporate EHS at ITC. He has been with the company for close to 25 years across several positions. Prior to that, he has worked with the Tata Group.

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## ITC LIMITED (ITC IN)

Estimates				
INR	2020A	2021E	2022E	2023E
Rev. (MM)	451,361	436,930	509,167	560,589
<i>Previous</i>				
EBITDA (MM)	179,042.5	160,293.3	187,000.2	205,728.1
<i>Previous</i>				
Net Profit	142,481.6	131,695.0	148,825.3	162,996.9
<i>Previous</i>				
BV/Share	52.09	52.65	55.26	57.52
<i>Previous</i>				
ROAE	23.4%	20.5%	22.4%	23.5%
<i>Previous</i>				
EPS	11.59	10.71	12.11	13.26
<i>Previous</i>				

Valuation				
	2020A	2021E	2022E	2023E
EV/Rev	5.0x	5.1x	4.4x	4.0x
P/Rev	5.5x	5.7x	4.9x	4.5x
EV/EBITDA	12.5x	14.0x	12.0x	10.9x
P/B	3.9x	3.9x	3.7x	3.5x
FY P/E	17.5x	19.0x	16.8x	15.3x

Market Data	
52-Week Range:	INR247.90 - INR134.95
Total Entprs. Value	INR2.2T
Avg. Daily Value MM (USD)	82.44
Float (%)	62.5%

## The Long View

### Scenarios

#### Base Case

In our base case, we forecast a c.3% annual growth in Cigarette Ebit over FY20-23E and a c.15% growth in FMCG revenues. Cigarette margins are expected to expand by ~180bps over FY20-23E as increase in consumer prices should more than offset tax hikes, although at the cost of lower volumes. The agri, paperboard and hotel businesses, after seeing a decline in FY21 on account of Covid-19, are expected to see a sharper recovery in FY22. We use SOTP methodology to value ITC cigarette business at 15x Sep-22 earnings, new FMCG at 4x Sep-22 sales, Agri and paperboard businesses at 15x Sep-22 EPS, and hotels at 1x Sep-21 invested capital to arrive at a price target of Rs265/sh.

#### Upside Scenario

In our upside scenario, we forecast c.7% annual growth in cigarette EBIT over FY20-23E and c.17% growth in FMCG revenues. Cigarette margins are expected to expand by ~230bps over FY20-23E as increase in consumer prices more than offsets tax hikes. Cigarette volumes are expected to remain robust, buoyed by a rural recovery in FY22. Strong FMCG sales and margins driven by lower crude and cuts in ad spends are expected to support overall earnings growth. We use SOTP methodology to value ITC cigarette business at 17x Sep-22 earnings, new FMCG at 5x Sep-22 sales, Agri and paperboard businesses at 18x Sep-22 EPS, and hotels at 1.2x Sep-21 invested capital to arrive at a price target of Rs320/sh.

#### Downside Scenario

In our downside scenario, we forecast a 2% decline in Cigarette EBIT over FY20-23E and c.13% growth in FMCG revenues. Cigarette margins are expected to remain flat over FY20-23E as increase in consumer prices just offsets tax hikes, but at the cost of lower volumes. Rural recovery is expected to be pushed out to FY22. We use SOTP methodology to value ITC cigarette business at 8x Sep-22 earnings, new FMCG at 3x Sep-22 sales, Agri and paperboard businesses at 10x Sep-22 EPS, and hotels at 1x Sep-21 invested capital to arrive at a price target of Rs155/sh.

### Investment Thesis / Where We Differ

We are c.5-8% below consensus on FY22-23 earnings. However, given the Covid-19 related concerns, we find consumer staple firms relatively better placed given the defensive nature of the business. Businesses with strong cashflows and robust balance sheets may be preferred during a period of disruption.

### Catalysts

#### Upside catalysts

- Volume recovery in cigarette business as Covid-19 issues settle down
- Margin expansion in new FMCG business led by cost optimisation
- Strong cash flows and balance sheet strength to help during the Covid-19 induced disruption

#### Downside catalysts

- Sharp rise in taxation – GST or NCCD
- Potential change in smoker behaviour post the lockdown period
- Certain set of ESG investors can no longer invest in tobacco due to ESG focus

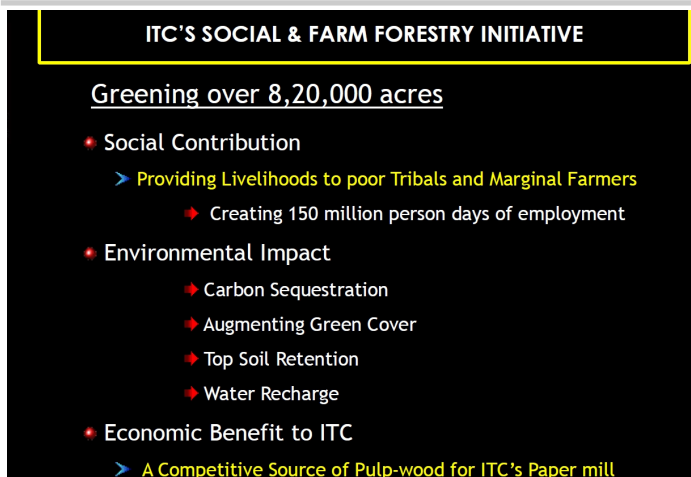
## Exhibit 1 - ITC has delivered strong ESG outcomes



Source: Company, Jefferies

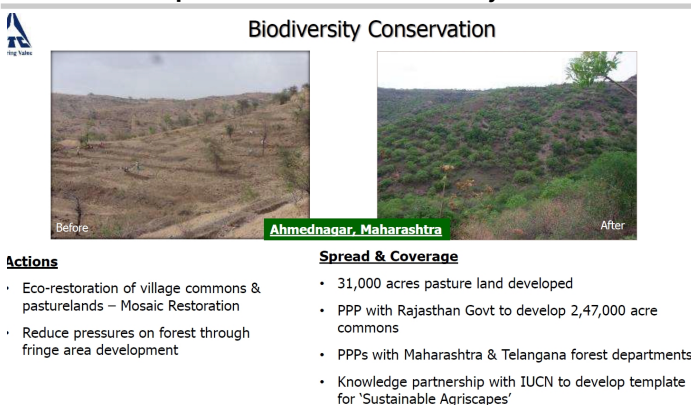
## Reduction in carbon footprint

### Exhibit 3 - Initiatives to reduce carbon footprint



Source: Company, Jefferies

### Exhibit 5 - Example of eco-restoration done by ITC



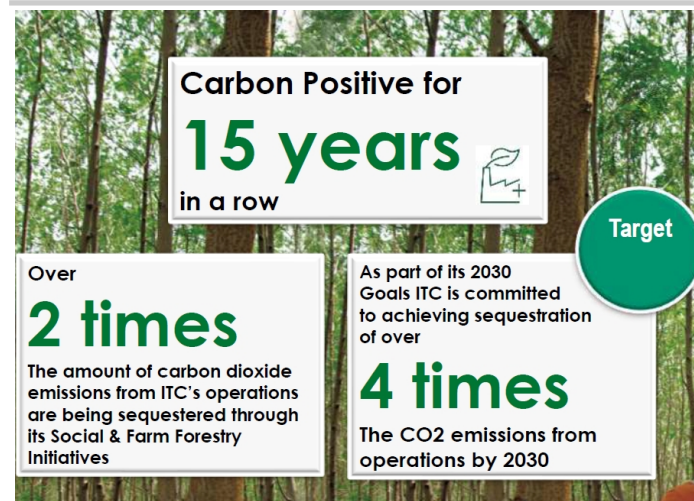
Source: Company, Jefferies

## Exhibit 2 - Key focus areas for ITC's ESG initiatives



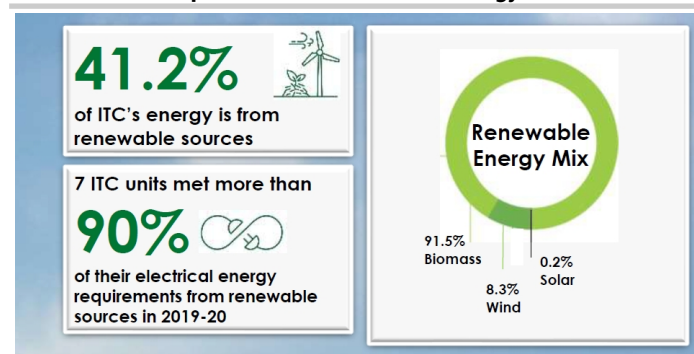
Source: Company, Jefferies

### Exhibit 4 - Target to double sequestration level by 2030



Source: Company, Jefferies

### Exhibit 6 - Widespread use of renewable energy sources



Source: Company, Jefferies

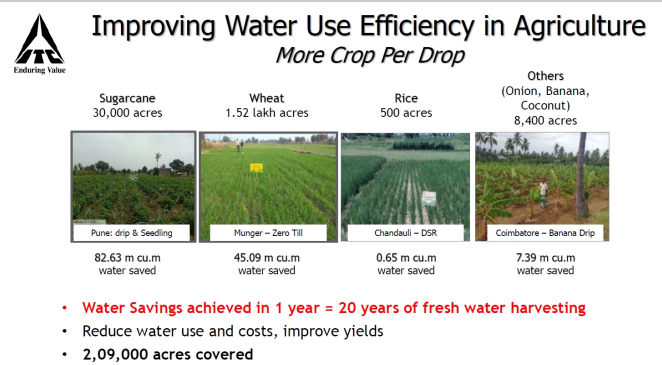
## Water conservation

### Exhibit 7 - Creating structures for rainwater harvesting



Source: Company, Jefferies

### Exhibit 8 - Improving water use efficiency in agriculture



Source: Company, Jefferies

## Solid waste management

### Exhibit 9 - Initiatives to manage solid waste



Source: Company, Jefferies

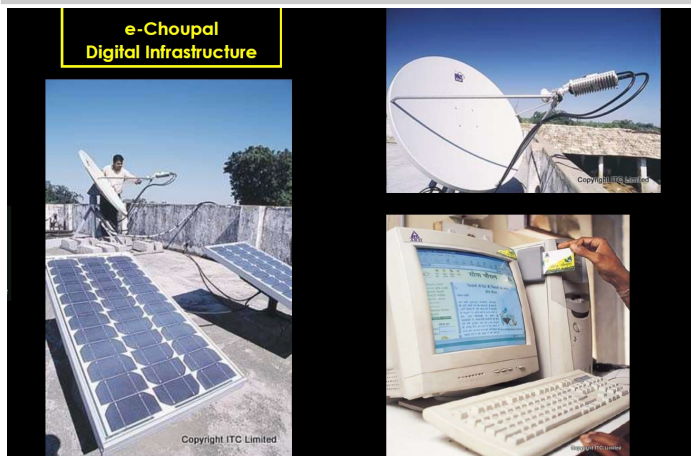
### Exhibit 10 - Innovation in developing sustainable packaging



Source: Company, Jefferies

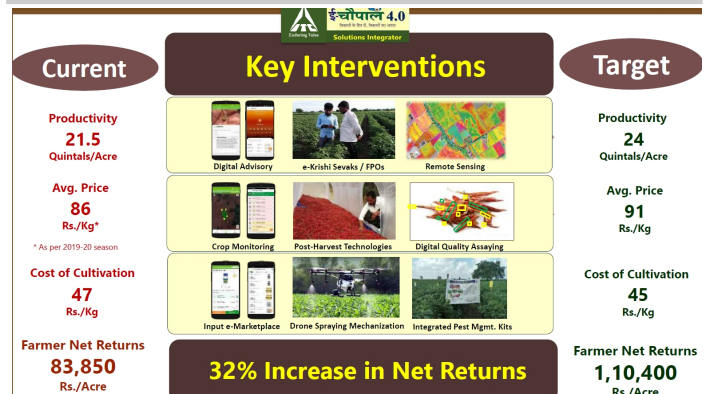
## Empowering farmers

### Exhibit 11 - e-Choupal platform empowers c.4 mn farmers through a network of 6,000+ centers



Source: Company, Jefferies

### Exhibit 12 - e-Choupal 4.0 will focus on a full array of solutions to empower the farmer



Source: Company, Jefferies

Exhibit 13 - Several other social initiatives

## ITC's Social Investments Initiatives

### Horizon 1- Sustainable Livelihoods Today

#### Social Forestry



Achieved: 364,240\*  
Target: 630,000\*

#### Watershed Development



Achieved: 1,133,703\*  
Target: 2,200,000 \*

#### Sustainable Agriculture



Achieved: 567,737\*  
Target: 3,000,000\*

#### Biodiversity



Achieved: 17,456\*  
Target: 100,000\*

#### Women's Empowerment



Covered: 72,402  
Target: 150,000

### Horizon 2: Creating Capabilities For Tomorrow

#### Education



Achieved: 7,75,013  
Target: 1,300,000

#### Youths Trained



Achieved: 81,510  
Target: 282,000

#### Waste Management (Households)



Achieved: 3,13,228  
Target: 600,000

#### Toilets Built



Achieved: 37,594  
Target: 40,000

\* - in acres

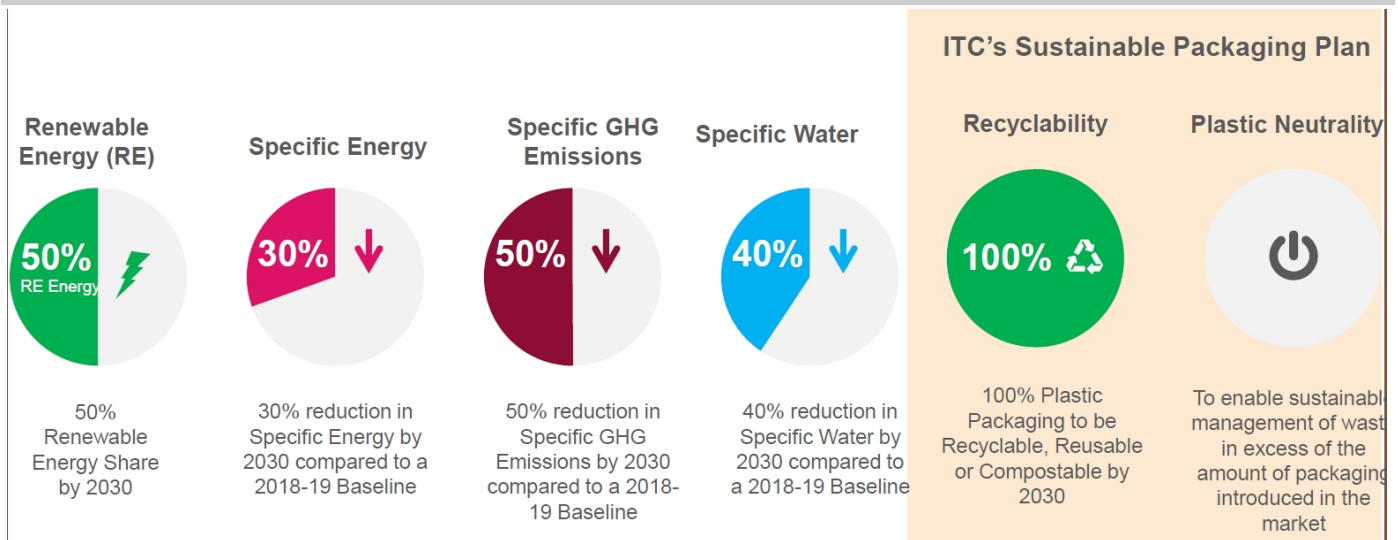
Source: Company, Jefferies

Exhibit 14 - Contributing to UN sustainable development goals

1 NO POVERTY	2 ZERO HUNGER	4 QUALITY EDUCATION	5 GENDER EQUALITY	6 CLEAN WATER AND SANITATION	8 DECENT WORK AND ECONOMIC GROWTH	12 RESPONSIBLE CONSUMPTION AND PRODUCTION	13 CLIMATE ACTION	15 LIFE ON LAND
Women's Economic Empowerment	Sustainable Products	Primary Education	Diversity and Equal Opportunity	Water Security for All	Occupational Health & Safety	Climate Resilience	Climate Resilience	Water Security for All
Climate Smart Agriculture	Sustainable Supply Chains		Women's Economic Empowerment	Sanitation & Solid Waste Mgmt	Vocational Training	Managing Waste	Social Forestry	Climate Smart Agriculture
Integrated Animal Husbandry	Sustainable Agriculture			Primary Education	Women's Economic Empowerment		Climate Smart Agriculture	Social Forestry
	Integrated Animal Husbandry						Integrated Animal Husbandry	
							Water Security for All	

Source: Company, Jefferies

Exhibit 15 - Ambitious targets for the next decade



Source: Company, Jefferies

Exhibit 16 - Multi-tiered governance structure



Source: Company, Jefferies

Exhibit 17 - Income statement

(Year end March; Rsm)	FY18	FY19	FY20	FY21E	FY22E	FY23E
<b>Segmental net revenues</b>						
Cigarettes	186,416	198,343	200,141	176,624	195,350	210,529
% YoY	2.3	6.4	0.9	(11.8)	10.6	7.8
New FMCG	113,286	125,053	128,442	145,140	171,289	192,700
% YoY	8.1	10.4	2.7	13.0	18.0	12.5
Hotels	14,175	16,654	18,373	6,430	11,575	13,311
% YoY	5.7	17.5	10.3	(65.0)	80.0	15.0
Aqri Business	80,677	93,965	102,407	111,624	128,367	141,204
% YoY	(2.4)	16.5	9.0	9.0	15.0	10.0
Paperboards	52,496	58,602	61,072	56,186	64,614	71,075
% YoY	3.9	11.6	4.2	(8.0)	15.0	10.0
<b>Total</b>	<b>447,050</b>	<b>492,617</b>	<b>510,435</b>	<b>496,004</b>	<b>571,195</b>	<b>628,820</b>
% YoY	3.1	10.2	3.6	(2.8)	15.2	10.1
Less : Inter-segment revenue	50,005	49,190	59,074	59,074	62,028	68,231
% YoY	13.9	(1.6)	20.1	-	5.0	10.0
<b>Net sales / Income from operations</b>	<b>397,044</b>	<b>443,427</b>	<b>451,361</b>	<b>436,930</b>	<b>509,167</b>	<b>560,589</b>
% YoY	1.9	11.7	1.8	(3.2)	16.5	10.1
<b>Segmental Ebit</b>						
Cigarettes	133,408	145,511	148,526	130,679	146,141	158,842
% Margin	71.6	73.4	74.2	74.0	74.8	75.4
% YoY	6.6	9.1	2.1	(12.0)	11.8	8.7
New FMCG	1,641	3,157	4,231	9,500	11,739	13,500
% Margin	1.4	2.5	3.3	6.5	6.9	7.0
% YoY	483.6	92.4	34.0	124.6	23.6	15.0
Hotels	1,398	1,777	1,578	(4,200)	1,273	1,597
% Margin	9.9	10.7	8.6	(65.3)	11.0	12.0
% YoY	26.0	27.1	(11.2)	(366.2)	(130.3)	25.5
Aqri Business	8,486	7,766	7,889	8,050	9,242	10,449
% Margin	10.5	8.3	7.7	7.2	7.2	7.4
% YoY	(6.3)	(8.5)	1.6	2.0	14.8	13.1
Paperboards	10,422	12,392	13,053	11,450	13,168	14,662
% Margin	19.9	21.1	21.4	20.4	20.4	20.6
% YoY	7.9	18.9	5.3	(12.3)	15.0	11.3
<b>Segmental Ebit</b>	<b>155,355</b>	<b>170,604</b>	<b>175,276</b>	<b>155,479</b>	<b>181,563</b>	<b>199,051</b>
% Margin	35.3	38.5	38.8	35.6	35.7	35.5
% YoY	7.0	9.8	2.7	(11.3)	16.8	9.6
Unallocable expenses	(10,406)	(10,722)	(11,866)	(11,285)	(12,463)	(13,223)
<b>Ebit</b>	<b>144,949</b>	<b>159,882</b>	<b>163,410</b>	<b>144,194</b>	<b>169,101</b>	<b>185,828</b>
% Margin	33.0	36.1	36.2	33.0	33.2	33.1
% YoY	6.4	10.3	2.2	(11.8)	17.3	9.9
Interest	(867)	(342)	(557)	(600)	(625)	(650)
Financial other income	20,306	24,197	30,137	32,000	32,640	35,088
<b>PBT</b>	<b>164,388</b>	<b>183,737</b>	<b>192,989</b>	<b>175,594</b>	<b>201,116</b>	<b>220,266</b>
Tax	(54,856)	(59,798)	(50,508)	(43,898)	(52,290)	(57,269)
Tax rate (%)	33.4	32.5	26.2	25.0	26.0	26.0
<b>Pre-ex PAT</b>	<b>109,533</b>	<b>123,939</b>	<b>142,482</b>	<b>131,695</b>	<b>148,825</b>	<b>162,997</b>
% YoY	7.4	13.2	15.0	(7.6)	13.0	9.5
<b>Pre-ex EPS</b>	<b>9.0</b>	<b>10.1</b>	<b>11.6</b>	<b>10.7</b>	<b>12.1</b>	<b>13.3</b>
% YoY	7	13	15	(8)	13	10

Source: Company data, Jefferies estimates

## Exhibit 18 - Balance sheet

(Year end March; Rsm)	FY18	FY19	FY20	FY21E	FY22E	FY23E
Networth	514,001	579,498	640,292	647,220	679,270	707,052
Debt	180	111	79	79	79	79
Deferred tax liability	19,179	20,441	16,177	17,277	18,477	19,677
<b>Total</b>	<b>533,360</b>	<b>600,051</b>	<b>656,547</b>	<b>664,576</b>	<b>697,825</b>	<b>726,807</b>
Net fixed assets	205,916	218,878	232,978	234,076	257,676	262,776
Investments	38,757	46,910	36,460	57,960	36,460	36,460
Cash & liquid	221,164	256,557	338,279	325,271	348,605	366,924
Net current assets	67,523	77,706	48,831	47,270	55,085	60,648
<b>Total</b>	<b>533,360</b>	<b>600,051</b>	<b>656,547</b>	<b>664,576</b>	<b>697,825</b>	<b>726,807</b>

Source: Company data, Jefferies estimates



## Company Description

### ITC Limited

ITC is the market leader in the Indian cigarette industry with a 75% volume share. In addition to cigarettes, which form 65% of its revenues, the company has a diversified presence across the consumer staples, branded foods, paper, hotels and retailing businesses.

## Company Valuation/Risks

### ITC Limited

SOTP derived value of Rs265/share (cigarette business at 15x Sep-22 earnings, new FMCG at 4x Sep-22 sales, Agri and paperboard businesses at 15x Sep-22 EPS and hotels at 1x invested capital). Key risks: ESG pressure, sharp rise in taxation & a potential change in smoker behavior post lockdown

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(Article 3(1)e and Article 7 of MAR)

Recommendation Published December 8, 2020 , 07:19 ET.

Recommendation Distributed December 8, 2020 , 07:19 ET.

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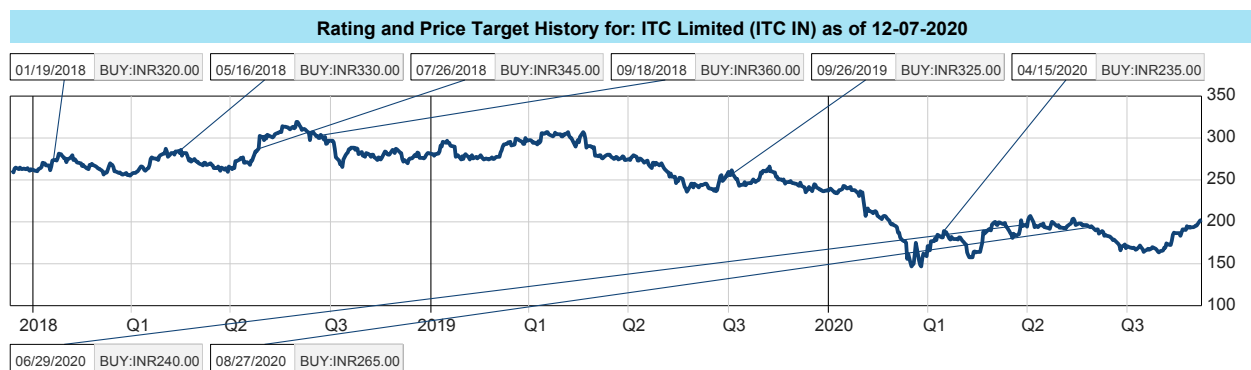
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**Notes:** Each box in the Rating and Price Target History chart above represents actions over the past three years in which an analyst initiated on a company, made a change to a rating or price target of a company or discontinued coverage of a company.

**Legend:**

I: Initiating Coverage

D: Dropped Coverage

B: Buy

H: Hold

UP: Underperform

### Distribution of Ratings

Distribution of Ratings						
			IB Serv./Past12 Mos.		JIL Mkt Serv./Past12 Mos.	
	Count	Percent	Count	Percent	Count	Percent
BUY	1520	58.26%	138	9.08%	14	0.92%
HOLD	955	36.60%	23	2.41%	6	0.63%
UNDERPERFORM	134	5.14%	1	0.75%	1	0.75%

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