

INDUSTRY	FMCG
CMP (as on 8 Jan 2018)	Rs 266
Target Price	Rs 358
Nifty	10,624
Sensex	34,353

KEY STOCK DATA

Bloomberg	ITC IN
No. of Shares (mn)	12,190
MCap (Rs bn)/(US\$ mn)	3,238/51,085
6m avg traded value (Rs mn)	3,611

STOCK PERFORMANCE (%)

52 Week high / low	Rs 368/242		
	3M	6M	12M
Absolute (%)	(0.2)	(20.6)	9.4
Relative (%)	(8.2)	(30.1)	(18.9)

SHAREHOLDING PATTERN (%)

Promoters	-
FIs & Local MFs	36.42
FPIs	19.11
Public & Others	44.47

Source : BSE

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Fiscal stress ≠ Tax burden for ITC

With fiscal stress on the rise, many investors are worried on the likelihood of govt. increasing taxes on cigarettes in the upcoming Union Budget. We think this fear is exaggerated.

- Cigarette taxes contribute only ~2% of total tax collection:** Cigarette industry contributed ~Rs 284bn to the exchequer in FY17 (ITC contribution ~75%). The total tax collection (direct and indirect) for India was at Rs 17,032bn in FY17 out of which Rs 8,562bn was from indirect taxes. Therefore, cigarette industry contributed ~3% to the indirect taxes and ~2% to the total taxes, not very significant. In addition, the dependence on tax revenues from cigarettes has declined over the years to 1.7% in FY17 ([link](#)).
- Historically higher fiscal deficit does not imply increase in cigarette taxes:** India's fiscal deficit was very high at 6%, 6.5%, 4.8% and 5.9% between FY09-12, respectively. However, Govt. had increased the taxes on cigarettes only once during those 4 years. Even if govt. prepares a populist budget for FY19, we believe India's fiscal deficit currently is healthy and not alarming as compared to the historical highs.

Financial Summary

(Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Net Revenue	391,921	428,036	458,944	501,974	552,424
EBITDA	144,509	154,359	165,792	182,862	204,853
APAT	95,009	104,772	113,410	124,815	139,098
EPS (Rs)	7.9	8.6	9.3	10.3	11.5
P/E (x)	33.5	30.6	28.3	25.7	23.1
EV/EBITDA (x)	20.8	19.5	18.1	16.4	14.5
ROE (%)	40.3	36.1	35.6	35.8	37.5

Source: Company, HDFC sec Inst Research

- Our View:** We anticipate neutral to mild increase in taxes during the upcoming budget since govt. has taken two hikes (FY18 Budget and GST hike) recently. Therefore imposing a third significant (high single digit) hike within a period of 12-months seems unlikely. Moreover, the govt. had stated that GST would be neutral for cigarettes; instead govt. increased the cess on cigarettes in July'17 resulting in cumulative ~20% (FY18 Budget and GST hike) hike in taxes for FY18.
- We see risk reward favoring ITC at current price. At CMP, the implied EPS CAGR (FY17-FY20E) at 30x FY20 P/E (Ex-ITC Sector P/E is at 37x FY20) is ~1% and reflecting higher discounting factored in the stock. ITC's last 5 year EPS CAGR (despite punitive taxes) is 10%. Even during the most challenging quarter i.e. 2QFY18, ITC posted 5.6% growth in APAT. Hence, we believe the stock has immense potential to perform well in the coming years. We expect Revenue/EBITDA/APAT CAGR of 9/10/10% respectively over FY17-20E. **We have a BUY rating with a TP of Rs 358, based on 32x Dec-19EPS.**

India's fiscal deficit was very high at 6%, 6.5%, 4.8% and 5.9% between FY09-12, respectively. However, govt. had increased the taxes on cigarettes only once during those 4 years

The dependence on tax revenues from cigarettes have declined over the years to 1.7% in FY17

Cigarette tax hike in FY18 is ~20% (FY18 budget and GST hike) and we see low probability of imposing a third significant (high single digit) hike within a period of 12-months

India's Tax Collection vs. Cigarette Revenue

Particulars	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17
Fiscal Deficit	6.0%	6.5%	4.8%	5.9%	4.9%	4.5%	4.0%	3.9%	3.5%
Cigarette Tax Increase									
Upto 65mm				0%	0%	0%	72%	25%	10%
65mm to 70mm	0%	0%	18%	0%	23%	18%	17%	15%	10%
Length 70-75mm	0%	0%	11%	0%	17%	18%	11%	15%	10%
Length 75-85mm	0%	0%	11%	0%	18%	18%	21%	14%	11%
Length >85mm	0%	0%	9%	0%	18%	18%	0%	15%	10%

Particulars (Rs bn)	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17
Tax collection from Cigarette (Rs bn)	122	128	153	176	218	235	258	278	285
Indirect Tax Collection	2,830	2,475	3,478	3,960	4,731	5,012	5,467	7,148	8,562
Direct Tax Collection	3,338	3,770	4,453	4,932	5,650	6,375	7,047	7,408	8,471
Total Tax Collection	6,168	6,245	7,931	8,892	10,380	11,387	12,514	14,556	17,032
Cigarette Tax (% Indirect Tax)	4.3%	5.2%	4.4%	4.4%	4.6%	4.7%	4.7%	3.9%	3.3%
Cigarette Tax (% Total Tax)	2.0%	2.1%	1.9%	2.0%	2.1%	2.1%	2.1%	1.9%	1.7%

Source: NIC, TII, Economic Survey, HDFC sec Inst Research

Cigarette taxes have increased by 20% in this FY of which 6% increased during the union budget and 14% due to GST

Cigarette below 65mm had a lesser impact due to transition to GST

Recent Performance

Cigarette Performance

Particulars (Rs mn)	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18
Gross Revenue	79,631	81,063	85,455	82,306	85,285	82,880	89,549	87,742	45,542
YoY Gr. (%)	1.6%	5.7%	10.2%	6.4%	7.1%	2.2%	4.8%	6.6%	-46.6%
Revenue Mix (%)	57.8%	58.9%	58.0%	54.8%	58.0%	58.2%	57.7%	55.5%	41.6%
EBIT	29,689	29,838	30,186	30,046	32,169	30,337	32,588	32,741	32,917
YoY Gr. (%)	3.0%	3.4%	11.5%	8.0%	8.4%	1.7%	8.0%	9.0%	2.3%
EBIT Mix (%)	85.9%	85.2%	86.1%	86.2%	85.9%	85.7%	86.8%	86.7%	85.6%
EBIT Margin (%)	37.3%	36.8%	35.3%	36.5%	37.7%	36.6%	36.4%	37.3%	72.3%
EBIT Margin Chg (bps)	161bps	171bps	286bps	54bps	44bps	-21bps	107bps	81bps	3,456bps
Capital Employed	52,444	50,282	52,491	51,465	49,581	47,937	55,467	44,294	39,733
RoCE (%)	226%	237%	230%	234%	260%	253%	235%	296%	331%

Source: Company, HDFC sec Inst Research

Note: Sales growth/margin expansion for 1QFY16 to 4QFY16 are calculated based on OLD AS

FMCG Performance

Particulars (Rs mn)	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18
Gross Revenue	23,580	24,849	27,108	23,852	26,717	25,693	28,858	26,009	28,041
YoY Gr. (%)	7.1%	7.1%	5.4%	9.5%	13.3%	3.4%	6.5%	9.0%	5.0%
Revenue Mix (%)	17.1%	18.1%	18.4%	15.9%	18.2%	18.0%	18.6%	16.5%	25.6%
EBIT	(111)	188	708	(45)	(33)	(197)	556	54	205
YoY Gr. (%)	7.7%	63.6%	45.9%	-43.3%	-70.6%	-204.9%	-21.5%	-220.1%	-728.5%
EBIT Mix (%)	-0.3%	0.5%	2.0%	-0.1%	-0.1%	-0.6%	1.5%	0.1%	0.5%
EBIT Margin (%)	-0.5%	0.8%	2.6%	-0.2%	-0.1%	-0.8%	1.9%	0.2%	0.7%
EBIT Margin Chg (bps)	0bps	26bps	72bps	18bps	35bps	-152bps	-69bps	40bps	85bps
Capital Employed	47,744	44,629	48,520	54,672	54,924	51,817	57,067	65,082	59,952
RoCE (%)	-0.9%	1.7%	5.8%	-0.3%	-0.2%	-1.5%	3.9%	0.3%	1.4%

Source: Company, HDFC sec Inst Research

Note: Sales growth/margin expansion for 1QFY16 to 4QFY16 are calculated based on OLD AS

Hotel Performance

Particulars (Rs mn)	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18
Gross Revenue	2,901	3,453	3,630	2,874	2,973	3,705	3,856	3,049	3,002
YoY Gr. (%)	10.9%	4.5%	4.8%	-0.2%	2.5%	7.3%	6.2%	6.1%	1.0%
Revenue Mix (%)	2.1%	2.5%	2.5%	1.9%	2.0%	2.6%	2.5%	1.9%	2.7%
EBIT	(55)	258	427	12	7	422	669	53	42
YoY Gr. (%)	-42.2%	-10.1%	1.5%	-116.8%	-111.7%	63.4%	56.9%	335.2%	552.3%
EBIT Mix (%)	-0.2%	0.7%	1.2%	0.0%	0.0%	1.2%	1.8%	0.1%	0.1%
EBIT Margin (%)	-1.9%	7.5%	11.8%	0.4%	0.2%	11.4%	17.4%	1.7%	1.4%
EBIT Margin Chg (bps)	175bps	-122bps	-39bps	294bps	213bps	390bps	561bps	132bps	119bps
Capital Employed	44,208	44,193	44,749	45,066	45,473	45,867	46,622	48,008	48,770
RoCE (%)	-0.5%	2.3%	3.8%	0.1%	0.1%	3.7%	5.7%	0.4%	0.3%

Source: Company, HDFC sec Inst Research

Note: Sales growth/margin expansion for 1QFY16 to 4QFY16 are calculated based on OLD AS

Agribusiness Performance

Particulars (Rs mn)	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18
Gross Revenue	18,437	14,810	18,068	27,941	18,800	16,719	19,185	27,605	19,680
YoY Gr. (%)	-10.4%	-7.3%	26.5%	20.2%	2.0%	12.9%	6.2%	-1.2%	4.7%
Revenue Mix (%)	13.4%	10.8%	12.3%	18.6%	12.8%	11.7%	12.4%	17.5%	18.0%
EBIT	2,939	2,314	1,703	2,373	2,970	2,366	1,349	2,351	2,562
YoY Gr. (%)	-1.4%	-3.1%	3.6%	1.5%	1.0%	2.2%	-20.8%	-0.9%	-13.7%
EBIT Mix (%)	8.5%	6.6%	4.9%	6.8%	7.9%	6.7%	3.6%	6.2%	6.7%
EBIT Margin (%)	15.9%	15.6%	9.4%	8.5%	15.8%	14.2%	7.0%	8.5%	13.0%
EBIT Margin Chg (bps)	146bps	68bps	-209bps	-156bps	-15bps	-148bps	-239bps	2bps	-278bps
Capital Employed	16,970	20,029	23,587	23,575	17,281	17,493	21,957	27,248	17,314
RoCE (%)	69%	46%	29%	40%	69%	54%	25%	35%	59%

Source: Company, HDFC sec Inst Research

Note: Sales growth/margin expansion for 1QFY16 to 4QFY16 are calculated based on OLD AS

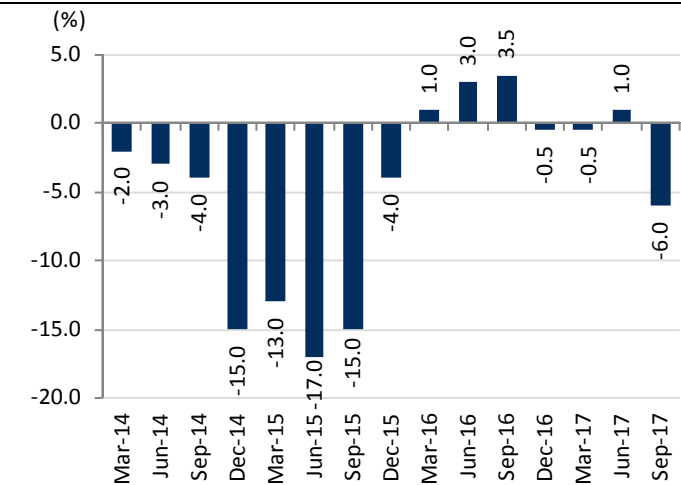
Paper Business Performance

Particulars (Rs mn)	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18
Gross Revenue	13,310	13,377	13,150	13,229	13,314	13,358	13,727	13,598	13,094
YoY Gr. (%)	-2.3%	5.1%	3.0%	-1.6%	0.0%	-0.1%	4.4%	2.8%	-1.7%
Revenue Mix (%)	9.7%	9.7%	8.9%	8.8%	9.1%	9.4%	8.8%	8.6%	12.0%
EBIT	2,092	2,410	2,030	2,477	2,320	2,460	2,402	2,573	2,742
YoY Gr. (%)	-13.6%	12.7%	6.5%	-2.6%	10.9%	2.1%	18.3%	3.9%	18.2%
EBIT Mix (%)	6.1%	6.9%	5.8%	7.1%	6.2%	7.0%	6.4%	6.8%	7.1%
EBIT Margin (%)	15.7%	18.0%	15.4%	18.7%	17.4%	18.4%	17.5%	18.9%	20.9%
EBIT Margin Chg (bps)	-314bps	17bps	-41bps	-21bps	170bps	40bps	206bps	20bps	352bps
Capital Employed	54,225	54,045	55,203	55,985	56,594	57,079	56,989	57,841	60,252
RoCE (%)	15%	18%	15%	18%	16%	17%	17%	18%	18%

Source: Company, HDFC sec Inst Research

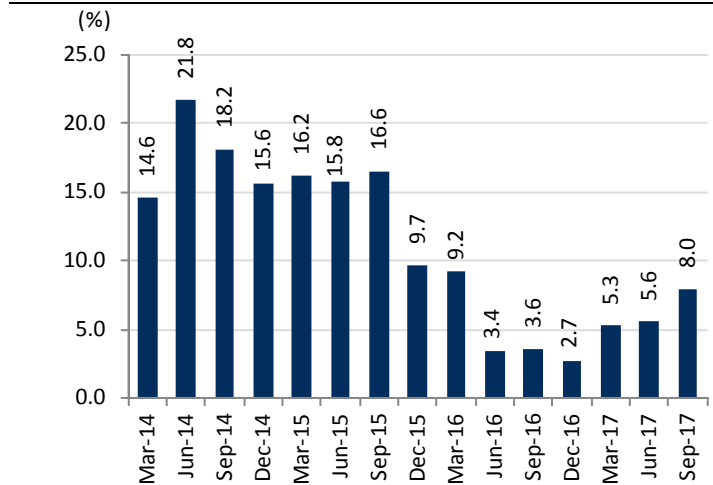
Note: Sales growth/margin expansion for 1QFY16 to 4QFY16 are calculated based on OLD AS

Cigarette volume growth



Source: Company, HDFC sec Inst Research

Cigarette price growth



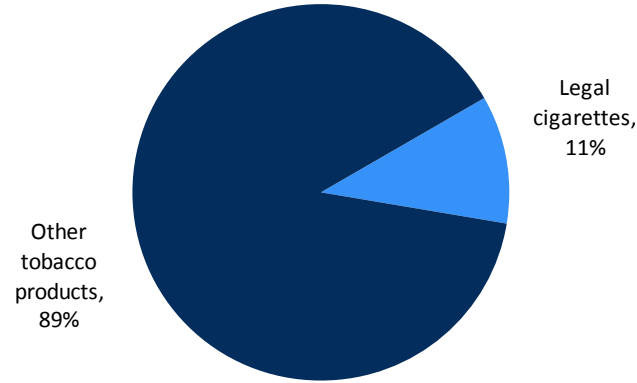
Source: Company, HDFC sec Inst Research

Assumptions

	FY16	FY17	FY18E	FY19E	FY20E
Cig. Revenue Gr (%)	6.2	5.1	3.7	7.7	8.5
Cig. Volume Gr (%)	(9.4)	0.6	(3.5)	2.5	2.5
FMCG Revenue Gr (%)	7.7	8.2	8.6	13.5	13.6
Hotels Revenue Gr (%)	11.5	6.1	7.4	9.8	9.3
Agri Revenue Gr (%)	0.2	12.6	13.6	14.3	14.7
Paper Revenue Gr (%)	5.9	12.1	15.2	15.2	15.2
Gross Margin (%)	65.4	62.5	62.7	62.9	63.4
Employee (% of sales)	8.8	8.5	8.0	7.9	7.7
ASP (% of sales)	2.5	1.9	2.2	2.3	2.4
Rent (% of sales)	2.4	2.1	2.2	2.2	2.3
Distribution (% of sales)	2.2	2.0	2.0	2.0	2.0
Cont. Manf. (% of sales)	0.8	0.9	0.9	0.9	0.9
EBITDA Margin (%)	36.9	36.1	36.1	36.4	37.1
Tax Rate (%)	36.1	34.6	34.0	34.0	34.0

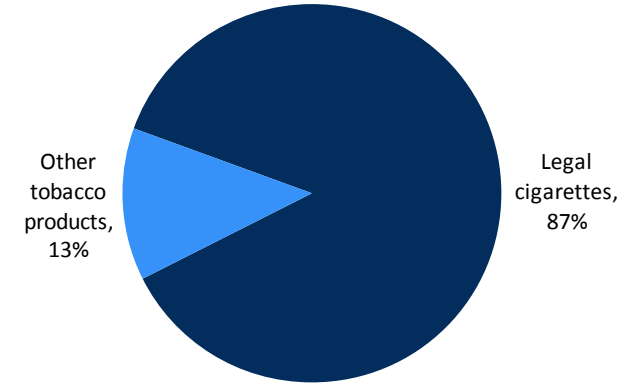
Source: Company, HDFC sec Inst Research

India's Tobacco Consumption
Tobacco consumption share



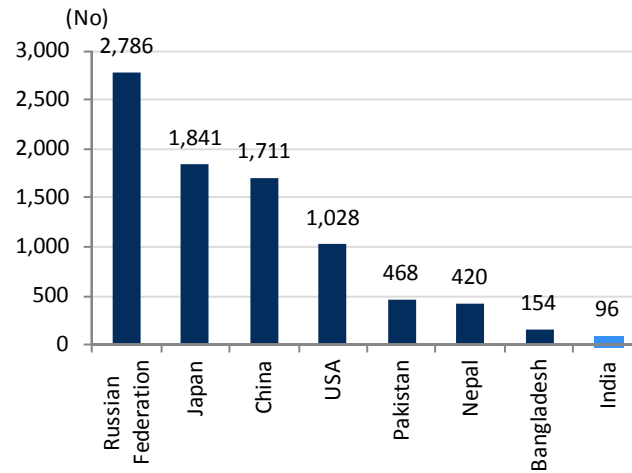
Source: Company, HDFC sec Inst Research

Tax revenue share



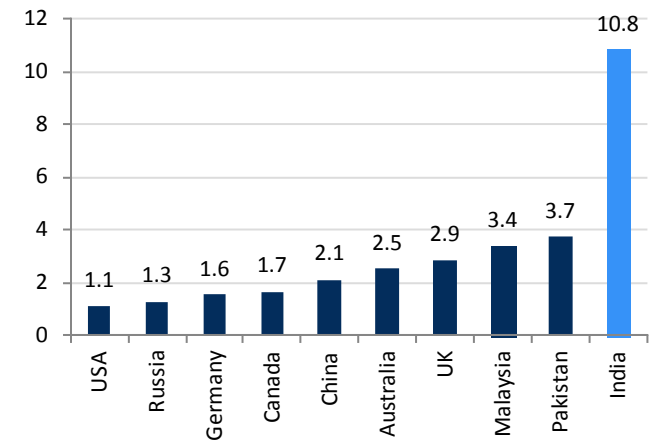
Source: Company, HDFC sec Inst Research

Per capita consumption of Tobacco in India – Per annum



Source: Company, HDFC sec Inst Research

Affordability (% of per capita GDP required to purchase 100 packs of 20 cigarettes of most sold brand)



Source: Company, HDFC sec Inst Research

Income Statement

(Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Net Revenues	391,921	428,036	458,944	501,974	552,424
Growth (%)	2.0	9.2	7.2	9.4	10.1
Material Expenses	135,685	160,492	171,319	186,158	202,435
Employee Expense	34,410	36,317	36,666	39,517	42,623
ASP Expense	9,887	8,107	10,097	11,545	13,258
Distribution Expense	8,528	8,560	9,178	10,038	11,047
Other Expenses	58,903	60,201	65,892	71,854	78,207
EBITDA	144,509	154,359	165,792	182,862	204,853
EBITDA Growth (%)	4.5	6.8	7.4	10.3	12.0
EBITDA Margin	36.9	36.1	36.1	36.4	37.1
Depreciation	10,774	11,528	12,282	13,330	14,242
EBIT	133,735	142,831	153,511	169,532	190,611
Other Income (Including EO)	15,308	17,615	18,392	19,644	20,199
Interest	536	243	173	182	192
PBT	148,507	160,204	171,730	188,993	210,618
Total Tax	53,582	55,491	58,388	64,258	71,610
RPAT	95,009	104,772	113,410	124,815	139,098
Exceptional Gain/(loss)	-	-	-	-	-
Adjusted PAT	95,009	104,772	113,410	124,815	139,098
APAT Growth (%)	(1.7)	10.3	8.2	10.1	11.4
Adjusted EPS (Rs)	7.9	8.6	9.3	10.3	11.5
EPS Growth (%)	(2.1)	9.6	8.2	10.1	11.4

Source: Company, HDFC sec Inst Research

Balance Sheet

(Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
SOURCES OF FUNDS					
Share Capital - Equity	8,047	12,147	12,147	12,147	12,147
Reserves	418,748	451,982	485,438	522,258	563,292
Total Shareholders' Funds	426,795	464,129	497,585	534,406	575,440
Minority Interest	2,609	2,947	2,879	2,800	2,709
Long Term Debt	267	184	184	184	184
Short Term Debt	440	191	210	231	254
Total Debt	706	375	394	415	438
Net Deferred Taxes	18,395	18,333	18,365	18,399	18,436
Other non current liabilities	2,756	2,174	2,174	2,174	2,174
TOTAL SOURCES OF FUNDS	451,261	487,959	521,397	558,194	599,197
APPLICATION OF FUNDS					
Net Block	149,060	157,778	175,187	185,957	195,815
CWIP	35,759	37,849	38,849	39,849	40,849
Goodwill	2,314	2,314	2,314	2,314	2,314
LT Loans & Advances	29,457	32,179	36,039	40,362	45,204
Total Non-current Assets	216,590	230,120	252,390	268,483	284,183
Inventories	90,621	86,711	93,018	101,354	110,695
Debtors	19,178	24,743	26,530	29,017	31,933
Other Expenses	11,109	17,471	19,567	21,915	24,545
Cash & Equivalents	179,800	199,938	199,555	213,978	231,973
Total Current Assets	300,707	328,863	338,669	366,264	399,146
Creditors	23,393	26,593	29,253	32,178	35,396
Other Current Liabilities & Provns	42,643	44,430	40,409	44,375	48,736
Total Current Liabilities	66,036	71,023	69,662	76,553	84,132
Net Current Assets	234,672	257,839	269,008	289,711	315,014
TOTAL APPLICATION OF FUNDS	451,261	487,959	521,397	558,194	599,197

Source: Company, HDFC sec Inst Research

Cash Flow Statement

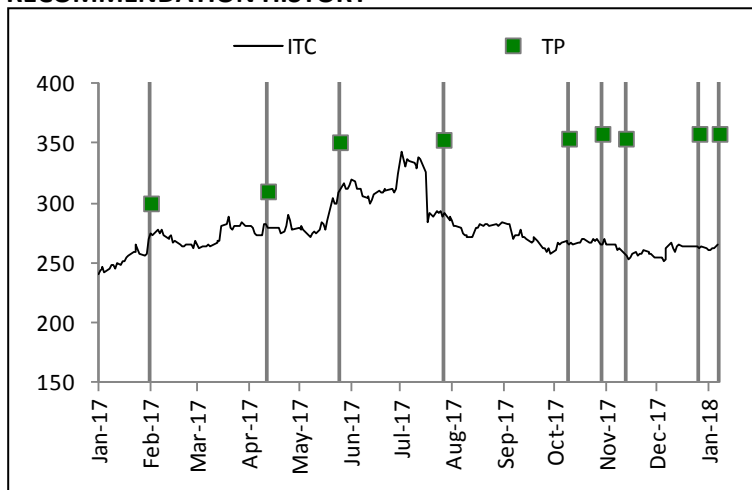
(Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Reported PBT	154,332	160,204	171,730	188,993	210,618
Non-operating & EO Items	(5,980)	-	-	-	-
Interest Expenses	(8,227)	243	173	182	192
Depreciation	11,134	11,528	12,282	13,330	14,242
Working Capital Change	(1,666)	2,350	(15,411)	(10,604)	(12,150)
Tax Paid	(50,812)	(55,462)	(58,356)	(64,224)	(71,573)
OPERATING CASH FLOW (a)	98,782	118,863	110,416	127,678	141,328
Capex	(23,835)	(31,798)	(30,691)	(25,100)	(25,100)
Free Cash Flow (FCF)	74,947	87,065	79,725	102,578	116,228
Investments	(34,379)	(52,788)	(15,000)	(15,000)	(15,000)
Non-operating Income	23,875	6,426	0	(0)	0
INVESTING CASH FLOW (b)	(34,340)	(78,160)	(45,691)	(40,100)	(40,100)
Debt Issuance/(Repaid)	(223)	-	-	-	-
Interest Expenses	(324)	(243)	(173)	(182)	(192)
FCFE	74,400	86,822	79,552	102,397	116,036
Share Capital Issuance	5,317	6,426	0	(0)	0
Dividend	(61,258)	(62,863)	(68,046)	(74,889)	(83,459)
Others	(1,300)	(11,001)	(11,908)	(13,106)	(14,605)
FINANCING CASH FLOW (c)	(57,788)	(67,681)	(80,127)	(88,176)	(98,256)
NET CASH FLOW (a+b+c)	6,655	(26,978)	(15,402)	(598)	2,972
EO Items, Others	(10,267)	-	-	-	-
Closing Cash & Equivalents	62,324	29,674	14,291	13,714	16,709

Source: Company, HDFC sec Inst Research

Key Ratios

	FY16	FY17	FY18E	FY19E	FY20E
PROFITABILITY (%)					
GPM	65.4	62.5	62.7	62.9	63.4
EBITDA Margin	36.9	36.1	36.1	36.4	37.1
EBIT Margin	34.1	33.4	33.4	33.8	34.5
APAT Margin	24.2	24.5	24.7	24.9	25.2
RoE	25.5	23.5	23.6	24.2	25.1
RoIC (or Core RoCE)	40.3	36.1	35.6	35.8	37.5
RoCE	25.4	23.4	23.4	24.1	24.9
EFFICIENCY					
Tax Rate (%)	36.1	34.6	34.0	34.0	34.0
Fixed Asset Turnover (x)	0.6	0.6	0.6	0.6	0.6
Inventory (days)	84.4	73.9	74.0	73.7	73.1
Debtors (days)	17.9	21.1	21.1	21.1	21.1
Other Current Assets (days)	10.3	14.9	15.6	15.9	16.2
Payables (days)	21.8	22.7	23.3	23.4	23.4
Other Current Liab & Provns (days)	39.7	37.9	32.1	32.3	32.2
Cash Conversion Cycle (days)	51.1	49.4	55.2	55.1	54.9
Net D/E (x)	(0.4)	(0.4)	(0.4)	(0.4)	(0.4)
Interest Coverage (x)	0.0	0.0	0.0	0.0	0.0
PER SHARE DATA (Rs)					
EPS	7.9	8.6	9.3	10.3	11.5
CEPS	8.8	9.6	10.3	11.4	12.6
Dividend	8.5	5.2	5.6	6.2	6.9
Book Value	35.4	38.2	41.0	44.0	47.4
VALUATION					
P/E (x)	33.5	30.6	28.3	25.7	23.1
P/BV (x)	7.5	6.9	6.4	6.0	5.6
EV/EBITDA (x)	20.8	19.5	18.1	16.4	14.5
EV/Revenues (x)	7.7	7.0	6.6	6.0	5.4
OCF/EV (%)	3.3	4.0	3.7	4.3	4.7
FCF/EV (%)	2.5	2.9	2.7	3.4	3.9
FCFE/Mkt Cap (%)	2.3	2.7	2.5	3.2	3.6
Dividend Yield (%)	3.2	2.0	2.1	2.3	2.6

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY


Date	CMP	Reco	Target
2-Feb-17	270	BUY	300
14-Apr-17	281	BUY	310
28-May-17	309	BUY	351
28-Jul-17	289	BUY	353
10-Oct-17	268	BUY	354
30-Oct-17	269	BUY	358
13-Nov-17	266	BUY	354
27-Dec-17	264	BUY	358
9-Jan-18	266	BUY	358

Rating Definitions

- BUY** : Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

INSTITUTIONAL RESEARCH

Disclosure:

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