MORNING FARSIGHT

Wednesday, September 19, 2018

ITC	CMP:RS 304	TRGT:RS 340	TIME HORIZON: 1 YEAR

ITC is looking a good buy now, after renewed buying seen in FMCG stocks, while company seen well placed to deliver strong Q2FY18 earnings, with positive data points seen in July and August, while stock also offers relative stability on earnings front and valuations are now seen getting re-rated (after significant under performance over the past years, as stock is still trading at hefty discount to FMCG sector) makes it attractive and should lead to out performance. For Q2, industry checks are suggesting that ITC is witnessing improving momentum in cigarettes with a possible 3-4% YoY volume growth in 2QFY19 (2% volume growth in Q1, after 3 consecutive quarters of decline). In the FMCG business, ITC is expected to post a healthy show, despite rising competitive intensity from Nestle in noodles and Britannia in the premium biscuits category. Over the longer term, ITCs' Non-tobacco operations are likely to surprise positively, led by good performance of FMCG (Foods) business and a demand revival in the hotel and paper division. Further, cigarette volumes grew —2% for Q1FY19 after three successive quarters of volume decline was a notable trend. A stable cigarette volume environment may allow ITC to take calibrated price hikes in H2FY19, with an objective to deliver low-to mid-teens cigarette EBIT growth. Besides this, the non-tobacco FMCG segment reported revenue growth of 10% YoY and adjusted for GST, revenues grew by 14%. According to the management, this was driven by the staples, snacks and meals business in the packaged foods business, and by deodorants and liquids (hand wash & body wash) in the personal care business, offset by the ongoing restructuring of the retail footprint in the Lifestyle Retailing Business. ITC is now the market leader in the potato chips category in Southem India, ahead of Pepsi. The hotel business reported 12% revenue growth and 2.5x EBIT growth in Q1FY19, while Paper and packaging reported flat revenue growth (in line with MSe); EBIT growth for the category stood at 15%YoY in Q1 FY19. Company's other FMCG business (ex-tobacco) has grown at an impressive pace over the past decade, registering a 20% revenue CAGR, and has revenues higher than most of the mid-size FMCG companies. Additionally, ITC's strong rural linkages, wide distribution reach (2mn direct outlets), agri-commodity sourcing, packaging know-how and cuisine knowledge provide significant synergies for this vertical. ITC is also exploring more categories (dairy, chocolates, coffee, juices) which should add to the growth profile over the medium term. Capex investments have risen materially for the other FMCG division in recent years, as large integrated manufacturing plants are being set up to increase in-house production. This will help lower the cost structure, have better quality control, and enhance e speed to market Company also offers an attractive dividend yield and has stepped its dividend payment to 57% from about 40% historically. On an estimated EPS of Rs 11for FY19, stock is trading at PE of sub 28x, which is at 28% discount to MSCI Consumer Staples, while this discount has historically been in the range of 10-15%, and offers room for appreciation. Share ruling at Rs 304 can move to Rs 340 in 1 year. Buy as an investor.