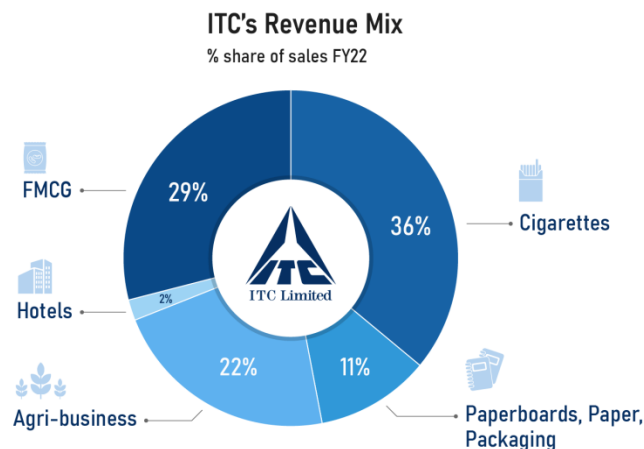


ITC- THE BUDGET STOCK

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Introduction

ITC Limited is a diversified conglomerate headquartered in Kolkata, India. ITC is often referred to as the "budget stock" due to its relatively low valuation compared to other large-cap stocks in India. ITC has got its hands in many pies—it sells biscuits, atta, and noodles. It has a chain of hotels. It has an agri-business that supplies and exports wheat. It even sells paper and packaging products.



Source: Nomura

The Cigarette Business: Cash Cow of ITC

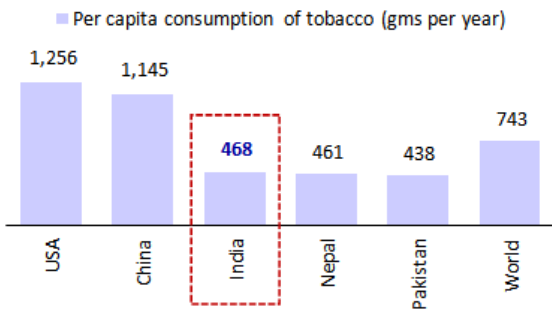
ITC has been selling a lot of cigarettes in the past couple of years—much more than what investors anticipated in fact. Despite all the anti-tobacco campaigns and warnings about the ill effects of tobacco, people are buying cigarettes. The stable tax regime has helped it and that has allowed it to bite into the share of the illicit market.

Because—and don't hate us for throwing this in here—low per capita consumption leaves room for cigarettes to grow in India! While on average, people across the world smoke 800 cigarettes a year, India's consumption of the legal variety is just 89 cigarettes. Most folks in India still prefer other tobacco products such as beedis and *ghutkas*. But if the tax regime remains more or less stable and as per capita incomes rise, we might see a gradual shift to cigarettes. It's a long shot but it's possible.

While India accounts for 18% of the world population and the third largest grower of tobacco, its share in Cigarette consumption is less than 2%.

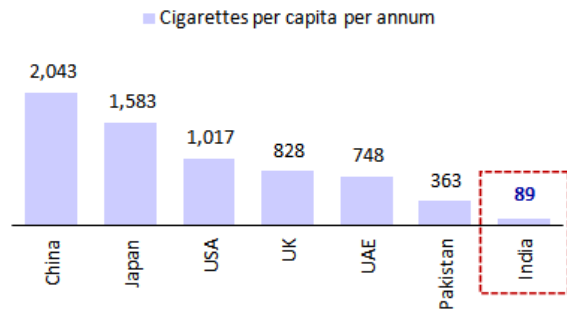
India has a long history of consuming tobacco in other forms such as *bidis*, *khaini*, *zarda*, and *gutkha*. It also has the fourth largest illicit Cigarette market in the world. Consequently, legal Cigarettes account for just 8% of tobacco consumption in India.

Exhibit 1: India's per capita tobacco consumption stands ~60% of the world average...



Source: Company, MOSL

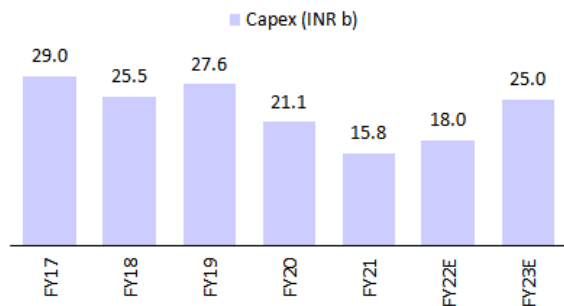
Exhibit 2: ...while its per capita Cigarette consumption is even lower at just 11% of the world average



Source: Company, MOSL

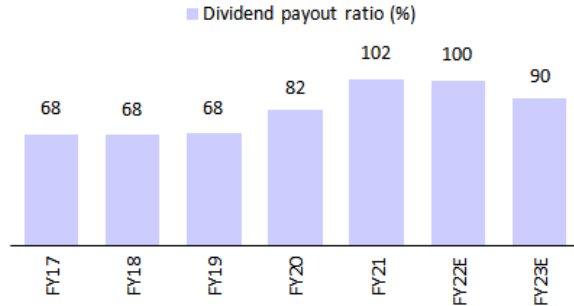
Capex Plans and Dividend Policy

Exhibit 3: Capex to have average annual run-rate of INR30b over next three years



Source: Company, MOFSL

Exhibit 4: Dividend payout to remain high, in line with dividend policy



Source: Company, MOFSL

Investors have a love-hate relationship with ITC. They know it's a sin stock that's at the whims and fancies of the government. They know that while the cigarette business is only 40% of revenues, it's still the cash cow that contributes to 80% of ITC's profits and allows the company to diversify its business interests. They know that foreign investors have cut their holdings from 20% in FY13 to just 12% in FY22.

But they also know that the company has a lot of cash and is hell-bent on diversifying and shedding the tag of simply being a tobacco player.

The Practice Case

Mr. Sharma is a 35-year-old investor who is looking to invest in the stock market. He has been researching various stocks and has come across ITC Limited. He is interested in investing in ITC as he has read that it is a "budget stock" and is available at a relatively low valuation. However, he is unsure about the future prospects of the company and is hesitant to invest without doing proper research.

Mr. Sharma starts by analyzing the financials of ITC Limited. He looks at the company's revenue and profit growth over the past few years and finds that it has been consistent, but not

exceptional. He also looks at the company's debt levels and finds that it has a relatively low debt-to-equity ratio, indicating a strong balance sheet. Additionally, he reads up on the company's various business segments and finds that they are diversified, with the FMCG segment being the largest contributor to revenue.

After conducting his research, Mr. Sharma consults with a financial advisor to get a second opinion. The financial advisor explains to him that ITC Limited is a stable company with a strong brand and a diversified business model. However, he also cautions Mr. Sharma that the company's growth potential may be limited due to regulatory challenges in the cigarette industry and increasing competition in the FMCG segment.

After considering the financial advisor's advice, Mr. Sharma decides to invest a portion of his savings in ITC Limited. He feels that the company's strong balance sheet, diversified business model, and relatively low valuation make it a good long-term investment option. However, he also acknowledges the risks associated with investing in a tobacco company and the potential for limited growth.

Questions:

1. What are the risks and benefits of investing in ITC Limited?
2. How might changes in the regulatory environment impact the company's future prospects?
3. What steps can an investor take to mitigate the risks associated with investing in a tobacco company?
4. How might the company's diversification across different business segments impact its long-term growth potential?

