CENTRUM

Company Update I Consumer I 15 December 2021

LIONHEART SERIES

ITC Limited

Strategy refresh to build investor confidence

In its first-ever analyst interaction, ITC showcased its strategy refresh focusing on *ITCNext* growth drivers for various business verticals. We believe such interactions are a step towards transparency and will enhance investor confidence. We note that its growth strategy has a lot of substance and will enable ITC to become a future-ready organization by banking on advanced technology and enhanced digital capability, driving growth as well as cost competencies. Focus on agility and consumer-centric innovations using disruptive technology will improve speed to market and deliver superior profitability. Further, improved disclosures on ESG and sustainability agenda (pointed by us in our previous report) should now warm up investors, who have otherwise remained fence sitters. We firmly believe that ITC is far below its fair value and will significantly outperform its peers. We expect operating scale to lift foods revenue and profitability in the near term, though the overhang on cigarette taxation could pose concerns. We maintain BUY, with a DCF-based target price of Rs345 (22.5x FY24E EPS).

Strategy refresh reemphasizes growth levers are intact

ITC's strategy refresh focuses on multiple growth drivers for various business verticals to capture market opportunities. Its attempt to build future-fit brands using agile and purposeful innovation should help in winning new age consumers, as its digital focus aids structural interventions in building new platforms to connect end consumers. Further, its efforts on cost optimization using advanced technology in smart buying and network optimization extracting cost efficiencies should ensure improvement in profitability.

Visible growth drivers across business segments

We have argued in our Lionheart report earlier that the foods segment (forms ~81% of revenues) is driving other-FMCG business, suggesting four growth drivers: (1) optimizing brand spends, (2) improving product mix, (3) increasing realizations, and (4) operating leverage, as the company is entering into new white spaces. These have started propelling FMCG segment margins. Notably, with scale and network optimization, we expect double-digit EBITDA margin soon. Despite lower consumption of cigarettes (8%), stable taxation policy could check illicit products, as the company plans to maximize cigarette potential within the tobacco consumption basket.

Focus on ESG and sustainability should lift investors' confidence

The ESG buzzword had created a perception that all sin good companies are in the ESG negative list for FIIs. However, as the dust is settling and the meaning of ESG is becoming clearer, investors are acknowledging ITC's achievements on the ESG front and revisiting earlier perceptions. ITC has been Carbon/Water/Solid Waste Recycling positive for 16/19/14 years in a row and is rated AA by MSCI-ESG (highest among global tobacco companies) and is included in the Dow Jones Sustainability Emerging Market Index.

Inexpensive valuations leave enough runway for stock re-rating

Strategy refresh, stable taxation for cigarette business, tailwinds for FMCG business, use of data analytics, widening distribution, and cost optimization via supply chain interventions and smart manufacturing are key positives. Company has ruled out any potential for demerger except hotels and share buy-back. Reasonable valuations make the stock more attractive. We maintain our BUY rating, with a DCF-based TP of Rs345 (22.5x FY24E EPS). Key risks: sharp increase in taxation, higher leaf tobacco prices, and delayed economic recovery.

Financial and valuation summary

YE Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenues	451,361	451,118	489,180	554,632	596,347
EBITDA	174,206	151,492	187,587	212,097	223,017
EBITDA margin (%)	38.6	33.6	38.3	38.2	37.4
Adj. Net profit	152,682	130,316	158,801	178,028	187,899
Adj. EPS (Rs)	12.4	10.6	12.9	14.5	15.3
EPS growth (%)	22.5	(14.6)	21.9	12.1	5.5
PE (x)	18.4	21.6	17.7	15.8	15.0
EV/EBITDA (x)	14.2	16.8	13.4	11.7	11.0
PBV (x)	4.4	4.8	4.6	4.4	4.2
RoE (%)	25.0	21.2	26.4	28.4	28.7
RoCE (%)	25.0	21.1	26.3	28.3	28.6

Source: Bloomberg, Centrum Broking

Buy

Target Price: Rs345
Current Price: Rs229
Forecast return: 51%

Market Data

Bloomberg:	ITC IN
52 week H/L:	265/197
Market cap:	Rs2817.0bn
Shares outstanding:	12322.7mn
Free float:	56.5%
Avg. daily vol. 3mth:	29.915,690

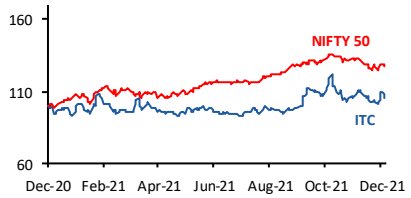
Source: Bloomberg

Changes in the report

Rating:	Buy; Unchanged
Target Price:	Rs345; Unchanged
EPS:	FY22E: Rs12.9;Unchanged FY23E: Rs14.5;Unchanged

Source: Centrum Broking

ITC relative to Nifty 50



Source: Bloomberg

Shareholding pattern

	Sep-21	Jun-21	Mar-21	Dec-20
Promoter	0.0	0.0	0.0	0.0
FIIs	10.8	11.7	12.8	13.3
DIIs	39.9	38.9	38.7	38.9
Public/other	49.3	49.3	48.5	47.8

Source: BSE

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Consumer

Thesis Snapshot

Estimate revisions

YE Mar (Rs mn)	FY22E New	FY22E Old	% chg	FY23E New	FY23E Old	% chg
Revenue	4,89,180	4,89,180	-	5,54632	5,54,532	-
EBITDA	1,87,587	1,87,587	-	2,12,097	2,12,097	-
EBITDA margin	38.3	38.3	0 bps	38.2	38.2	0 bps
Adj. PAT	1,58,801	1,58,801	-	1,78,028	1,78,028	-
Diluted EPS (Rs)	12.9	12.9	-	14.5	14.5	-

Source: Centrum Broking

ITC versus Nifty 50

	1m	6m	1 year
ITC IN	(1.8)	10.3	5.9
Nifty 50	(4.3)	9.2	27.7

Source: Bloomberg, NSE

Key assumptions

Rsm	FY22E	FY23E	FY24E
Cigarette Volume Growth (%)	7.0	8.0	5.0

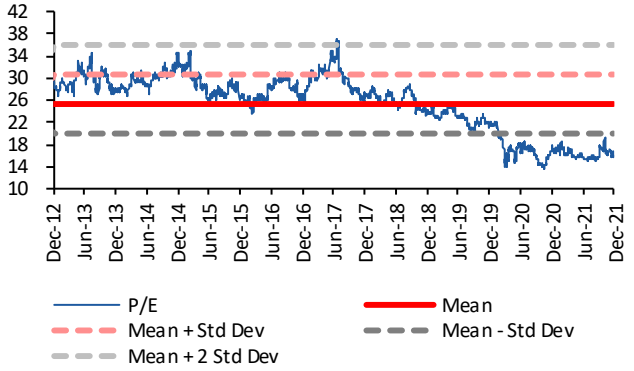
Source: Centrum Broking

Valuations

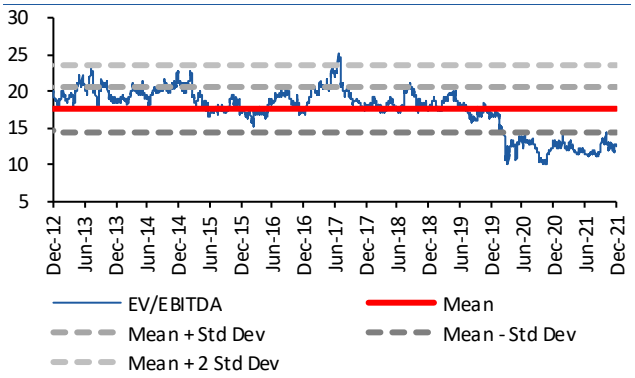
Strategy refresh, stable taxation for cigarette business, tailwinds for FMCG business, use of data analytics, widening distribution, and cost optimization via supply chain interventions and smart manufacturing are key positives. Reasonable valuations make the stock more attractive. We maintain our BUY rating, with a DCF-based TP of Rs345 (22.5x FY24E EPS). Key risks: sharp increase in taxation, higher leaf tobacco prices, and delayed economic recovery.

Valuations	Rs/share
DCF-based target price (Rs)	345
WACC (%)	9.0
Terminal growth (%)	3.0

P/E mean and standard deviation



EV/EBITDA mean and standard deviation



Source: Bloomberg, Centrum Broking

Peer comparison

Company	Mkt Cap (Rs mn)	CAGR (FY21-23E)			P/E (x)			EV/EBITDA (x)			ROE		
		Sales	EBITDA	PAT	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
ITC	**2,813.0**	**10.9**	**18.3**	**16.9**	**21.6**	**17.8**	**15.8**	**16.8**	**13.4**	**11.7**	**21.2**	**26.4**	**28.4**
Godfrey Phillip	64.0	10.1	9.9	12.5	17.8	15.1	13.2	10.5	8.5	7.1	15.9	16.4	16.5
VST Industries	48.3	9.8	6.9	15.5	15.5	14.6	13.6	9.5	9.1	8.0	36.0	32.6	30.5

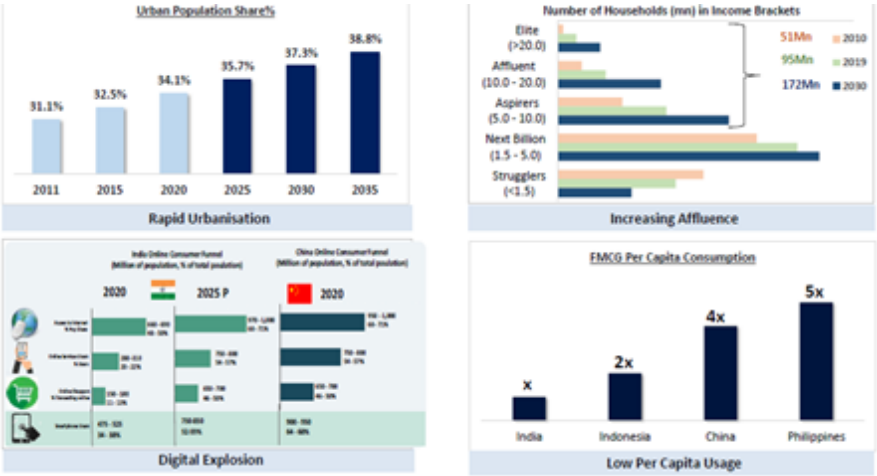
Source: Company, Centrum Broking

Analyst meet key highlights

Business imperatives

- The Chairman gave overview on ITCNext strategy and the management is committed to create enduring value with responsible competitiveness
- Under strategy refresh ITC has charted ITCNEXT strategy to triple bottom line next few years with competitive with strong margin trajectory
- It is the only company in the world to be: carbon positive for 16 years, water positive for 19 years and solid waste recycling positive for 14 years
- ITC contribute its earnings 71% to exchequer (govt.), 23% to stakeholders and 5% to employees
- ITC has been credited highest ESG rating by MSCI with AA, way above global cigarette companies
- India being fastest growing economy in the world, with inherent advantage of young population driving consumption led by rapid urbanisation
- Given most of the FMCG categories have low per capita consumption, there is huge headroom for growth, expecting rapid growth in overall, consumption
  - ITC Strategy has six pillars
    - Multiple avenues of growth – three tier structure driving right to win with consumer centric focus and mind set
    - Innovation and R & D focus – vector to power growth through cutting edge innovations, expand LSTC and improve speed to market, agile and purposeful innovation
    - Sustainability 2.0 - work on plank reduce-recycle-restore, supporting sustainable livelihood for farmers, raising from 6mn to 10mn in next three years
    - Focus on Digital – future tech enterprise using past learnings, reimagine and reinvent to build a dynamic future-tech enterprise
    - Cot management – work on end-to-end supply chain and cost optimization on the plank remove-reduce-reengineer to drive cost agility in procurement and production such as smart buying, cut overheads, reimagine supply chain
    - World class talent – strong background helps in attracting best talent in the industry

Exhibit 1: Poised for rapid growth in consumption



Source: Company

Exhibit 2: ITCNext – future ready, consumer centric and agile enterprise

Source: Company

Exhibit 3: Multiple growth drivers synergising institutional strength

Source: Company

ITCNext strategy

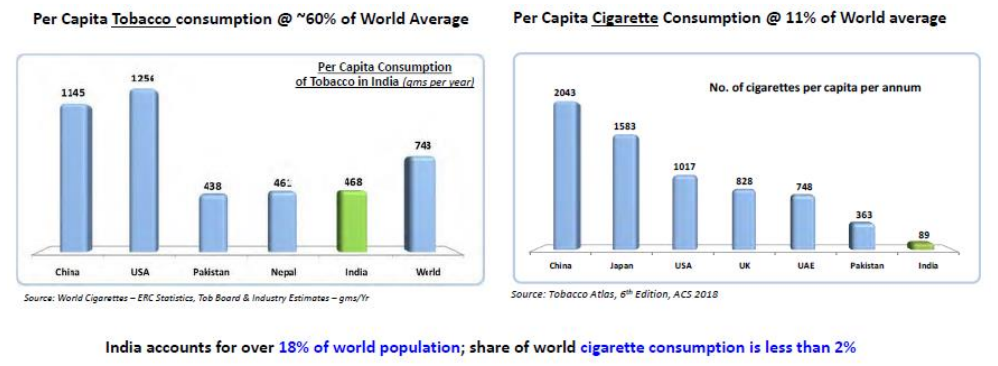
- Driving Scale and Profitability
  - ITC Synergy, future ready portfolio, strong growth platforms, power brands
  - Agile & purposeful innovation anchored on new age insighting and science-based R&D platforms
  - Structural interventions to drive margin expansion & capital productivity
  - Accelerating Digital to power growth & productivity
  - Harnessing opportunities at the intersection of Digital & Sustainability
  - Value Accretive M&A and exports: additional growth vectors
- Top notch ESG credentials - Bold Sustainability 2.0 agenda raising the bar
- Strategy of Organisation redefined to sharpen Consumer Centricity, Agility & Focus
- Engaged and motivated world-class talent pool driven by a 'proneurial' spirit

Cigarettes – a unique environment for tobacco consumption in India

- India: 3rd largest grower of Tobacco
- Unique Market - Multiple forms of tobacco consumption:
  - Smoking - Cigarettes, Bidis; Chewing - Khaini, Zarda, Gutkha
- Per capita consumption of cigarettes is one of the lowest in the world
- Legal Cigarettes ~ 8% of total tobacco consumption but contribute to ~80% of government tobacco tax revenue

- Legal industry impacted by sharp increase in tax incidence over the years
  - Sub-optimal tax collections
  - 4th largest illicit Cigarette market in the world
- In the periods of high tax incidence (15.7%) 2012-2013 revenue growth fell to 4.7% while in tax stability regimes revenues grew double digit at 10.2% (FY17-Mar'18)
- Company is banking on future ready portfolio as it commands 11% volume contribution from new products
- Cigarette division now reach 140k markets directly covering 7.1 mn outlets in the country
- Company works on 3CV model – create-capture and convey value proposition
- Classic remains strong volume contributor to the company
- Company strategy revolves around (1) maximise potential within tobacco industry (2) combating illegal and illicit trade and (3) enhance standing among legal players
- Agile innovation has helped the company to launch first to the market products

Exhibit 4: Tobacco consumption in India is diverse



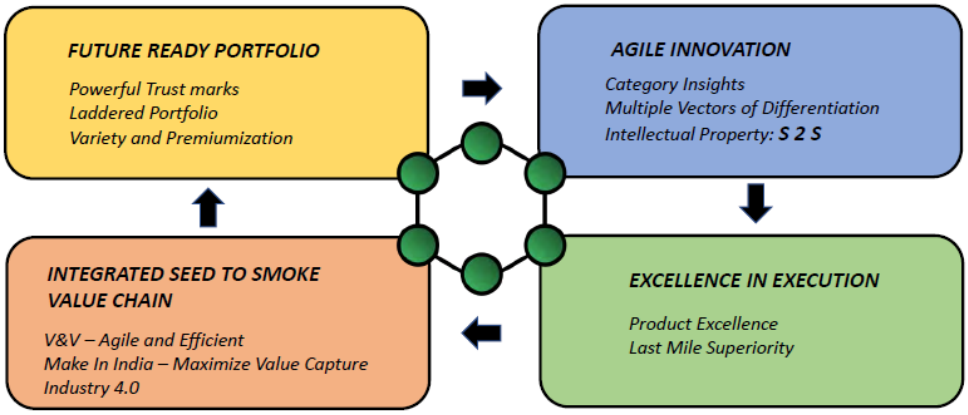
Source: Company

Exhibit 5: Cigarette division credentials

Leading Brands in every Market Segment	Strong Category Insight Generation Engine to strengthen Portfolio vitality	11% of Volumes from New launches
Direct reach to 1.4 Lac Markets	Best in Class Retail Service	Available in 7.1 Mn category Outlets > 2x nearest competitor
55% Energy Through Renewable Sources	99.9% Solid Waste Recycled	Leaders in Sustainability 6 Awards in the Last Year
Technology Prowess, Industry 4.0 & Proprietary Models	Integrated in-house capability for Leaf Development, Capsules & Specialty Filters	50:50 JV to create competitive advantage in differentiated filters

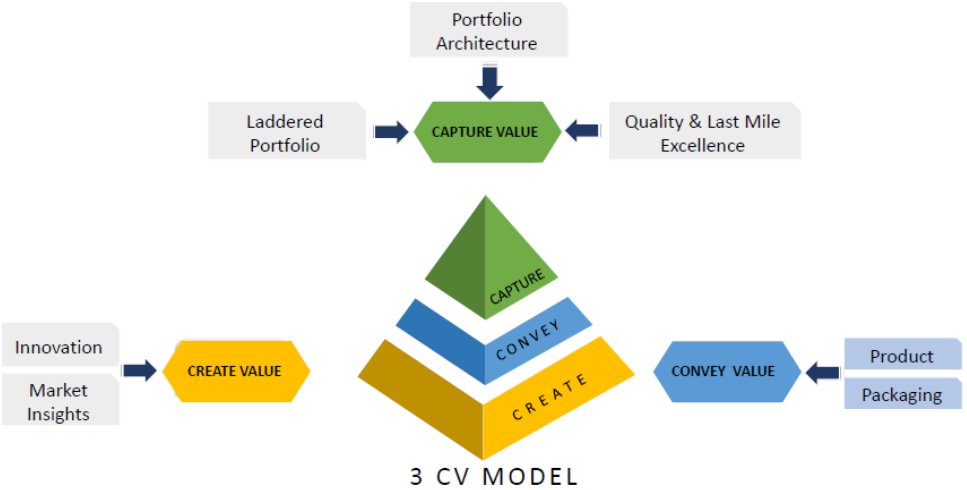
Source: Company

Exhibit 6: Source: Company Key strategic levers for growth



Source: Company

Exhibit 7: ITC value creation model



Source: Company

Branded Packaged Foods – Help India eat better

- Foods is one of the fastest growing segment for ITC
- ITC food brands available in 5.6mn stores in the country
- In 10 years foods division reported CAGR 16% growth or revenue multiplied 4.2x
  - Aashirwad atta has consumer spend Rs60bn and it grew 2.1x growing CAGR 18% over FY11-FY21 period
  - Sunfeast cream biscuits has category size of Rs40bn and grew CAGR 16%
  - Bingo grew CAGR 25%
  - Yippee grew CAGR 42%
- ITC is now targeting exports to 58 countries and revenues doubled in last three years
- ITC commands consumer product ratings ahead of competition
- Management said branded packaged foods in India is poised for growth and driven by (1) consumer seeking safe, hygienic food products (2) testimony to the claims was seen during Covid wave as consumers picked up trusted brands (3) Growth in e-commerce and D2c space
- Strategy: (1) innovations around consumer centric products (2) strengthening the core (3) driving profitability through smart manufacturing, agile cost management, improve mix- premium products and value accretive acquisitions

- ITC has expanded offerings in Aashirwad atta through premumisation launching organic products for better heart and health
- Company has partnered with Indigo and Spicejet for B-Natural
- B-Natural now commands 24% market share in modern trade, no1 in Reliance retail and Amazon
- ITC has 26% share in premium biscuits

Exhibit 8: Leveraging cross category competencies

Source: Company

Exhibit 9: ITC is leveraging on cross category competencies

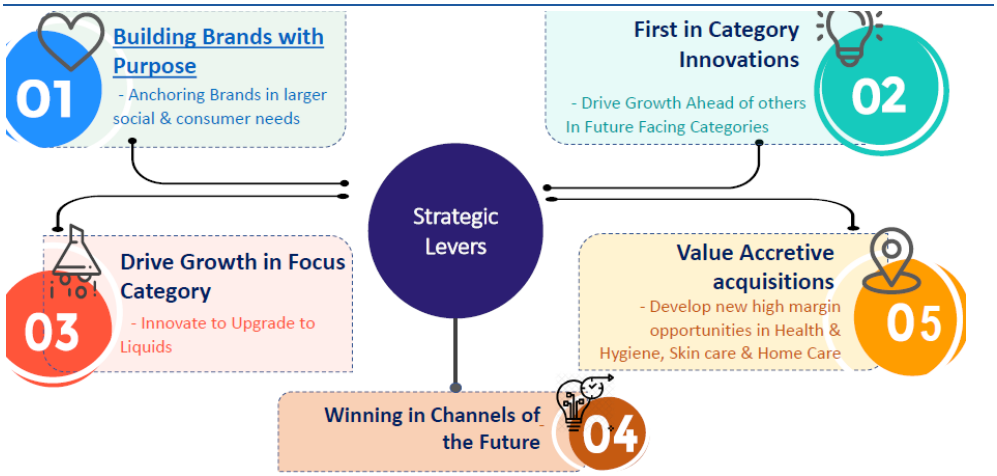
Source: Company

Personal care – in last four year business grew CAGR 19%

- Strategy: (1) building brands with purpose (2) innovations around first in the category (3) drive growth with category focus (4) wining in channels of future (5) value accretive acquisitions
- Focus on future facing categories with lower penetrations such as: deodorants (12%), body-wash (3%), hand-wash (48%), disinfectant spray (2%), floor cleaners (34%), dish-wash liquids (16%)
- Company is trying to upgrade consumers of soap bars to liquid with attractive price proposition delivering superior profitability
- In liquids ITC has grown CAGR 27.6%
- Focus on D2C brands: acquired Mother Sparsh brand recently to build scale
- ITC would like to build Savlon and Nimyle franchise as big growth drivers through adjacencies
- Savlon has grown 14x since the time of acquisition in 2015

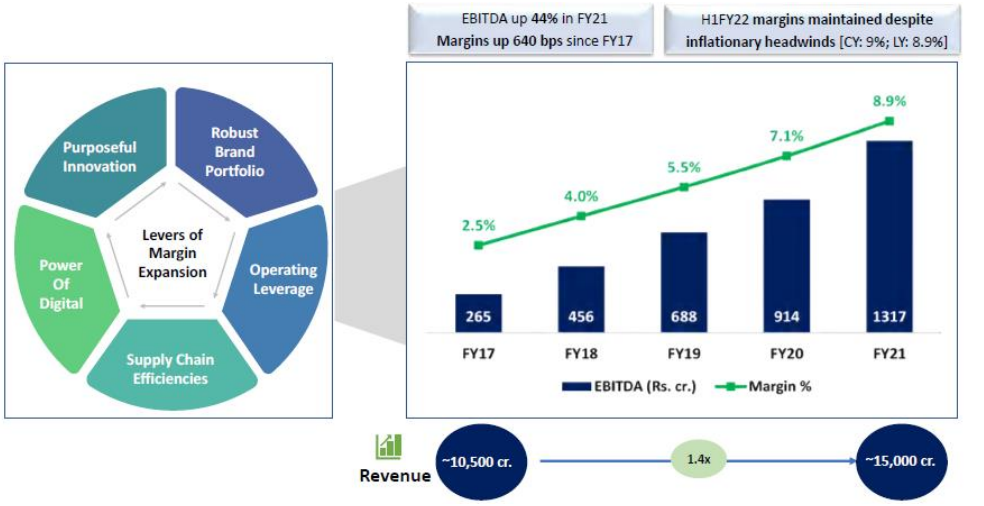
- Focusing on Future Facing Categories offering huge headroom for growth
- Driving growth through Penetration and Market Development
- Science-based R&D Platforms powering Innovation & Speed to Market
- Purpose-led brands backed by impactful communication & deep consumer engagement

Exhibit 10: Strategic levers to grow personal care business



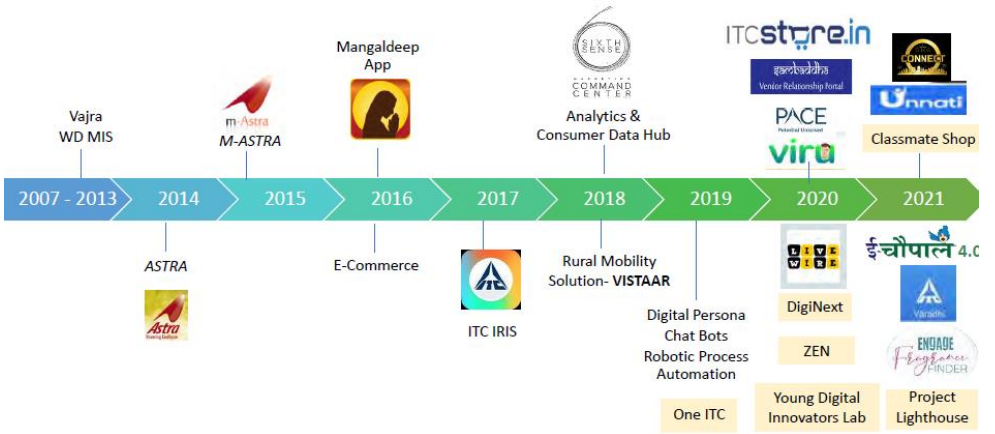
Source: Company

Exhibit 11: Consistent improvement in profitability



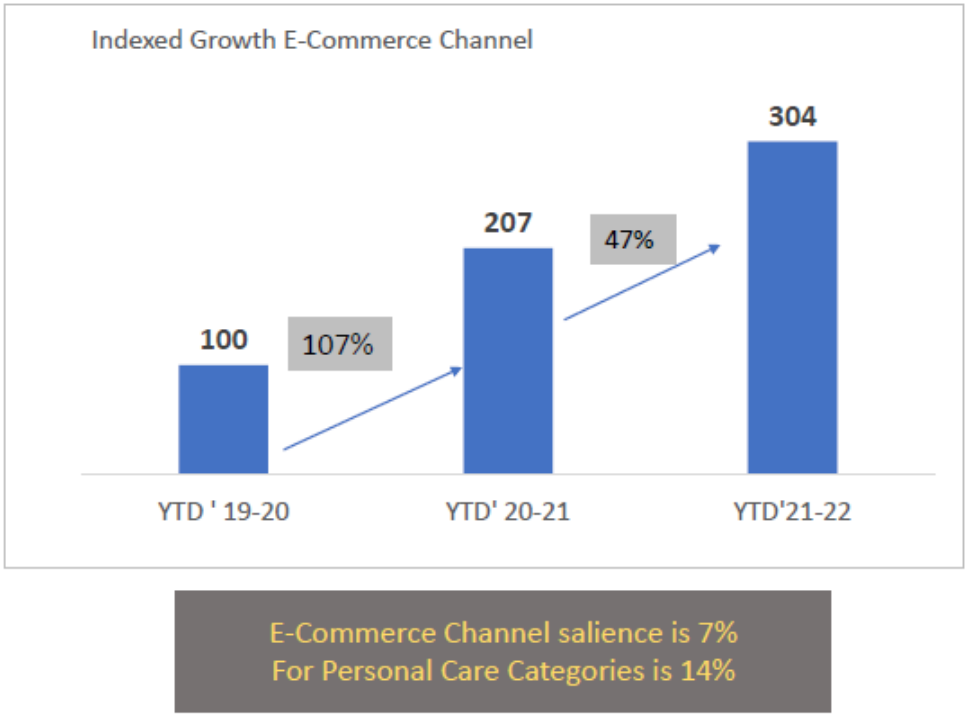
Source: Company

Exhibit 12: Digital transformation journey creating agile organisation



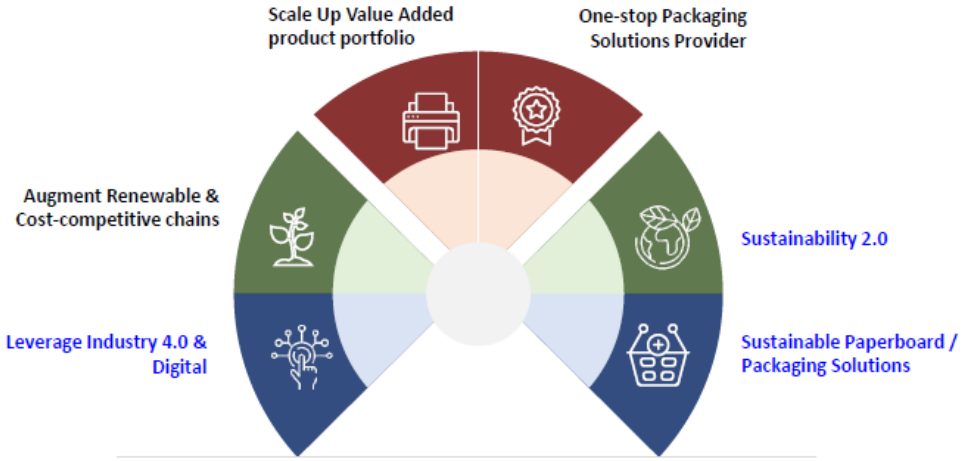
Source: Company

Exhibit 13: Strong growth across portfolio in channels of future



Source: Company

Exhibit 14: Strategy pillars for growth in Paper and packaging business



Source: Company

Exhibit 15: Strategy refresh for Hotels business

Source: Company

Exhibit 16: Accelerating transformation for ITC Infotech

Source: Company

Other points

- Profitability and margins: Company has taken various measure on cost optimisation in supply chain, yet in few categories has carried price interventions to expand margins
- Company is open for value accretive M & A to bridge product gaps especially open to build D2C portfolio, or regional brands or in adjacent categories, yet it may not pay high valuations such as 8-9x of sales multiples
- As mentioned in last AGM ITC is committed to unlock value with alternate structures divesting hotel business at the appropriate time
- ITC Infotech business is on growth path and company would invest to build thus business further by using strategic acquisitions
- In terms of capex management guided Rs100bn capex over next three years largely on FMCG (35%), Agri (20%) and paper board (25-30% building new capacities)
- ITC has been grated PLI approval from the Govt. and it would benefit in building capacities for (1) ready to eat (2) fruits and vegetable processing and (3) marine products
- Demerger of FMCG business value unlocking may not occur as business is in scale up mode
- Company is investing in new start up ecosystem through VC/PE route
- Company would stick to ordinary dividend distribution policy as special dividend is not liked by investor community
- Company has already spelt out its dividend distribution policy paying 80-85% of its earnings, however utilisation of excess cash may push the management to consider buy-back at appropriate time

Exhibit 17: Segment financial summary

Segmental	FY20	FY21	FY22E	FY23E	FY24E
Gross revenues (post inter-segment eliminations)					
Cigarettes	2,12,017	2,03,331	2,19,704	2,47,420	2,55,905
% Growth	2.4	-4.1	8.1	12.6	3.4
Other FMCG	1,28,442	1,47,282	1,60,484	1,80,375	2,02,355
% Growth	2.7	14.7	9.0	12.4	12.2
Hotels	18,372	6,275	11,770	16,548	22,157
% Growth	10.3	(65.8)	87.6	40.6	33.9
Agri business	1,02,407	1,25,822	1,30,899	1,45,407	1,63,271
% Growth	9.0	22.9	4.0	11.1	12.3
Paperboards, paper, and packaging	61,072	56,186	62,984	73,499	67,995
% Growth	4.2	(8.0)	12.1	16.7	(7.5)
Total	**4,63,237**	**4,81,512**	**5,19,584**	**5,88,637**	**6,31,663**
% Growth	**1.6**	**3.9**	**8.4**	**13.4**	**7.5**
Revenue Salience					
Cigarettes	44.3	38.3	38.7	38.5	37.0
Other FMCG	28.5	32.6	32.8	32.5	33.9
Hotels	4.1	1.4	2.4	3.0	3.7
Agri business	22.7	27.9	26.8	26.2	27.4
Paperboards, paper, and packaging	13.5	12.5	12.9	13.3	11.4
EBIT margin (on net revenues-net of ED, %)					
Cigarettes	74.2	73.6	66.1	66.6	66.5
Other FMCG	3.3	5.7	7.7	9.7	10.6
Hotels	8.6	(85.2)	9.2	9.7	10.2
Agri business	7.7	6.5	8.0	8.2	8.3
Paperboards, paper, and packaging	21.4	19.6	20.0	20.3	20.5
Total	**38.8**	**33.1**	**33.0**	**33.9**	**33.2**
EBIT Salience					
Cigarettes	84.7	85.2	77.4	75.6	74.1
Other FMCG	2.4	5.6	7.6	9.3	10.9
Hotels	0.9	-3.6	0.7	0.9	1.1
Agri business	4.5	5.5	6.5	6.3	6.9
Paperboards, paper, and packaging	7.4	7.4	7.8	7.9	7.0

Source: Company, Centrum Broking

P&L

YE Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenues	**451,361**	**451,118**	**489,180**	**554,632**	**596,347**
Operating Expense	172,351	199,746	185,292	210,083	225,884
Employee cost	26,582	28,210	30,590	34,405	36,695
Others	78,221	71,671	85,712	98,047	110,751
EBITDA	**174,206**	**151,492**	**187,587**	**212,097**	**223,017**
Depreciation & Amortisation	15,633	15,618	15,730	18,292	19,685
EBIT	**158,574**	**135,873**	**171,858**	**193,805**	**203,332**
Interest expenses	557	475	475	475	475
Other income	34,973	36,243	37,777	41,153	44,627
PBT	**192,989**	**171,642**	**209,159**	**234,483**	**247,484**
Taxes	40,308	41,325	50,358	56,455	59,585
Effective tax rate (%)	20.9	24.1	24.1	24.1	24.1
PAT	**152,682**	**130,316**	**158,801**	**178,028**	**187,899**
Minority/Associates	0	0	0	0	0
Recurring PAT	**152,682**	**130,316**	**158,801**	**178,028**	**187,899**
Extraordinary items	(15,139)	2,463	0	0	0
Reported PAT	**137,542**	**132,779**	**158,801**	**178,028**	**187,899**

Ratios

YE Mar	FY20A	FY21A	FY22E	FY23E	FY24E
Growth (%)					
Revenue	1.6	(0.1)	8.4	13.4	7.5
EBITDA	4.1	(13.0)	23.8	13.1	5.1
Adj. EPS	22.5	(14.6)	21.9	12.1	5.5
Margins (%)					
Gross	61.8	55.7	62.1	62.1	62.1
EBITDA	38.6	33.6	38.3	38.2	37.4
EBIT	35.1	30.1	35.1	34.9	34.1
Adjusted PAT	33.8	28.9	32.5	32.1	31.5
Returns (%)					
ROE	25.0	21.2	26.4	28.4	28.7
ROCE	25.0	21.1	26.3	28.3	28.6
ROIC	38.4	31.2	38.9	44.0	46.3
Turnover (days)					
Gross block turnover ratio (x)	1.8	1.7	1.7	1.9	1.9
Debtors	23	17	18	20	20
Inventory	165	160	176	154	157
Creditors	72	69	78	70	73
Net working capital	301	254	252	242	244
Solvency (x)					
Net debt-equity	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)
Interest coverage ratio	312.6	319.1	395.2	446.8	469.8
Net debt/EBITDA	(1.9)	(1.8)	(1.6)	(1.5)	(1.6)
Per share (Rs)					
Adjusted EPS	12.4	10.6	12.9	14.5	15.3
BVPS	52.1	48.0	49.9	52.1	54.4
CEPS	13.7	11.9	14.2	16.0	16.9
DPS	10.1	10.8	11.0	12.3	13.0
Dividend payout (%)	90.7	99.7	85.0	85.0	85.0
Valuation (x)					
P/E	18.4	21.6	17.7	15.8	15.0
P/BV	4.4	4.8	4.6	4.4	4.2
EV/EBITDA	14.2	16.8	13.4	11.7	11.0
Dividend yield (%)	4.4	4.7	4.8	5.4	5.7

Source: Company, Centrum Broking

Balance sheet

YE Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Equity share capital	12,292	12,309	12,309	12,309	12,309
Reserves & surplus	627,999	577,737	601,557	628,261	656,446
Shareholders fund	640,292	590,046	613,866	640,570	668,755
Minority Interest	0	0	0	0	0
Total debt	3,298	3,290	3,290	3,290	3,290
Non Current Liabilities	2,343	3,964	4,299	4,874	5,240
Def tax liab. (net)	16,177	17,277	17,277	17,277	17,277
Total liabilities	**662,108**	**614,577**	**638,732**	**666,011**	**694,563**
Gross block	255,847	265,633	281,427	297,521	313,915
Less: acc. Depreciation	(55,866)	(69,700)	(85,429)	(103,721)	(123,406)
Net block	199,981	195,933	195,997	193,800	190,509
Capital WIP	27,763	33,300	33,300	33,300	33,300
Net fixed assets	232,978	255,083	255,147	252,950	249,659
Non Current Assets	19,751	13,064	13,128	13,236	13,305
Investments	36,736	32,397	32,397	32,397	32,397
Inventories	80,381	94,709	83,531	93,948	100,197
Sundry debtors	20,920	20,904	28,643	32,095	34,101
Cash & Cash Equivalents	338,003	277,589	304,754	331,185	361,866
Loans & advances	15,108	11,999	13,012	14,753	15,862
Other current assets	8,477	10,061	10,910	12,369	13,300
Trade payables	34,467	41,195	37,690	43,113	46,764
Other current liab.	54,599	58,342	63,265	71,730	77,124
Provisions	1,179	1,691	1,833	2,078	2,235
Net current assets	372,643	314,033	338,061	367,429	399,202
Total assets	**662,108**	**614,577**	**638,732**	**666,011**	**694,563**

Cashflow

YE Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Profit Before Tax	191,668	171,642	209,159	234,483	247,484
Depreciation & Amortisation	15,633	15,618	15,730	18,292	19,685
Net Interest	(19,343)	(19,013)	(20,399)	(22,170)	(23,886)
Net Change – WC	4,180	(3,948)	3,408	(2,470)	(795)
Direct taxes	(46,501)	(39,566)	(50,358)	(56,455)	(59,585)
Net cash from operations	**138,062**	**114,940**	**157,541**	**171,679**	**182,902**
Capital expenditure	(21,136)	(15,794)	(15,794)	(16,094)	(16,394)
Acquisitions, net	0	0	0	0	0
Investments	(53,945)	61,508	0	0	0
Others	19,914	19,265	20,873	22,645	24,361
Net cash from investing	**(55,167)**	**64,979**	**5,079**	**6,551**	**7,967**
FCF	**82,895**	**179,918**	**162,620**	**178,230**	**190,870**
Issue of share capital	6,253	2,907	0	0	0
Increase/(decrease) in debt	(44)	389	0	0	0
Dividend paid	(84,222)	(186,153)	(134,981)	(151,324)	(159,714)
Interest paid	(896)	(931)	(475)	(475)	(475)
Others	0	0	0	0	0
Net cash from financing	**(78,909)**	**(183,789)**	**(135,456)**	**(151,798)**	**(160,189)**
Net change in Cash	3,986	(3,871)	27,164	26,432	30,681

Source: Company, Centrum Broking

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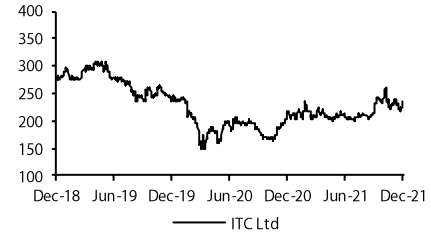
ITC Ltd



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