

ITC**Bloomberg: ITC IN Equity****Reuters: ITC.BO****Recommendation: BUY****COMPANY UPDATE**

Positive Earnings Cues

ITC has been a significant outperformer over last three months (absolute 17% and relative 18%). Our review of its balance sheet and earnings expectation suggest that there continues to be an upward bias to earnings growth (18% for FY10-12E) despite some weakness seen in 1QFY11 for cigarette business. We believe the stock can still deliver positive relative outperformance and we retain our BUY rating on the stock with a March 2011 target price of Rs320.

Cigarette business still on solid footing – We believe the recent weakness seen in cigarette volumes is somewhat short term in nature and we expect the company should be able to deliver low positive volume growth in FY11. Over last 12 months it has strengthened its brand portfolio significantly with brands such as Flake Excel and Duke Filter, entered less than 60mm category and augmented its production capacity by more than 20% with the set up of a more than 20 billion capacity stick plant at Ranjangaon near Pune.

FMCG business to maintain positive trend – The significant improvement seen in profitability for FY10 (nearly 640bps improvement in EBIT margin) should continue as outlook for both packaged foods and personal product business remains positive. Over last 12 months in case of personal products the company has added significant capacity at its Haridwar plant and also commissioned new facilities at Manpura, Himachal Pradesh. The nearly threefold increase in capacity implies that the company will be targeting low double-digit volume shares in personal product categories such as Soaps, Shampoo and Skin Cream over next three years. We believe existing players such as Hindustan Unilever, P&G, Dabur and Godrej Consumer will have to respond suitably to this increased competitive ante from the company.

Significant improvement in return ratios – On account of significantly improved working capital management (down nearly 5 days to 34 days in FY10), return on capital for FY10 is nearly 300bps higher v/s our previous expectation of 39%. Considering there is significant headroom for capacity utilization to improve we expect this upward trend in ROCE to continue and touch nearly 56% by FY12.

Outlook and Valuation – We expect the company to report 17% growth in topline and 22% in EBIT led by 30% growth in topline and 55% growth in EBIT for non-cigarette business in 1QFY11. Considering positive outlook for its non-cigarette business, improved subsidiary business performance (Surya Nepal and ITC Infotech) and improvement in return ratios, we expect valuations will continue to see improvement. Our target price implies forward P/E multiple of 21x and EV/EBIDTA multiple of 13x and is also consistent with our sum-of-the-parts approach.

Exhibit 1: Key financials

	FY09	FY10	FY11E	FY12E
Net Sales	153,880	181,531	211,446	244,049
EBIDTA	53,670	66,472	77,770	91,738
Net Profit	32,636	40,610	48,735	56,759
EPS	8.4	10.7	12.8	14.9
P/E (x)	37.0	29.9	25.0	21.5
EV/EBIDTA (x)	24.6	19.2	16.3	13.2
Dividend Yield %	1.2	3.1	1.7	2.0
ROE %	23.3	28.1	32.6	31.1
ROCE %	36.6	42.2	48.0	55.7

Source: Company, Ambit Capital research

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Recommendation

CMP:	Rs305
Target Price (Period):	Rs 320
Previous TP:	Rs305
Upside(%)	5
EPS (FY11E):	Rs12.8
Change from previous (%)	-
Variance from consensus (%)	5

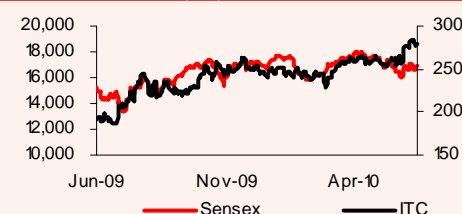
Stock Information

Mkt cap:	Rs1,166,262mn/US\$25,089mn
52-wk H/L:	308/183
3M Avg. daily vol. (mn):	7
Beta (x):	0.5
BSE Sensex:	17,701
Nifty:	5,313

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	10.2	18.6	63.6	24.4
Rel. to Sensex	5.5	17.4	33.9	22.7

Performance (%)



Source: Bloomberg, Ambit Capital research

Exhibit 2: Price performance - Tobacco

	Country	Price	MCAP	P/E			EV/EBITDA			EV/Sales			EPS Growth
			US\$m	FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E	(FY10E-FY12E CAGR %)
India													
ITC Ltd	India	305	24,642	28.5	23.8	20.5	18.2	15.6	12.6	6.6	5.8	4.6	18.01
Global													
Imperial Tobacco	Britain	1,879	28,592	28.7	10.5	9.7	10.2	9.4	9.0	2.1	3.8	3.7	8.41
Souza Cruz	Brazil	68	11,563	14.0	15.2	14.1	9.8	10.6	9.9	3.4	3.4	3.2	5.63
BAT	Malaysia	44	3,850	16.8	17.1	16.8	11.2	11.8	11.6	3.2	3.2	3.2	3.05
Gudang Garam	Indonesia	34,200	7,191	19.0	16.8	15.1	11.2	10.1	9.2	2.0	1.8	1.7	16.00
Philip Morris	United States	46	84,890	14.1	12.3	11.2	9.3	8.5	8.0	4.1	3.8	3.6	10.29
BAT	Britain	2,137	63,754	15.6	12.3	11.4	10.2	9.5	9.0	3.6	3.4	3.3	8.61
Altria Group Inc	United States	20	41,735	12.9	10.7	10.0	8.1	7.5	7.2	3.0	3.0	2.9	6.95
Japan Tobacco	Japan	277,700	30,792	19.2	15.9	11.4	6.6	6.4	5.7	0.6	0.6	0.6	26.91
Reynolds America	United States	52	15,190	15.8	10.6	10.1	6.4	6.2	6.0	1.9	1.9	1.9	5.18
Lorillard Inc	United States	72	11,002	12.5	11.2	10.2	6.4	6.1	5.8	2.7	2.9	2.6	9.46
Kt&G Corp	South Korea	60,200	6,699	10.4	9.6	9.6	n.a.	7.1	7.4	2.9	2.3	2.4	1.99
Swedish Match	Sweden	171	5,068	13.3	15.7	14.2	12.0	11.7	11.1	3.3	3.2	3.2	9.75

Source: Bloomberg, Company, Ambit Capital research

Exhibit 3: Price Performance

	Country	Price	MCAP	Absolute Performance (%)				Relative Performance to Index (%)			
			US\$m	1m	3m	6m	1yr	1m	3m	6m	1yr
India											
Itc Ltd	India	305	24,642	8.8	16.6	22.8	61.0	3.1	18.0	22.6	34.8
Global											
Imperial Tobacco	Britain	1,879	28,592	2.1	(6.2)	(4.1)	18.0	7.2	9.6	5.5	4.2
Souza Cruz	Brazil	68	11,563	3.5	8.3	17.7	19.3	5.1	26.4	32.5	0.9
Brit Amer Tobacc	Malaysia	44	3,850	(0.7)	(0.8)	2.3	(2.7)	(2.7)	0.8	(0.5)	(19.8)
Gudang Garam	Indonesia	34,200	7,191	3.0	34.7	57.8	175.3	(2.7)	32.1	38.6	96.5
Philip Morris	United States	46	84,890	4.3	(12.6)	(4.9)	4.0	8.3	(0.1)	2.9	(6.9)
Brit Amer Tobacc	Britain	2,137	63,754	1.0	(6.2)	6.0	26.1	6.1	9.6	16.6	11.3
Altria Group Inc	United States	20	41,735	(0.4)	(3.8)	2.1	20.1	3.5	10.0	10.4	7.6
Japan Tobacco	Japan	277,700	30,792	(5.7)	(21.6)	(13.0)	(6.0)	0.2	(6.7)	(4.7)	5.4
Reynolds America	United States	52	15,190	0.5	(4.9)	(1.6)	32.9	4.4	8.7	6.5	19.0
Lorillard Inc	United States	72	11,002	0.8	(5.0)	(10.3)	3.8	4.8	8.6	(2.9)	(7.0)
Kt&G Corp	South Korea	60,200	6,699	(4.0)	(4.3)	(6.8)	(15.1)	(6.9)	(2.1)	(6.7)	(28.7)
Swedish Match	Sweden	171	5,068	4.8	(0.7)	9.2	35.4	2.2	2.4	3.3	9.5

Source: Company, Ambit Capital research

Explanation of Investment Rating

Investment Rating	Expected return (over 12-month period from date of initial rating)
Buy	> 15%
Hold	5% to 15%
Sell	< 5%

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