RBS The Royal Bank of Scotland

23 July 2010

ITC

Strong start to the year

Strong growth in all businesses was the key highlight of 1Q11. Cigarettes volume growth was negative, but the mix continues to improve. ITC's pricing strategy and innovation in the cigarettes category should ensure profit growth. We upgrade our earnings forecasts by 3% and raise our target price to Rs336. Buy.

Buy

Target price
Rs336.00 (from Rs288.00)

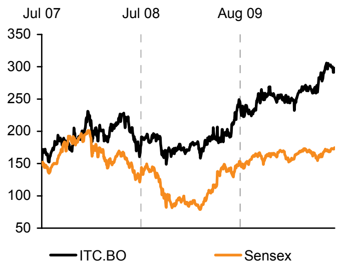
Price
Rs297.70

Short term (0-60 days)
n/a

Market view
Underweight

Price performance

	(1M)	(3M)	(12M)
Price (Rs)	301.8	264.3	218.0
Absolute (%)	-1.4	12.7	36.6
Rel market (%)	-3.3	9.3	11.9
Rel sector (%)	0.5	24.8	31.0



Market capitalisation
Rs1.12t (US$23.82bn)

Average (12M) daily turnover
Rs1159.95m (US$24.85m)

Sector: BBG AP Diversifieds
RIC: ITC.BO, ITC IN
Priced at close of business 22 Jul 2010.
Source: Bloomberg

Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue (Rsm)	156,119	181,532	206,276	236,916	277,694
EBITDA (Rsm)	48,585	60,740	71,507 ▲	83,852 ▲	95,694
Reported net profit (Rsm)	32,636	40,610	48,894	56,636	65,714
Normalised net profit (Rsm)[1]	32,636	40,610	48,894	56,636	65,714
Normalised EPS (Rs)	8.65	10.6	12.8	14.8	17.2
Dividend per share (Rs)	3.7	10	6 ▲	7 ▲	8
Dividend yield (%)	1.24	3.36	2.02	2.35	2.69
Normalised PE (x)	34.4	28	23.2	20.1	17.3
EV/EBITDA (x)	23	18.3	15.7	13.3	11.7
Price/book value (x)	8.18	8.08	6.99	6.05	5.22
ROIC (%)	22.7	25.6	30.2	29.6	29.7

Use of ▲ ▼ indicates that the line item has changed by at least 5%. year to Mar, fully diluted
1. Post-goodwill amortisation and pre-exceptional items
Accounting standard: Local GAAP
Source: Company data, RBS forecasts

Strong all-round growth boosted 1Q11 performance

ITC's 1Q11 numbers came in better than we expected on account of a better-than-expected performance from FMCG and the agri division. EBITDA grew by 20% (vs our expectation of 16%) on the back of 16% net sales growth driven by a 120bp expansion in margin on a yoy basis. The cigarettes division grew by 12% yoy, despite a 4% decline in volumes, driven primarily by improved product mix and price increases taken post budget. The agri division continued to surprise us positively with a revenue growth of 44% yoy.

We expect cigarettes volumes to recover in coming quarters

Cigarettes volumes fell 4% in 1Q11 after rising by 7.2% in FY10. Despite this, and with the launch of new variants such as Lucky Strike, Classic Menthol Rush and Gold Flake SLK, ITC was not only able to improve its market standing in the premium category, but also gained market share, clearly indicating better-than-industry performance. The company is also test-marketing its products in the micro-filter segment (length not exceeding 60mm). With these initiatives, we expect a recovery in ITC's cigarettes volumes in coming quarters.

FY10 capex fell, payout ratio increased

ITC's FY10 capex was Rs10.9bn, indicating a second year of decline after peak capex of Rs22.4bn in FY08. However, the payout ratio increased with ITC announcing a dividend of Rs10/share for FY10, cash outflow for which will be Rs44.5bn, according to the company. Even after paying off the dividend ITC will have liquid cash of Rs10.4bn (Rs2.7/share).

We roll forward earnings, maintain Buy

We raise our FY11-12F earnings by 3% to reflect this strong performance and roll forward our earnings forecasts by one year. We raise our DCF-based target price to Rs336 (from Rs288) to reflect these changes. At out target price, the stock would trade at 26.2x FY11F EPS of Rs12.8. This does not appear not cheap, but with strong visible growth we expect premium valuations to be sustainable. Reiterate Buy.

Researched by

RBS Equities (India) Limited
Institutional Team

Mafatlal Chambers – C Wing, Ground Floor, N.M. Joshi Marg, Lower Parel (E), Mumbai 400 013, India. Tel : +91 022 6754 8411 Fax : +91 022 6754 8420

www.rbs.in/broking

Important disclosures can be found in the Disclosures Appendix.

Strong start to the year

Strong growth in all businesses was the key highlight of 1Q11. While cigarettes volumes have dropped 4%, we expect them to recover in the coming quarters. ITC's key businesses – cigarettes and paper – have pricing power and strong competitive positions, and therefore we believe they can maintain margins.

ITC’s 1Q11 numbers exceeded our expectations. Net sales increased 16% yoy to Rs48.2bn in 1Q11, mainly on account of better-than-expected performances from the FMCG and agri divisions. While the FMCG division’s yoy growth of 15% was slightly better than our expectation of 14%, the strong 44% yoy growth in the agri division surprised us.

EBITDA increased 20% yoy (vs our expectation of 14% yoy growth) on the back of a 120bp expansion in the EBITDA margin (33.4% in 1Q11 vs 32.2% in 1Q10). NPAT increased 22% yoy vs our expectation of 16% yoy growth.

Sales

Gross sales increased from Rs62.7bn in 1Q10 to Rs71.7bn in 1Q11, registering 14% yoy growth. FMCG segment sales increased 15% yoy to Rs56.7bn in 1Q11, driven by 34% yoy growth in other FMCG sales and 12% growth in cigarettes.

Cigarettes sales increased 12% yoy to Rs46.7bn despite a 4% drop in volumes driven primarily by an improved product mix and price increases taken post-Budget. The introduction of new brands and variants such as Lucky Strike, Classic Menthol Rush and Gold Flake SLK boosted the company’s market standing in the premium category and improved market share. The key highlight for the quarter was the strong positive growth in the king-size segment, which to some extent saw a limited price hike after the excise duty hike in the Budget. The company is also test-marketing its products in the new micro-filter segment (length not exceeding 60mm) in select markets. We expect ITC to end the year with flat-to-positive cigarettes volumes on a yoy basis in FY11.

Other FMCG businesses registered strong growth of 32% yoy to Rs10.1bn in 1Q11, with a strong performance in all categories. The branded packaged foods division registered 34% growth during the quarter, driven by improved realisations , richer product mix and better cost management across the supply chain. The Bingo range of potato chips was further bolstered by the launch of a new variant Oye Pudina. In biscuits, Sunfeast grew 43% during the quarter. In staples, Aashirvad Atta sales grew 21%, led by improved realisations and higher volumes. Confectionery revenues grew 25%, supported by the launch of an orange variant of ‘mint-O Gol’. The personal care business registered strong growth of 86% during the quarter, driven by new product launches in the personal wash category and a foray into the skin care business. ITC’s soaps category achieved volume market share of 5%. The education and stationery products business grew 30% during the quarter.

The agri business continues to surprise us positively, with revenue growth of 44% yoy to Rs13.5bn in 1Q11, driven by increased sales of soya, leaf tobacco and wheat.

The paper, paperboards and packaging business grew 13% yoy to Rs8.3bn in 1Q11 (almost in line with our expectations).

The hotels business posted revenue growth of 21% yoy to Rs2.3bn in 1Q11. While the hotels business was seasonally weak, we are seeing an improving trend and expect strong growth for the hotels division in FY11 (partly from a low base).

EBITDA

EBITDA increased 20% yoy to Rs16.1bn in 1Q11 on the back of a 120bp expansion in the EBITDA margins. The EBITDA margin expanded from 32.2% in 1Q10 to 33.4% in 1Q11. Sequentially, the EBITDA margin expanded by 290bp from 30.5% in 1Q10.

EBIT

ITC’s EBIT grew from Rs11.9bn in 1Q10 to Rs14.5bn in 1Q11, registering yoy growth of 22%.The cigarettes business EBIT grew 16% yoy to Rs13.1bn in 1Q11. EBIT margins expanded 90bp to 27.9%, largely on account of an improved product mix and price increases. On a sequential basis, the EBIT margin expanded marginally by 20bp from 27.7% in 4Q10. Losses in other FMCG business declined from Rs998m in 1Q10 to Rs893m in 1Q11. Sequentially, however, this has risen from Rs787m in 4Q10 as the company invested behind new product launches in personal and skin care in the past quarter.

Agri business EBIT grew 23% yoy to Rs1.2bn on the back of 44% revenue growth because of a contraction in margins. The Agri division EBIT margin contracted from 10.6% in 1Q10 to 9.1% in 1Q11. This was, however, up sharply from a 5.9% EBIT margin reported in 4Q10. The paper business EBIT grew 47% yoy to Rs1.9bn in 1Q11. The EBIT margin expanded 520bp yoy and 250bp qoq to 22.7% in 1Q11. Higher realisations, improved product mix and enhanced value capture through integrated production (in-house pulp production) contributed to this margin expansion.

The hotels business EBIT grew 26% yoy to Rs385m. The EBIT margin, which rose to 28%-plus for the last two quarters, fell to 17.1% in 1Q11 vs 16.5% in 1Q10. NPAT grew from Rs8.8bn in 1Q10 to Rs10.7bn in 1Q11, registering yoy growth of 22%.

Other highlights

The company is investing heavily in its production facilities. In cigarettes, it recently commenced operations at its new facility in Ranjangaon, Pune. In agri, construction activity is under way at its new green leaf threshing facility at Karnataka. In paper boards, it is investing in a state-of-the-art machine expected to be operational by early 2012. In hotels, it is setting up super-luxury facilities in Chennai and Kolkata that are under construction. It also has undertaken several renovation programmes, including setting up a shopping mall at its Agra property.

Table 1 : ITC 1Q11 results

Rsm	1Q10	2Q10	3Q10	4Q10	1Q11	% growth
Gross sales	**62,687**	**64,297**	**68,689**	**72,957**	**71,722**	**14%**
% change	5%	10%	16%	22%		
Net sales	**41,476**	**42,926**	**45,319**	**50,538**	**48,166**	**16%**
% change	6%	14%	18%	28%		
Expenditure	**28,105**	**27,552**	**28,725**	**35,137**	**32,103**	**14%**
% change	1%	4%	16%	31%		
- +/- in stock	583	(344)	(490)	2,028	(998)	-271%
- Raw material	14,630	17,520	18,713	19,757	18,909	29%
- Employee remuneration	2,822	2,420	2,228	2,558	3,419	21%
- Other overheads	10,070	7,956	8,275	10,793	10,772	7%
EBITDA	**13,371**	**15,374**	**16,593**	**15,401**	**16,064**	**20%**
Growth	19%	38%	23%	22%		
Operating margin (%)	32.2%	35.8%	36.6%	30.5%	33.4%	
Interest	(58)	(181)	(109)	(185)	(58)	-1%
Depreciation	(1,516)	(1,484)	(1,549)	(1,539)	(1,597)	5%
Other Income	1,378	1,211	2,074	1,370	1,292	-6%
Profit before tax	**13,175**	**14,920**	**17,010**	**15,048**	**15,701**	**19%**
Tax	4,388	4,821	5,569	4,766	4,998	14%
Net profit	**8,787**	**10,099**	**11,442**	**10,282**	**10,703**	**22%**
Tax/ PBT (%)	33.3%	32.3%	32.7%	31.7%	31.8%	
Raw material to sales (%)	36.7%	40.0%	40.2%	43.1%	37.2%	
Empl cost/sales (%)	6.8%	5.6%	4.9%	5.1%	7.1%	
Other OH (%)	24.3%	18.5%	18.3%	21.4%	22.4%	
Segmental results						
Gross sales						
FMCG - Cigarettes	41,606	41,831	44,225	45,168	46,697	12%
% growth	*14%*	*15%*	*13%*	*14%*		
FMCG - Others	7,594	8,653	8,918	11,253	10,056	32%
% growth	*9%*	*14%*	*23%*	*34%*		
Total FMCG	**49,200**	**50,484**	**53,143**	**56,421**	**56,754**	**15%**
% growth	*14%*	*15%*	*15%*	*18%*		
Hotels	1,857	1,863	2,645	2,743	2,251	21%
% growth	*-28%*	*-25%*	*-2%*	*14%*		
Agri	9,406	10,283	9,052	9,881	13,498	44%
% growth	*-49%*	*19%*	*46%*	*88%*		
Paperboards, paper & packaging	7,306	8,217	8,453	8,360	8,291	13%
% growth	*12%*	*9%*	*26%*	*12%*		
Total	**67,769**	**70,847**	**73,293**	**77,405**	**80,794**	**19%**
PBIT						
FMCG - Cigarettes	11,254	12,517	13,098	12,512	13,050	16%
% growth	*17%*	*24%*	*15%*	*16%*		
FMCG - Others	(998)	(850)	(860)	(787)	(893)	-11%
% growth	*-19%*	*-27%*	*-32%*	*-33%*		
Total FMCG	**10,256**	**11,667**	**12,238**	**11,725**	**12,157**	**19%**
% growth	*22%*	*31%*	*22%*	*22%*		
Hotels	306	316	763	782	385	26%
% growth	*-64%*	*-54%*	*-16%*	*10%*		
Agri	999	1,741	1,041	583	1,231	23%
% growth	*31%*	*128%*	*107%*	*10%*		
Paperboards, paper & packaging	1,278	1,862	2,014	1,688	1,885	47%
% growth	*4%*	*52%*	*81%*	*11%*		
Total	**12,839**	**15,585**	**16,056**	**14,779**	**15,658**	**22%**
EBIT margins						
FMCG - Cigarettes	27.0%	29.9%	29.6%	27.7%	27.9%	
FMCG - Others	-13.1%	-9.8%	-9.6%	-7.0%	-8.9%	
Total FMCG	**20.8%**	**23.1%**	**23.0%**	**20.8%**	**21.4%**	
Hotels	16.5%	16.9%	28.8%	28.5%	17.1%	
Agri	10.6%	16.9%	11.5%	5.9%	9.1%	
Paperboards, paper & packaging	17.5%	22.7%	23.8%	20.2%	22.7%	

Source: Company data

FY10 balance sheet: capex falls, payout ratio rises

Capex trends

ITC's net capex has been Rs10.91bn in FY10, indicating the second year of decline after peak capex in FY07 (Rs17bn) and FY08 (Rs22.4bn). 36% of the capex was in the cigarettes business, 13% in other FMCG , 34% in hotels and 17% in paper.

Net cash position

ITC has a cash balance of Rs11.3bn and investments of Rs43.7bn (the total including long-term investments is Rs57.3bn). The company has recommended a total dividend of Rs10/share including a special centenary dividend of Rs5.5/share. The total cash outflow on this to be Rs44.5bn, according to the company. Even after paying off the dividend, we calculate the company will have Rs10.4bn (Rs2.7/share) in cash and current investments.

Cash flow

ITC has generated Rs241.7bn cash from its operations before working capital changes in the past 10 years. Together with other sources, it has generated Rs296.4bn of cash in aggregate over the same period. Of the total cash generated, the company has spent 33% on capex, 28% on dividend payouts (including corporate dividend tax) and 7% on working capital, clearly reflecting the strong working capital management of the company. 21% of its total cash accruals have been invested in interest-bearing securities.

Working capital

ITC's business continues to be well managed from a working capital perspective, with both inventory days (from 101 in FY09 to 92 days in FY10) and receivables days (16 days to 15 days) declining. Average working capital as a percentage of revenue was lower at 21% compared to 25% in FY09.

Table 2 : ITC balance sheet trends

Rsm (unless stated otherwise)	2006	2007	2008	2009	2010
Operating ratios					
Working capital	21,171	30,048	36,621	41,546	35,025
Average working capital as a % of revenue		21%	24%	25%	21%
Accounts receivable days		18	18	16	15
Inventory days		90	97	101	92
Sales/net current assets	6.18	5.00	5.39	4.52	230.25
Capex as % of revenue	7.2%	14.3%	16.1%	10.9%	6.0%
Cash as % of revenue		7.2%	5.3%	5.1%	5.9%
Leverage ratios					
Net debt (total debt - cash - liquid Investments)	(34,689)	(29,317)	(24,448)	(27,989)	(53,886)
Total assets	130,840	149,684	172,495	194,835	230,053
Net debt/equity ratio	(0.38)	(0.28)	(0.20)	(0.20)	(0.38)
Net debt/total assets	0.01	0.01	0.01	(0.14)	(0.23)
Return ratio					
Fixed assets turnover ratio		2.73	2.56	2.32	2.36
Average total assets turnover ratio		0.87	0.87	0.85	0.85
Average invested capital		90,316	107,198	122,917	129,637
Average net worth		97,493	112,474	128,964	138,997
Average capital employed		99,096	114,550	130,924	140,424
Return on equity		**28%**	**28%**	**25%**	**29%**
DuPont analysis					
Net margin		**22%**	**22%**	**21%**	**22%**
Average assets turnover		**0.87**	**0.87**	**0.85**	**0.85**
Equity multiplier		**144%**	**143%**	**142%**	**153%**
Return on invested capital		30%	29%	27%	32%
Return on total assets		19%	19%	18%	19%
Return on capital employed		27%	27%	25%	29%
Book-value per share (Rs)	**24.13**	**27.74**	**32.00**	**36.39**	**36.84**
Current market price	300.75				
Market cap	1,148,316				
Add: debt	1,077				
Less: cash	54,963				
Enterprise value	**1,094,431**				
EV/EBITDA (x)	**32.89**	**27.66**	**24.85**	**22.53**	**18.02**
Price/earnings (x)	**50.52**	**41.91**	**36.33**	**34.73**	**28.03**
Price/book value (x)	**12.46**	**10.84**	**9.40**	**8.26**	**8.16**

Source: Company data

Table 3 : Cash flow deployment analysis (analysis of cash deployment for past 10 years)

Sources of cash (Rsm)	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Cumulative	% of Total funds generated
Cash from operations before working capital changes (net of taxes)	11,080	15,042	15,450	16,345	20,483	24,641	28,084	31,545	35,681	43,394	241,744	82%
Increase in borrowings	-	-	-	-	1,244	-	812	136	-	-	2,191	1%
Proceeds from issue of share capital	-	0	-	112	373	660	424	446	448	7,207	9,670	3%
Net reduction in investments	-	-	-	-	-	4,814	4,355	1,718	1,444		12,331	4%
Decrease in working capital		2,653	3,690	2,588						2,912	11,844	4%
Others (income from investments, etc)	544	436	298	915	1,430	837	2,730	4,247	3,580	3,578	18,594	6%
TOTAL	**11,623**	**18,132**	**19,439**	**19,959**	**23,530**	**30,952**	**36,404**	**38,092**	**41,152**	**57,091**	**296,374**	**100%**
Application of funds												
Capex (net of assets sold)	4,497	5,116	4,492	4,438	4,957	7,033	17,391	22,424	16,941	10,916	98,205	33%
Dividend and corporate dividend tax	2,314	2,691	3,321	4,172	5,602	8,783	11,290	13,572	15,398	16,333	83,474	28%
Increase in working capital	1,169				1,971	4,666	6,672	4,315	3,264		22,056	7%
Repayment of debt	(2,061)	7,038	1,676	112	-	1,256	-	-	369	698	9,088	3%
Increase in investments	174	1,830	6,548	13,803	10,191	-	-	-	-	28,856	61,400	21%
Purchase of business	-	-	-	388	388	388	388	388	388	-	2,330	1%
Others	5,455	1,370	62	494	470	825	219	691	228	(604)	9,210	3%
TOTAL	**11,548**	**18,044**	**16,098**	**23,406**	**23,578**	**22,951**	**35,961**	**41,391**	**36,588**	**56,199**	**285,764**	**96%**
Net increase/(decrease) in cash & cash equivalents	**75**	**88**	**3,341**	**(3,447)**	**(48)**	**8,002**	**443**	**(3,299)**	**4,564**	**892**	**10,611**	**4%**

Source: Company data

Table 4 : Change in EPS

Rs	Old	New	Change
FY11F	12.5	12.8	2.5%
FY12F	14.4	14.8	3.0%
FY13F	na	17.2	na

Source: RBS forecasts

Income statement

Rsm	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue	156119	181532	206276	236916	277694
Cost of sales	-59579	-69714	-83200	-93835	-112577
Operating costs	-47955	-51078	-51569	-59229	-69424
EBITDA	**48585**	**60740**	**71507**	**83852**	**95694**
DDA & Impairment (ex gw)	-5494	-6087	-6674	-7274	-7844
EBITA	**43091**	**54653**	**64833**	**76578**	**87850**
Goodwill (amort/impaired)	n/a	n/a	n/a	n/a	n/a
EBIT	**43091**	**54653**	**64833**	**76578**	**87850**
Net interest	-183.2	-533.6	-139.2	-135.0	-135.0
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Forex gain / (loss)	n/a	n/a	n/a	n/a	n/a
Exceptionals (pre-tax)	n/a	n/a	n/a	n/a	n/a
Other pre-tax items	5349	6034	6168	5638	7523
Reported PTP	**48257**	**60153**	**70862**	**82081**	**95238**
Taxation	-15622	-19543	-21967	-25445	-29524
Minority interests	n/a	n/a	n/a	n/a	n/a
Exceptionals (post-tax)	0.00	0.00	0.00	0.00	0.00
Other post-tax items	0.00	0.00	0.00	0.00	0.00
Reported net profit	**32636**	**40610**	**48894**	**56636**	**65714**
Normalised Items Excl. GW	0.00	0.00	0.00	0.00	0.00
Normalised net profit	**32636**	**40610**	**48894**	**56636**	**65714**

Source: Company data, RBS forecasts year to Mar

Balance sheet

Rsm	FY09A	FY10A	FY11F	FY12F	FY13F
Cash & market secs (1)	10310	11263	5372	6318	7307
Other current assets	71287	70008	76587	85597	97588
Tangible fixed assets	84860	91514	96750	101476	105632
Intang assets (incl gw)	n/a	n/a	n/a	n/a	n/a
Oth non-curr assets	28377	57269	57269	77269	102269
Total assets	**194835**	**230053**	**235977**	**270660**	**312796**
Short term debt (2)	0.00	0.00	0.00	0.00	0.00
Trade & oth current liab	47036	80482	63944	73321	85549
Long term debt (3)	1776	1077	1500	1500	1500
Oth non-current liab	8672	7850	7850	7850	7850
Total liabilities	**57484**	**89410**	**73294**	**82671**	**94899**
Total equity (incl min)	137351	140644	162684	187989	217897
Total liab & sh equity	**194835**	**230053**	**235977**	**270660**	**312796**
Net debt	-8535	-10186	-3872	-4818	-5807

Source: Company data, RBS forecasts year ended Mar

Cash flow statement

Rsm	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA	48585	60740	71507	83852	95694
Change in working capital	-3264	2912	-5455	-4109	-4239
Net interest (pd) / rec	-206.5	-335.2	-139.2	-135.0	-135.0
Taxes paid	-14402	-19898	-21967	-25445	-29524
Other oper cash items	1497	2552	0.00	0.00	0.00
Cash flow from ops (1)	**32211**	**45971**	**43946**	**54164**	**61797**
Capex (2)	-16997	-10945	-11910	-12000	-14500
Disposals/(acquisitions)	55.6	28.6	0.00	0.00	0.00
Other investing cash flow	4571	-24400	6168	-14362	-17477
Cash flow from invest (3)	**-12371**	**-35316**	**-5742**	**-26362**	**-31977**
Incr / (decr) in equity	447.5	7207	0.00	0.00	0.00
Incr / (decr) in debt	-368.8	-698.4	422.9	0.00	0.00
Ordinary dividend paid	-15398	-16333	-44517	-26855	-31330
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	86.8	120.8	3250	3900	2500
Cash flow from fin (5)	**-15232**	**-9703**	**-44094**	**-26855**	**-28830**
Forex & disc ops (6)	n/a	n/a	n/a	n/a	n/a
Inc/(decr) cash (1+3+5+6)	**4608**	**952.7**	**-5891**	**946.6**	**989.0**
Equity FCF (1+2+4)	15214	35027	32035	42164	47297

Lines in bold can be derived from the immediately preceding lines. year to Mar
Source: Company data, RBS forecasts

Standard ratios

Performance	ITC FY09A	ITC FY10A	ITC FY11F	ITC FY12F	ITC FY13F	Hindustan Unilever FY10F	Hindustan Unilever FY11F	Hindustan Unilever FY12F	Nestle India FY10F	Nestle India FY11F	Nestle India FY12F
Sales growth (%)	11.9	16.3	13.6	14.9	17.2	-14.0	8.22	10.3	19.8	16.6	15.7
EBITDA growth (%)	10.3	25.0	17.7	17.3	14.1	-9.55	8.66	12.8	18.6	17.1	18.3
EBIT growth (%)	8.67	26.8	18.6	18.1	14.7	-9.81	7.93	13.5	19.7	18.0	19.4
Normalised EPS growth (%)	4.44	23.0	20.4	15.8	16.0	-16.5	9.97	13.0	16.5	17.5	19.3
EBITDA margin (%)	31.1	33.5	34.7	35.4	34.5	15.5	15.6	15.9	19.6	19.7	20.1
EBIT margin (%)	27.6	30.1	31.4	32.3	31.6	14.5	14.4	14.9	17.7	17.9	18.5
Net profit margin (%)	20.9	22.4	23.7	23.9	23.7	11.8	12.0	12.3	13.0	13.1	13.5
Return on avg assets (%)	17.8	19.3	21.0	22.4	22.6	24.6	24.6	25.6	40.5	46.7	51.1
Return on avg equity (%)	25.3	29.2	32.2	32.3	32.4	90.0	80.4	75.2	125.2	129.9	130.7
ROIC (%)	22.7	25.6	30.2	29.6	29.7	568.6	625.9	190.5	159.4	150.0	174.5
ROIC - WACC (%)	12.0	14.9	19.5	18.9	19.0	558.9	616.2	180.9	148.8	139.4	164.0
					year to Mar			year to Mar			year to Dec

Valuation	ITC FY09A	ITC FY10A	ITC FY11F	ITC FY12F	ITC FY13F	Hindustan Unilever FY10F	Hindustan Unilever FY11F	Hindustan Unilever FY12F	Nestle India FY10F	Nestle India FY11F	Nestle India FY12F
EV/sales (x)	7.14	6.13	5.43	4.72	4.03	3.12	2.92	2.63	4.53	3.87	3.34
EV/EBITDA (x)	23.0	18.3	15.7	13.3	11.7	20.1	18.7	16.5	23.1	19.7	16.6
EV/EBITDA @ tgt price (x)	25.9	20.7	17.7	15.1	13.2	19.6	18.3	16.1	24.7	21.0	17.7
EV/EBIT (x)	25.9	20.4	17.3	14.6	12.7	21.6	20.2	17.7	25.6	21.6	18.1
EV/invested capital (x)	8.11	8.05	6.72	5.86	5.08	125.1	33.9	28.4	49.4	48.0	41.0
Price/book value (x)	8.18	8.08	6.99	6.05	5.22	22.2	18.2	15.2	41.5	36.2	29.7
Equity FCF yield (%)	1.35	3.08	2.82	3.71	4.16	5.24	1.55	4.48	2.45	3.31	3.66
Normalised PE (x)	34.4	28.0	23.2	20.1	17.3	27.4	24.9	22.0	35.0	29.8	25.0
Norm PE @tgt price (x)	38.9	31.6	26.2	22.7	19.5	26.7	24.3	21.5	37.4	31.8	26.7
Dividend yield (%)	1.24	3.36	2.02	2.35	2.69	2.67	3.05	3.43	2.20	2.54	2.88
					year to Mar			year to Mar			year to Dec

Per share data	FY09A	FY10A	FY11F	FY12F	FY13F
Tot adj dil sh, ave (m)	3774	3818	3818	3818	3818
Reported EPS (INR)	8.65	10.6	12.8	14.8	17.2
Normalised EPS (INR)	8.65	10.6	12.8	14.8	17.2
Dividend per share (INR)	3.70	10.0	6.00	7.00	8.00
Equity FCF per share (INR)	4.03	9.17	8.39	11.0	12.4
Book value per sh (INR)	36.4	36.8	42.6	49.2	57.1
					year to Mar

Solvency	FY09A	FY10A	FY11F	FY12F	FY13F
Net debt to equity (%)	-6.21	-7.24	-2.38	-2.56	-2.67
Net debt to tot ass (%)	-4.38	-4.43	-1.64	-1.78	-1.86
Net debt to EBITDA	-0.18	-0.17	-0.05	-0.06	-0.06
Current ratio (x)	1.73	1.01	1.28	1.25	1.23
Operating CF int cov (x)	226.7	197.5	474.4	590.7	677.4
Dividend cover (x)	2.34	1.06	2.13	2.12	2.15
					year to Mar

Priced as follows: ITC.BO - Rs297.70; HLL.BO - Rs262.30; NEST.BO - Rs2949.90
Source: Company data, RBS forecasts

Valuation methodology

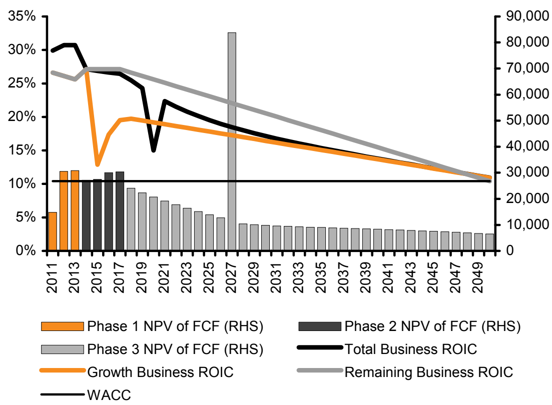
Economic Profit Valuation	Rs m	%
Adjusted Opening Invested Capital	164292.2	13
NPV of Economic Profit During Explicit Period	98329.2	8
NPV of Econ Profit of Remaining Business (1, 2)	331483.7	27
NPV of Econ Profit of Net Inv (Grth Business) (1, 3)	648095.2	52
Enterprise Value	1242200.3	100
Plus: Other Assets	0.0	0
Less: Minorities	0.0	0
Less: Net Debt (as at 23 Jul 2010)	-42531.0	-3
Equity Value	1284731.3	103
No. Shares (millions)	3818.2	
Per Share Equity Value	**336.00**	
Current Share Price	297.70	

Sensitivity Table		No of Years in Fade Period				
		15	18	20	23	25
WACC	**8.4%**	298.00	341.00	370.00	416.00	448.00
	9.4%	247.00	277.00	298.00	328.00	349.00
	10.4%	207.00	230.00	244.00	266.00	280.00
	11.4%	176.00	193.00	204.00	219.00	229.00
	12.4%	149.00	164.00	172.00	184.00	191.00

Performance Summary	2011	2012	2013	Phase 2 Avg (2014 - 2017)
Invested Capital Growth (%)	15.0	14.7	15.2	13.5
Operating Margin (%)	34.7	35.4	33.6	33.0
Capital Turnover (x)	1.2	1.2	1.2	1.2

Discounted Cash Flow Valuation	Rs m	%
Value of Phase 1: Explicit (2011 to 2013)	76177.3	6
Value of Phase 2: Value Driver (2014 to 2017)	114949.5	9
Value of Phase 3: Fade (2018 to 2050)	440072.6	36
Terminal Value	591611.1	48
Enterprise Value	1222810.6	100
FCF Grth Rate at end of Phs 1 implied by DCF Valuation		7.6
FCF Grth Rate at end of Phs 1 implied by Current Price		7.1

Returns, WACC and NPV of Free Cash Flow

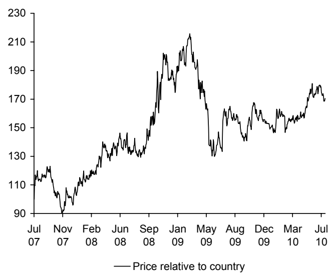


1. In periods following the Explicit Period i.e. Phase 2 and Phase 3
2. Remaining Business is defined as Capital as at the end of Phase 1 and capex = depreciation thereafter
3. Net Investment is defined as capex over and above depreciation after Phase 1
Source: Company data, RBS forecasts

Company description Buy

ITC dominates the Indian cigarette market with an 82% share. It has very strong positioning in the market with brands across all price points, and its distribution network spans 1.5m outlets across the country. Besides cigarettes, ITC runs a five-star hotel chain with properties in key cities. Over the last few years, the company, in an effort to leverage its key strengths - distribution and brands - has moved into other FMCG products like foods and confectionery using the outsourcing model. It also has a very profitable paper business that is fully integrated and focuses on the higher value-added paper-board business, where price volatility is lower.

Price relative to country



Strategic analysis Average SWOT company score: 4

Strengths 4

ITC dominates the market with an 82% share and, hence, should have the pricing power to sustain earnings growth.

Weaknesses 3

The government's lopsided taxation regime, which mainly taxes cigarettes, constrains volume growth in this segment. About 58% of the retail selling price of cigarettes is excise tax, which is beyond ITC's control.

Opportunities 4

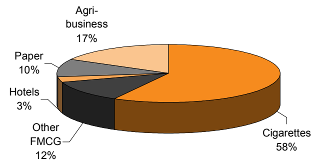
In India, just 15% of tobacco consumption is in the form of cigarettes, compared with the global average of 75-80%. With rising per-capita income, the aspiration to smoke cigarettes is likely to drive a switch from other forms of tobacco consumption.

Threats 3

Any sharp increases in excise duties on cigarettes would affect volume growth in the cigarette category.

Scoring range is 1-5 (high score is good)

Sales composition, 1Q11



Source: Company data

Market data

Headquarters
37, Virginia House Calcutta-700071

Website
www.itcportal.com

Shares in issue
3774.4m

Freefloat
65%

Majority shareholders
BAT (35%), FII's (11%)

Country view: India

The Indian market underperformed over 1Q10 in local currency terms and we suspect this trend will continue. However, currency strength saw the market outperform in USD. We believe the announced budget represented an opportunity missed for implementation of crucial structural reforms while leaving the central bank even more behind the curve as far as monetary policy is concerned. Thus, the inter-meeting hike was neither a surprise nor a one-off event, in our view. Liquidity conditions therefore, while reasonably benign today (although already past their peak), are likely to tighten going forward. That will matter for a market where an ambitious forward earnings yield ranks much below the prevailing bond yields.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.

Country rel to Asia Pacific

Competitive position Average competitive score: 3+

Supplier power 4+

ITC enjoys significant benefits of scale in raw-materials sourcing from tobacco farmers, as it dominates the Indian cigarette market.

Barriers to entry 4+

The entry of new MNC competition to the cigarette business is constrained by government FDI policy. In addition, the ban on media advertising hinders players' ability to promote new brands.

Customer power 4+

ITC dominates the market with very strong brands across all price points, which ensures it captures consumers across all income groups.

Substitute products 2-

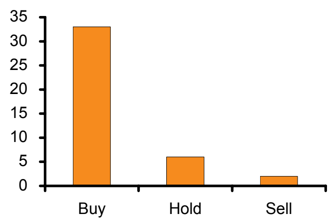
'Bidis', which are hand-rolled tobacco, dominate the mass market for tobacco. In fact, the share of cigarettes as a proportion of tobacco consumed has declined to 15%.

Rivalry 2-

ITC faces the threat of competition from the unorganised bidi players. These are not subject to tax, unlike cigarettes which are taxed at 58% of the retail price.

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse

Broker recommendations



Source: Bloomberg

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