

- Net sales surged by 24% yoy to Rs31.7bn in Q3 FY07; driven by strong 14% growth in core cigarettes and 20% rise in agri business revenues.
- Operating margins declined marginally to 34.2% due to higher raw material cost.
- Pre-exceptional net profit rose 23% yoy to Rs7bn.

Financials Highlights

| Period to | 12/06 | 12/05 | Growth | 12/06 | 12/05 | Growth | 03/07E | Growth |
|---------------------|----------|----------|--------|----------|----------|--------|----------|--------|
| (Rs mn) | (3) | (3) | (%) | (9) | (9) | (%) | (12) | (%) |
| Gross sales | 50,445 | 42,391 | 19.0 | 144,679 | 120,159 | 20.4 | 201,482 | 22.0 |
| Excise duty | (18,789) | (16,830) | 11.6 | (55,649) | (50,098) | 11.1 | 81,399 | 21.1 |
| Net sales | 31,656 | 25,560 | 23.8 | 89,030 | 70,061 | 27.1 | 120,083 | 22.7 |
| Expenditure | (20,828) | (16,777) | 24.1 | (58,769) | (44,811) | 31.1 | (80,336) | 24.3 |
| Operating profit | 10,828 | 8,783 | 23.3 | 30,261 | 25,249 | 19.8 | 39,748 | 19.5 |
| Other income | 698 | 489 | 42.8 | 2,342 | 2,115 | 10.8 | 3,155 | 10.3 |
| Interest | 9 | (15) | - | (33) | (23) | - | (52) | (56.4) |
| Depreciation | (921) | (831) | 10.8 | (2,707) | (2,462) | 10.0 | (3,623) | 9.0 |
| PBT | 10,614 | 8,426 | 26.0 | 29,863 | 24,880 | 20.0 | 39,227 | 20.0 |
| Tax | (3,440) | (2,603) | 32.1 | (9,370) | (7,751) | 20.9 | (11,768) | 19.0 |
| PAT | 7,174 | 5,823 | 23.2 | 20,493 | 17,129 | 19.6 | 27,459 | 20.4 |
| Extraordinary items | 0 | (454) | - | 0 | (454) | - | 0 | - |
| APAT | 7,174 | 5,368 | 33.6 | 20,493 | 16,675 | 22.9 | 27,459 | 22.8 |
| OPM (%) | 34.2 | 34.4 | - | 34.0 | 36.0 | - | 33.1 | - |
| Equity, F.V-Re1 | 3,760 | 3,755 | - | 3,760 | 3,755 | - | 3,760 | - |
| EPS (Rs) Annualized | 7.6 | 5.7 | - | 10.9 | 8.9 | - | 7.3 | - |
| P/E (x), CMP-Rs175 | 23.0 | - | - | 16.1 | - | - | 24.0 | - |

Strong growth across segments drives topline by 24%

ITC recorded 19% yoy growth during Q3 FY07 in gross sales at Rs50.4bn buoyed by robust growth in all businesses. Net sales increased by 23.8% yoy (9.6% qoq) to Rs31.7bn. Revenues from core cigarette business grew by 13.8% yoy to Rs32.8bn. It has been the fifth quarter of ~8% volume growth in the cigarette sales. The company has not taken any price increase during the quarter. Agri business revenues increased by 19.5% yoy at Rs7.8bn driven by higher leaf tobacco exports and increased trade in soya, non-basmati rice, chana and coffee. Revenues from paper & packaging segment grew by 11% yoy to Rs5.4bn while, FMCG segment (Branded Packaged Foods - 65% yoy, Lifestyle Retailing - 38%, Stationery - 27%) registered a strong 67.6% yoy growth at Rs4.4bn. ITC's hotel business registered a 28.5% yoy growth at Rs2.8bn in revenues driven by 37% growth in overall REVPAR (revenue per available room) mainly driven by WelcomHotel New Delhi, ITC Hotel Grand Maratha Sheraton & Towers, ITC Hotel Windsor Sheraton & Towers and ITC Hotel Maurya Sheraton & Towers.

Segmental break-up

| Segments | Q3 FY07 | | | | 9M FY07 | | | | |
|-------------------|---------|----------|---------|--------|---------|----------|---------|---------|---------|
| | (Rs mn) | Revenues | yoy (%) | EBIT | yoy (%) | Revenues | yoy (%) | EBIT | yoy (%) |
| Cigarettes | | 32,787 | 13.8 | 8,283 | 19.5 | 95,397 | 12.9 | 24,305 | 17.4 |
| FMCG - Others | | 4,367 | 67.6 | (465) | 17.8 | 12,059 | 70.4 | (1,537) | 18.7 |
| Hotels | | 2,816 | 28.5 | 1,184 | 54.5 | 6,813 | 31.0 | 2,337 | 45.8 |
| Agri Business | | 7,828 | 19.5 | 217 | 45.2 | 27,626 | 47.4 | 1,149 | 39.9 |
| Paper & Packaging | | 5,432 | 11.0 | 1,041 | 14.0 | 15,667 | 10.3 | 3,196 | 17.2 |
| Total | | 53,230 | 18.2 | 10,260 | 22.7 | 157,563 | 21.5 | 29,450 | 19.9 |

Business mix continues to evolve

ITC has been slowly and gradually lowering its dependence on cigarette (high margin) business and increasing its focus on the other businesses. The contribution of cigarette business to the total revenues has decreased to 61.6% compared to 63.9% in Q3 FY06. Non-cigarettes FMCG business, which accounts for 38.4% of total sales, recorded a strong growth of 25.9% yoy during the quarter under review. This business, currently, contributes marginally (19.3%) to the profitability of the company. However, the contribution is expected to increase substantially going forward.

Segmental revenue and EBIT contribution

| Segments | Revenue contribution (%) | | EBIT contribution (%) | |
|-------------------|--------------------------|---------|-----------------------|---------|
| | Q3 FY07 | Q3 FY06 | Q3 FY07 | Q3 FY06 |
| Cigarettes | 61.6 | 63.9 | 60.5 | 65.1 |
| FMCG - Others | 8.2 | 5.8 | 7.7 | 5.5 |
| Hotels | 5.3 | 4.9 | 4.3 | 4.0 |
| Agri Business | 14.7 | 14.5 | 17.5 | 14.5 |
| Paper & Packaging | 10.2 | 10.9 | 9.9 | 11.0 |

Higher raw material cost restricts further margin expansion

Operating margins for the quarter declined marginally by 20bps to 34.2% due to 190bps increase in raw material cost (higher contribution from agri business) and increasing revenue contribution of the low margin businesses.

Cost analysis

| Period | 09/06 | 09/05 | Inc/Dec | 09/06 | 09/05 | Inc/Dec |
|-------------------|-------|-------|---------|-------|-------|---------|
| As % of net sales | (3) | (3) | | (6) | (6) | |
| Raw Material | 42.6 | 40.7 | 1.9 | 42.8 | 38.9 | 3.9 |
| Staff | 5.2 | 5.3 | (0.1) | 5.2 | 5.7 | (0.4) |
| Other Expenditure | 18.0 | 19.6 | (1.6) | 18.0 | 19.4 | (1.4) |

Cigarette business recorded 120bps expansion in EBIT margins at 25.3% during Q3 FY07. EBIT margins of the hotels business expanded sharply (on a low base) to 42% from 35% Q3 FY06. Margins of the paper business improved by 50bps to 19.2%. Loss in the FMCG business (despite sharp increase in revenues) has increased to Rs465mn from Rs395mn in the corresponding quarter last year. Profitability of the agri business improved marginally due to incremental costs incurred by the company on scaling up of the choupal.



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ITC Ltd (Q3 FY07)
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EBIT margins

| Segment | 12/06 | 12/05 | Inc/Dec | 12/06 | 12/05 | Inc/Dec |
|-------------------|--------|--------|---------|--------|--------|---------|
| | (3) | (3) | | (9) | (9) | |
| Cigarettes | 25.3 | 24.1 | 1.2 | 25.5 | 24.5 | 1.0 |
| FMCG - Others | (10.6) | (15.1) | 4.5 | (12.7) | (18.3) | 5.6 |
| Hotels | 42.0 | 35.0 | 7.1 | 34.3 | 30.8 | 3.5 |
| Agri Business | 2.8 | 2.3 | 0.5 | 4.2 | 4.4 | (0.2) |
| Paper & Packaging | 19.2 | 18.7 | 0.5 | 20.4 | 19.2 | 1.2 |

Strong topline growth and higher other income drives bottomline

Pre-tax profit increased by 26% yoy to Rs10.6bn partly aided by higher other income (at Rs698mn compared to Rs489mn in Q3 FY06). Effective tax rate was higher at 32.4% resulting in a tax outgo of Rs3.4bn. Net profit rose 23.2% yoy (5.6% qoq) growth in net profit at Rs7.2bn. The company had incurred an exceptional charge of Rs454mn (once-off assistance to contract manufacturers in view of the retrospective withdrawal of Central Excise exemption on cigarettes manufactured in the North Eastern States during the year 2000) in Q3 FY06, post-which the bottomline growth is higher at 33.6% yoy. The company reported an annualized EPS of Rs7.6 for the quarter.

Scaling up of distribution network

ITC has extended its e-Choupal network to 6,500 kiosks and set up 12 Choupal Saagars (8 expected to be launched by March/April 2007) operational in the 3 states - Madhya Pradesh, Maharashtra and Uttar Pradesh.

Outlook

ITC recorded better than expected results driven by robust growth across categories. The strong growth in the cigarette business indicates continuing strong volume growth. Outlook for the non-cigarette businesses such as hotels and paper also remains positive with continued demand buoyancy. The other FMCG businesses are also rapidly expanding, while losses are being gradually curtailed.

The company has planned a capex of ~Rs150bn for the next 3-5 years. ITC's non-cigarette business has been growing rapidly over the last few quarters and now contributes to ~70% of net sales (9M FY07). Given the positive outlook for Indian tourism industry due to increasing foreign tourists, we expect ITC to grow its hotels segment both organically and inorganically. Also, strong cash flows from cigarette business can be invested in scaling up other segments. At the current market price of Rs175, ITC is trading at 24x FY07E EPS of Rs7.3 per share. We maintain our 'Buy' rating on this stock.

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