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India Infoline Result Update
ITC Ltd *(FY07)*
Rating: BUY CMP: Rs166
May 28, 2007

- **Net sales surged by 26% yoy to Rs124bn in FY07; driven by strong 13% growth in core cigarettes and 38% rise in agri business revenues.**
- **Higher raw material cost pulled down operating margins by 200bps to 32%.**
- **Net profit rose 21% yoy to Rs27bn.**
- **PAT stood at Rs710mn for Q4FY07 compared to Rs326mn for Q4FY06**

Financials Highlights

Period to	03/07	03/06	Growth	03/07	03/06	Growth
(Rs mn)	(3)	(3)	(%)	(12)	(12)	(%)
Gross sales	53,736	44,946	19.6	198,415	165,105	20.2
Excise duty	(19,073)	(17,102)	11.5	(74,722)	(67,200)	11.2
Net sales	34,663	27,845	24.5	123,693	97,905	26.3
Expenditure	(25,360)	(19,820)	28.0	(84,129)	(64,632)	30.2
Operating profit	9,303	8,024	15.9	39,564	33,274	18.9
Other income	1,023	746	37.1	3,365	2,861	17.6
Interest	1	(97)	-	(33)	(119)	(72.5)
Depreciation	(922)	(862)	7.0	(3,629)	(3,323)	9.2
PBT	9,404	7,812	20.4	39,267	32,692	20.1
Tax	(2,897)	(2,138)	35.5	(12,267)	(9,888)	24.1
PAT	6,507	5,675	14.7	27,000	22,804	18.4
Extraordinary items	0	4	-	0	(450)	-
APAT	6,507	5,679	14.6	27,000	22,354	20.8
OPM (%)	26.8	28.8	-	32.0	34.0	-
Equity, F.V-Re1	3,762	3,755	-	3,762	3,755	-
EPS (Rs) Annualized	6.9	6.0	-	7.2	6.0	-
P/E (x), CMP-Rs166	24.0	-	-	23.1	-	-

Strong growth across segments drives topline by 26%

ITC recorded 20% yoy growth during FY07 in gross sales at Rs198bn buoyed by robust growth in all businesses. Net sales increased by 26.3% yoy to Rs124bn. Revenues from core cigarette business grew by 13.3% yoy to Rs128bn. The company took price hike of ~20%+ during April 2007 to offset the impact of additional excise duty and VAT. Agri business revenues increased by 37.8% yoy at Rs36.9bn driven by higher soya, rice and leaf tobacco (strong 21% value growth) exports. Revenues from paper & packaging segment grew by 10.8% yoy to Rs21bn while, FMCG segment (Branded Packaged Foods - 51%, Biscuits - 55%, Lifestyle Retailing - 52%) registered a strong 68.2% yoy growth at Rs17bn. ITC's hotel business registered a 25.8% yoy growth at Rs10bn in revenues driven by better room rates, improved occupancies and food & beverage sales.

Segmental break-up

Segments	Q4 FY07				FY07			
(Rs mn)	Revenues	yoy (%)	EBIT	yoy (%)	Revenues	yoy (%)	EBIT	yoy (%)
Cigarettes	32,940	14.3	7,417	16.2	128,337	13.3	31,722	17.1
FMCG - Others	4,985	63.1	(483)	14.2	17,044	68.2	(2,020)	17.6
Hotels	3,044	15.6	1,171	19.7	9,857	25.8	3,508	35.9
Agri Business	9,287	15.5	87	(0.9)	36,914	37.8	1,236	36.0
Paper & Packaging	5,334	12.2	972	23.5	21,001	10.8	4,168	18.6
Total	**55,589**	**17.5**	**9,162**	**17.3**	**213,152**	**20.4**	**38,613**	**19.3**

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 82.2% compared to 83.7% in FY06. Non-cigarettes FMCG business, which accounts for 39.8% of total sales, recorded a strong growth of 33.1% yoy during the year. This business, currently, contributes marginally (17.8%) 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 (%)			
	Q4 FY07	Q4 FY06	FY07	FY06	Q4 FY07	Q4 FY06	FY07	FY06
Cigarettes	59.3	60.9	60.2	64.0	80.9	81.7	82.2	83.7
FMCG - Others	9.0	6.5	8.0	5.7	(5.3)	(5.4)	(5.2)	(5.3)
Hotels	5.5	5.6	4.6	4.4	12.8	12.5	9.1	8.0
Agri Business	16.7	17.0	17.3	15.1	0.9	1.1	3.2	2.8
Paper & Packaging	9.6	10.1	9.9	10.7	10.6	10.1	10.8	10.9

Higher raw material cost restricts further margin expansion

Operating margins for the year declined by 200bps to 32% mainly due to sharp 280bps increase in raw material cost (on account of higher contribution from agri business) and increasing revenue contribution of the low margin businesses.

Cost analysis

Period	03/07	03/06	Inc/Dec	03/07	03/06	Inc/Dec
As % of net sales	**(3)**	**(3)**		**(12)**	**(12)**	
Raw Material	45.5	45.2	0.2	43.5	40.7	2.8
Staff	4.7	5.2	(0.5)	5.1	5.5	(0.4)
Other Expenditure	23.0	20.8	2.2	19.4	19.8	(0.4)

Cigarette business recorded 80bps expansion in EBIT margins at 24.7% during FY07. EBIT margins of the hotels (on a low base) and paper business expanded sharply by 260bps and 130bps respectively. Loss in the FMCG business (despite sharp increase of 68% yoy in revenues) has increased to Rs2bn from Rs1.7bn in FY06. EBIT margins in the agri business remained almost constant due to incremental costs incurred by the company on scaling up of the choupal.

EBIT margins

Segment	03/07 (3)	03/06 (3)	Inc/Dec	03/07 (12)	03/06 (12)	Inc/Dec
Cigarettes	22.5	22.1	0.4	24.7	23.9	0.8
FMCG - Others	(9.7)	(13.9)	4.2	(11.9)	(17.0)	5.1
Hotels	38.5	37.1	1.3	35.6	32.9	2.6
Agri Business	0.9	1.1	(0.2)	3.3	3.4	(0.0)
Paper & Packaging	18.2	16.5	1.7	19.8	18.5	1.3

Strong topline growth and higher other income drives bottomline

Pre-tax profit for the year increased by 20.1% yoy to Rs39bn partly aided by higher other income (at Rs3.4bn compared to Rs2.9bn in FY06) on account of dividends from mutual funds. Effective tax rate was higher at 31.2% resulting in a tax outgo of Rs12.3bn. Adjusted net profit rose 20.8% yoy growth in net profit at Rs27bn. The company had incurred an exceptional charge of Rs450mn (one-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 - Rs679mn + income tax thereon Rs229mn) in FY06. EPS for the year stood at Rs7.2. The company has announced dividend of Rs3.1 (Rs2.65 in FY06) per equity share for FY07.

Quarter review

During Q4 FY07, net sales grew by 24.5% yoy to Rs34.7bn aided by 14.3% yoy growth in cigarettes segment. ITC launched 'Silk cut' in the regular size in addition to the king size category during the quarter. The company has also introduced some limited edition and different flavors in cigarettes. Operating margins dipped by 200bps to 26.8% mainly due to sharp 220bps increase in overhead cost. Net profit rose by 14.6% yoy to Rs6.5bn partly aided by higher other income (Rs1bn in Q4 FY07 compared to Rs746mn in Q4 FY06).

Outlook

ITC recorded better than expected results driven by robust growth across categories and strong ~7% volume growth for the year. The company has taken a price hike of ~20%+ across its brands to offset the impact of increased excise duty and VAT. We expect volume growth to remain under pressure in the next couple of quarters due to price hike and excise and VAT impact. 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.

ITC plans to set up a strategic business unit (SBU) for home and personal care products under the FMCG portfolio, as per its move of consolidating the Essenza Di Wills range of products. The company had launched prestige segment fragrance under this brand in 2005 and then extended the brand to bath and body care products last year. With the entry into the personal care category [soon to be extended to soaps, skincare and shampoos (likely brand name - Superia)], we expect ITC can become a tough competitor for HLL, given its strong distribution network in the rural (6,400 e-choupals and 18 Choupal Saagars) and urban markets. Also, strong cash flows from cigarette business can be invested in advertising heavily to build the personal care portfolio in the initial stage.

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 ~69% of net sales (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 Rs166, ITC is trading at 21.7x FY08E EPS of Rs7.7 per share. We maintain our 'Buy' rating on this stock.