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India Research

ITC

Accumulate

CMP: Rs203

Target Price: Rs227 (12 Months)

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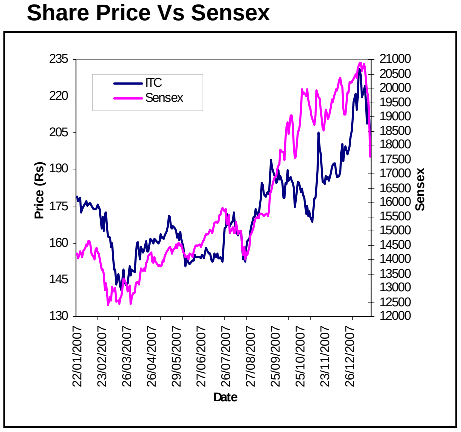
Sector	FMCG
Market Cap (Rs cr)	76,578
Beta	0.82
52 WK High / Low	239 / 140
Avg Daily Volume	13,28,161
Face Value (Rs)	1
BSE Sensex	17,605
Nifty	5,209
BSE Code	500875
NSE Code	ITC
Reuters Code	ITC.BO
Bloomberg Code	ITC@IN

Shareholding Pattern (%)

Promoters	-
MF/Banks/Indian FIs	39.9
FII/ NRIs/ OCBs	47.4
Indian Public	12.7

Share Price Vs Sensex



3QFY2008 Result Update

Performance Highlights

- **Topline growth muted, up 11%:** For 3QFY2008, ITC posted a Topline growth of 11% yoy to Rs3,458cr (Rs3,115cr) marginally below our estimates of Rs3,555cr. Growth was largely driven by the company's Non-Cigarette FMCG business, which grew 50.1% and resilient performance by its core Cigarette business. Cigarette revenues registered 7.6% growth in Topline (gross level) on the back of a 1% decline in volumes, which was better than our estimates of 2-2.5% decline. While the Hotels and Paperboard segments delivered a steady performance, ITC's Agri business once again posted a disappointing performance registering a 9.4% yoy decline in Revenues impacted by the ban on export of rice.

- **Earnings growth beats expectations, up 15.8%:** ITC registered a strong Earnings growth for the quarter at 15.8% yoy to Rs831cr (Rs717cr) as against our expectation of Rs817cr, a 13.8% growth. The higher-than-expected growth in Earnings, despite flat Margins, came largely on account of significantly higher Other Income (mainly due to better yield on investments), which increased by 97% to Rs137cr (Rs70cr).

- **Margins flat:** On the Operating front, ITC delivered a positive surprise registering flat Margins with OPM declining by a mere 7bp, as against our expectation of a 34bp decline. EBITDA grew by 10.8% yoy to Rs1,200cr (Rs1,083cr). EBIT Margins witnessed an improvement across segments. Cigarette Margins registered an expansion of 197bp owing to a combination of better product mix and price hikes. In the Non-cigarette FMCG business, the losses in absolute terms witnessed a substantial increase due to launch of HPC products. However, the Non-*Bingo* Food business has achieved break even in this quarter, which is a positive sign.

Exhibit 1: Key Financials

Y/E March (Rs cr)	FY2007	FY2008E	FY2009E	FY2010E
Net Sales	**12,369**	**13,930**	**16,480**	**19,534**
% chg	*26.3*	*12.6*	*18.3*	*18.5*
Net Profit	**2,700**	**3,139**	**3,720**	**4,385**
% chg	*20.8*	*16.3*	*18.5*	*17.9*
OPM (%)	32.2	31.6	31.9	31.8
EPS (Rs)	**7.2**	**8.3**	**9.9**	**11.6**
P/E (x)	28.3	24.4	20.6	17.4
P/BV (x)	7.3	6.3	5.4	4.6
RoE (%)	25.9	25.8	26.1	26.2
RoCE (%)	32.3	31.0	32.2	32.8
EV/Sales (x)	6.1	5.4	4.6	3.9
EV/EBITDA (x)	19.1	17.2	14.4	12.2

Source: Company, Angel Research

Segment-wise Performance

Cigarette Business – ITC's Cigarette business registered a 7.6% growth in Revenues (11.4% net of excise) to Rs3,529cr (Rs3,279cr) despite a weighted average price hike of 21% (on account of 12.5% VAT levy imposition and higher excise burden) impacting volumes of its cigarette portfolio. Growth was largely led by improved realisation (price hikes) and better product mix coupled with lower-than-expected volume decline of 1%. On the Margin front, ITC positively surprised us by registering a 197bp expansion in PBIT Margins in its Cigarette Division to 27.2% owing to the price hikes. **Going forward, we maintain our Volume decline estimates of 2% and expect Margin expansion of 160bp for FY2008. We believe the worst is over for ITC and expect volumes to improve from hereon with flat volume growth in 4QFY2008E. For FY2009E, we have factored in a 5% Volume growth in cigarettes.** Moreover, the imposition of VAT in UP (12.5%) from January 1, 2008 and removal of the Trade Tax (33%) in the state is an extremely positive development for ITC and would help improve Margins even further during the next quarter. However, on the negative side, the Health Ministry is working towards implementing pictorial warnings on cigarettes, pending approvals, which could act as a downward trigger for cigarette volumes in the short term.

Non-Cigarette FMCG business – ITC's Non-Cigarette FMCG business continued its strong growth momentum in the quarter registering a 50% yoy growth in Revenues to Rs655cr (Rs437cr) driven by robust performance of its branded packaged Food portfolio.

- *Branded Packaged Food Business* – This segment continued to expand rapidly with sales growing 60% yoy. The *Bingo* range of snacks launched by company in March 2007 continued its strong growth momentum, with wider distribution and extension into target markets during the quarter. The *Sunfeast* range of biscuits registered 58% yoy growth aided by an improved product mix (increased sales of higher value variants like creams, crackers and cookies) and Excise relief on low to mid-priced biscuits. During the quarter, *Sunfeast* range of biscuits was further enhanced with the launch of *Coconut* and *Nice* variants, and the addition of *Sunfeast BenneVita Flaxseed* biscuits.

  In the Staples category, *Aashirvaad* atta continued to build on its leadership position, with revenues growing 39% during the period. The recent launch of *Aashirvaad MP Chakki Atta* has met with excellent consumer response and is being extended to target markets. The business is also scaling up the branded spices volumes under the *Aashirvaad* brand. The confectionary category recorded a robust 38% revenue growth driven mainly by Deposited Mint and *Eclairs*. Sales of ready-to-eat foods under the *Kitchens of India* and *Aashirvaad* brands grew by 63% during the quarter on higher volumes of instant mixes and pasta.

- *Lifestyle Retailing Business*– The segment registered 26% growth in Revenues aided by wider retail footprint, launch of two new stores and robust growth (fuelled by both higher volumes and improved realisations) in the *John Players* brand.

- *Stationery Business* – This segment continued to scale up with sales increasing by 39% over last year. Both the premium range under the *Paperkraft* brand and mid range under *Classmate* continued to do well and have become the most widely distributed brands in the country.

- *Safety Matches* – Better research coupled with synergistic benefits arising from acquisition of *WIMCO* has helped ITC maintain its leadership position in this business. Value-added brands like *AIM Mega* and *AIM Metro* are now more widely available and continue to gain marketshare. *Mangaldeep* brand of incense sticks (agarbattis) registered sales growth of 31% yoy.

- *Personal Care* – During 2QFY2008, ITC had extended its product offerings in the Personal Care segment beyond fragrances into soaps, shampoos and shower gels. The company's Portfolio in the Premium Personal Care segment continued to expand, with the launch of *Fiama Di Wills* soaps. The *Superia* range of soaps and shampoos in the mass-market segment have gained wide acceptance and is now being extended beyond its test markets. We expect the Personal Care segment to be one of the key growth drivers for ITC going ahead and expect further launches in the segment.

Hotels Business – ITC's Hotel business reported a modest 11.4% yoy Revenue growth during the quarter to Rs314cr (Rs282cr) driven by improved REVPAR (revenue per available room) at most properties and superior performance by the Food & Beverage segment. PBIT Margins improved by a sharp 187bp yoy to 43.9% driving PBIT growth of 16.3% to Rs138cr (Rs118cr). Renovation of the premium Towers Block at ITC Hotel, *The Maurya,* New Delhi was successfully completed during the quarter. Product upgradation and renovation at three other hotels were also completed consistent with the premium positioning of the chain. Construction activity at the new super-deluxe luxury hotels at Bangalore and Chennai is also progressing as per schedule. **Going ahead, we expect the growth momentum in this segment to pick up and register a 15.7% CAGR growth in Revenues over FY2007-10E.**

Paperboard, Specialty Paper and Packaging – The Segment continued its modest performance clocking a Revenue growth of 11.2% yoy to Rs604cr (Rs543cr) driven by a 14% improvement in volumes of the value-added portfolio of Paper and Paperboards and robust performance of the Packaging business. PBIT Margins of the segment expanded by 42bp to 19.6% resulting in a growth in Segmental PBIT by 13.6%. The pulp mill, with a capacity of 1,20,000 tonnes of hardwood pulp, is expected to be commissioned in the last quarter of this fiscal and will provide a distinct cost advantage, which has adversely impacted Margins of the segment. The company is making rapid progress towards completion of capacity augmentation projects at Bhadrachalam. The paper machine will augment capacity by around 1,00,000tpa in 1QFY2009 and drive growth with strong forward linkages with the Stationery business. During the quarter, ITC commenced marketing a range of paper cups under the brand name, *Spectra,* made out of paperboard manufactured with the environment friendly elemental chlorine free (ECF) technology. In the Packaging and Printing business, investments made in capacity augmentation at the Chennai unit is now providing superior and innovative packaging solutions for the company's Cigarette business. **Going forward, we expect the Segment to accelerate momentum (driven by higher volume growth in the Cigarette business and commencement of new units) registering a CAGR growth of 13.4% in Revenues over FY2007-10E.**

Agri Business – This Segment witnessed de-acceleration in growth momentum for the second consecutive quarter and registered a decline of 9.4% in Revenues to Rs663cr (Rs732cr) primarily due to restrictions on the export of non-basmati rice. However, PBIT Margins expanded 123bp yoy to 4.2% riding on record export of leaf tobacco. Cigarette leaf tobacco exports grew by 37% during the quarter. The business, one of the largest integrated source of quality tobacco, serves customers in 48 countries across 69 destinations. The Segment has also successfully re-negotiated pricing of its export orders to offset the impact of the appreciating Rupee. Going ahead, management expects the Segment to regain its growth traction and profitability with market dynamics getting restored in the agri commodities sector. Meanwhile, rural marketing initiatives were further advanced. On the Rural Retail front, 21 *Choupal Saagars* are now operational in the three states of Madhya Pradesh, Maharashtra and Uttar Pradesh. A pilot project for retailing fresh fruits and vegetables is also progressing. Three *Choupal Fresh Cash & Carry Stores* and six *Choupal Fresh* retail stores are currently operational at Hyderabad, Pune and Chandigarh. **We expect the Segment to remain one of the key growth drivers for ITC over the long term and register a CAGR growth of 14% in Revenues over FY2007-10E.**

Exhibit 2: Segment-wise Performance						
Y/E March (Rs cr)	**3QFY2008**	**3QFY2007**	***% chg***	**9MFY2008**	**9MFY2007**	***% chg***
Cigarettes	3,529.4	3,278.7	*7.6*	10,242.6	9,539.7	*7.4*
Others	655.4	436.7	*50.1*	1,784.7	1,205.9	*48.0*
Hotels	313.6	281.6	*11.4*	760.9	681.3	*11.7*
Agri Business	662.9	731.9	*(9.4)*	2,790.3	2,659.8	*4.9*
Paperboards & Packaging	604.0	543.2	*11.2*	1,744.7	1,566.7	*11.4*
Less: Inter-segmental Revenues	413.4	348.3	*18.7*	1,801.2	1,522.6	*18.3*
Total Gross Income	**5,351.9**	**4,923.8**	***8.7***	**15,522.0**	**14,130.8**	***9.8***
Cigarettes	961.1	828.3	*16.0*	2,764.0	2,430.5	*13.7*
Others	(64.5)	(46.5)		(145.6)	(153.6)	
Hotels	137.7	118.4	*16.3*	268.0	233.7	*14.7*
Agri Business	27.8	21.7	*28.1*	92.2	114.9	*(19.8)*
Paperboards & Packaging	118.3	104.1	*13.6*	330.4	319.6	*3.4*
Total PBIT	**1,180.4**	**1,026.0**	***15.0***	**3,309.0**	**2,945.0**	***12.4***
Less: Interest Exp	1.8	(0.9)		1.9	3.3	
Less: Other Unallocable Exp	(47.0)	(34.5)		(180.6)	(44.6)	
PBT	**1,225.6**	**1,061.4**	***15.5***	**3,487.6**	**2,986.3**	***16.8***
PBIT Margin (%)						
Cigarettes	27.2	25.3		27.0	25.5	
Others	(9.8)	(10.6)		(8.2)	(12.7)	
Hotels	43.9	42.0		35.2	34.3	
Agri Business	4.2	3.0		3.3	4.3	
Paperboards & Packaging	19.6	19.2		18.9	20.4	

Source: Company, Angel Research

Outlook and Valuation

We believe the worst is over for ITC particularly with the VAT overhang finally getting addressed and volume growth is likely to pick up going forward. The Cigarette Division's resilience to price hikes and ITC's strategy to load the price hikes particularly in mid-end cigarettes is impressive and is working well in favour of the company driving a consistent Margin expansion in the segment. Moreover, a nominal 5% hike in Excise during the upcoming Budget would act as a positive trigger for the stock. The company's strong consumer demand profile and better pricing power coupled with strong cash flows and its ability to channel these flows into new growth opportunities reinforces our bullish stance on the company's future prospects. Over the last couple of months, expectations of demerger of ITC's business segments have gained momentum. However, we do not expect ITC to demerge any of its business segments in the short term as it derives significant synergies from the same, which would be lost in case any Division is demerged. Moreover, the Cigarette segment remains the cash cow funding the capital requirement of other high-growth Divisions, which would require additional funding in case such an event takes place.

During FY2007-10E, we expect ITC to report a CAGR growth of 16.7% in Topline and 17.5% in Bottomline backed by strong growth traction in its Non-Cigarette FMCG business, Hotels and Agri-business coupled with improved Margins in its core Cigarettes business and higher Other Income. On the Operating front, we expect the company to clock a CAGR growth of 16.3% in EBITDA and flat Margins owing to changing Revenue mix and extended losses in the Non-Cigarette FMCG business (due to new launches in HPC category). We have revised our FY2008 and FY2009 Earnings estimates 1.5% and 2.3% respectively to account for improved Margins in the Cigarette segment and higher Other Income. At the CMP of Rs203, the stock is trading at 20.6x FY2009E EPS of Rs9.5and 14.4x EV/EBITDA. **We recommend an Accumulate on the stock, with a revised 12-month Target Price of Rs227 (Rs212) on the back of better volume growth expectation in Cigarettes, strong growth traction in its Non-cigarette FMCG business and pickup in its Hotels and Paperboard Revenues in FY2009E post completion of the expansion program.**

Exhibit 3: 3QFY2008 Performance

Y/E March (Rs cr)	3QFY2008	3QFY2007	% chg	9MFY2008	9MFY2007	% chg
Net Sales	**3,458.0**	**3,114.7**	***11.0***	**10,025.2**	**8,800.1**	***13.9***
Consumption of RM	1,313.0	1,296.7	*1.3*	4,172.2	3,706.4	*12.6*
(% of Sales)	*38.0*	*41.6*		*41.6*	*42.1*	
Staff Costs	190.6	164.7	*15.7*	542.3	466.9	*16.1*
(% of Sales)	*5.5*	*5.3*		*5.4*	*5.3*	
Other Expenses	754.7	570.5	*32.3*	1,951.4	1,600.7	*21.9*
(% of Sales)	*21.8*	*18.3*		*19.5*	*18.2*	
Total Expenditure	**2,258.3**	**2,031.9**	***11.1***	**6,665.9**	**5,774.0**	***15.4***
Operating Profit	**1,199.7**	**1,082.8**	***10.8***	**3,359.3**	**3,026.1**	***11.0***
OPM (%)	*34.7*	*34.8*		*33.5*	*34.4*	
Interest	1.8	(0.9)	*(310.3)*	1.9	3.3	*(42.6)*
Depreciation & Amortisation	109.7	92.1	*19.2*	317.0	270.7	*17.1*
Other Income	137.4	69.8	*96.9*	447.2	234.2	*90.9*
PBT (excl. Extraordinary Items)	**1,225.6**	**1,061.4**	*15.5*	**3,487.6**	**2,986.3**	*16.8*
Extraordinary Income/(Expense)	-	-		-	-	
PBT (incl. Extraordinary Items)	**1,225.6**	**1,061.4**	***15.5***	**3,487.6**	**2,986.3**	***16.8***
(% of Sales)	*35.4*	*34.1*		*34.8*	*33.9*	
Provision for Taxation	394.8	344.0	*0.1*	1,103.2	937.0	*0.2*
(% of PBT)	*32.2*	*32.4*		*31.6*	*31.4*	
Reported PAT	**830.7**	**717.4**	***15.8***	**2,384.5**	**2,049.3**	***16.4***
PAT Margin (%)	*24.0*	*23.0*		*23.8*	*23.3*	
Equity shares (cr)	376.6	376.0		376.6	376.0	
EPS (Rs)	**2.2**	**1.9**	***15.6***	**6.3**	**5.4**	***16.2***

Source: Company, Angel Research

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