

ITC

STOCK INFO. BLOOMBERG
BSE SENSEX: 9,521 ITC IN
REUTERS CODE
S&P CNX: 2,901 ITC.BO

20 January 2006

Buy

Rs147

Previous Recommendation: Buy

		YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
		END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
Equity Shares (m)	3,723.3	03/05A	76,055	18,371	4.9	15.4	29.8	6.9	23.3	32.0	6.7	18.3
52-Week Range	149/81	03/06E	96,271	23,279	6.3	26.7	23.5	5.9	25.2	34.1	5.2	14.8
1,6,12 Rel. Perf. (%)	1/2/6	03/07E	111,102	27,521	7.4	18.2	19.9	5.0	25.2	35.2	4.3	11.8
M.Cap. (Rs b)	547.3											
M.Cap. (US\$ b)	12.4											

3QFY06 revenues were boosted by strong growth in cigarette sales even as higher contribution of low-margin FMCG and agri-business pulled down overall margins. Reported PAT was impacted by an extraordinary expense of Rs454m.

Cigarette revenues grew 19.1% YoY to Rs28.8b, driven by double-digit volume growth. FMCG businesses grew 71.2% YoY to Rs2.6b. ITC's hotel business grew 31.4% YoY to Rs2.2b. The agri and paper businesses grew 63.1% and 25.3% YoY respectively.

Overall operating margins were down 360bp, primarily due to higher contribution of the low-margin FMCG and agri-businesses.

Reported PAT was impacted by one-time assistance of Rs454m by the company to contract manufacturers in the North East in view of the retrospective withdrawal of central excise exemption for cigarettes manufactured in the North East since 2000.

We are upgrading our FY06E and FY07E EPS estimates to Rs6.3 and Rs7.4 by 3.3% and 2.8% respectively. We believe that momentum in all of ITC's business segments will likely be maintained. The stock is currently trading at 23.5x FY06E EPS and 19.9x FY07E EPS. We maintain a **Buy**.

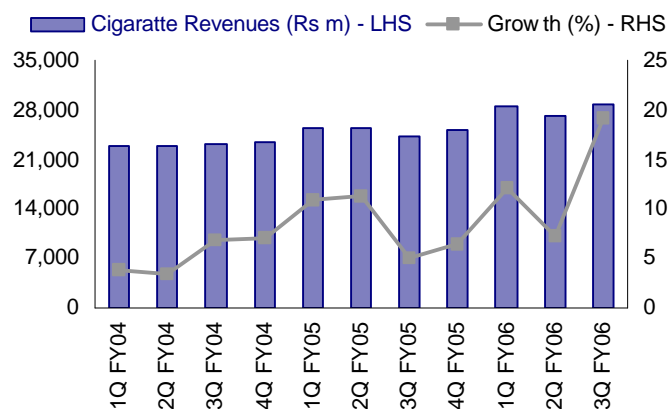
QUARTERLY PERFORMANCE										(Rs Million)
Y/E MARCH	FY05				FY06				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Sales	18,172	17,861	18,591	21,771	22,669	21,832	25,560	26,210	76,395	96,271
YoY Change (%)	27.2	16.3	14.5	15.7	24.7	22.2	37.5	20.4	18.5	26.0
Total Exp	11,080	10,726	11,525	15,139	14,401	13,633	16,777	17,694	48,469	62,506
EBITDA	7,092	7,135	7,066	6,632	8,268	8,198	8,783	8,516	27,926	33,765
Margins (%)	39.0	39.9	38.0	30.5	36.5	37.6	34.4	32.5	36.6	35.1
Depreciation	-728	-753	-750	-897	-801	-830	-831	-888	-3,129	-3,350
Interest	-129	-100	-182	-13	-11	3	-15	-7	-424	-30
Other Income	581	664	520	593	845	781	489	607	2,358	2,721
PBT	6,816	6,946	6,654	6,315	8,301	8,152	8,426	8,227	26,731	33,106
Tax	-2,167	-2,065	-1,987	-2,141	-2,718	-2,429	-2,603	-2,077	-8,360	-9,827
Rate (%)	31.8	29.7	29.9	33.9	32.7	29.8	30.9	25.2	31.3	29.7
PAT	4,649	4,881	4,667	4,174	5,583	5,723	5,823	6,150	18,371	23,279
YoY Change (%)	17.0	14.1	22.6	7.8	20.1	17.3	24.8	47.3	15.4	26.7
Extraordinary Inc/(Exp)	0	0	0	3,543	0	0	454	0	3,543	454
Reported PAT	4,649	4,881	4,667	7,718	5,583	5,723	5,368	6,150	21,914	22,825

E: MOSt Estimates

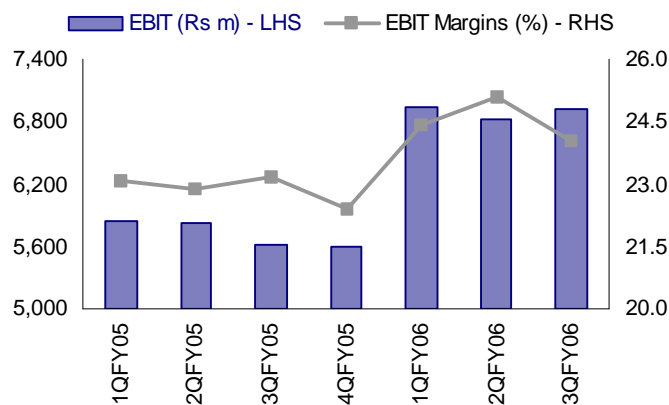
Cigarette business growth accelerates

Cigarette revenues grew 19.1% YoY to Rs27.2b, driven by an estimated double-digit volume growth. The strong growth in cigarette revenues was partly driven by the lower base of the corresponding quarter last year, which witnessed an inventory build-up. Nonetheless, we believe that the company has delivered one of its strongest quarters of growth in the cigarette business. EBIT margins for the cigarette business expanded 87bp YoY to 24.1% even as margins contracted 100bp on a sequential basis.

CIGARETTE REVENUE BOOSTED BY STRONG VOLUME GROWTH



CIGARETTE EBIT MARGINS EXPAND ON A YOY BASIS

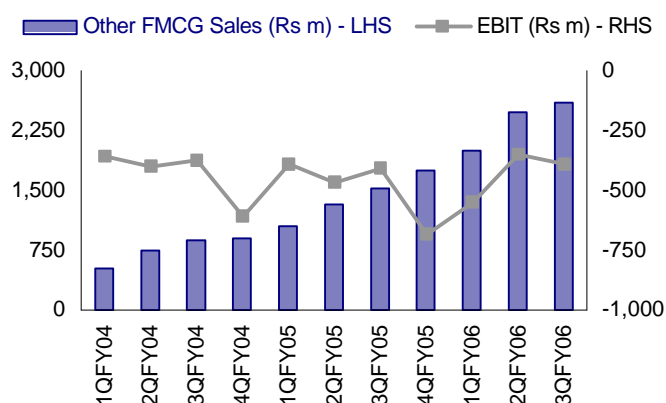


Source: Company/Motilal Oswal Securities

FMCG business on a strong footing

FMCG businesses grew by 71.2% YoY even as EBIT losses were higher at Rs395m compared with 2QFY06. However, on a YoY basis, EBIT losses were lower by 3.1%. The FMCG business continued to deliver strong performance in biscuits (market share, 10%) and packaged *atta* (flour). The company is driving topline growth by entering new segments and launching variants to increase its overall market share. With its impending entry in the home and personal care segment, we expect ITC's FMCG business to continue to maintain strong growth momentum.

OTHER FMCG SALES VS EBIT



Source: Company/Motilal Oswal Securities

Agri-business clocks strong growth even as hotel business maintains momentum

Agri-business was driven by strong growth in wheat, non-basmati rice exports and leaf tobacco. The company ramped up its 'e-choupal' network to 5,500 units. However, agri-business margins were impacted by costs associated in ramping up its e-choupal network. The hotel business grew 31.4% YoY maintaining its growth momentum. EBIT margins for the hotel business expanded 300bp YoY. We believe that the hotel business will continue to grow strongly, given the demand-supply scenario. Paper and paper product revenues grew 25.3% YoY and EBIT grew 19.8%.

Valuation and view

We are buoyed by ITC's record of overall growth momentum, particularly the growth in its cigarette division. We believe that cigarette revenues will continue to post strong growth ahead. Turnaround in the FMCG business in FY07 could be a strong earnings driver for the company going forward. We are upgrading our FY06E and FY07E EPS estimates by 3.3% and 2.8% respectively to Rs6.3 and Rs7.4 respectively. We are introducing our FY08E EPS at Rs8.4. We maintain **Buy** with our price target of Rs168.

REVISED ESTIMATES (RS M)

	FY06E			FY07E		
	OLD	NEW	VAR. %	OLD	NEW	VAR. %
Revenues	94,193	96,271	2.2	108,552	111,102	2.3
Growth (%)	23.8	26.6		15.2	15.4	
EBITDA Margin	35.5	35.1		36.5	36.6	
Net Profit	22,558	23,279	3.2	26,729	27,521	2.8
Growth (%)	22.8	26.7		18.5	18.2	
EPS (Rs)	6.1	6.3	3.2	7.2	7.4	2.8
Growth (%)	22.8	26.7		18.5	18.2	

Source: Company/Motilal Oswal Securities

ITC: an investment profile

Company description

ITC is an associate of the British Tobacco Company, BAT. It is India's largest cigarette manufacturer, with volumes of over 65b sticks per year and a dominant share of 65%+. Its other businesses include Hotels, Paper, Trading in agricultural commodities and FMCG.

Key investment arguments

- Dominant player in the market; hence, higher pricing power.
- Cigarette volumes showing signs of pick-up over last few quarters.
- Consistent EPS growth of 16%+ over next two years.
- Dividend payout will increase, as cash gets freed from potential liabilities.

Key investment risks

- A high indirect tax regime could dampen cigarette growth.
- Longer term risks related to tobacco consumption and regulatory attempts to contain consumption.

Recent developments

- Won the Golden Peacock Award for excellence in corporate governance 2005.
- Signed a memorandum of understanding with Khadi & Village Industries Commission (KVIC) to source and distribute its 'Mangaldeep' *agarbattis*.

Valuation and view

- We forecast a 19% EPS CAGR over the next three years, driven by higher cigarette volumes and turnaround in the FMCG business.
- The stock is currently trading at 23.5x FY06E EPS and 19.9x FY07E EPS. We recommend **Buy**.

Sector view

- We are underweight on the sector due to rising input prices and intense competition.
- Companies with low competitive pressures, like ITC, will be better off.
- Longer term prospects bright given rising incomes and low penetration.

COMPARATIVE VALUATIONS

		ITC	HLL	NESTLE
P/E (x)	FY06E	23.5	29.4	27.2
	FY07E	19.9	25.7	23.8
EV/EBITDA (x)	FY06E	14.8	25.4	16.6
	FY07E	11.8	22.4	14.6
EV/Sales (x)	FY06E	5.2	3.2	3.6
	FY07E	4.3	2.9	3.2
P/BV (x)	FY06E	5.9	17.7	25.1
	FY07E	5.0	16.2	21.7

SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEC.04
Promoters	0.0	0.0	0.0
Domestic Institutions	35.6	34.9	34.6
FIs/FDIs	49.1	50.4	52.6
Others	15.3	14.7	12.8

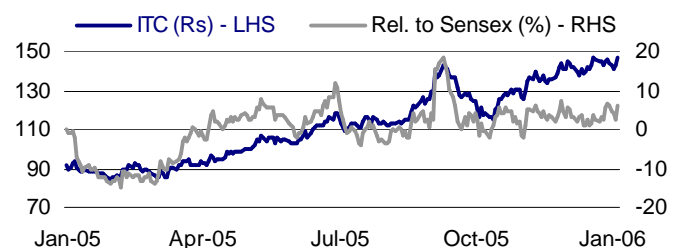
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	6.3	5.9	6.8
FY07	7.4	6.8	8.3

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
147	168	14.3	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)				
Y/E MARCH	2004	2005	2006E	2007E	2008E	
Net Sales	64,465	76,055	96,271	111,102	124,179	
Change (%)	10.2	18.0	26.6	15.4	11.8	
Total Expenditure	-40,810	-48,098	-62,506	-70,476	-77,653	
EBITDA	23,656	27,957	33,765	40,626	46,526	
Change (%)	9.6	18.2	20.8	20.3	14.5	
Margin (%)	36.7	36.8	35.1	36.6	37.5	
Depreciation	-2,419	-3,129	-3,350	-3,750	-4,110	
Int. and Fin. Charges	-342	-508	-30	-80	-80	
Other Income - Recurring	2,293	2,411	2,721	3,268	3,869	
Profit before Taxes	23,188	26,731	33,106	40,065	46,204	
Change (%)	12.8	15.3	23.8	21.0	15.3	
Margin (%)	36.0	35.1	34.4	36.1	37.2	
Tax	-8,190	-7,879	-10,097	-12,821	-15,247	
Deferred Tax	928	-481	270	277	277	
Tax Rate (%)	-31.3	-31.3	-29.7	-31.3	-32.4	
Profit after Taxes	15,926	18,371	23,279	27,521	31,234	
Change (%)	16.1	15.4	26.7	18.2	13.5	
Margin (%)	24.7	24.2	24.2	24.8	25.2	
Reported PAT	15,926	18,371	23,279	27,521	31,234	

BALANCE SHEET		(RS MILLION)				
Y/E MARCH	2004	2005	2006E	2007E	2008E	
Share Capital	2,477	2,482	3,723	3,723	3,723	
Reserves	61,624	76,474	88,797	105,374	123,863	
Net Worth	64,101	78,956	92,520	109,098	127,586	
Loans	1,209	2,454	800	800	800	
Deferred Liability	877	3,761	3,960	4,160	4,360	
Capital Employed	66,187	85,171	97,280	114,057	132,746	
Gross Block	47,409	57,463	63,463	69,463	75,463	
Less: Accum. Depn.	-14,427	-17,955	-21,305	-25,055	-29,165	
Net Fixed Assets	32,982	39,508	42,158	44,408	46,298	
Capital WIP	3,138	1,862	1,862	1,862	1,862	
Investments	30,540	38,747	49,141	67,373	87,389	
Curr. Assets, L&A	34,854	35,393	37,128	38,085	39,095	
Inventory	15,342	20,030	20,122	20,224	20,335	
Account Receivables	2,302	5,278	6,502	7,325	8,190	
Cash and Bank Balance	340	557	557	557	557	
Others	16,870	9,529	9,948	9,980	10,013	
Curr. Liab. and Prov.	35,326	30,338	33,008	37,671	41,897	
Account Payables	28,043	18,920	21,243	24,217	26,639	
Other Liabilities	1,773	2,171	2,020	2,211	2,564	
Provisions	5,510	9,247	9,746	11,243	12,695	
Net Current Assets	-472	5,055	4,120	415	-2,803	
Application of Funds	66,188	85,171	97,280	114,057	132,746	

E: MOST Estimates

RATIOS						
Y/E MARCH	2004	2005	2006E	2007E	2008E	
Basic (Rs)						
EPS	4.3	4.9	6.3	7.4	8.4	
Cash EPS	4.9	5.8	7.2	8.4	9.5	
BV/Share	17.2	21.2	24.8	29.3	34.3	
DPS	13	2.1	2.2	2.6	3.0	
Payout %	31.1	41.9	35.4	35.3	35.8	
Valuation (x)						
P/E		29.8	23.5	19.9	17.5	
Cash P/E		25.5	20.6	17.5	15.5	
EV/Sales		6.7	5.2	4.3	3.7	
EV/EBITDA		18.3	14.8	11.8	9.9	
P/BV		6.9	5.9	5.0	4.3	
Dividend Yield (%)		14	15	18	2.0	
Return Ratios (%)						
RoE	24.8	23.3	25.2	25.2	24.5	
RoCE	35.6	32.0	34.1	35.2	34.9	
Working Capital Ratios						
Debtor (Days)	13	25	25	24	24	
Asset Turnover (x)	1.0	0.9	1.0	1.0	0.9	
Leverage Ratio						
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0	

CASH FLOW STATEMENT		(RS MILLION)				
Y/E MARCH	2004	2005	2006E	2007E	2008E	
OP/(loss) before Tax	21,237	24,828	30,415	36,876	42,416	
Int./Div. Received	2,293	2,411	2,721	3,268	3,869	
Depreciation and Amort.	2,419	3,129	3,350	3,750	4,110	
Interest Paid	-342	-508	-30	-80	-80	
Direct Taxes Paid	-8,190	-7,879	-10,097	-12,821	-15,247	
(Incr)/Decr in WC	4,697	-5,310	935	3,705	3,217	
CF from Operations	22,114	16,671	27,294	34,699	38,284	
(Incr)/Decr in FA	-6,391	-8,778	-6,000	-6,000	-6,000	
(Pur)/Sale of Investments	-14,451	-8,207	-10,394	-18,231	-20,016	
CF from Invest.	-20,842	-16,985	-16,393	-24,230	-26,015	
Issue of Shares	112	872	0	0	0	
(Incr)/Decr in Debt	39	-150	-149	-149	-149	
Dividend Paid	-5,588	-8,792	-9,260	-10,944	-12,745	
Others	718	8,602	-1,491	624	625	
CF from Fin. Activity	-4,719	532	-10,900	-10,469	-12,269	
Incr/Decr of Cash	-3,448	217	0	0	0	
Add: Opening Balance	3,788	340	557	557	557	
Closing Balance	341	558	557	557	557	



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	ITC
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No

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