NEUTRAL

Price	**Rs213**
Target Price	**-**
Investment Period	

Stock Info

Sector	FMCG
Market Cap (Rs cr)	80,497
Beta	0.7
52 WK High / Low	239 /150
Avg Daily Volume	12,48,975
Face Value (Rs)	1
BSE Sensex	16,650
Nifty	4,947
BSE Code	500875
NSE Code	ITC
Reuters Code	ITC.BO
Bloomberg Code	ITC IN

Shareholding Pattern (%)

Promoters	-
MF/Banks/Indian FIs	40.1
FII/ NRIs/ OCBs	47.4
Indian Public	12.5

Abs.	3m	1yr	3yr
Sensex (%)	(4.0)	15.9	153.6
ITC (%)	6.8	28.4	113.4

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Performance Highlights

- **Steady Topline growth, up 17%:** For 4QFY2008, ITC posted a steady Topline growth of 16.7% yoy to Rs3,934cr (Rs3,372cr) ahead of our estimate of Rs3,821cr, a 10% yoy growth. The company's Non-Cigarette FMCG business, which grew 50.3% and resilient performance by its core Cigarette business, aided the growth. Cigarette revenues for the quarter registered 8.8% growth in Gross revenues (12% net of Excise) on the back of flat volumes. For FY2008, ITC's Cigarette Division registered a marginal volume decline of 1% in line with our estimates. While the Hotels and Paperboard segments delivered a steady performance, ITC's Agri business positively surprised registering a 28% yoy jump in Revenues after two consecutive quarters of decline.

- **Earnings growth muted, up 13%:** ITC registered a relatively muted Earnings growth for the quarter at 13% yoy to Rs736cr (Rs651cr) as against our expectation of 15.6% yoy growth to Rs752cr. The lower-than-expected Earnings growth, despite a sharp jump in Other Income (up 60% yoy), was impacted due to the Margin decline and marginal increase in the Tax rate (up 134bp yoy).

- **Margins disappoint, decline by 104bp:** On the Operating front, ITC delivered a disappointing performance registering a decline in Margins by 104bp yoy resulting in muted EBITDA growth of 12.3% to Rs1,045cr (Rs930cr). The Margins declined largely on back of rising input costs (up 274bp yoy) owing to sharp jump in losses in non-cigarette FMCG business (due to new product launches), deteriorating revenue mix (higher contribution from low-margin Agri business) and inflationary trend in agri commodity prices including leaf tobacco. However, barring non-cigarette FMCG business, EBIT Margins witnessed an improvement across segments. Cigarette Margins registered an expansion of 177bp owing to a combination of better product mix and price hikes. Hotels, Paperboard and Agri Business divisions witnessed a modest improvement in their EBIT Margins 362bp, 160bp and 240bp, respectively.

Key Financials

Y/E March (Rs cr)	FY2007	FY2008	FY2009E	FY2010E
Net Sales	**12,369**	**13,948**	**16,066**	**18,448**
% chg	*26.3*	*12.8*	*15.2*	*14.8*
Net Profit	**2,700**	**3,120**	**3,576**	**4,061**
% chg	*20.8*	*15.6*	*14.6*	*13.5*
OPM (%)	32.2	31.6	31.9	31.8
EPS (Rs)	**7.2**	**8.3**	**9.5**	**10.8**
P/E (x)	29.7	25.7	22.4	19.8
P/BV (x)	7.7	6.6	5.7	4.9
RoE (%)	25.9	25.7	25.4	25.0
RoCE (%)	32.3	31.0	31.6	31.5
EV/Sales (x)	6.5	5.7	4.9	4.3
EV/EBITDA (x)	20.1	18.0	15.5	13.5

Source: Company, Angel Research

Segment-wise Performance

Cigarette Business – ITC's Cigarette business registered a modest 8.8% growth in Revenues (12% net of Excise) to Rs3,583cr (Rs3,294cr). Growth during the quarter was largely led by better realisation (price hikes), improved product mix (higher proportion of filter cigarettes) and flat volumes (Non-Filter Cigarettes did not witness any volume loss in 4QFY2008 due to inventory pipeline). For FY2008, ITC's Cigarette Division registered a marginal 1% decline in volumes in line with our estimate. On the Margin front, ITC registered a 177bp expansion in PBIT Margins in its Cigarette Division to 24.3% owing to the price hikes.

In the Budget, the FM hiked the duty on *Micros* and *Plains* resulting in *Plains* becoming even more expensive than *Regulars*. Due to the higher taxes, non-filters will now cost almost the same as the filters. The proportion of non-filter cigarettes in ITC's Cigarette Portfolio is relatively low, at around 20%. However, the weighted average increase in Excise Duty works out to around 17%, which is quite high. As a result, ITC has stopped production of non-filter cigarettes. ITC has also not hiked the price of its filter cigarettes. We believe this is a sound strategy adopted by ITC as it would covert the *Plains* smokers to *Regulars,* but *Micros* would lose out on volumes. Hence, uptrading would benefit ITC to a certain extent (owing to higher prices) but volume loss in the *Plains* segment would have a short-term impact on ITC as not all consumers will migrate to filter products (we have factored in 75% conversion rate from *Plains* to *Regulars*). **We expect FY2009 to be a challenging year for ITC's core Cigarette business. We have modeled 3-4% volume decline in the company's Cigarette sales and 10.8% improvement in realisation (driven by better product mix and price increases in *Kings* and *Longs*). However, ITC's pricing strategy and conversion rate of *Plains* to *Regular* smokers remains the key factors to watch out for.** Moreover, 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 50% yoy growth in Revenues to Rs738cr (Rs491cr) driven by robust performance of its branded packaged Food Portfolio.

- *Branded Packaged Food Business* – This segment continued to expand rapidly with Sales growing 57% yoy. The *Bingo* range of snacks launched by company in March 2007 continued its strong growth momentum garnering double-digit marketshare. The *Sunfeast* range of biscuits registered 53% yoy growth aided by new launches, an improved product mix (increased sales of higher value variants like creams, crackers and cookies) and Excise relief on low to mid-priced biscuits. In the Staples category, *Aashirvaad* Atta continued to build on its leadership position, with revenues growing 43% 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 40% revenue growth driven mainly by Deposited Mint and *Eclairs*. Sales of ready-to-eat foods under the *Kitchens of India* and *Aashirvaad* brands grew 100% during the quarter on higher volumes of instant mixes and pasta. However, rising input costs remain a key challenge for this Division.

- *Lifestyle Retailing Business* – The segment registered 26% growth in domestic Revenues aided by wider Retail footprint. The *Wills Lifestyle* brands are now available nation-wide at 50 exclusive stores and in more than 150 'shop-in-shops'.

- *Stationery Business* – This segment continued to scale up with Sales increasing by 72% yoy. 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. The *Mangaldeep* brand of incense sticks (Agarbattis) registered sales growth of 28% yoy.

- *Personal Care* – During 2QFY2008, ITC had extended its product offerings in the Personal Care segment beyond fragrances to soaps, shampoos and shower gels. The company's Portfolio in the Premium Personal Care segment continued to expand, with the launch of of *Vivel Di Wills* and *Vivel* range of soaps. This follows the success of ITC's previous launches namely *Essenza Di Wills*, *Fiama Di Wills* and *Superia*. 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.

Hotel Business – ITC's Hotel business reported modest 11.5% yoy Revenue growth during the quarter to Rs339cr (Rs304cr) driven by improved REVPAR (revenue per available room) at most properties and superior performance by the Food & Beverage segment. EBIT Margins spiked 362bp yoy to 42.1% driving EBIT growth of 22% to Rs143cr (Rs117cr).

ITC is pursuing an aggressive investment led growth strategy for this segment. During the year, the company entered into an exclusive tie-up with its partner *Starwood* to re-position seven of its finest hotels, and undertook comprehensive renovation and product upgradation programmes (completed at 4 properties including the premium Towers Block at ITC Hotel *The Maurya*, New Delhi). It also shifted to Rupee billing September 2007 onwards, which should help it safeguard against any sharp currency fluctuations. **Going ahead, we expect the growth momentum in this segment to pick up and register 13.5% CAGR growth in Revenues over FY2008-10.**

Paperboard, Specialty Paper and Packaging – The segment continued its steady performance clocking Revenue growth of 16.2% yoy to Rs620cr (Rs533cr) driven by 15% improvement in volumes of the value-added Paper and Paperboards Portfolio and robust performance of the Packaging business. EBIT Margins of the segment expanded by 160bp to 19.8% resulting in growth in Segmental EBIT by 26.3%. During the quarter, ITC commissioned additional capacity of 1,20,000tpa of hardwood pulp taking the total pulp capacity at Bhadrachalam to 2,20,000tpa. The company is making rapid progress towards completion of capacity augmentation projects at Bhadrachalam and is expected to add 1,00,000tpa paper capacity in 1QFY2009 which will drive future growth in the segment with strong forward linkages to the Stationery business. In the Packaging and Printing business, investment towards capacity augmentation at the Chennai and Haridwar units is now providing superior and innovative packaging solutions for the company's branded Packaged Goods and Personal Care business. **Going forward, we expect the segment to accelerate momentum (driven by commencement of new units) registering a CAGR growth of 13.8% in Revenues over FY2008-10. However, slowdown in Cigarette volumes in FY2009 could pose a challenge.**

Agri Business – After two quarters of subdued performance, ITC's Agri Business regained momentum registering a strong growth of 28% in Revenues to Rs1,078cr (Rs842cr) aided by a strong performance in Soybean trading. EBIT Margins expanded 240bp yoy to 3.4% riding on record exports of leaf tobacco. In volume terms, Exports for the full year stood at 62 million kgs, representing a 27% yoy growth. The business, one of the largest integrated sources 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 restoring in the Agri Commodities sector. The business is progressively aligning its commodity portfolio with the sourcing needs of the company's Food Business to generate higher order value from its agri procurement infrastructure. **We expect the segment to remain one of the key growth drivers for ITC over the long term and register a CAGR growth of 13.8% in Revenues over FY2008-10.**

Exhibit 2: Segment-wise Performance

Y/E March (Rs cr)	4QFY2008	4QFY2007	% chg	FY2008	FY2007	% chg
Cigarettes	3,583.0	3,294.0	*8.8*	13,825.6	12,833.7	*7.7*
Others	738.4	491.2	*50.3*	2,511.1	1,689.5	*48.6*
Hotels	339.3	304.3	*11.5*	1,100.2	985.7	*11.6*
Agri Business	1,078.1	841.5	*28.1*	3,868.4	3,501.3	*10.5*
Paperboards & Packaging	619.7	533.4	*16.2*	2,364.3	2,100.1	*12.6*
Less: Inter-segmental Revenues	512.4	287.6	*78.2*	2,313.7	1,810.1	*27.8*
Total Gross Income	**5,846.1**	**5,176.9**	***12.9***	**21,355.9**	**19,300.0**	***10.7***
Cigarettes	870.1	741.7	*17.3*	3,634.0	3,172.1	*14.6*
Others	(117.9)	(48.3)		(263.5)	(202.0)	
Hotels	142.8	117.1	*22.0*	410.8	350.8	*17.1*
Agri Business	37.0	8.7	*327.0*	129.2	123.6	*4.6*
Paperboards & Packaging	122.7	97.2	*26.3*	453.1	416.8	*8.7*
Total PBIT	**1,054.7**	**916.2**	***15.1***	**4,363.6**	**3,861.3**	***13.0***
Less: Interest Exp	2.7	(0.0)		4.6	3.3	
Less: Other Unallocable Exp	(32.2)	(24.2)		(212.8)	(68.7)	
PBT	**1,084.2**	**940.4**	***15.3***	**4,571.8**	**3,926.7**	***16.4***
PBIT Margin (%)						
Cigarettes	24.3	22.5		26.3	24.7	
Others	(16.0)	(9.8)		(10.5)	(12.0)	
Hotels	42.1	38.5		37.3	35.6	
Agri Business	3.4	1.0		3.3	3.5	
Paperboards & Packaging	19.8	18.2		19.2	19.8	

Source: Company, Angel Research

Outlook and Valuation

During FY2008-10, we expect ITC to report a CAGR growth of 15% in Topline and 14.1% 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 (owing to uptrading of cigarette smokers from non-filters to filters). Moreover, the company's strong consumer demand profile, better pricing power, strong cash flows and its ability to channel these flows into new growth opportunities reinforces our positive stance on the company's future prospects in the long run. On the Operating front, we expect the company to clock a CAGR growth of 15.4% in EBITDA and marginal improvement in Margins owing to changing Revenue mix.

However, we believe ITC faces a tough year ahead in its core Cigarette business in the light of volume decline (sharp Excise hike in Non-filter cigarettes has led ITC to stop production) and likely imposition of new packaging regulations (pictorial warnings). Aggravated losses in Non-Cigarette FMCG business on account of new launches and rising input prices poses another key challenge. Hence, we have marginally tweaked our FY2009 and FY2010 Earnings estimates downwards by 1.7% and 3.1%, respectively. **At the CMP of Rs213, the stock is trading at 19.8x FY2010E EPS of Rs10.8 and 13.5x EV/EBITDA. Given the uncertainty in terms of Cigarette volumes, sharp jump in losses in its Non-cigarette FMCG business and slowdown in Earnings growth, we maintain our Neutral view on the stock.**

Exhibit 2: 4QFY2008 Performance

Y/E March (Rs cr)	4QFY2008	4QFY2007	*% chg*	FY2008	FY2007	*% chg*
Net Sales	**3,934.4**	**3,371.9**	***16.7***	**13,947.5**	**12,164.3**	***14.7***
Consumption of RM	1,844.5	1,488.4	*23.9*	6,016.7	5,194.8	*15.8*
(% of Sales)	*46.9*	*44.1*		*43.1*	*42.7*	
Staff Costs	191.1	163.2	*17.1*	733.3	630.2	*16.4*
(% of Sales)	*4.9*	*4.8*		*5.3*	*5.2*	
Other Expenses	854.2	789.9	*8.1*	2,793.6	2,383.0	*17.2*
(% of Sales)	*21.7*	*23.4*		*20.0*	*19.6*	
Total Expenditure	**2,889.7**	**2,441.6**	***18.4***	**9,543.6**	**8,207.9**	***16.3***
Operating Profit	**1,044.7**	**930.3**	***12.3***	**4,403.9**	**3,956.4**	***11.3***
OPM (%)	*26.6*	*27.6*		*31.6*	*32.5*	
Interest	2.7	(0.1)		4.6	3.3	
Depreciation & Amortisation	121.5	92.2	*31.8*	438.5	362.9	*20.8*
Other Income	163.7	102.3	*60.0*	610.9	336.5	*81.6*
PBT (excl. Extraordinary Items)	**1,084.2**	**940.4**	*15.3*	**4,571.8**	**3,926.7**	*16.4*
Extraordinary Income/(Expense)	-	-		-	-	
PBT (incl. Extraordinary Items)	**1,084.2**	**940.4**	***15.3***	**4,571.8**	**3,926.7**	***16.4***
(% of Sales)	*27.6*	*27.9*		*32.8*	*32.3*	
Provision for Taxation	348.5	289.7	*20.3*	1,451.7	1,226.7	*18.3*
(% of PBT)	*32.1*	*30.8*		*31.8*	*31.2*	
Reported PAT	**735.6**	**650.7**	***13.1***	**3,120.1**	**2,700.0**	***15.6***
PAT Margin (%)	*18.7*	*19.3*		*22.4*	*22.2*	
Equity shares (cr)	376.9	376.2		376.9	376.2	
EPS (Rs)	**2.0**	**1.7**	***12.9***	**8.3**	**7.2**	***15.4***

Source: Company, Angel Research

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Ratings (Returns) Buy (> 15%) Accumulate (5 to 15%) Neutral (5 to -5%) Reduce (> -5%) Sell (> -15%)