

January 25, 2010

Rating	BUY
Price	Rs249
Target Price	Rs300
Implied Upside	20.5%
Sensex	16,860

(Prices as on January 22, 2010)

Trading Data

Market Cap. (Rs bn)	939.8
Shares o/s (m)	3,774.4
Free Float	100%
3M Avg. Daily Vol ('000)	4,632.5
3M Avg. Daily Value (Rs m)	1,182.9

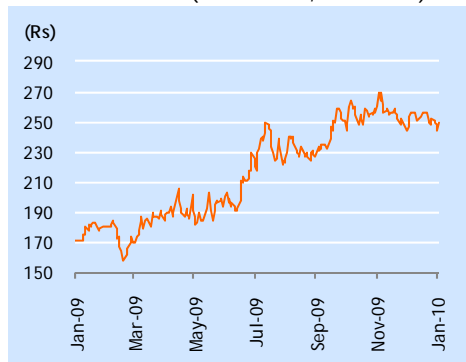
Major Shareholders

Promoters	NA
Foreign	13.1%
Domestic Inst.	37.7%
Public & Others	49.2%

Stock Performance

(%)	1M	6M	12M
Absolute	1.0	14.5	46.1
Relative	0.0	0.9	(45.2)

Price Performance (RIC: ITC.BO, BB: ITC IN)



Source: Bloomberg

ITC

All guns blazing, top pick in FMCG space

ITC reported strong Q3FY10 results (18% revenue growth, 27% PAT growth), ahead of our as well as market expectations, driven by strong performance in core cigarette business and improved profitability in all the other divisions, including Hotels.

- **Strong performance in cigarettes:** Net sales grew by 17% YoY led by ~8% volume growth and improved realization led by price hikes and richer mix. We expect ~5% volume growth for FY10E and FY11E, respectively. Excise hike in the region of 5-10% can be handled with price hikes as demonstrated in the past.
- **Non-Tobacco FMCG losses for FY10E may come in below Rs4bn:** FMCG-others posted healthy 17% revenue growth driven by branded packaged foods which grew 24% YoY (Aashirvaad 34%, Confectionery 34%, Bingo 59%). Improving product mix in the Biscuits segment (21% and 38% growth in cookies and cream variants, 78% growth in 'Marie' post re-launch). Other FMCG losses have come in at Rs860m, in line with the FY10E guidance of Rs4bn. For 9MFY10, FMCG losses have come in at Rs2.7bn. We expect FY10E EBIT loss of Rs3.7bn.
- **Across the board margin expansion in other businesses:** Led by continued strong performance of the leaf tobacco portfolio (prices up ~50% YoY), the Agri division has posted revenue growth of 46% (Leaf tobacco exports grew 194% YoY). Better mix (value added paper grew 50%), lower input costs and benefits from backward integration (recent investment in paper and pulp facilities) have aided ~710bps improvement in the Paper division margins to 24.8%. Hotels posted robust sequential improvement (~42% and 142% growth in revenues and EBIT sequentially). Occupancies improved from mid 50s in 2Q to mid 60s in current quarter, while ARR's witnessed ~20% QoQ growth. We expect full recovery in Hotels by FY11E.
- **Valuation and Outlook:** Better-than-expected a) volume growth in cig and b) profitability in paper division lead us to revise our earnings estimates for FY10E and FY11E by ~2% each. We believe ITC will be able to tackle 5-10% hike in excise duty in the forthcoming budget with well demonstrated pricing power. We expect ITC to sustain 5% volume growth in cigarettes in FY10E and FY11E, respectively. Current sluggishness in the stock on account of budget related uncertainty provides excellent entry opportunity in our view. We continue to highlight ITC as our top pick in the large cap space, with a revised target price of Rs300. Maintain 'BUY'.

Key financials (Y/e March)	FY09	FY10E	FY11E	FY12E
Revenues (Rs m)	163,323	183,614	204,314	229,186
Growth (%)	11.4	12.4	11.3	12.2
EBITDA (Rs m)	50,723	62,902	72,666	82,005
PAT (Rs m)	33,185	41,283	47,796	54,069
EPS (Rs)	8.8	10.9	12.7	14.3
Growth (%)	5.2	24.4	15.8	13.1
Net DPS (Rs)	3.7	4.9	5.7	6.9

Source: Company Data; PL Research

Profitability & valuation	FY09	FY10E	FY11E	FY12E
EBITDA margin (%)	31.1	34.3	35.6	35.8
RoE (%)	25.2	27.5	27.9	27.8
RoCE (%)	35.4	38.2	38.2	37.6
EV / sales (x)	5.5	4.9	4.4	3.9
EV / EBITDA (x)	17.7	14.3	12.4	11.0
PE (x)	28.3	22.8	19.7	17.4
P / BV (x)	6.7	5.9	5.1	4.6
Net dividend yield (%)	1.5	2.0	2.3	2.8

Source: Company Data; PL Research

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Q3FY10 Result Overview

(Rs m)

Y/e March	Q3FY10	Q3FY09	YoY gr. (%)	Q2FY10	9MFY10	9MFY09	YoY gr. (%)
Net sales	45,319	38,333	18.2	43,453	129,598	115,957	11.8
(Increase) / decrease in stock-in-trade & WIP	(490)	(480)		(344)	(301)	(2,046)	
Consumption of raw materials	16,803	12,984		15,627	45,824	40,705	
Purchase of traded goods	1,910	2,667		1,893	6,096	10,032	
Gross profit	27,096	23,162	17.0	26,277	77,980	67,266	15.9
<i>Margin (%)</i>	<i>59.8</i>	<i>60.4</i>		<i>60.5</i>	<i>60.2</i>	<i>58.0</i>	
Employees cost	2,228	2,130	4.6	2,420	7,469	6,687	11.7
Other expenditure	8,275	7,506	10.2	7,956	24,645	23,627	4.3
EBITDA	16,593	13,527	22.7	15,901	45,866	36,952	24.1
<i>Margin (%)</i>	<i>36.6</i>	<i>35.3</i>		<i>36.6</i>	<i>35.4</i>	<i>31.9</i>	
Depreciation	(1,549)	(1,442)		(1,484)	(4,549)	(4,043)	
EBIT	15,045	12,085	24.5	14,417	41,317	32,909	25.5
<i>EBIT margin (%)</i>	<i>33.2</i>	<i>31.5</i>		<i>33.2</i>	<i>31.9</i>	<i>28.4</i>	
Interest	(109)	(5)		(181)	(349)	(46)	
PBT	17,010	13,310	27.8	14,920	45,105	36,340	24.1
Tax	(5,569)	(4,277)		(4,821)	(14,777)	(11,794)	
<i>Tax Rate (%)</i>	<i>32.7</i>	<i>32.1</i>		<i>32.3</i>	<i>32.8</i>	<i>32.5</i>	
PAT	11,442	9,032	26.7	10,099	30,328	24,546	23.6

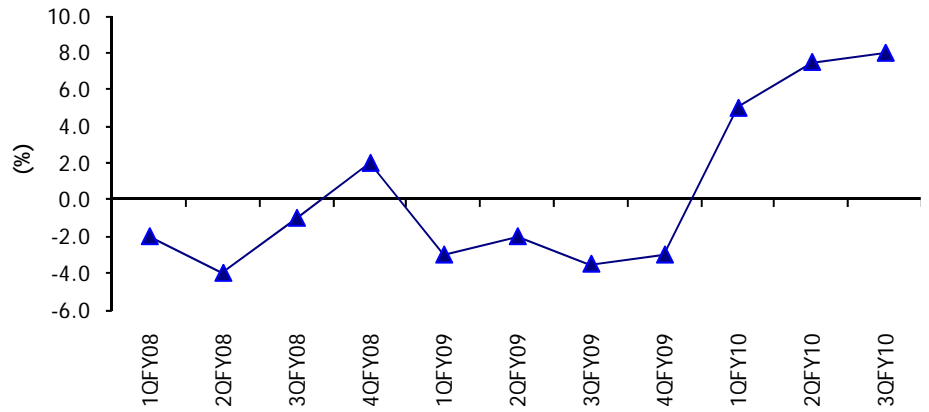


Segmental Break-up

(Rs m)

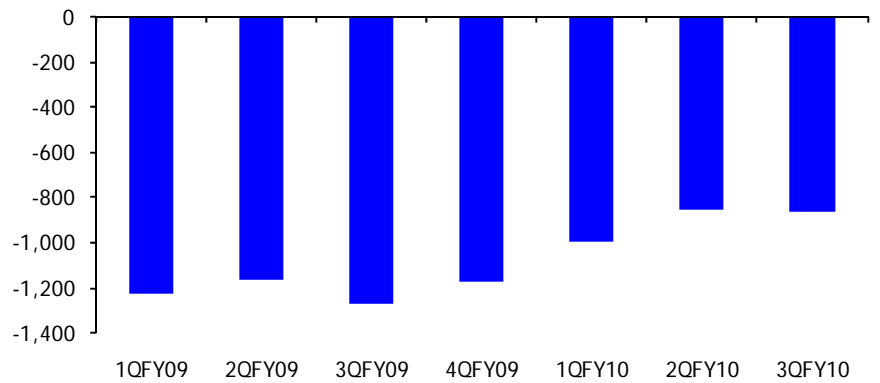
Y/e March	Q3FY10	Q3FY09	YoY gr. (%)	Q2FY09	QoQ gr. (%)
Revenues					
Cigarettes	23,316	19,935	17.0	21,997	6.0
Other FMCG	8,896	7,200	23.6	8,633	3.0
Total FMCG	32,213	27,135	18.7	30,630	5.2
Hotels	2,479	2,471	0.3	1,740	42.4
Agri business	9,052	6,215	45.6	10,283	-12.0
Paper and packaging	8,116	6,271	29.4	7,904	2.7
Total- other businesses	19,646	14,957	31.3	19,927	-1.4
Total segment revenue	51,859	42,093	23.2	50,557	2.6
Less: Inter segment revenue	6,540	3,760	74.0	7,631	-14.3
Gross sales	45,319	38,333	18.2	42,926	5.6
EBIT					
Cigarettes	13,098	11,341	15.5	12,517	4.6
Other FMCG	(860)	(1,270)	(32.3)	(850)	1.2
Total FMCG	12,238	10,071	21.5	11,667	4.9
Hotels	763	911	(16.2)	316	141.7
Agri business	1,041	502	107.4	1,741	(40.2)
Paper and packaging	2,014	1,111	81.4	1,862	8.2
Total- other businesses	3,818	2,523	51.3	3,919	(2.6)
Total recurring EBIT	16,056	12,594	27.5	15,585	3.0
EBIT margin					
			<i>Bps change</i>		<i>Bps change</i>
Cigarettes	56.2	56.9	(71)	56.9	(73)
Other FMCG	(9.7)	(17.6)	797	(9.8)	18
Total FMCG	38.0	37.1	88	38.1	(10)
Hotels	30.8	36.9	(607)	18.1	1,265
Agri business	11.5	8.1	342	16.9	(543)
Paper and packaging	24.8	17.7	711	23.6	126
Total- other businesses	19.4	16.9	256	19.7	-23
Overall recurring EBIT margin	31.0	29.9	104	30.8	13

Cigarettes volume growth: remains robust



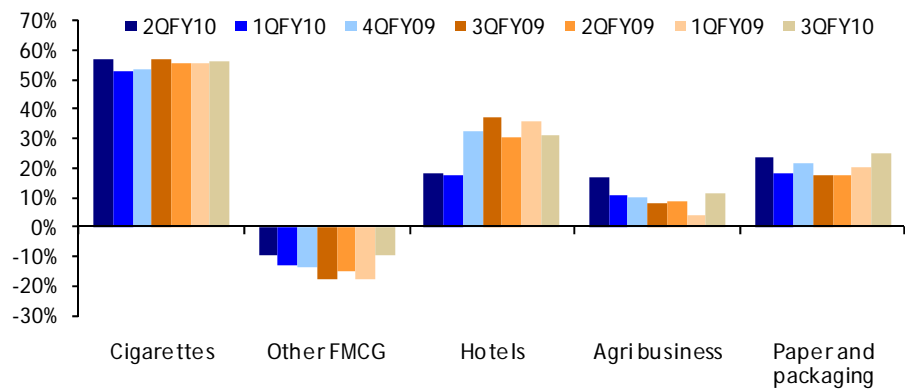
Source: Company Data, PL Research

Other FMCG losses : Improving profitability



Source: Company Data, PL Research

EBIT margin trend



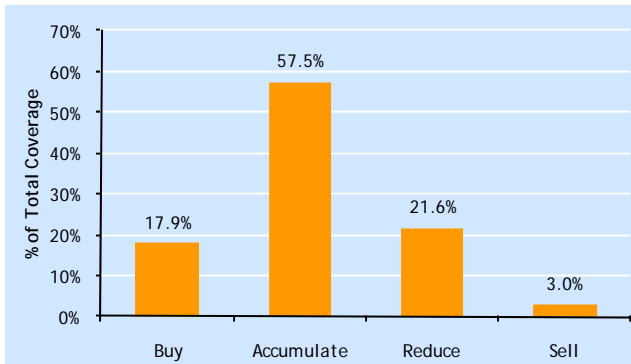
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Rating Distribution of Research Coverage



PL's Recommendation Nomenclature

BUY	: Over 15% Outperformance to Sensex over 12-months	Accumulate	: Outperformance to Sensex over 12-months
Reduce	: Underperformance to Sensex over 12-months	Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month	Trading Sell	: Over 10% absolute decline in 1-month
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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