

## ITC Ltd

### Steady performance continues

ITC's Q3FY11 results were above our and consensus estimates with sales/EBITDA/PAT growth of 18.6%/18.7%/21.4% against our estimates of 15.3%/17%/19.1%. Revenues from the cigarettes business rose 15.6% YoY with a 2% volume uptick (after a 1% decline in Q2FY11). Barring the paper & paperboard business which suffered inventory depletion in the cigarette packaging segment, all the other divisions reported strong double-digit growth along with margin improvement. At current valuations of 22.2x/18.8x FY12E/FY13E earnings, we maintain our BUY rating with a September '11 price target of Rs 210.

**Cigarette volumes up 2% for the quarter:** ITC's core cigarettes business reported strong topline growth of 15.6% YoY, with volumes up 2% during the quarter, as against a 2–3% decline witnessed in H1FY11. This business has once again demonstrated its resilience with volumes picking up QoQ as well. We expect the strong growth momentum to continue considering the ~3% price increase taken by the company over the past month.

**Growth across segments:** Most of the company's other businesses have done well—FMCG, agri and hotels reported growth of 23.8%, 17.9% and 13.7% YoY respectively. Paper and paperboard, though, reported disappointing numbers with sales growth of just 8.1% YoY for the quarter due to inventory depletion in the cigarettes packaging segment, stemming from uncertainty on graphic statutory warnings; the segment however reported healthy external sales growth.

Within the FMCG portfolio, branded packaged foods grew at 24% YoY, with a strong uptick of 48% and 28% in flagship brands *Bingo* and *Sunfeast* respectively. In the hotels business, ARR improved 10% YoY with marginal improvement in occupancy rates.

**EBITDA margin remains flat:** EBITDA increased by 18.7% YoY to Rs 19.7bn, with margins remaining stable YoY. In terms of segmental profits, cigarettes reported an improvement of 70bps YoY in EBIT margins, whereas the agri and hotels businesses recorded an expansion of 175bps and 65bps YoY respectively. EBIT losses in the FMCG business declined by Rs 124mn YoY to Rs 736mn. Paper & paperboard margins, however, shrank by 300bps YoY to 21.8%. Overall PAT rose 21.4% YoY to Rs 13.9bn.

**Maintain BUY with price target of Rs 210:** ITC is currently trading at a P/E of 22.2x/18.8x FY12E/FY13E earnings. We maintain our SOTP target price of Rs 210 for the stock. ITC remains our top pick in the large cap FMCG space.

#### Financial highlights

(Rs mn)	FY10	FY11E	FY12E	FY13E
Revenue	191,359	222,054	258,386	298,213
Growth (%)	15.6	16.0	16.4	15.4
Adj net income	42,108	47,699	58,267	68,916
Growth (%)	25.3	13.3	22.2	18.3
FDEPS (Rs)	5.5	6.2	7.6	9.0
Growth (%)	23.9	12.6	22.2	18.3

#### Profitability and return ratios

(%)	FY10	FY11E	FY12E	FY13E
EBITDA margin	33.0	32.1	33.7	33.4
EBIT margin	29.7	28.9	30.7	30.6
Adj PAT margin	22.0	21.5	22.6	23.1
ROE	29.6	30.6	32.2	32.6
ROIC	29.9	30.9	34.7	38.2
ROCE	29.5	30.4	32.0	32.4

#### What's New?

Target

Rating

Estimates

CMP	TARGET	RATING	RISK
Rs 169	Rs 210	BUY	MEDIUM

BSE	NSE	BLOOMBERG
500875	ITC	ITC IN

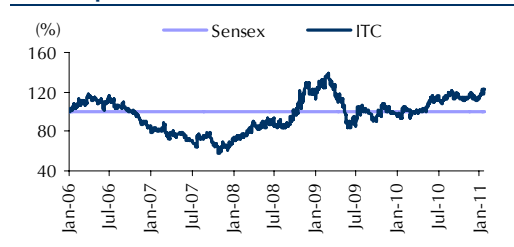
#### Company data

Market cap (Rs mn / US\$ mn)	1,295,444 / 28,396
Outstanding equity shares (mn)	7,706
Free float (%)	100
Dividend yield (%)	1.7
52-week high/low (Rs)	185 / 112
2-month average daily volume	7,553,916

#### Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
ITC	169	1.0	(3.1)	15.5
BSE FMCG	3,543	(0.1)	(3.7)	11.6
Sensex	19,008	(5.2)	(6.2)	5.7

#### Relative performance



#### Valuation matrix

(x)	FY10	FY11E	FY12E	FY13E
P/E @ CMP	30.6	27.2	22.2	18.8
P/E @ Target	38.1	33.8	27.7	23.4
EV/EBITDA @ CMP	20.4	18.1	14.8	12.9





## Result highlights

**Fig 1 - Actual vs estimated performance**

(Rs mn)	Actual	Estimate	% Variance
Revenue	54,535	53,023	2.9
EBITDA	19,690	19,406	1.5
EBITDA margins (%)	36.1	36.6	(50bps)
Adj net income	13,891	13,627	1.9

Source: RCML Research

**Fig 2 - Standalone – Quarterly performance**

(Rs mn)	Q3FY11	Q3FY10	% Chg YoY	Q2FY11	% Chg QoQ
Net sales	54,535	45,996	18.6	50,612	7.8
Raw material costs	20,478	16,939	20.9	18,532	10.5
Gross profit	34,057	29,057	17.2	32,080	6.2
staff costs	2,773	2,228	24.5	2,612	6.2
Other operating expenses	11,593	10,235	13.3	11,579	0.1
Operating profit	19,690	16,593	18.7	17,889	10.1
EBITDA margin (%)	36.1	36.1	-	35.3	70 bps
Depreciation	1,681	1,549	8.5	1,640	2.5
Other income	2,533	2,074	22.1	2,105	20.3
Interest	230	109	111.2	54	328.4
PBT	20,313	17,010	19.4	18,301	11.0
Tax	6,422	5,569	15.3	5,833	10.1
Reported PAT	13,891	11,442	21.4	12,468	11.4
Adj PAT	13,891	11,442	21.4	12,468	11.4
FDEPS (Rs)	1.78	1.50	18.8	1.61	10.6

Source: Company, RCML Research

### Segmental highlights

- ❖ **Cigarettes:** Volume growth for Q3 came in at 2% YoY with some mix improvement. There was no loss in sales on account of the plant shutdown due to uncertainty on graphic pictorial warnings on cigarette packs.
- ❖ **Paper & paperboard:** Sales were hit by inventory issues related to the cigarettes business. Losses on account of the same totalled ~Rs 200mn, as per the management, though external sales were healthy. We expect the business to report sales growth of 20% with segmental margins in the range of 22–23% in FY12.
- ❖ **Agri:** This business reported strong growth on account of leaf tobacco, soya and coffee exports. It is likely to have sustainable margins in the range of 10–12% going forward.
- ❖ **Foods:** ITC has reported strong growth in its foods business with *Sunfeast* growing at 28% YoY for the quarter. The company has not taken any price increase this quarter in the category (though some indirect hikes were taken in Q2FY11). Losses have been trimmed in the *Bingo* brand which has grown by 48% for the quarter.
- ❖ **Personal care:** ITC continues to see traction in the soaps and shampoos segment, with market share stable QoQ. It is contemplating a price increase in the category on account of the rise in input prices.

Net sales, EBITDA and PAT marginally above estimates

Sales growth driven by strong performance in FMCG, hotels and agri businesses

Margins remained stable for the quarter despite high overall inflation



- ❖ **Hotels:** ARR improved by 10% YoY, whereas occupancy rates were up marginally. As per the management, Q4FY11 is likely to be a strong quarter for the business with an improvement in profitability.

#### Standalone – Quarterly trend

Particulars	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Revenue (Rs mn)	45,996	50,538	48,166	50,612	54,535
YoY growth (%)	20.0	27.9	16.1	16.3	18.6
QoQ growth (%)	5.7	9.9	(4.7)	5.1	7.8
EBITDA (Rs mn)	16,593	15,401	16,064	17,889	19,690
EBITDA margin (%)	36.1	30.5	33.4	35.3	36.1
Adj net income (Rs mn)	11,442	10,282	10,703	12,468	13,891
YoY growth (%)	26.7	27.1	21.8	23.5	21.4
QoQ growth (%)	13.3	(10.1)	4.1	16.5	11.4

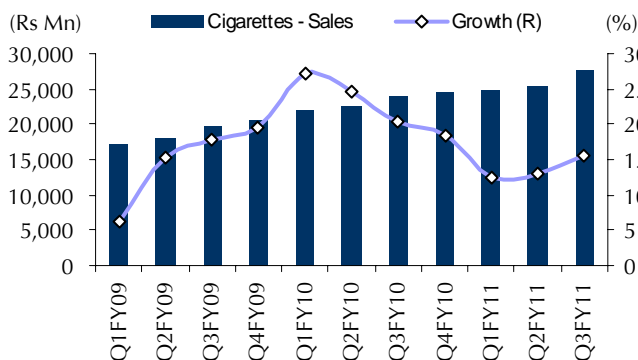
#### Standalone – Cost break-up

(As a % of Net Sales)	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Material cost	36.8	43.1	37.2	36.6	37.6
A&P expenses	4.8	5.1	7.1	5.2	5.1
Personnel expenses	22.3	21.4	22.4	22.9	21.3
Other expenses	36.1	30.5	33.4	35.3	36.1



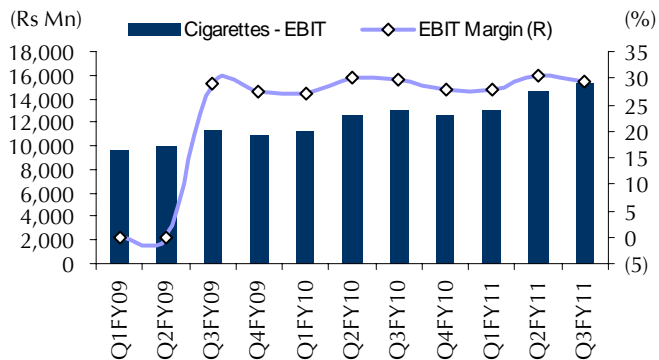
## Quarterly SBU trends

**Fig 3 - Cigarettes – Sales and sales growth trend**



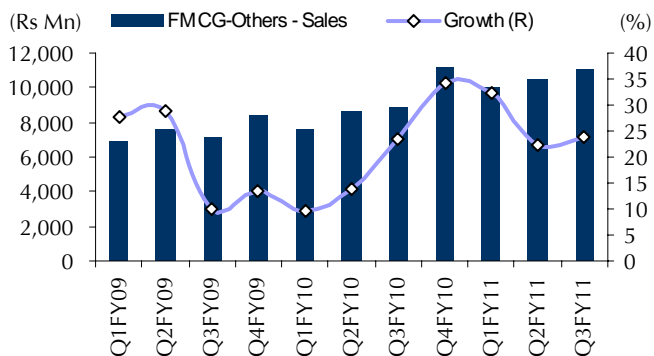
Source: RCML Research, Company

**Fig 4 - Cigarettes – EBIT and margin trend**



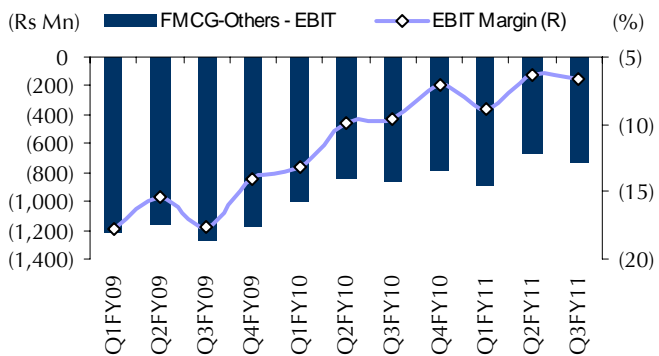
Source: RCML Research, Company

**Fig 5 - FMCG-Others – Sales and sales growth trend**



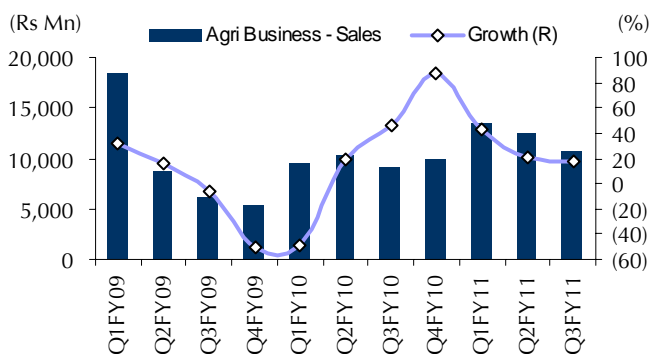
Source: RCML Research, Company

**Fig 6 - FMCG-Others – EBIT and margin trend**



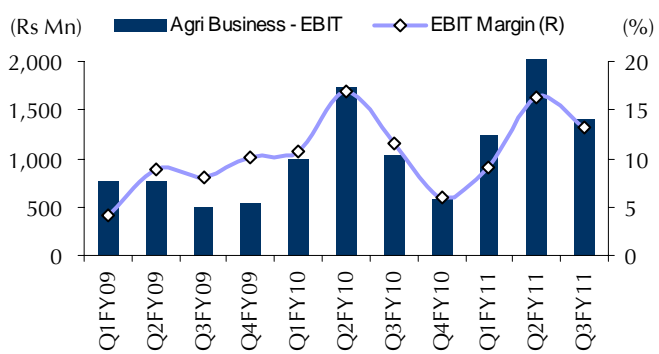
Source: RCML Research, Company

**Fig 7 - Agri business – Sales and sales growth trend**



Source: RCML Research, Company

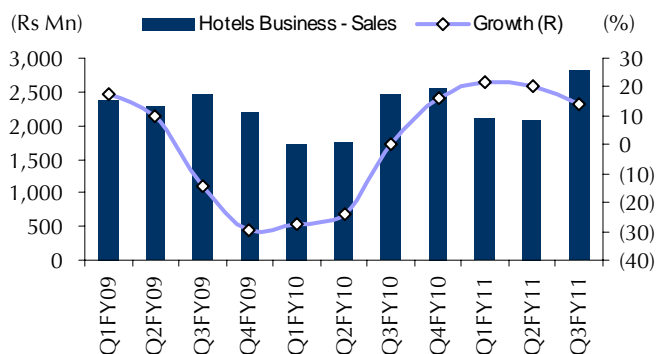
**Fig 8 - Agri business – EBIT and margin trend**



Source: RCML Research, Company

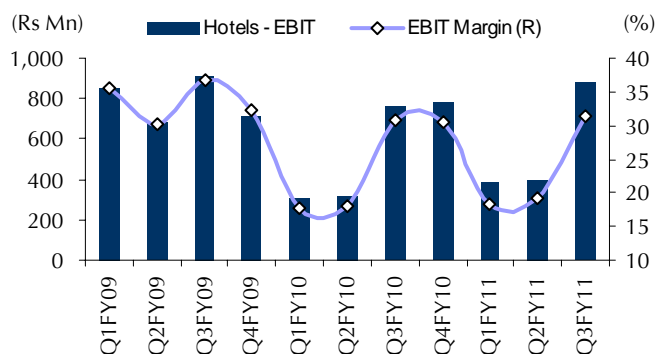


**Fig 9 - Hotels business – Sales and sales growth trend**



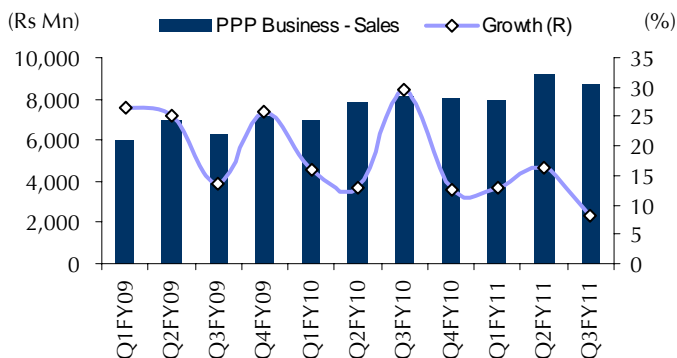
Source: RCML Research, Company

**Fig 10 - Hotels business – EBIT and margin trend**



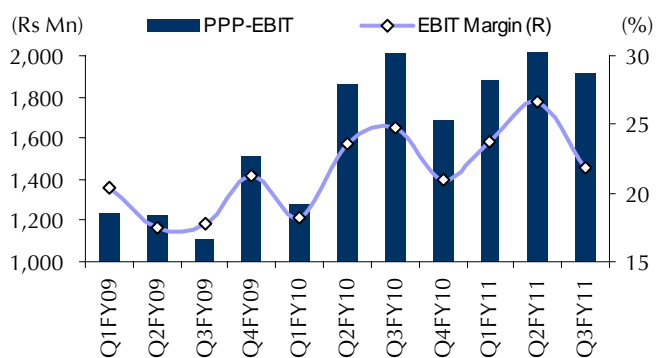
Source: RCML Research, Company

**Fig 11 - PPP business – Sales and sales growth trend**



Source: RCML Research, Company

**Fig 12 - PPP business – EBIT and margin trend**

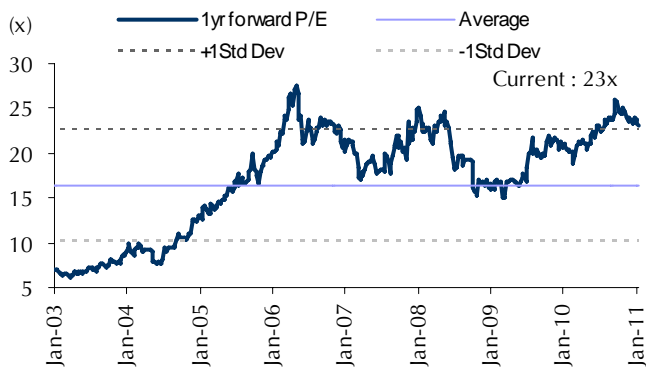


Source: RCML Research, Company



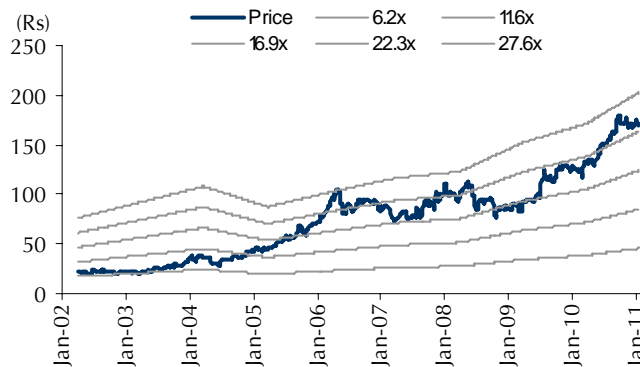
## Valuation

**Fig 13 - 1-year forward P/E**



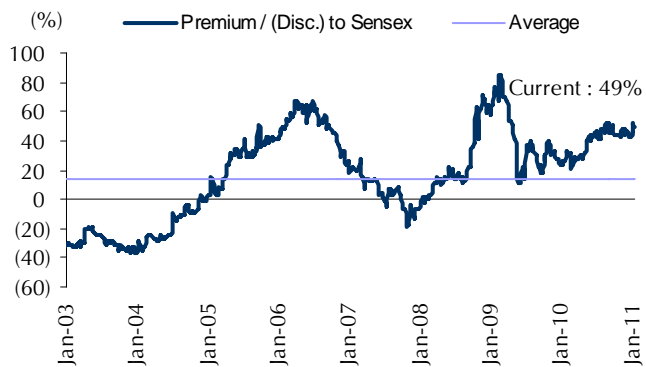
Source: RCML Research, Bloomberg

**Fig 14 - 1-year forward P/E bands**



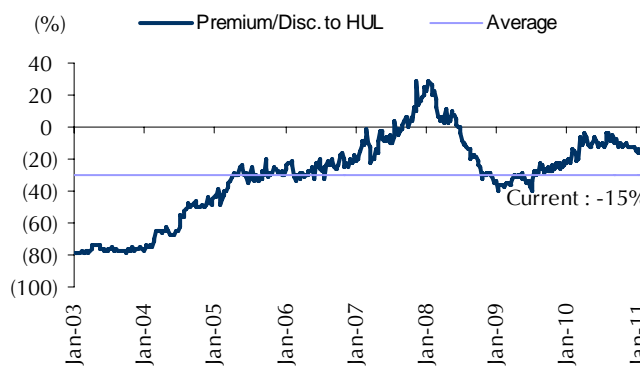
Source: RCML Research, Bloomberg

**Fig 15 - 1-year forward P/E – Premium/(Disc.) to Sensex**



Source: RCML Research, Bloomberg

**Fig 16 - 1-year forward P/E - – Premium/(Disc.) to HUL**



Source: RCML Research, Bloomberg



## Consolidated financials

### Profit and Loss statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
<b>Revenues</b>	<b>191,359</b>	<b>222,054</b>	<b>258,386</b>	<b>298,213</b>
<i>Growth (%)</i>	15.6	16.0	16.4	15.4
<b>EBITDA</b>	<b>63,241</b>	<b>71,302</b>	<b>87,176</b>	<b>99,508</b>
<i>Growth (%)</i>	24.7	12.7	22.3	14.1
Depreciation & amortisation	6,439	7,146	7,743	8,321
EBIT	56,802	64,156	79,433	91,187
<i>Growth (%)</i>	26.5	12.9	23.8	14.8
Interest	534	89	104	128
Other income	6,189	6,598	6,994	7,392
EBT	62,457	70,665	86,322	98,451
Income taxes	20,349	22,966	28,055	29,535
Effective tax rate (%)	32.6	32.5	32.5	30.0
Extraordinary items	-	-	-	-
Min into / inc from associates	(426)	(430)	(480)	(525)
Reported net income	41,682	47,269	57,787	68,391
Adjustments	(426)	(430)	(480)	(525)
<b>Adjusted net income</b>	<b>42,108</b>	<b>47,699</b>	<b>58,267</b>	<b>68,916</b>
<i>Growth (%)</i>	25.3	13.3	22.2	18.3
Shares outstanding (mn)	3,818.2	7,683.5	7,683.5	7,683.5
<b>FDEPS (Rs) (adj)</b>	<b>5.5</b>	<b>6.2</b>	<b>7.6</b>	<b>9.0</b>
<i>Growth (%)</i>	23.9	12.6	22.2	18.3
DPS (Rs)	11.7	2.8	3.4	4.0

### Cash flow statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Net income + Depreciation	47,335	54,327	65,427	76,584
Non-cash adjustments	(2,022)	2,694	3,176	3,473
Changes in working capital	(883)	(9,346)	(6,090)	(8,139)
Cash flow from operations	44,430	47,675	62,512	71,918
Capital expenditure	(12,463)	(15,847)	(14,829)	(14,335)
Change in investments	(238)	-	-	-
Other investing cash flow	(20,762)	5,000	-	-
Cash flow from investing	(33,464)	(10,847)	(14,829)	(14,335)
Issue of equity	7,207	3,865	0	0
Issue/repay debt	(781)	-	391	200
Dividends paid	(14,487)	(38,182)	(21,465)	(26,220)
Other financing cash flow	(2,641)	(7,424)	(4,353)	(5,144)
Change in cash & cash eq	266	(4,913)	22,256	26,418
Closing cash & cash eq	13,486	8,573	30,829	57,247

### Balance sheet

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Cash and cash eq	13,486	8,573	30,829	57,247
Accounts receivable	10,100	11,559	13,450	15,523
Inventories	50,920	62,716	70,633	81,422
Other current assets	15,510	19,985	23,255	26,839
Investments	50,005	45,005	45,005	45,005
Gross fixed assets	129,927	144,599	159,480	174,172
Net fixed assets	87,740	95,266	102,403	108,774
CWIP	10,236	11,411	11,359	11,002
Intangible assets	-	-	-	-
Deferred tax assets, net	(7,806)	(9,088)	(10,654)	(12,303)
Other assets	2	2	2	2
<b>Total assets</b>	<b>230,194</b>	<b>245,429</b>	<b>286,282</b>	<b>333,512</b>
Accounts payable	36,395	44,193	50,710	58,456
Other current liabilities	976	1,335	1,532	1,766
Provisions	45,868	30,360	36,518	42,937
Debt funds	1,108	1,108	1,498	1,698
Other liabilities	1,264	1,264	1,264	1,264
Equity capital	3,818	7,684	7,684	7,684
Reserves & surplus	140,765	159,486	187,076	219,708
Shareholder's funds	144,583	167,170	194,760	227,391
<b>Total liabilities</b>	<b>230,194</b>	<b>245,429</b>	<b>286,282</b>	<b>333,512</b>
BVPS (Rs)	37.9	21.8	25.3	29.6

### Financial ratios

Y/E March	FY10	FY11E	FY12E	FY13E
<b>Profitability &amp; Return ratios (%)</b>				
EBITDA margin	33.0	32.1	33.7	33.4
EBIT margin	29.7	28.9	30.7	30.6
Net profit margin	22.0	21.5	22.6	23.1
ROE	29.6	30.6	32.2	32.6
ROCE	29.5	30.4	32.0	32.4
<b>Working Capital &amp; Liquidity ratios</b>				
Receivables (days)	17	18	18	18
Inventory (days)	259	245	250	247
Payables (days)	177	173	178	178
Current ratio (x)	2.4	2.3	2.6	3.0
Quick ratio (x)	0.6	0.3	0.3	0.3
<b>Turnover &amp; Leverage ratios (x)</b>				
Gross asset turnover	1.6	1.6	1.7	1.8
Total asset turnover	0.9	0.9	1.0	1.0
Interest coverage ratio	106.4	724.0	762.0	713.2
Adjusted debt/equity	0.0	0.0	0.0	0.0
<b>Valuation ratios (x)</b>				
EV/Sales	6.7	5.8	5.0	4.3
EV/EBITDA	20.4	18.1	14.8	12.9
P/E	30.6	27.2	22.2	18.8
P/BV	4.5	7.7	6.7	5.7



### DuPont analysis

(%)	FY09	FY10	FY11E	FY12E	FY13E
Tax burden (Net income/PBT)	67.4	67.4	67.5	67.5	70.0
Interest burden (PBT/EBIT)	111.0	110.0	110.1	108.7	108.0
EBIT margin (EBIT/Revenues)	27.1	29.7	28.9	30.7	30.6
Asset turnover (Revenues/Avg TA)	90.7	90.5	93.4	97.2	96.2
Leverage (Avg TA/Avg equity)	138.7	148.5	152.6	146.9	146.8
<b>Return on equity</b>	<b>25.5</b>	<b>29.6</b>	<b>30.6</b>	<b>32.2</b>	<b>32.6</b>

### Company profile

ITC is India's leading cigarette player with a ~84% market share by value. It has a leadership position in every segment of the market, led by significant investments in marketing, distribution, product design, innovation, manufacturing technology and quality. ITC's distribution reach is one of the largest in India. The FMCG business has a retail network of over 2mn retailers in the country, ranging from premium outlets in metros to small shops in the interiors of rural India.

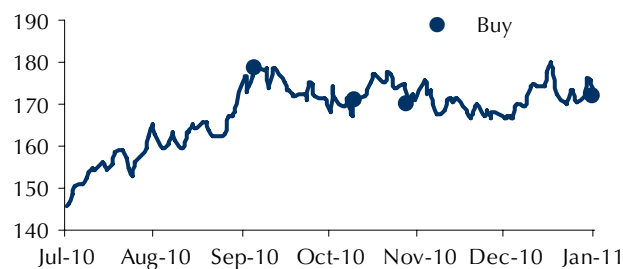
### Shareholding pattern

(%)	Mar-10	June-10	Sept-10
Promoters	-	-	-
FIs	13.4	13.5	14.2
Banks & FIs	37.2	36.8	36.1
Public	49.4	49.7	49.7

### Recommendation history

Date	Event	Reco price	Tgt price	Reco
27-Sep-10	Initiating Coverage	179	195	Buy
29-Oct-10	Results Review	171	210	Buy
16-Nov-10	Company Update	170	210	Buy
21-Jan-11	Results Review	169	210	Buy

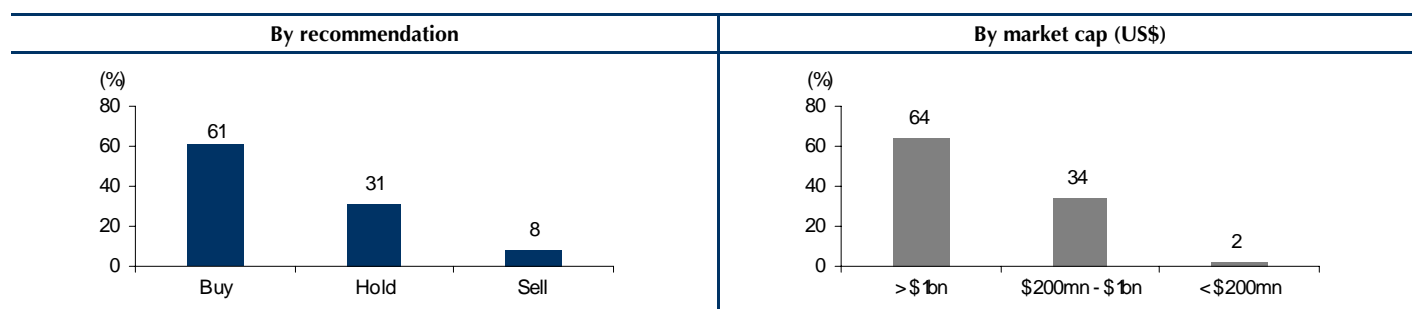
### Stock performance







### Coverage Profile



### Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

### Religare Capital Markets Ltd

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