

COMMENT
ITC (ITC.BO) Rs232.05

Taxing times, but have managed it in the past

News

At today's (Feb 26) Union Budget (2010-2011), the Minister of Finance indicated that the excise duty on cigarettes and other tobacco products would increase. This follows unchanged excise rates with the previous budget. The proposed increases vary between 11% and 18% for the filter segments that account for the majority of industry duty-paid volume. We believe this implies a weighted increase of 15%-16% versus our expectation of a 7% hike.

Analysis

With the increase in excise taxes coming in higher than our expectations, at first glance it would appear challenging for ITC to maintain the high single-digit yoy volume growth it has posted over the past two quarters. In fact, ITC's volumes fell 1% in FY08 and 3% in FY09 – these were years when tax hikes were steep due to the imposition of VAT on cigarettes and high tax on non-filter cigarettes. We believe ITC may need to implement significant cigarette price hikes, as it did in FY08-FY09, when it delivered robust profits in the cigarette division.

Implications

While the news on tax hikes has come in worse than we believe the market was expecting, we note that ITC's cigarette EBIT rose by 15% yoy in both FY08 and FY09 despite the unfavorable taxation backdrop. ITC has consistently grown cigarette EBIT margins since FY02 and delivered 14% cigarette EBIT CAGR in FY02-FY09, which in our view indicates that it has managed tax hikes well. We believe it may take 1-2 quarters of reporting until the market gets more clarity on any impact on volumes. We maintain our Buy rating with a 12-month target price of Rs284, based on 22X FY11E EPS and backed by Director's Cut analysis. Key risks to our view include a significant decline in cigarette volume on the back of tax hikes and a moderation in cigarette EBIT growth, and delays in the turnaround in FMCG-Others and Hotels.

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Coverage View: Neutral

India:
 Consumer Staples

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Exhibit 1: Excise tax hikes of 11%-18% for key filter segments

Excise tax slabs

	Excise tax (Rs. per 1000)		
	Current	Proposed	% ch
Non-filter length (mm)			
Up to 60	819	669	-18%
> 60 up to 70	1323	1473	11%
Filter length (mm)			
Up to 60	819	669	-18%
> 60 up to 70 *	819	969	18%
> 70 up to 75	1323	1473	11%
> 75 up to 85	1759	1959	11%
Others	2163	2363	9%
Cigarettes of tobacco substitutes	1208	1408	17%

* The existing slab of filter cigarettes of length not exceeding 70 mm is being broken up into two slabs - not exceeding 60 mm and > 60 mm but not exceeding 70 mm

Source: Ministry of Finance, Goldman Sachs Research.

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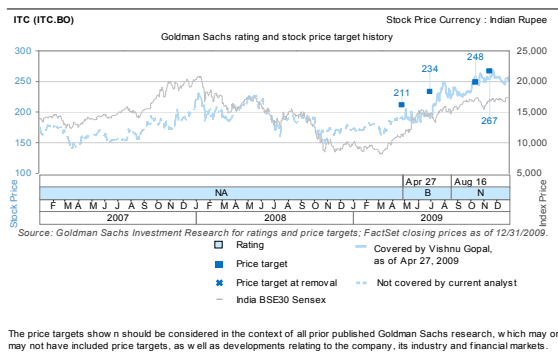
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Price target and rating history chart(s)



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