MOTILAL OSWAL

4QFY06 Results Update

SECTOR: FMCG

ITC

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,809	ITC IN
	REUTERS CODE
S&P CNX: 3,210	ITC.BO

Equity Shares (m)	3,723.3
52-Week Range	213/89
1,6,12 Rel. Perf. (%)	0/13/17
M.Cap. (Rs b)	682.3
M.Cap. (US$ b)	15.4

26 May 2006

Buy

Previous Recommendation: Buy Rs183

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
03/06A	97,905	22,807	6.1	24.2	29.9	7.5	25.1	33.5	6.5	19.2
03/07E	111,213	27,659	7.4	21.3	24.7	6.4	26.0	34.5	5.7	16.3
03/08E	131,298	31,594	8.5	14.2	21.6	5.5	25.6	33.9	4.8	14.1

- ITC's revenues for 4QFY06 grew 27.9% YoY due to strong growth across product segments. PAT increased by 35.9% YoY, as margins expanded in the hotels and paperboard business. For FY06, sales grew by 28.2% and PAT by 24.1%.
- Cigarette revenues grew 15.2% YoY during 4QFY06 to Rs28.8b. Other FMCG business grew 75.7% YoY to Rs3.1b. Hotel business grew 45.5% YoY to Rs2.6b. Agri and paper business grew 55.8% and 15.5% YoY, respectively.
- EBITDA margins for 4QFY06 declined by 170bp YoY, as the sales contribution of loss making and low margin new FMCG and agri business increased by 400bp. PAT grew 35.9% YoY, as tax rate for the quarter declined by 650bp.
- We expect ITC to maintain strong growth in FY07 due to business momentum in cigarettes. Paperboard will benefit from the stablization of new unit and strong prices, while hotel business will derive gains from higher occupancies and higher average revenue per room. Biscuits, atta (wheat flour) and lifestyle retailing will likely drive the growth in new FMCG business with turnaround likely by FY09.
- We are maintaining FY07E and FY08E EPS estimates at Rs7.4 and Rs8.5. The stock is currently trading at 24.7x FY07E EPS and 21.6x FY08E EPS. We maintain **Buy**.

QUARTERLY PERFORMANCE (Rs Million)

Y/E MARCH	FY05				FY06				FY05	FY06
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Net Sales	**18,172**	**17,861**	**18,591**	**21,771**	**22,669**	**21,832**	**25,560**	**27,845**	**76,395**	**97,905**
YoY Change (%)	*27.2*	*16.3*	*14.5*	*15.7*	*24.7*	*22.2*	*37.5*	*27.9*	*18.5*	*28.2*
Total Exp	11,080	10,726	11,525	15,139	14,401	13,633	16,777	19,820	48,469	64,632
EBITDA	**7,092**	**7,135**	**7,066**	**6,632**	**8,268**	**8,198**	**8,783**	**8,024**	**27,926**	**33,274**
Margins (%)	*39.0*	*39.9*	*38.0*	*30.5*	*36.5*	*37.6*	*34.4*	*28.8*	*36.6*	*34.0*
Depreciation	-728	-753	-750	-897	-801	-830	-831	-862	-3,129	-3,323
Interest	-129	-100	-182	-13	-11	3	-15	-97	-424	-119
Other Income	581	664	520	593	845	781	489	746	2,358	2,861
PBT	**6,816**	**6,946**	**6,654**	**6,315**	**8,301**	**8,152**	**8,426**	**7,812**	**26,731**	**32,692**
Tax	-2,167	-2,065	-1,987	-2,141	-2,718	-2,429	-2,603	-2,135	-8,360	-9,885
Rate (%)	*31.8*	*29.7*	*29.9*	*33.9*	*32.7*	*29.8*	*30.9*	*27.3*	*31.3*	*30.2*
PAT	**4,649**	**4,881**	**4,667**	**4,174**	**5,583**	**5,723**	**5,823**	**5,678**	**18,371**	**22,807**
YoY Change (%)	*17.0*	*14.1*	*22.6*	*7.8*	*20.1*	*17.3*	*24.8*	*36.0*	*15.4*	*24.1*
Extraordinary Inc/(Exp)	0	0	0	3,543	0	0	454	-4	3,543	450
Reported PAT	**4,649**	**4,881**	**4,667**	**7,718**	**5,583**	**5,723**	**5,368**	**5,682**	**21,914**	**22,356**

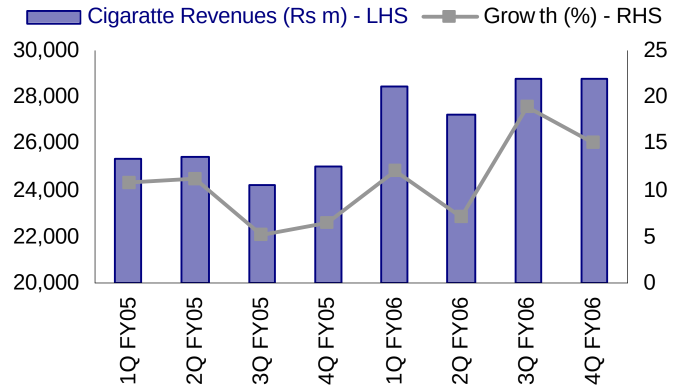
E: MOSt Estimates

Amnish Aggarwal (AmnishAggarwal@MotilalOswal.com) Tel: +91 22 3982 5404 /Sidharth Shah (Sidharths@MotilalOswal.com)

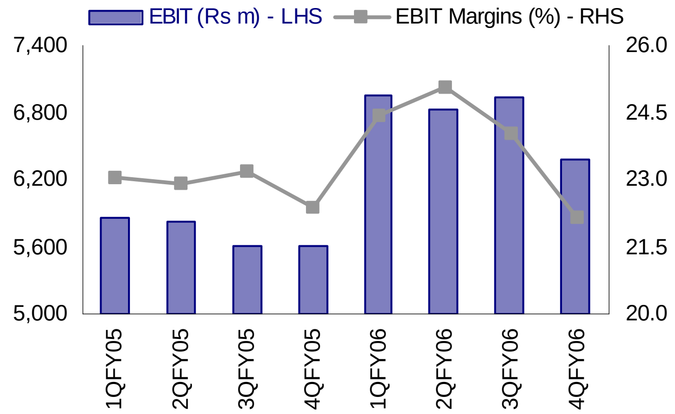
Cigarette business growth accelerates

Cigarette revenues grew 15.2% YoY to Rs28.8b, driven by mid-teen volume growth coupled with mix change and price increases. Cigarette sales growth indicates much higher momentum on YoY basis. Growth rates on sequential basis are not comparable –growth rates were high in 3QFY06 due to low base effect. PBIT margins for the quarter were lower by 30bp while for FY06 they expanded by 100bp. Sales volume for FY06 increased by 8.3%, which compares favorably with 7.1% volume growth achieved during FY05. We have assumed 7% volume growth in cigarette volumes for FY07, which coupled with selective price increase and mix change should ensure 12% sales growth during FY07.

CIGARETTE BUSINESS - STRONG GROWTH MOMENTUM



CIGARETTE EBIT DECLINES ON A YOY BASIS



Source: Company/Motilal Oswal Securities

Processed food and lifestyle retailing power other FMCG business growth

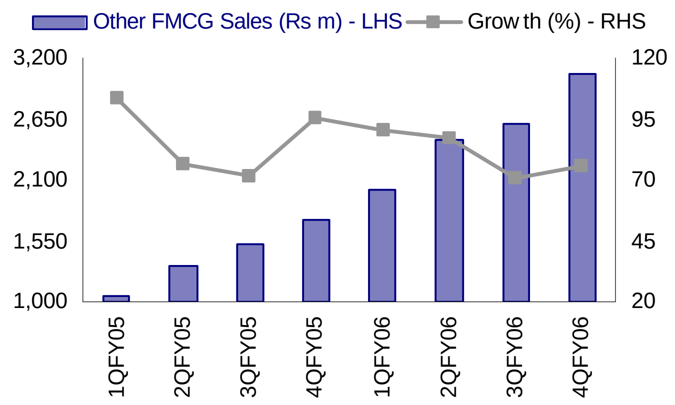
Other FMCG businesses grew by 75.7% YoY during 4QFY06 even as EBIT losses declined by 38.2%. Food products continued to be the single largest segment, with 10% national market share in biscuits and 45% market share in the organized atta market. The company continues to focus on the launch of new products and variants in these product categories. ITC has entered products like ready-to-eat mixes for idli, dosa, khaman dhokla, gulab jamun, etc. which is a Rs1.5b market, growing at 15% per annum. ITC has plans to launch more variants in the biscuits segment in the coming year (*Golden Bake* and *Crackers* launched during FY06), which should enable it to garner higher market share. ITC has been facing the problem of slow ramp-up in biscuits due to the long time taken to tie up outsourcing capacity. With the expected commissioning of its Haridwar facility in the current year, growth rates in biscuits should accelerate further. The year also saw the successful roll out of *Sunfeast Pasta Treat*, a whole-wheat based non-fried product, targeted at children and available in four exciting flavors. We expect the processed food segment to maintain high double-digit growth, on the back of the Welcome Group's strong product knowledge and raw material cost advantage from its E Choupal initiative.

Lifestyle retailing has started showing signs of improvement, as sales of *Wills* range of garments increased by 50% while *John Players* sales jumped by 70%. The company increased the distribution for *Wills* to 37 exclusive stores and 39 large format stores, in addition to 109 multi-brand outlets. Distribution of *John Players* was expanded to 75 exclusive outlets and 2,100 multi-brand outlets. We are bullish on the long-term prospects of this business as:

- Branded garments are likely to grow by more than 20% per annum due to rising impact of media and organized retailing
- There is a perceptible shift in trend away from tailoring even in category-2 towns, which augurs well for mass market brands like *John Players*
- Improving distribution network will increase availability and boost sales
- ITC has been able to find the right product and brand mix with extension into outwear and denims, in addition to formals
- Small but successful entry into the huge export market has been made. Current initiatives include establishing

contact with customers and expansion of manufacturing facilities.

OTHER FMCG SALES TREND



Source: Company/Motilal Oswal Securities

E Choupal and Choupal Sagar – driving agri business growth rates

Agri business reported 55.8% topline growth for 4QFY06 while PBIT increased by 247% YoY. Poor base effect due to bad soya crop of last year and strong rice, wheat and leaf tobacco exports boosted performance during the quarter. The company ramped up its E-Choupal network to 6,000 units. However, agri business margins continued to be impacted due to start up costs of E Choupal network and rising investments in Choupal Sagar. The rural distribution initiative reported more than 100% increase in channel transaction value to nearly Rs1b. This represents distribution of products of 45 companies, from both public and private sectors, in categories like FMCG products, consumer durables, vehicles, agri inputs, etc.

The company now has 7 Choupal Sagar malls under operation and the number is likely to increase by another 5 in the coming 1-2 quarters. Choupal Sagar continues to provide satisfactory performance, with sales in first mall at Sehore reaching a level of Rs100,000 per day. The concept seems to be settling well, as more and more product and service companies plan to use Choupal Sagar to distribute their goods and services. Despite difficulties in the acquisition of land, we expect the company to ramp up Choupal Sagar to 75-80 locations in the coming 3-4 years, with sales contribution of over Rs4b.

Hotels – reaping benefits of past investments

Hotels business reported 45.5% increase in topline and 72.2% increase in PBIT during 4QFY06, with PBIT margins expanding by 570bp. Sales for FY06 were up 35.7% while PBIT zoomed by 82%. Hotels business continues to reap the benefits of expansion undertaken during the recessionary period. Strong tourist inflow and 20-25% increase in ARR has been the major growth driver. **ITC Grand Central**, the company's second property at Parel in Mumbai, which was commissioned in January 2005, posted a positive bottomline in its first full year of operations. The company has commenced construction of a new super-deluxe luxury hotel at Bangalore while architectural planning has reached an advanced stage for the proposed hotel at Chennai. We expect the hotel division to grow in the coming year simply on the back of higher occupancy levels and higher average revenue per room. Margins are likely to expand further, as the current buoyancy in room rentals is likely to last for the coming couple of years due to long gestation nature of the industry.

Paperboards and paper – higher capacity utilization pays off

Paperboard division reported 21% sales growth and 25% PBIT growth, as PBIT margins expanded by 60bp. Increased capacity utilization at Kovai unit and 75,000 tpa capacity increase at Bhadrachalam provided 18% volume growth. Sales of value-added products grew by 33% over last year to touch 120,972 ton while specialty papers also registered strong growth driven by the fine printing segment. Production stablisation and commissioning of 8 MW captive power plant at Kovai were the main margin drivers.

The company is yet to finalize the location of its new proposed Rs25b integrated unit. It plans to double the capacity of its elemental chlorine free (ECF) pulp mill, and undertake brownfield expansion at existing locations, which would continue to provide growth to the company.

SEGMENT-WISE PERFORMANCE (RS M)

	4QFY05	4QFY06	CHG. (%)	FY05	FY06	CHG. (%)
Sales						
Cigarettes	25,035	28,827	15.1	100,025	113,297	13.3
FMCG - Others *	1,740	3,057	75.7	5,634	10,135	79.9
Hotels	1,810	2,633	45.5	5,773	7,834	35.7
Agri Business	5,162	8,040	55.8	17,801	26,784	50.5
Paper and Packaging	4,117	4,755	15.5	15,653	18,957	21.1
PBIT						
Cigarettes	5,602	6,383	13.9	22,882	27,088	18.4
FMCG - Others	-685	-423	-38.2	-1,952	-1,718	-12.0
Hotels	568	978	72.2	1,414	2,581	82.6
Agri Business	25	88	247.2	964	909	-5.7
Paper and Packaging	538	787	46.4	2,799	3,514	25.5
Margins (%)						
Cigarettes	22.4	22.1		22.9	23.9	
FMCG - Others	-39.4	-13.9		-34.7	-17.0	
Hotels	31.4	37.1		24.5	32.9	
Agri Business	0.5	1.1		5.4	3.4	
Paper and Packaging	13.1	16.5		17.9	18.5	

* (Greeting Cards, Garments, Packaged Foods)

Source: Company/Motilal Oswal Securities

Valuation and view

We expect the company to maintain strong growth in FY07 due to business momentum in cigarettes. Paperboard will benefit from stablization of new unit and strong prices while hotel business will derive gains from higher occupancies and average revenue per room. Biscuits, atta and lifestyle retailing will likely drive growth in new FMCG business, with turnaround likely by FY09. ITC has been improving its dividend distribution, with FY06 dividend indicating 43% payout, highest by the company so far. This also indicates growing management confidence in sustaining growth momentum.

We are maintaining FY07E and FY08E EPS estimates at Rs7.4 and Rs8.5. The stock is currently trading at 24.7x FY07E EPS and 21.6x FY08E EPS. We maintain **Buy**.

ITC: an investment profile

Company description

ITC is an associate of BAT (British American Tobacco) controls more than 2/3rd of the cigarette market in India. ITC has emerged as a diversified conglomerate with leading presence in Paperboards, Hotels and Processed foods. E-Choupal, the agri rural initiative of the company has been widely appreciated for its foresight in harnessing the potential in the rural market.

Key investment arguments

- Strong pricing power due to dominant market share in the cigarettes
- Hotels and Paperboard businesses have achieved self sustenance levels
- Fastest growing company in the processed food sector
- Excellent long term potential in its rural initiative of E Choupal and Choupal Sagar

Key investment risks

- A high indirect tax regime could dampen cigarette growth.
- Some of the SBU's like paper and Hotels are capital intensive with long gestation periods.

Recent developments

- Setting up Rs700m biscuit manufacturing facility in Uttaranchal.
- Launched new ready to eat foods and increased cigarette prices to neutralise impact of excise duty increase.

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 24.7x FY07E EPS and 21.6x FY08E EPS. We maintain **Buy**.

Sector view

- We are positive on the sector. The sector is showing strong volume growth across product categories with improving pricing power for leading players.
- Companies with low competitive pressures and brought product portfolios will be able to better with stand any slowdown in a particular segment.
- Longer term prospects bright, given rising incomes and low penetration.

COMPARATIVE VALUATIONS

		ITC	HLL	NESTLE
P/E (x)	FY07E	24.7	31.9	28.6
	FY08E	21.6	25.3	23.2
EV/EBITDA (x)	FY07E	16.3	27.5	17.4
	FY08E	14.1	21.3	14.4
EV/Sales (x)	FY07E	5.7	4.2	3.8
	FY08E	4.8	3.6	3.3
P/BV (x)	FY07E	6.4	23.1	26.8
	FY08E	5.5	20.0	22.8

SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	0.0	0.0	0.0
Domestic Institutions	36.2	35.6	33.8
FIIs/FDIs	49.0	49.1	53.5
Others	14.8	15.3	12.7

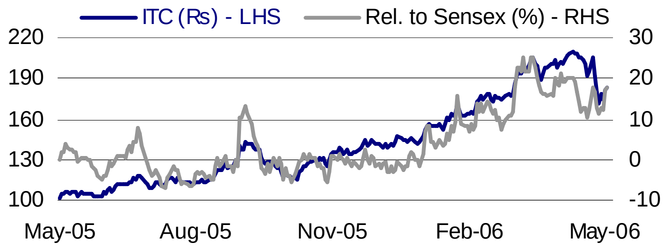
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	7.4	7.1	3.6
FY08	8.5	8.4	1.1

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
183	210	14.6	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (RS MILLION)

Y/E MARCH	2004	2005	2006	2007E	2008E
Net Sales	**64,456**	**76,044**	**97,905**	**111,213**	**131,298**
Change (%)	*10.0*	*18.0*	*28.7*	*13.6*	*18.1*
Total Expenditure	-40,810	-48,098	-64,632	-72,281	-86,903
EBITDA	**23,646**	**27,947**	**33,274**	**38,932**	**44,395**
Change (%)	*9.0*	*18.2*	*19.1*	*17.0*	*14.0*
Margin (%)	*36.7*	*36.8*	*34.0*	*35.0*	*33.8*
Depreciation	-2,419	-3,129	-3,323	-3,664	-4,028
Int. and Fin. Charges	-342	-508	-119	-25	-25
Other Income - Recurring	2,293	2,411	2,861	3,990	4,472
Profit before Taxes	**23,179**	**26,721**	**32,692**	**39,233**	**44,814**
Change (%)	*12.2*	*15.3*	*22.3*	*20.0*	*14.2*
Margin (%)	*36.0*	*35.1*	*33.4*	*35.3*	*34.1*
Tax	-8,190	-7,879	-9,685	-12,358	-14,116
Deferred Tax	928	-481	-200	785	896
Tax Rate (%)	*-31.3*	*-31.3*	*-30.2*	*-29.5*	*-29.5*
Profit after Taxes	**15,917**	**18,361**	**22,807**	**27,659**	**31,594**
Change (%)	*15.2*	*15.4*	*24.2*	*21.3*	*14.2*
Margin (%)	*24.7*	*24.1*	*23.3*	*24.9*	*24.1*
Non-rec. (Exp)/Income	0	3,543	-450	0	0
Reported PAT	**15,917**	**18,361**	**22,356**	**27,659**	**31,594**

BALANCE SHEET (RS MILLION)

Y/E MARCH	2004	2005	2006	2007E	2008E
Share Capital	2,477	2,482	3,723	3,723	3,723
Reserves	61,624	76,474	87,299	102,512	119,888
Net Worth	**64,101**	**78,956**	**91,023**	**106,235**	**123,612**
Loans	1,209	2,454	2,454	2,454	2,454
Deferred Liability	877	3,761	4,407	5,191	6,088
Capital Employed	**66,187**	**85,171**	**97,883**	**113,880**	**132,153**
Gross Block	47,409	57,463	63,463	70,463	77,463
Less: Accum. Depn.	-14,426	-17,955	-21,255	-24,919	-28,947
Net Fixed Assets	**32,983**	**39,508**	**42,208**	**45,543**	**48,515**
Capital WIP	3,137	1,862	5,000	12,000	22,000
Investments	30,540	38,747	45,615	50,369	57,307
Curr. Assets, L&A	**34,854**	**35,393**	**41,890**	**47,662**	**54,019**
Inventory	15,342	20,030	24,311	28,715	33,878
Account Receivables	2,302	5,278	6,776	7,617	8,274
Cash and Bank Balance	340	557	933	1,155	1,376
Others	16,870	9,529	9,870	10,175	10,492
Curr. Liab. and Prov.	**35,326**	**30,338**	**36,830**	**41,694**	**49,689**
Account Payables	28,043	18,920	23,098	25,246	31,015
Other Liabilities	1,773	2,171	2,495	2,794	3,078
Provisions	5,510	9,247	11,237	13,654	15,596
Net Current Assets	**-473**	**5,055**	**5,060**	**5,968**	**4,330**
Application of Funds	**66,188**	**85,171**	**97,883**	**113,881**	**132,153**

E: MOSt Estimates

RATIOS

Y/E MARCH	2004	2005	2006E	2007E	2008E
Basic (Rs)					
EPS	**4.3**	**4.9**	**6.1**	**7.4**	**8.5**
Cash EPS	4.9	5.8	7.0	8.4	9.6
BV/Share	17.2	21.2	24.4	28.5	33.2
DPS	1.3	2.1	2.4	3.0	3.4
Payout %	31.1	41.9	39.9	40.0	40.0
Valuation (x)					
P/E		37.2	29.9	24.7	21.6
Cash P/E		31.7	26.2	21.8	19.2
EV/Sales		8.5	6.5	5.7	4.8
EV/EBITDA		23.1	19.2	16.3	14.1
P/BV		8.6	7.5	6.4	5.5
Dividend Yield (%)		1.1	1.3	1.6	1.9
Return Ratios (%)					
RoE	24.8	23.3	25.1	26.0	25.6
RoCE	35.5	32.0	33.5	34.5	33.9
Working Capital Ratios					
Debtor (Days)	13	25	25	25	23
Asset Turnover (x)	1.0	0.9	1.0	1.0	1.0
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	21,228	24,818	29,950	35,268	40,367
Int./Div. Received	2,293	2,411	2,861	3,990	4,472
Depreciation and Amort.	2,419	3,129	3,323	3,664	4,028
Interest Paid	-342	-508	-119	-25	-25
Direct Taxes Paid	-8,190	-7,879	-9,685	-12,358	-14,116
(Incr)/Decr in WC	4,698	-5,311	371	-686	1,859
CF from Operations	**22,105**	**16,660**	**26,701**	**29,853**	**36,584**
(Incr)/Decr in FA	-6,391	-8,777	-9,139	-14,000	-17,000
(Pur)/Sale of Investments	-14,451	-8,207	-6,869	-4,753	-6,938
CF from Invest.	**-20,842**	**-16,985**	**-16,006**	**-18,752**	**-23,937**
Issue of Shares	112	872	0	0	0
(Incr)/Decr in Debt	38	-150	-149	-149	-149
Dividend Paid	-5,588	-8,792	-10,244	-12,447	-14,217
Others	726	8,612	74	1,717	1,940
CF from Fin. Activity	**-4,712**	**542**	**-10,319**	**-10,879**	**-12,426**
Incr/Decr of Cash	**-3,449**	**217**	**376**	**222**	**221**
Add: Opening Balance	3,788	340	557	933	1,155
Closing Balance	**340**	**557**	**933**	**1,155**	**1,376**

N O T E S

Rated - The Best Local Brokerage House in India by

2005 asia money BROKERS POLL

For more copies or other information, contact
Institutional: Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari
Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motilaloswal.com

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

MOSt is not engaged in providing investment-banking services.