

Raising volume and EPS estimates

■ EVENT: No increase in cigarette excise duties

The Union Budget today did not increase excise duty for cigarettes. We had expected a roughly 8% increase in cigarette excise duties, which we now roll back. We expect ITC to grow cigarette volumes ~6% (earlier expected ~3-4%) in FY12E as it would not need to raise prices in a significant manner.

■ IMPACT: Earnings estimates increased

We raise our EPS estimates for ITC from Rs7.1/8.3 to Rs7.4/8.7 by ~4.5% for FY12/13. The cigarette portfolio continues to be the key metric to watch for the stock.

■ ACTION: ITC is our top pick in the sector

ITC is our top pick for 2011 as we believe positive volume growth across its filter portfolio should bring in better operating efficiencies. Launches in the King-Size segment recently have aided uptrading, improving revenue mix.

■ VALUATION: Our price target is Rs220

We derive our price target from a DCF-based methodology and explicitly forecast long-term valuation drivers using UBS's VCAM tool. We assume a WACC of 11%, an interim growth rate of 13.5%, and a terminal growth rate of 5%.

Highlights (Rsm)	03/09	03/10	03/11E	03/12E	03/13E
Revenues	153,881	181,532	208,797	239,443	274,564
EBIT (UBS)	43,091	54,891	60,597	75,753	89,192
Net Income (UBS)	32,635	40,848	46,318	56,499	66,260
EPS (UBS, Rs)	4.34	5.34	6.05	7.39	8.66
Net DPS (UBS, Rs)	1.84	2.25	2.57	3.00	3.50

Profitability & Valuation	5-yr hist av.	03/10	03/11E	03/12E	03/13E
EBIT margin %	29.7	30.2	29.0	31.6	32.5
ROIC (EBIT) %	55.6	63.2	62.4	57.8	61.2
EV/EBITDA (core) x	7.4	9.7	13.6	10.9	9.4
PE (UBS) x	20.8	21.6	25.8	21.1	18.0
Net dividend yield %	2.2	2.0	1.6	1.9	2.2

Source: Company accounts, Thomson Reuters, UBS estimates. (UBS) valuations are stated before goodwill, exceptionals and other special items. Valuations: based on an average share price that year, (E): based on a share price of Rs156.15 on 25 Feb 2011 23:38 SGT

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Tobacco

12-month rating **Buy**
Unchanged

12m price target **Rs220.00/US\$4.85**
Unchanged

Price **Rs156.15/US\$3.45 (ADR)**

RIC: ITC.BO BBG: ITC:IB

28 February 2011

Trading data (local/US\$)

52-wk range	Rs179.90-116.03/US\$6.76-3.27
Market cap.	Rs1,194bn/US\$26.4bn
Shares o/s	7,650m (ORD)/7,650m (ADR)
ADR ratio	1 ADR:1 ORD
Free float	65%
Avg. daily volume ('000)	7,760/-
Avg. daily value (m)	Rs1,291.5/-

Balance sheet data 03/11E

Shareholders' equity	Rs177bn
P/BV (UBS)	6.7x
Net Cash (debt)	Rs41.9bn

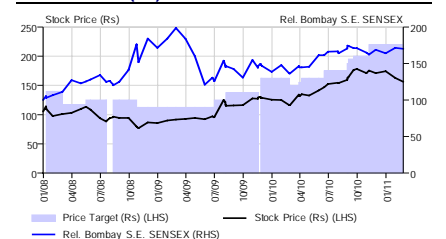
Forecast returns

Forecast price appreciation	+40.9%
Forecast dividend yield	1.6%
Forecast stock return	+42.5%
Market return assumption	13.1%
Forecast excess return	+29.4%

EPS (UBS, Rs)

	03/11E		Cons.	03/10 Actual
	From	To		
Q1E	0.00	0.00	-	1.15
Q2E	0.00	0.00	-	1.32
Q3E	0.00	0.00	0.00	1.50
Q4E	0.00	0.00	0.00	1.34
03/11E	6.12	6.05	6.12	
03/12E	7.07	7.39	7.07	

Performance (Rs)



Source: UBS

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ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 5.

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Table 1: Excise duty incidence on cigarettes (Rs/1000 sticks)

Movement of excise duties	FY06	FY07	FY08	FY09	FY10	FY11E	FY12E
KSFT	1595	1675	1759	1759	1,759	1,959	1,959
Longs	1200	1463	1463	1463	1,463	1,624	1,624
RSFT	740	780	819	819	819	969	969
Micro Filters						669	669
Plains	495	520	546	1323	na	na	na
Micro	150	160	168	819	na	na	na
Bidis	7	12	16	16	16	16	16

Source: Various Budget documents

Table 2: Change in estimates

Change in estimates (%)	New forecasts			Old forecasts			Change in forecasts		
	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E
Net profit	46,318	56,499	66,260	45,800	54,061	63,267	1.1%	4.5%	4.7%
EPS	6.05	7.39	8.66	6.00	7.07	8.27	0.9%	4.5%	4.7%

Source: UBS estimates

Table 3: Historical pre and post Budget stock movements

Price performance (1M)					
Union Budget	Budget Date	Excise Increase	Post Budget	Pre Budget	Comments
FY06	28/2/2005	5%	2%	-8%	
FY07	28/2/2006	5%	12%	11%	ITC implemented a blended 6-7% hike post budget
FY08	28/2/2007	5%	-17%	-4%	ITC implemented 12% price hike between Sep 2006-Mar 2007 & 23% hike in Apr 2007
FY09	28/2/2008	17%	2%	2%	25-35% in plains between Apr 2007-Mar 2008
FY10	06/7/2009	0%	18%	3%	Price increase in 1-2 brands
FY11	26/2/2010	17%	14%	-9%	6.8% price increase in Gold Flake King size, ~7% of ITC volumes
FY12	28/2/2011	0%		0%	Stock recovered losses of last one month, up on Budget day

Source: UBS estimates

Income statement (Rsm)	03/06	03/07	03/08	03/09	03/10	03/11E	% ch	03/12E	% ch	03/13E	% ch
Revenues	97,905	123,693	139,475	153,881	181,532	208,797	15.0	239,443	14.7	274,564	14.7
Operating expenses (ex dephn)	(64,607)	(84,101)	(95,369)	(105,296)	(120,554)	(141,200)	17.1	(155,639)	10.2	(176,517)	13.4
EBITDA (UBS)	33,299	39,592	44,106	48,585	60,978	67,597	10.9	83,804	24.0	98,047	17.0
Depreciation	(3,323)	(3,629)	(4,385)	(5,494)	(6,087)	(7,000)	15.0	(8,050)	15.0	(8,855)	10.0
Operating income (EBIT, UBS)	29,975	35,963	39,722	43,091	54,891	60,597	10.4	75,753	25.0	89,192	17.7
Other income & associates	2,861	3,337	6,109	5,349	6,034	6,637	10.0	7,633	15.0	8,549	12.0
Net interest	(119)	(33)	(46)	(183)	(534)	(300)	-43.8	(300)	0.0	(300)	0.0
Abnormal items (pre-tax)	(25)	0	(67)	(152)	(238)	0	-	0	-	0	-
Profit before tax	32,692	39,267	45,718	48,105	60,153	66,934	11.3	83,086	24.1	97,441	17.3
Tax	(9,888)	(12,267)	(14,518)	(15,622)	(19,543)	(20,616)	5.5	(26,588)	29.0	(31,181)	17.3
Profit after tax	22,804	27,000	31,200	32,483	40,610	46,318	14.1	56,499	22.0	66,260	17.3
Abnormal items (post-tax)	0	0	0	0	0	0	-	0	-	0	-
Minorities / pref dividends	0	0	0	0	0	0	-	0	-	0	-
Net income (local GAAP)	22,804	27,000	31,200	32,483	40,610	46,318	14.1	56,499	22.0	66,260	17.3
Net Income (UBS)	22,828	27,000	31,267	32,635	40,848	46,318	13.4	56,499	22.0	66,260	17.3
Tax rate (%)	30	31	32	32	32	31	-5.2	32	3.9	32	0.0
Pre-abnormal tax rate (%)	30	31	32	32	32	31	-4.8	32	3.9	32	0.0
Per share (Rs)	03/06	03/07	03/08	03/09	03/10	03/11E	% ch	03/12E	% ch	03/13E	% ch
EPS (local GAAP)	3.03	3.59	4.15	4.32	5.31	6.05	14.1	7.39	22.0	8.66	17.3
EPS (UBS)	3.03	3.59	4.16	4.34	5.34	6.05	13.4	7.39	22.0	8.66	17.3
Net DPS	1.51	1.55	1.75	1.84	2.25	2.57	14.4	3.00	16.5	3.50	16.7
Cash EPS	3.48	4.07	4.74	5.07	6.14	6.97	13.6	8.44	21.1	9.82	16.4
BVPS	12.07	13.90	16.05	18.29	18.42	23.16	25.7	29.04	25.4	35.96	23.8
Balance sheet (Rsm)	03/06	03/07	03/08	03/09	03/10	03/11E	% ch	03/12E	% ch	03/13E	% ch
Net tangible fixed assets	44,051	56,109	72,957	84,860	91,514	102,514	12.0	112,464	9.7	121,608	8.1
Net intangible fixed assets	0	0	0	0	0	0	-	0	-	0	-
Net working capital (incl. other assets)	4,033	10,591	14,717	15,565	(18,325)	18,571	-	28,654	54.3	28,529	-0.4
Other liabilities	0	0	0	0	0	0	-	0	-	0	-
Operating invested capital	48,084	66,700	87,673	100,425	73,189	121,085	65.4	141,118	16.5	150,137	6.4
Investments	9,346	9,346	9,346	9,191	14,186	14,186	0.0	14,186	0.0	14,186	0.0
Total capital employed	57,429	76,046	97,019	109,616	87,376	135,271	54.8	155,304	14.8	164,323	5.8
Shareholders' equity	90,615	104,371	120,577	137,351	140,644	177,131	25.9	222,175	25.4	275,072	23.8
Minority interests	0	0	0	0	0	0	-	0	-	0	-
Total equity	90,615	104,371	120,577	137,351	140,644	177,131	25.9	222,175	25.4	275,072	23.8
Net debt / (cash)	(33,186)	(28,325)	(23,558)	(27,735)	(53,268)	(41,859)	-21.4	(66,871)	59.8	(110,749)	65.6
Other debt-deemed items	0	0	0	0	0	0	-	0	-	0	-
Total capital employed	57,429	76,046	97,019	109,616	87,376	135,271	54.8	155,304	14.8	164,323	5.8
Cash flow (Rsm)	03/06	03/07	03/08	03/09	03/10	03/11E	% ch	03/12E	% ch	03/13E	% ch
Operating income (EBIT, UBS)	29,975	35,963	39,722	43,091	54,891	60,597	10.4	75,753	25.0	89,192	17.7
Depreciation	3,323	3,629	4,385	5,494	6,087	7,000	15.0	8,050	15.0	8,855	10.0
Net change in working capital	(3,829)	(6,836)	(3,575)	(3,727)	3,213	727	-77.4	(1,706)	-	(1,783)	4.6
Other (operating)	(25)	0	(67)	(152)	(238)	0	-	0	-	0	-
Operating cash flow (pre tax/interest)	29,445	32,756	40,464	44,706	63,952	68,324	6.8	82,098	20.2	96,264	17.3
Net interest received / (paid)	(119)	(33)	(46)	(183)	(534)	(300)	-43.8	(300)	0.0	(300)	0.0
Dividends paid	(8,676)	(11,347)	(11,663)	(13,190)	(13,894)	(8,591)	-38.2	(9,831)	14.4	(11,454)	16.5
Tax paid	(9,725)	(13,925)	(14,524)	(15,636)	(19,543)	(20,616)	5.5	(26,588)	29.0	(31,181)	17.3
Capital expenditure	(6,006)	(15,687)	(21,232)	(17,397)	(12,741)	(18,000)	41.3	(18,000)	0.0	(18,000)	0.0
Net (acquisitions) / disposals	0	0	0	0	0	0	-	0	-	0	-
Other	(1,647)	(2,408)	(2,997)	(1,140)	(1,591)	(1,955)	22.9	(10,000)	411.6	0	-
Share issues	202	(1,581)	(1,804)	0	0	0	-	0	-	0	-
Cash flow (inc)/dec in net debt	3,475	(12,224)	(11,802)	(2,840)	15,650	18,863	20.5	17,379	-7.9	35,329	103.3
FX / non cash items	2,206	7,364	7,035	7,017	9,883	(30,272)	-	7,633	-	8,549	12.0
Balance sheet (inc)/dec in net debt	5,681	(4,861)	(4,767)	4,177	25,533	(11,409)	-	25,012	-	43,877	75.4
Core EBITDA	33,299	39,592	44,106	48,585	60,978	67,597	10.9	83,804	24.0	98,047	17.0
Maintenance capital expenditure	(3,323)	(3,629)	(4,385)	(5,494)	(6,087)	(7,000)	15.0	(8,050)	15.0	(8,855)	10.0
Maintenance net working capital	(3,829)	(6,836)	(3,575)	(3,727)	3,213	727	-77.4	(1,706)	-	(1,783)	4.6
Operating free cash flow, pre-tax	26,147	29,127	36,146	39,364	58,103	61,323	5.5	74,048	20.7	87,409	18.0

Source: Company accounts, UBS estimates. (UBS) valuations are stated before goodwill, exceptional and other special items. Note: For some companies, the data represents an extract of the full company accounts.

12-month rating

Buy

12m price target

Rs220.00

Company profile

ITC is the leading cigarette manufacturer in India with a 67% share of the market by volume and 83% by value. ITC has identified tobacco and paperboard, hotels and agri-business as its core businesses for the future.

Valuation (x)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
P/E (local GAAP)	20.9	21.4	21.7	25.8	21.1	18.0
P/E (UBS)	20.8	21.3	21.6	25.8	21.1	18.0
P/CEPS	18.1	18.3	18.8	22.4	18.5	15.9
Net dividend yield (%)	2.2	2.0	2.0	1.6	1.9	2.2
P/BV	5.2	5.1	6.3	6.7	5.4	4.3
EV/revenue (core)	2.4	2.7	3.3	4.4	3.8	3.3
EV/EBITDA (core)	7.4	8.7	9.7	13.6	10.9	9.4
EV/EBIT (core)	8.3	9.8	10.8	15.1	12.1	10.3
EV/OpFCF (core)	9.8	10.7	10.2	15.0	12.4	10.5
EV/op. invested capital	4.6	4.5	6.8	9.4	7.0	6.3

Enterprise value (Rsm)	03/09	03/10	03/11E	03/12E	03/13E
Average market cap	694,650	869,326	1,194,484	1,194,484	1,194,484
+ minority interests	0	0	0	0	0
+ average net debt (cash)	(262,681)	(262,681)	(262,681)	(262,681)	(262,681)
+ pension obligations and other	0	0	0	0	0
- non-core asset value	(9,191)	(14,186)	(14,186)	(14,186)	(14,186)
Core enterprise value	422,778	592,459	917,616	917,616	917,616

Growth (%)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
Revenue	19.1	10.3	18.0	15.0	14.7	14.7
EBITDA (UBS)	14.8	10.2	25.5	10.9	24.0	17.0
EBIT (UBS)	14.8	8.5	27.4	10.4	25.0	17.7
EPS (UBS)	15.4	4.4	23.1	13.4	22.0	17.3
Cash EPS	15.4	7.0	21.1	13.6	21.1	16.4
Net DPS	12.4	5.0	22.2	14.4	16.5	16.7
BVPS	14.5	13.9	0.7	25.7	25.4	23.8

Margins (%)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
EBITDA / revenue	33.2	31.6	33.6	32.4	35.0	35.7
EBIT / revenue	29.7	28.0	30.2	29.0	31.6	32.5
Net profit (UBS) / revenue	22.6	21.2	22.5	22.2	23.6	24.1

Return on capital (%)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
EBIT ROIC (UBS)	55.6	45.8	63.2	62.4	57.8	61.2
ROIC post tax	-	31.0	42.8	43.2	39.3	41.6
Net ROE	26.7	25.3	29.4	29.2	28.3	26.7

Coverage ratios (x)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
EBIT / net interest	NM	NM	NM	NM	NM	NM
Dividend cover (UBS EPS)	2.2	2.4	2.4	2.4	2.5	2.5
Div. payout ratio (% , UBS EPS)	44.9	42.4	42.1	42.5	40.6	40.4
Net debt / EBITDA	NM	NM	NM	NM	NM	NM

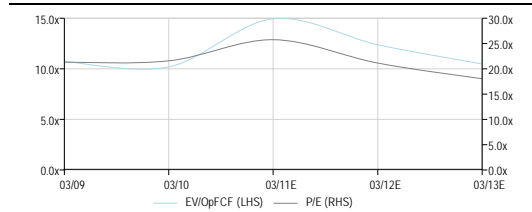
Efficiency ratios (x)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
Revenue / op. invested capital	1.9	1.6	2.1	2.1	1.8	1.9
Revenue / fixed assets	2.2	2.0	2.1	2.2	2.2	2.3
Revenue / net working capital	16.0	10.2	NM	NM	10.1	9.6

Investment ratios (x)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
OpFCF / EBIT	0.8	0.9	1.1	1.0	1.0	1.0
Capex / revenue (%)	11.6	11.3	7.0	8.6	7.5	6.6
Capex / depreciation	3.4	3.2	2.1	2.6	2.2	2.0

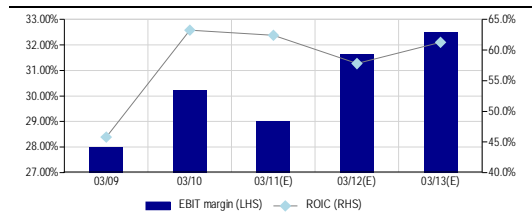
Capital structure (%)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
Net debt / total equity	(26.4)	(20.2)	(37.9)	(23.6)	(30.1)	(40.3)
Net debt / (net debt + equity)	(35.8)	(25.3)	(61.0)	(30.9)	(43.1)	(67.4)
Net debt (core) / EV	(91.7)	(62.1)	(44.3)	(28.6)	(28.6)	(28.6)

Source: Company accounts, UBS estimates. (UBS) valuations are stated before goodwill, exceptional and other special items. Valuations: based on an average share price that year, (E): based on a share price of Rs156.15 on 25 Feb 2011 23:38 SGT Market cap(E) may include forecast share issues/buybacks.

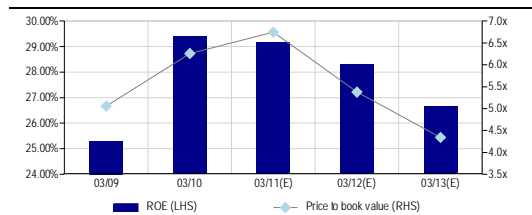
Value (EV/OpFCF & P/E)



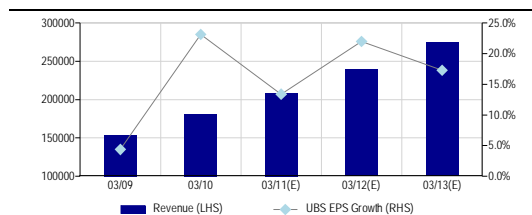
Profitability



ROE v Price to book value



Growth (UBS EPS)



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■ ITC

ITC is the leading cigarette manufacturer in India with a 67% share of the market by volume and 83% by value. ITC has identified tobacco and paperboard, hotels and agri-business as its core businesses for the future.

■ Statement of Risk

We believe higher excise duty is the key risk to ITC's earnings growth and valuation. A steady increase in excise duty would adversely affect the long-term growth trend and lead to lower purchases by smokers.

■ Analyst Certification

Each research analyst primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.

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UBS Investment Research: Global Equity Rating Allocations

UBS 12-Month Rating	Rating Category	Coverage ¹	IB Services ²
Buy	Buy	49%	40%
Neutral	Hold/Neutral	42%	35%
Sell	Sell	8%	21%
UBS Short-Term Rating	Rating Category	Coverage ³	IB Services ⁴
Buy	Buy	less than 1%	14%
Sell	Sell	less than 1%	0%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 31 December 2010.

UBS Investment Research: Global Equity Rating Definitions

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.
UBS Short-Term Rating	Definition
Buy	Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.
Sell	Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

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UBS Securities India Private Ltd: Sunita Sachdev; Deepa Mirchandani.

Company Disclosures

Company Name	Reuters	12-mo rating	Short-term rating	Price	Price date
ITC	ITC.BO	Buy	N/A	Rs156.15	25 Feb 2011

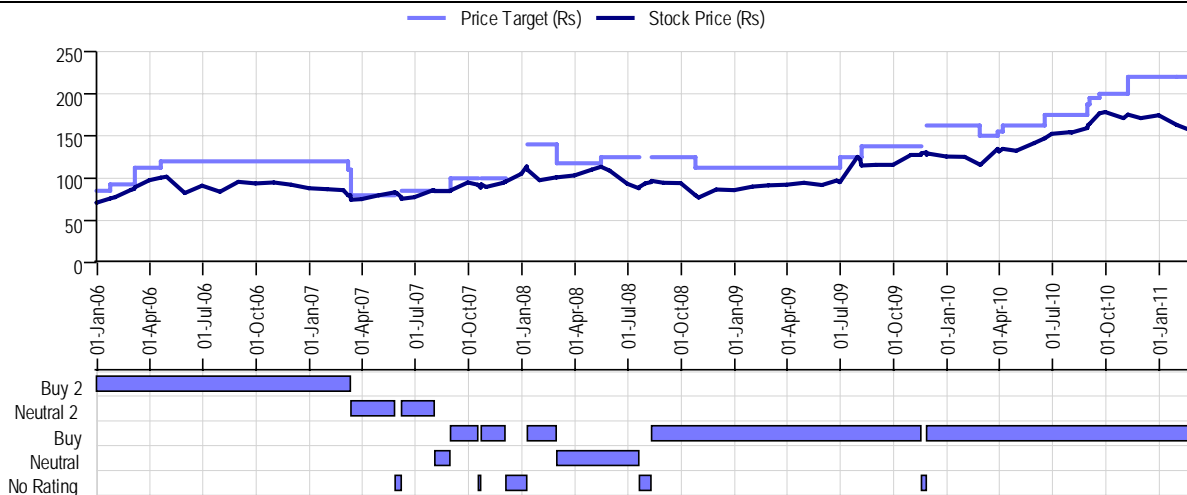
Source: UBS. All prices as of local market close.

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ITC (Rs)



Source: UBS; as of 25 Feb 2011

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