

ITC Limited

Expectedly, another nice quarter ticks by

ITC reported yet another good quarter with revenue/EBITDA/net earnings growth of 18%/18%/21% during Q2FY12. Cigarette and other FMCG divisions in particular registered healthy sales and margin performance. We maintain our positive stance on the stock and it remains our preferred pick. We expect ITC to deliver an EPS CAGR of 17% over FY11-14E. ITC has outperformed the broad market by 38% YTD and in the current volatile market, we think it should do relatively better than its peers.

- Cigarettes - robust volume and EBIT growth trend maintained.** ITC registered 14% and 19% sales and EBIT growth for cigarettes, respectively, supported by an estimated 7-8% volume growth, price/mix growth of ~6% and lower excise payout during Q2FY12. Product mix improvement continued with premium cigarettes growing at a faster rate than mass brands. We expect healthy volume growth (~7%) and EBIT growth in FY12E supported by reasonable price increases (~6%) for cigarettes.
- Other FMCG surprises positively** with strong top-line growth of 27% y/y and EBIT losses declining by 16% y/y. Better revenue and profitability for foods (supported by price increases) and education businesses was a key driver for the same. ITC's recent forays into instant noodles and skin care category have been met with an encouraging consumer response. Performance of personal care continues to be steady, aided by new variant launches and increased distribution.

Non-FMCG businesses - a mixed bag. While revenue growth for paper business was a tad lower at 10%, better product mix led to 18% EBIT growth and 190bp y/y margin expansion. Agri business had a steady quarter with 13% revenue and 15% EBIT growth. The hotel division, however, had a weak quarter with just 4% sales and 9% EBIT growth driven by flat occupancy level growth and low single digit growth in ARR's.

ITC Limited (Reuters: ITC.BO, Bloomberg: ITC IN)

Rs in mn, year-end Mar	FY10A	FY11A	FY12E	FY13E	FY14E
Revenue (Rs mn)	181,532	211,676	245,252	284,681	328,741
Net Profit (Rs mn)	40,610.0	49,876.1	58,958.9	68,101.9	79,296.7
EPS (Rs)	5.28	6.41	7.58	8.75	10.19
Revenue growth (%)	16.3%	16.6%	15.9%	16.1%	15.5%
EPS growth (%)	22.2%	21.4%	18.2%	15.5%	16.4%
ROE	29.2%	33.2%	34.9%	35.4%	35.8%
P/E (x)	38.6	31.8	26.9	23.3	20.0
EV/EBITDA (x)	23.9	20.1	17.2	14.5	12.3
Dividend Yield	0.9%	2.4%	2.5%	2.5%	3.1%

Source: Company data, Bloomberg, J.P. Morgan estimates.

See page 10 for analyst certification and important disclosures, including non-US analyst disclosures.

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Overweight

ITC.BO, ITC IN

Price: Rs204.00

Price Target: Rs217.00

India

Consumer, Retail, Media

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Regional Consumer

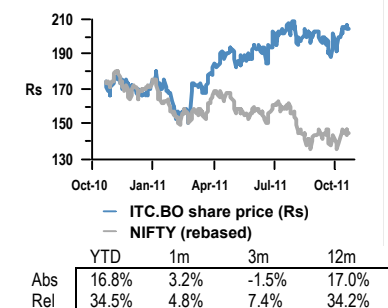
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Price Performance



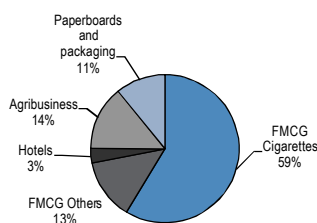
Company Data

Shares O/S (mn)	7,773
Market cap (Rs mn)	1,585,700
Market cap (\$ mn)	31,698
Price (Rs)	204.00
Date Of Price	21 Oct 11
3mth Avg daily volume	8,549,029.00
3M - Avg daily Value (\$ mn)	34.21
NIFTY	5,050
Fiscal Year End	Mar

Company Description

ITC is India's largest cigarette company with about 73% volume share and 85%+ value share. Cigarettes account for 45% of net sales and 83% of EBIT. ITC also operates other non-tobacco businesses such as hotels, paper, retailing, consumer products, and agri exports.

Net Revenue break-up – FY11



Source: Company data.

EPS: J.P. Morgan vs. consensus

Rs Mn	J. P. Morgan	Consensus
FY12E	7.6	7.6
FY13E	8.8	9.1

Source: Bloomberg and J.P. Morgan estimates.

P&L sensitivity metrics

	EBITDA impact (%)	EPS impact (%)
Cigarette volume growth assumption		
Impact of each 1% increase	1%	1%
Cigarette price growth assumption		
Impact of each 1% increase	2.5%	2.5%

Source: J.P. Morgan estimates.

Price target and valuation analysis

We maintain our sum-of-the-parts based Sep-12 target price of Rs217 for the stock. Our target EV/EBITDA multiple for the cigarette division is 13x, in line with the benchmark to global tobacco multiples adjusted for growth.

	Methodology	Multiple (X)	Per Share
Cigarettes	EV/EBITDA	13.0x	141
FMCG	EV/Sales	3.0x	31
Hotel	EV/EBITDA	13.0x	10
Paper	EV/EBITDA	7.0x	14
Agri	EV/EBITDA	6.0x	7
EV			204
Net Cash			13
Equity Value			217

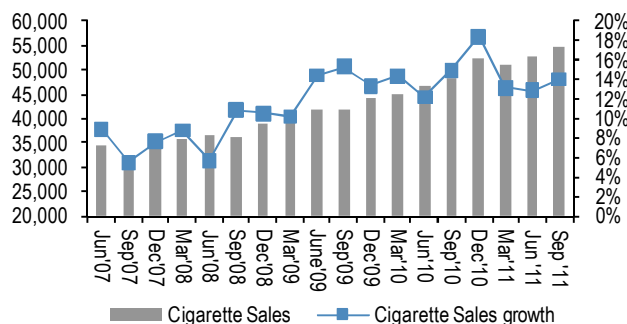
Key downside risks to our earnings and PT are substantial decline in volume growth for cigarettes, any business diversification that is substantially dilutive of earnings and any legislative changes that impact cigarette demand.

Cigarettes – robust volume and EBIT growth trends maintained

Revenue growth of the cigarettes division at 14% y/y during 2QFY12 was marginally ahead of our expectations. Sales growth was led by an estimated 7-8% volume growth, implying price/mix growth of ~6%. Better realisations and lower excise payout led to 120bp y/y expansion in EBIT margins and a healthy 19% EBIT growth. Product mix improvement continued with premium cigarettes growing at a faster rate vs. mass brands. We expect healthy volume growth (~6-7%) and EBIT growth in FY12E to be supported by reasonable price increases (6%) for cigarettes.

Figure 1: Cigarette sales and growth trends

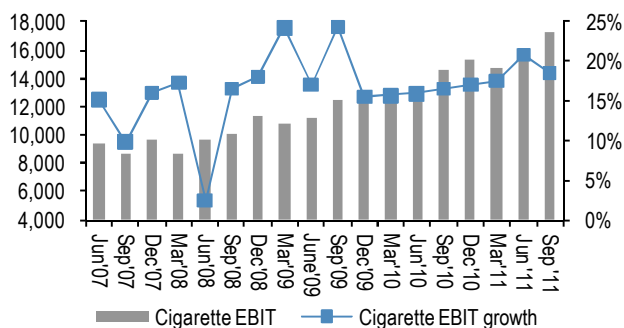
Rs in mn, %



Source: Company reports.

Figure 2: Cigarette EBIT and growth trends

Rs in mn, %



Source: Company reports.

Other FMCG: profitability continues to improve

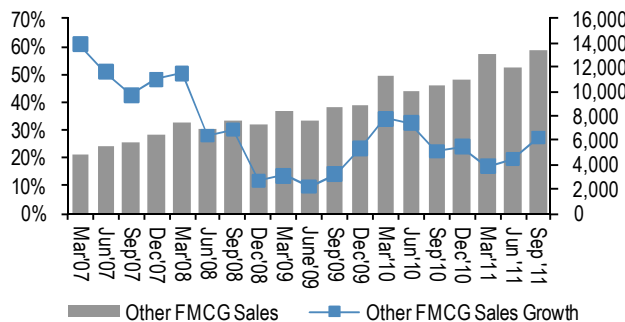
Other FMCG division's revenues grew 27% y/y during Q2FY12 driven by healthy sales performance of branded packaged foods (supported by price increases), and education business. The branded packaged foods sub-segment also improved profitability, driven by better realizations, improved product mix, and better cost management actions. Biscuits portfolio benefited from increased premiumization and addition of new cream biscuit variants under the "Sunfeast" brand. Distribution expansion also supported higher growth for instant noodles during the quarter.

Performance of personal care continues to be steady, aided by new variant launches and increased distribution. ITC's skin care portfolio was introduced into more markets. Management also reported that launch of talc in select markets has been well received.

While sales growth was healthy for other FMCG, importantly EBIT losses for this division declined 16% y/y. EBIT losses as a percentage of sales were lower 220bp y/y supported by scale benefits, price increases and mix benefits. This improvement came despite firm input costs and expenses related to new launches.

Figure 3: Other FMCG sales and growth trends

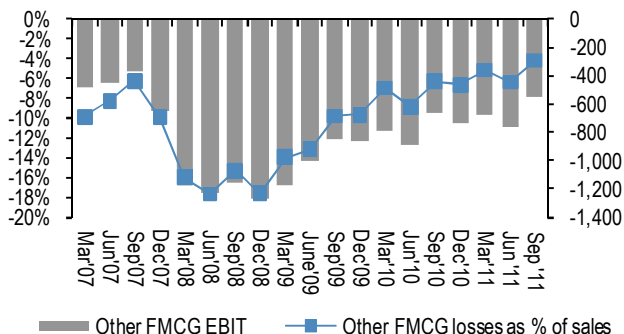
Rs in mn, %



Source: Company reports.

Figure 4: Other FMCG EBIT trends

Rs in mn, %



Source: Company reports.

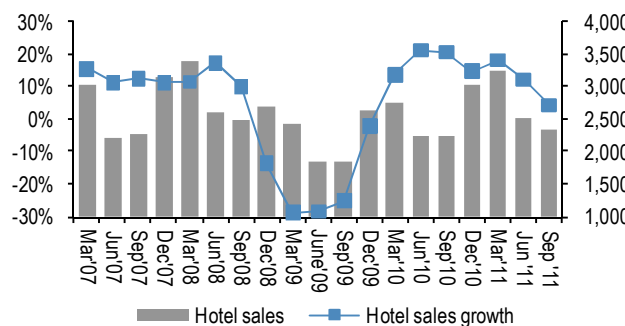
Hotels – weak performance; expansion plans on track

Hotels division saw weak revenue growth at 4% y/y and EBIT growth of 9% y/y. Flat occupancy levels y/y (mid-60s) and low single digit improvement in ARRs on account of a weak macro environment led to poor performance of the hotel division during the quarter.

The company mentioned that their capacity expansion plans in Chennai (expected to be operational by FY12E), Kolkata (to be operational by FY13E/FY14E), and Gurgaon (to be operational by FY1E3/FY14E) are on track.

Figure 5: Hotel sales and growth trends

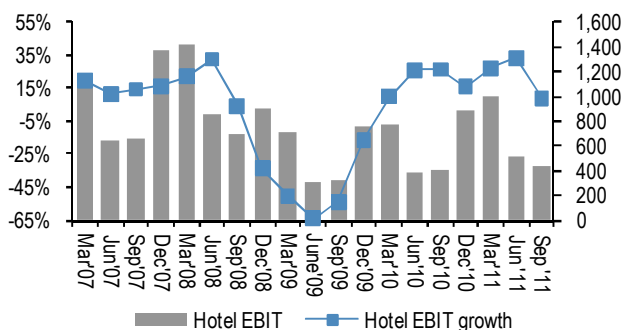
Rs in mn, %



Source: Company reports.

Figure 6: Hotel EBIT and growth trends

Rs in mn, %



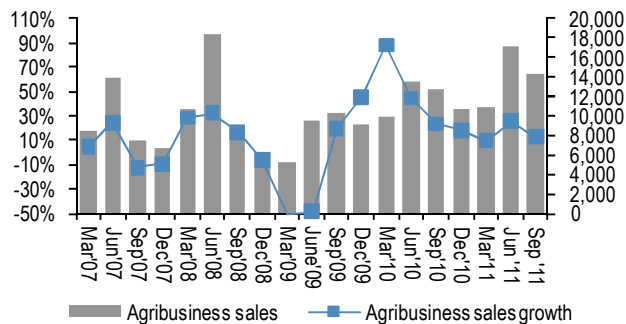
Source: Company reports.

Agri business – a steady quarter

Agri business reported steady top-line growth of 13% during 2QFY12. Strong revenue growth was driven by higher trading volumes and improved realisations in soya, wheat and coffee. This is a seasonally strong quarter, given higher share of high-margin leaf tobacco exports. EBIT margins improved by 30bps y/y to 16.6%.

Figure 7: Agri-business sales and growth trends

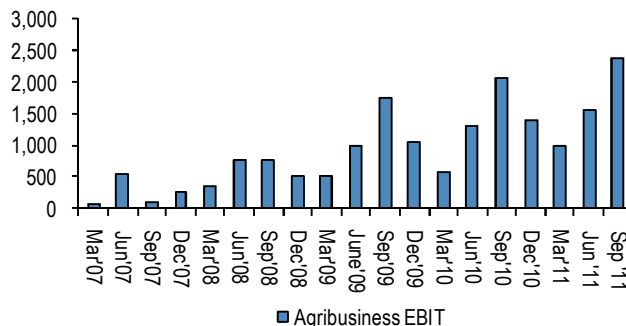
Rs in mn, %



Source: Company reports.

Figure 8: Agri-business EBIT trends

Rs in mn



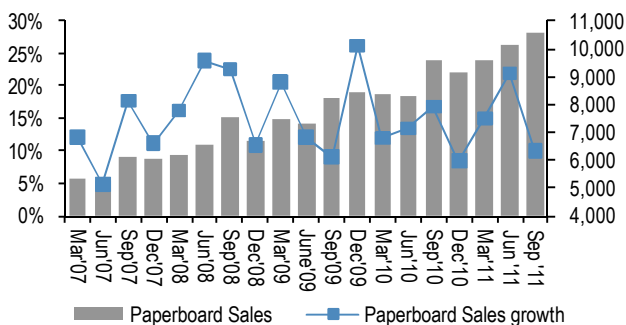
Source: Company reports.

Paper: weaker volume growth; capacity expansion to support growth

Sales growth at 10% y/y was a tad lower than expectations, though much of this was on account of better mix/realisations. Favorable mix, however, led to a 190bp y/y expansion in margins and 18% y/y EBIT growth. With new capacity additions by the end of FY12, revenue growth trends should likely pick up.

Figure 9: Paperboard sales and growth trends

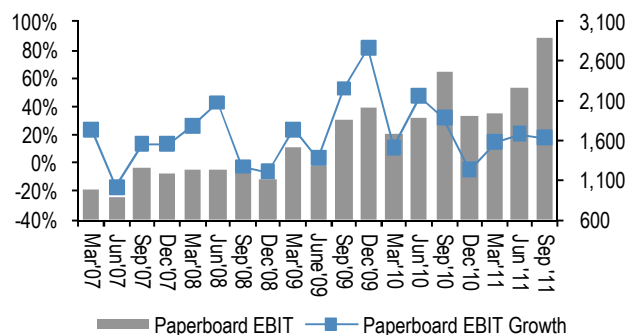
Rs in mn, %



Source: Company reports.

Figure 10: Paperboard EBIT and growth trends

Rs in mn, %



Source: Company reports.

2QFY12 results – a snapshot

Table 1: ITC - 2QFY12 Quarterly P&L

	Sep'10	Sep'11	Y/Y	Q/Q
Gross Income	76,019	88,414	16%	5%
Net Sales Turnover	50,835	59,742	18%	4%
Change in Stock	(2,112)	(398)		
Raw Materials/ Packaging	20,722	23,590	25%	1%
Staff Cost	2,612	2,650	1%	-33%
Other Expenditure	11,732	12,821	9%	8%
Total Expenditure	32,955	38,662	17%	0%
EBITDA	17,880	21,080	18%	12%
Other Income	2,167	2,918	35%	23%
Depreciation	1640	1701	4%	2%
EBIT	18,407	22,297	21%	14%
Interest	106	142	33%	18%
PBT	18,300	22,155	21%	14%
Current Tax	5,833	7,012	20%	16%
Deferred Tax				
PAT	12,467	15,143	21%	13%
Margin				
EBITDA Margin	35.2%	35.3%		
Net Margin	24.5%	25.3%		
% of Sales				
Cost of Goods	36.6%	38.8%		
Staff Cost	5.1%	4.4%		
Others	23.1%	21.5%		
Tax as % of PBT	31.9%	31.6%		

Source: Company reports.

Table 2: ITC - Segment wise quarterly results (2QFY12)

Rs mn

Segment Revenues	Sep'10	Sep'11	Y/Y	Q/Q
FMCG Cigarettes	48,104	54,860	14%	4%
FMCG Others	10,577	13,453	27%	12%
Total FMCG	58,681	68,312	16%	6%
Hotels	2,247	2,343	4%	-7%
Agri Business	12,719	14,345	13%	-16%
Paper and Packaging	9,596	10,554	10%	4%
Others Total	24,562	27,242	11%	-8%
Total Segment Revenue	83,244	95,555	15%	1%
Less: Inter segment Revenue	9,400	10,059	7%	-18%
Total Sales	73,844	85,495	16%	4%

Segment EBIT				
FMCG Cigarettes	14,582	17,289	19%	10%
FMCG Others	(669)	(559)	-16%	-27%
Total FMCG	13,913	16,730	20%	12%
Hotels	399	434	9%	-15%
Agri Business	2,076	2,388	15%	52%
Paper and Packaging	2,456	2,897	18%	28%
Others Total	4,931	5,719	16%	31%
Total EBIT	18,845	22,449	19%	16%
EBIT Margin				
FMCG Cigarettes	30.3%	31.5%		
FMCG Others	-6.3%	-4.2%		
Total FMCG	23.7%	24.5%		
Hotels	17.7%	18.5%		
Agri Business	16.3%	16.6%		
Paper and Packaging	25.6%	27.4%		
Others Total	20.1%	21.0%		
Total EBIT	22.6%	23.5%		

Source: Company reports.

ITC Limited: Summary of Financials

Income Statement						Cash flow statement					
Rs in millions, year end Mar	FY10	FY11	FY12E	FY13E	FY14E	Rs in millions, year end Mar	FY10	FY11	FY12E	FY13E	FY14E
Revenues	181,532	211,676	245,252	284,681	328,741	EBIT	59,062	70,497	82,806	96,649	112,457
% change Y/Y	16.3%	16.6%	15.9%	16.1%	15.5%	Depr. & amortization	6,087	6,560	6,765	8,238	9,393
EBITDA	65,149	77,057	89,571	104,887	121,850	Change in working capital	2,914	52	-1,556	-3,133	-3,501
% change Y/Y	24.6%	18.3%	16.2%	17.1%	16.2%	Taxes	19,900	21,957	26,987	32,048	37,316
EBIT	59,062	70,497	82,806	96,649	112,457	Cash flow from operations	46,418	52,642	64,168	73,207	85,189
% change Y/Y	26.2%	19.4%	17.5%	16.7%	16.4%	Capex	-10,916	-12,734	-15,016	-16,190	-16,771
EBIT Margin	32.5%	33.3%	33.8%	34.0%	34.2%	Disposal/(purchase)	29	81	-	-	-
Net Interest	-648	-481	-481	-481	-481	Net Interest	-648	-481	-481	-481	-481
Earnings before tax	60,153	72,682	85,946	100,150	116,613	Other	24,177	-4,526	0	0	0
% change Y/Y	24.7%	20.8%	18.3%	16.5%	16.4%	Free cash flow	35,502	39,908	49,152	57,017	68,418
Tax	-19,543	-22,806	-26,987	-32,048	-37,316	Equity raised/(repaid)	-	-	-	-	-
as % of EBT	32.5%	31.4%	31.4%	32.0%	32.0%	Debt raised/(repaid)	-82	-105	0	-	-
Net income (reported)	40,610.0	49,876.1	58,958.9	68,101.9	79,296.7	Other	3,615	4,816	-	-	-
% change Y/Y	24.4%	22.8%	18.2%	15.5%	16.4%	Dividends paid	13,965	38,182	39,829	40,277	49,227
Shares outstanding	7,692	7,783	7,783	7,783	7,783	Beginning cash	29,765	54,963	62,346	72,333	89,074
EPS (reported)	5.28	6.41	7.58	8.75	10.19	Ending cash	54,834	61,401	71,668	89,074	108,265
% change Y/Y	22.2%	21.4%	18.2%	15.5%	16.4%	DPS	1.82	4.91	5.12	5.18	6.33
Balance sheet						Ratio Analysis					
Rs in millions, year end Mar	FY10	FY11	FY12E	FY13E	FY14E	Rs in millions, year end Mar	FY10	FY11	FY12E	FY13E	FY14E
Cash and cash equivalents	54,963	62,346	72,333	89,074	108,265	EBITDA margin	35.9%	36.4%	36.5%	36.8%	37.1%
Accounts receivable	8,581	9,076	10,751	12,479	14,411	Operating margin	33.5%	34.6%	35.2%	35.4%	35.6%
Inventories	45,491	52,675	60,473	70,195	81,060	Net margin	22.4%	23.6%	24.0%	23.9%	24.1%
Others	15,945	17,656	18,712	18,712	18,712	Sales per share growth	14.1%	15.2%	15.9%	16.1%	15.5%
Current assets	124,979	141,753	162,270	190,461	222,448	Sales growth	16.3%	16.6%	15.9%	16.1%	15.5%
LT investments	13,569	15,633	15,633	15,633	15,633	Net profit growth	24.4%	22.8%	18.2%	15.5%	16.4%
Net fixed assets	91,514	96,785	105,036	112,988	120,366	EPS growth	22.2%	21.4%	18.2%	15.5%	16.4%
Total Assets	230,062	254,171	282,939	319,083	358,447	Interest coverage (x)	100.62	160.10	186.10	217.92	253.17
Liabilities						Net debt to equity	-38.3%	-38.5%	-39.9%	-42.7%	-45.4%
Short-term loans	-	-	-	-	-	Sales/assets	0.85	0.87	0.91	0.95	0.97
Payables	34,441	43,821	51,738	60,056	69,351	Assets/equity	1.35	1.31	1.58	1.55	1.52
Others	46,050	41,807	43,528	43,528	43,528	ROE	29.2%	33.2%	34.9%	35.4%	35.8%
Total current liabilities	80,491	85,628	95,266	103,584	112,879	ROCE	42.1%	46.7%	48.7%	49.9%	50.5%
Long-term debt	1,077	992	992	992	992						
Other liabilities	7,850	8,019	8,019	8,019	8,019						
Total Liabilities	89,418	94,638	104,277	112,595	121,890						
Shareholders' equity	140,644	159,533	178,663	206,488	236,557						
BVPS	18.28	20.50	22.96	26.53	30.39						

Source: Company reports and J.P. Morgan estimates.

JPM Q-Profile

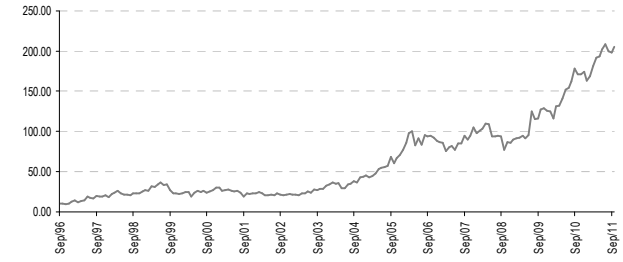
ITC Ltd. (INDIA / Consumer Staples)

As Of: 21-Oct-2011

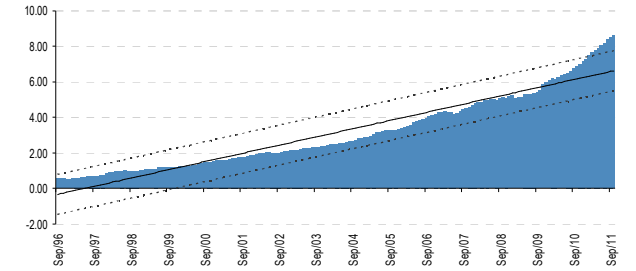
Global Equity Quantitative Analysis

Quant_Strategy@jpmorgan.com

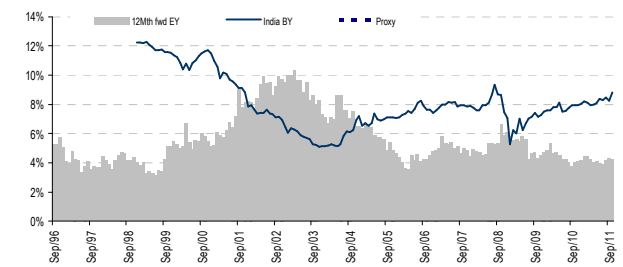
Local Share Price Current: **205.20**



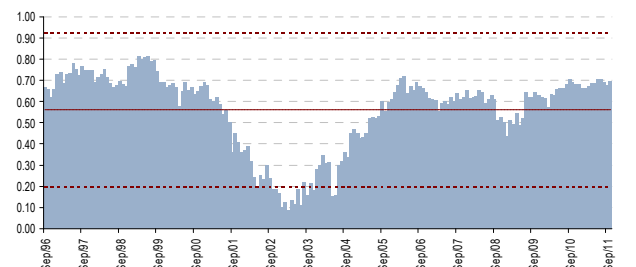
12 Mth Forward EPS Current: **8.62**



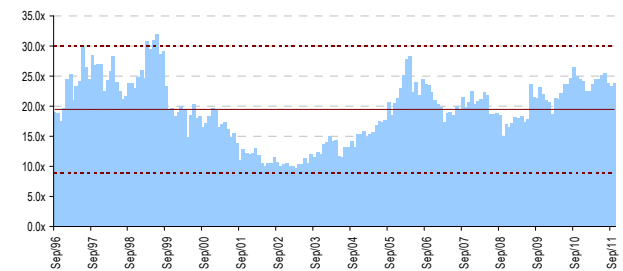
Earnings Yield (& local bond Yield) Current: **4%**



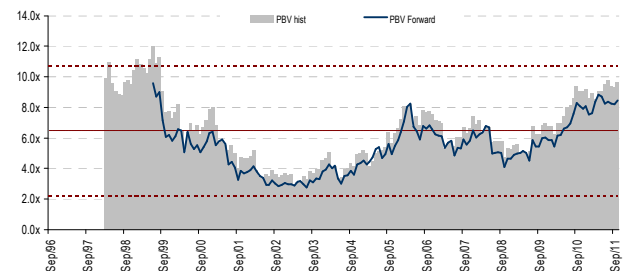
Implied Value Of Growth* Current: **69.56%**



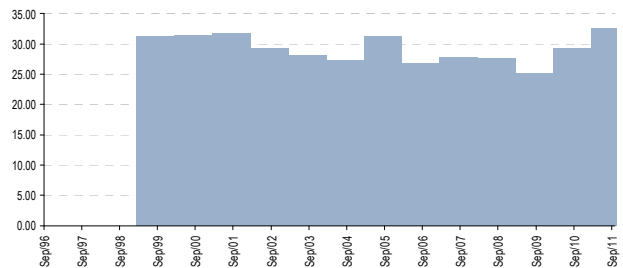
PE (1Yr Forward) Current: **23.8x**



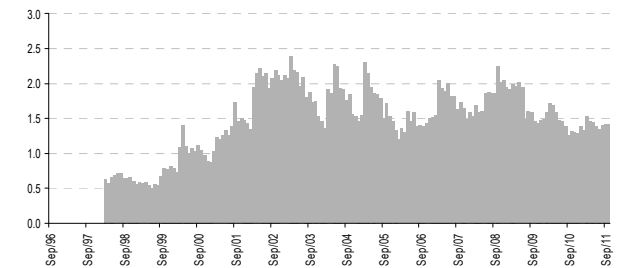
Price/Book Value Current: **9.6x**



ROE (Trailing) Current: **32.46**



Dividend Yield (Trailing) Current: **1.41**



Summary

ITC Ltd.		SEDOL		B0JGGP5		As Of:		21-Oct-11			
INDIA						Local Price:		205.20			
Consumer Staples						EPS:		8.62			
	Latest	Min	Max	Median	Average	2 S.D.+	2 S.D. -	% to Min	% to Max	% to Med	% to Avg
12mth Forward PE	23.79x	9.71	31.96	19.66	19.44	29.95	8.93	-59%	34%	-17%	-18%
P/BV (Trailing)	9.65x	2.89	12.03	6.34	6.50	10.77	2.23	-70%	25%	-34%	-33%
Dividend Yield (Trailing)	1.41	0.50	2.39	1.50	1.49	2.43	0.55	-65%	69%	6%	5%
ROE (Trailing)	32.46	25.27	32.46	29.26	29.09	33.39	24.80	-22%	0%	-10%	-10%
Implied Value of Growth	69.6%	0.09	0.81	0.62	0.56	0.93	0.20	-87%	17%	-10%	-19%

Source: Bloomberg, Reuters Global Fundamentals, IBES CONSENSUS, J.P. Morgan Calcs

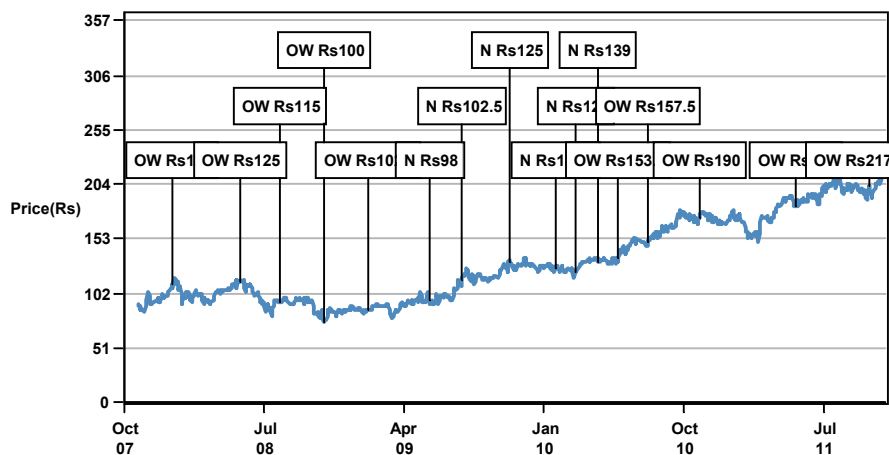
* Implied Value Of Growth = (1 - EY/Cost of equity) where cost of equity = Bond Yield + 5.0% (ERP)

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- **Lead or Co-manager:** J.P. Morgan acted as lead or co-manager in a public offering of equity and/or debt securities for ITC Limited within the past 12 months.
- **Client:** J.P. Morgan currently has, or had within the past 12 months, the following company(ies) as clients: ITC Limited.
- **Client/Investment Banking:** J.P. Morgan currently has, or had within the past 12 months, the following company(ies) as investment banking clients: ITC Limited.
- **Investment Banking (past 12 months):** J.P. Morgan received in the past 12 months compensation for investment banking ITC Limited.
- **Investment Banking (next 3 months):** J.P. Morgan expects to receive, or intend to seek, compensation for investment banking services in the next three months from ITC Limited.

ITC Limited (ITC.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
02-Jan-08	OW	110.55	120.00
15-May-08	OW	113.15	125.00
31-Jul-08	OW	94.15	115.00
26-Oct-08	OW	74.50	100.00
19-Jan-09	OW	85.88	102.50
23-May-09	N	94.90	98.00
24-Jul-09	N	114.88	102.50
25-Oct-09	N	130.10	125.00
24-Jan-10	N	124.55	132.50
02-Mar-10	N	120.98	127.00
14-Apr-10	N	131.38	139.00
23-May-10	OW	134.03	153.50
23-Jul-10	OW	148.85	157.50
31-Oct-10	OW	171.85	190.00
08-May-11	OW	183.60	209.00
29-Sep-11	OW	202.25	217.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Jan 02, 2008.

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.

J.P. Morgan ratings: OW = Overweight, N= Neutral, UW = Underweight

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Limited (HLL.BO), ITC Limited (ITC.BO), Nestlé India Limited (NEST.BO), Pantaloon Retail (India) Ltd (PART.BO), Titan Industries Limited (TITN.BO), United Spirits Limited (UNSP.BO), Zee Entertainment Enterprises (ZEE.BO)

J.P. Morgan Equity Research Ratings Distribution, as of September 30, 2011

	Overweight (buy)	Neutral (hold)	Underweight (sell)
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IB clients*	51%	44%	33%
JPMS Equity Research Coverage	45%	47%	7%
IB clients*	70%	60%	52%

*Percentage of investment banking clients in each rating category.

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