



ITC

STOCK INFO.	BLOOMBERG
BSE SENSEX: 19,243	ITC IN
	REUTERS CODE
S&P CNX: 5,702	ITC.BO

26 October 2007

Buy

Rs181

Previous Recommendation: Buy

	YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/	
	END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA	
Equity Shares (m)	3,762.2											
52-Week Range	195/140											
1,6,12 Rel. Perf. (%)	-16/-23/-53	03/07A	123,693	27,000	7.2	18.4	25.2	6.5	25.9	35.4	5.2	16.2
M.Cap. (Rs b)	680.2	03/08E	141,244	30,783	8.2	14.0	22.1	5.7	25.8	35.7	4.5	14.2
M.Cap. (US\$ b)	17.1	03/09E	171,013	35,593	9.5	15.6	19.1	5.0	26.1	36.3	3.6	11.9

- For 2QFY08, ITC reported sales of Rs32.7b, as against our estimate of Rs33.2b, and PAT was Rs7.7b as against our estimates of Rs7.8b. Other income increased from Rs795m to Rs2,083m due to Rs200m increase in dividend from subsidiaries, Rs250m as interest on income tax refunds and higher yields on mutual fund and debt instruments.
- Cigarette volumes degrew 4%, which was in line with our estimates. Cigarette business reported 5.1% increase in net sales and 9.8% increase in PBIT, as PBIT margins expanded 100bp. Management has guided for improvement in volumes in the coming quarters.
- Agri business reported 14.7% decline in sales and 78% decline in PBIT, as the company had to sell pulses, maize and bajra purchased from e-Choupal for exports in the domestic market at lower rates due to policy interventions. Paper and Paperboards reported 17.7% increase in sales and 13.3% increase in PBIT as margins declined 80bp. Commissioning of 1,20,000 pulp capacity in November 2007 and 1,00,000 TPA paper facility in 1QFY09 will boost volumes and profits in FY09.
- New FMCG businesses were the star performers with 43% increase in sales and 25% lower losses as PBIT margins improved 580bp. Biscuits, atta, and confectionary grew 54%, 44% and 33% respectively. Bingo has attained over 10% market share while the product has been rolled out in less than 50% of the markets. Management expects the food products to turn profitable either by 4QFY08 or 1QFY09.
- ITC has launched personal care products under Fiana Di Wills and Superia brands targeted at premium and popular segments respectively; more launches are likely. We have increased other income estimates from Rs3.8b to Rs4.8b and tax rate by 50bp. Our EPS estimate stands at Rs8.2 for FY08 and Rs9.5 for FY09. The stock trades at 19.1x FY09E earnings. Maintain **Buy** with SOTP-based target price of Rs207, an upside of 14.5%.

QUARTERLY PERFORMANCE										(Rs Million)	
Y/E MARCH	FY07				FY08				FY07	FY08E	
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			
Net Sales	28,498	28,876	31,656	34,663	33,252	32,734	35,850	39,408	123,693	141,244	
YoY Change (%)	25.7	32.3	23.8	24.5	16.7	13.4	13.2	13.7	26.3	14.2	
Total Exp	18,792	19,149	20,828	25,360	21,977	22,414	23,900	28,198	84,129	96,489	
EBITDA	9,706	9,727	10,828	9,303	11,276	10,320	11,950	11,210	39,564	44,755	
Margins (%)	34.1	33.7	34.2	26.8	33.9	31.5	33.3	28.4	32.0	31.7	
Depreciation	876	910	921	922	1,010	1,062	1,080	1,182	3,629	4,334	
Interest	7	35	-9	-1	-8	9	12	12	33	25	
Other Income	849	795	698	1,023	1,016	2,083	765	943	3,365	4,806	
PBT	9,672	9,578	10,614	9,404	11,289	11,331	11,623	10,959	39,267	45,202	
Tax	3,149	2,782	3,440	2,897	3,461	3,623	3,725	3,611	12,267	14,420	
Rate (%)	32.6	29.0	32.4	30.8	30.7	32.0	32.0	33.0	31.2	31.9	
Reported PAT	6,523	6,796	7,174	6,507	7,829	7,709	7,898	7,347	27,000	30,783	
YoY Change (%)	16.8	18.7	23.2	14.7	20.0	13.4	10.1	12.9	20.8	14.0	
Adjusted PAT	6,523	6,796	7,174	6,507	7,829	7,709	7,898	7,347	27,000	30,783	
YoY Change (%)	21.1	18.7	33.6	14.7	20.0	13.4	10.1	12.9	18.4	14.0	

E: MOSt Estimates

SEGMENT-WISE PERFORMANCE (YOY %)

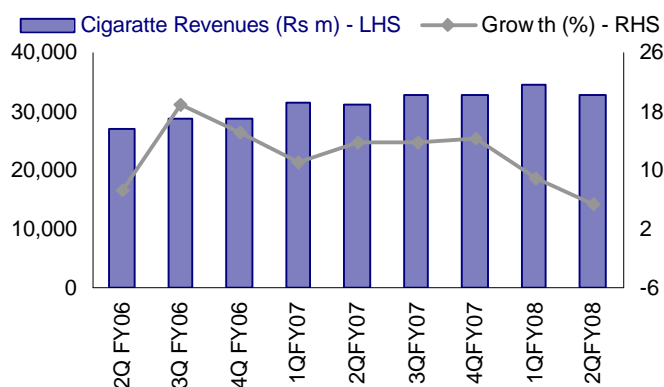
ITC - SEGMENTAL	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08
Sales Growth (% YoY)								
Cigarettes	19.1	15.1	11.1	13.9	13.8	14.3	8.9	5.5
FMCG - Others	71.2	75.7	79.6	65.9	67.6	63.1	50.8	43.3
Hotels	31.4	45.5	35.3	30.5	28.5	15.6	11.3	12.5
Agri business	63.1	55.8	47.4	86.6	19.5	15.5	27.6	-14.7
Paper and packaging	25.3	15.5	8.8	11.1	11.0	12.2	4.9	17.7
EBIT Margin								
Cigarettes	22.4	24.4	25.8	25.4	25.3	22.5	27.3	26.4
FMCG - Others	-39.4	-27.3	-16.2	-12.0	-10.6	-9.7	-8.2	-6.2
Hotels	31.4	20.0	29.0	28.8	42.0	38.5	29.0	29.2
Agri business	0.5	4.8	4.2	5.3	2.8	0.9	3.8	1.3
Paper and packaging	13.1	19.4	20.9	21.2	19.2	18.2	16.5	20.5

Source: Company/Motilal Oswal Securities

Cigarettes – VAT imposition impact still unclear

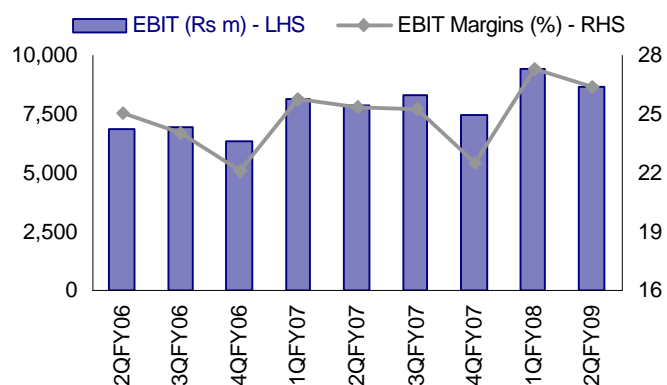
Cigarette volumes degrew 4%, which was in line with our estimates. Cigarette business reported 5.1% increase in net sales and 9.8% increase in PBIT, as PBIT margins expanded 100bp. Just 4% decline in cigarette volumes despite more than 20% price increase shows consumer resilience in a booming economy. 2QFY08 depicted the full impact of VAT, UP trade tax and excise increase. The management has guided for improvement in volumes in the coming quarters. The health ministry has given December 1 as the deadline for implementing pictorial warnings on cigarettes, but the matter is pending before a group of ministers. If implemented, these can impact the short term growth rates for cigarettes but the impact is not likely to be significant as 70% of cigarettes are sold in loose form. Our estimates factor in 3% volume decline in FY08 and 5% volume growth in FY09.

CIGARETTE - STRONG GROWTH MOMENTUM CONTINUES



Source: Company/Motilal Oswal Securities

CIGARETTE – STEADY MARGIN EXPANSION



Source: Company/Motilal Oswal Securities

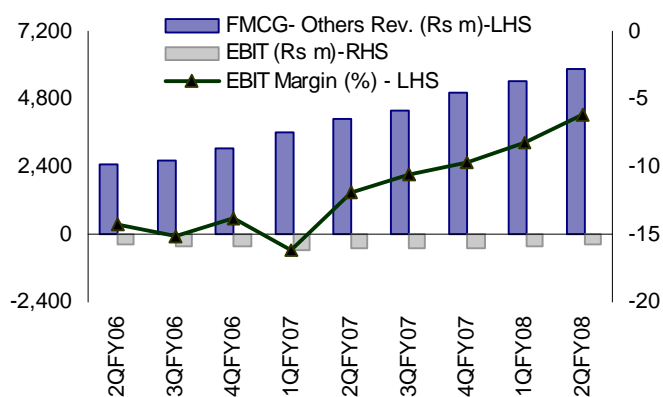
Processed food continues to power other FMCG businesses

Other FMCG businesses grew 43.1% YoY during 2QFY08. PBIT margin during the quarter was -6.2%, a 580bp improvement on YoY basis. Management has indicated strong growth momentum in the processed foods business as the sales have increased 58% YoY. Biscuits have grown 54%, atta 44% and confectionary 33%. ITC has achieved 10% market share in high growth salty snacks segment with its Bingo range of potato chips. The product is likely to emerge as a major growth driver as it is yet to be rolled out in 50% of the target markets. Aashirvaad atta was further strengthened with the launch of MP Blend Atta and Aashirvaad Select Organic Spice. ITC launched Mint-O Fresh Cool Green' and 'Candyman Mango Licks' in the confectionary segment. Management expects the processed foods segment to turn profitable by 4QFY08 or 1QFY08.

Lifestyle retailing: Sales during the quarter grew over 52% on YoY basis. All the major lifestyle brands like ‘Classic’, ‘Wills Sport’ & ‘Wills Clublife’ maintained growth momentum, driven by consumer franchisee expansions. The company increased the Wills Lifestyle and John Players exclusive outlets to 200 and 170 respectively. The business continued to post significant improvements in several operating parameters such as average realizations, footfalls/conversion and sell through rates. The company in collaboration with some leading Indian designers introduced the ‘Wills Signature range’ in select Wills lifestyle stores.

ITC enters personal care: ITC has entered the personal care segment in both the premium and mass markets. The company has launched Fiama Di Wills’ shampoos in four variants and body washes in three variants. In addition, the company has launched Superia brand of toilet soaps and shampoos in the mass segment in select markets of Orissa and Andhra Pradesh. The products have been introduced after extensive research of more than four years and assistance of American product formulation and fragrance experts. The company will be competing with Proctor & Gamble and Hindustan Unilever Ltd (HUL) in the premium shampoos (Pantene and Dove) and Dove and Palmolive in the body wash category. In the mass market, the competition will come from HUL and Godrej Consumer Products Ltd in the soaps category. Although some of the categories like toilet soaps and shampoos are large in size but ITC will have to face competition with some of the best marketers globally. Management has indicated that any concrete response can be judged only after 2-3 months of launch.

OTHER FMCG - GROWTH MOMENTUM CONTINUES WITH REDUCED LOSSES



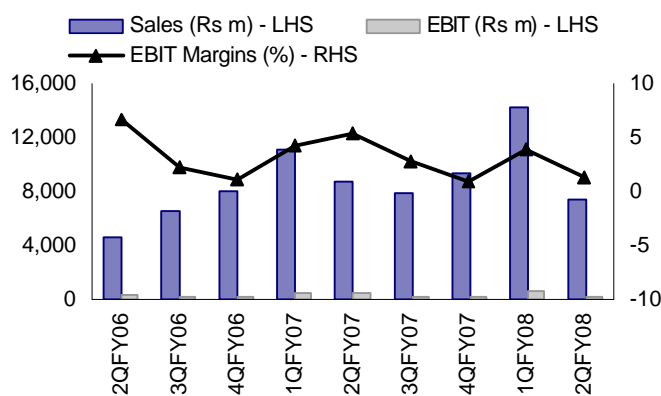
Source: Company/Motilal Oswal Securities

Agri business hit; e-Choupal enters second stage of ramp up

Agri business reported 14.7% decline in sales and 78% decline in PBIT, as the company had to sell pulses, maize and bajra purchased from e-Choupal for exports in the domestic market due to policy intervention of GoI. The sale at prices lower than procurement prices led to decline in profitability. We estimate that the company suffered a loss of Rs400m due to this. Management believes this loss is one time in nature and the performance is expected to be back on track from next quarter.

The e-Choupal network was further ramped up during the quarter to 6,500 installations while number of Choupal Sagars was increased to 19. The company guided for 25-26 Choupal Sagars by the end of current year. e-Choupal initiative is entering second phase of ramp up with focus on horticulture as against the first phase which had its focus on hard grains. This, we believe, gels with the Choupal Fresh initiative and growth of cold chain in the country. The company has tied up with Food Bazaar and Trumart for horticulture, which augurs well for exploiting the huge potential in this segment. We expect these initiatives to pay off in the long term only.

SEASONAL TREND IN AGRI-BUSINESS



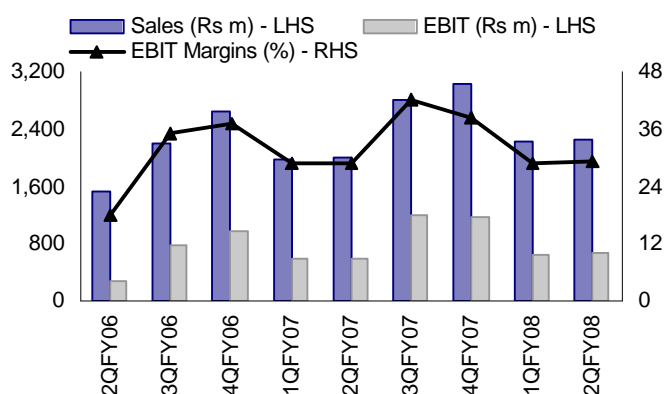
Source: Company/Motilal Oswal Securities

Hotel – steady growth continues

Hotel business reported 12.5% increase in topline in 2QFY08 and 14.2% increase in PBIT. Sales growth was primarily driven by an increase in ARR (average revenue

per room) as the head room for increasing the occupancy levels is limited. Food and beverage sales also contributed to growth. The company has moved away from dual policy of rupee and dollar denominated charges, and the charges will be denominated in rupee only. This will insulate the losses due to currency fluctuations. The progress on new properties at Bangalore and Chennai is in line with schedule and the company acquired land for another property in Hyderabad. Management indicated that while Kolkata and Mumbai markets are strong, Bangalore is showing some softening of ARR. We expect this business to report steady growth up to 15% in the coming quarters.

HOTEL – STEADY GROWTH CONTINUES



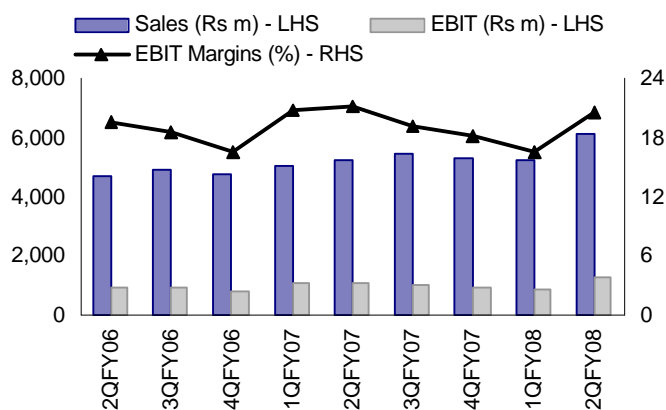
Source: Company/Motilal Oswal Securities

Paperboards and Paper - richer sales mix boosts margin

The paper business reported 17.7% increase in sales and 13.3% increase in PBIT as margin declined 80bp. However, on QoQ basis, margin improved 360bp. This was driven by the stabilization of the paperboard machine at Bhadrachalam after its rebuild and growth in sales of Value Added Paperboard. Increase in sales was also due to inventory re-stocking as the de-stocking in the cigarette packing business had materialized in view of impending implementation of pictorial warnings from June. Rapid progress is being made in completion of the capacity

augmentation projects – a new paper machine and an additional pulp mill, both at Bhadrachalam. The pulp mill with a capacity of 1,20,000 tons of hardwood pulp is expected to start commercial production from January 2008. It will provide a distinct cost advantage apart from removing the dependency on imported hardwood pulp, which has seen an unprecedented run up in prices. The paper machine will augment capacity by about 1,00,000 TPA from 1QFY09 and will drive growth with strong forward linkages with the stationery business. We expect this SBU to report acceleration in sales and profit growth from FY09 as new units start contributing.

PAPER AND PAPER BOARDS - IMPROVING EBITDA MARGINS



Source: Company/Motilal Oswal Securities

We believe that the growth story in ITC is intact. Cigarette volumes have shown considerable resilience after VAT imposition and price increases. Paper and new FMCG business are likely to report increase in sales growth and profitability after a couple of quarters. We expect agri business to bounce back in the coming quarter while hotels will grow steadily. We have increased other income estimates from Rs3.8b to Rs4.8b and tax rate by 50bp. Our EPS estimate stands at Rs8.2 for FY08 and Rs9.5 for FY09. Then stock trades at 19.1x FY09E earnings. Maintain **Buy** with SOTP-based target price of Rs207, an upside of 14.5%.

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

- ✎ ITC entered the salty snacks market, with its *Bingo* range of potato chips and finger snacks
- ✎ ITC Welcomgroup entered into an agreement with Starwood Hotels & Resorts to bring in its premium brand, *The Luxury Collection* to India.
- ✎ Branded Packaged Foods business expanded with rollout of variants like *Mango Natkhat*, *Maha Mango*, *Sunfeast Benne Vita* pasta in four variants.

Valuation and view

- ✎ We have EPS forecasts of Rs8.2 for FY08 and Rs9.5 for FY09.
- ✎ ITC is currently trading at 22.1x FY08E EPS and 19.1x FY09E EPS. We maintain **Buy**.

Sector view

- ✎ We have a cautious view on the sector on the back of inflationary tendency in the economy, which might impact volumes as well as profit margins of companies.
- ✎ Companies with low competitive pressures and broad product portfolios will be able to better withstand any slowdown in a particular segment.
- ✎ Longer-term prospects are bright, given rising incomes and low penetration.

COMPARATIVE VALUATIONS

		ITC	HLL	NESTLE
P/E (x)	FY08E	22.1	26.7	24.8
	FY09E	19.1	22.3	20.0
EV/EBITDA (x)	FY08E	14.2	23.5	15.0
	FY09E	11.9	20.3	12.3
EV/Sales (x)	FY08E	4.5	3.3	3.1
	FY09E	3.6	2.8	2.7
P/BV (x)	FY08E	5.7	16.4	16.9
	FY09E	5.0	15.3	15.3

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	0.0	0.0	0.0
Domestic Inst	37.7	37.6	36.8
Foreign	47.1	46.9	47.7
Others	15.2	15.5	15.5

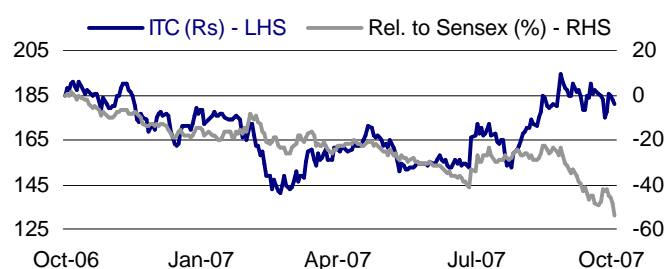
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	8.2	8.1	0.6
FY09	9.5	9.6	-1.2

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
181	207	14.5	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
Net Sales	76,395	97,905	123,693	141,244	171,013	
Change (%)	18.5	28.2	26.3	14.2	21.1	
Total Expenditure	-48,438	-64,578	-84,129	-96,489	-118,794	
EBITDA	27,957	33,327	39,564	44,755	52,219	
Change (%)	18.2	19.2	18.7	13.1	16.7	
Margin (%)	36.6	34.0	32.0	31.7	30.5	
Depreciation	-3,129	-3,323	-3,629	-4,334	-4,854	
Int. and Fin. Charges	-508	-211	-33	-25	-20	
Other Income - Recurring	2,411	2,899	3,365	4,806	4,920	
Profit before Taxes	26,731	32,692	39,267	45,202	52,265	
Change (%)	15.3	22.3	20.1	15.1	15.6	
Margin (%)	35.0	33.4	31.7	32.0	30.6	
Tax	-7,879	-10,584	-12,267	-15,098	-17,457	
Deferred Tax	-481	696	0	678	784	
Tax Rate (%)	-31.3	-30.2	-31.2	-31.9	-31.9	
Profit after Taxes	18,371	22,804	27,000	30,783	35,593	
Change (%)	15.4	24.1	18.4	14.0	15.6	
Margin (%)	24.0	23.3	21.8	21.8	20.8	
Non-rec. (Exp)/Income	3,543	-450	0	0	0	
Reported PAT	18,371	22,353	27,000	30,783	35,593	

BALANCE SHEET		(RS MILLION)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
Share Capital	2,482	3,755	3,762	3,762	3,762	
Reserves	76,474	86,860	100,609	115,544	132,398	
Net Worth	78,956	90,615	104,371	119,307	136,160	
Loans	2,454	1,197	2,009	2,009	2,009	
Deferred Liability	3,761	3,248	4,729	5,222	5,808	
Capital Employed	85,171	95,060	111,108	126,537	143,976	
Gross Block	57,463	62,272	71,343	83,343	93,343	
Less: Accum. Depn.	-17,955	-20,654	-23,895	-28,229	-33,083	
Net Fixed Assets	39,508	41,617	47,448	55,114	60,260	
Capital WIP	1,862	2,434	8,661	8,000	6,000	
Investments	38,747	35,170	30,678	36,968	47,713	
Curr. Assets, L&A	35,393	51,619	62,897	69,250	80,883	
Inventory	20,030	26,363	33,540	38,323	46,185	
Account Receivables	5,278	5,480	6,367	6,578	7,496	
Cash and Bank Balance	557	8,558	9,002	9,379	10,587	
Others	9,529	11,218	13,988	14,970	16,614	
Curr. Liab. and Prov.	30,338	35,781	38,576	42,794	50,879	
Account Payables	18,920	21,484	23,434	25,327	30,355	
Other Liabilities	2,171	2,674	3,478	3,922	4,507	
Provisions	9,247	11,622	11,664	13,545	16,018	
Net Current Assets	5,055	15,838	24,321	26,456	30,004	
Application of Funds	85,171	95,060	111,108	126,537	143,976	

E: MOST Estimates

RATIOS						
Y/E MARCH	2005	2006	2007	2008E	2009E	
Basic (Rs)						
EPS	4.9	6.1	7.2	8.2	9.5	
Cash EPS	5.7	7.0	8.1	9.3	10.8	
BV/Share	210	24.1	27.7	31.7	36.2	
DPS	2.0	2.6	3.1	3.6	4.3	
Payout %	419	43.7	43.2	44.0	45.0	
Valuation (x)						
P/E		29.8	25.2	22.1	19.1	
Cash P/E		26.0	22.2	19.4	16.8	
EV/Sales		6.5	5.2	4.5	3.6	
EV/EBITDA		19.1	16.2	14.2	11.9	
P/BV		7.5	6.5	5.7	5.0	
Dividend Yield (%)		15	17	2.0	2.4	
Return Ratios (%)						
RoE	23.3	25.2	25.9	25.8	26.1	
RoCE	32.0	34.6	35.4	35.7	36.3	
Working Capital Ratios						
Debtor (Days)	25	20	19	17	16	
Asset Turnover (x)	0.9	1.0	1.1	1.1	1.2	
Leverage Ratio						
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0	

CASH FLOW STATEMENT		(RS MILLION)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
OP/(loss) before Tax	24,828	30,004	35,935	40,421	47,365	
Int./Div. Received	2,411	2,899	3,365	4,806	4,920	
Depreciation and Amort.	3,129	3,323	3,629	4,334	4,854	
Interest Paid	-508	-211	-33	-25	-20	
Direct Taxes Paid	-7,879	-10,584	-12,267	-15,098	-17,457	
(Incr)/Decr in WC	-5,311	-2,782	-8,040	-1,757	-2,339	
Deff Tax	2,884	-513	1,481	494	586	
CF from Operations	19,554	22,136	24,070	33,175	37,909	
(Incr)/Decr in FA	-8,777	-5,382	-15,299	-11,339	-8,000	
(Pur)/Sale of Investments	-8,207	3,577	4,492	-6,290	-10,745	
CF from Invest.	-16,985	-1,804	-10,805	-17,628	-18,743	
Issue of Shares	872	650	424	0	0	
(Incr)/Decr in Debt	1,245	-1,256	812	0	0	
Dividend Paid	-8,792	-11,347	-13,645	-15,847	-18,739	
Exceptional Income	3,543	-450	0	0	0	
Others	780	72	-411	677	782	
CF from Fin. Activity	-2,352	-12,331	-12,821	-15,170	-17,957	
Incr/Decr of Cash	217	8,001	444	377	1,208	
Add: Opening Balance	340	557	8,558	9,002	9,379	
Closing Balance	557	8,558	9,002	9,379	10,587	

N O T E S



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	ITC
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

This information is subject to change without any prior notice. MOST reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOST is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.