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Result Update- Q4FY08

ITC Ltd. (CMP: Rs. 209) May 27, 2008

Q4FY08 Results Review

We had initiated coverage on ITC Ltd. on March 31st 2008 at a price of Rs.206 with an add recommendation at Rs.185-192 and a price target of Rs.235. The stock rose to Rs.232.4 on March 21st 2008 and is currently quoting at Rs.209. We present an update on the stock after the Q4FY08 results:

14.7% Sales growth, PAT grows by 15.6%:

- Net Sales grew by 14.7% in FY08 to Rs.13947 cr as against Rs.12164 cr in FY07. This is attributable to strong resilience shown by the cigarettes with a growth of 7.7%, 47.3% growth in the FMCG business, hotels revenue by 11.6%, paper by 12.6% and agri business by 4.8%. Other income was higher by 81% to Rs.610.9cr.
- The OPM in FY08 has dipped by 94 bps to 31.58%, which was primarily due to the higher contribution from low margin business and higher losses from the FMCG business. The EBIT margin in the cigarettes segment has improved by 160 bps to 26.3%, which is due to increase in the selling price of most of the brands by an average of 20%. The major drag had been the FMCG business where expenses have been on the higher side due to increased branding activity and launch of personal care products.

	Rs crore		% y-o-y growth	PBIT Margins (%)		Favourable Change in bps
	FY08	FY07		FY08	FY07	
FMCG - cigarettes	13825.6	12833.7	7.7%	26.3%	24.7%	160
FMCG - others	2511.05	1704.3	48.6%	-10.5%	-12.0%	-
Hotels	1100.2	985.6	11.6%	37.3%	35.6%	170
Agri-business	3868.4	3691.3	10.5%	3.34%	3.53%	-20
Paperboards, paper & packaging	2364.3	2100.0	12.6%	19.2%	19.8%	-60
Total	**23669.6**	**21110.2**	12.1%	18.4%	18.3%	10

- Interest cost stood at Rs.4.61 cr for the FY08 whereas the depreciation was higher by 20.8% at Rs.438cr due to the commissioning of the new pulp mill (Capacity: 100000 TPA). Net profit has increased by 15.6% to Rs.3120 cr, which was slightly above our expectations resulting into an EPS of Rs.8.34.

Cigarettes Business

Despite the imposition of a 12.5% value-added tax (VAT), a 5% increase in the excise duty and a 33.5% trade tax in Uttar Pradesh (till Dec, 2007), the volume dip in cigarette has been restricted to 1% in FY08, which is quite commendable. The net realization in the cigarette segment had not been affected due to an average 20% increase in prices per pack from March 2007. But with the duty increase in the non-filter segment (announced in the Union budget 2008-2009), which has been substantial, an equivalent price hike would now prove detrimental and ITC had decided to stop the production in this segment. We believe that the impact on ITC's profitability in the business would be minimal as the non-filter cigarettes account for only 20% of its sales volumes. We expect ITC (with about 80% market share in filter cigarettes) to capture a large volume shift from its competitor's non-filter cigarettes and also shift its non-filter business to low priced filter category.

Non Cigarette FMCG business

The Branded Packaged Foods business continued to expand rapidly with sales growing by 57% over the previous year. Bingo in its first year of launch has been able to garner double-digit market share in the Rs.2000 cr salty snack category. Two of its brands Aashirvaad and Sunfeast have reached up to almost Rs.1000 cr of retail sales each. The biscuit category continued its growth momentum with sales growing by 53%. In the staples category, 'Aashirvaad' further built on its leadership position with revenues growing by 43%. The confectionary category recorded robust sales with revenues growing by 40% over last year mainly driven by 'Deposited Mint' and 'Eclairs'. In the Ready- to-Eat (RTE) group, 'Sunfeast PastaTreat' and 'Aashirvaad Instant Mixes' have grown more than 100%.

The Lifestyle Retailing business continued to show strong growth, both in the premium and popular segments of the branded apparel market. Domestic sales grew by 26% over the previous year, while exports registered a growth of 17%.

With the strategy of aggressively scaling up the FMCG initiatives, the Personal Care business was initiated during the year with the launch of a range of shampoos, soaps, shower gels and conditioners under the brand names of 'Fiama Di Wills', 'Vivel Di Wills', 'Vivel' and 'Superia'.

Hotels

In the hotel segment, with the current properties working at peak occupancies, the 11.6% growth in the topline was driven by improved REVPAR and stellar performance of the F&B segment. This has also helped it to maintain its EBIT margins at 37.3%. This segment reported sales of Rs.1100 cr as against Rs.985 cr. The results would have been even more impressive but for the adverse impact of the strengthening rupee in the first half of fiscal 2007/08. The business resorted to rupee billing from September 2007 onwards as an insurance against rupee appreciation. The 280-room Bangalore property is expected to get operational by Q4FY09.

Paperboards, speciality paper and packaging

With the recent commissioning of the new pulp mill, the pulp capacity at the Bhadrachalam unit has increased by 1 lac ton per annum leading to a total capacity of 2.22 lac tons per annum and will enable the business to mitigate the impact of escalations in prices of hardwood pulp.

The incremental pulp capacity is adequate to support the requirements of the new paper machine, which is at an advanced stage of commissioning at the Bhadrachalam unit. This machine, with a capacity of 1 lac TPA, will service the growing demand of value added printing and writing paper and is expected to commence commercial production by the middle of 2008.

Agri-business

The business is progressively aligning its commodity portfolio with the sourcing needs of ITC's Foods Business to generate higher order value from its agri procurement infrastructure. The business commenced procurement of potatoes, one of the critical raw materials in the manufacture of the Company's 'Bingo!' brand of potato chips. The acquisition of Technico, an Australian company with technology leadership in the production of early generation seed potatoes, helped the business access a ready pipeline of new high-yielding varieties of potato seeds.

The leaf tobacco business achieved a new high in tobacco exports for the 3rd consecutive year, and despite the sharp appreciation of the rupee, recorded a 21% increase in export revenues over the previous year. In volume terms, exports for the year stood at 62 million Kgs., representing a 27% growth. The business continued to provide strategic sourcing support to the company's cigarette business. Around 60% of the leaf tobacco procured is for captive consumption, while 100% of the wheat procured is used by its bakery and staples business.

Recommendation:

With healthy cash flows, ITC has a strong business model with multiple revenue streams. ITC has proved its entrepreneurial mettle in seeding new ventures and nurturing them in the right direction so as to derisk its business model from the vagaries of cigarettes business. At the current price of Rs.209, the stock is trading at price/earnings ratio (PER) of 21.6X FY2009E EPS of Rs.9.65. We maintain our buy recommendation with an add recommendation at Rs.191 and a price target of Rs.235.

Result Table:

In cr	FY08	FY07	YOY
Net Sales	13947.53	12164.29	14.7
Other Income	610.9	336.49	81.6
Total Income	14558.43	12500.78	16.5
Raw Material Consumed	6022.39	5390.67	11.7
Stock Adjustment	-5.69	-195.89	-97.1
Employee Expenses	733.32	630.15	16.4
Other Expenses	2793.57	2382.95	17.2
Total Expenditure	9,543.6	8,207.9	16.3
PBIDT	4,403.9	3,956.4	11.3
Interest	4.61	3.28	40.5
Depreciation	438.46	362.92	20.8
PBT	4,571.8	3,926.7	16.4
Tax	1451.67	1226.73	18.3
Reported Profit After Tax	3,120.1	2,699.97	15.6
EPS	8.34	7.22	
PBIDTM (%)	31.58%	32.52%	

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