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ITC

2QFY2010 Result Update

ACCUMULATE

Price	**Rs260**
Target Price	**Rs279**
Investment Period	**12 Months**

Stock Info	
Sector	FMCG
Market Cap (Rs cr)	98,228
Beta	0.5
52 WK High / Low	263/132
Avg Daily Volume	872,116
Face Value (Rs)	1
BSE Sensex	16,811
Nifty	4,997
BSE Code	500875
NSE Code	ITC
Reuters Code	ITC.BO
Bloomberg Code	ITC @IN

Shareholding Pattern (%)	
Promoters	-
MF/Banks/Indian FIs	42.3
FII/ NRIs/ OCBs	46.0
Indian Public	11.7

Abs.	**3m**	**1yr**	**3yr**
Sensex (%)	10.4	72.0	33.2
ITC (%)	13.0	54.0	40.6

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Performance Highlights

- **Except Hotels, all divisions contribute to Top-line growth:** For 2QFY2010, ITC declared a modest Top-line growth of 14.1% yoy to Rs4,293cr (Rs3,763cr) ahead of our estimates of a 9.7% growth to Rs4,129cr. The Cigarette Division, for the quarter, registered 15.3% growth in Gross Revenues (21.4% yoy growth in Net Revenues) on the back of better realisation (price hikes) and improved product mix (up-trading to filter cigarettes). In terms of volumes, we expect ITC registered 5-6% growth for the quarter, marginally ahead of our expectation. Among its other segments, Agri-Business posted strong growth of 19% while the Non-Cigarette FMCG business and Paperboards chipped in a modest 14% and 9% yoy growth, respectively. The Hotels business was the only laggard during the quarter registering a decline of 25.2% yoy.

- **Earnings beat estimates, up 26%:** Earnings for the quarter grew by a robust 25.8% yoy to Rs1,010cr (Rs803cr) significantly ahead of our expectation of 10.9% yoy growth to Rs891cr. The higher-than-anticipated Earnings grew despite the 42.3% dip in Other Income on account of the sharp increase in Margins. We expect the Earnings momentum to continue in the ensuing quarters as well driven by lower losses in the Non-Cigarette FMCG Business, Margin expansion in cigarettes and improved traction in the Hotel Business in 2HFY2010E.

- **Strong Margin expansion across segments:** On the operating front, ITC delivered a strong Margin expansion of 616bp yoy to 35.8% (29.7%) ahead of our estimates, owing to better Margins across segments, except Hotels. While its core Cigarette business and Paperboards registered modest expansion in Margins, lower losses in Non-Cigarette FMCG business and sharp Margin improvement in Agri-business were the key drivers on the operating front. Hence, EBITDA for the quarter registered an impressive growth of 37.8% yoy to Rs1,537cr (Rs1,116cr).

Key Financials

Y/E March (Rs cr)	**FY2008**	**FY2009**	**FY2010E**	**FY2011E**
Net Sales	**13,948**	**15,388**	**17,511**	**19,961**
% chg	*14.7*	*10.3*	*13.8*	*14.0*
Net Profit	**3,120**	**3,264**	**4,039**	**4,711**
% chg	*15.6*	*4.6*	*23.8*	*16.6*
OPM (%)	31.5	31.5	34.2	34.8
EPS (Rs)	**8.3**	**8.6**	**10.7**	**12.5**
P/E (x)	31.4	30.1	24.3	20.8
P/BV (x)	8.1	7.1	6.2	5.3
RoE (%)	25.9	23.8	25.4	25.6
RoCE (%)	30.9	29.0	31.8	32.4
EV/Sales (x)	6.8	6.1	5.3	4.6
EV/EBITDA (x)	21.5	19.4	15.6	13.3

Source: Company, Angel Research

Segment-wise Performance

Cigarette Business – Steady volume growth continues: For the quarter, ITC's Cigarette Division registered 15.3% growth in Gross Revenues (21.4% yoy growth in Net Revenues) on the back of better realisations (price hikes) and improved product mix (up-trading to filter cigarettes). In terms of volumes, we expect ITC registered 5-6% volume growth for the quarter, marginally ahead of our expectation. On the Margin front, ITC registered a sharp 217bp expansion in PBIT Margins at the Gross level (134bp expansion at Net level) in its Cigarette Division to 29.9% aided by price hikes and up-trading to filter cigarettes. ITC's Cigarette volumes have shown impressive resilience to the government ban on cigarette smoking in public places and imposition of pictorial warnings. Hence, **we have modeled in ITC's Cigarette volumes to register 6% and 7% growth (revised marginally upwards) in FY2010E and FY2011E, respectively.**

Non-Cigarette FMCG business – Losses continue to decline: ITC's Non-Cigarette FMCG business registered a modest 14% yoy growth in Revenues to Rs865cr (Rs759cr). However, the Division registered significant moderation in losses to Rs85cr (Rs117cr) yoy and dropped on a sequential basis from Rs100cr in 1QFY2010 due to softening of input costs and increased focus on profitability. **We expect the Division to end FY2010E with losses of Rs373cr (Rs483cr).**

- *Branded Packaged Food Business* – This segment continued to expand with sales growing by 13% yoy during the quarter. The *Bingo* range of snacks further consolidated its position in the Finger Snack platform. The *Sunfeast* range of biscuits continued to improve with enhanced sales of value added variants of cookies and creams, which increased by 31% yoy. The re-launch of *Marie* found wide acceptance with sales increasing sequentially by 85%. In the Staples category, *Aashirvaad* Atta continued to build on its leadership position with sales improving by 11%. The Confectionery category Revenues grew by 23% with enhanced sales of *Eclairs* and wider consumer acceptance of its variants such as *Lactos* and *Tofichoos*. This category also witnessed the launch of *Minto Gol* during the quarter
- *Lifestyle Retailing Business* – The Lifestyle Retailing business is consolidating its market presence in the branded apparel market. The business has successfully restructured its cost base and aligned itself to take advantage of emerging opportunities.
- *Stationery Business* – The Stationery business continued on its impressive growth trajectory with improvement in market standing, emerging as the largest player in the Notebook Segment with a market share of 12%.
- *Personal Care* – The carefully architected portfolio of brands is gaining increasing consumer acceptance. A range of personal care products under the brands *Fiama Di Wills*, *Vivel Di Wills*, *Vivel* and *Superia* addresses identified segments of the market with differentiated value benefits. Adding yet another unique variant to the range of personal care products, the business launched transparent gel bathing bars**. We expect the Personal Care Segment to be one of the key growth drivers for ITC going ahead and expect further launches in the Segment in 2HFY2010.**

Hotel Business – Still a laggard, expect up-tick in 2HFY2010E: ITC's Hotel business continues to remain under pressure due to the economic slowdown. The squeeze on corporate travel along with the steep reduction in foreign arrivals has triggered a significant slide in occupancies and average room rates for the Hotel Sector in India. Thus, ITC's Hotel Revenues for the quarter declined by 25.2% yoy to Rs186cr (Rs249cr). Moreover, EBIT Margins tanked by 1,067bp yoy to 16.9% resulting in a sharp decline in EBIT by 54% to Rs32cr (Rs69cr). ITC Royal Gardenia was soft launched in Bangalore during the quarter. Improvement in occupancies in the last couple of weeks of the quarter seems to provide early signals of recovery in the business**. We believe that the Hotel business will bounce back in 2HFY2010 owing to up-tick in economic activity. Nonetheless, we have modeled in flat growth in Revenues for the Hotel Segment over FY2009-11E.**

Paperboard and Packaging – Sharp improvement in Profitability: The Segment registered modest growth in Revenue of 9% yoy (12.8% at the Net level) to Rs822cr (Rs753cr). Sales of value-added paperboards and paper continued to record strong growth during the quarter, further enriching the product mix. EBIT Margins of the Segment registered a sharp expansion of 643bp to 22.7% driving a robust 52% yoy growth in Segmental EBIT to Rs186cr (Rs122cr). The improvement in profitability was driven by better product mix, lower input costs and significant value capture in pulp mill operations.

Production of paper from the one lakh TPA line and output of the pulp machine reached peak levels. The doubling of pulp capacity following investment in the 'Ozone Bleached' pulp mill has enabled the business to achieve cost competitiveness and create a hedge against any future rise in pulp prices. In the Packaging and Printing business, satisfactory commissioning of investments in flexible and carton lines is augmenting its capability to deliver value-added packaging to key customers in the Consumer Electronics and FMCG industries. **Going forward, we expect the Segment to accelerate momentum (driven by commencement of new units) registering a CAGR of 18.2% in Revenues over FY2009-11E.**

Agri Business – Leaf tobacco portfolio drives profitability: ITC's Agri Business registered a strong 19% yoy growth in Revenues to Rs1,028cr (Rs864cr) despite lower throughput of soya, coffee and spices, driven by the continuing strong performance of the leaf tobacco portfolio. ITC maintained its position as the foremost exporter of leaf tobacco, leveraging the growing demand for Indian tobaccos. Thus, EBIT Margins expanded by 809bp yoy to 16.9% driving a whopping 128% yoy growth in segmental EBIT to Rs174cr (Rs76cr). **We expect the Division to register a CAGR of 5.6% in Revenues over FY2009-11E.**

Exhibit 1: Segment-wise Performance

Y/E March (Rs cr)	2QFY2010	2QFY2009	% chg	1HFY2010	1HFY2009	% chg
Cigarettes	4,183.1	3,628.2	*15.3*	8,343.7	7,264.3	*14.9*
Others	865.3	759.3	*14.0*	1,624.7	1,452.9	*11.8*
Hotels	186.3	249.0	*(25.2)*	372.0	508.4	*(26.8)*
Agri Business	1,028.3	864.1	*19.0*	1,968.9	2,698.6	*(27.0)*
Paperboards & Packaging	821.7	753.3	*9.1*	1,552.3	1,405.0	*10.5*
Less: Inter-segmental Rev	776.1	619.8	*25.2*	1,422.1	1,850.6	*(23.2)*
Total Gross Income	**6,308.6**	**5,634.0**	***12.0***	**12,439.4**	**11,478.6**	***8.4***
Cigarettes	1,251.7	1,006.9	*24.3*	2,377.1	1,968.3	*20.8*
Others	(85.0)	(116.6)		(184.8)	(239.2)	
Hotels	31.6	68.7	*(54.1)*	62.2	154.0	*(59.6)*
Agri Business	174.1	76.4	*127.9*	274.0	152.9	*79.1*
Paperboards & Packaging	186.2	122.2	*52.3*	314.0	245.7	*27.8*
Total PBIT	**1,558.5**	**1,157.7**	***34.6***	**2,842.4**	**2,281.7**	***24.6***
Less: Interest Exp	18.1	2.8		24.0	4.2	
Less: Other Exp	48.3	(34.2)		8.9	(25.5)	
PBT	**1,492.0**	**1,189.1**	***25.5***	**2,809.5**	**2,303.0**	***22.0***
PBIT Margin (%)						
Cigarettes	29.9	27.8		28.5	27.1	
Others	(9.8)	(15.3)		(11.4)	(16.5)	
Hotels	16.9	27.6		16.7	30.3	
Agri Business	16.9	8.8		13.9	5.7	
Paperboards & Packaging	22.7	16.2		20.2	17.5	

Source: Company, Angel Research

Exhibit 2: 2QFY2010 Performance

Y/E March (Rs cr)	2QFY2010	2QFY2009	% chg	1HFY2010	1HFY2009	% chg
Net Sales	**4,292.6**	**3,763.3**	***14.1***	**8,375.3**	**7,663.0**	***9.3***
Consumption of RM	1,717.6	1,548.4	*10.9*	3,339.6	3,352.0	*(0.4)*
(% of Sales)	*40.0*	*41.1*		*39.9*	*43.7*	
Staff Costs	242.0	237.7	*1.8*	524.1	455.8	*15.0*
(% of Sales)	*5.6*	*6.3*		*6.3*	*5.9*	
Other Expenses	795.6	861.2	*(7.6)*	1,637.0	1,612.1	*1.5*
(% of Sales)	*18.5*	*22.9*		*19.5*	*21.0*	
Total Expenditure	**2,755.2**	**2,647.3**	***4.1***	**5,500.8**	**5,419.9**	***1.5***
Operating Profit	**1,537.4**	**1,116.0**	***37.8***	**2,874.5**	**2,243.1**	***28.1***
OPM (%)	*35.8*	*29.7*		*34.3*	*29.3*	
Interest	18.1	2.8	*552.5*	24.0	4.2	*472.3*
Depreciation	148.4	134.0	*10.7*	300.0	260.1	*15.3*
Other Income	121.1	209.8	*(42.3)*	258.9	324.2	*(20.1)*
PBT (excl. Extr Items)	**1,492.0**	**1,189.1**	*25.5*	**2,809.5**	**2,303.0**	*22.0*
Extr Income/(Expense)	-	-		-	-	
PBT (incl. Extr Items)	**1,492.0**	**1,189.1**	***25.5***	**2,809.5**	**2,303.0**	***22.0***
(% of Sales)	*34.8*	*31.6*		*33.5*	*30.1*	
Provision for Taxation	482.1	386.4	*24.8*	920.9	751.6	*22.5*
(% of PBT)	*32.3*	*32.5*		*32.8*	*32.6*	
Reported PAT	**1,009.9**	**802.7**	***25.8***	**1,888.6**	**1,551.4**	***21.7***
PAT Margin (%)	*23.5*	*21.3*		*22.5*	*20.2*	
Equity shares (cr)	378.0	377.0		378.0	377.0	
EPS (Rs)	**2.7**	**2.1**	***25.5***	**5.0**	**4.1**	***21.4***

Source: Company, Angel Research

Outlook and Valuation

Post the impressive 2QFY2010 results we have marginally tweaked our numbers for both FY2010E and FY2011E to factor in superior performance in ITC's core Cigarette business and improved profitability in its Agri business.

Exhibit 3: Revision in Estimates

	Old Estimate		New Estimate		% chg	
(Rs cr)	FY2010E	FY2011E	FY2010E	FY2011E	FY2010E	FY2011E
Revenue	17,272	19,304	17,511	19,961	*1.4*	*3.4*
OPM (%)	*32.5*	*34.0*	*34.2*	*34.8*	*165bp*	*80bp*
EPS (Rs)	10.2	12.0	10.7	12.5	*4.9*	*4.0*

Source: Angel Research

Post the Union Budget (no hike in Excise duty on cigarettes), we have been maintaining that worst is over for ITC in terms of punitive regulatory actions and decline in its Cigarette Volumes (factoring in 6% volume growth for FY2010E). Strong volume growth during the quarter (despite imposition of pictorial warnings and price hikes) has only vindicated our stance. Moreover, moderation of losses in ITC's Non-Cigarette FMCG business, improving profitability in Agri business, pick up in the Paperboard Division (driven by capacity expansion) and better performance by the Hotel Business in 2HFY2010E are likely to improve ITC's growth trajectory over FY2009-11E.

At the CMP of Rs260, the stock is trading at 20.8x FY2011E revised EPS of Rs12.5. **We maintain an Accumulate on the stock with a revised Target Price of Rs279 (Rs255) driven by P/E multiple expansion (22x FY2011E EPS – 10% premium to its historical valuations) on account of better visibility in its core Cigarette Division (no Excise hike) and improved Profitability.**

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	Reduce (-5% to -15%)	Sell (< -15%)	