

ITC

**Bloomberg: ITC IN Equity**  
**Reuters: ITC.BO**
**BUY****RESULT UPDATE**

## Encouraging earnings performance

**3QFY11 earnings positively surprised with both topline and net earnings about 4% ahead of expectations. Most of the surprise was contributed by cigarette division which reported positive volume growth of approximately 2% and improvement in mix. Non-cigarette business performance was marginally below expectations largely because of paper business which was faced with production disruptions of cigarette business. We retain our BUY rating on the stock with a Sep 2011 target price of Rs 200.**

Cigarette business performance has consistently shown improvement in the last three quarters and this is encouraging. Some of the recent price increase announced in tandem with normalization of trends are ahead of expectations and we have factored this into our estimates. We expect the business should report volume growth of 4% for FY12-13E.

Non-cigarette business performance after several quarters was marginally below expectations. Much of the disappointment, however, was from the paper business which had to cope with production disruptions of cigarette business. Hotel, Agri and FMCG business performances were encouraging especially on the margin front.

**Outlook:** Normalization of cigarette business performance and higher than expected pricing trends should help the cigarette business post earnings ahead of our previous expectations. In case of non-cigarette business we expect positive trends to resume and this should help in sustaining overall earnings growth momentum.

**Valuation and recommendation:** Considering the encouraging performance and improved outlook we have raised our estimates by 4%. Our target price implies a forward P/E multiple of 24x and EV/EBITDA multiple of 15x and is also consistent with our sum of the parts approach.

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### Recommendation

|                                  |              |
|----------------------------------|--------------|
| CMP:                             | Rs169        |
| <b>Target Price (Sept 2011):</b> | <b>Rs200</b> |
| Previous TP:                     | Rs200        |
| <b>Upside (%)</b>                | <b>18</b>    |
| EPS (FY12E):                     | Rs7.7        |
| Change from previous (%)         | 4            |
| Variance from consensus (%)      | 1            |

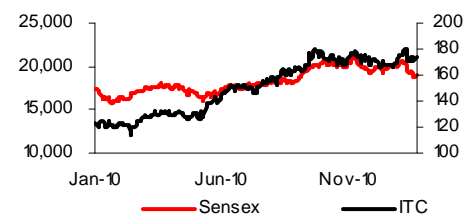
### Stock Information

|             |                        |
|-------------|------------------------|
| Mkt cap:    | Rs1,303bn/US\$28,564mn |
| 52-wk H/L:  | Rs185/112              |
| 3M ADV.:    | Rs1,285mn/US\$28mn     |
| Beta:       | 0.5x                   |
| BSE Sensex: | 19,151                 |
| Nifty:      | 5,743                  |

### Stock Performance (%)

|                | 1M    | 3M    | 12M  | YTD   |
|----------------|-------|-------|------|-------|
| Absolute       | (0.5) | (1.2) | 38.7 | (3.2) |
| Rel. to Sensex | 4.1   | 3.8   | 25.1 | 3.4   |

### Performance (%)



Source: Bloomberg, Ambit Capital research

### Exhibit 1: Key financials

| Year to January          | FY09    | FY10    | FY11E   | FY12E   | FY13E   |
|--------------------------|---------|---------|---------|---------|---------|
| Operating income (Rs mn) | 153,880 | 181,531 | 213,682 | 248,470 | 286,877 |
| EBITDA (Rs mn)           | 52,021  | 64,733  | 78,671  | 94,336  | 111,955 |
| Adjusted PAT (Rs mn)     | 32,636  | 40,610  | 49,867  | 59,333  | 70,443  |
| Adjusted EPS (Rs)        | 4.3     | 5.3     | 6.5     | 7.7     | 9.1     |
| RoE (%)                  | 23%     | 28%     | 33%     | 32%     | 31%     |
| P/E (x)                  | 39.1    | 31.6    | 26.1    | 22.0    | 18.5    |
| EV/EBITDA (x)            | 26.6    | 20.8    | 17.3    | 13.7    | 11.3    |

Source: Company, Ambit Capital research

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**Exhibit 2: Aggregate Quarterly Earnings Performance**

|                    | Dec'08 | Mar'09 | Jun'09 | Sep'09 | Dec'09 | Mar'10 | Jun'10 | Sep'10 | Dec'10 |
|--------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Gross Income       | 59,172 | 58,586 | 61,309 | 64,297 | 68,689 | 72,957 | 71,722 | 75,725 | 82,186 |
| Net Sales Turnover | 38,331 | 38,918 | 41,329 | 42,926 | 45,319 | 50,538 | 48,166 | 50,612 | 54,535 |
| Operating Profit   | 13,525 | 12,627 | 13,873 | 15,901 | 17,077 | 16,180 | 16,371 | 18,749 | 20,293 |
| EBIDTA             | 14,754 | 13,505 | 14,749 | 16,586 | 18,668 | 16,772 | 17,356 | 19,994 | 22,223 |
| PAT                | 9,080  | 8,090  | 8,787  | 10,099 | 11,442 | 10,282 | 10,703 | 12,467 | 13,891 |
| <b>Margins</b>     |        |        |        |        |        |        |        |        |        |
| EBIDTA             | 24.9%  | 23.1%  | 24.1%  | 25.8%  | 27.2%  | 23.0%  | 24.2%  | 26.4%  | 27.0%  |
| Net                | 15.3%  | 13.8%  | 14.3%  | 15.7%  | 16.7%  | 14.1%  | 14.9%  | 16.5%  | 16.9%  |
| <b>Growth</b>      |        |        |        |        |        |        |        |        |        |
| Gross Income       | 7.8%   | -2.5%  | 2.9%   | 10.0%  | 16.1%  | 24.5%  | 17.0%  | 17.8%  | 19.6%  |
| Net Sales          | 10.8%  | -1.1%  | 6.0%   | 14.1%  | 18.2%  | 29.9%  | 16.5%  | 17.9%  | 20.3%  |
| Operating Profit   | 12.7%  | 20.9%  | 23.1%  | 30.8%  | 26.3%  | 28.1%  | 18.0%  | 17.9%  | 18.8%  |
| EBIDTA             | 10.3%  | 11.8%  | 18.8%  | 25.1%  | 26.5%  | 24.2%  | 17.7%  | 20.5%  | 19.0%  |
| PAT                | 9.3%   | 10.0%  | 17.4%  | 25.8%  | 26.0%  | 27.1%  | 21.8%  | 23.5%  | 21.4%  |

Source: Company, Ambit Capital research

**Exhibit 3: Divisional Quarterly Earnings Performance**

|                               | Dec'08 | Mar'09 | Jun'09 | Sep'09 | Dec'09 | Mar'10 | Jun'10 | Sep'10 | Dec'10 |
|-------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| <b>Segment Revenues</b>       |        |        |        |        |        |        |        |        |        |
| Cigarettes                    | 39,015 | 39,493 | 41,606 | 41,831 | 44,225 | 45,168 | 46,697 | 48,104 | 52,363 |
| Others                        | 18,927 | 19,214 | 19,703 | 21,254 | 22,389 | 26,419 | 23,879 | 25,516 | 27,290 |
| Total                         | 57,943 | 58,707 | 61,309 | 63,086 | 66,614 | 71,587 | 70,576 | 73,621 | 79,653 |
| <b>Segment EBIT</b>           |        |        |        |        |        |        |        |        |        |
| Cigarettes                    | 11,341 | 10,814 | 11,254 | 12,517 | 13,098 | 12,512 | 13,050 | 14,582 | 15,330 |
| Others                        | 1,253  | 1,588  | 1,585  | 3,069  | 2,958  | 2,266  | 2,608  | 4,210  | 3,475  |
| Total                         | 12,594 | 12,401 | 12,839 | 15,585 | 16,056 | 14,779 | 15,658 | 18,792 | 18,805 |
| <b>Segment Revenue Growth</b> |        |        |        |        |        |        |        |        |        |
| Cigarettes                    | 10.5%  | 10.2%  | 14.4%  | 15.3%  | 13.4%  | 14.4%  | 12.2%  | 15.0%  | 18.4%  |
| Others                        | 3.9%   | -15.1% | -10.8% | 6.0%   | 18.3%  | 37.5%  | 21.2%  | 20.1%  | 21.9%  |
| Total                         | 8.3%   | 0.4%   | 4.9%   | 12.0%  | 15.0%  | 21.9%  | 15.1%  | 16.7%  | 19.6%  |
| <b>Segment Margin Growth</b>  |        |        |        |        |        |        |        |        |        |
| Cigarettes                    | 18.0%  | 24.3%  | 17.1%  | 24.3%  | 15.5%  | 15.7%  | 16.0%  | 16.5%  | 17.0%  |
| Others                        | -42.9% | -14.0% | -2.5%  | 103.4% | 136.1% | 42.7%  | 64.5%  | 37.2%  | 17.5%  |
| Total                         | 6.7%   | 17.6%  | 14.2%  | 34.6%  | 27.5%  | 19.2%  | 22.0%  | 20.6%  | 17.1%  |
| <b>Segment Margins</b>        |        |        |        |        |        |        |        |        |        |
| Cigarettes                    | 29.1%  | 27.4%  | 27.0%  | 29.9%  | 29.6%  | 27.7%  | 27.9%  | 30.3%  | 29.3%  |
| Others                        | 6.6%   | 8.3%   | 8.0%   | 14.4%  | 13.2%  | 8.6%   | 10.9%  | 16.5%  | 12.7%  |
| Total                         | 21.7%  | 21.1%  | 20.9%  | 24.7%  | 24.1%  | 20.6%  | 22.2%  | 25.5%  | 23.6%  |

Source: Company, Ambit Capital research

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## Explanation of Investment Rating

| Investment Rating | Expected return<br>(over 12-month period from date of initial rating) |
|-------------------|---|
| Buy               | >15%  |
| Hold              | 5% to 15%   |
| Sell              | <5%   |

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