



ITC

STOCK INFO.	BLOOMBERG
BSE SENSEX: 13,024	ITC IN
	REUTERS CODE
S&P CNX: 3,769	ITC.BO

30 October 2006

Buy

Previous Recommendation: Buy

Rs188

Equity Shares (m)	3,755.2
52-Week Range	213/115
1,6,12 Rel. Perf. (%)	-5/-16/-9
M.Cap. (Rs b)	704.1
M.Cap. (US\$ b)	15.3

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
03/06A	97,905	22,803	6.1	24.1	30.9	7.8	25.2	34.6	6.8	19.9
03/07E	122,081	27,535	7.3	20.8	25.6	6.8	26.4	36.6	5.4	16.8
03/08E	145,191	32,939	8.8	19.6	21.4	5.8	27.3	38.0	4.5	13.9

- 2QFY07 revenues grew 32.3% due to strong growth across product segments. PAT for 2QFY07 increased by 18.7% YoY as margins expanded in the following businesses - Cigarettes, Hotels and Paperboard.
- Cigarette revenues grew 13.9% YoY to Rs31.0b driven by 8% volume growth. Other FMCG business grew 65.9% YoY to Rs4.09b. Hotels grew 31% YoY to Rs2.01b; Agri-and-Paper business grew 86.6% and 11.1% YoY respectively.
- 1QFY07 EBITDA margins declined 370bp YoY as sales contribution of loss-making and low-margin New FMCG and Agri business increased by 740bp to 25%.
- We expect the company to maintain strong growth in the coming quarters due to strong business momentum in Paper and Hotels. We are revising our cigarette volume growth estimates to 8% for FY07 and 7% for FY08. In addition, we expect FMCG Others to turnaround to get delayed to FY09 due to rising material costs and aggressive brand building initiatives as well as expected breakeven period of 2 years for Choupal Sagar.
- We are reducing our FY07 EPS estimates to Rs7.3 from Rs7.5 while maintaining FY08 EPS at Rs8.8. The stock is currently trading at 25.6x FY07E EPS and 21.4x FY08E EPS. We maintain **Buy**.

QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Sales	22,669	21,832	25,560	27,845	28,498	28,876	31,695	33,012	97,905	122,081
YoY Change (%)	24.7	22.2	37.5	27.9	25.7	32.3	24.0	18.6	28.2	24.7
Total Exp	14,401	13,633	16,777	19,768	18,792	19,149	21,600	23,301	64,579	82,841
EBITDA	8,268	8,198	8,783	8,077	9,706	9,727	10,095	9,712	33,326	39,240
Margins (%)	36.5	37.6	34.4	29.0	34.1	33.7	31.9	29.4	34.0	32.1
Depreciation	-801	-830	-831	-862	-876	-910	-900	-916	-3,323	-3,602
Interest	-11	3	-15	-188	-7	-35	-6	23	-211	-25
Other Income	845	781	489	785	849	795	900	1,179	2,899	3,723
PBT	8,301	8,152	8,426	7,811	9,672	9,578	10,089	9,998	32,691	39,336
Tax	-2,718	-2,429	-2,603	-2,138	-3,149	-2,782	-3,050	-2,820	-9,888	-11,801
Rate (%)	32.7	29.8	30.9	27.4	32.6	29.0	30.2	28.2	30.2	30.0
Reported PAT	5,583	5,723	5,823	5,674	6,523	6,796	7,039	7,177	22,803	27,535
YoY Change (%)	20.1	17.3	24.8	35.9	16.8	18.7	23.0	23.3	24.1	20.8
Extraordinary Inc/(Exp)	195	0	454	4	0	0	0	0	450	0
Adjusted PAT	5,388	5,723	5,368	5,670	6,523	6,796	7,039	7,177	22,353	27,535
YoY Change (%)	15.9	17.3	15.0	-26.5	21.1	18.7	23.0	33.7	2.0	23.2

E: MOSSt Estimates

ITC - SEGMENTAL

	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07
Sales Growth % (YoY)					
Cigarettes	7.2	19.1	15.1	11.1	13.9
FMCG - Others	87.1	71.2	75.7	79.6	65.9
Hotels	27.1	31.4	45.5	35.3	30.5
Agri business	15.5	63.1	55.8	47.4	86.6
Paper and packaging	21.9	25.3	15.5	8.8	11.1
EBIT Margin					
Cigarettes	25.1	24.1	22.1	25.8	25.4
FMCG - Others	-14.3	-15.1	-13.9	-16.2	-12.0
Hotels	17.9	35.0	37.1	29.0	28.8
Agri business	6.6	2.3	1.1	4.2	5.3
Paper and packaging	19.5	18.7	16.5	20.9	21.2

Source: Company/ Motilal Oswal Securities

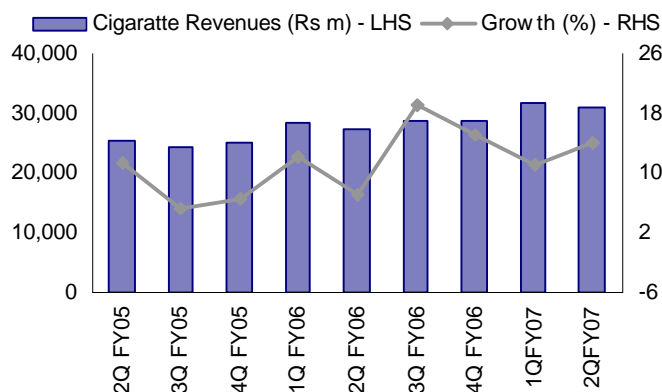
Cigarette business growth accelerates

Cigarette revenues grew 13.9% YoY to Rs31.0b, driven by around 8% volume growth, price increases of 2.5% in April, product mix changes, as also some price increases effected during the quarter. ITC increased the prices of Gold Flake Filter by 5%, Scissors Plane and Classic King Size by 13% and 5% respectively. Cigarette volumes are growing due to rising affordability and relatively lower price increases by the companies in the past few years.

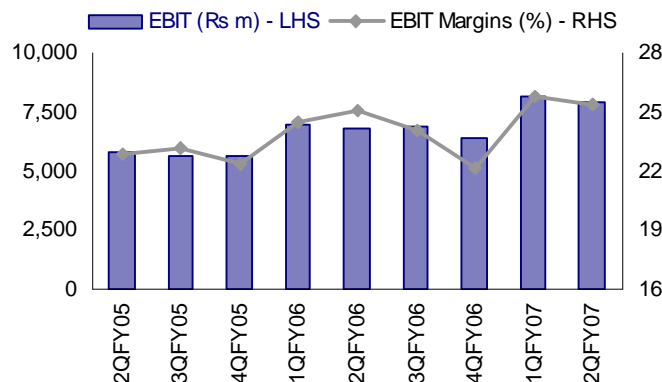
PBIT margins for the quarter expanded 30bp to 25.4% reflecting the gains of rising volumes and better sales mix. Cigarette business offers scope for sustained volume growth, as cigarettes constitutes just 14% of total tobacco consumed in the country. Growing number of users having multiple tobacco consuming formats is rising (currently 61%), which should continue to fuel demand for the product.

The next few quarters will determine the trend in the imposition of VAT as against current sales tax rate of nil. We have not factored in any impact of VAT in our numbers. Management expects a maximum VAT rate of 4%. Based on strong volume growth during the first two quarters we are increasing the cigarette volume growth assumptions to 8% for FY07 and 7% for FY08 as against earlier estimates of 7% (FY07) and 6% (FY08) respectively.

CIGARETTE - STRONG GROWTH MOMENTUM CONTINUES



CIGARETTE - STEADY MARGIN EXPANSION



Source: Company/ Motilal Oswal Securities

Processed food continues to power Other FMCG business growth

Other FMCG businesses grew by 65.9% YoY during 2QFY07 even as EBIT losses increased by 38.6%. EBIT margin during the current quarter was -14.3%, a 230bp improvement YoY. In addition to food products and lifestyle retailing, other businesses like Classmate notebooks, Mangaldeep incense sticks, Aim matchboxes and Impressions greeting cards continue to gain ground and maintain category leadership.

Food products continued to power the growth with 54% YoY growth during 2QFY07. Aashirvaad atta consolidated its leadership position with market share touching 52%. Other notable food products were:

- introduction of Sunfeast Special in the fast growing mid-price cookies segment.

- ✎ extension of Sweet 'n Salt Crackers to target markets
- ✎ progress in establishing its own production facilities at Bangalore and Uttaranchal apart from tying up additional outsourced manufacturing capacity, with a view to reducing the costs and servicing proximal markets efficiently
- ✎ sponsorship of Sunfeast open tennis tournament
- ✎ Confectionery segment expanded with the success of Eclairs, Cofitino and Mango Natkhat
- ✎ Aashirvaad Instant Mixes (Dosa, Khaman Dhokla, Gulab Jamun) introduced recently has been well received by consumers and extended to all target markets during the quarter.

We expect the branded foods business to continue its growth momentum supported by differentiated products and innovation according to the tastes of the Indian consumer. We believe ITC appears best placed to exploit the expected surge in demand for branded foods due to cuisine experience of the Welcomgroup, strong R&D and strong backend provided by the e-Choupal network of the company. The biscuits business has witnessed sharp increase in costs due to rise in wheat costs, but the company has indicated it would continue its aggressive strategy in advertising and launch new products in this fast-growth and largest processed food category.

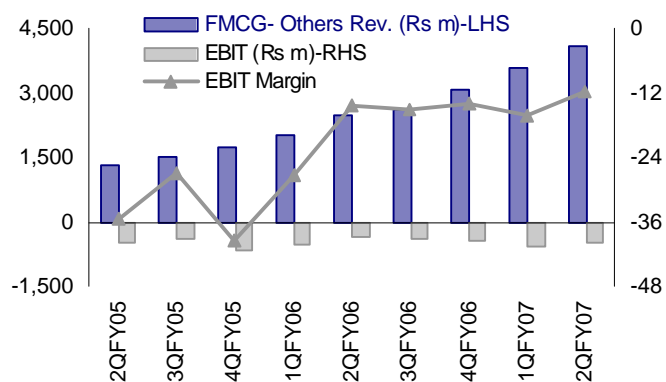
Lifestyle retailing: Sales during the quarter grew by over 64% on a YoY basis. All the leading lifestyle brands like Classic, Wills Sport and Wills Clublife maintained growth momentum driven by higher footfalls/conversion and improved realizations.. The company plans to enhance its retail footprint with the launch of eight new stores in upcoming malls progressively over the next 6-9 months. The brand's association with high fashion and imagery stood reinforced with the resounding success of the second Wills Lifestyle India Fashion Week (WIFW) held in August-September 2006. Future holds potential as:

- ✎ Branded garments are likely to grow by more than 20% per annum due to rising impact of media and organized retailing
- ✎ There is a perceptible shift in trend away from tailoring even in category two towns which augurs well for mass market brands like John Players

- ✎ Improving distribution network will increase availability and boost sales
- ✎ ITC is underway to find the right product and brand mix with extension into outwear, denims, premium and popular segments

The company has established long term partnerships with high potential customers for exports. The business has tied up with an exclusive manufacturing arrangement with a state-of-the-art unit located at the Noida SEZ.

FMCG-OTHERS: HIGH GROWTH CONTINUES



Source: Company/ Motilal Oswal Securities

Other FMCG businesses like stationery, greetings and match boxes continued to gain ground with the stationery business growing 77% YoY.

e Choupal and Choupal Sagar - huge investments in pipeline

Agri-business reported 86.6% topline growth for 2QFY07 while PBIT increased by 49.4% as EBIT margin declined 130bp. Growth was led by exports of leaf tobacco and increased levels of trade in soya, non-basmati rice, channa and coffee. EBIT margin declined due to incremental costs associated with scaling up of the e-Choupal network and higher proportion of low margin trading sales during the quarter.

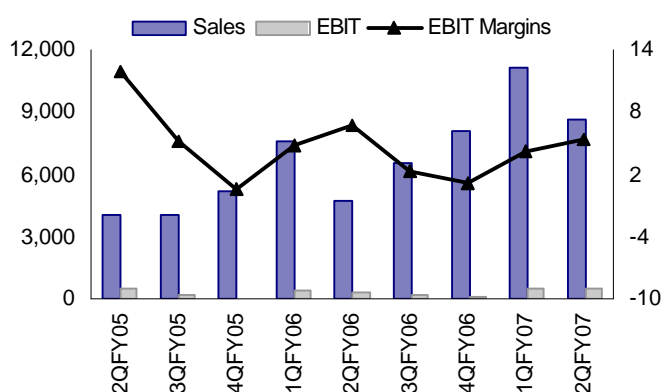
The e-Choupal network was further ramped up during the quarter to 6,400 installations from 6,270 in June 2006. The network now reaches out to over 3.5 million farmers in the

states of Madhya Pradesh, Haryana, Uttaranchal, Uttar Pradesh, Rajasthan, Karnataka, Maharashtra, Andhra Pradesh and Kerala.

Rural retail initiative gained momentum with the launch of one more Choupal Sagar during the quarter. ITC now has 11 Choupal Sagers operational in the three states of Madhya Pradesh, Maharashtra and Uttar Pradesh while nine more are likely to start operations in another six months. ITC plans to increase the number of Choupal Sagers to 40 in the coming 12-18 months. Existing Choupal Sagers continue to ramp up well with rising customer affiliation and strong support from companies, which have identified e-Choupal as a tool to enter the rural hinterlands. The company expects the Choupal Sagers to breakeven in two years from the date of commissioning of stores. Management seems unperturbed by the planned entry of Reliance Retail in rural India.

Despite lower profit margins on a standalone basis, this initiative holds excellent long term value in synergistic combination with the branded foods and ITC's rural distribution strategy.

AGRI-BUSINESS AND RURAL RETAIL: QUATERLY PERFORMANCE TREND



Source: Company/ Motilal Oswal Securities

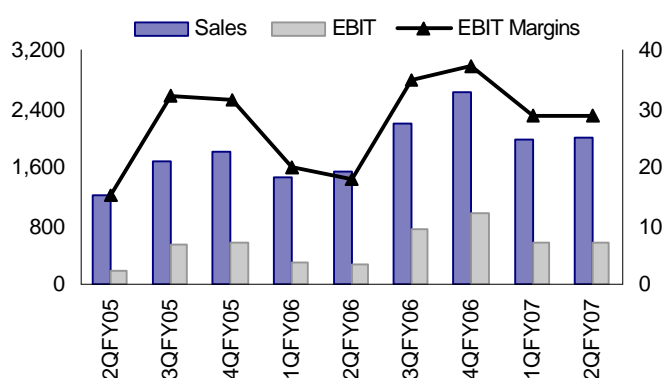
Hotels - boom times continue

Hotels business reported 31% increase in topline and 110% increase in PBIT as PBIT margins expanded by 1,090bp. Improvement in performance was on the back of 37% improvement in average revenue per room (ARR) The

company has commenced the construction of a new super-deluxe luxury hotel at Bangalore while the ground work for the project at Chennai is expected to commence in another 4-5 months. We expect the hotel division to grow in the coming year on the back of higher occupancy levels and higher ARR per room. Margins are expected to expand further as the current buoyancy in room rentals is expected to last for the forthcoming couple of years due to the long gestation nature of industry.

ITC expects Bangalore to witness some decline in ARR in 2008-2009 but volume growth from new property is expected to more than make up for the same. The company foresees delays in the properties being commissioned due to which the current phase of buoyancy is expected to continue beyond FY08.

HOTELS: QUATERLY PERFORMANCE TREND



Source: Company/ Motilal Oswal Securities

Paperboards and Paper - capacity utilization pays off

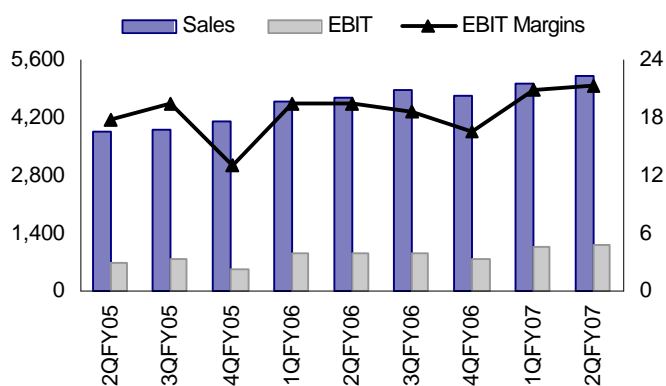
Paperboard division reported 11.1% sales growth and 20.7% EBIT growth as the EBIT margins expanded by 170bp. Increased capacity utilization at Kovai, benefits of captive power plant and 75,000 tpa capacity increase at Bhadrachalam, powered growth. Sales of value-added products touched 50% of total paper sales during the quarter. Raw material costs continue uptrend during H107 due to which the company has undertaken 5.5% price increase so far.

The company is in the process of augmenting its paperboard capacity by 90,000 tpa by 2008-2009, which would be an integrated facility including captive power. In addition, the new 1,00,000 tpa ECF pulp plant will enable the company to focus on the value-added paperboard demand from the Food and Pharma industries. The company is expanding the capacity of Cartons, Flexibles and the Cigarette packaging unit to cater to growing demand of the New FMCG and Cigarettes divisions. We expect paperboard SBU to report steady growth in sales and profits. Growth rates are expected to accelerate further once the company-conceived Rs25b project materializes, for which the company has not been able to finalize any location so far.

Valuation and view

We expect the company to maintain strong growth in the coming quarters due to strong business momentum in Cigarettes and Hotels. We expect Paper business to continue the good showing due to benefits from stabilisation of new line and rising sales of value-added paperboards. Biscuits, Atta and Lifestyle retailing will likely drive the growth in New FMCG business with turnaround likely by FY09. We are reducing the FY07 EPS from Rs7.5 to Rs7.3 due to higher-than-expected losses in the foods business, and advertising costs. The stock is currently trading at 25.6x FY07E EPS and 21.4x FY08E EPS. We maintain **Buy**.

PAPER BOARD AND PAPER: QUATERLY PERFORMANCE TREND



Source: Company/ Motilal Oswal Securities

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

- ✍ Setting up Rs700m biscuit manufacturing facility in Uttaranchal.
- ✍ Launched new ready to eat foods and increased cigarette prices to neutralise impact of excise duty increase.

Valuation and view

- ✍ We forecast a 19% EPS CAGR over the next three years, driven by higher cigarette volumes and turnaround in the FMCG business.
- ✍ The stock is currently trading at 25.6x FY07E EPS and 21.4x FY08E EPS. We maintain **Buy**.

Sector view

- ✍ We are positive on the sector. The sector is showing strong volume growth across product categories with improving pricing power for leading players.
- ✍ Companies with low competitive pressures and brought product portfolios will be able to better with stand any slowdown in a particular segment.
- ✍ Longer term prospects bright, given rising incomes and low penetration.

COMPARATIVE VALUATIONS

		ITC	HLL	NESTLE
P/E (x)	FY07E	25.6	31.9	34.2
	FY08E	21.4	25.3	27.7
EV/EBITDA (x)	FY07E	16.8	27.5	21.0
	FY08E	13.9	21.3	17.7
EV/Sales (x)	FY07E	5.4	4.2	4.2
	FY08E	4.5	3.6	3.8
P/BV (x)	FY07E	6.8	23.1	18.5
	FY08E	5.8	20.0	16.2

SHAREHOLDING PATTERN (%)

	SEPO6	JUN.06	SEPO5
Promoter	0.0	0.0	0.0
Domestic Inst	36.8	36.9	34.9
Foreign	47.7	47.8	50.4
Others	15.4	15.3	14.7

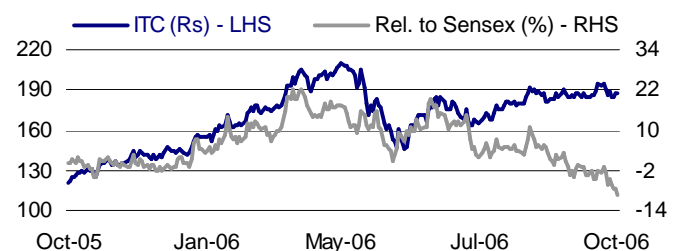
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	7.3	7.3	0.4
FY08	8.8	8.7	1.6

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
188	195	4.0	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)				
Y/E MARCH	2005	2006E	2007E	2008E	2009E	
Net Sales	76,395	97,905	122,081	145,191	169,450	
Change (%)	18.5	28.2	24.7	18.9	16.7	
Total Expenditure	-48,438	-64,579	-82,841	-98,391	-116,222	
EBITDA	27,956	33,326	39,240	46,800	53,228	
Change (%)	18.2	19.2	17.7	19.3	13.7	
Margin (%)	36.6	34.0	32.1	32.2	31.4	
Depreciation	-3,129	-3,323	-3,602	-3,966	-5,370	
Int. and Fin. Charges	-508	-211	-25	-25	-20	
Other Income - Recurring	2,411	2,899	3,723	4,248	4,922	
Profit before Taxes	26,731	32,691	39,336	47,056	52,759	
Change (%)	15.3	22.3	20.3	19.6	12.1	
Margin (%)	35.0	33.4	32.2	32.4	31.1	
Tax	-7,879	-10,584	-12,627	-14,823	-16,619	
Deferred Tax	-481	696	826	988	1,108	
Tax Rate (%)	-31.3	-30.2	-30.0	-29.4	-29.4	
Profit after Taxes	18,371	22,803	27,535	32,939	36,931	
Change (%)	15.4	24.1	20.8	19.6	12.1	
Margin (%)	24.0	23.3	22.6	22.7	21.8	
Non-rec. (Exp)/Income	3,543	-450	0	0	0	
Reported PAT	18,371	22,353	27,535	32,939	36,931	

BALANCE SHEET		(RS MILLION)				
Y/E MARCH	2005	2006E	2007E	2008E	2009E	
Share Capital	2,482	3,755	3,755	3,755	3,755	
Reserves	76,474	86,860	100,455	116,719	134,954	
Net Worth	78,956	90,615	104,210	120,474	138,709	
Loans	2,454	1,197	0	0	0	
Deferred Liability	3,761	3,248	3,376	3,509	3,644	
Capital Employed	85,171	95,060	107,586	123,983	142,353	
Gross Block	57,463	62,272	69,272	76,272	103,272	
Less: Accum. Depn.	-17,955	-20,654	-24,257	-28,223	-33,593	
Net Fixed Assets	39,508	41,617	45,015	48,049	69,679	
Capital WIP	1,862	2,434	8,000	14,000	4,000	
Investments	38,747	35,170	45,365	52,372	57,610	
Curr. Assets, L&A	35,393	51,619	53,131	60,203	67,709	
Inventory	20,030	26,363	34,161	39,526	45,514	
Account Receivables	5,278	5,480	6,020	6,961	7,660	
Cash and Bank Balance	557	8,558	1,224	1,464	1,722	
Others	9,529	11,218	11,726	12,252	12,813	
Curr. Liab. and Prov.	30,338	35,781	43,926	50,642	56,645	
Account Payables	18,920	21,484	26,685	30,191	33,790	
Other Liabilities	2,171	2,675	2,902	3,298	3,623	
Provisions	9,247	11,622	14,339	17,153	19,232	
Net Current Assets	5,055	15,838	9,205	9,561	11,064	
Application of Funds	85,171	95,060	107,586	123,983	142,353	

E: MOST Estimates

RATIOS						
Y/E MARCH	2005	2006E	2007E	2008E	2009E	
Basic (Rs)						
EPS	4.9	6.1	7.3	8.8	9.8	
Cash EPS	5.7	7.0	8.3	9.8	11.3	
BV/Share	210	24.1	27.8	32.1	36.9	
DPS	2.0	2.6	3.3	3.9	4.4	
Payout %	41.9	43.6	45.0	45.0	45.0	
Valuation (x)						
P/E		30.9	25.6	21.4	19.1	
Cash P/E		26.9	22.6	19.1	16.6	
EV/Sales		6.8	5.4	4.5	3.8	
EV/EBITDA		19.9	16.8	13.9	12.1	
P/BV		7.8	6.8	5.8	5.1	
Dividend Yield (%)		1.4	1.8	2.1	2.4	
Return Ratios (%)						
RoE	23.3	25.2	26.4	27.3	26.6	
RoCE	32.0	34.6	36.6	38.0	37.1	
Working Capital Ratios						
Debtor (Days)	25	20	18	18	17	
Asset Turnover (x)	0.9	1.0	1.1	1.2	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	2006E	2007E	2008E	2009E	
OP/(loss) before Tax	24,827	30,003	35,638	42,834	47,858	
Int./Div. Received	2,411	2,899	3,723	4,248	4,922	
Depreciation and Amort.	3,129	3,323	3,602	3,966	5,370	
Interest Paid	-508	-211	-25	-25	-20	
Direct Taxes Paid	-7,879	-10,584	-12,627	-14,823	-16,619	
(Incr)/Decr in WC	-5,311	-2,782	-702	-116	-1,245	
CF from Operations	16,670	22,648	29,609	36,084	40,265	
(Incr)/Decr in FA	-8,777	-5,382	-12,566	-13,000	-17,000	
(Pur)/Sale of Investments	-8,207	3,577	-10,194	-7,007	-5,238	
CF from Invest.	-16,985	-1,804	-22,759	-20,006	-22,236	
Issue of Shares	872	1,923	0	0	0	
(Incr)/Decr in Debt	-150	-149	-149	-149	-148	
Dividend Paid	-8,792	-11,347	-13,940	-16,676	-18,697	
Others	8,602	-3,270	-89	993	1,081	
CF from Fin. Activity	532	-12,843	-14,178	-15,832	-17,764	
Incr/Decr of Cash	217	8,002	-7,327	246	266	
Add: Opening Balance	340	557	8,558	1,224	1,464	
Closing Balance	557	8,558	1,231	1,470	1,730	

For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motiloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

This report is for the personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. Motilal Oswal Securities Limited (*hereinafter referred as MOST*) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

The report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon such. MOST or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOST or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

MOST and/or its affiliates and/or employees may have interests/ positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOST has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

Disclosure of Interest Statement	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.